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CURRENT DEVELOPMENTS IN ARBITRATION: ARBITRABILITY AND PUNITIVE DAMAGES

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I. ARBITRABILITY

A. *Introduction*

The authority of arbitrators to determine their own jurisdiction has traditionally been the topic of vigorous debate and conflicting opinion.[1] Arbitrability has also been the subject of a recent pronouncement of the Illinois Supreme Court.[2] Specifically, the issue of arbitrability arises when a litigant contests whether a dispute falls within the terms of an arbitration agreement and is, therefore, subject to arbitration. Generally, this party will seek a stay of the arbitration proceedings until the issue of arbitrability is determined.[3]

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1. *Compare* School Dist. No. 46 v. Del Bianco, 68 Ill. App. 2d 145, 215 N.E.2d 25 (1966) (prior agreement to arbitrate resulting in court order to arbitrate) *with* Roosevelt Univ. v. Mayfair Constr. Co., 28 Ill. App. 3d 1045, 331 N.E.2d 835 (1975) (distinguishing between arbitrable and non-arbitrable claims).

2. *See* Donaldson, Lufkin & Jenrette Futures, Inc. v. Barr, 124 Ill. 2d 435, 530 N.E.2d 439 (1988).

3. The statutory authority for this action is contained in the Uniform Arbitration Act §2, 7 U.L.A. 68-69 (1985).

> (a) On application of a party showing an agreement described in Section 1, and the opposing party's refusal to arbitrate, the Court shall order the parties to proceed with arbitration, but if the opposing party denies the existence of the agreement to arbitrate, the Court shall proceed summarily to the determination of the issue so raised and shall order arbitration if found for the moving party, otherwise, the application shall be denied.
>
> (b) On application, the court may stay an arbitration proceeding commenced or threatened on a showing that there is no agreement to arbitrate. Such an issue, when in substantial and bona fide dispute shall be forthwith and summarily tried and the stay ordered if found for the moving party. If found for the opposing party, the court shall order the parties to proceed to arbitration.

It is settled that when the dispute is plainly arbitrable or non-arbitrable, the court can and should compel — or stay — arbitration. Moreover, it is equally settled that the *ultimate* determination of arbitrability is within the province of the judiciary upon review of the arbitration award.[4] However, in those situations where it is unclear whether a dispute is subject to arbitration or not, who should make the *initial* determination - the court or the arbitrator?

B. Relevant Statutory Provisions

Both the Uniform and Federal Arbitration Acts, and their state counterparts, include provisions for the stay of arbitration on the basis that the subject matter of the arbitration is not within the contemplation of the arbitration agreement.[5] Illinois and twenty-five other states have adopted, with some modifications, the Uniform Arbitration Act.

The Illinois Arbitration Act parallels the Uniform Arbitration Act, with only minor variations.[6] The Federal Arbitration Act also provides for the resolution of the arbitrability issue.[7] These state

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(c) If an issue referable to arbitration under the alleged agreement is involved in an action or proceeding pending in a court having jurisdiction to hear applications under subdivision (a) of this Section, the application shall be made therein. Otherwise and subject to Section 18, the application may be made in any court of competent jurisdiction.
(d) Any action or proceeding involving an issue subject to arbitration shall be stayed if an order for arbitration or an application therefor has been made under this section or, if the issue is severable, the stay may be with respect thereto only. When the application is made in such action or proceeding, the order for arbitration shall include such stay.

4. *See, e.g.*, Unif. Arbitration Act § 12(a)(5), 7 U.L.A. (1985).

5. The pertinent provisions of the Unif. Arbitration Act, § 2 (a) and (b), are set forth in *supra* note 3.

6. Section 102 of the Illinois Arbitration Act provides in pertinent part:
c. On application of a party showing an agreement described in Section 1, and the opposing party's refusal to arbitrate, the court shall order the parties to proceed with arbitration, but if the opposing party denies the existence of the agreement to arbitrate, the court shall proceed summarily to the determination of the issue so raised and shall order arbitration if found for the moving party, otherwise, the application shall be denied.
d. On application, the court may stay an arbitration proceeding commenced or threatened on a showing that there is no agreement to arbitrate. That issue, when in substantial and bona fide dispute, shall be forthwith and summarily tried and the stay ordered if found for the moving party. If found for the opposing party, the court shall order the parties to proceed to arbitration.
ILL. REV. STAT. ch. 10, ¶¶ 101-123 (1985).

7. Section 4 of the Federal Arbitration Act provides in pertinent part:
A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any United States district court which, save for such agreement, would have jurisdiction under Title 28, in a civil action or in admiralty of the subject matter of a suit arising out of the controversy between the parties, for an order directing that such arbitration proceed in the manner provided for in such agreement . . . the parties, and upon being satisfied that the making of the agreement for arbitra-

and federal statutes all provide a mechanism for the resolution of the arbitrability issue. The Uniform and Illinois Arbitration Acts, however, do not specifically identify the proper forum for the resolution of the issue in the event of an *ambiguous* arbitration agreement.

C. *Judicial Treatment of the Arbitrability Issue*

1. *Recent State Court Decisions*

In applying the relevant statutory provisions on the issue of arbitrability, the judiciary of various state jurisdictions have reached differing results. Indeed, some courts within the same jurisdiction have disagreed as to the appropriate result.

For example, in *Donaldson, Lufkin & Jenrette Futures, Inc., v. Barr*,[8] the Illinois Supreme Court recently resolved a split that had existed within the Illinois Appellate Court. In *Barr*, the plaintiff, Donaldson, Luftkin & Jenrette Futures, Inc., a commodities futures broker associated with the Chicago Board of Trade, hired the defendant Edwin Barr as senior vice-president of the company. As compensation, Barr was to receive, in addition to a membership in the Chicago Board of Trade, a straight salary, a top and bottom-line percentage of a maximum of 5% of the gross generated from any new business for the first year, and more importantly, 15% of the bottom-line profit of the Chicago office activities.

Sometime after Barr ceased his employment with Donaldson, Barr's attorney sent a demand letter to Donaldson. The letter requested over $400,000 of unpaid compensation, which apparently represented 15% of the operating income generated from Barr's Chicago office during his employment at Donaldson.

After Donaldson failed to comply with Barr's demand, Barr sought arbitration before the Chicago Board of Trade, pursuant to

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> tion or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement. . . . If the making of the arbitration agreement or the failure, neglect, or refusal to perform the same be in issue, the court shall proceed summarily to the trial thereof. . . . If the jury finds that an agreement for arbitration was made in writing and that there is a default in proceeding thereunder, the court shall make an order summarily directing the parties to proceed with the arbitration in accordance with the terms thereof.

9 U.S.C. § 1 et seq.

8. 124 Ill. 2d 435, 530 N.E.2d 439 (1988). The Illinois Appellate Court decision was quickly cited with approval in three cases: Landmark Properties, Inc. v. Architects Int'l-Chicago, 172 Ill. App. 3d 379, 526 N.E.2d 603 (1988); Geldermann Inc. v. Mullins, 171 Ill. App. 3d 255, 524 N.E.2d 1212 (1988); Warren Tp. High School Dist. No. 121 v. Local 504, Federation of Teachers, 162 Ill. App. 3d 676, 515 N.E.2d 1331 (1987).

Board Rule 600.00. This rule mandates arbitration of any dispute between members "which arises out of the Exchange business of such parties." In response, however, Donaldson contended that Barr's dispute as to compensation did not fall within Chicago Board of Trade business and, therefore, was not within the ambit of the Chicago Board of Trade rule. Accordingly, Donaldson filed an application for a stay of the arbitration proceeding[9] in the Circuit Court of Cook County, on the grounds that he had not agreed to arbitrate Barr's compensation claims.

In denying the application for stay, the trial court determined that in cases arising under the Uniform Arbitration Act "if it is unclear whether [a claim] is arbitrable, the matter would be directed to arbitration to allow the arbitrator to determine his own jurisdiction."[10] On appeal, however, the majority of the appellate court adopted what it deemed to be the predominant approach in favor of the trial court deciding the issue of arbitrability, and it remanded the action to the trial court for a determination of whether the trial court had jurisdiction to decide the claim. In contrast, the dissent by Justice Jiganti resolved the arbitrability determination in favor of the arbitrator. This conclusion was based upon the provisions of the Uniform Arbitration Act itself and the public policy considerations that underlie arbitration.

The Illinois Supreme Court reversed the appellate court and concluded that the initial determination of arbitrability must lie with the arbitrator.[11] This conclusion was contrary to a number of Illinois decisions ruling in favor of the judicial resolution of the arbitrability issues.[12] However, the Supreme Court's ruling was consistent with several prior Illinois decisions to the effect that the arbitrator, rather than the trial court, should decide the question of arbitrability in the first instance.[13]

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9. ILL. REV. STAT. ch. 10, ¶ 102(b) (1985) is the statutory provision followed.

10. 124 Ill. 2d 435, 440, 530 N.E.2d 439, 441.

11. *Id.* at 447-48, 530 N.E.2d at 445.

12. *See, e.g.*, J & K Cement Constr. Inc. v. Montalbano Builders, Inc., 119 Ill. App. 3d 524, 456 N.E.2d 889 (1983) ("whether a dispute is within the scope of an arbitration clause 'should be determined at the earliest possible moment and should be controlled by judicial guidelines' ") *citing* Farris v. Hedgepeth, 58 Ill. App. 3d 1040, 1043, 374 N.E.2d 1086, 1088 (1978) (*quoting* Harrison F. Blades, Inc. v. Jarman Memorial Hosp. Bldg. Fund, Inc., 109 Ill. App. 2d 224, 229, 248 N.E.2d 289, 291 (1969)); Kelso-Burnett Co. v. Zeus Dev. Corp., 107 Ill. App. 3d 34, 40, 437 N.E.2d 26, 30 (1982); Iser Elec. Co., Inc v. Fossier Builders, Ltd., 84 Ill. App. 3d 161, 164, 405 N.E.2d 439, 441 (1980) (the scope of an arbitration clause should be controlled by judicial guidelines); Paschen Contractors, Inc. v. John J. Calnan Co., 13 Ill. App. 3d 485, 489, 300 N.E.2d 795, 798 (1973).

13. *See, e.g.*, Butler Products Co. v. Unistrut Corp., 367 F.2d 733 (7th Cir. 1966) (applying Illinois law); Village of Westville v. Loitz Bros. Constr. Co., Inc., 165 Ill. App. 3d 338, 519 N.E.2d 37 (1988); Ozdeger v. Altay, 66 Ill. App. 3d 629, 384 N.E.2d 82 (1978) (where the scope of the arbitration clause is in doubt, the issue should be

The *Barr* decision does not stand alone among recent rulings by other state courts, many of which have supported the same result. In *Gold Coast Mall, Inc. v. Larmar Corp.*,[14] for example, a case involving a petition to compel arbitration of a percentage rental dispute arising under a lease agreement containing an arbitration clause, the Maryland Supreme Court held that:

> [W]hen the language of an arbitration clause is unclear as to whether the subject matter of the dispute falls within the scope of the arbitration agreement, the legislative policy in favor of the enforcement of agreements to arbitrate dictates that ordinarily the question of substantive arbitrability initially should be left to the decision of the arbitrator.[15]

In the earlier Maryland case of *Bel Pre Medical Center, Inc. v. Frederick Contractors, Inc.*,[16] the Maryland Appellate Court explained:

> A problem is created for the court when the language of the arbitration provision is unclear as to whether the subject matter of the dispute falls within the scope of the arbitration agreement. In such circumstances the legislative policy in favor of the enforcement of agreements to arbitrate dictates that the question should be left to the decision of the arbitrator. Whether the party seeking arbitration is right or wrong is a question of contract application and interpretation for the arbitrator, not the court, . . . and the court should not deprive the party seeking arbitration of the arbitrator's skilled judgment by attempting to resolve the ambiguity. Under such circumstances arbitration should be compelled.[17]

In *Layne-Minnesota Co. v. Regents of University of Minnesota*,[18] the Supreme Court of Minnesota ordered the parties to proceed with arbitration. The Court concluded that since the intention of the parties to arbitrate the issues was "reasonably debatable," arbitrability of the issues should be initially determined by the arbitrator, subject to ultimate review by the court. The Court stated:

> Upon application to compel arbitration pursuant to the provisions of the Uniform Arbitration Act (Minn. St. c. 572), where the intention of

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resolved in the first instance by the arbitrators); *Roosevelt Univ.*, 28 Ill. App. 3d at 1051, 331 N.E.2d at 841-42 (if there is a reasonable doubt as to whether the subject matter is within the scope of the arbitration agreement, then the court should refer the issue of arbitrability to the arbitrator for the initial decision); School Dist. No. 46 v. Del Bianco, 68 Ill. App. 2d 145, 155, 215 N.E.2d 25, 30 (1966) (where there is an agreement to arbitrate and its scope is reasonably in doubt, the issue of arbitrability should be initially determined by the arbitrators).

14. 298 Md. 96, 468 A.2d 91 (1983).

15. *Id.* at 107, 468 A.2d at 97.

16. 21 Md. App. 307, 320 A.2d 558 (1974).

17. *Id.* at 321-322, 320 A.2d at 566. *See also*, Howard County Bd. of Educ. v. Howard County Educ. Ass'n. Inc., 61 Md. App. 631, 487 A.2d 1220 (1985) (the arbitrator must make the determination as the "first step").

18. 266 Minn. 284, 123 N.W.2d 371 (1963).

> the parties concerning the scope of the arbitration clause of their contract is clearly expressed or ascertainable, the issue of arbitrability shall be determined by the court. Where such intention cannot be ascertained or is reasonably debatable, §572.09 limits judicial interference and requires that the scope of the arbitration clause be initially determined by arbitration, subject to review by the court at the insistance of any contracting party.[19]

In *Portland Association of Teachers v. School District No. 1*,[20] the Oregon Appellate Court held that since the scope of grievance procedures provided in a teachers' employment agreement was clear on its face, it was appropriate for the court, and not an arbitrator, to interpret the agreement. However, the Court noted that, "Only when the agreement is ambiguous as to the scope of arbitrability must the question of arbitrability be resolved, at least initially, by an arbitrator." The Delaware Chancery Court in *Pettinaro Construction Co. v. Harry C. Partridge, Jr., & Sons, Inc.*,[21] noted that, " . . . where ambiguities relating to the issue of arbitrability exist, the question of arbitrability itself may be submitted to the arbitrators."[22]

Applying New York law, the court in *Katz v. Shearson Hayden Stone, Inc.*,[23] held that the meaning and scope of an arbitration provision, as well as the arbitrability of a claim, are in the first instance, questions for the arbitrators to decide.[24]

In a number of recent decisions, other state jurisdictions have resolved the issue contrary to *Barr*, concluding that the initial determination of arbitrability must be made by the court. These decisions include *Detroit Automobile Inter-Insurance Exchange v. Straw*,[25] wherein the Michigan Appellate Court held that the arbitrability of an issue is a matter for judicial determination. In *Hass-*

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19. *Id.* at 284, 123 N.W.2d at 372. Twelve years later in Dunshee v. State Farm Mutual Automobile Insurance Co., 303 Minn. 473, 228 N.W.2d 567, 571 (1975), the Minnesota Supreme Court specifically noted that the rule established in the *Layne* case was reaffirmed in the 1972 case of Atcas v. Credit Clearing Corp. of America, 292 Minn. 334, 197 N.W.2d 448 (1972) and the 1974 case of Har-Mar Inc. v. Thorsen & Thorshov, Inc., Minn., 300 Minn. 149, 218 N.W.2d 751 (1974).

20. 27 Or. App. 247, 555 P.2d 943 (1976).

21. 408 A.2d 957, 963 (Del. 1979).

22. *See also*, Alco Standard Corp. v. Benalal, 345 F. Supp. 14, 22 (E.D. Pa. 1972) (construing Pennsylvania law), and Youmans. v. Dist. Court In And For the County of Denver, 197 Colo. 28, 31, 589 P.2d 487, 489 (1979) (an arbitrator should first decide the issue of arbitrability).

23. 438 F. Supp. 637, 641 (S.D. N.Y. 1977).

24. *See* Societe Nationale Pour La Recherche, La Production, Le Transport, La Transformation et La Commercialisation des Hydrocarbures (SONATRACH) v. General Tire & Rubber Co., 430 F. Supp. 1332 (S.D. N.Y. 1977); Pearl Street Dev. Corp. v. Conduit and Found. Corp., 41 N.Y.2d 167, 391 N.Y.S.2d 98, 359 N.E.2d 693 (1976).

25. 96 Mich. App. 773, 293 N.W.2d 704 (1980), *appeal denied*, 417 Mich. 932, 331 N.W.2d 225 (1983).

ler v. Columbia Gas Transmission Corp.,[26] the Pennsylvania Superior Court also held that whether a dispute is within the terms of an arbitration agreement is for the court to determine, as did the Maine Supreme Court in *Board of School Directors v. Tri-Town Teachers Association.*[27]

2. *Recent Federal Court Decisions*

The United States Supreme Court recently addressed the issue of arbitrability under the Federal Arbitration Act in *AT&T Technologies, Inc. v. Communications Workers.*[28] In *AT&T Technologies*, the Supreme Court concluded that:

> It is the court's duty to interpret the agreement and to determine whether the parties intended to arbitrate grievances concerning layoffs predicated on a "lack of work" determination by the Company. If the court determines that the agreement so provides, then it is for the arbitration to determine the relative merits of the parties' substantive interpretations of the agreement. It was for the court, not the arbitrator, to decide in the first instance whether the dispute was to be resolved through arbitration.[29]

The lower federal courts have addressed the issue of arbitrability, and have uniformly held that it is for the court, and not the arbitrator, to decide the issue of arbitrability.[30]

D. *Arguments in Favor of the Arbitrator Making the Initial Arbitrability Decision*

1. *Arguments in Favor of the Arbitrator*

One of the fundamental purposes of the Uniform Arbitration Act is "to encourage and facilitate the arbitration of disputes by providing a speedy, informal and relatively inexpensive procedure for resolving controversies arising out of commercial transactions."[31]

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26. 318 Pa. Super. 302, 464 A.2d 1354 (1983).

27. 412 A.2d 990 (Me. 1980). *See also* LaCourse v. Firemen's Ins. Co. of Newark, N.J., 756 F.2d 10, 12 (3rd Cir. 1985) (construing Pennsylvania law) and Gaslin, Inc. v. L.G.C. Exports, Inc., 334 Pa. Super. 132, 482 A.2d 1117 (1984).

28. 475 U.S. 643 (1986).

29. 475 U.S. at 651. *See also* Atkinson v. Sinclair Refining Co., 370 U.S. 238, *aff'd*, 370 U.S. 195 (1962).

30. Local 232, Allied Indus. Workers of America, AFL-CIO v. Briggs & Stratton Corp., 837 F.2d 782, 784 (7th Cir. 1988); Brotherhood of Teamsters & Auto Truck Drivers, Local No. 70 v. Interstate Distrib. Co., 832 F.2d 507, 509 (9th cir. 1987); Life of America Ins. Co. v. Aetna Life Ins. Co., 744 F.2d 409, 413 (5th Cir. 1984); Int'l Union, UAW v. General Electric Co., 714 F.2d 830, 831 (8th Cir. 1983).

31. Layne-Minnesota Co. v. Regents of Univ. of Minn., 266 Minn. 284, 287, 123 N.W.2d 371, 374 (1963).

Since the inception of the Uniform Arbitration Act and many of its state counterparts, the public policy of many states has been to favor and encourage arbitration.[32] This general trend in favor of arbitration as an effective and viable dispute resolution mechanism militates in favor of giving arbitrators the power to make the initial determination of arbitrability.

Another factor in favor of the arbitration forum is the expertise of the arbitrators themselves. Allowing the arbitrators, who generally possess special experience and qualifications, to make the initial determination of arbitrability allows the trial court to take advantage of this expertise. Moreover, if ultimate judicial review of the arbitration proceeding is sought, the trial court will have before it a record of the arbitration proceeding which will then aid the court in a more effective resolution of the arbitrability decision.

Finally, the most compelling reason to allow arbitrators to make the initial arbitrability determination is evinced by those cases where the merits of the controversy are inextricably intertwined with the determination of the arbitrability issue. In these cases, the court will be able to determine the arbitrability issue only after a full evidentiary hearing. Where the hearing results in a finding of arbitrability, the arbitrators will then perform their task and reconsider the entire matter. This will result in a waste of judicial resources, defeating the very purposes underlying the arbitration process.[33]

2. *Arguments in Favor of Trial Court Making the Initial Arbitrability Decision*

Generally, courts that have determined that the initial arbitrability determination resides with the trial court do so on the basis of a strict judicial construction of the relevant statutory provisions. For example, Section 12 of the Uniform Arbitration Act states that a dispute as to arbitrability "shall be summarily tried." It has been argued that the term "summarily" means without delay and undue formality and therefore subject to judicial determination. Moreover, the term "shall" has been deemed to be mandatory language which requires the trial court to make the arbitrability determination.

An additional argument in support of the position that the trial

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32. *See e.g.*, Schutt v. Allstate Ins. Co., 135 Ill. App. 3d 136, 478 N.E.2d 644 (1985); *see also* Pirsig, *Some Comments on Arbitration Legislation and The Uniform Act*, 10 VAND. L. REV. 685, 691 (1957).

33. *See* Donaldson, Lufkin & Jenrette Futures, Inc. v. Barr, 151 Ill. App. 3d 597, 607, 503 N.E.2d 786, 793 (1987) (Jiganti J., dissenting), *aff'd*, 124 Ill. 2d 435, 530 N.E.2d 439 (1988); *see also* County of Ottawa v. Jaklinski, 423 Mich. 1, 25, 377 N.W.2d 668, 678 (1985) ("courts must assiduously avoid deciding the merits of the underlying dispute in the guise of deciding arbitrability").

court should make the initial arbitrability decision derives from the purpose of arbitration: namely, efficient and economical resolution of disputes. If the arbitrability determination were deferred to the arbitrator, it would be possible that three separate determinations would be made during the course of the arbitration proceeding. There would be the motion to stay or compel arbitration, followed by the arbitrator's determination of arbitrability, succeeded by the trial court's review after the arbitration proceeding has concluded. This series of determinations would defeat the purpose of arbitration — to provide economical adjudication of disputes.[34] Finally, it has been suggested that the arbitrators themselves may not want to make the determination for fear that a decision in favor of arbitration may be criticized as a decision made out of self-interest.

E. Conclusion

As the survey indicates, the issue of who should initially make the arbitrability decision remains split among the various state jurisdictions. In Illinois, however, it is now settled that the arbitrator should decide the issue, with ultimate authority remaining with the court.

II. Punitive Damages

A. Introduction

Until very recently, the judiciary had historically prohibited punitive arbitration awards. The 1974 culmination of this tradition, *Garrity v. Lyle Stuart*, held that an arbitrator has no power to award punitive damages, even if agreed to by the parties.[35] The *Garrity* court opined that punitive arbitration awards impinged upon the authority of the judiciary and were prone to abuse, and were thus violative of public policy.[36] Although *Garrity* was frequently followed,[37] a number of courts implicitly acted in a way contrary to

34. *See* Board of Trustees of Junior College Dist. No. 508 v. Cook County College Teachers Union, Local 1600, 87 Ill. App. 3d 246, 252, 408 N.E.2d 1026, 1031 (1980); Kalevitch, *Arbitrability: The Uniform Arbitration Act in Illinois*, 4 Loy. U. Chi. L.J. 23, 33 (1973).

35. 40 N.Y.2d 354, 356, 353 N.E.2d 793, 794, 386 N.Y.S.2d 831, 832 (1976).

36. *Id.* at 356, 353 N.E.2d at 796, 386 N.Y.S.2d at 833.

37. *See* Surman v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 733 F.2d 59, 63 (8th Cir. 1984) (court acknowledged, without discussion, that if appellees argue their fraud claims in arbitration they will be unable to recover punitive damages); Pierson v. Dean, Witter, Reynolds, Inc., 551 F. Supp. 497 (C.D. Ill. 1982) (court discussed New York law which rendered punitive damages unavailable in an arbitration award), *rev'd on other grounds*, 742 F.2d 443 (7th Cir. 1984); Baselski v. Paine, Webber, Jackson & Curtis, Inc., 514 F. Supp. 535, 543 (N.D. Ill. 1981) (a party agreement containing an arbitration clause waives the right to seek punitive damages if that is the rule

Garrity.[38] Put simply, the case law was in disarray, although the discernible majority followed the *Garrity* rule.

The modern trend in favor of punitive arbitral awards began in 1983 with the case of *Willis v. Shearson/American Express, Inc.*[39] Holding that federal law applied, the *Willis* court was able to distinguish *Garrity* on the basis that it restricted the power of arbitrators under only state law.[40] One year later, the *Willis* court advanced a major step further in the case of *Willoughby Roofing & Supply v. Kajima International Inc.*,[41] in which the court upheld an arbitral award of punitive damages on its own merit. In this watershed ruling, the *Willoughby* court held that public policy did not prohibit

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of the agreed upon controlling forum); United States Fidelity & Guaranty Co. v. DeFluiter, 456 N.E.2d 429, 432 (Ind. Ct. App. 1983) ("Since arbitration arises out of a contractual relationship, punitives are unavailable because parties may not contract to benefit from or be penalized by punitive damages"); School City of E. Chicago Ind. v. E. Chicago Federation of Teachers, Local #511, 422 N.E.2d 656, 662-63 (Ind. Ct. App. 1981) (arbitrator's award of punitive damages void because the award was contrary to state public policy and would not further the purposes of punitive damages); Cone Mills Corp. v. August F. Nielsen Co., 90 A.D.2d 31, 33-34, 455 N.Y.S.2d 625, 627 (N.Y. App. Div. 1982) (punitive damages unavailable in arbitration).

38. Courts implicitly acted contrary to *Garrity* by compelling arbitration of punitive damages claims. *See* Drayer v. Krasner, 572 F.2d 348 (2d cir. 1978), *cert. denied*, 436 U.S. 948 (1978) (involving a former registered representative's claims against a securities firm for wrongful termination); Corcoran v. Shearson/American Express Inc., 596 F. Supp. 1113 (N.D. Ga. 1984) (involving claims of willful and malicious breach of fiduciary duty by customers against a commodities broker); Cullen v. Paine, Webber, Jackson & Curtis, Inc., 587 F. Supp. 1520 (N.D. Ga. 1984) (involving claims by a general securities representative against its employer for alleged tortious misconduct), *aff'd*, 863 F.2d 851 (11th Cir. 1989); Sports Factory, Inc. v. Chanoff, 586 F. Supp. 342 (E.D. Pa. 1984) (involving claims of fraud and intentional and willful breach of lease); Speck v. Oppenheimer & Co., 583 F. Supp. 325 (W.D. Mo. 1984) (involving customer's claims of negligence, breach of fiduciary duty, and fraudulent misrepresentation against a securities firm); Creson v. Quickprint of America, 558 F. Supp. 984 (W.D. Mo. 1983) (involving licensees' allegations of fraud in inducement of commercial franchise agreements); Ging v. Parker-Hunter Inc., 544 F. Supp. 49 (W.D. Pa. 1982) (court referred claims for punitive damages to arbitration, implicitly holding that arbitrators have the authority to consider such claims and grant the requested relief); Coudert v. Paine Webber Jackson & Curtis, 543 F. Supp. 122 (D. Conn. 1982) (involving a former account executive's claim of alleged defamation, intentional infliction of emotional distress, and tortious invasion of privacy against her past employer), *rev'd on other grounds*, 705 F.2d 78 (2d Cir. 1983); Kelleher v. Reich, 532 F. Supp. 845 (S.D. N.Y. 1982) (involving a former chief executive's claim that he was fraudulently induced to enter into a voting trust agreement by agents of his brokerage form); TAC Travel America Corp. v. World Airways, Inc., 443 F. Supp. 825 (S.D. N.Y. 1978) (involving a charterer's claims of defamation against an airline); Pacific Investment Co. v. Townsend, 58 Cal. App. 3d 1, 129 Cal. Rptr. 489 (1976) (involving claims arising out of alleged misuse and mismanagement of partnership property); Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Melamed, 453 So.2d 858, 861 (Fla. Dist. Ct. App. 1984), (claims for punitive damages are subject to arbitration); Van C. Argiris & Co. v. Pain/Wetzel & Assocs., 63 Ill. App. 3d 993, 380 N.E.2d 825 (1978) (involving a claim of malicious interference with a contractual relationship).

39. 569 F. Supp. 821 (M.D. N.C. 1983).

40. *Id.* at 823.

41. 598 F. Supp. 353 (N.D. Ala. 1984), *aff'd*, 776 F.2d 269 (11th Cir. 1985).

arbitrators from making punitive damage awards.[42]

Significantly, the *Willoughby* court reasoned that a prohibition of punitive awards would undermine the value of arbitration and frustrate punitive damage policy.[43] In apparent consensus, nearly every decision for the past three years has followed the *Willoughby* rule and upheld punitive arbitration awards.[44] This trend has recently accelerated with a recent series of very strong, pro-arbitration decisions.

B. Historical Overview

1. The History of Arbitration

With the passage of the Federal Arbitration Act,[45] Congress established a strong federal policy favoring arbitration.[46] The Federal Arbitration Act provides that a written agreement to arbitrate in any "contract evidencing a transaction involving commerce . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."[47] The statute further provides that any party aggrieved by the improper refusal of another party to commence arbitration may petition a federal court of competent jurisdiction for an order compelling arbitration. If the formation of an arbitration agreement is not at issue, "the court *shall* make an order summarily directing the parties to proceed with the arbitration in accordance with the terms [of the agreement]."[48]

Despite the mandatory language of the Federal Arbitration Act, there has been considerable historical disagreement in the federal judiciary over its interpretation and application.[49] However, in the

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42. *Id.* at 359-361.

43. *Id.* at 362-364.

44. *See, e.g.*, In re Costa and Head (Atrium), Ltd., 486 So.2d 1272 (Ala. 1986); Baker v. Sadick, 162 Cal. App. 3d 618, 208 Cal. Rptr. 676 (1984); Rodgers Builders, Inc. v. McQueen, 76 N.C. App. 16, 331 S.E.2d 726 (1985).

45. 9 U.S.C. §§ 1-14 (1982).

46. *See* Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, 473 U.S. 614, 625 (1985); Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24-25 (1983).

47. 9 U.S.C. § 2 (1982).

48. 9 U.S.C. § 4 (1982) (emphasis added). The Federal Arbitration Act also provides that, if a claim is brought before any federal court upon any issue referable to arbitration under a written agreement, the court shall, on the application of a party, "stay the trial until arbitration has been had in accordance with the agreement." 9 U.S.C. § 3 (1982).

49. This resulted in the common judicial refusal to enforce arbitration clauses in disputes arising under federal remedial legislation. The judiciary has often found arbitration to be an unsuitable method of dispute resolution, *see e.g.*, Merrill Lynch, Pierce, Fenner & Smith v. Moore, 590 F.2d 823 (10th Cir. 1978); Applied Digital Technology, Inc. v. Continental Casualty Co., 576 F.2d 116 (7th Cir. 1978); Allegaert

recent trilogy of *Dean Witter Reynolds, Inc. v. Byrd*,[50] *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*,[51] and *Shearson/American Express, Inc. v. McMahon*,[52] the United States Supreme Court dispelled this interpretive confusion and significantly broadened the scope of enforceability of arbitration agreements. In *Byrd*, the Supreme Court mandated the prompt arbitration of arbitrable claims irrespective of the judicial resolution of non-arbitrable claims. In *Mitsubishi*, the Court held international antitrust disputes to be arbitrable, and in *McMahon*, the Supreme Court held that disputes arising under the Securities Exchange Act of 1934 and the Racketeer Influenced and Corrupt Organizations Act are arbitrable.

Thus, federal policy — embodied in the Arbitration Act and the recent decisions of the Supreme Court — unequivocally favors arbitration as a means of resolving disputes.[53] In *Mitsubishi* the Supreme Court noted: "[W]e are well past the time when judicial suspicion of the desirability of arbitration and the competence of arbitral tribunals inhibited the development of arbitration as an al-

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v. Perot, 548 F.2d 432 (2d Cir. 1977), *cert. denied*, 432 U.S. 910 (1977); S.A. Mineracao da Trindade-Samitri v. Utah Int'l, Inc., 576 F. Supp. 566 (S.D. N.Y. 1983) (holding arbitration clauses unenforceable in the areas of antitrust, 10b-5 claims and RICO respectively) and has generally precluded arbitration in the areas of securities. *See* Wilko v. Swan, 346 U.S. 427 (1953) (holding claims brought under 1933 Securities Act non-arbitrable).

See also Surman v. Merrill Lynch, Pierce, Fenner & Smith, 733 F.2d 59 (8th Cir. 1984); Merrill Lynch, Pierce, Fenner & Smith v. Moore, 590 F.2d 823 (10th Cir. 1978) (both holding claims brought under § 10(b) of Securities Exchange Act of 1934 and 10b-5 claims non-arbitrable, following *Wilko*). *See also* Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 723 F.2d 155 (1st cir. 1983) (excepting antitrust issues from arbitrability) *modified*, 473 U.S. 614 (1985); Applied Digital Technology, Inc. v. Continental Casualty Co., 576 F.2d 116 (7th Cir. 1978) (antitrust issues excepted from arbitration); Sibley v. Tandy Corp., 543 F.2d 540 (5th Cir. 1976) (securities laws claims stayed pending arbitration of other issues); Cobb v. Lewis, 488 F.2d 41 (5th Cir. 1974) (antitrust claims not arbitrable); American Safety Equip. Corp. v. J.P. Maguire & Co., 391 F.2d 821 (2d Cir. 1968) (antitrust claims inappropriate for arbitration).

Cases holding bankruptcy arbitration unenforceable include: In re Braniff Airways, 33 Bankr. 33 (Bankr. N.D. Tex. 1983); Coar v. Brown, 29 Bankr. 806 (Bankr. N.D. Ill. 1983); Zimmerman v. Continental Airlines, Inc., 712 F.2d 55 (Bankr. 3d Cir. 1983), *cert. denied*, 464 U.S. 1038 (1984); In re Ludwig Honold Mfg. Co., 22 Bankr. 436 (Bankr. E.D. Pa. 1982).

RICO issues are addressed in: Witt v. Merrill Lynch, Pierce, Fenner & Smith, 602 F. Supp. 867 (W.D. Pa. 1985) (adopting intertwining doctrine so that in addition to securities claims, common law claims were not arbitrable); Universal Marine Ins. Co. v. Beacon Ins. Co., 588 F. Supp. 735 (W.D. N.C. 1984) (RICO claims not arbitrable); Wilcox v. Ho-Wing Sit, 586 F. Supp. 561 (N.D. Cal. 1984) (non-arbitrable claims stayed pending state claim arbitration).

50. 470 U.S. 213 (1985).

51. 473 U.S. 614 (1985).

52. 482 U.S. 220 (1987).

53. *Id.* at 225-26.

ternative means of dispute resolution."[54] Since 1953, every relevant Supreme Court decision has favored arbitration.[55]

With the seminal *Byrd*, *Mitsubishi*, and *McMahon* decisions, the Supreme Court has swept away any doubts as to the enforceability of valid arbitration clauses. The Supreme Court's recent pronouncements have accelerated the judicial acceptance of punitive damages as a valid component of the substantive law of arbitrability.

2. *The History of Punitive Damages*

Civil awards of punitive or exemplary damages[56] have been generally justified by four policy objectives.[57] First, such damages punish flagrant wrongdoers and deter others from the offense.[58] Second,

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54. 473 U.S. at 626-27 (1984). *Accord*, Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. 124 (1982) (Arbitration Act "is a congressional declaration of a liberal federal policy favoring arbitration . . . [and] questions of arbitrability must be addressed with a healthy regard for the federal policy favoring arbitration"); Southland Corp. v. Keating, 465 U.S. 1 (1983) (in passing the Arbitration Act, "Congress declared a national policy favoring arbitration . . . [that] mandated the enforcement of arbitration agreements"). *See also* Wilko v. Swann, 346 U.S. 427, 439 (1953) (Frankfurter, J., dissenting) ("[t]here is nothing in the record . . . to indicate that the arbitral system . . . would not afford the plaintiff the rights to which he is entitled.")

55. *See, e.g.*, *Mitsubishi*, 473 U.S. at 614, *Byrd*, 470 U.S. at 213; *Southland Corp.*, 465 U.S. at 1 (holding preempted state laws invalidating arbitration clauses otherwise valid under Arbitration Act); *Moses H. Cone Memorial Hosp.*, 460 U.S. 1 (holding a federal district court's stay of federal suit seeking arbitration under §4 of Arbitration Act improper); Prima Paint Corp. v. Flood & Conklin Manufacturing Co., 388 U.S. 395 (1967) (holding that, where one party to a contract containing an arbitration clause claims fraud in the inducement of the contract generally, the claim must be settled in arbitration according to the terms of the arbitration clause).

56. Punitive or exemplary damages afford a plaintiff recovery in excess of the amount necessary to compensate for proven loss or injury. To justify such a recovery, the aggrieved party is generally required to demonstrate that the conduct complained of was willful, wanton, malicious, oppressive, or reckless. *See* D. DOBBS, REMEDIES 205 (1973). *See generally* K. REDDEN, PUNITIVE DAMAGES 161-256 (1980) (providing a detailed discussion of the standards employed by various courts in the assessment of punitive damages).

57. See Belli, *Punitive Damages: Their History, Their Use and Their Worth in Present-Day Society*, 49 U. MO. KAN. CITY L. REV. 1, 5-6 (1980); Long, *Punitive Damages: An Unsettled Doctrine*, 25 DRAKE L. REV. 875-79 (1976).

58. J. GHIRDI & J. KIRCHER, PUNITIVE DAMAGE LAW AND PRACTICE §4.14 n.1 (1981) (citing cases and statutes from 36 states and the District of Columbia) (1984). As a noted torts commentator has observed:

> The idea of punishment and deterrence usually does not enter into tort law, except in so far as it may lead the courts to balance the scales somewhat in favor of the plaintiff's interest in determining that a tort has been committed in the first place. In one rather anomalous respect, however, an element of the criminal law has invaded the field of torts. Where the defendant's wrongdoing has been intentional and deliberate, and has the character of outrage frequently associated with crime, all but a few courts have permitted the jury to award in the tort action "punitive" or "exemplary" damages. Such damages are given to the plaintiff over and above the full compensation for his injuries, for the purpose of punishing the defendant, and of deterring others from following

punitive damages are monetary awards that supplement compensatory damages.[59] Third, punitive awards offer an element of revenge both to the injured party and to society as a whole.[60] Fourth, punitive awards promote justice by providing an incentive to pursue causes of action where the damages are nominal, but where the defendant's behavior subjects society to substantial risks.

Not surprisingly, punitive damages have come under harsh attack in recent years.[61] Many commentators perceive that the claims for, and awards of, punitive damages increased greatly in the past few years.[62] Critics also perceive that the size of awards have grown steadily, and that an ever larger number of verdicts can properly be described as excessive.[63] In reality, punitive awards have grown in size and absolute number, but have not grown in relative frequency.[64]

An array of arguments have advanced against the theory and

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his example.
W. PROSSER, THE LAW OF TORTS, §2 at 9 (4th ed. 1971).

59. Connecticut, Michigan, New Hampshire, and Kentucky view punitive damages as purely compensatory. H. OLECK, DAMAGES TO PERSONS AND PROPERTY §269 (1961); C. MCCORMICK, DAMAGES §77 (1935). Texas, Idaho, and Oregon view compensation as one of the major function of punitive awards. Long, *supra* note 57, at 875. *See* Comment, *Punitive Damages: A Cat's Clavicle in Modern Civil Law*, 22 J. MARSHALL L. REV. 657 (1989) (argues punitive damages initially permitted to compensate otherwise non-compensable intangible injuries).

60. D. DOBBS, REMEDIES 205, 221 (1973).

61. See, e.g., Sales & Cole, *Punitive Damages: A Relic That Has Outlived Its Origins*, 37 VAND. L. REV. 1117 (1984); Ellis, *Fairness and Efficiency in the Law of Punitive Damages*, 56 S. CAL. L. REV. 1, 76-78 (1982); Long, *supra* note 57, at 888-89; Carsey, *The Case Against Punitive Damages: An Annotated Argumentative Outline*, 11 FORUM 57 (1975); Ghiardi, *The Case Against Punitive Damages*, 8 FORUM 411 (1972); Duffy, *Punitive Damages: A Doctrine Which Should Be Abolished* (Def. Research Inst., 1969).

62. See Morrison, *Punitive Damages and Why the Reinsurer Cares*, 20 FORUM 73 (1984); Belli, *supra* note 57; Ellis, *supra* note 61, at 2; *TRB: The Tort Explosion*, THE NEW REPUBLIC, Nov. 11, 1985, at 4.

63. See Sales & Cole, *supra* note 61, at 1154.

64. The total amount awarded in 1980-84 was six times greater than in 1975-79 in the Circuit Court of Cook County (Cook County) and twice as much in the San Francisco Superior Court (San Francisco). The size of a typical punitive award also increased from $20-30,000 before 1980, to $50-60,000 after 1980, representing a doubling in San Francisco and nearly fourfold increase Cook County. Finally, the size of the largest awards also increased, especially in Cook County. As to the number of punitive awards, between 1975 and 1985 the number increased by 67% in Cook County and 53% in San Francisco. However, this "increased number" still represented a very small number and proportion of cases: 50 cases in San Francisco and 65 in Cook County from 1980-84, representing only 8% of trials and 14% of plaintiff's verdicts in San Francisco and only 4% of trials and 6% of plaintiff's verdicts in Cook County. More importantly, despite the increase in absolute number, the relative frequency of punitive awards, in proportion to the number of trials and number of plaintiff's verdicts, remained almost unchanged over the entire 25-year period, in both jurisdictions. Peterson, Sarma, & Shanley, *Punitive Damages: Empirical Findings* 8-45 (Rand Institute 1980).

practice of punitive damages.[65] The most cogent criticism is that punitive damages are no longer necessary. First, critics note that the compensatory damages concept was broadened long ago to include total compensation — including tangible and intangible, direct and indirect harm — removing compensation as a justification for punitive damages.[66] Second, commentators argue that the punishment rationale is inappropriate for civil litigation, and that punitive damages should be confined to criminal law.[67] Third, critics contend that the availability of liability insurance to cover punitive damage awards vitiates the punishment and deterrence rationales.[68] Finally, at least one commentator believes that the public justice rationale is rarely applicable.[69]

The same factors that have led commentators to criticize punitive damages in the judicial setting have led the courts to resist the application of the doctrine in the arbitration setting. By the same token, the beneficent goals of punitive awards are equally well served in arbitration. More importantly, the Supreme Court's pro-arbitration stance favors the inclusion of punitive damages as an arbitration remedy, in order to most fully compensate the injured party and punish the wrongdoer.

III. Punitive Damages in Arbitration

A. *Pre-Willoughby: Hostility to Punitive Awards*

1. *Garrity: Prohibition of Punitive Award*

In 1974, *Garrity v. Lyle Stuart, Inc.*[70] was the first case to hold unequivocally that punitive damages could not be awarded in arbitration under a modern arbitration statute. In *Garrity*, a prominent author sued her publisher for fraudulent inducement and "gross" underpayment of royalties, as well as for various "malicious" acts. Garrity's contract contained a broad arbitration provision. The arbitration panel awarded Garrity $45,000 in compensatory damages and $7,500 in punitive damages. The New York Court of Appeals, in a 4-3 decision, vacated the award of punitive damages.

The *Garrity* majority articulated a sweeping rule: "An arbitra-

65. See Long, *supra* note 57, at 883-89; Sales, *supra* note 61, at 1154-1171.

66. Long, *supra* note 59, at 888; Sales, *supra* note 61, at 1164-1165.

67. See Long, *supra* note 59, at 884-85; Sales, *supra* note 61, at 1159. Both commentators note that civil parties are being subjected to quasi-criminal penalties without the procedural safeguards afforded under criminal law.

68. A majority of jurisdictions have judicially declared that punitive damages are insurable. Ellis, *supra* note 61, at 71; Morrissey, *Punitive Damages - Insurability*, 24 Trial Law. Guide 257 (1987).

69. Long, *supra* note 59, at 889.

70. 40 N.Y.2d 354, 353 N.E.2d 793, 386 N.Y.S.2d 831 (1976).

tor has no power to award punitive damages, *even if agreed upon by the parties. . . .*"[71] At the root of the *Garrity* doctrine is the notion that freedom to contract does not include the freedom to impose penalties.[72] If parties may not agree to punish, and the sole source of an arbitrator's power is the agreement, then the arbitrator has no grounds upon which to levy punitive sanctions.

The public policy expressed in *Garrity*, which the court believed was "of such magnitude as to call for judicial intrusion to prevent its contravention,"[73] was supported by several rationales. First, the court noted that punitive damages have not been awarded in breach of contract actions on a historical basis.[74] Second, the court reasoned that allowing arbitrators to award punitive damages would "amount to an unlimited draft upon judicial power," thereby displacing courts as the arbiters of social justice.[75] Third, the court observed that the absence of guidelines for arbitral awards, coupled with the limited range of judicial supervision, might result in unpredictable and uncontrollable awards.[76] Fourth, the court theorized that one party could obtain an unfair advantage through manipulation of the arbitrator.[77] Finally, the court speculated that punitive arbitration awards would erode confidence in the arbitral process and discourage its use.[78]

2. *The Post-Garrity - Pre-Willoughby Period*

Although *Garrity* was severely criticized,[79] it was frequently followed for the proposition that punitive damages are not available in arbitration.[80] Many courts acted contrary to the *Garrity* rule, how-

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71. 40 N.Y.2d at 356, 353 N.E.2d at 794, 386 N.Y.S.2d at 823 (emphasis added).

72. "The law does not and should not permit private persons to submit themselves to punitive sanctions of the order reserved to the State. The freedom of contract does not embrace the freedom to punish, even by contract." *Id.* at 360, 353 N.E.2d at 797, 386 N.Y.S.2d at 834.

73. *Id.* at 356, 353 N.E.2d at 794, 386 N.Y.S.2d at 832.

74. *Id.* at 358, 353 N.E.2d at 795, 386 N.Y.S.2d at 833.

75. *Id.* at 358, 353 N.E.2d at 796, 386 N.Y.S.2d at 834.

76. *Id.* at 359, 353 N.E.2d at 796, 386 N.Y.S.2d at 834.

77. *Id.*

78. *Id.*

79. *See, e.g.*, Hackett, *Punitive Damages in Arbitration: The Search for a Workable rule*, 63 CORNELL L. REV. 272, 287-300 (1978) and Zerden, *Arbitration: The Award of Punitive Damages as a Public Policy Question, Garrity v. Lyle Stuart, Inc.*, 43 BROOKLYN L. REV. 546, 551 (1976).

80. *See* Surman v. Merrill, Lynch, Pierce, Fenner & Smith, 733 F.2d 59, 63 (8th Cir. 1984) (Eighth Circuit acknowledged, without discussion, that if appellees argue their fraud claims in arbitration they will not be able to recover punitive damages); Pierson v. Dean, Witter, Reynolds, Inc., 551 F. Supp. 497 (C.D. Ill. 1982), *rev'd on other grounds*, 742 F.2d 334 (7th Cir. 1984) (district court applied New York law which rendered punitive damages unavailable in an arbitration award); Baselski v. Paine Webber, Jackson & Curtis, Inc., 514 F. Supp. 535, 543 (N.D. Ill. 1981) (a party to an agreement containing an arbitration clause has waived the right to seek puni-

ever, compelling arbitration of punitive damage claims along with other types of controversies within the scope of the arbitration agreement.[81] Although these decisions failed to directly address the appropriateness of punitive damages in arbitration, they indicated dissatisfaction with, or confusion over, the *Garrity* ruling. At least two state appellate courts went further, however, and held that an arbitration panel has the authority to award punitive damages — although neither court discussed *Garrity*.[82] At the same time, the First Circuit upheld an arbitral award despite its conclusion that the

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tive damages in any forum); United States Fidelity & Guar. v. DeFluiter, 456 N.E.2d 429, 432 (Ind. Ct. App. 1983) ("Since arbitration arises out of a contractual relationship, punitive damages are unavailable because parties may not contract to benefit from or be penalized by punitive damages"); School City of E. Chicago, Ind., v. E. Chicago, Federation of Teachers, Local #511, 422 N.E.2d 656, 663 (Ind. Ct. App. 1981) (holding an arbitrator's award of punitive damages void because the award was contrary to state public policy and would not further the purposes of punitive damages); Cone Mills Corp. v. August F. Nielsen Co., 90 A.D.2d 31, 33-34, 455 N.Y.S.2d 625, 627 (N.Y. App. Div. 1980) (punitive damages unavailable in arbitration).

81. *See, e.g.*, Drayer v. Krasner, 572 F.2d 348 (2d Cir. 1978) (involving a former registered representative's claims against a securities firm for wrongful termination), *cert. denied*, 436 U.S. 948; Corcoran v. Shearson/American Exp. Inc., 596 F. Supp. 1113 (N.D. Ga. 1984) (involving claims of willful and malicious breach of fiduciary duty by customers against a commodities broker); Cullen v. Paine, Webber, Jackson & Curtis, Inc., 587 F. Supp. 1520 (N.D. Ga. 1984) (involving claims by a general securities representative against its employer for alleged tortious misconducts); Sports Factory, Inc. v. Chanoff, 586 F. Supp. 342 (E.D. Pa. 1984) (involving claims of fraud and intentional and willful breach of lease); Speck v. Oppenheimer & Co., Inc., 583 F. Supp. 325 (W.D. Mo. 1984) (involving a customer's claim of negligence, breach of fiduciary duty, and fraudulent misrepresentation against a securities firm); Creson v. Quickprint of America, Inc., 558 F. Supp. 984 (W.D. Mo. 1983) (involving licensees' allegations of fraud in inducement of commercial franchise agreements); Ging v. Parker-Hunter Inc., 544 F. Supp. 49 (W.D. Pa. 1982) (the court referred claims for punitive damages to arbitration, implicitly holding that arbitrators have the authority to consider such claims and grant the requested relief); Coudert v. Paine, Webber, Jackson & Curtis, 543 F. Supp. 122 (D. Conn. 1982), *rev'd on other grounds*, 705 F.2d 78 (2d Cir. 1983) (involving a former account executive's claim of alleged defamation, intentional infliction of emotional distress, and tortious invasion of privacy against her past employer); Kelleher v. Reich, 532 F. Supp. 845 (S.D. N.Y. 1982) (involving a former chief executive's claim that he was fraudulently induced to enter into a voting trust agreement by agents of his brokerage firm); Horne v. New England Patriots Football Club, 489 F. Supp. 465 (D. Mass 1980) (involving a public relations director's claim of breach of contract arising out of his termination); TAC Travel America Corp. v. World Airways, Inc., 443 F. Supp. 825 (S.D. N.Y. 1978) (involving a charterer's claims of defamation against an airline); Pacific Investment Co. v. Townsend, 58 Cal. App. 3d 1, 129 Cal. Rptr. 489 (1976) (involving claim arising out of alleged misuse and mismanagement of partnership property); Merrill Lynch, Pierce, Fenner & Smith v. Melamed, 453 So.2d 858 (Fla. Dist. Ct. App. 1984), *aff'd.*, 476 So.2d 140 (1985) (holding that the claims for punitive damages are subject to arbitration); Van C. Argiris & Co. v. Pain/Wetzel & Assocs., 63 Ill. App. 3d 993, 380 N.E.2d 825 (1978) (involving a claim of malicious interference with a contractual relationship).

82. Bishop v. Holy Cross Hosp. of Silver Spring, 44 Md. App. 688, 690, 410 A.2d. 630, 632 (Md. Ct. Spec. App. 1980) (under the health care malpractice claim statute, arbitration panel has authority to award punitive damages); Grissom v. Greener & Sumner Const. Inc., 676 S.W.2d 709, 711 (Tex. Ct. App. 1984) (holding that since the arbitration agreement expressly allowed punitive damages, there was no basis for modifying an arbitration award which included punitive damages).

award was punitive in nature.[83]

The first clear break from the *Garrity* rule occurred in *Willis v. Shearson/American Express, Inc.*[84] The *Willis* case involved a customer-brokerage agreement to arbitrate any controversy arising out of transactions between the parties. The customer complained of fraud and breach of fiduciary duty. He requested punitive damages. The customer opposed the brokerage firm's request for arbitration, fearing that the arbitrators would apply New York law (as required in the arbitration clause), and therefore apply the *Garrity* rule and deny him punitive damages.

The court, however, applied the Federal Arbitration Act, because the agreement between the parties evidenced a transaction in interstate commerce.[85] Thus, the court was able to distinguish *Garrity* on the ground that it restricted the power of arbitrators only under New York state law, not federal law.[86] Although the arbitration clause did not refer to punitive damages, the court concluded that the broad language of the arbitration provision included claims for punitive damages since: (1) public policy did not prohibit arbitrators from resolving issues of punitive damages, and; (2) any doubts concerning the scope of arbitration should be resolved in favor of arbitration.[87]

B. Willoughby: The Approval of Punitive Arbitral Awards

The seminal case for the validity of awards of punitive arbitral awards is *Willoughby Roofing & Supply v. Kajima International Inc.*[88] In *Willoughby*, the arbitration panel awarded the Willoughby Roofing Co. $41,091 in compensatory damages and $108,909 in punitive damages, based upon a finding of "willful misrepresentations of material fact.[89]

The *Willoughby* court applied federal law[90] and federal policy contained in the Federal Arbitration Act because the construction

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83. Cadillac Auto Co. v. Metro. Auto. Salesman, 588 F.2d 315, 316 (1st Cir. 1978).

84. 569 F. Supp. 821 (M.D. N.C. 1983).

85. *Id.* at 823.

86. *Id.*

87. *Id.* at 824.

88. Willoughby Roofing & Supply Co., Inc. v. Kajima Int'l, 598 F. Supp. 353 (N.D. Ala. 1984), *aff'd*, 776 F.2d 269 (11th Cir. 1985).

89. *Id.* at 354-55.

90. Even though the parties to the contract agreed that Alabama law should govern the resolution of issues submitted to arbitration, the court found that "federal law governs the categories of claims subject to arbitration [and the] resolution of issues concerning the arbitration provision's interpretation, construction, validity, revocability, *and enforceability*." *Id.* at 359 (*citing* Willis v. Shearson/American Express, Inc., 569 F. Supp. 821, 823-24 (M.D. N.C. 1983)) (emphasis in original).

contract was a transaction involving interstate commerce to which the policies and provisions of the Arbitration Act apply.[91] The *Willoughby* court held that the standard arbitration clause was broad enough to empower the arbitration panel to award punitive damages.[92] To arrive at this conclusion, the court initially noted that the strong federal policy favoring arbitration requires the liberal construction of arbitration agreements.[93] Since arbitrators have broad remedial powers to fashion a remedy,[94] the court continued, the specific remedy need not be authorized by the arbitration agreement.[95] Rather, the court stated, any limitation upon the arbitrator's broad remedial powers should be clearly and expressly stated in the arbitration agreement.[96] Since the arbitration agreement in *Willoughby* did not expressly prohibit arbitrators from awarding punitive damages, the arbitration panel should be empowered to handle "all disputes," the court concluded.[97]

Next, the *Willoughby* court carefully analyzed, and rejected, the theoretical underpinnings of the *Garrity* doctrine. First, the court rejected *Garrity's* fear of the displacement of the judicial system, noting that this was the very purpose of the Arbitration Act.[98] Second, the *Willoughby* court observed that the purposes of punitive damages would be furthered by arbitral award every bit as much as by judicial awards.[99] Moreover, the *Willoughby* court reasoned that an arbitrator's expertise in the relevant field would often put him in the best position to discern appropriate punitive awards.[100]

C. *Post-Willoughby: The Growing Modern Trend*

Since the watershed *Willoughby* ruling, courts have had the opportunity to directly address the issue of the arbitrability of punitive damages in arbitration in a number of cases. The overwhelming weight of authority is to allow punitive damages in arbitration; indeed, only one post-*Willoughby* case has failed to follow the *Willoughby* rule.[101]

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91. *Willoughby*, 598 F. Supp. at 359. For this reason, the trial court distinguished *Garrity*, which restricted the power of arbitrators only under New York law, not federal law.

92. *Id.* at 357.

93. *Id.*

94. *Id.* at 357-8.

95. *Id.* at 357.

96. *Id.* at 358.

97. *Id.* at 357.

98. *Id.* at 363 (*citing*, Southland v. Keating, 465 U.S. 1, 13 (1984)).

99. *Id.*

100. *Id.*

101. The case which does not follow *Willoughby* is Shaw v. Kuhnel & Associates, Inc., 102 N.M. 607, 698 P.2d 880 (1985). In *Shaw*, the plaintiff brought an action for breach of contract and fraud, seeking punitive damages. The New Mexico Su-

In the 1984 case of *Baker v. Sadick*,[102] the California Court of Appeals affirmed an arbitrator's award of $300,000 in punitive damages under a state statute providing for arbitration of medical malpractice claims. Dr. Sadick claimed on appeal that the arbitrator's awarding of punitive damages violated California law and public policy. The *Baker* court disagreed, stating that public policy, at least in California, favored arbitration.[103] The court thought it most important that arbitration be placed on equal footing with judicial proceedings stating: "[a]rbitration serves as a substitute for proceedings in court. As a substitute, arbitration would not be encouraged by a decision which effectively holds a claim, which may otherwise be asserted in a court of law, may not be asserted in arbitration."[104]

In the 1988 case of *Belko v. AVX Corp.*,[105] the California Court of Appeals refined the *Baker* analysis in its affirmance of the confirmation of an arbitrator's award of punitive damages for wrongful termination arising from the breach of an employment contract. AVX Corporation contended that the award of $500,000 in punitive damage was: (1) contrary to the "majority rule" against arbitral awards of punitive damages; and (2) beyond the scope of the express language of the employment agreement.[106] The *Belko* court, characterizing *Garrity* as an anomaly and concluding that the *Garrity* rule is unduly restrictive, rejected the traditional "majority rule" represented by that decision.[107] After a thorough examination of the jurisprudential considerations affecting the issues, the *Belko* court concluded that public policy,[108] freedom to contract,[109] judicial policy,[110]

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preme Court, in dicta, stated, "We also determine that an arbitrator should not be given authority to award punitive damages. This power is reserved to the courts." *Id.* at 609, 698 P.2d at 882 (*citing* Garrity v. Lyle Stewart, Inc., 40 N.Y.2d 354, 353 N.E.2d 793, 386 N.Y.S.2d 831 (1976)). The *Shaw* court did not mention *Willoughby*, discuss *Garrity*, or explicate the issue of punitive damages. Clearly, *Shaw* is an anomaly.

102. 162 Cal. App. 3d 618, 208 Cal. Rptr. 676 (1984).

103. *Id.* at 628, 208 Cal. Rptr. at 684.

104. *Id.* at 628-29, 208 Cal. Rptr. at 682-83.

105. 204 Cal. App. 3d 894, 251 Cal. Rptr. 557 (1988).

106. *Id.* at 900-06, 251 Cal. Rptr. 562-67.

107. *Id.*

108. The *Belko* court discussed the applicable public policies in the following terms:

> We find no public policy significant enough to restrict the right of contracting parties to vesting agreed upon arbitrators with the authority to consider and resolve claims for punitive damages. Indeed, a contrary holding violates those strong public policy considerations supporting arbitration as an alternative dispute resolution mechanism, requiring the courts to liberally construe the contractual language within the arbitration clause and recognize the remedial flexibility of arbitrators' authority.

Id. at 902, 251 Cal. Rptr. at 563.

109. "We believe the most practical rule consistent with fairness is one which permits the parties to expressly confer the power to award punitive damages upon an arbitrator." *Id.* at 901, 251 Cal. Rptr. at 562.

and practical considerations[111] militate in favor of the validity of arbitral awards of punitive damages. On the other hand, the *Belko* court determined that neither the possibility[112] of incompetent arbitrators,[113] the displacement of courts as the arbiters of social sanctions,[114] the limited judicial review of arbitrator's awards,[115] nor the private enforcement of penal sanctions,[116] dictated the elimination of punitive damages from the wide range of arbitration remedies.

Perhaps the most important discussion in the *Belko* opinion concerned the source of the arbitrator's power to award punitive damages. The court posited that exemplary damages may not be awarded by an arbitrator in the absence of an express provision in the arbitration agreement authorizing such relief, or a stipulated submission order or its legal equivalent.[117] Thereupon, the court observed that the contractual arbitration provision itself could not form the basis of consent to exemplary relief, since the provision did not *expressly* permit an award of punitive damages.[118]

Accordingly, the *Belko* court next considered whether an express understanding as to the availability of punitive damages existed outside the four corners of the contractual arbitration provision. The court concluded that the claimant placed the issue of punitive damages before the arbitrator both by the pleadings (*i.e.*, the claimant's statement of claim), and by the evidence. Concomitantly, the court found that the issue was not removed from the scope of arbitral review by the defendant, either by means of an affirmative defense or an objection to specific evidence.[119] On that ba-

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110. *Id.* at 900-06, 251 Cal. Rptr. at 562-67.

111. *Id.* at 906, 251 Cal. Rptr. at 567.

112. "[T]he mere possibility of bias or corruption no more justifies a wholesale withdrawal of the authority of arbitrators to make an award of punitive damages than it would a wholesale withdrawal of their authority to resolve disputes at all. *Id.* at 903, 251 Cal. Rptr. at 564, *quoting*, Willoughby Roofing & Supply v. Kajima Int'l. Inc., 598 F. Supp. at 362.

113. *Id.* at 902-03, 251 Cal. Rptr. at 563-64.

114. *Id.*

115. *Id.* at 901-02, 251 Cal. Rptr. at 562-63.

116. *Id.*

117. This view is embraced by several courts and jurisdictions. *See, e.g.*, Intern. Ass'n of Heat & General Pipe Covering, 792 F.2d 96 (8th Cir. 1986); Howard P. Foley Co. v. Int'l. Bro. of Elec. Workers, 789 F.2d 1421 (9th Cir. 1986); Baltimore Regional Joint Bd. v. Webster Clothes, 596 F.2d 95 (4th Cir. 1979); Westinghouse Elec. v. Intern. Broth., 561 F.2d 521 (4th Cir. 1977); Westmoreland Coal Co. v. United Mine Workers, 550 F. Supp. 1044 (W.D. Va. 1982); Sweeney v. Morganroth, 451 F. Supp. 367 (S.D. N.Y. 1978); Int'l U. of Op. Eng., Local 450 v. Mid-Valley, Inc., 347 F. Supp. 1104 (S.D. Tex. 1972); and Kennewick Educ. Ass'n v. Kennewick School Dist., 666 P.2d 928 (Wash. App. 1983).

118. It should be noted that the contractual arbitration provision did not expressly prohibit exemplary awards. *Belko*, 204 Cal. App. 3d at 896, 251 Cal. Rptr. at 559.

119. The defendant's answer raised as its sole affirmative defense that plaintiff was "required by agreement and law to arbitrate the disputes and claims contained

sis, the court concluded that the parties had jointly submitted the issue of punitive damages to the arbitrator.[120]

Under the *Belko* doctrine, a claimant is not necessarily stymied by the existence of a contractual arbitration provision which is silent as to punitive awards. Rather, the *Belko* rule places the burden on the respondent to contest the arbitrability of punitive damages — so long as the plaintiff has expressly sought punitive damages. Effectively, the *Belko* rule provides that a party may ensure the preclusion of an arbitral award of punitive damages only by means of an express prohibition in the arbitration agreement, to the effect that claims for punitive damages are not subject to arbitration.

In *Bonar v. Dean Witter Reynolds*,[121] the Federal Court of Appeals for the Eleventh Circuit solidly reaffirmed the *Willoughby* rule in favor of punitive damages in arbitration.[122] Although the Eleventh Circuit was compelled to reverse the punitive damages award because of perjured testimony, the court found ample authority both in precedent and in the arbitration agreement for the arbitrator's power to award punitive damages. The court, in a partial restatement of the *Willoughby* holding, concluded that a state choice of law provision does not deprive an arbitrator of the power to award punitive damages under the Federal Arbitration Act.[123] The court did, however, conclude that the choice of law provision established "the substantive law that the arbitrators must apply in determining whether the conduct of the parties warrants an award of punitive damages."[124] Thus, the door may be open for a court to vacate an arbitrator's punitive award if the arbitrator contravened the substantive state law mandated by the choice of law provision.[125]

In *Ehrich v. A. G. Edwards & Sons, Inc.*,[126] the South Dakota federal district court upheld an arbitrator's award of $97,341 in exemplary damages in an action involving mismanagement of a commodities fund stating that "*Willoughby* furnishes the final authority on the issue of whether punitive damages can be awarded . . . ."[127] The Court found *Garrity* inapplicable since federal law, not state

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(in the complaint)". Furthermore, the answer did not suggest that the arbitral remedy was, or should be, limited to compensatory damages. *Id.* at 905, 251 Cal. Rptr. at 566.

120. *Id.*

121. 835 F.2d 1378 (11th Cir. 1988).

122. *Id.* at 1387.

123. The court, in a footnote citing *Willoughby*, stated that the Arbitration Act would not override a clear provision in a contract prohibiting an arbitrator from awarding punitive damages. *Id.*

124. *Id.* at 1387.

125. Stipanowich, *Punitive Damages in Commercial Arbitration*, COM. DAMAGES REP. 175, 178-79 (Sept. 1988) [hereinafter *Commercial Arbitration*].

126. 675 F. Supp. 559 (D. S.D. 1987).

127. *Id.* at 564.

law, applied to the present case.[128] The Court based its ruling on the strong federal policy in favor of upholding an arbitrator's ability to fashion appropriate remedies and the legislative history of the Commodity Exchange Act supporting the remedy of arbitration.[129]

In *Peabody v. Rotan Mosle, Inc.*,[130] the Middle District of Florida similarly relied on *Willoughby* in confirming an arbitrator's award of exemplary damages in a securities law case governed by the Federal Arbitration Act. The court, after noting that the parties' arbitration agreement authorized the arbitration panel to fashion any appropriate remedy, and stating that a federal court "is to resolve all doubt in favor of the arbitrator's authority to award a particular remedy,"[131] was unable to find that the panel's award of punitive damages exceeded its authority.[132]

In *Rodgers Builders, Inc. v. McQueen*,[133] the North Carolina Court of Appeals held that a punitive damage claim was arbitrable under the North Carolina arbitration statute. Rodgers Builders, Inc. filed a variety of fraud claims against the contractor pursuant to the construction contract which contained a broad arbitration clause. The plaintiff was awarded the aggregate of $407,259 on all claims.[134] The *Rodgers* court affirmed a grant of summary judgment and rejected the contractor's contention that the punitive damage claim was not arbitrable, stating: "We detect no public policy in this State prohibiting the arbitration of claims for punitive damages which fall within the scope of an arbitration agreement . . . ."[135]

In *In re Costa and Head (Atrium), Ltd.*,[136] the Alabama Supreme Court cited *Willoughby* in affirming an award of punitive damages in a construction dispute pursuant to the Federal Arbitration Act.[137] Similarly, in *State Farm Fire and Casualty Co. v. Wise*,[138] the Arizona Appellate Court upheld an arbitrator's award of punitive damages against an automobile insurer. The court noted that the automobile insurance policy, pursuant to which the insured filed his claim, did not specifically exclude punitive damages from its uninsured motorist coverage.

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128. *Id.*
129. *Id.* at 565.
130. 677 F. Supp. 1135 (M.D. Fla. 1987).
131. *Id.* at 1139 (citing Willoughby Roofing v. Kajima Int'l., Inc., 598 F. Supp. 353 (N.D. Ala. 1984), *aff'd*, 776 F.2d 269, 270 (11th Cir. 1985)).
132. *Id.* at 1139.
133. 76 N.C. App. 16, 331 S.E.2d 726 (1985).
134. *Id.* at 18, 331 S.E.2d at 728.
135. *Id.* at 24, 331 S.E.2d at 734.
136. 486 So.2d 1272 (Ala. 1968).
137. *Id.* at 1276.
138. 150 Ariz. 16, 721 P.2d 674 (1986).

In *Grissom v. Greener & Sumner Construction*,[139] the Texas Court of Appeals reversed the lower court and upheld an arbitrator's award of $65,000 in punitive damages for breach of contract and independent tortious conduct in a construction setting.[140] The court's holding turned on two findings: first, that the arbitration agreement expressly encompassed exemplary relief;[141] and second, that the arbitrator's award of punitive damages was not contrary to public policy.[142] Interestingly, the court noted that it was not necessary that the arbitral remedy be available at law or equity to render such relief pursuant to the Texas Arbitration statute.[143]

In addition to the foregoing precedents expressly upholding an arbitral award of punitive damages, other decisions have compelled the arbitration of claims in which exemplary damages are requested. In *Merrill Lynch, Pierce, Fenner and Smith, Inc. v. Melamed*,[144] the court held that a customer's claim of fraud and prayer for punitive damages arising from account mismanagement was subject to arbitration under the Federal Arbitration Act in light of the Supreme Court's mandate that any doubts concerning the scope of arbitrable issues under the Federal Arbitration Act are to be resolved in favor of arbitration.[145] In *Richardson Greenshields Securities, Inc. v. McFadden*,[146] the court referred a claim which demanded punitive damages to arbitration, citing *Melamed* for the proposition that claims for punitive damages are subject to arbitration.[147]

It should also be noted that a number of post-*Willoughby* decisions have implicitly recognized the arbitrability of punitive damage claims. In *Mitsubishi Motors Corp. v. Soler Chrysler Plymouth, Inc.*,[148] the Supreme Court ordered arbitration of an antitrust claim, including the claim for treble damages under the statute. In *Shearson/American Express v. McMahon*,[149] the Supreme Court approved arbitration of RICO claims, including the claim for treble damages under the statute. The decisions in three recent securities cases: *Cohen v. Wedbush, Noble, Cooke, Inc.*;[150] *Schriner v. Bear, Stearns, & Co.*;[151] and *Ex parte Thomson McKinnon Securities,*

139. 676 S.W.2d 709 (Tex. App. 1984).
140. *Id.* at 710.
141. *Id.*
142. *Id.* at 711.
143. *Id.*
144. 453 So.2d 858 (Fla. App. 1984).
145. *Id.* at 861.
146. 509 So.2d 1212 (Fla. App. 1987).
147. *Id.* at 1213.
148. 473 U.S. 614 (1985).
149. 482 U.S. 220 (1987).
150. 841 F.2d 282 (9th Cir. 1988).
151. 635 F. Supp. 373 (N.D. Cal. 1986).

Inc.;[152] demonstrate similar tacit judicial recognition of the appropriateness of arbitrating claims in which punitive awards are an element of possible relief.[153]

IV. Conclusion

The evolution of jurisprudence in this area reveals the basic tension between the modern doctrine favoring arbitration and judicial perceptions of the inherent limitations of the arbitration process.[154] Nevertheless, the case law reveals that the clear trend is to empower arbitrators to award punitive damages.

152. 517 So.2d 614 (Ala. 1987).
153. *Commercial Arbitration*, *supra* note 125, at 172.
154. Stipanowich, *Punitive Damages in Arbitration: Garrity v. Lyle Stuart, Inc. Reconsidered*, 66 B.U.L. Rev. 953, 970-72 (1986).