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When "Contracting Around" the Law Will Not Work: The Potential Inability to Expressly Prohibit Punitive Damages in Arbitration

Stark v. Sandberg, Phoenix & von Gontard, P.C.[1]

I. INTRODUCTION

Just as the availability of all appropriate remedies is an important part of judicial litigation, the attempt to identify and limit those remedies is an issue in an arbitration proceeding. After the United States Supreme Court's 1995 decision in *Mastrobuono v. Shearson Lehman Hutton, Inc.*, it seemed clear that parties would be allowed to seek punitive damages if an agreement did not expressly prohibit such damages.[2] Even so, parties continue to falter in writing agreements meant to contain the proper language that will succeed in limiting the availability of certain remedies. This is due to the continued confusion over how to limit the application of choice-of-law provisions in arbitration agreements, and to the policy argument that, even if parties can put limitations on liability, perhaps such limitations are not fair when tortious and grievous acts have been committed.

II. FACTS & HOLDING

In April 2000, Plaintiffs-Appellants Stanley and Patricia Starks (the Starks) filed for bankruptcy protection after borrowing money against their home and securing the loan with a mortgage to fund a failing business.[3] At the time, their note was owned by EMC Mortgage Corporation (EMC), a debt collector subject to the provisions of the Fair Debt Collection Practices Act (FDCPA).[4] The Starks moved from their home, but retained legal title and did not abandon it.[5] EMC motioned to lift the automatic stay on the Starks' home in June 2000, and foreclosure proceedings began.[6] The Starks' attorney, Roy True, informed Scott Greenberg of Sandberg, Phoenix & von Gontard, P.C. that his representation of the Starks was not limited to bankruptcy proceedings, and that Greenberg, and EMC, should not contact the Starks directly.[7]

After EMC repeatedly attempted direct contact with the Starks between October 2000 and March 2001, the Starks filed suit in the United States District

1. 381 F.3d 793 (8th Cir. 2004).
2. Mastrobuono v. Shearson Lehman Hutton, Inc., 514 U.S. 52, 62 (1995).
3. *Stark*, 381 F.3d at 797.
4. *Id.* The note was sold to EMC by the Starks' original lender around April 2000, just prior to these proceedings. *Id. See* Fair Debt Collection Practices Act, 15 U.S.C. § 1692 (2004).
5. *Stark*, 381 F.3d at 797.
6. *Id.*
7. *Id.*

Court for the Western District of Missouri against EMC and its attorneys in April 2001, under the FDCPA.[8] The district court ordered the parties to arbitration, as mandated in the parties' loan agreement.[9] Even while the claim was pending in arbitration, an EMC agent forcibly entered the Starks' home, called Mrs. Stark, and wrote to the Starks directly.[10] These actions led to an amended complaint wherein the Starks alleged intentional torts by EMC and asked for punitive damages.[11] EMC opposed the motion to amend, maintaining that their arbitration agreement expressly excluded punitive damages, while the Starks argued that such a limitation was unconscionable and unenforceable.[12] Discerning the contract language as ambiguous,[13] the arbitrator construed the language against EMC, finding that punitive damages were not prohibited as a matter of law, and awarded actual damages totaling around $34,000, and punitive damages of $6,000,000.[14]

EMC moved to vacate the punitive damage award, continuing to claim that punitive damages were expressly prohibited in their agreement.[15] The district court sustained the challenge and vacated the punitive damage award, finding that the agreement was not ambiguous, and thus, did not require any interpretation by the arbitrator that would allow for a punitive damage award.[16]

The Starks appealed the vacatur to the United States Court of Appeals for the Eighth Circuit, arguing that the arbitrator had the authority to construe the contract, and it was not irrational to have concluded that punitive damages were allowed.[17] Among other points,[18] EMC argued that the finding of an ambiguity was irrational because the language of the agreement clearly prohibited punitive damages, and that the award was "excessive and made in manifest disregard of the law."[19] Reversing the district court's decision to vacate the punitive damage

8. Stark v. Sandberg, Phoenix & von Gontard, P.C., 381 F.3d 793, 797 (8th Cir. 2004).

9. *Id.* The parties did not dispute the district court's order to compel arbitration.

10. *Id.*

11. *Id.*

12. *Id.* The relevant contract provision granted the arbitrator "all powers provided by law," and subsequently denied the power to award "punitive . . . damages . . . as to which borrower and lender expressly waive any right to claim to the fullest extent permitted by law." *Id.* at 797-98.

13. *Id.* The arbitrator based the holding of ambiguity on the fact that the agreement between the Starks and EMC purported, in three sections, to allow the Starks "to seek all damages allowed by law," and then took away their ability to do so in a later section of the agreement. *Id.* at 798. The arbitrator stated this practice was "the keystone of an ambiguous contract," and should be construed in favor of the Starks. *Id.* at 798.

14. *Id.* The award of $6,000,000 was based on 1% of EMC's shareholder equity. *Id.* at 798 n.1. Although 1% would have actually been $60,000,000, the arbitrator later rectified his mistake by stating his intent was to award only $6,000,000. *Id.* Therefore, the Starks were awarded one-tenth of one percent of shareholder equity. *Id.*

15. *Id.* at 798.

16. *Id.*

17. *Id.* The Federal Arbitration Act (FAA) allows a district court to vacate an arbitration award under very limited circumstances, including fraud or corruption, evidence of partiality, arbitrator misconduct, or an arbitrator's misuse of power. 9 U.S.C. § 10(a) (2004).

18. EMC argued two additional points in its response. First, they argued that the district court properly vacated the award under § 10 of the FAA "because the arbitrator exceeded his powers by modifying [an] unambiguous [contract]." *Stark*, 381 F.3d at 799. Secondly, the award was properly modified under § 11 of the FAA, because the arbitrator made a decision on punitive damages, an issue which was not presented for assessment. *Id.* The court disregarded this second argument because the issue of punitive damages clearly was given to the arbitrator, leaving § 10 as the only appropriate avenue to remedy an excessive award. *Id.* at 800 n.2.

19. *Id.* at 800.

award, the Eighth Circuit found that, when the applicable law governing the arbitration agreement does not permit a waiver of punitive damages, an agreement that purports to waive or limit future liability will not be ruled ambiguous and punitive damages are expressly permitted.[20]

III. LEGAL BACKGROUND

Practitioners often seek arbitration as a forum for their clients, desiring it as a more expeditious means to resolve the matter at hand, as well as a forum that will not expose the client to excessive risks.[21] Because punitive damages are often awarded as a form of "punishment," in order to deter future behavior, and for the "public benefit," parties may believe that the more private system of arbitration will not open them up to the risk of having to pay punitive damages.[22] However, parties often risk having a punitive damages award assessed against them, whether in front of a judge, jury, or arbitrator. Due to the language of the parties' contract, and the applicable law, punitive damages can, and often are, awarded in arbitration.

Generally, a court's review of a final arbitration award, including any punitive damage award given by the arbitrator, is quite narrow.[23] If the arbitrator was "arguably construing or applying the contract and acting within the scope of his authority," even a serious error will not result in a reversal.[24] The reviewing court will not consider the merits, no matter if the parties contend that the arbitrator based his or her decision on a factual error or misinterpreted the contract.[25] Beyond the few grounds for vacatur provided by the Federal Arbitration Act (FAA),[26] an award will be overturned only where "it is completely irrational or evidences a manifest disregard for the law."[27] When an award includes punitive damages, that award is subject to the same standard of review, and the same considerable deference, as the arbitrator's general decision.[28]

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20. Stark v. Sandberg, Phoenix & von Gontard, P.C., 381 F.3d 793, 800 (8th Cir. 2004). Citing the plain language of the agreement, the court stated that a waiver of damages could only be made "to the fullest extent of the law." *Id.* This meant that there was only a limited waiver of damages that depended solely on the applicable state law; only if the state in question permitted a waiver could punitive damages be waived. *Id.* The court found it was plain that only Missouri law applied to the issue of the waiver. *Id.* at 800-01. In addition, the court found that, in Missouri, EMC could not "exonerate itself from liability for the intentional torts committed against the Starks by procuring the damages waiver." *Id.* at 800.

21. Barry Richard, *Corporate Litigation: Arbitration Clause Risks*, THE NAT'L L. J., June 14, 2004, *at* http://www.gtlaw.com/pub/articles/2004/richardb04b.pdf.

22. Timothy E. Travers, Annotation, *Arbitrator's Power to Award Punitive Damages*, 83 A.L.R.3d 1037 (2004). *See also* Richard, *supra* note 21, at 15 (stating that an attorney's belief that arbitration could "result in lower awards than a trial makes no sense").

23. Bureau of Engraving, Inc. v. Graphic Communication Int'l Union, 284 F.3d 821, 824 (8th Cir. 2002).

24. *Id.* (quoting United Paperworkers Int'l Union v. Misco, Inc., 484 U.S. 29, 38 (1987)).

25. *Id.*

26. 9 U.S.C. § 10(a) (2004). The FAA allows a district court to vacate an arbitration award under very limited circumstances, including fraud or corruption, evidence of partiality, arbitrator misconduct, or an arbitrator's misuse of power. *Id.*

27. Kiernan v. Pipar Jaffray Cos., 137 F.3d 588, 594 (8th Cir. 1998) (quoting Lee v. Chica, 983 F.2d 883, 885 (8th Cir. 1993)).

28. *See* Stark v. Sandberg, Phoenix & von Gontard, P.C., 381 F.3d 793, 798-99 (8th Cir. 2004).

There are at least three splits in the law regarding the courts' deference to arbitrators in upholding or vacating awards that contain punitive damages.[29] The first line of cases hold that, as a matter of policy, arbitrators have no power to award punitive damages.[30] This is known as the *Garrity* rule, and, while still in force in some state courts, has been mostly abandoned at the federal level.[31] The second line of cases have held that arbitrators have the power to award punitive damages, but only when there is an *express* provision in the contract or arbitration agreement allowing such "exemplary relief," or punitive relief.[32] Courts applying this principle will not construe broad language that provides for "all disputes" to be arbitrated in order to encompass a claim for punitive damages; rather, "exemplary relief" must be explicitly included in the arbitration agreement.[33] The third line of cases holds that punitive damages can be awarded unless it is *expressly prohibited* in the arbitration agreement, acting under the presumption that arbitrators can award exemplary relief unless taken away.[34]

Where the second and third views most clearly diverge is in interpreting an agreement where federal and state law appear to conflict.[35] Any agreement arguably involving interstate commerce is governed by the FAA, but state law can control portions of the agreement if it contains a choice-of-law clause.[36] When the arbitration clause is broad enough to permit exemplary damages under federal law, but a choice-of-law clause grants authority to the state law, and the state prohibits or limits parties' ability to waive certain exemplary relief, the conflict is especially evident.[37]

A. The Garrity Rule

The *Garrity* rule provides that arbitrators do not have the authority to assess punitive damages, regardless of what the language of the contract purports to provide, because only the state through the courts has the authority to assess punitive damages. Demonstrated first in *Garrity v. Lyle Stuart*,[38] that policy became law in New York after their highest state court removed any power from an arbitrator to award punitive damages, even if the parties had agreed the arbitrator could award such damages.[39] The court in *Garrity* made two findings, which continue to hold

29. John Y. Gotanda, *Awarding Punitive Damages in International Commercial Arbitrations in the Wake of Mastrobuono v. Shearson Lehman Hutton, Inc.*, 38 HARV. INT'L L.J. 59, 68 (1997).

30. *Id.*

31. Jessica Jia Fei, *Awards of Punitive Damages*, Jones Day, 2003 Stockholm Arbitration Report 2, at 21-22 (2003), *available at* http://www1.jonesday.com/FILES/tbl_s31Publications/FileUpload137/1223/JiaFei_Punitive_Damages.pdf (last visited Oct. 9, 2004) (discussing *Garrity v. Lyle Stuart*, 40 N.Y.2d 354 (N.Y. 1976) wherein the New York court vacated the punitive damages award because punitive damages can only be awarded by the state in a judicial forum in New York).

32. Gotanda, *supra* note 29, at 69.

33. *Id.*

34. *Id.* at 69-70.

35. *Id.* at 70-71.

36. *Id.*

37. *Id.* at 71.

38. 40 N.Y.2d 354 (N.Y. 1976).

39. Brett Alan Barfield & Judith Korchin, *Punitive Damages and Summary Disposition in the Revised Uniform Arbitration Act*, Holland & Knight Publications (Jan. 31, 2003), *at* http://www.hklaw.com/Publications/OtherPublication.asp?ArticleID=1306.

sway in some jurisdictions as the *Garrity* rule.[40] The court reasoned that punitive damages are a punishment and strong public policy gives exclusive authority to the state through its courts to define when such "socially exemplary remed[ies] are appropriate," and that little judicial review given to arbitration awards would make punitive awards "both unpredictable and uncontrollable."[41] In addition, arbitration awards are generally unpublished, so the court noted that any deterrent effect of a large punitive award, which is often a goal in giving such awards, would go unnoticed.[42]

Eight years after *Garrity*, in *Willoughby Roofing & Supply Co. v. Kajima International*, the parties did not authorize or deny the arbitrator the power to award punitive damages in their agreement, so the district court interpreted that silence as authority to award punitive damages under the FAA.[43] In direct contrast to *Garrity*, the federal court in *Willoughby* held that public policy favors arbitration in resolving disputes, and an arbitrator is more likely than the courts to be versed in the particular issue at hand, and therefore more able to award appropriate remedies.[44] The court also theorized that a party's option to waive punitive damages could "encourage grossly unjustified conduct in certain cases by making it more economically feasible" to engage in tortious conduct, knowing liability will not attach.[45] Many state courts followed *Willoughby*, ignoring the precedent set by the New York court in *Garrity*, and held that arbitrators do have the authority to award punitive damages without being expressly given such authority.[46] However, *Willoughby* and cases following it did not overrule *Garrity* in the state courts, and the *Garrity* rule still holds influence in arbitrations where only state arbitration law applies, and the state law allows waiver of certain remedies.

B. Express Provision Allowing Punitive Damages

Some courts have held that punitive damages can be awarded only with an express provision giving the arbitrator the power to do so,[47] reasoning that punitive damages are an extraordinary remedy, and broad language should not be conclusive to imply that parties intend to provide for punitive damages.[48] However, because intent of the parties to decide their own outcome is important, these courts will give effect to provisions that expressly award punitive damages should a dispute arise.[49]

A typical example of a case falling into this view is one where the agreement authorizes the arbitrator to award general fines, penalties, or damages. In a 1986 Eighth Circuit case,[50] the parties' agreement stated that, upon violation, the claim

40. *Id. See also* Gotanda, *supra* note 29, at 69 n.50.
41. Garrity v. Lyle Stuart, 40 N.Y.2d 354, 359 (N.Y. 1976).
42. Gotanda, *supra* note 29, at 69 n.50.
43. 598 F. Supp. 353 (N.D. Ala. 1984), *aff'd*, 776 F.2d 269 (11th Cir. 1985).
44. *Id.* at 363.
45. *Id.*
46. *See* Barfield & Korchin, *supra* note 39, at 2 n.13.
47. Gotanda, *supra* note 29, at 69.
48. *Id.*
49. *Id.*
50. Int'l Ass'n of Heat & Frost Insulators & Asbestos Workers, Local 34 v. Gen. Pipe Covering, 792 F.2d 96 (8th Cir. 1986).

would be arbitrated by the Trade Board, which would have the authority to "impose fines or other penalties."[51] The Eighth Circuit confirmed the arbitrator's award, even though the court had to interpret the arbitration language to discern that punitive damages were expressly allowed, and stated that "punitive arbitration awards are generally disfavored."[52]

C. Punitive Damages Favored in the Face of Ambiguity

In 1995, the United States Supreme Court attempted to resolve the conflicting interpretations among the federal circuits and the states in enforcing arbitration agreements by developing a third view of the arbitrator's power to award punitive damages in the process.[53] The courts of appeals were split on "whether 'a contractual choice-of-law provision may preclude an arbitral award of punitive damages that otherwise would be proper.'"[54] The issue in *Mastrobuono* stemmed from a securities arbitration claim, where the customers of Shearson, a brokerage firm, brought a claim against the firm for "mishandling their account."[55] Two clauses from their arbitration agreement were relevant: (1) a generic choice-of-law clause stating the agreement was to be governed by New York state law; and (2) a clause stating that any "disputes between the parties were to be resolved through arbitration in accordance with" federal provisions.[56] After the arbitration, defendant Shearson paid the compensatory damages ordered by the arbitrator, but sought to vacate the punitive damage award.[57] The district court granted the motion to vacate, and the Seventh Circuit affirmed. Both courts used *Garrity* to find the New York choice-of-law provision was controlling, and that the power to award punitive damages was reserved exclusively for the courts.[58]

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51. *Id.* at 100.

52. *Id.*

53. Gotanda, *supra* note 29, at 71 (citing Mastrobuono v. Shearson Lehman Hutton, Inc., 514 U.S. 52 (1995)).

54. Mastrobuono v. Shearson Lehman Hutton, Inc., 514 U.S. 52, 55 (1995). *Compare* Barbier v. Shearson Lehman Hutton, Inc., 948 F.2d 117 (2nd Cir. 1991) (vacating the award because arbitrators abused their discretion in awarding punitive damages because both parties intended state law to apply, which prohibited the award), *and* Pierson v. Dean, Witter, Reynolds, Inc., 742 F.2d 334 (7th Cir. 1984) (favoring separation of the claims so that those claims the parties agreed to arbitrate would be arbitrated), *with* Bonar v. Dean Witter Reynolds Inc., 835 F.2d 1378, 1386-1388 (11th Cir. 1988) (holding that the district court abused its discretion when it failed to vacate an arbitral award that included punitive damages when it was shown an expert witness had fraudulent credentials), Raytheon Co. v. Automated Bus. Sys., Inc., 882 F.2d 6 (1st Cir. 1989) (holding that commercial arbitrators have the power and authority to award punitive damages under a general contractual arbitration clause where parties did not specifically exempt punitive damages), *and* Lee v. Chica, 983 F.2d 883 (8th Cir. 1993) (finding that the FAA applied to the agreement, federal substantive law allows punitive damages, and arbitrators were permitted to award punitive damages under the plain meaning of the contract language).

55. Jill I. Gross, *Over-Preemption of State Vacatur Law: State Courts and the FAA*, 3 J. AM. ARB. 1, 14 (2004).

56. Gotanda, *supra* note 29, at 71. Under the agreement, the parties' dispute could be resolved under the rules of the National Association of Securities Dealers, Inc. (NASD), the New York Stock Exchange (NYSE), or the American Stock Exchange, Inc. (AMEX). *Id.* The court ordered the arbitration procedure of the NASD would be used, which is not relevant to the holding, except that the NASD is federal law and conflicts with the agreement's clause that New York law would govern. *Id.*

57. *Mastrobuono*, 514 U.S. at 54.

58. *Id.* at 54-55.

In reversing the lower courts, the Supreme Court found that neither clause intended to exclude punitive damages, although neither explicitly included punitive damages as an option for the arbitrator.[59] If anything, the parties left their intent regarding punitive damages ambiguous, leaving it open for the court to construe the choice-of-law clause narrowly and applying it only to substantive principles of New York law.[60] The Court's decision gave deference to both state and federal law, furthered the policy that discrepancies should favor arbitration and a broad range of remedies, and followed the "well-settled principle" to resolve ambiguities against the drafter of the document.[61] In addition to using ambiguity in favor of the Mastrobuonos, the Court did not want to punish them for their apparent ignorance of New York's "bifurcated approach" to punitive damages, where a party to an agreement governed solely by New York common law and policy would clearly be giving up a substantive right to punitive damages.[62]

In deciding the case, the Court had to distinguish its earlier decision in *Volt Information Sciences v. Board of Trustees of Leland Stanford Junior University*.[63] *Volt* involved a construction contract where all disputes would be arbitrated, and the contract itself was to be governed by the place of the incident; in this case, California law applied.[64] However, the choice-of-law was not clear, and a conflict arose as to whether one party could seek to stay arbitration, pending related litigation in a state court.[65] Ending up in the United States Supreme Court, the case was resolved in favor of the California provisions allowing one party to seek a stay of the arbitration proceedings.[66] The Court held that if "parties have agreed to abide by state rules of arbitration, enforcing those rules according to the terms of the agreement is fully consistent with the goals of the FAA."[67] Therefore, the choice-of-law clause in the agreement incorporated procedural aspects of state law.[68] Resolving its decision in *Volt* with its decision in *Mastrobuono*, the Court reasoned that *Mastrobuono* was reviewing the Seventh Circuit's interpretation of a

59. Gotanda, *supra* note 29, at 73.

60. *Id.* at 73-74. The Supreme Court did not consider the state's arbitration law and policy as "substantive." *See also* Jia Fei, *supra* note 31, at 25 (discussing that "the power to award punitive damages is a power derived from procedural law"). *Garrity* remains the New York procedural law; arbitration agreements governed by state law will prohibit arbitrators from awarding punitive damages as a procedural matter. *Id.* Additionally, state substantive law will still be used in any case as *justification* for the grant of punitive damages if a choice-of-law clause is used. *Id.*

61. Gotanda, *supra* note 29, at 74.

62. *Id. See also* Lisa Mellas, *New York Update—Arbitration Agreements May Not Protect You From Punitive Damages*, White & Williams L.L.P., FINDLAW FOR LEGAL PROFESSIONALS, *available at* http://library.lp.findlaw.com (2000) (last visited Oct. 9, 2004) (discussing that acknowledgement of the *Garrity* or *Mastrobuono* holdings in a contract can aid parties in avoiding the effect of those holdings). In that the Supreme Court was swayed in *Mastrobuono*, because the parties likely did not know of *Garrity*, Mellas theorizes that "contractual clarity" may aid a party in avoiding the effect of *Mastrobuono*. *Id.* In support of this theory, Mellas cites *Lian v. First Asset Management*, 710 N.Y.S.2d 52 (N.Y. App. Div. 2000), wherein the court found that failure to acknowledge *Mastrobuono* in the arbitration agreement "rendered unenforceable an express waiver of punitive damages." *Id.*

63. 489 U.S. 468 (1989).

64. Gross, *supra* note 55, at 13.

65. *Id.*

66. *Id.* at 14.

67. *Id.* (quoting Volt Info. Scis., Inc. v. Bd. of Trs. of Leland Stanford Junior Univ., 489 U.S. 468, 479 (1989)).

68. Mastrobuono v. Shearson Lehman Hutton, Inc., 514 U.S. 52, 64 (1995) (Thomas, C., dissenting).

contract, while *Volt* was a review of a state court's interpretation of the parties' contract under that state's rules of contract.[69]

D. Effect of Mastrobuono

While the majority in *Mastrobuono* purported to resolve that federal law would govern as to punitive damages due to the procedural nature of the issue, in his dissent, Justice Thomas concluded that the issue was still wide open.[70] Thomas wrote that *Volt*, where state law was not preempted by the FAA, and *Mastrobuono*, where the FAA preempted state law, were not distinguishable simply on the grounds of procedural posture.[71] He contended that *Mastrobuono* and *Volt* had choice-of-law clauses that were "functionally equivalent" and should have resulted in the same decision regarding which law applied, whether it be federal or state.[72] In resolving the decisions for himself, Thomas stated that at least the "majority's decision [was] limited and narrow," and would amount to nothing more than a single federal court's use of a state law.[73]

Justice Thomas was not the only person to have difficulty resolving which law would apply after *Mastrobuono*.[74] Commentators have remarked that the holding encourages forum-shopping because of the potential that Thomas was correct, and that it only applies in the limited circumstance of review of a federal court's interpretation of a choice-of-law clause.[75] Supreme Court decisions following *Mastrobuono* have clarified that *Volt* involved preemption of a state procedural rule, while *Mastrobuono* was a decision that preempted New York's substantive law that limited punitive damages under the *Garrity* rule.[76]

Although federal courts now follow *Mastrobuono* and leave punitive damages as a procedural issue under federal law,[77] state courts are not necessarily so quick to follow suit. Particularly in New York, where many securities' arbitrations take place, courts continue to ignore *Mastrobuono*, retaining the *Garrity* rule and prohibiting arbitrators from awarding punitive damages.[78] Somewhere between those two views, *Mastrobuono* likely suggests, when it comes to the issue of punitive damages in arbitration: (1) arbitrators are free, in many situations, to award punitive damages; (2) a state law that purported to preclude punitive awards would likely be preempted by the FAA if federal law applied to any procedural part of the arbitration agreement; and (3) parties may, if done explicitly, take punitive

69. Gross, *supra* note 55, at 15.

70. Mastrobuono v. Shearson Lehman Hutton, Inc., 514 U.S. 52, 64 (1995) (Thomas, C., dissenting).

71. *Id.*

72. *Id.* at 66-67. State law would prohibit punitive damages in *Mastrobuono*, and state law would have stayed the dispute from even going to arbitration in *Volt*. *Id.* *See* Volt Info. Scis., Inc. v. Bd. of Trs. of Leland Stanford Junior Univ., 489 U.S. 468, 479 (1989).

73. *Mastrobuono*, 514 U.S. 52, 71-72 (Thomas, C., dissenting).

74. Gross, *supra* note 55, at 15.

75. *Id.*

76. *Id.*

77. Gotanda, *supra* note 29, at 75-76 & n.96.

78. *Id.* at 75. *See* Dean Witter Reynolds Inc. v. Trimble, 631 N.Y.S.2d 215 (N.Y. Sup. Ct. 1995). In *Trimble*, the court "[found] *Mastrobuono* inapplicable and [held] that [the] arbitrator lacked authority to award punitive damages under the *Garrity* rule when the arbitration was to take place in New York, be conducted under AMEX rules, and be governed by New York law." *Id.* at 75 n.95.

damages off the table in their contracts.[79] Additionally, because *Mastrobuono* was more directly concerned with the issue of choice-of-law provisions than the more specific issue of how punitive damages fit into those choices, the case also served to show that a choice-of-law provision in an arbitration agreement will generally apply only to state substantive law.[80]

IV. INSTANT DECISION

In *Stark v. Sandberg, Phoenix & von Gontard, P.C.*, the Eighth Circuit considered the applicability of a punitive damages waiver in an arbitration agreement that gave the arbitrator "all powers provided by the law," and then denied, "to the fullest extent permitted by the law," the power to award punitive damages.[81] The court analyzed the agreement itself in finding, contrary to the district court, that the award of punitive damages should not be vacated.[82]

Without question, the Eighth Circuit determined that because the plain language of the agreement gave either party the right to "expressly waive any right to claim [punitive damages] to the fullest extent permitted by law," punitive damages could be waived "only if governing law permitted such a waiver."[83] Therefore, if the governing law did *not* permit a right to waive such damages, as was the case with Missouri state law, neither party could do so.[84] It was the parties' intent to apply Missouri law, and Missouri law is well-settled on this issue; future liability can never be waived "for intentional torts or for gross negligence, or for activities involving the public interest."[85] Because a waiver of punitive damages is an attempt to "exonerate oneself from future liability," the court discerned that the parties could not waive future claims against them for punitive damages.[86]

The court acknowledged that the parties could have avoided this holding if the FAA, which allows parties to put terms into their arbitration agreements that are not otherwise permitted under state law, had been the sole governing authority for their agreement.[87] However, the court stated it was clear that Missouri law applied because the arbitration clause provided for arbitration "to the extent allowed by applicable law," and the "applicable law" was defined later in the agreement as "the laws of the state" where the Starks' property was located.[88] Therefore, Missouri state substantive law clearly applied to the agreement.[89] Unlike *Mastrobuono*, where the authority of an arbitrator to award punitive damage awards was an issue of procedural law,[90] the court in *Stark* defined the authority to award punitive damages as an issue of substantive law.[91]

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79. Jia Fei, *supra* note 31, at 24.
80. Gotanda, *supra* note 29, at 76-77.
81. Stark v. Sandberg, Phoenix & von Gontard, P.C., 381 F.3d 793, 797-98 (8th Cir. 2004).
82. *Id.* at 803.
83. *Id.* at 800.
84. *Id.*
85. *Id.* (quoting Alack v. Vic Tanny Int'l of Mo., Inc., 923 S.W.2d 330, 337 (Mo. 1996)).
86. *Stark*, 381 F.3d at 800.
87. *Id.*
88. *Id.* The Starks' home was located near Kansas City, Missouri. *Id.* at 797.
89. *Id.* at 800.
90. Mastrobuono v. Shearson Lehman Hutton, Inc., 514 U.S. 52, 64 (1995).
91. *Stark*, 381 F.3d at 800.

The Eighth Circuit also addressed the arbitrator's finding that the agreement was ambiguous, a finding which the district court considered irrational.[92] Because the agreement was to "operat[e] within the framework of the FAA,"[93] while also governed by the choice-of-law provision as to waiver of punitive damages, the court found that "an arbitrator could reasonably conclude [the] agreement [was] ambiguous" and award punitive damages.[94] Comparing this case to *Mastrobuono*, where the Supreme Court agreed that a "choice-of-law clause introduces an ambiguity into an arbitration agreement that would otherwise allow punitive damages awards," the court in *Stark* was further convinced that the arbitrator's finding of ambiguity was not irrational.[95]

Lastly, the Eighth Circuit addressed the possibility that the punitive damage award exhibited "manifest disregard of the law."[96] Because the arbitrator clearly explained his reasoning for the award, and his reasoning was based on a percentage of shareholder equity, the court did not find manifest disregard.[97] In conclusion, the court maintained that EMC "got exactly what it bargained for" because it chose to enter an agreement to arbitrate in order to decide the rules by which it would be governed, and it should have to abide by such rules.[98] As similarly stated in *Mastrobuono*, where one party "drafted an ambiguous document . . . they cannot [later] claim the benefit of the doubt," and the party who did not select the language is protected from an "unintended or unfair result."[99]

V. COMMENT

A cursory reading of *Stark* implies that parties, or at least the offending party, can find relief from liability, even after grievously tortious conduct, by simply including the right language in the arbitration agreement.[100] If only federal law applies to the agreement, parties can clearly limit punitive damages under the FAA. If only state law applies, parties can also clearly limit punitive damages, as seen by the continued use of the *Garrity* rule in some jurisdictions. However, if parties wish to apply both state and federal law, their drafting must be exceptionally clear in defining which law is intended to govern which provisions in the

92. Stark v. Sandberg, Phoenix & von Gontard, P.C., 381 F.3d 793, 800 (8th Cir. 2004).
93. *Id.*
94. *Id.* at 801.
95. *Id.* (quoting *Mastrobuono*, 514 U.S. at 62).
96. *Id.* at 802.
97. *Id.*
98. *Id.* at 803.
99. Mastrobuono v. Shearson Lehman Hutton, Inc., 514 U.S. 52, 62 (1995).
100. *See* Mellas, *supra* note 62 (stating that "parties may be able to waive liability for punitive damages with forethought and careful contractual drafting"); Barfield & Korchin, *supra* note 39, at 3 (stating that, the court's decision to look directly to the contract in *Mastrobuono*, "suggests that agreements containing express waivers of the right to claim punitive damages may be upheld, where statutory rights are not implicated"); CPR Institute for Dispute Resolution, *Model ADR Clauses, at* www.cpradr.org/formbook/pdfs/2/arbc.pdf (last visited Jan. 5, 2005) (describing how to write arbitration clauses, suggests that "unless punitive damages are explicitly carved out in the arbitration clause, the arbitrator(s) may be empowered to award such damages"). *See also* UHC Mgmt. Co. v. Computer Scis. Corp., 148 F.3d 992, 997 (8th Cir. 1998) (asserting that it is not that difficult for parties to ensure the FAA is applied because the court "will not interpret an arbitration agreement as precluding the application of the FAA unless the parties' intent that the agreement be so construed is abundantly clear").

agreement. In order to clearly prohibit punitive damages, the contract must use only federal law, which allows for such a waiver, or provide for the use of state law, where that state actually allows a waiver, which was not the case in *Stark*. On the other hand, it is less difficult to ensure that an arbitrator will be given the authority to award punitive damages, because federal law favors arbitrability, and all possible remedies that entails.

In essence, the Eighth Circuit based its opinion in *Stark* on the agreement language that stated: parties "expressly waive any right to claim [punitive damages] to the fullest extent permitted by law."[101] Because the court found, without question, that parties intended Missouri law to apply to the substantive terms of the agreement, and Missouri law allows no waiver of future liability of punitive damages, the Starks could receive punitive damages stemming from EMC's conduct.[102] The court further stated that, if only the FAA governed the agreement, "the punitive damages waiver might have barred any such award."[103]

While the *Stark* court's holding clearly applied the law correctly based on the contract language and Missouri's limitations on waivers, its implication is troubling, particularly when considered in the context of the facts of the case. Not only did EMC continue to contact the Starks in violation of the FDCPA, but an EMC agent also forcibly entered the Starks' home.[104] In front of a judge or jury, this would surely be compelling evidence for punitive damages. Similarly, if placed in front of an arbitrator, punitive damages would likely be awarded, except for the fact that parties may have taken that remedy off the table. Arbitration is partially intended to allow parties to lay out their potential complaints pre-dispute, in exchange for the belief that they would be settled quickly, and the parties therefore have reasonable expectations as to the outcome.

However, at least in certain contexts, public policy does not favor waiving liability for intentional tortious conduct concluding that it should be outside the reach of parties' ability to waive, even if done so expressly. In *Mastrobuono*, the United States Supreme Court, holding that punitive damages were not foreclosed, discussed that it appeared "unlikely that petitioners were actually aware of New York's bifurcated approach[105] to punitive damages" or that "by signing a standard-form contract . . . they might be giving up an important substantive right."[106] This implies that the Court's holding was not only based on the finding that federal law applied to the arbitration agreement and also to the parties' situation. Therefore, it is possible, and perhaps likely, that even if parties expressly waive punitive damages, the measure could still be awarded by an arbitrator, and upheld by a reviewing court.

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101. Stark v. Sandberg, Phoenix & von Gontard, P.C., 381 F.3d 793, 800 (8th Cir. 2004) (alteration in original).

102. *Id.*

103. *Id.*

104. *Id.* at 797.

105. "Bi-furcated approach" refers to New York state law that "the power to award punitive damages is limited to judicial tribunals and may not be exercised by arbitrators . . . ." Mastrobuono v. Shearson Lehman Hutton, Inc., 514 U.S. 52, 53 (1995). *See also* Gotanda, *supra* note 29, at 84. Gotanda noted that the *Mastrobuono* court was "concerned about unequal bargaining power between the securities company and private investors [and] had sought to protect investors from abusive practices . . . ." *Id.*

106. *Mastrobuono*, 514 U.S. at 53.

Beyond specific examples of when punitive damages seem appropriate, such as in *Stark* and *Mastrobuono*, public policy generally favors awards of punitive damages in situations where unequal bargaining power exists.[107] Punitive damages are awarded when a party has acted in a "willful or malicious" manner with the goal of keeping the injured "from engaging in self-help remedies," and for "compensating victims for otherwise uncompensable losses."[108]

In *Willoughby*,[109] the Eleventh Circuit provided several arguments in favor of punitive damage awards.[110] First, arbitration is no longer mistrusted, as it had been historically, thus encouraging courts and parties in arbitration to want to avoid giving too much leeway to arbitrators.[111] Second, in practice, it has not played out that arbitrators, if given the power, abuse their ability to award punitive damages.[112] Third, arbitrators have usually been allowed to use "broad powers" in crafting their remedies in order to fit each unique arbitration situation.[113] Fourth, if arbitration is a more cost and time efficient means of settling disputes, then it is more expeditious to put all claims before an arbitrator, rather than leaving open the possibility of a later judicial claim for punitive damages.[114] Finally, if the party who might seek a claim to punitive damages in court does not do so, or is barred from doing so, then he or she has lost an important substantive right.[115]

Even if parties follow the suggestion of the *Stark* court, and explicitly waive punitive damages as allowed by the governing law, it appears there are at least three reasons why courts may discount language purporting to waive punitive damages and give arbitrators the power to award punitive remedies. The first is found when public policy mandates that it would not be "fair" for the particular parties to take punitive damages out of the picture. As in *Mastrobuono*, courts will look at the facts in order to protect one party from "unintended or unfair result[s]."[116] The party who would benefit from a waiver of punitive damages is often the party that drafted the agreement, giving that party the upper hand; consequently, courts will construe the agreement against that party.[117] This interpretation is supported by the non-statutory reasons for vacatur, which include reversal if an award is "completely irrational," in "manifest disregard of the law," [118] or void against public policy.[119]

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107. *See also* Gotanda, *supra* note 29, at 84.
108. *Id.* at 63.
109. Willoughby Roofing & Supply Co. v. Kajima, 776 F.2d 269 (11th Cir. 1985).
110. *See* Jia Fei, *supra* note 31, at 30 (providing a summary of the supporting arguments presented in *Willoughby*, 776 F.2d 269 (11th Cir. 1985)).
111. *Id.* at 30.
112. *Id.*
113. *Id.*
114. *Id.*
115. *Id.*
116. Gotanda, *supra* note 29, at 84.
117. Barfield & Korchin, *supra* note 39, at 3 n.24. The *Willoughby* court even remarked that, if a party could simply eliminate punitive damages with the right contract language, many more would attempt to do so. *Id.*
118. Stark v. Sandberg, Phoenix & von Gontard, P.C., 381 F.3d 793, 799 (8th Cir. 2004) (quoting Hoffman v. Cargill Inc., 236 F.3d 458, 461 (8th Cir. 2001)).
119. Gulf Guar. Life Ins. Co. v. Conn. Gen. Life Ins. Co., 304 F.3d 476, 488 (5th Cir. 2002). The Fifth Circuit stated, "We have recently similarly determined that a court may entertain a challenge to the enforcement of arbitration agreements based on a theory that the agreement is void as against public policy." *Id.*

Second, there are particular types of disputes where courts have consistently been disinclined to prohibit punitive damages. One such area is in arbitrations involving employment disputes.[120] For example, the Eleventh Circuit voided an arbitration clause that gave the arbitrator power to only award compensatory damages, stating that it denied the employee "the possibility of meaningful relief in an arbitration proceeding."[121] In addition to employment disputes, securities agreements involving the potential waiver of punitive damages, such as in *Mastrobuono*, are particularly troublesome.[122] When an investor contracts with a brokerage firm, he or she is at an obvious disadvantage in knowing about securities, the intangibility of securities leaves them "susceptible to abuse," and brokers almost always work on commission, leaving them dependent on the investor to continue buying.[123] These characteristics leave the securities industry particularly open for "fraud and breaches of fiduciary duty,"[124] and explain why securities firms make it a point to arbitrate most of their disputes in New York under the *Garrity* rule. Certainly securities firms are not the only commercial entities engaged in potentially "unscrupulous and malicious conduct,"[125] and one can easily imagine other settings in which it would be unjust to completely take away the possibility of punitive damages for an injured claimant.

A third reason a court might not interpret language that was intended to prohibit punitive damages is the disagreement over whether the authority to award punitive damages is an issue of procedure or substance. In *Stark*, the court stated that Missouri law clearly applied to the substantive terms of the agreement.[126] In *Mastrobuono*, state law was applied to "substantive principles," but whether or not the arbitrator has the authority to award punitive damages was an issue of procedure.[127] Even if a contract is drafted with specificity so as to apply state law to certain provisions, and federal law to others, a drafter must also forecast whether the state court, or the federal court applying state law, will consider the authority to award punitive damages an issue of substance or procedure.

It appears Justice Thomas' contention that *Mastrobuono* was a narrow holding was enlightening, although for reasons other than he stated.[128] He believed that more parties would be successful in limiting their damages and avoiding *Mastrobuono's* holding, but in cases like *Stark*, it has been the opposite. *Stark* and *Mastrobuono* imply that clear language in the arbitration agreement would effectuate a limitation on punitive damages. However, parties continue to be exposed to liability because they have not tweaked the language quite enough, or been careful in using the appropriate governing law. This is further stymied by a vari-

120. Barfield & Korchin, *supra* note 39, at n.3. The authors cite *Paladino v. Avnet Computer Techs., Inc.*, 134 F.3d 1054, 1062 (11th Cir. 1998), wherein the Eleventh Circuit found that Title VII prohibits limiting an arbitrator to only compensatory damages because it "denies the employee the possibility of meaningful relief in an arbitration proceeding." *Id.* at 3 n.23.

121. *Id.* (quoting *Paladino*, 134 F.3d at 1062).

122. Gotanda, *supra* note 29, at 85.

123. *Id.* at 85-86.

124. *Id.* at 86 (quoting Norman S. Poser, *When ADR Eclipses Litigation: The Brave New World of Securities Arbitration*, 59 BROOK L. REV. 1095, 1096 (1993)).

125. *Id.*

126. Stark v. Sandberg, Phoenix & von Gontard, P.C., 381 F.3d 793, 800 (8th Cir. 2004).

127. Mastrobuono v. Shearson Lehman Hutton, Inc., 514 U.S. 52, 64 (1995).

128. *Id.* at 72-73 (Thomas, C., dissenting).

ety of mechanisms courts will use to ensure that awards are fair and appropriate to the circumstances, such as in *Stark*, where the Eighth Circuit considered limitations on damages to be a substantive, rather than a procedural issue.

VI. CONCLUSION

Although it appears *Stark* implies that parties can easily limit their liability with appropriate waiver clauses and choice-of-law provisions, it is possible courts will continue to find the means—whether based on public policy, or based on requirements for even more specific provisions—to uphold arbitral awards giving punitive damages. While this protects the "little guy" from losing the right to potentially viable claims for punitive damages, it also holds the potential to make it more difficult for two parties approaching a dispute on equal footing to be assured they will get exactly what they bargained for in arbitration. Even so, parties skilled in drafting will most likely find appropriate language and choice-of-law provisions to contract their preferred terms, or choose to apply only federal law, which certainly allows parties to limit the potential that they will be liable for punitive damages.

ALEXIA NORRIS