



Digital Commons@

Loyola Marymount University
LMU Loyola Law School

Loyola of Los Angeles Law Review

Volume 20 | Number 2

Article 6

1-1-1987

Punitive Damage Awards in International Arbitration: Does the Safety Valve of Public Policy Render Them Unenforceable in Foreign States

Karen J. Tolson

Follow this and additional works at: <https://digitalcommons.lmu.edu/llr>



Part of the [Law Commons](#)

Recommended Citation

Karen J. Tolson, *Punitive Damage Awards in International Arbitration: Does the Safety Valve of Public Policy Render Them Unenforceable in Foreign States*, 20 Loy. L.A. L. Rev. 455 (1987).

Available at: <https://digitalcommons.lmu.edu/llr/vol20/iss2/6>

This Notes and Comments is brought to you for free and open access by the Law Reviews at Digital Commons @ Loyola Marymount University and Loyola Law School. It has been accepted for inclusion in Loyola of Los Angeles Law Review by an authorized administrator of Digital Commons@Loyola Marymount University and Loyola Law School. For more information, please contact digitalcommons@lmu.edu.

**PUNITIVE DAMAGE AWARDS IN INTERNATIONAL
ARBITRATION: DOES THE "SAFETY VALVE"
OF PUBLIC POLICY RENDER THEM
UNENFORCEABLE IN FOREIGN
STATES?**

If a man shall steal an ox, or a sheep, and kill it, or sell it; he shall restore five oxen for an ox, and four sheep for a sheep.¹

I. INTRODUCTION

The concepts of arbitration and punitive damages are ancient. In Greek mythology, the giant, Briareus, arbitrated a dispute between Poseidon (God of the Sea) and Helios (God of the Sun) to fairly divide Corinth.² In the third millennium B.C., when two city-states disputed over borders, the leader of a third state made an award based on divine inspiration.³ King Solomon, the wisest king of Israel, settled a disagreement between two female subjects who both claimed to be the mother of one baby.⁴ And as the Biblical law above demonstrates, since time immemorial, tortfeasors have been punished for egregious conduct by being required to pay damages in excess of compensation.⁵

Today, arbitration between citizens of foreign States requires implementation of a complicated and sophisticated system of rules and procedures. Arbitration is commonly employed to resolve a myriad of conflicts which arise between people who live under vastly different systems of law. Even more complex are the methods by which individual States enforce foreign arbitral awards.

An American party and a foreign party may contract to resolve all disputes in an arbitral forum. The parties may also agree that United

1. *Exodus* 22:1 (King James).

2. G. RAYMOND, *CONFLICT RESOLUTION AND THE STRUCTURE OF THE STATE SYSTEM: AN ANALYSIS OF ARBITRATIVE SETTLEMENTS* 1 (1980).

3. *Id.* at 9. This "first recorded case of international arbitration" occurred in Mesopotamia. The third city-state leader's award was revealed to him by the ancient god Enlil. *Id.*

4. 1 *Kings* 3:16-28 (King James).

5. *Exodus* is replete with examples of over-compensating damages as punishment:

If the theft be certainly found in his hand alive, whether it be ox, or ass, or sheep; he shall restore double.

For all manner of trespass, *whether it be* for ox, for ass, for sheep, for raiment or for any manner of lost thing, which *another* challengeth to be his, the cause of both parties shall come before the judges; *and* whom the judges shall condemn, he shall pay double unto his neighbour.

Exodus 22:4, 9 (King James) (emphasis in original).

States law will govern the arbitration. This type of agreement requires that arbitrators apply United States substantive and, in some cases, procedural law to the issues presented by the conflict.⁶ When United States law governs a dispute which includes tort and contract issues, punitive

6. Two or more foreign individuals or companies, transacting international business, may agree in advance or after a dispute arises to submit to arbitration all or some disputes arising out of the contract. An arbitration agreement binds the parties as does any contract. Parties usually choose the substantive law applicable to disputes and the forum at which the arbitration will take place. If the forum chosen is one party's sovereign, the arbitration procedure may be governed by that country's rules for arbitration, where any exist. See Ehrenhaft, *Effective International Commercial Arbitration*, 9 LAW & POL. INT'L BUS. 1191, 1209-11 (1977). Otherwise, the parties may submit to a more neutral forum's rules, perhaps one of the major international arbitral forums. See *infra* text accompanying notes 33-38.

When formulating an award, arbitrators must follow the choices of law and forum specified in the arbitration agreement. If an arbitrator ignores the parties' choices, a national court may review and overturn the award. See *infra* note 207 for a discussion of the review and confirmation process in several foreign nations. Because the agreement binds the arbitrators, choice of law provisions in the arbitration agreement are crucial. Depending upon the forum and the type of dispute, choice of law provisions may preempt the parties' national rights—both procedural and substantive.

For example, suppose an American company contracts with a British company to build a factory in England. In some American jurisdictions, proof of bad faith in a contractual matter may be the basis for an award of punitive damages. See, e.g., *Seaman's Direct Buying Serv., Inc. v. Standard Oil Co.*, 36 Cal. 3d 752, 686 P.2d 1158, 206 Cal. Rptr. 354 (1984) (punitive damages awardable for breach of contract and breach of implied covenant of good faith and fair dealing in dealer's action against oil company). However, suppose the parties agree to arbitrate any and all disagreements arising out of the contract and agree that British law governs the disputes. British law does not recognize punitive damages for bad faith. See *infra* text accompanying notes 62-65 for a discussion of British actions which may involve punitive damages. Thus, the American company, by agreeing to arbitrate under British law, has relinquished rights and remedies available under comparable United States law.

Careful drafting may designate one or the other party's national laws, as in the example above, or may, as happens frequently, designate a neutral foreign law as the governing law. The laws of England, France and Switzerland are most often chosen as the neutral body of law. W. CRAIG, W. PARK & J. PAULSSON, *INTERNATIONAL CHAMBER OF COMMERCE ARBITRATION* § 17.04, at 86 (1984) [hereinafter ICC ARBITRATION]. For a discussion of drafting to ensure the intent of the parties, see Ehrenhaft, *supra* at 1191-209. Failure to include a choice of law provision in an arbitration agreement leaves the parties completely unprepared for an arbitral outcome and complicates the arbitrators' duties. In this situation an arbitrator must properly apply conflict of law principles to concerns of each of the jurisdictions involved in the dispute. He or she must then determine which country's substantive laws have the most significant relationship to the parties and their transaction. Derains, *Arbitrage et Droit de la Concurrence*, 14 REVUE SUISSE DU DROIT INTERNATIONAL DE LA CONCURRENCE 39, 56-57 (1982).

Under International Chamber of Commerce Court of Arbitration (ICC Court) rules, article 13(3), for example, in the absence of a choice of law provision by the parties, the arbitrator "shall apply the law designated as the proper law by the rule of conflict which he deems appropriate." INTERNATIONAL COUNCIL FOR COMMERCIAL ARBITRATION, *ICC Court Rules* [1976] 1 Y.B. COM. ARB. 158, 167. The ICC Court rules are also codified at ICC Publication No. 291 (1975). According to one author "the arbitrators are able to infuse an international element into the proceedings and assure both parties that the issue has not been determined by

damages may constitute part of the arbitral award.⁷ To obtain redress in

the narrow application of the system of a single State, whose relation to the dispute is not necessarily predominant." ICC ARBITRATION, *supra*, § 17.02, at 79.

When parties choose "United States law" to govern an international commercial contract and arbitration agreement, arbitrators must determine which type of United States law to apply. The parties may designate the law of a specific state. If no state law is mentioned, the arbitrators may apply the law of the state in which the transaction or breach occurred. A party who recognizes the opportunity to collect punitive damages may suggest the law of a state like California. California law allows arbitrators to award punitive damages. *Baker v. Sadick*, 162 Cal. App. 3d 618, 208 Cal. Rptr. 676 (1984). For a discussion of *Baker*, see *infra* note 67. A potential wrongdoer might prefer the more conservative New York approach set out in *Garrity v. Lyle Stuart, Inc.*, 40 N.Y.2d 354, 353 N.E.2d 793, 386 N.Y.S.2d 831 (1976) under which arbitrators may not award punitive damages. For a discussion of *Garrity*, see *infra* note 67. The arbitrators will then decide whether to apply state law or whether the United States Arbitration Act (Federal Arbitration Act or Act) preempts state law. 9 U.S.C. §§ 200-09 (1986). See *Willis v. Shearson/American Express, Inc.*, 569 F. Supp. 821 (M.D.N.C. 1983). For a discussion of *Willis*, see *infra* text accompanying notes 89-95.

Where federal law preempts the state law, the arbitrators must make a careful choice. Some arbitrators may apply federal common law. See *Southland Corp. v. Keating*, 465 U.S. 1, 14 (1984) (action to compel compliance with arbitration clause where arbitration would decide franchise investment matters state law had declared nonarbitrable) (Stevens, J., concurring in part and dissenting in part); *Acevedo Maldonado v. PPG Indus.*, 514 F.2d 614, 616 (1st Cir. 1975) (diversity action for negligence against corporation for injuries suffered from gas which escaped from chlorine manufacturing plant). Others may fashion the federal common law by referring to aspects of state law which are not preempted by the Federal Arbitration Act. See *Keating*, 465 U.S. at 15 (Stevens, J., concurring in part and dissenting in part); *Comprehensive Merchandising Catalogs, Inc. v. Madison Sales Corp.*, 521 F.2d 1210 (7th Cir. 1975) (corporation's diversity action against second corporation to enforce out of state default judgment); see also *Southeastern Enameling Corp. v. General Bronze Corp.*, 434 F.2d 330 (5th Cir. 1970) (court properly granted stay pending arbitration where defendant claimed as a defense he had only partially read contract with plaintiff and failed to notice provisions mandating that all disputes would be submitted to arbitration and would be governed by New York law); Note, *State Law Under the Federal Arbitration Act*, 78 MICH. L. REV. 1391 (1980).

7. Charles N. Brower, an arbitrator sitting on the Iran-United States Claims Tribunal, acknowledged the possibility that punitive damages might be claimed in a case where property has been taken unlawfully and restitution is impossible. Separate Opinion of Charles N. Brower (Mar. 27, 1986), *Sedco, Inc. v. National Iranian Oil Co. (U.S. v. Iran)*, Interlocutory Award No. 59-129-3 of Mar. 27, 1986 (Mangard, Ansari & Brower, Arbs.) 1, 25, reprinted in MEALEY'S LITIGATION REPORTS: IRANIAN CLAIMS 3937, 3949 (Apr. 4, 1986). Brower stated:

There are strong reasons in logic why it would be appropriate for an international tribunal to award punitive or exemplary damages against a State in such circumstances. In the absence of such damages being awarded against an unlawfully expropriating State, where restitution is impracticable or otherwise inadvisable, that State is required to furnish only the same full compensation as it would need to provide had it acted entirely lawfully. Thus, the injured party would receive nothing additional for the enhanced wrong done it and the offending State would experience no disincentive to repetition of unlawful conduct. If it is not deemed unseemly for the national courts of one State to "punish" at least certain entities of a foreign State, see U.S. Foreign Sovereign Immunities Act, 28 U.S.C. § 1606 (court award of punitive damages prohibited against a foreign State "except for an agency or instrumentality thereof," defined in § 1603(b) to include "a separate legal person . . . which is an organ of a foreign state"), it is questionable whether an international tribunal,

a country which houses the tortfeasor's property, the award-holder must present the award to that State's legal system for enforcement.⁸ The award must survive that foreign government's scrutiny. If it fails to pass muster, the tortfeasor's property may be judgment proof. This Comment is concerned with the above conundrum which confronts practitioners involved in international business.

Contracts are not written by parties who expect an accident or a breach. Thus, most parties do not consider punitive damages when transacting international business. A businessperson cannot predict whether his or her actions will lead to an arbitrator's award of punitive damages or even how much an award might be. Yet several types of breach of contract involve tortious acts which are punishable by punitive damages under United States law.⁹ For example, a party contracting to buy or sell goods or services may commit fraud, contract in bad faith, or design, manufacture or service a product with gross negligence.¹⁰

Until recently, punitive damage claims were nonarbitrable under American state and federal law.¹¹ If awarded, they were struck down in enforcement actions.¹² Because they believed it an abuse of arbitrators' powers to punish parties voluntarily submitting to arbitration, many judges rejected such awards on public policy grounds.¹³ Yet a change occurred in 1985, when the United States Supreme Court, in *Mitsubishi*

particularly one formed by agreement of the only States Parties as to which it can adjudicate, need be so reticent.

Id. at 25 n.35, reprinted in MEALY'S LITIGATION REPORTS: IRANIAN CLAIMS 3937, 3949 (Apr. 4, 1986).

8. For a discussion of enforcement procedures for international arbitral awards see *infra* text accompanying notes 39-45.

9. K. REDDEN, PUNITIVE DAMAGES § 5.18, at 53 (1980). See *infra* text accompanying notes 51-66 for a discussion of punitive damages in contract actions.

10. *Id.*

11. In New York, for example, the law assigns punitive damage determinations to the judiciary. *Garrity v. Lyle Stuart, Inc.*, 40 N.Y.2d 354, 353 N.E.2d 793, 386 N.Y.S.2d 831 (1976). For a discussion of *Garrity* and other state court opinions regarding punitive damages in arbitration, see *infra* note 67. In *International Union of Operating Eng'rs v. Mid-Valley, Inc.*, 347 F. Supp. 1104 (S.D. Tex. 1972), the United States District Court for the Southern District of Texas decided that the scope of an arbitrator's authority extended only to the determination of whether a breach of contract had occurred, and not to award punitive damages. *Id.* at 1109. See Carper, *Punitive Damages in Commercial Arbitration*, 41 ARB. J., Sept. 1986, at 27, in which the author summarizes the recent domestic decisions allowing punitive damages in arbitration, concludes that the decisions do not clearly provide support for their submission and proposes that Congress ensure that the several states uniformly accept or reject arbitral punitive damage awards.

12. See, e.g., *International Union*, 347 F. Supp. at 1109 (holding that punitive damages cannot be awarded absent an authorizing provision where the award constitutes a penalty).

13. *Garrity*, 40 N.Y.2d at 356, 353 N.E.2d at 794, 386 N.Y.S.2d at 833. "Punitive damages is a sanction reserved to the State, a public policy of such magnitude as to call for judicial

Motors Corp. v. Soler Chrysler-Plymouth, Inc.,¹⁴ held that arbitrators may award treble damages in an international arbitration concerning American federal antitrust issues.¹⁵ Ignoring state law, two United States district courts have recently held that punitive damage claims are arbitrable under federal law and a United States court of appeals has affirmed one district court holding.¹⁶ Such innovative opinions demonstrate the strong public policy now favoring arbitration as a means of dispute resolution.

Although United States federal courts agree, international arbitrators' opinions differ about whether punitive damage awards could be enforced in their jurisdictions.¹⁷ Some believe international comity¹⁸ and the 1958 Convention on the Recognition and Enforcement of Foreign

intrusion to prevent its contravention." *Id.* See generally Note, *Punitive Damages in Arbitration: The Search for a Workable Rule*, 63 CORNELL L. REV. 272 (1978).

14. 105 S. Ct. 3346 (1985).

15. *Id.* at 3358-60.

16. *Willoughby Roofing & Supply Co. v. Kajima Int'l, Inc.*, 598 F. Supp. 353 (N.D. Ala. 1984), *aff'd*, 776 F.2d 269 (11th Cir. 1985); *Willis v. Shearson/American Express, Inc.*, 569 F. Supp. 821 (M.D.N.C. 1983). For a discussion of *Willoughby*, see *infra* text accompanying notes 96-104. For a discussion of *Willis*, see *infra* text accompanying notes 89-95. Following this trend, a California Court of Appeal upheld an arbitrator's punitive damage award. *Baker*, 162 Cal. App. 3d at 629-30, 208 Cal. Rptr. at 683-84. See *infra* note 67 for a discussion of *Baker*.

17. In response to this author's letter which posed the question of whether punitive damages would be enforced in their own countries, international arbitrators and lawyers from Austria, Canada, Denmark, England, Hong Kong, Italy, Japan, the Netherlands and Poland responded with conflicting opinions. (Copy of letter is on file at *Loyola of Los Angeles Law Review*.) International arbitrators in the United States believe the issue is unresolved. Michael F. Hoellering, Esq., General Counsel for the American Arbitration Association (AAA) in New York, stated that he recalled no situation where a foreign court refused to enforce a punitive damage award. However, he agreed that a country disfavoring punitive damages might employ domestic public policy and refuse to enforce an award. Telephone interview with Michael F. Hoellering, Esq., General Counsel, AAA (Mar. 21, 1986). The Society of Maritime Arbitrators, Inc. (SMA) in New York maintains a general policy of not awarding punitive damages in its arbitrations. Letter from Sally Sielski, Society of Maritime Arbitrators, Inc. to Karen Tolson (Mar. 17, 1986). The SMA sent a report of a maritime arbitration involving a dispute between charterers and owners of a vessel which delivered goods late from St. Croix to New Jersey and Maryland (copy of letter and report on file at *Loyola of Los Angeles Law Review*). The arbitrators denied a claim for punitive damages, stating:

The Panel believes that the award of punitive damages is not within the intent and scope of the arbitral process which is fundamentally grounded in the concept of equitable resolutions of commercial disputes. Moreover, there appears to be legal precedent which would deny arbitration panels the power to award punitive damages.

Transcoast Navigation, Ltd. v. Amerada Hess Shipping Corp., (S/T "ATHENA"), 1874 S.M.A. 15 (1983) (Nichols, Ottaway & Engelbrecht, Arbs.). The SMA publishes a quarterly newsletter. Three issues in 1985 were largely devoted to articles by and letters from maritime arbitrators who strongly disagreed with each other on whether punitive damages should be awarded by arbitrators. See 17 ARB., Nos. 1, 2 & 4 (Mar., June & Dec. 1985).

Arbitral Awards (Convention),¹⁹ signed by seventy nations, strongly support enforcement of foreign awards, even where the enforcing State's domestic laws or policies would not permit enforcement.²⁰ Other arbitrators believe that because punitive damages penalize a wrongdoer, and penal judgments are generally unenforceable in a foreign State, such an award should be rendered invalid.²¹ Because there is no record of any international arbitral award of punitive damages,²² the question remains

18. In *Hilton v. Guyot*, 159 U.S. 113 (1895), the United States Supreme Court defined comity as follows:

"Comity," in the legal sense, is neither a matter of absolute obligation, on the one hand, nor of mere courtesy and good will, upon the other. But it is the recognition which one nation allows within its territory to the legislative, executive or judicial acts of another nation, having due regard both to international duty and convenience, and to the rights of its own citizens or of other persons who are under the protection of its laws.

Id. at 163-64.

19. June 10, 1958, 21 U.S.T. 2517, T.I.A.S. No. 6997, 330 U.N.T.S. 38 [hereinafter the Convention]. The Convention was adopted by the United Nations Conference on International Commercial Arbitration on June 10, 1958, in New York. The following countries have ratified the Convention: Australia, Austria, Belgium, Benin, Botswana, Bulgaria, Byelorussian SSR, Canada, Central African Republic, Chile, Colombia, Cuba, Cyprus, Czechoslovakia, Democratic Kampuchea, Denmark (on behalf of the Faeroe Islands and Greenland), Democratic Republic of Germany, Djibouti, Ecuador, Egypt, Federal Republic of Germany, France, Finland, Ghana, Greece, Guatemala, Haiti, Holy See, Hungary, India, Indonesia, Ireland, Israel, Italy, Japan, Jordan, Kuwait, Luxembourg, Madagascar, Malaysia, Mexico, Monaco, Morocco, Netherlands, New Zealand, Niger, Nigeria, Norway, Panama, Philippines, Poland, Republic of Korea, Rumania, San Marino, South Africa, Spain, Sri Lanka, Sweden, Switzerland, Syrian Arab Republic, Thailand, Trinidad and Tobago, Tunisia, Ukrainian SSR, United Arab Republic, United Kingdom (on behalf of Belize, Bermuda, Hong Kong, Gibraltar, the Isle of Man and the United Kingdom), United Republic of Tanzania, U.S.A., USSR, Uruguay, Yugoslavia. UNITED NATIONS, UNITED NATIONS MULTILATERAL TREATIES WITH THE SECRETARY-GENERAL: STATUS AS AT 31 DECEMBER 1984 685-91 (1985). Malaysia acceded to the Convention on November 5, 1985. INTERNATIONAL COUNCIL FOR COMMERCIAL ARBITRATION, *New York Convention of 1958: List of Contracting States* [1986] 11 Y.B. COM. ARB. 395-96. Canada acceded to the Convention on August 10, 1986 by incorporating it into the Foreign Arbitral Awards Act, 74 B.C. REV. STAT. § 1 (1986); BRITISH COLUMBIA INT'L COMMERCIAL ARBITRATION CENTRE, *Foreign Arbitral Awards Act of British Columbia*, INTERNATIONAL COMMERCIAL ARBITRATION: THE CANADIAN ADVANTAGE, pt. 2, at 1 (1986).

20. Dr. Albert Jan van den Berg, General Editor of the *Yearbook Commercial Arbitration*, writes: "A punitive damage award would most likely be enforced in signatory States." Letter from Dr. van den Berg to Karen Tolson (Mar. 24, 1986) (copy on file at *Loyola of Los Angeles Law Review*).

21. See *infra* text accompanying note 223.

22. Dr. van den Berg found no recorded enforcement action in which punitive damages were rejected. His research included the library of the International Arbitration Department of the TMC Asser Institute for International Law at the Hague. Dr. van den Berg stated: "Although this library is probably one of the best documented on international arbitration in the world, no decision could be found in which enforcement was refused because of an award of punitive damages." Letter from Dr. van den Berg to Karen Tolson, *supra* note 20. The libraries of several prominent international arbitration institutions in Austria, Denmark, Hong

unanswered.

The major obstacle to enforcing a punitive award in international arbitration is the "public policy exception" to enforcement in the Convention. The exception states that an award which violates the public policy of the enforcing country is void.²³ As used in the exception, "public policy" has been interpreted most often to mean policy guided by international principles of fairness and procedural due process, rather than by parochial policies or laws.²⁴ This definition is preferred by most commentators.²⁵ However, inconsistent definitions of public policy could test the validity of the punitive portion of an award, depending on which country is deciding whether or not to enforce the award.

Kong, Italy, Japan and Poland reveal no record of a punitive damage award or any type of damage award which a court refused to enforce. Letter from Dr. Werner Melis, Schiedsgericht der Bundeskammer der gewerblichen Wirtschaft (Council for Mutual Economic Assistance) in Vienna, Austria to Karen Tolson (Apr. 4, 1986); Letter from G. Stark, Det Danske Voldgiftsinstitut (Copenhagen Arbitration) in Copenhagen, Denmark to Karen Tolson (Mar. 17, 1986); Letter from Andrew Yui, Assistant Manager, Trade Division, The Hong Kong General Chamber of Commerce, to Karen Tolson (Mar. 17, 1986) and Letter from B.H. Tisdall, Secretary-General, The Hong Kong International Arbitration Centre, to Karen Tolson (Mar. 24, 1986); Letter from Mauro Ferrante, Secretary-General, Associazione Italiana Per L'Arbitrato in Rome, Italy, to Karen Tolson (Mar. 19, 1986); Letter from Hiroshi Hattori, Director, The Japan Commercial Arbitration Association in Tokyo, Japan, to Karen Tolson (Mar. 12, 1986); Letter from Stanislaw Mozejko, Secretary, International Court of Arbitration for Marine and Inland Navigation at Gdynia, to Karen Tolson (Mar. 17, 1986). There is also no record of such an award in the auspices of the ICC Court or the International Centre for the Settlement of Investment Disputes (ICSID). Letter from Sigvard Jarvin, General Counsel, ICC Court of Arbitration in Paris, France, to Karen Tolson (Mar. 21, 1986); Letter from Bertrand P. Marchais, Counsel for ICSID in Washington, D.C., to Karen Tolson (Mar. 12, 1986) (copies of all letters on file at *Loyola of Los Angeles Law Review*).

23. The Convention states:

Recognition and enforcement of an arbitral award may also be refused if the competent authority in the country where recognition and enforcement is sought finds that:

(a) The subject matter of the difference is not capable of settlement by arbitration under the law of that country; or

(b) The recognition and enforcement of the award would be contrary to the public policy of that country.

Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, art. V(2), 21 U.S.T. 2517, T.I.A.S. No. 6997, 330 U.N.T.S. 38. See *infra* text accompanying notes 127-94, for a discussion of the potential effect of the public policy exception on punitive damage awards.

24. See *infra* text accompanying notes 187-94, for a discussion of what constitutes "international" public policy.

25. INTERNATIONAL COUNCIL FOR COMMERCIAL ARBITRATION, *Court Decisions on the New York Convention 1958* [1985] 10 Y.B. COM. ARB. 401-02; Ehrenhaft, *supra* note 6, at 1212-16; van den Berg, *Should an International Arbitrator Apply the New York Arbitration Convention of 1958?*, in *THE ART OF ARBITRATION* 45, 48-49 (J. Schultz & A.J. van den Berg, eds. 1982); Bernini, *The Enforcement of Foreign Arbitral Awards By National Judiciaries: A Trial of the New York Convention's Ambit and Workability*, in *THE ART OF ARBITRATION* 51, 59-60.

Because few countries even recognize civil punishment—much less punitive damages²⁶—it is unlikely that enforcement of a punitive damage award will be consistent with the public policy or domestic laws of most countries. If the arbitral award is not enforced by the court which has jurisdiction over the asset-holder, the award-holder may not receive any punitive damages, despite the fact they are due him under the American law governing the contract.²⁷

This Comment analyzes the problems surrounding the enforcement of an international arbitral award of punitive damages. First, it explains when arbitration is “international” and how public policies behind punitive damages may conflict with those of the arbitral forum. Second, it explains how a party enforces an international arbitration award and how an enforcing State’s domestic public policies and its familiarity with civil penalties like punitive damages affect enforcement. Finally, this Comment sets forth a proposal for alternative enforcement procedures and gives advice to contracting parties who wish to avoid the problems inherent in enforcing an international arbitral punitive damage award.

II. BACKGROUND OF THE PROBLEM

A. *The Nature of International Arbitration*

Arbitration is “international” when parties from different countries submit to arbitration questions concerning transnational commercial business transactions.²⁸ “Domestic” arbitration denotes arbitral proceedings between citizens of the country in which the arbitration takes place (the forum).²⁹

26. See *infra* text accompanying notes 207-41 for a discussion of civil punishment in other countries.

27. See *supra* note 6 for a discussion of choice of law in the arbitration agreement.

28. The Geneva Convention of April 21, 1961, art. 1, states that litigation arising from international commercial operations constitutes “international arbitration” when it is employed by parties from different countries. Swedish law mandates only that the parties’ national residences differ. French law adds to the mandate of different nationalities that the operations must affect international commerce. Finally, U.S. law labels a proceeding “international arbitration” when foreign law, foreign countries’ concerns or international commerce is at all involved. Thieffry, *The Finality of Awards in International Arbitration*, 2 J. INT’L ARB. 27, 31 (1985).

29. For the most part, international arbitration procedures assimilate domestic arbitration procedures. The essential qualities are set forth below for the practitioner unfamiliar with them.

Parties to a transaction—commercial or otherwise—may contract to have specified disputes submitted to arbitration, a process growing in popularity as an alternative dispute resolution mechanism to traditional adjudication. See generally Burger, *Isn’t There a Better Way?*, 68 A.B.A. J. 274 (Mar. 1982). In American domestic arbitration, the parties choose a neutral party—the arbitrator (or panel of arbitrators)—who listens to a presentation of the conflicting

The Americas, Europe, Asia, Africa and the Soviet Union have discovered that international arbitration can be the optimum means of co-

facts by each party, his counsel, his representative or all three. After the presentation, the arbitrator renders an equitable, binding decision in writing. The parties should voluntarily comply with the award. If one does not, the other(s) may have a court "confirm" the award, as long as the arbitration was conducted properly. An award may be set aside in most state jurisdictions where the award was procured by fraud or corruption or where arbitrators were not impartial, were engaged in misconduct or exceeded their powers under the agreement. See, e.g., § 1286.2 of the California Code of Civil Procedure, which states:

[T]he court shall vacate the award if the court determines that:

- (a) The award was procured by corruption, fraud or other undue means;
- (b) There was corruption in any of the arbitrators;
- (c) The rights of such party were substantially prejudiced by misconduct of a neutral arbitrator;
- (d) The arbitrators exceeded their powers and the award cannot be corrected without affecting the merits of the decision upon the controversy submitted; or
- (e) The rights of such party were substantially prejudiced by the refusal of the arbitrators to postpone the hearing upon sufficient cause being shown therefor or by the refusal of the arbitrators to hear evidence material to the controversy or by other conduct of the arbitrators contrary to the provisions of this title.

CAL. CIV. PROC. CODE § 1286.2 (West 1982). Confirmation may involve a brief review and entry of the award or a hearing on its validity. Once confirmed, an award becomes as enforceable as a court judgment. The rules of the AAA are the generally accepted rules for domestic arbitration. Rule 47(c) states: "Parties to these Rules shall be deemed to have consented that judgment upon the arbitration award may be entered in any Federal or State Court having jurisdiction thereof." INTERNATIONAL COUNCIL FOR COMMERCIAL ARBITRATION, *Arbitration Rules* [1982] 7 Y.B. COM. ARB. 189, 199 [hereinafter *Arbitration Rules*]. See also 1 LAW. ARB. LETTER No. 3, Sept. 1973, at 1.

The parties' agreement defines the rules and procedures of the arbitration and usually specifies the substantive (state or federal) law governing their contract. See generally Aksent, *What You Need to Know About Arbitration Law—A "Triality" of Research*, 10 FORUM 793, 793-96 (1975). See *supra* note 6 for a discussion of choice of law in an arbitration agreement.

The forum is completely private and confidential by law. AAA Rule 25 states: "The Arbitrator shall maintain the privacy of the hearings unless the law provides to the contrary." *Arbitration Rules, supra*, at 189, 195. Its proceedings and evidence usually go unrecorded and awards may be rendered without reporting the reasons for the decisions made. AAA Rule 23 states that proceedings will be recorded only if the parties request a record. *Id.* Arbitration hearings are not limited by judicial rules of evidence and are not restricted in the kinds of complaints that can be arbitrated, unless the parties agree otherwise. Nor are remedies confined by established legal principles—equity governs. AAA Rule 31 states: "The Arbitrator shall be the judge of the relevancy and materiality of the evidence offered and conformity to legal rules of evidence shall not be necessary." *Id.* at 196. AAA Rule 43 states: "The Arbitrator may grant any remedy or relief which the Arbitrator deems just and equitable and within the scope of the agreement of the parties, including, but not limited to, specific performance of a contract." *Id.* at 198.

As a result of the lack of formality, these hearings usually occur sooner and may cost substantially less than trials. See *Prima Paint Corp. v. Flood & Conklin Mfg.*, 388 U.S. 395, 404 (1967) (arbitration is quick and economical and relieves court congestion). The minimum AAA filing fee for an arbitration is \$200. To date, the largest administrative filing fee known to the AAA regional office in Los Angeles, California was \$45,000. Telephone interview with Jackie Downs, Deputy Director of Case Administration, AAA (Sept. 5, 1986). Also, since the parties voluntarily agree to submit to arbitration, about 90% of participants comply with the final arbitral award. See *Major Arbitration Institutions: Duration and Administrative Cost of*

operatively settling disputes.³⁰ Many countries, including Canada, England, France, Italy, Sweden, Switzerland and the United States, have

Proceedings and Estimated Rate of Compliance with Awards, I. RICHTER, INTERNATIONAL CONSTRUCTION CLAIMS: AVOIDING & RESOLVING DISPUTES table 10-2, at 188-89 (1983).

30. See Ovington, *Arbitration and U.S. Antitrust Law: A Conflict of Policies*, 2 J. INT'L ARB. 53, 53 (1985). Another author states: "Arbitration has emerged as the preferred remedy for resolving private international commercial disputes." Carbonneau, *Rendering Arbitral Awards With Reasons: The Elaboration of a Common Law of International Transactions*, 23 COLUM. J. TRANSNAT'L L. 579, 579-80 & n.1 (1985). "[A]rbitration is the only means of settlement of disputes arising from economic relations between economic organizations in member-countries" of the Council for Mutual Assistance. Melis, *Enforcement of Foreign Awards in European Member-Countries of the Council for Mutual Economic Assistance*, 2 ARB. INT'L 33 (1986). The member-countries of the Council are Bulgaria, Czechoslovakia, the German Democratic Republic, Hungary, Poland, Rumania and the Soviet Union. All of these countries are signatories to the Convention.

The International Chamber of Commerce (ICC) has recently espoused the arguments favoring international arbitration:

Arbitration is a favored method of settling international business disputes. By selecting the forum for dispute resolution, and often choosing the substantive law that will apply, parties to international contracts ensure the neutrality, certainty, and predictability that are essential to the continued growth of international trade. Without an arbitration clause, an international trader runs the risk of being forced to litigate in one or more of several jurisdictions, including the courts of the other party's home country. Arbitrations also are attractive because they are resolved more rapidly than most judicial litigation and because they provide the parties with greater assurance that trade secrets and other sensitive business information will remain confidential. The legitimate interest of parties in protecting their business secrets makes arbitration especially useful, particularly because some countries make all court papers public.

Brief of the International Chamber of Commerce as Amicus Curiae at 3, *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 105 S. Ct. 3346 (1985) (Nos. 83-1569, 83-1733) [hereinafter ICC *Mitsubishi* Brief].

Clearly, because law varies from state to state, it is advantageous to select a forum to govern disputes. Selection avoids the unpredictability inevitable when the parties do not agree on the governing law in advance.

In some cases, judicial dispute resolution better serves the ends of justice than arbitration. Because arbitrations and awards are generally confidential, injured persons other than the claimant may never know about the proceeding, the wrongdoer's violations or the arbitral result. Parties not aware of the proceeding also may never be able to assert their own rights. In most jurisdictions, an arbitral award has the same collateral estoppel and res judicata effects as a court award, so the private hearing affects future claims on the same issue. Parties who are not included in the private proceeding may lose their rights to legal action on a claim. See generally Note, *Foreign Judgments Based on Foreign Arbitral Awards: The Applicability of Res Judicata*, 124 U. PA. L. REV. 223 (1975). See, e.g., 8 LAW. ARB. LETTER No. 1, Mar. 1984, at 1 (collateral estoppel in domestic arbitration); 3 LAW. ARB. LETTER No. 27, Sept. 1979, at 1 (res judicata in domestic arbitration).

An arbitral award generally may not be appealed or set aside before or after it is confirmed, even for errors of law, unless it is clearly arbitrary. Section 10 of the Federal Arbitration Act, for example, states a court may vacate an award "[w]here the award was procured by corruption, fraud, or undue means . . . [w]here there was evident partiality or corruption in the arbitrators . . . [or] [w]here the arbitrators exceeded their powers" 9 U.S.C. § 10 (1982). See *infra* text accompanying notes 70-74, for a discussion of the Federal Arbitration Act. See also *Wilko v. Swan*, 346 U.S. 427, 436-37 (1953); 9 U.S.C. § 207 (1986); M. DOMKE, DOMKE

established procedures for holding international arbitrations within their borders and for enforcing foreign arbitral awards within their jurisdictions.³¹ Other countries—from Brazil to the People's Republic of China—have established procedures for domestic arbitrations which may involve their own citizens and those from different nations.³²

The American Arbitration Association (AAA) is the largest forum in the United States for domestic and international commercial arbitration.³³ The other three most well-known international arbitration fora are the International Chamber of Commerce Court of Arbitration (ICC Court),³⁴ the International Centre for the Settlement of Investment Disputes (ICSID)³⁵ and the United Nations Commission on International Trade Law (UNCITRAL).³⁶ While ICSID has its own rules for enforce-

ON COMMERCIAL ARBITRATION ch. 29, § 29:06 (1984) (written opinions are not necessary in arbitration).

Finally, international arbitrators are often business persons, rather than legal scholars or lawyers. AAA Rules 12 and 19 state that the qualifications of arbitrators are minimal. They require only that arbitrators must be neutral and subject to disqualification for bias. *Arbitration Rules*, *supra* note 29, at 189, 193-94. Thus, although they may be generally more knowledgeable than juries, they are not briefed on applicable laws the way juries are briefed in court proceedings. Brief for the United States as Amicus Curiae at 19 n.25, *Mitsubishi*, 105 S. Ct. 3346 [hereinafter United States *Mitsubishi* Brief].

In sum, whether there are more commentators in favor of or militating against international arbitration, it is a "preferred" means of dispute resolution. It provides an informal yet sophisticated forum where parties of diverse nationality can resolve disputes with some degree of predictability. Moreover, arbitration conserves time, resources and aggravation associated with adjudication in a foreign State.

31. See generally Thieffry, *supra* note 28; Close, *Choosing a Forum for International Commercial Arbitration*, 76 AM. SOC'Y INT'L L. PROC. 166 (1982).

32. Domestic arbitration procedures of most countries involved in international trade are reported in the first eleven volumes of the *Yearbook Commercial Arbitration* (1976-86).

33. The AAA rules for commercial arbitration are set forth at *Arbitration Rules*, *supra* note 29.

34. The ICC Court was established in 1923. Most of its present clientele come from Western Europe, Arab countries and the United States. It provides arbitrators for hearings outside the ICC, rather than administering hearings through its own auspices. Close, *supra* note 31, at 173-74. The ICC Court rules are codified at ICC Publication No. 291 (1975). They are also set forth at INTERNATIONAL COUNCIL FOR COMMERCIAL ARBITRATION, *Rules of Conciliation of the International Chamber of Commerce* [1983] 8 Y.B. COM. ARB. 200. For a discussion of three of the four major international forums mentioned in this section—ICC, ICSID and the United Nations Commission on International Trade Law (UNCITRAL)—see Branson & Tupman, *Selecting an Arbitral Forum: A Guide to Cost-Effective International Arbitration*, 24 VA. J. INT'L L. 933 (1984); see generally ICC ARBITRATION, *supra* note 6.

35. ICSID was formed by the Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, Mar. 18, 1965, 17 U.S.T. 1270, T.I.A.S. No. 6090, 575 U.N.T.S. 159. The ICSID Convention was ratified by 67 foreign States. Thieffry, *supra* note 28, at 29 n.8. The ICSID Court rules are codified at ICSID/4/Rev. 1 (May 1975).

36. On June 21, 1985, UNCITRAL adopted the "UNCITRAL Model Law on International Commercial Arbitration." *Report of the U.N. Commission on International Trade Law*

ing awards rendered under its auspices,³⁷ the AAA, the ICC Court and UNCITRAL have no such aid to enforcement.³⁸ Armed with an award from one of the latter institutions, a party must independently seek enforcement measures.

The procedures for enforcing an international award are somewhat different from those in domestic arbitration. After the international arbitrator renders an award, the successful party must have a court confirm it.³⁹ The national court of the country in which the arbitration takes place usually confirms the award. With confirmation, most international tribunals recognize the award as a final court judgment.⁴⁰ However, this does not guarantee that the judgment will be enforced.⁴¹

A successful party may seek enforcement in any State where an unsuccessful party retains assets.⁴² The national court enforcing the judgment may be the same as the court confirming it, if the debtor owns assets in that country. However, the enforcing court might be the national court of another country which reviews the award after the first country has confirmed the award. The enforcing court must decide whether to approve or deny the award's enforcement within its own boundaries. Unlike domestic arbitration, this review may be cursory or substantive, depending upon the country's public policies or laws.⁴³ For example, some countries authorize the judiciary to review the merits of an award while others demand that the award go through diplomatic channels before several government officers decide whether it is valid.⁴⁴ It is during this last stage—enforcement—that the debtor will dispute the punitive damages element of the underlying award, claiming that portion infects the entire award. The objecting party's argument would be formidable because in most States, punitive damages are completely unknown

on the Work of its Eighteenth Session, 40 U.N. GAOR Supp. at 1 (No. 17), U.N. Doc. A/40/17 Annex 1 (1985); 2 ARB. INT'L 11 (1986).

37. ICSID Convention, *supra* note 35, at art. 52(2).

38. Branson & Tupman, *supra* note 34, at 934-36.

39. The court order affirms that the court has jurisdiction over the matter, declares the arbitral proceedings were proper and renders a judgment with which the unsuccessful party must comply by law. I. RICHTER, *supra* note 29, at 187.

40. *Id.*

41. See *infra* notes 118-35 and accompanying text for a discussion of the problems in enforcing an international arbitral award.

42. Foreign courts may attach the losing party's assets to force compliance with the arbitral award. I. RICHTER, *supra* note 29, at 187; Close, *supra* note 31, at 182-83.

43. I. RICHTER, *supra* note 29, at 193. "Nations without a blanket policy of enforcing foreign arbitral awards may subject the entire dispute to de novo consideration (a second look) by their own courts." *Id.* at 193.

44. For a discussion of enforcement procedures in different countries, see *infra* note 207.

or violate public policy.⁴⁵ For example, punitive damages are considered "penal" in some circumstances and it is well settled that there is an international policy against enforcing one country's judgment which punishes another's citizens.⁴⁶ If these penal damages under one country's laws are adjudged unenforceable against another country's citizen, the enforcing court will render the award void.⁴⁷

Even though it is clear that United States law properly governed an arbitrator's decision,⁴⁸ conflict over enforcement in a foreign forum may occur. Public policies behind punitive damages may not be served by an award in the international arbitral forum.⁴⁹ A party challenging an award is most likely to succeed when the enforcing country's laws emasculate or nullify the award because its enforcement violates that country's public policy.⁵⁰

B. Punitive Damages in Arbitration

1. Punitive damages in contractual disputes

Punitive damages have two purposes. The first is to deter the wrongdoer, as well as others, from offensive conduct. The second is to severely punish the tortfeasor in a civil manner for conduct which borders on the criminal.⁵¹ Since the 1800's, courts have awarded plaintiffs

45. See *infra* text accompanying notes 207-41.

46. Foreign States will not enforce foreign penal judgments. RESTATEMENT OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 483 (Tent. Final Draft July 15, 1985) reporter's notes 1-4 (available on LEXIS); RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 89 (1969); see also Lowenfeld, *Public Law in the International Arena: Conflict of Laws, International Law, and Some Suggestions For Their Interaction*, 163 HAGUE ACADEMY, RECEUIL DES COURS 310 (1979).

47. See *infra* text accompanying notes 195-206 for a discussion of whether punitive damages are penal.

48. See *supra* note 6 for a discussion of choice of law in the arbitration agreement.

49. See *infra* notes 67-104 for a discussion of recent cases allowing punitive damages in arbitration.

50. For a discussion of public policy and enforcement of foreign arbitral awards, see *infra* text accompanying notes 127-241.

51. M. MINZER, J. NATES, C. KIMBALL & D. AXELROD, DAMAGES IN TORT ACTIONS § 40.12 (1962) [hereinafter MINZER & NATES]; I J. GHIARDI & J. KIRCHER, PUNITIVE DAMAGES LAW AND PRACTICE, § 4.3(A) (Cum. Supp. 1985) [hereinafter GHIARDI & KIRCHER]; see Note, *Exemplary Damages in the Law of Torts*, 70 HARV. L. REV. 517, 522 (1957). The most widely cited objectives of punitive damages are to punish the wrongdoer where no criminal action lies and to deter the wrongdoer and others like him from the opprobrious conduct.

Other possible reasons for punitive damages are to compensate the plaintiff for expenses not covered in an award (such as litigation costs and attorneys' fees) and to discourage society's revenge against the defendant. MINZER & NATES, *supra*, § 40.12; see GHIARDI & KIRCHER, *supra*, § 4.3(A); see also Note, *supra*, at 520-22; Belli, *Punitive Damages: Their History, Their Use and Their Worth in Present Day Society*, 49 UMKC L. REV. 1, 5-6 (1980). The latter reasons are not widely recited because compensation is accomplished by other reme-

punitive damages where a defendant's conduct was "malicious, oppressive, fraudulent, willful, reckless, wantonly indifferent, or opprobrious."⁵² Tort law almost exclusively governed these claims. Yet recently, courts have held punitive damages are available in certain breach of contract actions when one party commits a tortious act. Examples include fraudulent inducement, malicious interference with business enterprises or contracts, defamation, trespass, nuisance, gross negligence and recklessness, outrageous conduct in settling insurance claims and violations of civil rights.⁵³ Thus, an international contracting party who commits one of these torts may be subject to punitive damages whether an action is brought against him under tort or contract law.

In the United States, contract actions which carry punitive damage remedies include breach of contract to marry (where the claim asserts fraud or malice),⁵⁴ breach of a public service contract (where common carriers, such as water and power companies, fail to carry out a duty imposed by statutory law),⁵⁵ breach of contract accompanied by fraud (usually fraudulent misrepresentation),⁵⁶ breach of contract between parties with a fiduciary relationship,⁵⁷ and breach of the duty of good faith and fair dealing in contractual relations.⁵⁸ Some recent cases in this area concern claims by an insured that his insurer acted arbitrarily or in bad faith.⁵⁹ Also prominent are disputes in which an attorney engages in

dies and societal revenge is too similar to criminal punishment. *See Note, supra*, at 521-22; Belli, *supra*, at 5-6. This Comment will concentrate on the primary policies of punishment and deterrence in analyzing international punitive damage awards.

52. MINZER & NATES, *supra* note 51, § 40.11, at 8.

53. K. REDDEN, *supra* note 9, § 2.6, at 42. Total failure to perform a contract (nonfeasance) generally will not be considered a tort, but improper performance of contractual obligations (misfeasance) may give rise to tort liability in the United States. *Id.* § 5.18, at 51-52.

54. *Id.*

55. *Id.*

56. *Id.*

57. *Id.*

58. GHIARDI & KIRCHER, *supra* note 42, § 4.3(A).

59. In *Vernon Fire & Casualty Ins. Co. v. Sharp*, 161 Ind. App. 413, 316 N.E.2d 381 (1974), the defendant insurer refused, without explanation, to pay the plaintiff insured's claim. The Indiana Court of Appeals authorized a judgment of punitive damages where the jury found that the insurer's breach of contract itself amounted to fraud, malice, gross negligence or oppression. *Id.* at 416-17, 316 N.E.2d at 384. The court, influenced by the state's strong public policy in favor of regulating the insurance industry, affirmed the jury's award of \$17,000 in punitive damages. *Id.* at 415, 418, 316 N.E.2d at 383-84. *See also* *Henderson v. United States Fidelity & Guar. Co.*, 695 F.2d 109 (5th Cir. 1983) (jury award of punitive damages affirmed by court where insurer failed to produce insurance policy after insured's request for production); *Phillips v. Aetna Life Ins. Co.*, 473 F. Supp. 984 (D. Vt. 1979) (award of punitive damages proper if in addition to wrongful concealment, insurer acted maliciously and dishonestly). *Cf. Wiggins v. North Am. Equitable Life Assurance Co.*, 644 F.2d 1014 (4th Cir. 1981) (under Maryland law, punitive damages may not be awarded where life insurance beneficiary

unscrupulous and negligent conduct in connection with an employment contract.⁶⁰ Moreover, in 1984, the Supreme Court of California held that punitive damages are available where a party has wrongfully denied the existence of a contract in bad faith and without probable cause.⁶¹

Punitive damages are rarely available in breach of contract actions because contractual damages should only compensate and should not punish, according to the English common law case of *Addis v. Gramophone Co.*⁶² In *Addis*, the House of Lords noted but three exceptions when contract damages should punish: (1) actions for breach of promise to marry; (2) actions against a banker who wrongfully refuses to pay a customer's good check; and (3) actions against sellers of land who fail to give good title.⁶³ Yet, in the 1964 case of *Rookes v. Barnard*,⁶⁴ the House of Lords authorized punitive damages under certain circumstances. These included situations where government employees commit oppressive acts, where a defendant's conduct was calculated to make a profit exceeding the compensation payable to the plaintiff and where expressly authorized by statutes.⁶⁵ The more recent case may evidence a trend in

sued insurance company for breach of contract; however, punitive damages may be awarded where malice consists of evil or rancorous motive and deliberately and willfully injures plaintiff); *Egan v. Mutual of Omaha Ins. Co.*, 24 Cal. 3d 809, 598 P.2d 452, 157 Cal. Rptr. 482, appeal dismissed, 445 U.S. 912 (1979) (jury's award of \$5,000,000 in punitive damages for breach of disability insurance contract overturned as excessive as a matter of law).

60. See Annotation, *Allowance of Punitive Damages in Action Against Attorney for Malpractice*, 13 A.L.R. 4TH 95 (1982); Jackson, *Professional Responsibility*, 16 IND. L. REV. 265 (1983); Note, *Punitive Damages in Attorney Malpractice Cases*, 8 J. LEGAL PROF. 217 (1983).

61. *Seaman's Direct Buying Serv. v. Standard Oil Co.*, 36 Cal. 3d 752, 686 P.2d 1158, 206 Cal. Rptr. 354 (1984) (dealer's action against oil company for breach of contract and breach of implied covenant of good faith and fair dealing); see also *Egan v. Mutual of Omaha Ins. Co.*, 24 Cal. 3d 809, 620 P.2d 141, 169 Cal. Rptr. 691 (1979) (claims concerning breach of implied covenant of good faith and fair dealing sound in tort because insurer and insured have a "special relationship" and punitive damages are awardable for such breach).

62. 1909 App. Cas. 488; see also GHIARDI & KIRCHER, *supra* note 51, at *Cases*, § 4.3(A). As the Court of Exchequer's rule in the 1854 case of *Hadley v. Baxendale*, 156 Eng. Rep. 145 (Ex. Ch. 1854), states:

Where two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such breach of contract should be such as may fairly and reasonably be considered either arising naturally, . . . or such as may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it.

Id. at 151. The *Hadley* restriction does not encompass punitive damages since parties cannot contemplate these damages in advance of breach. Also, punitive damages imposed on unsuspecting parties might serve to inhibit contracting, since the risks inherent in any business transaction are increased in an unpredictable manner.

63. *Addis*, 1909 App. Cas. 488, at 495. Even where death occurs out of a breach of contract, the British courts have only allowed a recovery of pecuniary losses. B. KERCHER & M. NOONE, REMEDIES 103-04 (1983) [hereinafter KERCHER & NOONE].

64. 1964 App. Cas. 1129.

65. KERCHER & NOONE, *supra* note 63, at 232.

English law towards expanding punishment in contract claims which involve employer/employee agreements or involve the proper compensation a user of services pays to a provider.

As will be explained below, civil law countries recognize some forms of civil punishment, such as fines for wrongful behavior. However, punitive damages, as common law recognizes them, are foreign to civil law sovereigns.⁶⁶

2. Arbitral awards of punitive damages

The several United States have conflicting policies and court rulings on whether punitive damage issues may be submitted to and awarded in domestic arbitration.⁶⁷ Federal courts, however, are in harmony and

66. See *infra* text accompanying notes 207-41.

67. Recent state law decisions explain American public policies concerning punitive damages which reflect foreign countries' concerns about arbitral punitive damage awards. A brief discussion of these decisions will give American parties an idea of the present domestic status of punitive damages in arbitration.

The 1976 case of *Garrity v. Lyle Stuart, Inc.*, 40 N.Y.2d 354, 353 N.E.2d 793, 386 N.Y.S.2d 831 (1976), demonstrates New York's reluctance to grant arbitrators power to award punitive damages. *Garrity*, an author, and *Lyle Stuart, Inc.*, a publisher, had entered into a contract with broad arbitration clauses. *Garrity* accused *Lyle Stuart* of fraudulent inducement and malicious harassment and invoked the arbitration clause. An arbitrator awarded *Garrity* \$45,000 in royalties and \$7500 in punitive damages. *Id.* at 355-56, 353 N.E.2d at 794, 386 N.Y.S.2d at 832. When *Garrity* tried to confirm the award, the publisher objected, claiming punitive damages were beyond the arbitrator's authority. *Id.* at 356, 353 N.E.2d at 794, 386 N.Y.S.2d at 832.

Although the trial court confirmed *Garrity's* award, the New York Court of Appeals, in a 4-3 decision, vacated that portion of the award designated as punitive damages. *Id.* at 360, 353 N.E.2d at 797, 386 N.Y.S.2d at 835. The court held that punitive damage issues are reserved to the state courts because such an award is intended primarily to serve the public good. A private arbitration, the court continued, is an improper forum for such issues. *Id.* at 358-59, 353 N.E.2d at 796, 386 N.Y.S.2d at 834.

The *Garrity* court feared that because arbitrators may ignore substantive law in favor of principles of equity, arbitrators would "ride roughshod over strong policies in the law which control coercive private conduct and confine to the State and its courts the infliction of punitive sanctions on the wrongdoers." *Id.* at 357, 353 N.E.2d at 795, 386 N.Y.S.2d at 832. It also concluded that "[t]he day is long past since barbaric man achieved redress by private punitive measures." *Id.* at 360, 353 N.E.2d at 797, 386 N.Y.S.2d at 834.

The *Garrity* court's concerns are in part well-founded. American arbitrators are free to fashion a remedy for the dispute before them and may conduct their hearings without adhering to rules of evidence or procedure established by American courts. See *supra* note 29. However, an award may be set aside in most state jurisdictions where the award was procured by fraud or corruption or where arbitrators were not impartial, engaged in misconduct or exceeded their powers under the agreement. *Id.*

The dissenters in *Garrity* argued that the public policy favoring peaceful dispute resolution overrides the policy which precludes a private punitive remedy. Therefore, the award of punitive damages in the *Garrity* arbitration was not violative of public policy. *Garrity*, 40 N.Y.2d at 362-63, 353 N.E.2d at 798-99, 386 N.Y.S.2d at 836 (Gabrielli, J., dissenting). The dissent stated that the rule in other New York cases provided "that only where the public

favor their arbitrability in domestic arbitration and most likely would

interest clearly supersedes the concerns of the parties should courts intervene and assert exclusive dominion over disputes in arbitration." *Id.* at 365, 353 N.E.2d at 800, 386 N.Y.S.2d at 838 (Gabrielli, J., dissenting). *See also* Note, *Arbitration: The Award of Punitive Damages as a Public Policy Question*, 43 BROOKLYN L. REV. 546 (1976).

The case of *Baker v. Sadick*, 162 Cal. App. 3d 618, 208 Cal. Rptr. 676 (1984), demonstrates the California Legislature's strong support of arbitration as an effective dispute resolution technique for medical malpractice disputes. Mrs. Baker contracted with her doctor for breast reduction surgery. They agreed that "any dispute as to medical malpractice, that is as to whether any medical services rendered under this Contract were unnecessary or unauthorized or were improperly, negligently or incompetently rendered, will be determined by submission to arbitration as provided by California law . . ." *Id.* at 622-23, 208 Cal. Rptr. at 679 (emphasis in original). It is undisputed that after the defendant performed the surgery, Baker developed an infection which was ineffectively treated. Resulting scars made it necessary for her to undergo extensive corrective plastic surgery. She compelled arbitration to resolve the tort claims against Sadick. *Id.* at 622, 208 Cal. Rptr. at 678. The trial court confirmed an award of punitive damages for fraud, willful neglect, and malicious acts. The California Court of Appeal affirmed. *Id.* at 622-23, 631, 208 Cal. Rptr. at 678-79, 684.

Even though Baker's claims did not involve breach of the contract, the court of appeal held that the agreement was broad enough to include all claims arising out of the contract, including those for intentional torts. *Id.* at 625-26, 208 Cal. Rptr. at 681. The court stated that the public policy reasons for excluding punitive damage claims from arbitration, including those asserted in *Garrity*, were weak when compared to the possible result: the defendant could release himself from liability for punitive damages by agreeing to arbitrate all disputes with someone like the plaintiff. *Id.* at 630, 208 Cal. Rptr. at 684. A plaintiff like Baker may agree to arbitrate without knowing some of her claims are nonarbitrable. The defendant then receives a windfall by exculpating himself from certain legal actions. The *Garrity* court did not voice concern that the instant parties may have possessed unequal bargaining power. The *Garrity* court mentioned only in the abstract that an arbitration would be a "trap for the unwary" if punitive damage claims were arbitrable and that the State must impose a social sanction because selection of an arbitrator "is often restricted or manipulatable by the party in a superior bargaining position . . ." *Garrity*, 40 N.Y.2d at 358-59, 353 N.E.2d at 796, 386 N.Y.S.2d at 834.

The *Baker* court also found that an arbitral award would serve "the dual purpose of punishing and hopefully deterring the wrongdoer from engaging in similar egregious conduct in the future." *Baker*, 162 Cal. App. 3d at 629, 208 Cal. Rptr. at 683. With this point, the court perhaps improperly assumes that an arbitration carries out the punitive damage function of deterrence. Effective deterrence depends upon whether physicians hear about this arbitral punishment and whether they are deterred by it. Media and word of mouth may achieve this notice, especially with the threat of excessive money damages posed to the large California medical community. However, notice to potential wrongdoers is not guaranteed. *See* Comment, *Awarding Punitive Damages in Medical Malpractice Arbitration*, 20 CAL. W.L. REV. 312 (1984).

Other cases involving punitive damages in arbitration include: *Cuevas v. Potamkin Dodge, Inc.*, 455 So.2d 398 (Fla. Dist. Ct. App. 1984) (court allowed unchallenged punitive damage award to stand); *Rodgers Builders, Inc. v. McQueen*, 331 S.E.2d 726 (N.C. App. 1985) (punitive damages awarded and confirmed for untimely completion of construction project and refusal to pay excess charges); *Grissom v. Greener & Sumner Constr. Inc.*, 676 S.W.2d 709 (Tex. App. 1984) (punitive damages awarded in arbitration and confirmed in subcontractor's suit against general contractor for breach of contract and independent tort). *Cf.* *Shaw v. Kuhnel & Assocs.*, 102 N.M. 607, 698 P.2d 880 (1985) (punitive damages and fraud in inducement both held nonarbitrable in New Mexico for breach of contract action). *See also*

favor their arbitrability in international arbitration. United States legislation and case law strongly support arbitration for resolving disputes. Federal and state court decisions cite public policy reasons which mandate the development of and the resort to arbitration over adjudication whenever possible.⁶⁸ These policy reasons include court congestion, the money and time spent on litigation and the litigiousness of the American public.⁶⁹ The United States Arbitration Act (Federal Arbitration Act or Act)⁷⁰ governs all interstate and international commercial business transactions in which the parties have agreed—in advance or at the time of the dispute—to arbitrate.⁷¹ The Act codifies the federal rule that an agreement to submit any contractual dispute to arbitration “shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.”⁷² This has been interpreted to mean that, absent illegality or fraud in the agreement to arbitrate, neither state nor federal courts will interfere with the parties’ desire to arbitrate.⁷³

The Act demonstrates congressional confidence in arbitration and encourages courts to adopt this confidence. Since the Act was passed in 1924, there has been a trend in favor of courts’ granting to arbitrators

Penna, *Arbitration: Punitive Damages and Public Policy*, N.Y.L.J. Jan. 14, 1986, at 1; Hoellerling, *Remedies in Arbitration*, 1 J. INT’L ARB. 516, 520-22 (1984).

68. *Southland Corp. v. Keating*, 465 U.S. 1, 10 (1984) (“In enacting § 2 of the federal Act, Congress declared a national policy favoring arbitration and withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration.”); *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24-25 (1983) (“Any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration.”); *Willoughby Roofing & Supply Co. v. Kajima Int’l, Inc.*, 598 F. Supp. 353, 362 (N.D. Ala. 1984), *aff’d*, 776 F.2d 269 (11th Cir. 1985) (“Congress has enunciated a broad and pervasive federal policy that . . . mandates that whenever a written contract evidencing a transaction in interstate commerce contains an arbitration provision, that provision must be given effect by state and federal courts alike.”); *Baker v. Sadick*, 162 Cal. App. 3d 618, 628, 208 Cal. Rptr. 676, 682 (1984) (There is a “strong public policy in favor of settling arbitrations speedily with a minimum of court interference.”).

69. See generally Burger, *supra* note 29.

70. 9 U.S.C. §§ 1-14 (1982). Chapter 2 of the Federal Arbitration Act was added in 1970. Pub. L. No. 91-368, 84 Stat. 693 (1970).

71. The Act states in pertinent part:

A written provision in any maritime transaction [including any matters in foreign commerce within admiralty jurisdiction] or a contract evidencing a transaction involving commerce [defined as commerce among the several States or with foreign nations] to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

Id.

72. *Id.*

73. Section 10 of the Act states that a United States district court may vacate an award:

powers traditionally reserved for the judiciary—such as authority over domestic securities and antitrust issues.⁷⁴ This liberal trend grants to arbitrators jurisdiction to award civil punishment including punitive damages.

The United States Supreme Court has not specifically decided whether punitive damage claims are arbitrable. However, the Court has held that international arbitrators can decide United States antitrust issues involving treble damages, which are one-third compensatory and two-thirds punitive.⁷⁵ This authority supports the conclusion that United States courts must respect punitive damages awarded by arbitrators, at least in international disputes. Also, the United States Court of Appeals for the Eleventh Circuit and two federal district courts agree that domestic arbitrators can award punitive damages where parties have

-
- (a) Where the award was procured by corruption, fraud, or undue means.
 - (b) Where there was evident partiality or corruption in the arbitrators, or either of them.
 - (c) Where the arbitrators were guilty of misconduct . . . or of any other misbehavior by which the rights of any party have been prejudiced.
 - (d) Where the arbitrators exceeded their powers

Id. § 10; see also *Southland Corp. v. Keating*, 465 U.S. 1, 10 (1984) (Section 2 of the Act declared national policy in favor of arbitration applicable in state and federal courts); *Willoughby Roofing & Supply Co. v. Kajima Int'l, Inc.*, 598 F. Supp. 353, 362 (N.D. Ala. 1984). For a discussion of the facts and reasoning of *Willoughby*, see *infra* text accompanying notes 96-104.

74. The three most notable nonarbitrable claims were violations of the federal Securities Act of 1933, 15 U.S.C. §§ 77a-77aa (1982), the Securities Exchange Act of 1934, 15 U.S.C. §§ 77b-78kk (1982) and the Sherman Antitrust Act, 15 U.S.C. §§ 1-7 (1982). Although the Securities Act claims are still nonarbitrable, the latter two Acts have been held arbitrable in recent United States Supreme Court decisions. In *Scherk v. Alberto-Culver Co.*, 417 U.S. 506 (1974), the Supreme Court granted an order to compel arbitration when a United States company brought a securities law action against a German individual under the 1934 Act. This reversed a prior holding in *Wilko v. Swan*, 201 F.2d 439, *rev'd*, 346 U.S. 427 (1953), that securities claims under the 1933 Act were nonarbitrable in the context of a domestic dispute. In *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 105 S. Ct. 3346 (1985), the Supreme Court held federal antitrust claims under the Sherman Act could be arbitrated. See *infra* notes 77-87 and accompanying text for a discussion of *Mitsubishi*. See also *S.A. Minerao Da Trinidad-Samitri v. Utah Int'l, Inc.*, 576 F. Supp. 566 (S.D.N.Y. 1984) (claimed violations of the Racketeer Influenced and Corrupt Organizations Act (RICO) held nonarbitrable); I. RICHTER, *supra* note 29, at 192. "American court decisions, indicat[e] a clear trend toward effective enforcement of international arbitration awards, at least by U.S. courts." I. RICHTER, *supra* note 29, at 192.

75. *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 105 S. Ct. 3346 (1985). Treble damages are one-third compensatory because the initial amount of damages awarded by the trier of fact is compensation for the wrong. This sum is automatically tripled, as a punitive sanction, to deter the wrongdoer and others from future conduct and to punish the defendant. 15 U.S.C. § 15 (West Supp. 1984). See, e.g., *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426, *reh'g denied*, 349 U.S. 925 (1955), in which the United States Supreme Court held that "the punitive two-thirds portion of a treble-damage antitrust recovery" is taxable gross income. *Id.* at 427 (emphasis added).

agreed to submit *all* their disputes to arbitration.⁷⁶

a. Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.

In the 1985 case of *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*,⁷⁷ Mitsubishi, a Japanese corporation, contracted with Soler, a Puerto Rican corporation, for Soler to sell Mitsubishi vehicles in Puerto Rico. The parties agreed that all disputes arising out of their agreement would be settled by arbitration in Japan, under the Japan Commercial Arbitration Association rules.⁷⁸

When new car sales decreased in 1981, Soler could not meet its expected sales volume of Mitsubishi automobiles. The parties disagreed over Soler's proposed changes for distributing the cars. Soler accused Mitsubishi of antitrust violations and Mitsubishi filed a complaint in the United States District Court for the District of Puerto Rico, seeking an order to compel arbitration. Soler responded that the policies underlying the Sherman Act prohibited arbitration by a foreign tribunal.⁷⁹

Because it found that the international character of the contract and agreement to arbitrate governed even the antitrust claims, the district court ordered arbitration.⁸⁰ The United States Court of Appeals for the First Circuit affirmed in part and reversed in part. It ordered that parallel judicial and arbitral proceedings should handle the nonarbitrable antitrust and the other arbitrable claims separately.⁸¹

In a decision with important ramifications for international arbitration, the United States Supreme Court ordered that the entire matter be arbitrated in Japan. The Court found that the arbitration agreement ap-

76. *Willoughby Roofing & Supply Co. v. Kajima Int'l, Inc.*, 598 F. Supp. 353, 363 (1984), *aff'd*, 776 F.2d 269 (11th Cir. 1985); *Willis v. Shearson/American Express, Inc.*, 569 F. Supp. 821, 824 (M.D.N.C. 1983). Two authors have opined:

With respect to American Antitrust laws, it can be anticipated that some foreign states will enforce only the compensatory portion of the damages, and some "might regard the entire judgment as penal and decline to enforce it, both because of the method of assessing damages and because the plaintiff had acted as a 'private attorney general,' i.e., had sued to enforce a public law."

Newman & Burrows, *Consequences of International Arbitration of Antitrust and RICO*, N.Y.L.J. Dec. 23, 1985, at 1, 2 (citing RESTATEMENT OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES, § 483 (Tent. Final Draft July 15, 1985) reporter's note 4 (available on LEXIS)).

77. 105 S. Ct. 3346 (1985).

78. *Id.* at 3349. The Mitsubishi/Soler arbitration agreement submitted to arbitration "[a]ll disputes, controversies or differences which may arise between [the parties] out of or in relation to . . . this Agreement, or for the breach thereof." *Id.*

79. *Id.* at 3350.

80. *Id.* at 3351.

81. *Id.* at 3351-53.

plied to *all* disputes, including those concerning domestic statutory violations.⁸² Recognizing that international comity, respect for foreign tribunals and the need for predictability in resolving international commercial disputes were vital, the Court upheld the parties' agreement by respecting their original choice of forum.⁸³ The Court reiterated that "[w]e cannot have trade and commerce in world markets and international waters exclusively on our terms, governed by our laws, and resolved in our courts."⁸⁴ The Court's line of reasoning reflects the Federal Arbitration Act's national policies favoring arbitration—international as well as domestic—even where parochial statutory claims are at issue.⁸⁵

The *Mitsubishi* Court further held that the treble damages claim available within the United States may also be available in proceedings outside the United States. The Court, quoting the Second Circuit, stated:

"A claim under the antitrust laws is not merely a private matter. The Sherman Act is designed to promote the national

82. *Id.* at 3354-55.

83. *Id.* at 3356-58.

84. *Id.* at 3356 (quoting *The Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 9 (1972)).

85. In a controversial footnote, the *Mitsubishi* Court implied it would review a Japanese arbitral award if the foreign tribunal improperly adjudicated United States federal antitrust issues. It stated that if the choice of forum and choice of law clauses in an arbitration agreement operated in tandem as a prospective waiver of a party's right to pursue statutory remedies for antitrust violations, it would have little hesitation in condemning the agreement as against public policy. *Id.* at 3360 n.19. The extent to which this displays a strong policy in favor of international arbitration or international comity is questionable. At the very least, it is obvious the Supreme Court would protect Americans' rights provided in the antitrust laws, possibly including rights to treble damages, even after an arbitration is held.

By adopting this rule, the Court prohibits a party who agrees to arbitrate in an international forum from waiving his rights to treble damages. The Court would condemn the waiver "as against public policy." The court in *Willoughby Roofing & Supply Co. v. Kajima Int'l, Inc.*, 598 F. Supp. 353, 363-64 (1984), *aff'd*, 776 F.2d 269 (11th Cir. 1985), forbid a party to waive punitive damages simply because that party agreed to arbitrate domestically. See *infra* notes 96-104 and accompanying text for a discussion of *Willoughby*. One may conclude that, if punitive damages are protected by the same public policy as are treble damages, a party may not waive rights to the former in international arbitration. See *infra* note 104. Federal public policy would then condemn any foreign punitive damage award not in conformity with American law, despite the party's submission to a private international forum. In Newman & Burrows, *Consequences of International Arbitration of Antitrust and RICO*, N.Y.L.J. Dec. 23, 1985, at 1, the authors compare the *Mitsubishi* claims in international arbitration with claims based on the Racketeer Influenced Corrupt Organizations Act (RICO), and conclude RICO claims are also arbitrable in international arbitration (citing *Development Bank of the Philippines v. Chemtex Fibers, Inc.*, 617 F. Supp. 55 (S.D.N.Y. 1985) (holding RICO claims internationally arbitrable)). For a further discussion of *Mitsubishi* and RICO in international arbitration, see Newman & Burrows, *Will RICO Move Abroad Through International Arbitration?*, N.Y.L.J. Nov. 21, 1985, at 1. The authors analogize treble damages under antitrust statutes to those damages under the RICO statute, as both having a penal rather than a remedial purpose. Newman & Burrows, *Consequences of International Arbitration of Antitrust and RICO*, *supra*, at 2.

interest in a competitive economy; thus the plaintiff asserting his rights under the Act has been likened to a private attorney-general who protects the public's interest." The treble-damages provision wielded by the private litigant is a chief tool in the antitrust enforcement scheme, posing a *crucial deterrent to potential violators*.

The importance of the private damages remedy, however, does not compel the conclusion that it may not be sought outside an American court.⁸⁶

The Court acknowledged first that the main purpose behind United States antitrust law is to promote a national interest in a competitive market. Second, it noted that claims brought and damages awarded under those laws protect the public's interest. Third, it confirmed that treble damages are designed to deter certain conduct.⁸⁷

Public policy supporting punitive damages is similar to that behind treble damages. Punitive damage awards, like treble damage awards, promote a national interest—civil punishment for egregious wrongful conduct. Punitive damages, like treble damages, are in excess of com-

86. 105 S. Ct. 3358-59 (quoting *American Safety Equip. Corp. v. J.P. Maguire & Co.*, 391 F.2d 821, 826 (2d Cir. 1968)) (citations omitted) (emphasis added).

87. The Court also stated: "Notwithstanding its important incidental policing functions, the treble-damages cause of action conferred on private parties . . . seeks primarily to enable an injured competitor to gain compensation for that injury." *Id.* at 3359. This Comment disagrees. See *supra* note 75. If the Sherman Act is designed to protect and promote the public's interest, treble damages cannot have only an "incidental policing function" and a primary remedial function. Their primary effect must be to deter the anticompetitive wrongdoer from future public harm, because the compensatory portion of the award is only one-third of the total.

There is nothing incidental about punitive damages' policing functions; both deterrence and punishment are essential functions which, in fact, protect the public. Therefore, the two types of damages are similar in domestic case law and should be treated similarly in international proceedings. For example, in *Perma-Life Mufflers, Inc. v. International Parts Corp.*, 392 U.S. 134 (1968), a dealers' action against Midas Muffler Shops and others for illegal conspiracy, the Court stated:

The purposes of the antitrust laws are best served by insuring that the private action will be an ever-present threat to deter anyone contemplating business behavior in violation of the antitrust laws. The plaintiff who reaps the award of treble damages may be no less morally reprehensible than the defendant, but the law encourages his suit to further the overriding public policy in favor of competition.

Id. at 138-39; see also 21 CONG. REC. 3146-47, 3150, 4091 (1890).

Alternatively, if the *Mitsubishi* Court decided treble damages are suitable for international arbitration because they primarily compensate the plaintiff, then the Court may disapprove punitive damage issues in international arbitrations because the latter are always awarded in addition to compensatory damages. See *Lawlor v. National Screen Serv.*, 349 U.S. 322, 329 (1955); *Lyons v. Westinghouse Elec. Corp.*, 222 F.2d 184, 189, *cert. denied*, 350 U.S. 825 (1955); *Blumenstock Bros. Advertising Agency v. Curtis Publishing Co.*, 252 U.S. 436, 440 (1920).

pensation and are awarded to protect the public's interest rather than the wronged party's. Like treble damages, punitive damage awards made public deter the wrongdoer and potential wrongdoers from opprobrious conduct and thus protect the public from future harm.⁸⁸ Thus, if the United States Supreme Court allows international arbitrators to award treble damages, and treble damages and punitive damages are designed to effectuate similar purposes, then the Court would probably allow international arbitrators to award punitive damages.

b. other federal court decisions

In 1983, the United States District Court for the Middle District of North Carolina decided *Willis v. Shearson/American Express, Inc.*⁸⁹ In 1982, Willis invested funds in an account the defendant broker managed. The broker's agents periodically assured Willis his account's status was satisfactory. In fact, the account had suffered substantial losses. Willis charged the broker with fraud, fraud in the inducement and breach of fiduciary duty.⁹⁰ The court stayed adjudication pending arbitration, despite the fact that Willis' claims included a prayer for punitive damages.⁹¹

Willis objected to a motion to compel arbitration, arguing that the parties' contract was governed by New York law and New York law has not, to date, recognized an arbitral award of punitive damages. Arbitration of the dispute, Willis argued, violated public policy; however, the court held otherwise.⁹²

The court reasoned that since the arbitration clause was extraordinarily broad, the arbitrators had an extensive range of powers.⁹³ Relying on the national policy encouraging arbitration embodied in the Federal Arbitration Act, the court stated, "[i]f an issue is arbitrable under federal law, it remains so despite contrary state law."⁹⁴ Although the court expressly failed to analyze the policies underlying punitive damage awards,

88. For example, *Baker v. Sadick*, 162 Cal. App. 3d 618, 208 Cal. Rptr. 676 (1984), held that a physician is liable to an injured patient for punitive damages awarded in an arbitration. For a discussion of *Baker*, see *supra* note 67. *Baker* has been widely reported in periodicals which surely reach the California medical community. Certainly physicians are deterred from future injurious conduct by the threat of an arbitrator's ability to award and enforce punitive damages for that conduct.

89. 569 F. Supp. 821 (M.D.N.C. 1983).

90. *Id.* at 822.

91. *Id.* at 825.

92. *Id.* at 823.

93. The Willis/Shearson arbitration agreement covered "'any controversy arising out of or relating to . . . the account.'" *Id.* (emphasis in original).

94. The court also noted that because the parties' business transactions were interstate,

it found "no public policy reason persuasive enough to justify prohibiting arbitrators from resolving issues of punitive damages submitted by the parties."⁹⁵

The following year, the United States District Court for the Northern District of Alabama adopted the position taken by the *Willis* court and in 1985, the United States Court of Appeals for the Eleventh Circuit affirmed. In *Willoughby Roofing & Supply Co. v. Kajima International, Inc.*,⁹⁶ the court confirmed an arbitral award of punitive damages based on fraud in the inducement or performance of a subcontract. The court held that because the *Willoughby* dispute arose from an interstate transaction, the Federal Arbitration Act applied and federal arbitration policies governed the award.⁹⁷

Willoughby Roofing, a subcontractor from Georgia, agreed with Kajima, a general contractor from Alabama, to construct and install a roof for a building Kajima was erecting in Alabama. Relying on Kajima's original specifications, Willoughby prepared a bid which Kajima accepted. Kajima then materially altered its plans. Willoughby tried to renegotiate but Kajima cancelled and gave the contract to another subcontractor.⁹⁸

The Willoughby/Kajima arbitration agreement was broad and vested the arbitrators with authority to decide virtually any claim that could arise in relation to a roofing subcontract.⁹⁹ The arbitrators determined that Kajima misrepresented material facts and willfully deceived and induced Willoughby's reliance, causing damages.¹⁰⁰ Punitive damages comprised most of Willoughby's award.¹⁰¹

the Federal Arbitration Act applied and preempted New York state law which would have made the controversy nonarbitrable. *Id.* at 823-24.

95. *Id.* at 824.

96. 598 F. Supp. 353 (N.D. Ala. 1984), *aff'd*, 776 F.2d 269 (11th Cir. 1985).

97. *Id.* at 356 n.5, 359.

98. *Id.* at 355. The Eleventh Circuit's opinion stated: "In light of the federal policy favoring arbitration at work here our task is to remove all doubt in favor of the arbitrator's authority to award a particular remedy." 776 F.2d at 270. The court of appeals opinion affirmed the district court holding and discussed and dismissed Kajima's claim that the parties' contract contained a termination clause which limited damage awards to actual damages for all claims. *Id.* at 270-71.

99. The Kajima/Willoughby arbitration agreement submitted to the arbitrators "[a]ll claims, disputes, and other matters in question arising out of, or relating to, this Agreement or a Work Assignment or the breach thereof, except with respect to matters for which the Architect's decision shall be final and binding as provided in this Agreement." *Id.* at 355-56.

100. *Id.*

101. The arbitrators awarded Willoughby \$150,000 in unspecified damages which, at the court's request, were broken down into \$41,091.25 compensatory damages and \$108,908.75 punitive damages. *Id.* at 356.

The *Willoughby* court employed the reasoning from *Willis* to confirm the award. Although state substantive law governed the issues submitted to arbitration, federal law governed "the resolution of issues concerning the arbitration provision's interpretation, construction, validity, revocability, and enforceability."¹⁰²

In its decision, the *Willoughby* court stated:

*[There is no] reason to believe that the purposes of punitive awards—punishment of the present wrongdoer and deterrence of others who might otherwise engage in similar conduct—will not be furthered by arbitral awards every bit as much as by formal judicial awards. Indeed, an arbitrator steeped in the practice of a given trade is often better equipped than a judge not only to decide what behavior so transgresses the limits of acceptable commercial practice in that trade as to warrant a punitive award, but also to determine the amount of punitive damages needed to (1) adequately deter others in the trade from engaging in similar misconduct, and (2) punish the particular defendant in accordance with the magnitude of his misdeed.*¹⁰³

Finally, the court noted that if public policy prohibits arbitrators from awarding such damages, a plaintiff might contractually waive his right to punitive damages by entering into an arbitration agreement.¹⁰⁴

Although *Willis* and *Willoughby* stand alone, they demonstrate the growing trend in the federal arena towards granting punitive damage powers to arbitrators. Both courts recognized the liberal federal policy of delegating traditional judicial powers to arbitrators when possible, and generally encouraging arbitration as an alternative form of dispute resolution. The *Mitsubishi* decision reflects the American public policy which favors resolution of claims containing punitive-like damages in international arbitration.

In sum, all three federal court decisions indicate that domestic and international arbitration awards can include elements of punitive dam-

102. *Id.* at 359 (citing *Willis v. Shearson/American Express, Inc.*, 569 F. Supp. 821, 823-24 (M.D.N.C. 1983)) (emphasis omitted).

103. *Willoughby*, 598 F. Supp. at 363 (emphasis added).

104. *Id.* According to the court, a plaintiff's claims of tort and breach of contract with a prayer for punitive damages would necessitate two proceedings with some issues submitted to arbitrators and some reserved to the courts. The court called this "a wasteful exercise." *Id.* at 363-64. Yet the court failed to fully realize that if a party waived the right to trial by agreeing in writing to submit all claims to arbitration, he may not maintain a separate court proceeding. A court would dismiss the claimant's complaint because he agreed to arbitrate. He has not transferred punitive damages to another forum; rather, he has indeed waived any right he had to punitive damages.

ages and still be consistent with the public policy behind such damages. This consensus of American federal law provides little or no bar to the enforcement of an international arbitral award of punitive damages.

3. Conflict between punitive damage awards and arbitration

A claimant anxious to resolve a problem and not wedded to a court system with its restrictive evidentiary and procedural rules may find arbitration ideal. Yet the appealing informal rules of domestic and international arbitration limit the system as a substitute for adjudication, especially where civil punishment is involved. Of course, all rules and procedures in an arbitration are subject to the parties' agreement.¹⁰⁵

For example, because arbitration decisions are rarely published, a punitive damage award from a private arbitral forum may fail to warn potential wrongdoers of the penalty imposed for the conduct. A court decision, on the other hand, is usually published and made public, warning wrongdoers about possible penalties.¹⁰⁶

As another example, when an award-holder petitions a court to confirm an award, a dissatisfied party may move to have the award vacated. One reason for having the award vacated is that an arbitrator has exceeded his powers under the agreement or under laws governing the arbitration.¹⁰⁷ Thus, in a jurisdiction where punitive damages are nonarbitrable, an award including them may be vacated.¹⁰⁸

Because arbitration association rules do not usually require that arbitrators have a legal background, they may be businesspersons, administrators, lawyers or retired judges.¹⁰⁹ The arbitrator will not necessarily make decisions based upon legal precedent; his or her own notions of

105. *See supra* note 29.

106. *Id.* Some foreign countries do report arbitration decisions. *See supra* note 30 for comments of the ICC on publishing arbitration decisions.

107. *See supra* notes 29 and 73.

108. *See supra* note 29. Courts are rarely willing to review the merits of an arbitration. The review defeats the time-saving and cost-saving benefits of arbitration, clogs the court docket, denies the parties freedom to contract for arbitration and fails to reflect the public policy of confidence in alternative dispute resolution. Also, if an arbitral punitive award is excessive, a reviewing court may fail to overturn it. "An award made in accordance with all legal requirements is a final and binding determination of the dispute. Once a final and binding award has been made, all issues settled by the award are no longer subject to further litigation or arbitration." 3 LAW. ARB. LETTER No. 27, Sept. 1979, at 1. This rule has led to the decision that arbitral awards almost always bind third parties who are not privy to the arbitration process under the doctrines of *res judicata*, *id.* at 1-5, and collateral estoppel. 8 LAW. ARB. LETTER No. 1, Mar. 1984, at 1.

109. AAA Rules 12 and 19 state that the qualifications of arbitrators are minimal. The rules require only that arbitrators must be neutral and subject to disqualification for bias. *Arbitration Rules*, *supra* note 29, at 193-94.

fairness may govern the entire process. Therefore, the binding arbitral decision may negate precedent which strongly favors one party's case and which might have won the day in court. Since the amount of punitive damages is awarded according to the arbitrator's idea of what is equitable, there may be no check on the arbitrary or unfair imposition of excessive damages.¹¹⁰

Because the use of arbitration has increased, many countries including the United States have restricted its application to certain subject matter. National laws declare specific issues "nonarbitrable," and reserve them for resolution through more conventional domestic adjudication.¹¹¹ Although United States federal courts have declared punitive damages arbitrable, they may be nonarbitrable in other countries. Even if arbitrable, the punitive award from an arbitration may be unenforceable if the court which must enforce the award holds that punitive damages violate public policy.

However, a punitive arbitral award does serve both purposes behind the damages. The award, like a court judgment, punishes the wrongdoer by awarding extra-compensating damages to the injured party. The award also deters at least one tortfeasor—the party in the arbitration—from similar future conduct.

The arbitral forum may also provide a more progressive solution to a party's problem than would a court. For example, there is a growing practice in American states to have the punitive portion of a punitive damage award deposited into a public fund or into a community service organization's budget.¹¹² An arbitrator may fashion the award to fit the

110. See *supra* note 13, for a discussion of the *Garrity* court's concern with arbitrators' imposition of punishment.

111. See *supra* note 74.

112. In Colorado, limitations on punitive damages have been set by the state legislature and one-third of a punitive damage award goes to the Water Conservation Board Construction Fund. Colo. H.B. 1197, 1985-86 Reg. Sess. (1985). In Florida, a flexible cap on punitive damages has been set at around three times the amount of compensatory damages, and 60% of any punitive award goes to the Public Medical Assistance Trust Fund or a general state fund. Fla. S.B. 465, 1985-86 Reg. Sess. (1985). In Illinois, a court has the discretion to distribute a punitive award between the plaintiff, his or her attorney and the state's Department of Rehabilitation Services. Ill. S.B. 1200, 1985-86 Reg. Sess. (1985). Finally, in Iowa, 75% or more of a punitive damage award must be paid to the state's Civil Reparations Trust Fund, except where the action resulted from a tort specifically directed at the particular plaintiff. Iowa S.B. 2265, 1985-86 Reg. Sess. (1985). All 1986 enactments are discussed in *Alliance of American Insurers (Schaumburg, Illinois), Civil Justice Enactments: 1986 Session*, prepared July 11, 1986 (copy on file at *Loyola of Los Angeles Law Review*). Also, a bill called the "Litigation Abuse Reform Act of 1986" is before Congress which proposes a limitation on awards of punitive damages. S. 2046, 99th Cong., 2d Sess. § 2121 (1986). The bill states, in pertinent part:

circumstances. Thus, the arbitrator could order that the wrongdoer pay the portion of damages over compensation to an organization which will work to correct the injustice complained about in the arbitration—whether for tort law reform, improvement of a product line or social work.

III. RECOGNITION AND ENFORCEMENT OF FOREIGN ARBITRAL AWARDS

Domestic disputes involving punitive damage claims may have international implications. Arbitration may result in a punitive damage award that a party needs to enforce in a foreign State. For example, a Swiss broker mismanages an American investor's account;¹¹³ an Indian contractor fraudulently subcontracts with an American roof builder for construction in India;¹¹⁴ a doctor in New Zealand contracts for and negligently performs surgery on an American patient;¹¹⁵ or a German publisher maliciously harasses an American author while under contract to publish the author's books.¹¹⁶ Since arbitration is favored abroad as it is in the United States,¹¹⁷ it is probable that such agreements between foreign parties will include a clause to arbitrate internationally "any dispute arising out of" the contract. And, where United States federal law governs the dispute, arbitrators abroad may decide punitive damage claims.

A. *The 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards*

There are no uniform procedures for enforcing an international arbi-

(c)(1) Punitive damages awarded in any civil action to which this chapter applies shall be paid to the clerk of the court in which the action is pending.

(2) Such awards of punitive damages shall be transmitted promptly to the Treasurer of the United States, for the use of the Administrative Office of the United States Courts and the Federal Judicial Center.

Id. § 2126.

113. *See Willis v. Shearson/American Express, Inc.*, 569 F. Supp. 821 (M.D.N.C. 1983). *See also supra* text accompanying notes 89-91.

114. *See Willoughby Roofing & Supply Co. v. Kajima Int'l, Inc.*, 598 F. Supp. 353 (N.D. Ala. 1984), *aff'd*, 776 F.2d 269 (11th Cir. 1985). *See also supra* text accompanying notes 96-98.

115. *See Baker v. Sadick*, 162 Cal. App. 3d 618, 208 Cal. Rptr. 676 (1984). *See also supra* note 67.

116. *See Garrity v. Lyle Stuart, Inc.*, 40 N.Y.2d 354, 353 N.E.2d 793, 386 N.Y.S.2d 831 (1976). *See supra* note 67.

117. "Arbitration has emerged as the preferred remedy for resolving private international commercial disputes." Carbonneau, *Rendering Arbitral Awards With Reasons: The Elaboration of a Common Law of International Transactions*, 23 COLUM. J. TRANSNAT'L. L. 579, 579-80 & n.1 (1985). *See also* Bockstiegel, *States in the International Arbitral Process*, 2 ARB. INT'L 22, 22 (1986).

tral award. The successful party must obtain an enforcement order or judgment from a national court, usually in the jurisdiction where the arbitration occurred. Then the party attempts to have the order "recognized" by the courts in the country or countries where it must be enforced. Recognition and enforcement are defined as follows:

[C]ourts may give one of two effects to a foreign decision. The court may recognize the judgment, or it may additionally enforce it. If it limits its action to recognition, it decides that there is an issue, or issues, which do not need to be relitigated. If it enforces the judgment, it goes further and grants to the successful party some part or all of the judgment decreed by the foreign court.¹¹⁸

Bilateral treaties between foreign States have unified some procedures for enforcement, yet they bind only the two countries which sign the treaty.¹¹⁹ To expand enforcement, the Convention on the Recognition and Enforcement of Foreign Arbitral Awards¹²⁰ was ratified in 1958. The Convention encourages arbitration of international commercial disputes and provides uniform standards for enforcing the resulting awards. It obligates its signatories, subject to certain exceptions, to recognize and enforce an arbitral award rendered in a foreign State, as if that award was a domestic judgment rendered by the recognizing State.¹²¹ The Convention's goal, then, is to expedite enforcement of and improve compliance with international arbitral awards.

The United States acceded to the Convention in 1970 by incorporating it into the Federal Arbitration Act.¹²² The Act governs all arbitration agreements arising out of a commercial transaction, contract or

118. R. FOLSOM, M. GORDON & J. SPANOGLE, JR., *INTERNATIONAL BUSINESS TRANSACTIONS: A PROBLEM-ORIENTED COURSEBOOK* 347 (1986) [hereinafter FOLSOM & GORDON].

119. For example, Algeria has Judicial Treaties with Morocco (Mar. 15, 1963), Tunisia (July 26, 1963), Mauritania (Dec. 3, 1969), the Democratic Republic of Germany (Dec. 2, 1972) and France (Aug. 27, 1964); Libya has bilateral treaties with Tunisia (June 14, 1961) and Morocco (Dec. 22, 1962). *INTERNATIONAL COUNCIL FOR COMMERCIAL ARBITRATION, National Reports: Algeria, Libya* [1979] 4 Y.B. COM. ARB. 20, 160.

120. June 10, 1958, 21 U.S.T. 2517, T.I.A.S. No. 6997, 330 U.N.T.S. 38.

121. The Convention applies in all cases if the arbitration takes place in a (contracting) State other than that State which invokes the arbitration agreement. It also applies if the agreement is invoked in the same State where the arbitration takes place, and "(a) if at least one of the parties is a foreign national and/or (b) if the underlying transaction involves a subject matter which has contacts with one or more foreign States." van den Berg, *Should an International Arbitrator Apply the New York Arbitration Convention of 1958?*, in *THE ART OF ARBITRATION*, *supra* note 25, at 39, 45.

122. Act of July 31, 1970, Pub. L. No. 91-368, 84 Stat. 692 (codified at 9 U.S.C. §§ 201-08 (1982)). See Quigley, *Accession By the United States to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards*, 70 YALE L.J. 1049 (1961).

agreement between a United States citizen and a foreign national. It also governs agreements between United States citizens where the award will be performed or enforced abroad or has some reasonable relationship with one or more foreign States.¹²³ Thus, if an American company or individual contracts with a foreign State or even with a United States citizen who owns assets abroad for any kind of services or goods, the Convention governs their agreement to arbitrate disputes.

Some provisions of the Convention limit the effectiveness of its recognition and enforcement procedures. The International Chamber of Commerce (ICC) has stated: "The Convention provides just a few, narrowly drawn exceptions to a national authority's obligation to compel arbitration but offers broader grounds for denying recognition and enforcement of an arbitral award."¹²⁴ The first important limit on the Convention's authority is Article VII, paragraph 1, which states that the Convention "shall not affect the validity of multilateral or bilateral agreements concerning the recognition and enforcement of arbitral awards entered into by the contracting States."¹²⁵ Thus, an enforcing national court may determine that the Convention recognizes an arbitration award which conflicts with bilateral agreements between countries with a relation to the dispute. With this determination, Article VII allows the enforcing court to use less effective rules in unfamiliar treaties to enforce the award. Even more damaging to the arbitration, following Article VII's language, the bilateral treaties may allow the court to refuse recognition of the award.¹²⁶

123. 9 U.S.C. § 202 (1982).

124. ICC *Mitsubishi* Brief, *supra* note 30, at 27. Aside from the exceptions to enforcement discussed in the text of this Comment, there are essentially five grounds for nonenforcement under the Convention:

- (a) the arbitration agreement was invalid;
- (b) a party was unable to present his case;
- (c) the award does not comply with the terms of the submission;
- (d) the appointment of the arbitrators or the arbitral procedure was not in accordance with the agreement of the parties;
- (e) the award was not yet binding on the parties, or had been set aside in the country where it was made.

Sanders, *A Twenty Years' Review of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards*, 13 INT'L LAW. 269, 272 (1979). "Submission" as a ground for jurisdiction signifies that the parties, especially the defendant, concede that the court is competent to deal with their dispute. J.A.C. THOMAS, *PRIVATE INTERNATIONAL LAW* 37 (1955).

125. Convention, *supra* note 19, art. VII, para. 1. See van den Berg, *supra* note 121, at 43.

126. van den Berg, *supra* note 121, at 43. See Derains, *France as a Place For International Arbitration*, in *THE ART OF ARBITRATION*, *supra* note 25, at 111, 116. If parties must join in an agreement which provides for arbitration in a nonsignatory State to the Convention, they should set the arbitration in a country which at least has a bilateral treaty with a signatory State to the Convention. In other words, suppose a United States company contracts and agrees to arbitrate with a Turkish company. Turkey is not a signatory to the Convention. If

The second major limit on enforcement under the Convention, the public policy exception, is contained in Article V, paragraph 2, which states:

Recognition and enforcement of an arbitral award may also be refused if the competent authority in the country where recognition and enforcement is sought finds that:

(a) The subject matter of the difference is not capable of settlement by arbitration under the law of that country; or

(b) The recognition and enforcement of the award would be *contrary to the public policy of that country*.¹²⁷

The impact of Article V(2)(a) is demonstrated by the following examples of subject matter considered nonarbitrable under American law, and which, until recently, barred enforcement of a foreign award: violations of the Securities Exchange Act of 1934,¹²⁸ violations of the Sherman Antitrust Act¹²⁹ and tort or contract actions involving claims of punitive damages.¹³⁰ In other words, an arbitral award which purported to decide some American federal securities or antitrust issues or which awarded punitive damages would have been invalidated by an enforcing court. American judicial decisions in the last few years have altered the rules that federal courts have exclusive jurisdiction over the statutory violations and that state and federal courts have exclusive jurisdiction over punitive damages.¹³¹

As an example of foreign nonarbitrable subject matter, laws in France, Germany and Switzerland state that antitrust claims are nonarbitrable.¹³² Austrian law forbids arbitration of whether a party owes a gambling debt.¹³³ Any award which punished the gambling debtor or

Turkey has a treaty governing enforcement of foreign arbitral awards with any State which has signed the Convention, the arbitration award may be recognized in the signatory country and enforced in Turkey by means of the bilateral treaty. *Id.* See FOLSOM & GORDON, *supra* note 118, at 374-75.

127. Convention, *supra* note 19, art. V, para. 2 (emphasis added).

128. 15 U.S.C. §§ 77b-78 (1982). Federal statutory claims under the Securities Exchange Act of 1934 were under the exclusive jurisdiction of the United States federal courts. *Id.* § 77b (1982). See *supra* note 74.

129. 15 U.S.C. §§ 1-7. Federal antitrust claims under the Sherman Act were also under the exclusive jurisdiction of the United States federal courts. *Id.* § 1. See *supra* text accompanying notes 77-87 for a discussion of *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 105 S. Ct. 3346 (1985), the case that changed this rule.

130. See *supra* note 67 and text accompanying notes 89-104.

131. See *supra* text accompanying notes 74-104.

132. Newman & Burrows, *Consequences of International Arbitration of Antitrust and RICO*, N.Y.L.J., Dec. 23, 1985, at 1, 2 nn.26-29.

133. In the matter at the Oberster Gerichtshof [Supreme Court], May 11, 1983, INTERNATIONAL COUNCIL FOR COMMERCIAL ARBITRATION, *Court Decisions on the New York Conven-*

decided the anticompetitive issues would be automatically void.¹³⁴

Because punitive damages are now arbitrable in most American jurisdictions, Article V's public policy limitation is the Convention's potential barrier to enforcing a punitive damage award. As the ICC has noted: "Arbitral tribunals are not likely to enforce agreements—or require the payment of damages for breach of agreements—'when a mandatory national law in effect at the place of performance forbids such performance.'"¹³⁵ Since recognition and enforcement may be refused for nonarbitrable subject matter or public policy conflicts, it is vital that a contracting party realize initially that an award may be worthless in certain situations. When not recognized, an arbitral award simply will not be enforced. A successful party who walks away from an international arbitration with a punitive damage award may encounter this scenario when he claims the sum from a country which will not honor the award.

B. Confusion Surrounding the Public Policy Exception

Parties have tried to employ the Convention's public policy exception to avoid enforcement of arbitral awards in many situations: where national political policies or political conflict arguably justified an act which led to an award;¹³⁶ where procedural due process violations resulted in an unfair award;¹³⁷ and where an award failed to state reasons for the arbitrators' final decisions.¹³⁸

tion 1958 [1985] 10 Y.B. COM. ARB. 421. An Austrian party successfully defeated an award when a Dutch party brought an enforcement proceeding. The Supreme Court affirmed a lower court's holding that the underlying contract violated public policy. *Id.* The contract terms provided for payment by margin, rather than on delivery, and thus violated Austrian foreign exchange law. *Id.* at 422. The lower court had found no distinction between domestic and "international" public policy, and rendered the award invalid. *Id.* at 422-23.

134. See Convention, *supra* note 19, at art. V(2)(a).

135. ICC *Mitsubishi* Brief, *supra* note 30, at 23 (citing ICC ARBITRATION, *supra* note 6, § 17.04, at 89).

136. *Parsons & Whittemore Overseas Co. v. Societe Generale de L'Industrie du Papier (RAKTA)*, 508 F.2d 969 (2d Cir. 1974). For a discussion of *Parsons*, see *infra* text accompanying notes 148-56.

137. *Firm P (U.S.A.) v. Firm F (F.R.G.)*, Apr. 3, 1975, reported in INTERNATIONAL COUNCIL FOR COMMERCIAL ARBITRATION, *Court Decisions on New York Convention 1958: Federal Republic Germany* [1977] 2 Y.B. COM. ARB. 241. But cf. *Leopold Lazarus Ltd. (U.K.) v. Chrome Resources S.A. (Switz.)*, Sept. 17, 1976, reported in INTERNATIONAL COUNCIL FOR COMMERCIAL ARBITRATION, *Court Decisions on New York Convention 1958: Switzerland* [1979] 4 Y.B. COM. ARB. 311-13 (irregularities in arbitration procedure did not constitute "a violation on fundamental principles of the Swiss legal order, hurting intolerably the feeling of justice").

138. *S.A. Tradax Export (Panama) v. S.p.a. Carapelli (Italy)*, Oct. 22, 1976, reported in INTERNATIONAL COUNCIL FOR COMMERCIAL ARBITRATION, *Court Decisions on New York Convention: Italy* [1978] 3 Y.B. COM. ARB. 279, 280. Parties have made other attempts at

Conflict over what constitutes a proper public policy defense is great, and the question of whether the purposes supporting punitive damages violate the public policy of other countries is substantial. Parties in conflict over the Convention's authority to render an award unenforceable should be aware of two principles. First, the opinion that domestic public policy is not the same as international notions of public policy is widely accepted and militates against a court's liberal use of the public policy exception. Second, a punitive damage award, which civilly penalizes a wrongdoer, may be considered a foreign penal judgment which is unenforceable in the courts of another State.

1. The definition of "public policy" under the Convention

The "public policy" language in Article V has been interpreted *not* to mean parochial or domestic policy of the enforcing State, but rather to mean "international public policy."¹³⁹ Parochial policies are unique to the State, whereas international policy encompasses essential principles of international law—fairness, morality and legality.¹⁴⁰ Still, the international element is subject to various interpretations. Indeed, some countries insist on injecting parochial policies to defeat an award. This treatment vitiates "the general pro-enforcement bias" of the Convention.¹⁴¹

using the public policy exception for lack of impartial arbitrators, illegal behavior of a party, contracts made under duress and unavailability of evidence due to national security. See INTERNATIONAL COUNCIL FOR COMMERCIAL ARBITRATION, *Court Decisions on the New York Convention: Commentary* [1986] 11 Y.B. COM. ARB. 464-68.

139. See A.J. VAN DEN BERG, *THE NEW YORK ARBITRATION CONVENTION OF 1958: TOWARDS A UNIFORM JUDICIAL INTERPRETATION* 360-68 (1981). Dr. van den Berg has also commented on the impracticality of an international arbitrator's attempts at guessing which public policy would best apply in a controversial situation. van den Berg, *supra* note 121, at 48-49. Dr. van den Berg believes an international arbitrator cannot practically apply, in addition to the law governing the arbitration, the public policy of the countries in which enforcement of the arbitral award may be sought. Dr. van den Berg states:

Even if these countries could be identified to the arbitrator before the award is rendered, a cumulative application of the rules of public policy of several countries would be both impractical and improper. It would be impractical especially because rules of public policy, usually developed by case law with all kinds of subtle distinctions, are difficult to determine. To charge the arbitrator (or the parties) with the burden of finding out all the possibly relevant rules of public policy of other countries is bound to result in misapprehension and delays in arbitration; the arbitrator has already work enough to determine the public policy of his forum.

Id. This is because it is difficult to determine where the award must be enforced. *Id.* at 48. See also Bernini, *The Enforcement of Foreign Arbitral Awards by National Judiciaries: A Trial of the New York Convention's Ambit and Workability*, in *THE ART OF ARBITRATION*, *supra* note 25, at 51, 59-61.

140. See A.J. VAN DEN BERG, *supra* note 139, at 360-61.

141. *Parsons*, 508 F.2d at 973.

In 1958, some signatories to the Convention were concerned that judges might apply parochial policies of their respective countries when asked to recognize arbitral awards and that the courts could thereby thwart international arbitration agreements.¹⁴² A commentator recently downplayed this concern as "unwarranted since . . . the courts generally use the distinction between domestic and international public policy," thus avoiding "undesirable consequences."¹⁴³ This opinion has largely proven to be true. However, a potential threat that a court will misuse the exception and apply domestic policies still exists.

In the United States, President Johnson presented the Convention to the Senate with a memorandum from the State Department analyzing the Convention's articles.¹⁴⁴ The memorandum mentioned that both the nonarbitrability provision of Article V(2)(a) and the public policy exception of Article V(2)(b) "would give the courts to which application is made *considerable latitude in refusing enforcement*."¹⁴⁵ Backed by this concern, the Solicitor General of the United States concluded that "the Senate, in consenting to accession, understood that the Convention would not require United States courts to enforce arbitration agreements in a limited class of matters as to which arbitration would interfere with *fundamental policies of the United States*."¹⁴⁶ If this advice is followed, United States courts would have considerable flexibility in applying the Convention's provisions and may refuse enforcement by recognizing fundamental domestic policies which conflict with the award.

2. American judicial interpretations of public policy under the Convention

More often than not, United States courts have refused to apply Article V's "catch-all" public policy provision to invalidate an award.¹⁴⁷

142. G.W. HAIGHT, CONVENTION ON THE RECOGNITION AND ENFORCEMENT OF FOREIGN ARBITRAL AWARDS: SUMMARY ANALYSIS OF RECORD OF UNITED NATIONS CONFERENCE 66 (1958).

143. A.J. VAN DEN BERG, *supra* note 139, at 368-69.

144. S. EXEC. DOC. NO. E, 90th Cong., 2d Sess. 19 (1968). Such memoranda are entitled to great weight in the interpretation of a treaty. *Sumitomo Shoji Am., Inc. v. Avagliano*, 457 U.S. 176, 184-85 (1982) (female employees of wholly-owned subsidiary of Japanese trading company brought unsuccessful class action suit against Sumitomo for violation of Title VII of Civil Rights Act of 1964, because terms of United States-Japan Treaty provided defense to discrimination suit).

145. S. EXEC. DOC. NO. E, 90th Cong., 2d Sess. at 21 (1968) (emphasis added).

146. United States *Mitsubishi* Brief, *supra* note 30, at 28 (emphasis added). See also the United States Supreme Court's opinion in *Lauritzen v. Larsen*, 345 U.S. 571 (1953). "[E]xcept as forbidden by some public policy, the tendency of the law is to apply in contract matters the law which the parties intended to apply." *Id.* at 588-89.

147. See generally Comment, *The Public Policy Defense to Recognition and Enforcement of*

For example, the United States Court of Appeals for the Second Circuit, in the 1974 case of *Parsons & Whittemore Overseas Co., Inc. v. Societe Generale de L'Industrie du Papier (RAKTA)*,¹⁴⁸ rejected the public policy defense where the Arab-Israeli Six Day War forced an American contractor to cease building a paper mill in Egypt. In *Parsons*, an American corporation claimed that the severed American-Egyptian relations resulted in withdrawal of financial support for the building project, and therefore justified its nonperformance of contractual obligations.¹⁴⁹

An arbitral panel from the ICC Court granted the Egyptian party damages for breach of contract. In the judicial confirmation proceeding, the corporation argued that because of American-Egyptian tensions, it was forced to breach the contract. Therefore, an international arbitral award for damages against the corporation was void under the public policy exception.¹⁵⁰ The United States District Court for the Southern District of New York granted summary judgment to the defendant Egyptian corporation and confirmed the award.¹⁵¹ The United States Court of Appeals for the Second Circuit affirmed, stating the claimant "quite plainly misse[d] the mark."¹⁵²

The court decided that the public policy defense could be invoked "only where enforcement would violate the forum State's most basic notions of morality and justice."¹⁵³ It further held:

To read the public policy defense as a parochial device protective of national political interests would seriously undermine the Convention's utility. This provision was not meant to enshrine the vagaries of international politics under the rubric of "public policy." Rather, a circumscribed public policy doctrine was contemplated by the Convention's framers and every indication is that the United States, in acceding to the Convention,

Foreign Arbitral Awards, 7 CAL. W. INT'L L.J. 228 (1977). See, e.g., *La Societe Nationale pour la Recherche, la Production, le Transport, la Transformation et la Commercialisation des Hydrocarbures, ["Sonatrach"] v. Shaheen Natural Resources Co.*, 585 F. Supp. 57 (S.D.N.Y. 1983) (arbitration award held not contrary to United States public policy and recognized and enforceable under Convention), *aff'd*, 733 F.2d 260 (2d Cir.), *cert. denied*, 105 S. Ct. 251 (1984).

148. 508 F.2d 969 (2d Cir. 1974).

149. *Id.* at 974.

150. *Id.*

151. *Id.* at 971.

152. *Id.* at 974.

153. *Id.* (citing *Fotochrome, Inc. v. Copal Co.*, 517 F.2d 512 (2d Cir. 1975)). The court in *Fotochrome* expressly found it unnecessary to determine "whether the Bankruptcy Act involves a 'public policy' [in requiring equal treatment of creditors] which is contrary to enforcement of arbitral awards under the Convention." *Fotochrome*, 517 F.2d at 516.

meant to subscribe to this supranational emphasis.¹⁵⁴

In *Parsons*, the arbitrators had also refused to grant a continuance to accommodate a key witness. The court of appeals, however, still found no public policy reason by which it could reject the award.¹⁵⁵ Although the lack of a key witness could substantially prejudice a case, the court did not find this procedural issue important enough to implicate due process or fairness concerns.¹⁵⁶ Thus, for this court of appeals, the definition of public policy included only a consideration of basic norms of fairness, or solely international concerns.

In the 1980 case of *Laminoirs-Trefileries-Cableries de Lens, S.A. v. Southwire Co.*,¹⁵⁷ a French company and an American company agreed to have their disputes governed by "Georgia law to the extent that it was in accordance with French law."¹⁵⁸ The arbitrator had applied the French variable interest rate of nine and one-half percent to ten and one-half percent per year to the damages he awarded. The party against whom damages were awarded claimed the award was unenforceable under Article V(2)(b) of the Convention because the rate was "usurious" and violated United States (domestic) public policy.¹⁵⁹

The United States District Court for the Northern District of Georgia applied the *Parsons* standard of "most basic notions of morality and justice" and enforced, but modified, the award. The court found that the interest rate matched the rates in some American states, so the rate alone did not violate public policy.¹⁶⁰ It also noted that the choice of law notified the complaining party that French laws could be applied.¹⁶¹ What the district court could not accept was the arbitrator's decision to apply French law to increase the interest rate by five percent two months after the date of the award. The district court held that this portion of the award was impermissible under American law and egregious enough to invoke the Convention's public policy exception.¹⁶² The court reasoned:

An award of interest is made so that a person wrongfully deprived of the use of his money should be made whole for his loss. A penalty, on the other hand, is a sum of money which the law exacts by way of punishment for doing something that

154. *Parsons*, 508 F.2d at 974.

155. *Id.*

156. *Id.*

157. 484 F. Supp. 1063 (N.D. Ga. 1980).

158. *Id.* at 1067 (emphasis in original).

159. *Id.* at 1068.

160. *Id.*

161. *Id.* at 1067.

162. *Id.* at 1069.

is prohibited or omitting to do something that is required to be done. The law does not lightly impose penalties. *A foreign law will not be enforced if it is penal only and relates to the punishing of public wrongs as contradistinguished from the redressing of private injuries.* Agreements to pay fixed sums as damages plainly without reasonable relation to any probable damage which may follow will not be enforced.¹⁶³

The *Laminoirs* court decided without evidentiary basis that the increased rate was a penalty in excess of compensation and that it bore "no reasonable relation to any damage resulting from delay in recovery of the sums awarded."¹⁶⁴ Although this case has not been reversed on appeal, several aspects of the decision are vulnerable to criticism. First, the court incorrectly reviewed the arbitrator's decision to apply French law to the award. The arbitrator has the exclusive authority to make this decision at the time he decides the merits of the case.¹⁶⁵ Second, the court's decision that the increased interest did not relate to the damages (determined by the arbitrator) was not based on a review of the principles supporting the French law that the arbitrator applied.¹⁶⁶ If a court looks into the merits of an arbitral dispute, certainly the parties' choice of law should influence the review. For this reason, the court should not have labeled the problematic portion of the award a "penalty" and rendered it unenforceable. Finally, the court could not have known whether the "penalty" bore a reasonable relationship to the damages because the court was not the arbiter of justice which heard the evidence.

Laminoirs is one of the few cases in which the Convention's public policy exception has nullified any portion of an award. Yet it is difficult to see how the French interest penalties fail to comply with the enforcing American court's interpretation of *international* public policy. To analyze whether the award violated the public policy of Article V, the *Laminoirs* court compared the variable rate to *domestic* rates in individual American states and found no violation because that rate existed in some American jurisdictions. The court then found that the increased rate met the public policy standards of the Convention because it was a penalty, and was therefore inconsistent with *domestic* law.

One must wonder whether the court even considered international

163. *Id.* (emphasis added) (citations omitted).

164. *Id.*

165. See *supra* notes 6 & 30.

166. *Laminoirs*, 484 F. Supp. at 1069. The *Laminoirs* opinion quoted the French statute which allowed the increased interest. Nowhere does the opinion discuss whether the purpose of the statute was to penalize. *Id.*

public policy when it refused to enforce the violative portion of the award. If the *Laminoirs* court only compared the arbitrator's ruling with domestic law, as the opinion seems to indicate, then only certain courts will give the Convention's exception a "pro-enforcement bias," and award-holding parties could then be vulnerable to an enforcing court's whim.¹⁶⁷

A penalty of punitive damages in an award could similarly fail to conform to a foreign State's interpretation of domestic or international public policy. The enforcing court could, therefore, nullify a valid award under Article V of the Convention. This possibility is especially threatening where a foreign court could cite United States case law—*Laminoirs*—to support the nullification.

3. Interpretations of public policy under the Convention in arbitrations and foreign states

In July 1985, an American company (buyer) brought an action in India's High Court of Delhi to have an arbitral award enforced against the Steel Authority of India Ltd. (seller).¹⁶⁸ The High Court found that the buyer could not collect money damages arbitrators had awarded for the seller's breach of contract because the award violated public policy under Article V of the Convention.¹⁶⁹

The parties had contracted through correspondence in 1977 to have the seller supply the buyer with 25,000 tons of hot rolled steel sheet coils in two installments. The letters contained a *force majeure* clause which excused delay or excused contractual performance if circumstances beyond either party's control prevented performance.¹⁷⁰ The contract also included an arbitration clause which mandated that the parties submit

167. On the other hand, the *Laminoirs* court may have objected to the arbitrator's choice of the French increasing interest rate because the parties' agreement designated that the law governing their dispute should be American law where consistent with French law. The arbitrator's rejection of the parties' primary choice of United States law may have violated the "most basic notions of morality and justice" and interfered with the international policies of fairness and freedom to contract which the court intended to protect.

The court's opinion, however, is unclear on this issue. There are other reasons why an arbitrator might choose to apply an interest rate other than the one applicable under the substantive law chosen by the parties. An arbitrator is often free to apply procedural law of the forum (of France, in *Laminoirs*) to arbitration procedures and damages if those issues are considered procedural rather than substantive. See *supra* note 6.

168. INTERNATIONAL COUNCIL FOR COMMERCIAL ARBITRATION, *Court Decisions of the 1958 New York Convention: India* [1986] 11 Y.B. COM. ARB. 502. At least half of the seller company was owned by the Indian government. *Id.*

169. *Id.* at 507.

170. A *force majeure* clause "protect[s] the parties in the event that a part of the contract cannot be performed due to causes which are outside the control of the parties and could not

any disputes to arbitration before the ICC Court.¹⁷¹ After the seller delivered half of the coils called for in the agreement, the Indian government banned the export of hot rolled steel sheet coils.¹⁷²

The parties resorted to the ICC Court and its arbitrators decided that the seller had breached the contract. The arbitrators rendered an award in favor of the buyer for compensatory damages, interest and costs. A London court recognized the award as a final judgment and the buyer proceeded to India to enforce the judgment.¹⁷³

The High Court of India held that under Indian domestic arbitration rules, it could review the merits of an arbitration in order to determine whether the award violated Indian public policy. The court also held that even after an arbitrator has rendered a valid, enforceable award, if circumstances arose which make the award violative of public policy, the court could overturn that award.¹⁷⁴ The court decided that the Indian government had banned steel coil exports for the public good or for public policy reasons "in view of acute shortage of coils existing in the country at the relative time."¹⁷⁵ The court thus held that this domestic policy on foreign exchange controls excused the seller's performance of the contract, and rendered the foreign award unenforceable.¹⁷⁶

The court refused to recognize a distinction between domestic and international public policy, even though the buyer raised the issue. The court reasoned that the expression "public policy" in Article V of the Convention "refers to the public policy of the country where enforcement is sought, i.e. India."¹⁷⁷ Thus, for this court, the domestic controls

be avoided by exercise of due care." BLACK'S LAW DICTIONARY 581 (5th ed. 1979). The agreement between the parties in the arbitration before the Indian court specifically stated:

If the Seller and/or the Buyer be prevented from discharging its or their obligation under this agreement . . . on account of any . . . cause beyond the Seller's or the Buyer's control and interfering with the production and/or delivery as hereinabove contemplated, the time for delivery shall be postponed . . . [and] either the Seller or Buyer may at their option cancel this agreement . . . without, however, any right against or being responsible to the other party for such cancellation.

Id. at 502. The enforcing court may have taken this liberal clause into account when it decided the seller's breach was guided by proper public policy. Arguably, almost any cause out of one party's control could have excused performance, irrespective of public policy considerations. The court did not address whether the broad clause coupled with domestic policies made the seller's Article V(2)(b) defense more viable.

171. *Id.* at 502-03.

172. *Id.* at 503, 506.

173. *Id.* at 503.

174. *Id.* at 506-07.

175. *Id.*

176. *Id.*

177. *Id.* at 507. Because the Indian (enforcing) court voided the award as violating public policy, the creditor may have no mechanism to enforce the award and the debtor is discharged.

on foreign exchange met the standards for public policy under the Convention and rendered a valid judgment of money damages unenforceable in the one State which could enforce the judgment.

Another case arose in 1982 when a Dutch company (seller) contracted to sell pure unrefined maize oil to an Italian company (buyer).¹⁷⁸ The buyer refused to pay for the oil, arguing its quality was inferior to that called for in the contract.¹⁷⁹

Under an arbitration clause, the parties submitted the dispute to arbitration in Rotterdam. The arbitrators found the oil was of the proper quality and awarded money damages against the buyer.¹⁸⁰ When the seller submitted the award to the Italian court of appeal for enforcement, the buyer argued the award violated Article V public policy for two reasons: the delivery of goods inferior to those contractually bargained for was contrary to Italian public policy, and enforcement of the award would violate public policy by violating Italian foreign exchange laws.¹⁸¹

The Italian appellate court declined to review the merits of the arbitrators' decisions and refused to allow the buyer's objections. The court held that the foreign award "did not violate the basic principles of the Italian legal system," and did not constitute a violation of Article V pub-

The award-holder may be able to seek redress from the International Court of Justice because the arbitration resulted in an award against the governmentally-held company. The International Court of Justice is one of the principal organs of the United Nations and has jurisdiction only over matters which involve a State's national government. Judgments are awarded against the State itself. *See generally* S. ROSENNE, *THE WORLD COURT: WHAT IT IS AND HOW IT WORKS* (3d rev. ed. 1973); M. HUDSON, *THE WORLD COURT 1921-38: A HANDBOOK* (5th ed. 1938). Foreign State parties to the statute may recognize the Court's jurisdiction in any legal disputes concerning:

- a. the interpretation of a treaty;
- b. any question of international law;
- c. the existence of any fact which, if established, would constitute a breach of an international obligation;
- d. the nature or extent of the reparation to be made for the breach of an international obligation.

Statute of the International Court of Justice, Sept. 14, 1929, I.C.J. (ser. D.) No. 1, at 13 art. 36. *See* S. ROSENNE, *supra*, at 177. Thus, with a State's permission, the World Court could hear questions about the Convention's public policy exception and its application to a punitive damage award.

178. INTERNATIONAL COUNCIL FOR COMMERCIAL ARBITRATION, *Court Decisions of the 1958 New York Convention: Italy* [1986] 11 Y.B. COM. ARB. 510.

179. *Id.*

180. *Id.* at 510-11.

181. *Id.* at 510. Under Italian law, payment for goods is due only if the goods are actually imported into Italy. The buyer claimed that because the goods were inferior, they were different goods and the contracted-for goods were never actually imported into Italy. Therefore, according to the buyer, the award demanded that the buyer pay the seller for goods never received and this payment would violate foreign exchange laws and Italian public policy. *Id.* at 510.

lic policy.¹⁸²

Thus, foreign exchange controls may constitute public policies which are so important that their violation excuses breach of contract (India); yet, in at least some circumstances, foreign exchange controls will not defeat an arbitral award or excuse a breach of contract (Italy). These two conflicting decisions demonstrate that in foreign countries, international public policy limitations under Article V(2)(b) can be as inconsistent as those used in American courts and by individual arbitrators.

In other foreign States, Article V public policy may have little connection to domestic laws. For example, the French find procedural violations of *international* public policy in only two categories: where an arbitrator fails to treat parties equally in an arbitration hearing and where one party is unable to present its views on every point in dispute.¹⁸³ An award made in default of the defendant cannot be enforced in Spain.¹⁸⁴ In the Federal Republic of Germany, a fundamental due process violation, such as the arbitrators' failure to forward an important letter from one party to the other, constitutes an "international" public policy violation.¹⁸⁵ Moreover, an Austrian court has refused to enforce an award in which the determination under Dutch law violated Austrian gambling and betting laws.¹⁸⁶

In sum, in *Parsons*, American-Egyptian diplomatic relations allegedly obstructed a party from performing its contractual obligations; however, the soured relations failed to constitute a sufficient international public policy exception which could defeat an arbitral award. This outcome conflicts with *Laminoirs*, in which the court held that interest awarded under French law, which is excessive under American law, fulfilled the Convention's public policy requirements. In an Indian enforcement action, a domestic governmental directive to ban exports may be sufficient to render an award unenforceable under the Convention, despite the prominent view that only international policies should excuse enforcement. Yet, in another State such as Italy, an arbitration award

182. *Id.* at 511.

183. INTERNATIONAL COUNCIL FOR COMMERCIAL ARBITRATION, *National Reports: France* [1981] 6 Y.B. COM. ARB. 13-14.

184. INTERNATIONAL COUNCIL FOR COMMERCIAL ARBITRATION, *Court Decisions on New York Convention 1958, Commentary* [1985] 10 Y.B. COM. ARB. 405 [hereinafter *Commentary*].

185. *Firm P (U.S.A.) v. Firm F (F.R.G.)*, Apr. 3, 1975, reported in INTERNATIONAL COUNCIL FOR COMMERCIAL ARBITRATION, *Court Decisions on New York Convention 1958: Federal Republic of Germany* [1977] 2 Y.B. COM. ARB. 241-42.

186. *Commentary*, *supra* note 184, at 407-08.

will be left intact unless it violates "basic principles" of the domestic legal system. These cases and the varying definitions of public policy under other countries' laws amply demonstrate the confusion over the meaning and proper application of Article V(2)(b).

4. What is international public policy—that which touches a nation's "most basic notions of morality and justice?"

Even the American Arbitration Association acknowledges that domestic considerations will be addressed by a court in enforcing an award¹⁸⁷ and labels Article V(2)(b) a " 'safety valve,' designed to ensure that the international arbitration process, when recognized to its fullest extent, remains *consistent with the national policies of the Convention's signatories*."¹⁸⁸ These statements infer that American parochial policies may block enforcement of an award.

One side of this controversy holds that international public policy is violated if a foreign State's domestic law would be willfully violated by enforcement of the arbitral award in that State.¹⁸⁹ The other side is represented by a commentator who opines:

The law in force in the forum of the enforcement should be more or less as beneficial as the treaty law resulting from the cumulative effects of the New York and Geneva Conventions. The ideal would be that the law so considered does not contain, as an obstacle to enforcement, a procedure to nullify the award or even to accept a nullification pronounced in the country where the award was rendered.¹⁹⁰

All of the limitations on international public policy discussed above, in countries other than the United States, could touch "the forum State's most basic notions of morality and justice."¹⁹¹ The French, Spanish, German and Austrian procedural rights listed above are "basic" to international mores of fairness and morality, so the foreign States consider them international public policies.

One example of a domestic policy which does not upset uniform international ideas of morality and justice is illustrated by the fact that

187. Brief for the American Arbitration Association as Amicus Curiae at 10, *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 105 S. Ct. 3346 (1985) (Nos. 83-1569, 83-1733).

188. *Id.* at 25 (emphasis added).

189. Schultz, *Recognition and Enforcement of Foreign Arbitral Awards Without a Convention Being Applicable*, in *THE ART OF ARBITRATION*, *supra* note 25, at 295, 299 n.13.

190. Theiffry, *supra* note 28, at 47.

191. *Parsons*, 508 F.2d at 975-76.

under French and Italian domestic laws, a domestic arbitral award which fails to state reasons behind the arbitrator's decision violates public policy.¹⁹² Under domestic law in most common law countries, arbitral awards do not traditionally contain reasons.¹⁹³ Yet this type of conflict in arbitration procedure has never been held to violate international public policy. This is true even though it touches a vital national concern—the ability of a reviewing court to review the basis for an arbitral decision and determine whether the arbitrator decided the case on a proper, legal basis.¹⁹⁴

The Convention's public policy defense is construed inconsistently because the area between international and domestic public policies is gray. Some courts favor a narrow construction which will not impede the enforcement action, so that awards will be enforced promptly. However, high interest rates adjudged unenforceable can hardly meet the narrow definition or touch "morality" or "justice" issues; therefore, other courts interpret the provision broadly to protect a party from excessive foreign penalties. Even if the standard of "morality and justice" were internationally adopted, different enforcing States' ideas of morality and justice might inconsistently render awards enforceable or unenforceable. Because holdings in this area do not clearly distinguish between domestic and international public policy, it remains to be seen whether policies such as those behind punitive damages, punishment and deterrence, will cross the muddy line.

C. *Historical Foreign Punitive Judgments and Appropriate Public Policy Considerations*

As a matter of public policy and respect for other nations' court

192. Bernini, *supra* note 139, at 51, 59.

193. INTERNATIONAL COUNCIL FOR COMMERCIAL ARBITRATION, *Court Decisions on the New York Convention 1958: Commentary*, [1985] 10 Y.B. COM. ARB. 406-07. See, e.g., Efxinos Shipping Co. (Greece) v. Rawi Shipping Lines Ltd. (Lebanon), May 2, 1980 (enforcement of English arbitral award which did not contain written reasons, in violation of Italian arbitration procedural law held not contrary to Italian international public policy), reported in INTERNATIONAL COUNCIL FOR COMMERCIAL ARIBTRATION, *Court Decisions on New York Convention 1958: Italy* [1983] 8 Y.B. COM. ARB. 381.

194. For example, in *Mutual Shipping Corp. v. Bayshore Shipping Co.*, 1 W.L.R. 625 (1985) (available on LEXIS, Enggen/Cases library), an arbitrator made an accidental error in calculating damages and included reasons for his decisions in separate papers marked "confidential." Because the papers were inaccessible to the court, the party in whose favor the error was made argued the court could not correct the error. The court disagreed and held it had authority to review the confidential reasons. It affirmed that an award without reasons is void as against public policy because "[f]ew nations are prepared to lend the power of the state to enforcing arbitral awards without retaining some right to review the awards themselves." To avoid injustice, the court sent the award back to the arbitrator for correction.

systems, it is well established that international tribunals "do not possess the right to assess or inflict punishment for the wrongful acts of other States."¹⁹⁵ Some courts adhering to this principle have refused to enforce foreign judgments which included punitive damages.¹⁹⁶ Because judicial punitive damage judgments have not survived foreign judicial scrutiny in the past, arbitral awards of punitive damages may also fail in foreign enforcing courts which consider such awards penal. A foreign enforcing court determines whether an enforcing arbitral award is penal. If considered penal, the award may be unenforceable. Therefore, it is important to determine whether punitive damages are in fact penal.

The United States Supreme Court has defined "penal" and "penalty" as follows:

Strictly and primarily, they denote punishment, whether corporal or pecuniary, imposed and enforced by the State, for a crime or offence against its laws. But they are also commonly used as including any extraordinary liability to which the law subjects a wrongdoer in favor of the person wronged, not limited to the damages suffered. . . .

Statutes giving a private action against the wrongdoer are sometimes spoken of as penal in their nature, but in such cases it has been pointed out that neither the liability imposed nor the remedy given is strictly penal.¹⁹⁷

195. 2 M. WHITEMAN, DAMAGES IN INTERNATIONAL LAW 857 (1937). Whiteman also notes:

There is an apparent desire on the part of international tribunals to avoid punitive or exemplary damages. The assessment of damages is a civil and not a penal act. . . . [T]here is an evident desire on the part of arbitrators or those charged with the settlement of international claims not to allow unreasonable amounts, viz, neither more than the respondent should or can reasonably be expected to pay nor more than the claimant should reasonably expect to receive.

3 M. WHITEMAN, DAMAGES IN INTERNATIONAL LAW 1874 (1943). See Janis, *The Recognition and Enforcement of Foreign Law: The Antelope's Penal Law Exception*, 20 INT'L LAW. 303 (1986), in which the author contends that foreign penalty judgments should be enforced only where enforcement serves a vital public interest. See also Comment, *The Protection of Trading Interests Act of 1980: Britain's Response to U.S. Extraterritorial Antitrust Enforcement*, 2 NW. J. INT'L L. & BUS. 476 (1980). "Foreign governments . . . have long protested that . . . [treble] damages, which are uniquely American, are penal and hence, should not be available to private plaintiffs." *Id.* at 489. See also M. HANCOCK, TORTS IN THE CONFLICT OF LAWS 93 (1942), which states that criminal prosecution under foreign laws is also historically forbidden.

196. 2 M. WHITEMAN, *supra* note 195, at 857. See also M. HANCOCK, *supra* note 195, at 93.

197. *Huntington v. Attrill*, 146 U.S. 657, 667 (1892) (citations omitted). In *Huntington*, a New York judgment held a British corporate officer personally liable for corporate debts because he had signed a false certificate regarding the corporation's affairs. The United States Supreme Court and the English Privy Council both decided that type of judgment was non-

Punitive damages certainly denote pecuniary punishment and constitute liability not limited to the damages suffered.¹⁹⁸ Punitive damages are also enforced by the State because an American court will enforce a judgment of punitive damages which was validly awarded under American law.

Some American state courts expressly classify punitive damages and their analogous cousins, double or treble damages, as penal.¹⁹⁹ Also, punitive damages are sometimes statutorily awarded in a private plaintiff's action against a tortfeasor.²⁰⁰ Therefore, under the Supreme Court's definition, punitive damages are penal.²⁰¹

In the past, punitive judgments have been awarded or enforced on a case-by-case basis, especially when the civil damages in a judgment did not conform with the forum's policies.²⁰² Traditionally most actions

penal and enforceable outside New York. The English Privy Council's opinion is at 1893 App. Cas. 150 (P.C.).

198. See *supra* text accompanying notes 51 & 62.

199. Punitive damages were considered penal in the following cases and annotations: Smith v. Wade, 461 U.S. 30 (1983); Grinstead v. New York Cent. R.R., 253 Ill. App. 589 (1929); Armbruster v. Chicago R.I. & P. Ry., 166 Iowa 155, 147 N.W. 337 (1914); McLay v. Slade, 48 R.I. 357, 138 A. 212 (1927); Annotation, *Judgment of Court of Foreign Country As Entitled to Enforcement or Extraterritorial Effect in State Court*, 13 A.L.R. 4TH 1109 (1982). See Grass, *The Penal Dimensions of Punitive Damages*, 12 HASTINGS CONST. L.Q. 241 (1985), in which the author concludes punitive damages are penal and their imposition should be accomplished through the criminal justice system. Cf. Holbein v. Rigot, 245 So. 2d 57 (Fla. Dist. Ct. App. 1971); Annotation, *Requirement of Full Faith and Credit to Foreign Judgment for Punitive Damages*, 44 A.L.R. 3D 960 (1972). Double or treble damages were considered penal in the following cases: Consolidated Copper Mines Corp. v. Nevada Consol. Copper Co., 127 Misc. 71, 215 N.Y.S. 265 (N.Y. Sup. Ct. 1926); Mohr v. Sands, 44 Okla. 330, 133 P. 238 (1913); Chrome Plating Co. v. Wisconsin Elec. Power Co., 241 Wis. 554, 6 N.W.2d 692 (1942).

200. For example, the Equal Credit Opportunity Act provides that "any creditor that fails to comply with a requirement imposed by the Act or this regulation is subject to civil liability for actual and punitive damages in individual or class actions." 12 C.F.R. § 202.14(b) (1986). Also, the federal rules for highway claims allow punitive damages to prevent violations of hazardous materials regulations or motor carrier safety regulations. 50 Fed. Reg. 40,304 (1985); 49 C.F.R. § 386.71 (1985).

201. Conversely, although punitive damages are largely penal in nature, they serve other purposes, such as deterring wrongdoers. See *supra* note 51. The fact that punitive damages serve non-penal purposes may distinguish them from the "strictly penal" classification in the Supreme Court's definition. Deterring others from wrongful conduct is a purpose aimed at helping or protecting society, not at punishing a tortfeasor; therefore, deterrence is not "penal."

202. For example, in *Galef v. United States*, 25 F.2d 134 (E.D.S.C. 1928), an American plaintiff claimed and was awarded full damages for cargo lost on board a German lighter, which was sunk by the United States government. The government had argued that under German law (the law controlling where the wrong occurred), it was liable only for damages to the degree of its own fault. The United States District Court for the Eastern District of South Carolina held that American law (the forum's law) applied because the German rule violated public policy and German law should not be applied to a United States vessel. *Id.* at 136.

against foreign nations in which quasi-punitive damages were awarded and enforced involved damages for violent death.²⁰³ The State in which the death occurred paid damages to the decedent's national government and/or his heirs. Diplomatic settlements between nations for acts against citizens of foreign States have also produced successful punitive judgments which were paid to governments and heirs.²⁰⁴

In all of these cases, the public policy in favor of compensating the family or the property owner or of paying back the State for diplomatic reasons conflicted with the policy against enforcing penal judgments of foreign States. The former policy outweighed the latter because the judgments were paid. Therefore, the stronger policy supports the idea that an arbitral award of punitive damages should be enforced, even if it is considered penal.

Foreign States penalize wrongdoers to different degrees, depending on the State's objectives and the public policies behind its laws.²⁰⁵ Even if the public policy of an arbitrator's punitive damage award is acceptable to the enforcing State, it may not be enforceable if the State's courts cannot administer or monitor the judgment.²⁰⁶ Whether a State will impose

Similarly, in *Royal Mail Steam Packet Co. v. Campanhia de Navegacao Lloyd Brasileiro*, 27 F.2d 1002 (E.D.N.Y. 1928), a collision occurred in Belgian waters. The respondent was awarded higher damages by the American court than he would have received in a Belgian court, solely because the suit was brought in the United States. Despite this fact, the district court affirmed the judgment. *Id.* at 1004. Thus again, the forum's public policies were held to be superior to the law governing the collision.

203. For example, one case involved the wife and children of an American missionary who was murdered by a mob in China. The Chinese government paid a punitive judgment. See 1 M. WHITEMAN, *supra* note 195, at 37-38 for a discussion of *Reverend E.R. Beckman (United States v. China) (1914)* (unreported case). In another case, the Persian government paid an American Vice Consul's wife a punitive judgment of \$60,000 when her husband was murdered by a mob in Teheran. See 1 M. WHITEMAN, *supra* note 195, at 136-38, for a discussion of the case of *Robert M. Imbrie (1912)* (unreported case). *Id.* at 136-38. In a third case, involving property damage rather than death, the U.S. Coast Guard intentionally sank a Canadian-owned ship used by Americans for bootlegging liquor. The United States government was fined and paid a punitive judgment of \$25,000 as "amend[s] in respect of the wrong." See 1 M. WHITEMAN, *supra* note 195, at 150-57, for a discussion of the case of *United States Coast Guard (1929)* (unreported case).

204. See, e.g., *British Gov't v. Japanese Gov't* (1863), *French Gov't v. Japanese Gov't* (1868), *British Gov't v. Sultan of Zanzibar* (1888), *French Gov't v. Dominican Republic Gov't* (1895) and *U.S. Gov't v. China* (1906). 1 M. WHITEMAN, *supra* note 195, at 722-30.

205. 2 M. HANCOCK, *supra* note 195, at 117-18.

206. For example, in *Slater v. Mexican Nat'l R.R.*, 194 U.S. 120 (1904), a wrongful death occurred in Mexico for which the plaintiff sued in federal district court in Texas. Mexican laws (the law of the place of wrong) mandated that punitive damages be paid out over a long time period, while American law (the law of the forum) required the defendant to pay in one lump sum. During the enforcement proceeding, Justice Holmes conveyed the United States Supreme Court's concern that American law might unjustly force the defendant to pay an amount greater than that called for in Mexico. The Court decided that reducing liability in

its own public policy on a foreign judgment is unpredictable. Therefore, if one country's parochial public policies come head to head with punitive damage purposes—punishment and deterrence—or with the United States federal policy which grants arbitrators powers to award punitive damages, the outcome is also unpredictable.

IV. CIVIL PUNISHMENT AND PUBLIC POLICY IN FOREIGN SIGNATORY STATES

It will be helpful to look at several signatory States' domestic views on punitive damages or other forms of civil punishment.²⁰⁷ These views may gauge whether countries with public policies unlike those in the

this way "would be to leave the whole matter to a mere guess." *Id.* at 128. The Texas court had no way to supervise periodic payments, so the plaintiff's action for damages was dismissed. *Id.* at 129.

207. A full discussion of the public policy restrictions in nonsignatory countries to the Convention is beyond the scope of this Comment. However, it is important to review the policies of several foreign States with which United States businesspersons do business.

Every country which recognizes domestic or international arbitration as a substitute for adjudication has a public policy exception which mirrors article V(2)(b) of the Convention. I. SZASZY, *INTERNATIONAL CIVIL PROCEDURE: A COMPARATIVE STUDY* 182-83 (1967). Szaszy cites civil code sections which confirm or enforce State courts' authority to refuse recognition and execution of foreign arbitral awards with a finding that those awards are contrary to domestic public policy. Szaszy includes the States of Argentina, Austria, Belgium, Brazil, Bulgaria, Chile, Columbia, Ecuador, Germany, Honduras, Hungary, Italy, Mexico, Poland, Russia, Spain and Uruguay. *Id.* See also *INTERNATIONAL COUNCIL FOR COMMERCIAL ARBITRATION*, [1976-1986] 1-11 *Y.B. COM. ARB.* for a discussion of the current civil codes of each signatory State and some nonsignatory States. The *Yearbook Commercial Arbitration* also explains how civil policies affect international and domestic arbitral awards. Some countries' rules further mandate that arbitral awards conform to domestic laws. Thus, in addition to the ambiguities present in the judicial holdings on the Convention's exception, parties to an international transaction should concern themselves with the potentially greater barriers to enforcement of a punitive damage award in nonsignatory States.

A bilateral treaty between a signatory country and a nonsignatory country may aid enforcement of a foreign award. See *supra* note 126. Some of the countries mentioned below have bilateral treaties, but further discussion of how these treaties and the Convention would coexist is beyond the focus of this Comment.

Costa Rica, a nonsignatory jurisdiction, has signed but not ratified the Convention. In Costa Rica, foreign awards are enforceable only if the judgment is enforceable in the country of origin and if it does not contravene the public order (public policy). *INTERNATIONAL COUNCIL FOR COMMERCIAL ARBITRATION, National Reports: Costa Rica* [1978] 3 *Y.B. COM. ARB.* 75. Venezuela also will not enforce any award in conflict with the public order. *INTERNATIONAL COUNCIL FOR COMMERCIAL ARBITRATION, National Reports: Venezuela* [1978] 3 *Y.B. COM. ARB.* 149.

For defamation or false imprisonment, Brazilian law penalizes the wrongdoer by doubling the actual fine imposed. If the defamation is republished, the penalty is also doubled. XI *INTERNATIONAL ENCYCLOPEDIA OF COMPARATIVE LAW* ch. 8, at 87 (1973). For personal injury, the Brazilian civil code allows compensation for losses which cannot be measured arithmetically, usually considered non-pecuniary harm. In addition to medical costs, the tortfeasor

United States will recognize and enforce an arbitral award granting an

must pay the plaintiff a sum in atonement equal to half the corresponding statutory penal fine for the tort. This is doubled if the act results in a mutilation or disfigurement. *Id.*

In the People's Republic of China (PRC), with which Americans do a great deal of business, businesspersons downplay the need for any resolution system—arbitration or adjudication—because it is presumed any dispute will be negotiated in conversations between the parties. *See* I. RICHTER, *supra* note 29, at 198-200.

Formal dispute resolution of just about any dispute is coupled with "loss of face. . . ."

There is a common feeling that any dispute resolution process merely reflects the political desires of the governing jurisdiction. Therefore, if binding arbitration is to be agreed upon, the location and selection process are received with some suspicion.

Interview with David Noble, American Arbitration Association in Los Angeles (Mar. 17, 1986). All goodwill aside, if there is a problem with enforcement of an award executed in China, a party must petition the People's Court of the PRC to enforce it. Yet "there has never been a single case that had to be enforced by the People's Court. The Chinese foreign trade and maritime enterprises are state-owned enterprises. They respect the [domestic] arbitration awards." INTERNATIONAL COUNCIL FOR COMMERCIAL ARBITRATION, *National Reports: People's Republic of China* [1978] 3 Y.B. COM. ARB. 159. Foreign arbitral awards are treated differently. Chinese enterprises and corporations will execute foreign awards "so long as they are fair and not in violation of the Chinese laws and policies." *Id.* at 160. Would punitive damages seem "fair" to a country like the PRC which shuns formal dispute resolution? Chinese law does not recognize punitive damages, so they are certainly in violation of the Chinese law. Where does this leave the contracting parties? Switzerland is a signatory to the Convention; nevertheless, only sixteen of its twenty-five cantons (as of 1977) signed an intercantonal agreement unifying cantonal laws on domestic arbitration, which may always involve international parties. The other nine have their own rules for arbitration. *Id.* at 181. Zurich, one of the nine, hosts many arbitrations and allows annulment of an award when it constitutes a clear violation of substantive law or of *ordre public* (public policy). *Id.* at 181, 202.

Algeria, not bound by Conventions, has Judicial Treaties with two of the Convention's signatory states—Morocco and France. INTERNATIONAL COUNCIL FOR COMMERCIAL ARBITRATION, *National Reports: Algeria* [1979] 4 Y.B. COM. ARB. 20 & n.1. In addition to a rule that awards conform with Algerian public order, "the [Algerian] courts may be tempted to go into the merits of the case, especially where no exequatur (leave [or recognition] for enforcement) of the award has been obtained in its country of origin." *Id.* Could Algeria's judiciary reexamine the merits of a punitive damage award and authorize the punishment of one of its own citizens?

Daily, Americans execute many commercial transactions with Saudi Arabia; however, the Saudis are nonsignatories to the Convention. Enforcing an award is difficult. First, the award must be submitted to Saudi Arabia through diplomatic channels. It then will be transferred from the Ministry of Foreign Affairs to the Office of the Prime Minister. The Prime Minister's Office decides whether to issue appropriate instructions for enforcement to the relevant executive arm of the government, or to refer the award to the Board of Grievances for confirmation that it does not conflict with public or Saudi Arabian law. *Id.* at 168. What punitive damage award could survive this strict scrutiny?

Other nonsignatory States have the public policy exception to enforcement in their Codes of Civil Procedure. Among these are Argentina, Honduras, Paraguay, Uruguay, Iran, Iraq and Libya. *See* I. SZASZY, *supra*, at 182-83. (It may be noted some of these transact very little business lately with the United States.) In the least, a party holding an international arbitral punitive damage award must assume enforcement procedures will be complicated and problematic. The public policies behind punitive damages, especially the civil punishment of a foreign State's citizen or corporation bring the award dangerously close to national morality and justice.

American penalty. States which employ civil punishment would most likely recognize and enforce an arbitral award which civilly punishes a citizen with punitive damages. The States embracing public policies which do not recognize civil punishment will be more likely to review the merits of an award presented for enforcement and hold that the award violates public policy.²⁰⁸ Any general conflict between the enforcing State's public policy and the award, coupled with the Convention's public policy exception to enforcement, potentially arms an unsuccessful party with a valid excuse to ignore an international punitive damage award.

As noted above, exemplary (punitive) damages are well-known to British common law. In New Zealand and England, they have been awarded for false imprisonment by a government official.²⁰⁹ In New Zealand they have also been awarded for the tortious wrongs of defamation, especially with proof of malice on the part of the defamer.²¹⁰ They have also been awarded for malicious prosecution,²¹¹ conspiracy,²¹² tres-

208. Countries which find the concept of civil punishment or the purposes of punitive damages offensive may not normally punish civilly. Moreover, they would certainly reject another State's decision to civilly punish its citizens by assessing money damages against those citizens. The offended foreign State might, therefore, find a punitive damage judgment or award against public policy for one of several reasons. First, the mere fact that an action has been brought against a person or a business for fraud or some other opprobrious conduct might mar that person's reputation in the business community. Then that person is "punished" for his publicly-reported breach merely by being forced to compensate the injured party. Enforcing extra money damages would, in a sense, be redundant. Second, deterring potential wrongdoers might not be part of a country's legal system. If there are no national policies designed to deter, the punitive damage purpose of deterrence will be inapplicable to a foreign State's citizens. The award will not have the same effect on that State's citizens as it would on American citizens; in fact, the award may have no effect at all on parties outside the arbitration. Thus, an enforcing court may nullify an award because its own national policies defeat the American purposes behind punitive damages. Third, an enforcing court may simply take offense at an arbitrator's award which imposes foreign laws or policies on the enforcing State's citizens. In this situation, national sovereignty and pride in one's own laws may outweigh international cooperation, and thus emasculate punitive damage awards. An enforcing court could use these reasons or any number of others to defeat a punitive award which is contrary to the foreign State's public policies against civil punishment within its boundaries.

209. *Rookes v. Bernard*, 1964 App. Cas. 1129; see *supra* notes 62-65 and accompanying text. See also Ryan, *Civil Punishment of the Uncivil: The Nature and Scope of Exemplary Damages in New Zealand*, 5 AUCKLAND U.L. REV. 53 (1984).

210. *Broome v. Cassels, Ltd.*, 1972 App. Cas. 1027 (grave libels perpetuated deliberately and without regard to truth by book publishers).

211. *M'Comb v. Low*, [1873] 1 N.Z. Jur. 49; *Taylor v. Beere*, 1982 1 N.Z.L.R. 81 (C.A.N.Z.).

212. *Harding v. Kummer*, 1983 N.Z. Recent Law 308 (H.C.); *O'Boyle v. Liggett*, 1983 N.Z. Recent Law 117 (H.C.).

pass,²¹³ negligence,²¹⁴ breach of promise of marriage²¹⁵ and nuisance.²¹⁶ Any of these actions could arise out of a breach of contract.²¹⁷ In an action solely for breach of contract, the New Zealand courts have inconsistently decided whether punitive damages may be awarded.²¹⁸ In England, the House of Lords has disallowed them.²¹⁹ Australia's High Court and Canadian courts have also awarded punitive damages for defamation.²²⁰

Because the British legal system is familiar with civil punishment by damages in excess of compensation, it would seem that a foreign punitive damage award would be enforced in the United Kingdom. However, Professor Ronald H. Graveson, author of *Conflict of Laws*²²¹ and general editor of *Problems in Private International Law*,²²² believes otherwise. He states:

A foreign (e.g. U.S.) award of punitive damages would not be enforced in England because it would be regarded as penal, and foreign criminal law is not enforced. . . . I know of no cases dealing with the point on enforcing arbitral awards, but I think the courts would follow the same principle. Whether this is right or wrong is a different point.²²³

213. *Donselaar v. Donselaar*, 1982 N.Z. Recent Law 230 (C.A.); *Percy v. Le Heux*, Unreported, High Court Christchurch, Feb. 12, 1982. See Ryan, *supra* note 209, at 53 n.96.

214. *Furniss v. Fitchett*, 1958 N.Z.L.R. 396.

215. *A v. B*, 1974 1 N.Z.L.R. 673.

216. *Riley v. Amalgamated Brick & Pipe Co. (Wellington) Ltd.*, 1982 N.Z. Recent Law 270 (H.C.).

217. Defamation, trespass and nuisance, all intentional torts, could arise out of a contractual relation between two businesspersons. This might happen when one defames the other, where one trespasses in an unauthorized area and causes property damage, or where activity of one landowner is a nuisance to the adjoining landowner with whom he has a business contract for some related enterprise. Almost any contract could lead to malicious prosecution, if relations sour and one party brings a frivolous law suit.

Finally, a conspiracy to intimidate an oil-tanker driver who defied his union might arise out of an employee-employer contract.

218. *Furniss v. Fitchett*, 1958 N.Z.L.R. 396; *Taylor v. Beere*, 1982 1 N.Z.L.R. 81; see also 1982 N.Z. Recent Law 269 (C.A.).

219. *Addis v. Gramophone Co.*, 1909 App. Cas. 488 (manager's action for damages due to alleged wrongful dismissal from employment). See *supra* text accompanying notes 62-63 for a discussion of *Addis*.

220. *Uren v. John Fairfax & Sons, Ltd.*, 117 C.L.R. 118 (Austl. 1966); *Paragon Properties Ltd. v. Magna Invest. Ltd.*, 1972 24 D.L.R.3d 156 (S.C.R.); *McElroy v. Cowper-Smith & Woodman*, 1967 62 D.L.R.2d 65 (S.C.R.).

221. See R. GRAVESON, *CONFLICT OF LAWS: PRIVATE INTERNATIONAL LAW* (7th ed. 1974).

222. See R. GRAVESON, *PROBLEMS IN PRIVATE INTERNATIONAL LAW* (1978).

223. Letter from Professor Ronald Graveson to Karen Tolson (May 3, 1986) (copy on file at *Loyola of Los Angeles Law Review*).

If punitive damages are treated as civil punishment, then a foreign punitive award would not disrupt the domestic British system for punishment because the British courts currently punish with punitive damages. The award also would not violate any basic international notions of justice because the concept of pecuniary punishment is ancient and universal.²²⁴ However, if Professor Graveson is correct and punitive damages are viewed by some English courts as an aspect of criminal law, then such penal judgments do upset basic universal notions that only a sovereign can punish its own citizens.

Although punitive damages are penal because they are meant to punish according to public policy, they are not penal and unenforceable in the sense that they are criminal sanctions. Because punitive damages are not considered criminal punishment in the United States,²²⁵ they should not be considered so outside the United States.

Other countries preferring not to use punitive damages punish with other forms of monetary damages which exceed compensation. For example, Norway allows an injured victim damages for non-pecuniary harm regardless of whether the injury is punishable.²²⁶ Moreover, Norwegian law authorizes damages in excess of compensation as a penalty in cases of violation of sexual integrity and honor, infringement of liberty and invasion of privacy.²²⁷ Two factors go into the determination of the amount awarded: the defendant's financial situation and the gravity of the act committed.²²⁸

The USSR and Poland are signatories to the Convention.²²⁹ Socialist legal systems recognize multiple damages as punishment. In the USSR, a worker or employee who is "specially" responsible for the "loss, destruction or waste of raw materials, partially manufactured goods [or] the completed products of the business" is liable under Soviet labor law for five times the amount of loss.²³⁰ If cattle are lost, the employee is liable for three times the amount of injury.²³¹ On a collective farm, a member who wrongfully appropriates an animal must pay back one and a half times the animal's purchase price, as determined by the state.²³²

224. See *supra* text accompanying notes 1-5. Therefore, civil penalties can never violate a nation's most "basic notions of morality and justice."

225. Punitive damages are part of tort and contract law, not part of criminal law. See *supra* notes 51-53.

226. XI INTERNATIONAL ENCYCLOPEDIA OF COMPARATIVE LAW ch. 10, at 86 (1981).

227. *Id.*

228. *Id.*

229. See *supra* note 19.

230. XI INTERNATIONAL ENCYCLOPEDIA OF COMPARATIVE LAW ch. 8, at 108 (1973).

231. *Id.* See *supra* text accompanying note 1.

232. XI INTERNATIONAL ENCYCLOPEDIA OF COMPARATIVE LAW ch. 8, at 108 (1973).

Finally, a tortfeasor who damages forestry may be liable to pay ten times the amount of the loss.²³³

France has similar laws. For example, a judgment debtor who refuses to comply with the terms of his civil punishment is subject to a coercive penalty called the *astreinte*.²³⁴ The debtor must pay the creditor "a certain sum for every infraction of a prohibitory judgment or for every day of non-compliance with a judgment decreeing performance of an act."²³⁵ The French courts developed this civil penalty to aid enforcement of non-monetary judgments, although it has been used to aid execution of monetary judgments.²³⁶ As with civil penalties in Norway, the French courts determine the penalty amount after considering the gravity of the debtor's fault and the debtor's financial circumstances.²³⁷

Several other signatory States have adopted a civil penalty similar to the *astreinte*. For example, Egypt and the Swiss Canton Geneva have adopted the *astreinte*, and the Netherlands employs a punishment like the *astreinte* called the *dwangsom*.²³⁸

Private-law penalties are also allowed in the Philippines "by way of example or correction for the public good, in addition to the moral, temperate, liquidated, or compensatory damages."²³⁹ A tortfeasor may also need to pay exemplary damages if he has committed gross negligence.²⁴⁰

Conversely, one example of a signatory nation which does not recognize punitive damages is Austria. Dr. Werner Melis, for the Council for Mutual Economic Assistance, writes:

[N]o such case [involving punitive damages] has gone before an Austrian Court so far.

The legal institute of punitive damages does not exist in the Austrian legal system and arbitrators are, therefore, also not entitled to award such punitive damages.

In view of this it is difficult to predict the findings on [sic] an Austrian Court if a foreign award in which punitive damages are granted should be enforced in Austria. In my personal opinion I think that the result might to a certain degree also depend on the quantum. I could imagine that the public policy issue would not be raised if the quantum of the punitive dam-

233. *Id.*

234. *Id.*

235. *Id.*

236. *Id.* at 109 & n.913.

237. *Id.* at 111.

238. *Id.* at 111, 114.

239. *Id.* at 106 (quoting the PHILIPPINE CIV. CODE (art. 2229)).

240. *Id.*

ages would be considered as reasonable and could also be argued under other legal aspects.²⁴¹

Countries which punish civilly, such as those above, use those penalties to punish judgment debtors when they fail to comply with court awards and tortfeasors who fail to comply with "the public good." All these penalties may also deter other wrongdoers from the same conduct, because others are aware of the State's penalties. Yet deterrence is not the main objective of these penalties; punishment is. Thus, these signatory States, bound by the Convention to enforce foreign awards which do not violate the State's public policy, should not refuse enforcement of a punitive damage award which enlists civil penalties similar to the State's own laws.

V. PROPOSAL FOR A UNIFORM PUBLIC POLICY EXCEPTION

A. *The Proper Definition of Public Policy Under the Convention*

The "public policy" exception to enforcement is the Convention's most controversial clause because the varying definitions of the Article V(2) (b) language necessarily leave contracting parties in the dark as to whether their assets will be subject to or insulated from an international arbitrator's award. This Comment has illustrated that parties improperly claim the exception as a "safety valve" or a "catch-all" excuse by which they can delay or avoid compliance with an award.

The Convention's purpose is to create uniform enforcement procedures which will expedite compliance with international arbitration awards.²⁴² This objective supports the proposition that the public policy in Article V is meant solely to denote international public policy.²⁴³ Thus, a national enforcing court should heed an objecting party's protests only when they properly invoke principles of "international public policy." That is, public policy should only block enforcement when the

241. Letter from Dr. Werner Melis, Schiedsgericht der Bundeskammer der gewerblichen Wirtschaft (Council for Mutual Economic Assistance), Vienna, Austria, to Karen Tolson (Apr. 4, 1986) (copy on file at *Loyola of Los Angeles Law Review*).

242. In *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 105 S. Ct. 3346 (1985), the United States Supreme Court stated:

The utility of the Convention in promoting the process of international commercial arbitration depends upon the willingness of national courts to let go of matters they normally would think of as their own. Doubtless, Congress may specify categories of claims it wishes to reserve for decision by our own courts without contravening this Nation's obligations under the Convention. But we decline to subvert the spirit of the United States' accession to the Convention by recognizing subject-matter exceptions where Congress has not expressly directed the courts to do so.

Id. at 3360 n.21.

243. See *supra* text accompanying notes 139-41.

arbitration process or the resulting award violates critical procedural rights involving impartiality, fairness or legality.

Countries will continue to inconsistently apply the Convention's intended uniform procedures if the defenses to enforcement are not limited to these principles. Therefore, this Comment proposes three alternative methods to resolve confusion about what constitutes public policy under the Convention: (1) an amendment to the Convention; (2) a uniform test courts could apply to any Article V(2)(b) claim for nonenforcement; and (3) specific language parties could include in their international arbitration agreements.

B. Amendment to the Convention

A short statement amending the Convention would eliminate most domestic public policy defenses under Article V(2)(b), yet would leave some discretion to the enforcing national court. The amendment should read:

AMENDMENT TO THE CONVENTION ON THE RECOGNITION AND ENFORCEMENT OF FOREIGN ARBITRAL AWARDS

The term "public policy" in Article V(2)(b) of this Convention is defined as that policy which internationally ensures (1) reasonably impartial arbitrators; (2) fair procedures including proper notice and the ability to present one's case; and (3) absence of illegality in the arbitral process and award.

Three qualities will make this amendment workable and acceptable to foreign nations. First, this definition excludes a court's unwarranted search into the merits of an award during an enforcement action unless it finds a critical procedural violation. The court will necessarily have to respect the fact-finding in the arbitral process, and its review will necessarily be more cursory than substantive. Therefore, the Convention language preserves the integrity of international commercial arbitration as a substitute for adjudication.

Second, the definition mandates that the arbitrator alone make all decisions about how to apply the substantive law chosen by the parties to the situation presented. An enforcing State's court is not free to ignore or change the determination and impose its own policies in the enforcement process. This serves the arbitral goal of predictability in international dispute resolution because the substantive law of the enforcing State remains excluded from the trier of fact's determination.

Third, the definition incorporates unobjectionable, internationally-accepted principles—impartiality, fairness and legality—which are al-

ready supposed to accompany the arbitral process worldwide. The amendment's goals are universal, and do touch the enforcing State's *most* basic notions of morality and justice. Thus, an agreement to amend the Convention among the sixty or so nations which have signed the Convention should not be difficult. In fact, a majority of signatories would welcome a universal definition of public policy.

C. A Judicial Test for Article V(2)(b) "Public Policy"

The second alternative this Comment proposes is a uniform test an enforcing court could apply to any claim of an Article V public policy violation. The test incorporates the standards of the proposed amendment in a question:

Do the arbitration procedures or the terms of the arbitral award violate that public policy which internationally ensures (1) reasonably impartial arbitrator(s); (2) fair procedures including proper notice and the ability to present one's case; and (3) absence of illegality in the arbitral process and award?

Foreign courts would approve of the test for the same reasons they would agree with the language in the amendment. Additionally, since the Convention is a multilateral treaty and a misinterpretation of a multilateral treaty is a violation of international law, the International Court of Justice has jurisdiction over a case arising out of the misinterpretation.²⁴⁴ The International Court of Justice could therefore overturn any court's decision not to properly apply a uniform, generally-accepted test for treaty interpretation.

Obtaining seventy nations' agreement to ratify the proposed amendment or to apply the proposed test in every appropriate situation is admittedly no small task. However, one of the international arbitration conventions held annually under various auspices could devote serious effort to enlisting support for this proposal.²⁴⁵ The confusion about the public policy exception justifies the effort required because the Convention's success in the future depends upon uniform application of its provisions.

D. Drafting the Arbitration Agreement Language

Realistically, there may be little contracting parties can do to

244. See *supra* note 177 for a discussion of the International Court of Justice's jurisdiction.

245. For example, one convention this year, called the International Arbitration Congress, was held by the International Council for Commercial Arbitration in New York City, May 6-9, 1986. The International Bar Association, ICC and ICSID hosted a Conference in San Francisco, California on September 11-12, 1986.

change the way enforcing courts interpret and apply the Convention's current public policy exception. After an international arbitrator applies the parties' contractual choice of substantive law to a fact situation and a national court confirms the award, the only role parties play in the enforcing process is to submit the award to the enforcing court for review. Yet under universally-accepted freedom of contract principles, a contract between parties embodies the agreement by which their dispute is governed. If a court truly honors contract terms which limit an enforcing court's power to review the arbitral award, the court is bound to limit its review. To create this possible scenario, this Comment proposes that contracting parties include the following language in their arbitration agreements:

The parties to this contract agree that they shall comply with the arbitral award decided under the substantive law governing this contract. To further this goal, the parties agree that the following provisions apply in a proceeding for enforcement of the arbitral award:

(1) Neither party will claim Article V(2)(b) of the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards as a defense to enforcement unless the arbitrator's decision violates international public policy. International public policy is defined in this agreement as that public policy which internationally ensures (a) reasonably impartial arbitrator(s); (b) fair procedures including proper notice and the ability to present one's case; and (c) absence of illegality in the arbitral process and award.

(2) An enforcing court is not authorized to review the merits of an award arbitrated under this arbitration agreement. The court is only authorized to review the procedures of the arbitration to ensure the arbitration process did not violate that public policy which internationally ensures (a) reasonably impartial arbitrator(s); (b) fair procedures including proper notice and the ability to present one's case; and (c) absence of illegality in the arbitral process and award.

Although some enforcing courts could choose to ignore the parties' limits on review and, thereby, the notion of freedom of contract, other enforcing courts would respect the parties' agreement and restrict the review to the notions of fairness and legality. Thus, this language may guarantee the parties some predictability in their agreement to arbitrate. Because predictability is one of the greatest advantages to participating in

international arbitration, any contractual provisions which further that goal should be included in arbitration agreements whenever possible.

The contracting parties may also include language in their agreement which specifically states that punitive damages may be awarded against a party under the chosen substantive law. Another clause might state the parties specifically agree to comply with any punitive damage award, even if the award is considered a penalty in the foreign State where the debtor has assets. These agreements not only could help to make enforcement proceedings run more smoothly and make compliance more predictable, but the clauses would also deter parties from breaching the contract or committing tortious acts, which may lead to large punitive damage awards.

VI. CONCLUSION

This Comment has analyzed the problems inherent in enforcing an international arbitral award which includes punitive damages. Recent United States federal case law authorizes domestic arbitrators to decide punitive damage issues, and therefore, international arbitrators may decide punitive damage issues when they are claimed by a party in an international contractual dispute governed by United States law. A foreign State's court presented with a punitive damage award in an enforcement proceeding may decide the State cannot accept the American policies behind punitive damages. It may find domestic public policy limitations which defeat the award. Then the enforcing court is at liberty to frustrate enforcement by using Article V(2)(b) of the Convention. At present, Article V(2)(b) is interpreted inconsistently in the courts of different nations. These interpretations allow a court to defeat a valid arbitral award by contrasting the substantive law applied in the award with domestic, not international, public policy.

Some foreign States which are familiar with the idea of civil punishment or which rarely apply the rule rendering as void one State's penal judgment against another State's citizens may make the enforcement process somewhat easier; yet, countries with their own staid interpretations of public policy or strict policies on national sovereignty may block enforcement at all costs. Therefore, this Comment has proposed an amendment to the Convention, a uniform test for enforcing courts to apply to arbitral awards and arbitration agreement language which may limit an enforcing court's review of a valid award. All three proposals use as a basis the internationally accepted guarantees or "public policies" of impartial arbitration, fair procedures and legality in the arbitral process and

award. All three proposals intend to ensure that a party trying to avoid a punitive damage award will be unsuccessful.

This Comment urges that either the amendment to the Convention or the test for courts which apply Article V(2)(b) of the Convention be adopted at the next international arbitration convention as the standard for a successful defense to enforcement of an arbitral award including punitive damages. As the public policy exception is used now, it could defeat almost any award which conflicts with any domestic public policy of the State in which the award must be enforced. Therefore, a uniform standard for applying the public policy exception is critical to the international acceptance of arbitration as a mechanism for alternative dispute resolution.

*Karen J. Tolson**

* The author wishes to thank Catharine H. Miller for her generosity and support of her granddaughter's educational pursuits.