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Punitive Damages Awards in International Arbitration: Franchising Case

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Abstract. This article is written to evaluate the practical significance of punitive damages in the field of arbitration concerning international commercial disputes and franchise disputes. It finds that punitive damages awards are frequent in domestic arbitrations in the United States but not internationally common. This article discusses the severity of the punitive damages awards to explain why such decisions are not frequent in international trade disputes; it still has a significant influence that concerns the contracting parties, making them exclude punitive damages in their agreements. This article also explains the reasons for limiting the use of these punitive damages. The first one is the limitation of punitive damages applied to arbitration. Indeed, punitive damages are only recognised under a handful of domestic arbitration laws in a number of countries, especially the ones associated with contract claims. Secondly, the enforceability of such awards is internationally limited due to public policy. Therefore, this difficulty caused the arbitral tribunal to refuse to award such damages. Finally, the statistics on punitive damages award in international commercial arbitration are scarce, so the article refers to provide and analyse the cases that are not international-thereby discussing and evaluating the suitability of punitive damages in the context of international commercial arbitration.

Keywords: punitive damages; international commercial arbitration; arbitral punitive damages award; franchise.

Research area: law.

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Присуждение штрафных убытков в международном арбитраже: случай франчайзинга

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Аннотация. Данная статья написана с целью оценки практической значимости штрафных убытков в сфере арбитража применительно к международным коммерческим спорам и спорам о франчайзинге. Автор приходит к выводу, что решения о возмещении штрафных убытков часто выносятся в национальных арбитражах в Соединенных Штатах, но такие решения не являются общепринятыми на международном уровне. В этой статье обсуждается серьезность присуждения штрафных убытков, чтобы объяснить, почему такие подопечные обычно не используются в международных торговых спорах; это по-прежнему оказывает значительное влияние на договаривающиеся стороны, заставляя их исключать штрафные убытки в своих соглашениях. В данной статье также объясняются причины ограничения применения этих штрафных санкций. Прежде всего, из-за ограничения штрафных убытков, применяемых в арбитражном разбирательстве. Действительно, штрафные убытки признаются лишь в нескольких национальных арбитражных законах в ряде стран, особенно штрафные убытки, связанные с контрактными требованиями. Во-вторых, возможность приведения в исполнение таких решений в международном масштабе ограничена из-за государственной политики. Таким образом, эта трудность привела к тому, что Арбитражный суд отказался присудить такие убытки. Статистические данные о присуждении штрафных убытков в международном коммерческом арбитраже скудны, поэтому в статье говорится о предоставлении и анализе дел, которые не являются международными, тем самым обсуждается и оценивается пригодность штрафных убытков в контексте международного коммерческого арбитража.

Ключевые слова: штрафные убытки, международный коммерческий арбитраж, арбитражное решение о штрафных убытках, франшиза.

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Introduction

Punitive damages themselves have been a subject of controversy for a very long time. However, in recent years, punitive damages in international commercial arbitration have been a subject of fierce discussion. Basically, punitive damages are only awarded by courts in tort cases that have nothing to do with commercial arbitration. However, the United States, «home-land» of punitive damages, is gradually introducing this practice in its domestic arbitration. As a result, the effects of punitive damages are increasingly going beyond the jurisdictions

where they are awarded. This process raises the question of whether arbitrator(s) should apply punitive damages when hearing international commercial disputes. Can arbitration be used as a method to prevent punitive damages in resolving international commercial disputes? Looking at famous brands in one's country, most of them are franchises from other countries. When it comes to franchising, people immediately think of international franchising. That is the reason why the author chose a franchise to use as an example for international disputes in international commercial arbitration.

Statement of the problem

In general, the nature of punitive damages is a controversial topic. In fact, it is not internationally common, and punitive damages in the arbitration are even more limited. Under what circumstances are the punitive damages awarded, by whom, and is it reasonable if awarded by international arbitrators?

Arbitration is often analysed and recognised by scholars as having many advantages. However, court proceedings or arbitration also have advantages and disadvantages that create the specificity of these methods. In recent years, in some places, arbitrators were given the authority to award punitive damages, which should only belong to the national court. As mentioned, this practice is not common and even considered contrary to public orders in many countries. So if punitive damages are recognised wider in the arbitration and especially in the international arbitration institutions, it will significantly affect the contractual parties (franchise parties) representing the countries where punitive damages do not exist or are forbidden.

Discussion

1. Punitive damages

1.1. Punitive damages: The beginning

Punitive damages, exemplary damages, treble damages, or punitive relief are of ancient origin. The Code of Hammurabi (2000 B.C.) was the earliest law system to make use of punitive damages (Kocourek & Wigmore, 1915).

The Bible says in Exodus 22:1, ⁹ that for all manner of trespass shall come before the judges, and the person who is condemned by the judges shall pay double unto his neighbor (Exodus 22:1, 9 (King James)). Before the Eighteenth Century, English courts upheld verdicts of the jury in which exceeded the plaintiff's actual physical harm (Redden, 1980). In 1763, a court in England started using the term «exemplary damages» in the *Huckle v. Money*² case (1763) to recognise that a jury could render a monetary award that exceeds the actual damage (Bedell, 1987).

Punitive damages give a plaintiff an excess amount of money to compensate for his or her proven loss or injury. In this case, the plaintiff is often asked to prove that the defendant's conduct was «*willful, wanton, malicious, oppressive, or reckless*» (Redden, 1980) to justify such a recovery.

Courts have the power to award a variety forms of damages such as compensatory, consequential, punitive damages, and they also have the power to grant broad forms of equitable relief. According to two professors Mitchell Polinsky (Stanford University) and Steven Shavell (Harvard University), punitive damages is an important form of damages that sometimes are awarded to plaintiffs in addition to compensatory damages (Mitchell Polinsky, 2000). In other words, they are extra-compensatory.

Black's Law Dictionary defines punitive damages as the costs that are awarded to a person due to negligence that caused personal injury or personal property damage. It is a payment by the wrongdoer to the «injured party» as a «punishment» for his reckless behaviour (The Law Dictionary). According to this definition, Black's Law Dictionary considers punitive damages only to happen in tort cases. Generally, in civil litigation, the compensatory damages are referred to as actual damages that a civil court awards a plaintiff. Moreover, for these damages, the defendant must compensate the plaintiff for any awarded compensatory damages. However, in the case of awarding punitive damages, they are essentially designed to punish or deter the wrongdoer for their wrongdoing. Most jurisdictions that recognise the punitive damages all focus on the defendant's wrongful conduct nature rather than the plaintiff's actual harm nature (Sales & Kenneth B. Cole, 1984). For example, the Second Restatement of Torts³ of the U.S. defines punitive damages as damages, other than compensatory damages, to punish a person's outrageous conduct and to deter him from committing similar conduct in the future (1979). Moreover, punitive damages awards also provide «an element of revenge both to the injured party and to society as a whole» (Dobbs, 1973).

¹ Exodus 22:1, 9 (King James).

² *Huckle v. Money*, 95 Eng. Rep. 768 (C.P. 1763).

³ Second Restatement of Torts, § 908 (1979)

1.2. Punitive damages in the law systems

Punitive damages are recognised in various common law countries. They are primarily awarded by the courts of the United States (the U.S.), Canada, Australia, New Zealand (Gotanda, 2003), and South Africa (Vanleenhove, 2015). Within the European Union, only the United Kingdom (England, Wales, Ireland, Northern Ireland) and Cyprus recognise this type of damages in their respective legal systems (Vanleenhove & Bruyne, 2018). Although the United Kingdom (the U.K.) first developed the concept of punitive damages, it has only a limited application on this type of award. By contrast, the U.S. courts have long upheld the practice. In the U.S., the availability of punitive is a question of state law, and a majority of states authorise such awards.

Meanwhile, in civil law jurisdiction, punitive damages are generally not available. However, there are still a few civil law countries recognise the availability of some punitive relief form, such as Norway, Poland, Brazil, Israel, and the Philippines (Gotanda, 2003). China and Argentina are also on the list of countries that have recently enacted laws that clearly regulate this type of remedy (leidenlawblog, 2018). In 2008, Argentina enacted this remedy as «daños punitivos» (punitive damages in Spanish) in Consumer Protection Statute. China has also extended such provisions to the Law on Food Safety in 2009 (leidenlawblog). Recently, on May 28, 2020 Chinese Congress passed New Civil Code Includes Punitive Damages in Intentional Intellectual Property Infringement that will take effect on January 1, 2021. The Supreme People's Court of China is currently working on a draft of Interpretation Application of Law on Punitive damages in Intellectual Property Infringement, which will be completed in the first half of 2021 (Wininger, 2020).

1.3. Punitive Damages for Breach of Contract claims

The use of arbitration occurs based on an arbitration clause that has been signed by the contractual parties. Consequently, the availability of punitive damages in either domestic arbitration or international commercial arbitration all depends on whether such damages are

available for breach of contract cases under the applicable law.

In most countries that recognise punitive damages, such damages may only be granted in tort claims. For instance, in the U.K., punitive damages in breach of contract actions are unavailable. It has been affirmed by the House of Lords as early as 1909 was recently reiterated in a report of the English Law Commission (*Addis v Gramophone*, 1909)⁴. The courts in New Zealand as well as Australia share the same opinion with the English courts. Therefore, punitive damages in breach of contract cases are only available in the United States and Canada. The United States Restatement Second of Contracts expressly provides for the availability of punitive damages when the breach of contract also constitutes an «independent» tort. Punitive damages awards for breach of contract are also found in Canada, though apparently to a more limited extent (Castagno, 2011). Nevertheless, there is still an exception. Punitive damages are not provided in Russia. Under Russian law, damages are compensatory, which can include damages for direct losses or loss of profits (Thomson Reuters PRACTICAL LAW). However, the punitive damages are generally enforceable by Russian courts, unless the amount awarded is excessive and not proportionate to the value of the contract (iclg.com). In other words, Russian courts do recognise and enforce the arbitral awards that contain punitive (or exemplary damages) for breach of contract (Niki-forov, 2018).

2. Punitive damages: the case of Franchising

An arbitrator's power to award remedies or provide punitive relief can be limited because either the parties have limited such powers by the arbitration clause or the applicable law has imposed such limitations. This section will address the use of commercial arbitration by the disputing parties' choice to avoid the punitive damages award. The applicable law for awarding punitive damages will be discussed in the third section of this article.

⁴ *Addis v Gramophone* [1909] AC488 House of Lords, July 26, 1909

In the United States, the developments in recent court decisions demonstrate a judicial willingness to award additional damages to the parties in the franchise. In the case of *Holiday Inn Franchising, Inc. v. Hotel Assocs. Inc.*, (2011)⁵ on August 15, 2005, the appellee Hotel Associates Inc. (HAI) sued Holiday Inn Franchising Inc. (Holiday Inn) to claim for compensatory and punitive damages and confirmed causes of contract, fraud, and promissory estoppel. The jury awarded HAI for the compensatory damages and punitive damages, respectively \$13,000,000 and \$12,000,000. However, the circuit court decided to reduce the amount of compensatory damages to \$10,056,000 and to \$1,000,000 for punitive damages. Both parties appealed. The Court of Appeals of Arkansas resolved to reverse the circuit court's remittitur of the punitive damages award and reinstated the jury's punitive damages award (\$12,000,000)⁶. Holiday Inn filed a petition for rehearing and a petition for review to the Arkansas Supreme Court, all denied in 2011.

In Canada, punitive damages historically were not available for breach of contract. However, the Canadian Supreme Court has extended the door of punitive damages to such claims in recent years (Steven H. Goldman of Goldman Rosen LLP, 2005). In *Katotikidis v. Mr. Submarine Ltd.*, (2002)⁷, the Court awarded punitive damages against the franchisor for opening a new competitive store approximately 1,500 feet away from the franchisee's store. Specifically, the franchisor gave up the franchisee when the franchisee was known to be in financial trouble. Later, the franchisee found a new location that could remedy the situation. The franchisor opened a new store in that location and offered it to another party. In *Khachikian v. Williams et al.* (2003)⁸, the court awarded punitive damages of \$10,000.00 against the franchisor because the franchisor had deliberately taken advantage of the franchisee's vulnerability and, in violation of the

Arthur Wishart Act (Franchise Disclosure), induced the franchisee to enter into a franchise agreement without providing him with the required disclosure notice. In the cases of *Triple 3 Holdings Inc. v. Jan* (2004)⁹, the franchisor was ordered to pay punitive damages for his conduct that was held to be planned, deliberate, and abusive behaviour motivated by profit.

However, in the case of *Dunkin' Donuts Franchising, LLC, v. SAI Food and Hospitality, LLC* (2013)¹⁰, the US District Court for the Eastern District of Missouri granted Dunkin's motion to strike the franchisees' request for punitive damages and lost profits. Because such damages are not fundamental rights. They can be waived in commercial contracts, particularly where the waiver provisions are mutual. Accordingly, the court granted Dunkin's motion to strike the claim for damages.

Aware of the seriousness of punitive damages awarded by the court, parties in the franchise agreement decided to use an arbitration clause that includes the punitive damages waiver as a method to prevent such a remedy. Franchise agreements often contain provisions intended to prohibit the provision of certain types of damage, such as consequential or punitive damage. Arbitration is considered as a matter of contract, and arbitration agreements or arbitration clauses are generally interpreted in the same way as conventional contracts. Thus, the provisions in arbitration agreements are typically enforceable (Appleby, Rosen, & Steinberg, 2008). By using the arbitration clause that excludes the punitive damages, the franchise parties are likely to prevent such damages if any disputes arise. Baskin-Robbins and Dunkin' Donuts' franchise agreements have provisions that allow the franchisee to opt out of arbitration in the condition that the franchisee agrees to waive his rights to claim for punitive damages. The provisions agreed on the franchisee's exceptions as the franchisee shall have an option to litigate any cause of action otherwise eligible for arbitration and shall

⁵ *Holiday Inn Franchising, Inc. v. Hotel Assocs. Inc.*, No. CA10-21 (Ark. Ct. App. 2011)

⁶ *Id.*

⁷ *Katotikidis v. Mr. Submarine Ltd.*, [2002] O.J. No. 1959 (QL) (Ont. S.C.J.).

⁸ *Khachikian v. Williams et al.*, [2003] O.J. No. 5876 (QL) (Ont.S.C.J).

⁹ *Triple 3 Holdings Inc. v. Jan*, [2004] O.J. No. 2749 (QL) (Ont. S.C.J.).

¹⁰ *Dunkin' Donuts Franchising LLC v. SAI Food Hospitality, LLC.*, Case No. 4:11CV01484 AGF (E. D. Mo. Apr. 18, 2013)

exercise that option solely by filing a complaint in any competent court in which the franchisee expressly waives the right to all claim(s) for punitive, multiple and/or exemplary damages. If any such complaint fails to include such express waivers or if such a competent court determines that all or any part of such waivers is ineffective or void, the parties agree that the action shall be dismissed and leave the parties to their arbitration remedies (2007)¹¹.

The franchise agreements between Dunkin' Donuts Franchising LLC and Sai Food Hospitality also contain a «Waiver of Rights» provision that includes the following language as the parties to this agreement agree to waive and not to present any claims for punitive, multiple, or exemplary damages in any pleading or arbitration request. If one of the parties files any pleading that contains any punitive damages claims or if a court determines that the waivers are ineffective, the pleading shall be dismissed, leaving the pleading party to its arbitration remedy (2013)¹².

In addition to the scope of franchising, the provisions in arbitration agreements that prohibit the punitive damages were also found generally enforceable in *Investment Partners, L.P. v. Glamour Shots Licensing, Inc.*, (2002)¹³. Similarly, *Davis v. Prudential Securities, Inc.*, (1995)¹⁴ stated that perhaps, the parties wishing to avoid the imposition of punitive damages in the arbitration could simply clearly exclude punitive damages in their arbitration agreement. In the case of *Baravati v. Josephthal, Lyon & Ross Inc.* (1994)¹⁵, the power of arbitrators to award such a remedy could be withdrawn because the parties to adjudication under the Federal Arbitration Act have a considerable right to change the standard procedures and can certainly stipulate that punitive damages will not be awarded. The case of *Raytheon Co. v.*

Automated Bus. Sys., Inc. (1989)¹⁶ involved a contract with a California choice of law provision and the American Arbitration Association (AAA) as the choice of forum. In this case, the court claimed that the parties that wish arbitration provisions to exclude punitive damages are free to do so explicitly (1989)¹⁷. (However, unfortunately, such exclusion from the general language of the arbitration clause does not exist in this case).

Punitive damages, as one particular form of remedy, has generated considerable debate in the arbitration area. Choosing arbitration over court proceedings as an alternative method of resolving disputes in the franchise may help franchisors exclude the seeking punitive damages by the franchisees.

3. Punitive damages: the Applicable Law

3.1. *Applicable law determining the availability of punitive damages*

The rights and obligations of parties in a dispute are affected by the availability of punitive damages, awarded either by courts or arbitration. Thus, the availability of such awards should be governed by the applicable substantive law or *lex causae* as well as *lex contractus*. It is the view of Redfern and Hunter that the arbitrators «should examine the question of whether such damages can be awarded under the law applicable to the substance of the dispute» (Blackaby, Partasides, Redfern, & Hunter, 2009). Noussia also agrees that it is necessary to consider the «law applicable to the substance of the dispute» to determine whether punitive relief may be granted (Noussia, 2010). Farnsworth also observes that where the applicable substantive law is the California law, the suitability of the punitive damages award must be determined under that law (Farnsworth, 1991).

If the parties choose American law (specific state laws or federal laws) as the applicable law, even if they use arbitration to resolve their disputes, they are likely going to get punitive

¹¹ § 11. Baskin-Robbins Franchising LLC, Franchise Agreement ¶ 11.6, at 17 (2007)

¹² *Dunkin' Donuts Franchising LLC*, *supra*, note 10, Dec. 31, 2013

¹³ *Investment Partners, L.P. v. Glamour Shots Licensing, Inc.*, 298 F.3d 314, 318 n.1 (5th Cir. 2002)

¹⁴ *Davis v. Prudential Securities, Inc.*, 59 F.3d 1186, 1193 n.6 (11th Cir. 1995)

¹⁵ *Baravati v. Josephthal, Lyon & Ross Inc.*, 28 F.3d 704, 709 (7th Cir. 1994)

¹⁶ *Raytheon Co. v. Automated Bus. Sys., Inc.*, 882 F.2d 6, 12 (1st Cir. 1989)

¹⁷ *Id.*

damages. The United States Uniform Arbitration Act (section 21(a)) recognises the arbitrators' rights to award punitive damages. This act provides that an arbitrator may award punitive damages if such an award is permitted by law, and under the applicable law for the claim, the evidence presented at the hearing also justifies the award (United States Uniform Arbitration Act, § 21 (a), 1955). In practice, however, this provision only implies that arbitrators are not prevented from awarding such punitive damages, as long as it is available under the applicable substantive laws.

As mentioned above, the case of *Baravati v. Josephthal, Lyon & Ross Inc.* (1994) found that under the Federal Arbitration Act, the arbitrators have authority to award punitive damages unless the parties to the dispute have withdrawn that power. In the case of *Mulder v. Donaldson, Lufkin & Jenrette* (1996)¹⁸, the Supreme Court of New York: Appellate Division granted the motion to compel arbitration of the plaintiff's first cause of action for punitive damages. Also, in *Aguilera v. Palm Harbor Homes Inc.*,¹⁹ the Court of Appeals of New Mexico relied on the proposition that when they determine the Supreme Court would conclude that «the precedent is no longer good law» and «would overrule it» when given the opportunity, they will refuse to comply with the precedent. (2001). As a result, the Court of Appeals held that arbitrators have the authority to award punitive damages.

As illustrated above, the parties can agree to waive punitive damages in their arbitration clauses. However, such remedy waiver provisions may be void as contrary to public policy under the applicable law where the punitive damages are provided by state or federal laws. In the case of *Mitsubishi Motors Corporation v. Soler Chrysler-Plymouth, Inc.*,²⁰ the US Court of Appeals for the First Circuit has held that when the disputing parties agree to arbitrate a statutory claim, one party does not waive the fundamental rights provided by law; it was

¹⁸ *Mulder v. Donaldson, Lufkin & Jenrette*, 224 A.D.2d 125 (N.Y. App. Div. 1996)

¹⁹ *Aguilera v. Palm Harbor Homes Inc.*, 228, 34 P. 3d 617 (N.M. Ct. App. 2001)

²⁰ *Mitsubishi Motors Corporation v. Soler Chrysler-Plymouth, Inc.*, 473 US614 (1st Cir. 1985)

only subject to their settlement in arbitration, instead of a judicial forum. (*Mitsubishi Motors Corporation v. Soler Chrysler-Plymouth, Inc.*, 1985) The US Court of Appeals for the Eighth Circuit in case *Bailey v. Ameriquest Mortg. Co.*²¹ said that when an agreement to arbitrate includes statutory claims, the arbitrator has the authority to exercise the substantive statutory rights, even if those rights conflict with contractual limits in the agreement (*Bailey v. Ameriquest Mortg. Co.*, 2003). Also, in *Hadnot v. Bay, Ltd.* (2003)²², the arbitration agreement that bans on punitive damages is unenforceable as to Title VII claim. In *Alterra Healthcare Corp. v. Estate of Linton*,²³ the waiver of punitive damages in an arbitration agreement is void as against the public policy. Because eliminating punitive damages will destroy the remedial purpose of the Florida Assisted Living Facilities Act (*Alterra Healthcare Corp. v. Estate of Linton*, 2007).

Similarly, in *Stark v. Sandberg*,²⁴ the unambiguous language of the arbitration agreement states that the parties expressly waive any right to claim [punitive damages] to the fullest extent permitted by law. Hence, punitive damages were waived only if the governing law permitted such a waiver. Apply to the case, the parties intended to waive punitive damages only to the extent permitted by Missouri law (the applicable law), and unfortunately, Missouri law would not permit such a waive. As a result, the arbitrator properly awarded \$6,000,000 in punitive damages against the defendant (EMC) (*Stark v. Sandberg Phoenix & von Gontard, P.C.; EMC*, 2004).

In *James C. Justice Companies, Inc. v. Deere Co.* (2008)²⁵, the arbitration clause included provision waiving punitive damages. However, concerning the treble damage limitation, the First Circuit in *Kristian v. Comcast*

²¹ *Bailey v. Ameriquest Mortg. Co.*, 346 F.3d 821, 824 (8th Cir. 2003)

²² *Hadnot v. Bay, Ltd.*, 344 F.3d 474, 478 & n. 14 (5th Cir. 2003)

²³ *Alterra Healthcare Corp. v. Estate of Linton*, 953 So.2d 574, 578 (Fla. 1st DCA 2007)

²⁴ *Stark v. Sandberg Sandberg Phoenix & von Gontard, P.C.; EMC*, 381 F.3d 793 (8th Cir. 2004)

²⁵ *James C. Justice Companies, Inc. v. Deere Co.*, Civil action No. 5:06-cv-00287, 7 (S.D.W. Va. Mar. 27, 2008).

*Corp.*²⁶ held that «the award of treble damages under the federal antitrust statutes cannot be waived» (*Kristian v. Comcast Corp.*, 2006). The District Court of West Virginia agreed with the *Kristian* court that «treble damages as provided for in the Sherman Act is a non-waivable substantive right»²⁷. Therefore, as in *Kristian*, the Court in *James* held that «provision prohibiting the recovery of treble damages in the Dealership Agreement is severed»²⁸.

So, there are cases where the parties had banned on punitive damages in their agreements, but punitive damages still cannot be waived under some particular applicable law. For this reason, arbitration agreements should include a savings clause specifically providing that, if certain remedies cannot be contractually waived under applicable law, a plaintiff retains those remedies under the agreement despite any contractual clauses to the contrary. In *Kristian*, the court noted that the arbitration agreement contained a «savings clause», which allowed the court to sever only that provision and compel arbitration²⁹. Similarly, in *James*, the arbitration clause included provisions waiving punitive damages, prohibiting jury trials, barring recovery of attorney's fees and establishing a two year limitations period. The plaintiff argued rendered the clause unenforceable for all of those provisions. However, the court severed only the waiver of punitive damages, and saved all the remaining terms of arbitration clause³⁰.

In contrast, in International Chamber of commerce (ICC) Case no. 8445³¹, the arbitration tribunal rejected a punitive damages claim on the grounds that such damages generally were not available under the applicable Indian law (ICC Final award in Case No. 8445 of 1996, 2001). The arbitration tribunal held that in accordance with the laws of India (the *lex contractus*), a court, and an arbitral tribunal, will normally award damages for breach of contract only by compensating for loss incurred, not by

punishment³². Similarly, the enforcement of punitive arbitral awards is highly unlikely in the UK, since under English law such awards are not available in contractual cases (*Castagno*, 2011).

3.2. Applicable law in punitive damages: the cases of New York applicable law

Historically, the authority of arbitrators to grant punitive damages is a fiercely debated public policy issue confronting both the arbitral process and parties to arbitration (*Stipanowich*, 1986). The seminal New York case on the propriety of punitive damages in the arbitration is *Garrity v. Lyle Stuart, Inc.*³³. In this case, the plaintiff brought a proceeding to confirm an arbitration award of \$45,000 in compensatory damages and \$7,500 in punitive damages. The New York Court of Appeal was unequivocal in its rejection of the arbitrators' award of punitive damages: «An arbitrator has no power to award punitive damages, even if agreed upon by the parties»³⁴. And as public policy matter, the award of punitive damages is reserved to courts of law (*Garrity v. Lyle Stuart, Inc.*, 1976). From this point of view, New York law has long banned the award of punitive damages in arbitration.

However, the Federal Arbitration Act (FAA), which was enacted by Congress in 1925, does not explicitly prohibit punitive damages in arbitration field. In practice, *Garrity's* applicability on prohibiting arbitrator's power in awarding punitive damages also was changed by the United States Supreme Court. This change began with the case of *Mastrobuono v. Shearson Lehman Hutton, Inc.* (1993)³⁵, in which the US Supreme Court stated that punitive damages could be awarded in arbitration pursuant to the Federal Arbitration Act unless the parties explicitly excluded such a remedy in the governing arbitration clause. As a result, an arbitration panel of the National Association of Securities Dealers ultimately awarded

²⁶ *Kristian v. Comcast Corp.*, 446 F.3d 25, 48 (1st Cir. 2006).

²⁷ *James*, *supra* note 26

²⁸ *James*, *supra* note 26

²⁹ *Kristian*, *supra* note 27, at 49.

³⁰ *James*, *supra* note 26.

³¹ *Final award in Case No. 8445 of 1996*, 26 Y.B. Commercial Arbitration, 178 (2001)

³² *Id.*

³³ *Garrity v. Lyle Stuart, Inc.*, 40 N.Y.2d 354, 353 N.E.2d 793, 386 N.Y.S.2d 832 (N.Y. 1976)

³⁴ *Id.*

³⁵ *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 812 F. Supp. 845, 846 (N.D. Ill. 1993) (footnote added), *aff'd*, 20 F.3d 713 (7th Cir. 1994), and *rev'd*, 115 S. Ct. 1212 (1995).

the Mastrobuonos \$159,327 for compensatory damages and \$400,000 for punitive damages³⁶. In Mastrobuono's case, the United States Supreme Court held that only choosing New York law as the applicable law in arbitration does not automatically trigger the Garrity rule. The parties in their arbitration agreement must use straightforward language to exclude punitive damages claims. Therefore, only an arbitration clause with explicit language that excludes punitive damages might prevent arbitrator(s) from awarding this remedy.

As a result, outside the New York, several courts have been rejected the Garrity rule. For instance, in *Bonar v. Dean Witter Reynolds, Inc.* (1988)³⁷, the customer agreement contained a choice of law provision designating the New York law. However, the Eleventh Circuit court declined to apply Garrity and resolved that a choice of law provision in a contract governed by the FAA merely designates the substantive law that the arbitrators must apply to determine whether the parties' conduct justifies a punitive damages award, that «choice of law provision does not deprive the authority of the arbitrator(s) from awarding punitive damages»³⁸.

4. Should the arbitrators award Punitive damages in International Arbitration?

The question of whether arbitrators should award punitive damages primarily involves two factors: the compatibility of an award for punitive damages with the public policy under applicable law or under the law of the seat of arbitration, and therefore, the question of the award's enforceability is taken into account. These two factors are closely related because, in the end, the arbitrator's decision has the ultimate goal of being recognised and enforced. An arbitration award that cannot be enforced, is no more than a piece of paper for disputing parties.

First of all, the incompatibility of punitive damages with the domestic public policy may cause arbitral awards being annulled (set aside)

³⁶ *Id.*

³⁷ *Bonar v. Dean Witter Reynolds, Inc.*, 835 F.2d 1378 (11th Cir. 1988).

³⁸ *Id.* at 1387 (citing, *Willoughby Roofing & Supply Co., Inc. v. Kajima International, Inc.*, 598 F. Supp. 353 (N.D. Ala. 1984).

by the courts of the place of arbitration (UNCITRAL Model Law on International Commercial Arbitration, Article 34 (2)(b)(ii), 1985). Therefore, if the courts of arbitration seat consider that punitive damages violate public policy, they may set aside punitive arbitral awards. In the context of international commercial arbitration, ICC Case No. 5946 (1991)³⁹ the parties had selected the New York law as the law governing their contract. When addressing the claimant's request for punitive damages, the arbitration tribunal recognised the applicability of the *lex contractus* to this claim. However, the tribunal ultimately declined to consider awarding such damages because they held that such a decision would have been contrary to the public policy of the Swiss arbitral seat (1991)⁴⁰.

Secondly, the arbitral punitive damages award may be refused to recognise and enforce due to the incompatibility with the country's public policy where the award's recognition and enforcement is sought. According to Article V (2) of the New York Convention, «the recognition and enforcement of arbitral awards may be refused» if the competent authority of the country where recognition and enforcement is sought finds that recognition or enforcement of such award would be contrary to national «public policy» (United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, Article V (2)(b), 1958). The UNCITRAL Model Law contains a similar provision regarding the enforcement of foreign arbitral awards (1985). As mentioned above, Russian courts do recognise and enforce the arbitral awards that contain punitive for breach of contract. However, in extreme cases, it is possible to treat arbitral awards regarding multiple punitive or exorbitant damages as a violation of public policy (Nikiforov, 2018).

The fact is that in many countries around the world, they may have very different definitions of public policy, under which the availability of the punitive damages award is considered differently. Generally, in most countries, especially civil jurisdiction, the award of punitive damages is incompatible

³⁹ *Final award in Case No. 5946 of 1990*, 16 Y.B. Commercial Arbitration. 97 (1991).

⁴⁰ *Id.*

with the basic function assigned to the obligation laws. Therefore, it is not surprising that such damages are considered contrary to public policy. As a result, such awards would not be enforced in Italy and Germany, for instance. According to the limited data gathered, the highest courts of two countries have clearly stated that foreign punitive damages are unenforceable because they are contrary to their domestic public policy. The first case is in a 1992 decision, the German Supreme Court refused to enforce the punitive damages award part of the California ruling on the grounds that the damages were contrary to public policy of Germany⁴¹. And recently, on January 19, 2007, the Italian Supreme Court handed down a similar decision⁴².

Punitive damages not only contradict the basic views on the public policy matter, but also lead to situations that can be considered «unjust enrichment». As explained above, in the case that if the plaintiff suffers actual damages, he will receive the compensation from the defendant. Meanwhile, punitive damages are meant to punish the defendant wrongdoer, not to get the second compensation from the defendant. In fact, however, punitive damages are awarded to the plaintiff instead of paying the government. As a result, the plaintiff is «compensated» beyond the actual damage he suffered, which means he is enriched. Such enrichment would be considered as «unjust» in most countries. For example, in continental Europe, damages are meant to compensate the injured party for the loss suffered, and they may not entail the enrichment under any circumstances: because the purpose of the damages awarded is to restore the initial status, i. e., to compensate only (Nagy, 2012).

Considering the arbitrator's aspect, as has been explained, punitive arbitral awards can be nullified by the courts of the arbitrator's seats if they are contrary to current public policy. This scenario may affect the decision of the arbitral tribunal. Even though the arbitral tribunal is re-

luctant to award such relief, it is still quite risky considering the possibility of enforcing the arbitral award later. Moreover, some arbitrators believe that because punitive damages actually penalise a wrongdoer, and «penal» judgments are generally unenforceable in a foreign state, such an award should be rendered invalid (Fei, 2003).

From the view of arbitration institutions, most of their rules are generally silent with regard to available remedies and, more specifically, with regard to the availability of punitive damages (Petsche, 2013). For example, section IV The award of the UNCITRAL Arbitration Rules 1976 (as revised in 2010) contains no provision pertaining to remedies. Article 32 of the ICC Arbitration Rules 2017, which relates to the «making of the award», similarly fails to address this issue. Article 26 that covers the issues related to awards of the London Court of International Arbitration Rules 2014 also remains silent on the question of remedies. However, the International Mediation and Arbitration Rules of the AAA is an exception. Article 28(5) of the International Arbitration Rules 2001 expressly excluded punitive relief. According to those Rules, the parties expressly waive any right to punitive, exemplary, or similar damages in their agreement, unless the parties agree otherwise. In other words, the parties may expressly authorise punitive damages awards in their agreement but if they fail to do so, such awards will be automatically excluded under the Rules. In the International Arbitration Rules amended and effective in 2014, although the AAA does not specifically mention the punitive damages, these rules noted that the arbitrator(s) may grant any remedy of relief that they deem fair and within the scope of the parties' agreement.

It is not uncommon that there are almost no provisions regarding the availability of punitive damages in the institutional arbitration rules. To explain for this, the party autonomy is considered as a fundamental principle to arbitration in general and to international arbitration in particular. A rule authorising or proscribing the award of punitive relief would be considered as undue interference with the principle of arbitration, i. e. party autonomy.

⁴¹ Bundesgerichtshof [BGH] [Federal Court of Justice] June 4, 1992, 118 Entscheidungen des Bundesgerichtshofes in Zivilsachen [BGHZ] 312 (F.R.G.)

⁴² Italian Supreme Court, Decision of Jan. 19, 2007, No. 1183/2007 reported by Rouhette, 331

Besides, punitive damages awards are also explicitly excluded under a number of public international law instruments. For instance, the arbitration tribunals hearing investor–state disputes, in accordance with the Draft Model Agreement on International Investment prepared by the International Institute for a Sustainable Development, «may not award punitive damage»⁴³. Likewise, under the Dominican Republic–Central America Free Trade Agreement, constituted arbitral tribunals are «not authorised to award punitive damages»⁴⁴. Even though these provisions are not directly related to the purposes of international commercial arbitration, they do show that punitive damages are generally considered inappropriate in the international context.

Conclusion

Some argued that to be an out-of-court or alternative dispute resolution truly, all existing remedies available in litigation should be available in arbitration, too, including punitive damages. However, in the author’s opinion, all these arguments may only be relevant to domestic arbitration. In the context of international commercial arbitration, punitive damages are generally inconsistent and should not be available due to the diversity and complexity of public policy issues in each country’s legisla-

tion. At this moment, punitive damages in international commercial arbitration still remain as a theoretical issue. Furthermore, the fact is that punitive arbitral awards in the international field are either non-existent or extremely rare. The main reason for the uncommon punitive damages awards in international commercial arbitration is because this type of remedy is available in a limited number of countries, and due to public policy influence, such awards can hardly be enforced internationally. This fact partly influences to reconsider the interpretation of Article V of the New York Convention and the interpretations of public policies by domestic states. The systems and attitudes of different countries with public policies are too diverse, and that also raises the question of whether there should be an international public policy rather than domestic public policy in order to promote the process of harmonisation and unification of international arbitration in particular and harmonisation and unification of private international law in general. From the studies of domestic arbitration cases, it is found that choosing arbitration to resolve commercial disputes does not automatically avoid punitive damages. The parties must explicitly exclude punitive damages in their arbitration agreements. Moreover, indeed, in some exceptions, punitive damages cannot be waived under some applicable laws. However, in terms of franchising, at least arbitration is one excellent method that may help franchisors and franchisees avoid unnecessary punitive damages at present time.

⁴³ International Institute for a Sustainable Development, Draft Model Agreement on International Investment, Annex A. Investor-State Dispute Settlement, Art. 13(3)

⁴⁴ Dominican Republic–Central America Free Trade Agreement, Ch. 10, Sec. A: Investment, Art. 10.26(3)

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