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PUNITIVE DAMAGES – A RISING STAR IN INTERNATIONAL COMMERCIAL ARBITRATION?

Abstract:

Punitive damages in international commercial arbitration has been considered more a theoretical than a practical issue, especially in civil law countries. Nevertheless, the national law regulations must provide a way how to react on such claims, particularly in the area of international commercial arbitration. This article is considered primarily with the analysis of the current status quo of certain civil law countries related to punitive damages since not only applicable substantive law, but also procedural law of the seat of arbitration has an impact on the availability of punitive damages in international arbitration. It also discusses legal reasons why punitive damages are of limited relevance in international commercial arbitration that consequently leads to a minimal number of arbitral awards of punitive damages. Despite of infrequency, the importance and clear approach to whether punitive damages should have a place in international commercial arbitration must be drawn.

Keywords:

Arbitral award; international commercial arbitration; punitive damages; compensatory principle; enforcement and recognition of arbitral award.

JEL Classification: K13, K33, K40

1 Introduction

The perception of availability of different kinds of remedies that the claimant can achieve in litigation depends on where he or she comes from. But is it good that someone's origin defines the possibilities of how to get the proper compensation? The dissimilarity between legal systems and national laws all over the world was the first and main issue when the international arbitration was developing. The main goal of the whole process was to provide unified rules that would lead to fair and square decision with no emphases on dissimilarity based on involved party's legal background. Although, in many areas of law this goal has been achieved many years ago, the difference has not vanished yet absolutely.

Generally speaking, the issue of punitive damages has been discussed among scholars and practitioners for decades. Not only in the scope of international commercial arbitration, but generally in law. Despite these debates, the unified outcome has not been reached yet and it probably cannot be expected in the near future. Since the world, in respect of law, is divided into different legal systems represented by distinctive approaches and principles, the conclusion cannot be drafted so easily. Although we have to start somewhere. In my opinion, the first potential and possible area of law, that could successfully achieve the unified approach to the availability of punitive damages globally, could be the international commercial arbitration.

The development of applicability of punitive damages in the arbitration disputes has long history. Examples can be found in the Code of Hammurabi, the Bible, the laws of the Babylonians, the Hittites and ancient Greeks Manu.[1]

Nevertheless, the development of a positive approach to applicability of punitive damages is linked with growth of questions and significant dissimilar opinions that are opposing this development and therefore slowing down the whole progression of integration. Despite of punitive damages being hot topic among lawyers, the controversy and uncertainty related to this institute has led to stagnation in granting the punitive damages arbitration awards on international level, especially when particular countries are involved. But what really stays behind the limited practical application of punitive damages in the framework of international commercial arbitration?

In the context of punitive damages, it is tempting to consider that arbitrators are empowered by the same jurisdictional authorities as judges to award such a relief based on the applicable substantive law on the merits of the case. However, the powers of arbitrators are nothing but limited in contrast with those of a court.

The arbitral tribunals increasingly struggle with transnational disputes involving punitive damages, because of the divergent laws involved in the proceedings. The problem is not the diversity among legal systems. No one wants to blur the unique principles that have developed for ages and have made each state unique, but rather to find a way how to understand the manner of addressing these issues in different legal systems. The starting line is to realize the role of punitive damages, its nature and importance in international arena and subsequently become more capable of finding the compromise on how to deal with raising issues related to such a relief. Exactly that is the aim of the paper.

[1] Gotanda, J., 2003 "Punitive Damages: A Comparative Analysis" *Working Paper Series*, p. 4.

Part one of this paper begins with an introduction to general understanding of punitive damages, and explanation of nature of disputes that are settled in international arbitration. In the second part, I focus on perception of punitive damages in different legal systems and national laws focusing mainly on principles that are applicable and incompatible with applicability of punitive damages. In the next part, the connection between arbitration, conflict of laws and punitive damages is drawn. In the last part of the paper, I sum up the most important preconditions of arbitrators that must be met in order to decide whether it is appropriate to consider granting punitive relief.

2 The general understanding of punitive damages

The doctrine of punitive damages comes originally from common law countries and is typically linked to the American legal system even though its beginnings are reaching to the United Kingdom.[2]

Punitive damages remedy, also called exemplary damages, is kind of a monetary remedy in the form of a civil sanction.[3] Its nature is however focused mainly on punishment and deterrence of certain manners of conduct, particularly wanton, reckless or malicious behavior. In the practice, the damages constitute a sum of money that is awarded beyond the normal, compensatory damages to a claimant. However, opponents of such a remedy claim that punitive damages constitute an extra profit for the claimant and exceed the purpose of remedies in relation to the defendant.[4]

3 The nature of disputes in international commercial arbitration

International commercial arbitration is a widely-accepted way of dispute resolution arising out of international trade contracts. Generally, the nature of arbitration is mainly private and confidential, based on party autonomy expressed in an arbitration agreement. Therefore, the arbitration proceedings are based on the parties' will to adjudicate their rights and duties by preferred private persons - arbitrators. Thus, the arbitration is generally regarded as an area reserved for the private law. The primary source of the arbitrator's mandate to draw civil consequences of a particular misconduct is determined by the parties' personal choice. Consequently, not all disputes and claims that are brought by the parties in the scope of arbitration are allowed to be resolved in such a manner.

In general, two parties from different jurisdictions conclude a contract that sums up their transaction in details. The contract can directly deal with potential disputes that can arise in connection with the transaction. The one way is to submit the disputes to arbitral proceedings. The submission is based on an arbitration agreement as mentioned above. The breach of the

[2] Meurkens, L., Nordin, E., 2012 "The power of punitive damages - is Europe missing out?" Cambridge: Intersentia, Ius commune Europaeum, p. 4.

[3] Meurkens, L., Nordin, E., 2012 "The power of punitive damages - is Europe missing out?" Cambridge: Intersentia, Ius commune Europaeum, p. 3.

[4] Werner, J., 2006 "Punitive and Exemplary Damages in International Arbitration" *Dossier of the ICC Institute of World Business Law: Evaluation of Damages in International Arbitration*, p. 102.

contract causes the raise of a dispute that is consequently referred to arbitration based on the arbitration agreement. In other words, the breach of the contract is the dispute that is submitted to arbitrators for settlement based on the arbitration agreement between the involved parties. Therefore, the nature of dispute is a breach of a contractual obligation, not a duty imposed by law. How does this explanation relate to the matter of the paper? When arbitrators are determining whether the institute of punitive damages can be granted to one of the parties, they must find the legal base in a particular law for such an action. The law must allow them to award such damages based on breach of a contract.

At the end of the proceedings the arbitrators must issue an arbitration award that is enforceable. The process of enforcement takes place in a particular country, the country in which the obliged party has its assets. However, the arbitrators do not know in advance what country it can be, so they must, based on their legal knowledge, consider the potential grounds that could be invoked by the national court for non-enforcement of the award in general. In relation to punitive damages, the usual ground for refusing enforcement is the violation of public policy.[5] As long as the legal order of the country wherein the enforcement is sought does not recognize punitive damages as remedy for the breach of a contract and moreover considers such damages against the public policy, the enforcement will not be allowed.

4 Recognition of punitive damages in national laws

If we look at all legal system of all countries over the world, we would find out that the world is from the perspective of legal principles and rules divided into two systems – civil law and common law system[6]. In relation to the availability of punitive damages, no consensus exists between these parts of the legal world. On the contrary, there is a general approach that punitive damages are not allowed to be granted in most of the civil law countries. Most of the civil law countries consider the recovery of damages as compensation to the amount that should restore the injured party to its pre-injury conditions.[7] In states such as Germany, Italy, France, Czech Republic etc., the doctrine of punitive damages is considered as incompatible with principles, mainly the principle of legality since such a relief blurs the difference between criminal and private law. Moreover, the prohibition of punitive damages awards is considered to be a matter of fundamental public policy.[8]

Despite the abovementioned facts, there are limited exceptions that suggest some changes in the rejecting approach of the civil law countries.

[5] Article V (2) (b) of the Convention on Recognition and Enforcement of Foreign Arbitral Awards (hereinafter as “the New York Convention”).

[6] For the purpose of this paper, I will divide the legal systems into these two groups. In practice, there are some countries that have mixed legal systems.

[7] Gotanda, J., 2003 “Punitive Damages: A Comparative Analysis” *Working Paper Series*, p. 5.

[8] Gómez Tomillo, M., 2012 “Punitive Damages: A European Criminal Law Approach. State Sanctions and the System of Guarantees” *European Journal on Criminal Policy and Research*, Vol. 19, p. 216.

On the contrary, the availability of punitive damages in general are recognized in the common law countries, mostly in the United Kingdom and the United States[9]. Logically, the circumstances in which the damages may be applied, and the degree of availability differs even within the common law system. Despite the fact that it is a controversial institution in the civil law countries, its validity is not questioned in the US. In connection with the breach of a contract, the damages can be awarded only in the United States since the damages serve a public policy function.[10] That is the reason why the United States are generally considered as a "homeland" of this institute.[11]

Such a difference in the understanding between the two law systems causes reasonable concern in the context of the international commercial arbitration, even in international arbitration taking place on the territory of the United States.

4.1 The birth of applicability of punitive damages in international commercial arbitration

Despite the fact that the doctrine of punitive damages was first developed in the United Kingdom, the application of such a relief has been limited in the country since then. The closest national legal system – the one of the United States – nevertheless endorsed the practice of applicability of the institute where such a relief is governed by both state and federal law.[12]

The role of punitive damages in the United States and other common law countries is, on one hand, to punish and deter the defendant and on the other, compensate the claimant.[13] The deterrence and punishment of the defendant are the primary purposes of the availability of punitive damages even though the nature of damages in general, and as considered in the civil law countries, is to compensate. The main argument against the punitive damages in the civil law system is therefore that this institute is incompatible with the basic distinction between private and public, criminal law. It is the domain of criminal law to punish the wrongdoer, not of the private law.[14]

Although the United States are considered as the "homeland" of punitive damages, in the area of international commercial arbitration the reality wasn't always like that. The approach of domestic arbitrators and judges wasn't very punitive damages-friendly. It has started to change in the middle of the 20th century. In fact, the possibility to grant punitive damages in arbitration was not allowed since these sanctions were in breach of public policy. Even today, opinions that such

[9] In the United States the availability and applicability of punitive damages is generally recognized in almost all states. The exceptions are Louisiana, Massachusetts, Nebraska, New Hampshire and Washington.

[10] Fei Jia, J., 2003 "Awards of Punitive Damages" *Jones Day, Stockholm Arbitration Report 2*, p. 19-20.

[11] Gómez Tomillo, M., 2012 "Punitive Damages: A European Criminal Law Approach. State Sanctions and the System of Guarantees" *European Journal on Criminal Policy and Research*, Vol. 19, pp. 216-217.

[12] Fei Jia, J., 2003 "Awards of Punitive Damages" *Jones Day, Stockholm Arbitration Report 2*, p. 20.

[13] WIlkes v Wood: CCP 6 DEC 1763. Available at: http://press-pubs.uchicago.edu/founders/documents/amendIVs4.html

[14]Petsche A., M., 2013 "Punitive Damages in International Commercial Arbitration: Much Ado about Nothing?" Arbitration International, Vol. 23 (1), pp. 97-98.

sanctions are considered as monopoly of a state and therefore reserved mainly for state courts maintain.

Although the practice of American courts confirms that punitive damages have long been recoverable when the defendant is found guilty of malicious, fraudulent, willful, reckless or wanton conduct, only in the 1990s the courts gave held that the punitive damages are available even in the cases of breach of a contractual obligation when one party commits a tort. Hence, in the arbitration taking place in the United States the party who commits one of the torts may be *"subject to punitive damages whether an action is brought against him under tort or contract law."*[15]

The arbitrators in the United States have always been sceptic about awarding such a relief. As confirmed in *Garrity v Lyle Stuart, Inc.* case "*Punitive damages is a sanction reserved to the State, a public policy of such magnitude as to call for judicial intrusion to prevent its contravention. Since enforcement of an award of punitive damages as a purely private remedy would violate strong public policy, an arbitrator's award which imposes punitive damages should be vacated."*[16]

Nevertheless, the possibility to apply the punitive damages in the commercial arbitration taking place in the United States was confirmed 20 years ago. The breakthrough decision, that confirmed the importance and appropriateness of punitive relief in arbitration, was the final decision of the Supreme Court in *Mastrobuono* case. The Supreme Court declared the power of arbitral tribunal to grant punitive damages.[17]

Basically, if the arbitration does not include an international element and takes place within the United States, the arbitrators have the power to award the punitive damages as a punishment and compensation for the breach of a contract as long as the contract itself or the arbitration rules do not bear a contrary provision.[18]

Despite the regular punitive damages' awards, the opinions of the international arbitrators in the United States "*differ about whether punitive damage awards could be enforced in their jurisdictions."*[19]

4.2 The traditional approach among civil law countries

As opposed to the approach of common law countries and especially the United States, the attitude on the other part of the world is more restrictive. This is mainly because, the tort law and

[15] Tolson J., K., 1987 "Punitive Damage Awards in International Arbitration: Does the Safety Valve of Public Policy Render Them Unenforceable in Foreign States" *Loyola of Los Angeles Law Review,* Vol. 20 (2), pp. 467-468.

[16] *Garrity v Lyle Stuart, Inc,* Court of Appeals of New York, July 6, 1976. Available at: https://h2o.law.harvard.edu/cases/2403

[17] ANTONIO MASTROBUONO and DIANA G. MASTROBUONO, PETITIONERS v SHEARSON LEHMAN HUTTON, INC., et al., Supreme Court of United States, March 6, 1995. Available at: https://www.law.cornell.edu/supct/html/94-18.ZO.html

[18] Fei Jia, J., 2003 "Awards of Punitive Damages" *Jones Day, Stockholm Arbitration Report 2*, p. 24.

[19] Tolson J., K., 1987 "Punitive Damage Awards in International Arbitration: Does the Safety Valve of Public Policy Render Them Unenforceable in Foreign States" *Loyola of Los Angeles Law Review,* Vol. 20 (2), p. 459.

the system of damages in these countries is based on different principles. The first and the most important principle is to compensate the claimant in the way that he or she will restore into same conditions as the circumstances before loss. Punishment and deterrence are the domain of criminal law that is strictly separated from the civil and private law. This approach is moreover confirmed by the Principles of European Tort Law in its Article 10:101 that reads as follows: *"Damages are a money payment to compensate the victim, that is to say, to restore him, so far as money can, to the position he would have been in if the wrong complained of had not been committed. Damages also serve the aim of preventing harm."*[20]

Many nations in civil law system are influenced by the abovementioned principles and therefore do not allow in the transnational disputes any derogations from the rule. For example, the decision of the German Federal Court of Justice of the 4th June 1992 concluded that it is the primary role of the criminal court to impose punishment on a wrongdoer and therefore the judgement awarding punitive damages is contrary to the German public policy. As the court stated further, non-compensatory damage awards are incompatible with the constitutional principles of proportionality and illegitimately concatenate private and criminal law.[21]

This view was followed by other countries as well. In Italy, the Court of Appeal held that punitive damages are inconsistent with the fundamental principles of the Italian legal order.[22]

Countries from the civil law system consider punitive damages as a form of punishment that is only allowed under criminal law, since only criminal law provides proper guarantees against the abuse of law.

However, the approaches among civil law countries are moving to the more pro-international way. The influence of transnational movement of trade and related international disputes require to adapt and adjust the conservative attitudes towards more flexible and inter-national legal environment.

The first country that showed the new attitude was France. As contrary to supreme courts of other civil law countries, the French Court of Appeal held that *"the principle of awarding punitive damages is not, in itself, contrary to public policy; this is not the case when the amount awarded is disproportional to the loss suffered and to the contractual breach of the debtor (...)".*[23] The United States decisions awarding punitive damages can therefore in principle be enforced in France since they are not considered a breach of French public policy as in other civil law countries.

[20] Article 10:101 Principles of European Tort Law. Available at: http://civil.udg.edu/php/biblioteca/items/283/PETL.pdf

[21] Sztefek, M., 2017 "Punitive Damages - Experience from Common Law: One Piece of the Puzzle in Continental Law Still Missing" *Common L. Rev.*, Vol. 13, p. 15.

[22] Sztefek, M., 2017 "Punitive Damages - Experience from Common Law: One Piece of the Puzzle in Continental Law Still Missing" *Common L. Rev.*, Vol. 13, p. 15.

[23] Vanleenhove, C., 2015 "The Use of Public Policy in the Enforcement of American Punitive Damages in the European Union", In Bruyne, J., de Potter de ten Broesck, M., Van Hiel, I. (eds.), 2015 "Policy within and through law" *Maklu-Pubishers*: the Netherlands, p. 214.

The same turning point can be perceived from the recent development in the Czech case law. The punitive damages itself are not automatically considered as against the public policy. There are some conditions that must be taken into consideration when dealing with such an award: (i) their primary role is to compensate the claimant, and (ii) the amount of damages in proportionate to the actual harm to be compensated.[24]

The national courts' perception on the availability of punitive damages has finally started to change. However, the expectations should not be too high. There are many obstacles that must be considered by the national judges in order to fulfill their obligations towards national legal order and parties' expectancies.

5 The conflict of laws in international commercial arbitration and its impact on punitive damages

The issue of punitive damages in the course of international commercial arbitration has given rise to three main issues - considering the availability of punitive damages in international commercial arbitration, the arbitrators' powers to grant punitive damages during proceedings and mainly the possibility of enforcement of an arbitration award granting punitive damages in third countries, especially in civil law countries.

Undeniably, there are many conditions that must be met before the arbitrators can deal with such disputes and grant punitive damages to the claimant.

Firstly, the case law study shows that a legal base for granting punitive damages must exist in order for the arbitrators to decide whether the claimant has the right to acquire such a relief. Punitive damages, as mentioned earlier, are categorized as claims in area of tort law. Hence, the pending dispute must be based on a civil wrong that causes the claimant a loss or harm as a consequence of a breach of an obligation imposed by law. Since the arbitration is based on a dispute concerning the breach of a contract, this breach must be therefore categorized as a tort as well. The claimant must prove that he or she suffered foreseeable loss or harm as a direct result of the breach of obligation.

Secondly, the parties must expressly provide in their arbitration agreement that if one of the parties breaches the contract, the other one has the right to claim punitive damages.[25] Even the United States courts' practice confirms such findings. In the *Cunard Lines* case the Supreme Court held that although the parties chose as substantive law the law that does not provide for punitive damages, the arbitrators have the power to do so since the parties granted the power to the arbitrators through the arbitration agreement.[26]

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[24] Judgement of the Supreme Court of the Czech Republic of the 22nd of August 2014, Ref. No. 30 Cdo 3157/2013. Availabe at: http://nsoud.cz/Judikatura/judikatura_ns.nsf/WebSearch/1695B2F8C389F407C1257D55004ADBF6?openDocument&Highlight=0,

[25] Gonzales, F., 2006 "The Treatment of Tort in ICC Arbitral Awards" *ICC International Court of Arbitration Bulletin,* Vol. 13 (2), point 56.

[26] Rubino-Sammartano, M., 2010, "International Arbitration: Law and Practice 2. rev. ed." *The Hague: Kluwer Law International*, p. 187.

Thirdly, the law applicable to the merits of the case, or so-called applicable substantive law, must recognize the existence and availability of punitive damages within the scope of its legal rules.

Generally, most of private international laws of states consider the applicable substantive law on substantive matters of the legal relation between the parties – *lex contractus* – as the law that governs the matters related to damages. In arbitration *lex contractus* is the law applicable to the rights and duties of the parties. The possibility of the existence of punitive damages and its granting is based on a breach of the main contract. Therefore, it is important to examine the question whether the particular *lex contractus* allows the arbitrators to award punitive damages.[27]

Usually, the parties determine the applicable law on substantive matters of their transaction, and consequently to their dispute, in the main contract. Unfortunately, this is the obstacle that is sometimes impossible to overcome. As aforementioned, many legal orders, particularly in the civil law system, do not recognize the existence of punitive damages. Therefore, the parties must carefully choose the applicable law on their rights and duties in order to avoid the refusal of such a claim as punitive damages, based on the unavailability under chosen legal rules. However, the parties may not think about the issue when concluding the main contract, since they do not count with any potential disputes that may arise.

Beside the applicable substantive law, the arbitral tribunal that is constituted due to the arbitration agreement must apply procedural rules in order to conduct the arbitration. The procedural law is the law of the seat of arbitration – *lex arbitri* – and cover the procedural aspects of arbitration and rights and duties of arbitrators. Furthermore, the application of *lex arbitri*, the parties have the right to choose arbitration rules of arbitration courts such as International Chamber of Commerce International Court of Arbitration, or London Court of International Arbitration to cover the procedural aspects of arbitration, or they can base the arbitration on UNCITRAL Arbitration Rules.[28]

Procedural laws deal mainly with general questions, lay down the main legal framework for arbitrators to commence the proceedings since the arbitration is based on party autonomy and arbitration discretion. However, this does not mean that the parties or arbitrators can freely choose to grant punitive damages. Since it intervenes with the obliged party's rights the grant must be based on law that allows such a relief.

Arbitrators generally, unlike judges, do not have the broad power to order any criminal or civil penalties in private matters. Moreover, they cannot wide their powers because they risk acting beyond the scope entrusted to them by the parties.[29] The only source of the arbitrators' power to award punitive damages can be *lex arbitri* or arbitration rules.

In the scope of civil law countries, the punitive damages are, as mentioned above, unknown, whether in breach of a contractual obligation or duty imposed by law. Furthermore, some

[27] Petsche A., M., 2013 "Punitive Damages in International Commercial Arbitration: Much Ado about Nothing?" *Arbitration International*, Vol. 23 (1), p. 92.

[28] Petsche A., M., 2013 "Punitive Damages in International Commercial Arbitration: Much Ado about Nothing?" *Arbitration International*, Vol. 23 (1), p. 93.

[29] Gonzales, F., 2006 "The Treatment of Tort in ICC Arbitral Awards" *ICC International Court of Arbitration Bulletin,* Vol. 13 (2), point 56.

legislators took the initiative into their own hands and expressly prohibited the arbitrators' power to award any criminal penalties or fines on the parties of the arbitration.[30]

To sum up, arbitrators in order to decide whether punitive damages may be awarded must examine the substantive law that regulates the availability of such damages and procedural law that provides the arbitrators with the power to award it.

However, the relevance of substantive law of the seat or arbitration is also essential. Since the parties have their autonomy upon what law will govern their rights and duties, and the seat of arbitration, they do not have the power to avoid the potential application of the substantive law of the seat of arbitration.

Basically, the substantive law of the seat of arbitration is important to consider mainly because it can influence the faith of the award. However, it is relevant in connection with the availability of punitive damages, because of the law does not determine the availability as such, it may have an impact on the arbitrators' decision. The public policy of the seat that constitutes a part of its substantive law can contravene the validity of the arbitration award that can be consequently annulled by the courts of the seat of arbitration.

5.1 The risk of unenforceability of an arbitration award

Another important issues arise when arbitrators are issuing the final and binding arbitration award – is there a risk that award granting punitive damages may be challenged at stage of recognition and enforcement? Can the enforceability of an award be considered as "an elephant in the living room" as reasonably stated Noussia in here article?[31]

As mentioned above, civil law countries are, from the perspective of availability of punitive damages, not very optimistic. That would not be a problem, if the arbitration award issued in a country allowing punitive damages remedy would not have to be recognized and enforced in a country that does not. However, this is not the case. Each state has a sovereignty over its territory and laws and therefore can decide what is allowed under its legal framework. Furthermore, the national courts have the tendency to sympathize with their own nationals, so when it comes to the recognition and enforcement of a foreign award that grant rights beyond the domestic legal framework, they will always find an excuse how to protect them.[32]

Nevertheless, the courts of a country in which the enforcement of an arbitration award granting punitive damages is sought have a difficult issue to resolve. However, there are some "guidance" that will help them. Firstly, the enforcement of an arbitration award is more accessible than foreign court judgements, thanks to the New York Convention. The New York Convention stipulates that awards issued in the signatory countries are in general enforceable in all other

[30] Werner, J., 2006 "Punitive and Exemplary Damages in International Arbitration" *Dossier of the ICC Institute of World Business Law: Evaluation of Damages in International Arbitration*, p. 104.

[31] Noussia, K., 2010 "Punitive Damages in Arbitration: Panacea or Curse?", *Journal of International Arbitration*, 2010, Vol. 27(3), p. 286.

[32] Fei Jia, J., 2003 "Awards of Punitive Damages" *Jones Day, Stockholm Arbitration Report 2*, pp. 27-28.

signatory states, subject only to a narrow list of limits. Unless the court does not find the ground for non-enforcement of the award, the award gets the go-ahead.[33]

In relation to the institute of punitive damages and the approach of some countries, mainly from the civil law system, the Article V (2) (b) of the New York Convention is the major obstacle - the main ground based on which the enforcement of a punitive damages award could be refused. The article reads as follows: *"Recognition and enforcement of an arbitration award may also be refused if the competent authority in the country where recognition and enforcement is sought finds that: (b) The recognition or enforcement of the award would be contrary to the public policy of that country."*[34] The discussions whether the New York Convention' s wording of public policy refers to domestic or international public policy of a particular state have been in progress since the Convention came into effect. So long as the New York Convention regulates the international foreign arbitration awards, the outcome of the debates should be the latter mentioned. However, since the wording is not precise, each signatory state adapts and interprets the Convention as it suits it their interests.

The fact is, that the domestic public policy focuses more on the national principles, policies and laws that are so valuable for the state that cannot be disrupted under any circumstance. On the contrary, the international public policy, forming the part of domestic public policy, should be interpreted narrowly, encompassing only the very basic notions of those principles of morality and fairness, that includes category of slavery, discrimination, murder, piracy and economic crimes and alike, accepted by civilized nations over the world.[35]

If the civil law countries would interpret the public policy in this way, there would not be a problem with recognition and enforcement of the punitive damages award since it would be against the mandatory laws of the particular state, but it would not be contrary to globally accepted principles of procedural due process, morality and fairness.[36]

Unfortunately, the inconsistent interpretations of public policy are testing the validity of the punitive damages awards, depending on which country in a particular case is deciding whether or not to recognize and enforce the award. Since some countries recognize civil punishment, but not in the form of punitive damages, it is unlikely that the enforcement of such an award will be consistent with the domestic public policy of most of the civil law countries. Consequently, the risk that the arbitration award is not enforced in the country where the defendant has its assets and

[33] Werner, J., 2006 "Punitive and Exemplary Damages in International Arbitration" *Dossier of the ICC Institute of World Business Law: Evaluation of Damages in International Arbitration*, p. 105.

[34] Article V (2) (b) of the New York Convention.

[35] Werner, J., 2006 "Punitive and Exemplary Damages in International Arbitration" *Dossier of the ICC Institute of World Business Law: Evaluation of Damages in International Arbitration*, p. 106.

[36] Werner, J., 2006 "Punitive and Exemplary Damages in International Arbitration" *Dossier of the ICC Institute of World Business Law: Evaluation of Damages in International Arbitration*, p. 106.

the claimant may not receive any punitive damages despite the fact that they are under the applicable substantive law allowed, is quite high.[37]

Even the opinions of arbitrators themselves are not consistent in this case. Some believe that the New York Convention and the international society strongly support enforcement of an arbitration award that is compatible with the international public policy as explained earlier. Others believe that even court judgements punishing a wrongdoer are not able of an enforcement in a foreign country and since the punitive damages reflect the same purpose, they should be rendered invalid.[38]

5.2 The importance of an arbitration agreement

The parties have powers they are not aware of. They are the ones who are deciding about the applicable law, procedural law, arbitration rules and finally, powers of the arbitrators. Through the arbitration agreement the parties can even decide about the possibility of awarding punitive damages. Since the main contract and arbitration agreement are mostly concluded before any troubles and disputes arise, there is bigger chance to include clauses that could lately serve as potential tools for winning the dispute.

Regarding the above mentioned, the parties can include or exclude the arbitrators' power to grant punitive damages by an express clause in the arbitration agreement. Moreover, by choosing the applicable substantive law that allows them to claim punitive remedy in the arbitration proceedings and locate the seat of arbitration into legal system that does not prohibit the power of arbitrators to grant such a remedy, the parties can decide the direction of the whole decision-making process and ensure that they will achieve their goals.

Unfortunately, it is not an easy path. Parties must pay caution when drafting the agreement so their intention of awarding the authority to the arbitrators is expressly stated.[39]

On the other hand, the arbitrators must examine whether the parties based on the agreement intended to give them the power to award punitive damages and subsequently, whether the law chosen by the parties allowed them to act that way.

6 Should the arbitrators award punitive damages?

Unfortunately, the issue of punitive damages is not on a rise in the course of transnational arbitration proceedings. However, the practice of courts and arbitral tribunal has shown the progress and tendency in the way that could, one day, lead to the availability of such a relief in relation to international arbitration in civil law countries and, maybe, to the unified approach among decision makers.

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[37] Tolson J., K., 1987 "Punitive Damage Awards in International Arbitration: Does the Safety Valve of Public Policy Render Them Unenforceable in Foreign States" *Loyola of Los Angeles Law Review,* Vol. 20 (2), pp. 461- 462.

[38] Fei Jia, J., 2003 "Awards of Punitive Damages" *Jones Day, Stockholm Arbitration Report 2*, pp. 31-32.

[39] Noussia, K., 2010 "Punitive Damages in Arbitration: Panacea or Curse?", *Journal of International Arbitration*, Vol. 27(3), p. 296.

Yet, there are some concerns that may be important to bring an attention to. It is generally suggested that certain preconditions must be met during the arbitration proceedings in order to ensure fair punitive damages award. The compliance with the conditions would serve as a safeguard not only for the defendant, but courts as well.

Firstly, as long as many jurisdictions do not accept the remedy in the form of punitive damages for breach of contract, but only for a tort, it should be established that the behavior of the defendant and the breach of a contract must be categorized as grossly negligent, willfully malicious, criminally indifferent or in reckless disregard for the rights of the claimant.[40]

Second of all, in the scope of international law, the justification for punitive damages should be limited to the proof of existence of special circumstances that allow to grant punitive remedy since the compensation is not sufficient in comparison to the claimant's loss and the defendant's reckless behavior.

Finally, the boundaries of the maximum sum of punitive damages must be established in order to ensure that the award will not be excessive with regard to the circumstances of the case.

7 Conclusion

The focus of this paper was to analyze the current perspective of availability of punitive damages in the international commercial arbitration. The main goal was to study the dissimilar concepts of understanding and interpreting the doctrine of punitive damages that are represented by two groups of countries – civil law and common law. Since I studied the punitive damages in respect of its availability in international commercial arbitration, I pointed about the most debatable issues, in particular the conflict of laws and the risk of unenforceability of award granting punitive damages.

The arbitrators should treat claims of punitive damages carefully and with considerable caution. They must consider whether such a remedy is available under applicable law of the merits – *lex cotractus*, the legal base for awarding the remedy exist in the procedural law – *lex arbitri*, or arbitration rules, and finally, they should also address themselves the question of potential grounds of refusal of an enforcement of an arbitration award. Their duty is to issue an enforceable award and if the punitive damages are likely to be the cause of refusal of recognition and enforcement, they should rather abstain from granting such a remedy.

On one side, the undeniable existence of the dichotomy in international arena with regard to the availability of punitive damages, with the United States on the one side, and the rest of the world on the other, makes things more complicated. But even the international arbitrators cannot find consensus whether the award of punitive damages could be enforced in their own jurisdiction. As was mention above, some of them think that the drafters of the New York Convention meant to support the enforcement of a foreign awards despite of the inadmissibility of such a remedy under domestic legal policies. Then others considering the nature of punitive damages as penalization and deterrence that such decisions, including judgements, are generally unenforceable in a foreign state.

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