

## **U.S. punitive damages awards before German courts – Time for a new approach**

von *Hendrik Auf'mkolk*, Universität Münster

### **I. Introduction – punitive damages revisited**

Punitive damages have always been a characteristic and much debated feature of U.S. tort law. Curiously, punitive damages seem to be discussed most passionately in civil law jurisdictions.<sup>1</sup> The sheer amount of judicial works regarding punitive damages is overwhelming. In September 2006, even the German Lawyers Assembly (*Deutscher Juristentag*) concerned itself, among other things, with punitive damages. When asked whether punitive damages should be introduced into Germany law, however, a vast majority of delegates declined categorically.<sup>2</sup> In light of this traditional resistance on the one hand and contrary tendencies in the modern law of damages in Germany on the other hand, this article examines whether U.S. punitive damages awards can still be denied recognition and enforcement before German courts.

To begin with, it is important to keep in mind that U.S. tort law is not federal law and as a result differs considerably among the fifty states. In

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<sup>1</sup> See *Mörsdorf-Schulte*, Strafschadensersatz – eine deutsche Hassliebe?, NJW 2006, 1184 for a recent comment on the peculiar fascination with punitive damages in Germany.

<sup>2</sup> Detailed results can be found on the website of the German Lawyers Assembly at [http://www.djt.de/files/djt/66/66\\_DJT\\_Beschluesse.pdf](http://www.djt.de/files/djt/66/66_DJT_Beschluesse.pdf)

fact, Nebraska and Puerto Rico do not allow punitive damages.<sup>3</sup> All other states acknowledge the general idea that compensatory damages are not enough in cases of reckless, willful and wanton misconduct of the defendant. In order to punish the tortfeasor for his behaviour and deter him and others from repeating it, courts may therefore increase the sum awarded to the plaintiff beyond the actual loss.

In accordance with the idea of punishing only exceptionally wrong conduct, courts are expected to treat punitive damages with reserve. In almost 12,000 civil cases that were decided by the courts of the seventy-five most populous counties in 2001, only three percent lead to punitive damages awards.<sup>4</sup> They are most frequently granted in cases of product liability, unfair competition and professional liability. Traditionally, punitive damages awards were not limited in size, which resulted in a number of spectacular jury verdicts in cases such as *Grimshaw v. Ford*<sup>5</sup> (\$125 mil.) and *Pennzoil, Co. v. Texaco, Inc.*<sup>6</sup> (\$3 bil.) to name but a few. In 2000, a class-action against Philip Morris made headlines around the world when a Florida court awarded the unprecedented amount of \$145 billion. However, such exorbitant sums were usually reduced to reasonable figures by the judge or on appeal. In *BMW of North America v. Gore*<sup>7</sup>, the U.S. Supreme Court set forth certain constitutional limits to punitive damages. Later the court confirmed in a key judgment<sup>8</sup> that awards exceeding compensatory damages by the factor of ten or more normally violate due process rules guaranteed by the constitution. Additionally, most states have recently enacted tort reforms to curtail such awards.

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<sup>3</sup> Fritz, Punitive/exemplary damages in den USA und ihre Qualifikation als Zivilsache, Diss. Münster 2004, p. 19.

<sup>4</sup> Cf. statistics provided by the US Department of Justice, <http://ojp.usdoj.gov/bjs/civil.htm>

<sup>5</sup> 174 Cal. Rptr. 348 (1981).

<sup>6</sup> 729 S.W. 2d 768 (1987).

<sup>7</sup> 517 U.S. 559 (1996).

<sup>8</sup> *State Farm Mutual Automobile Insurance Co. v. Campbell*, 123 S.Ct. 1513 (2003).

## **II. Punitive damages - a civil court matter under Sec. 328 ZPO?**

Whether a foreign civil judgement is enforceable in Germany is subject to German procedural law if not regulated in a relevant treaty. To date there is no such treaty between Germany and the U.S., thus the German Civil Procedure Code (abbr. ZPO) is applicable, in particular sections 722, 723 and 328. Sec. 722, 723 ZPO require the foreign judgement to be enforceable in the state from which it originates and to be compatible with the prerequisites set forth in Sec. 328 ZPO.

However, if there is no civil court matter anyway, the Civil Procedure Code is not applicable. This raises the question whether punitive damages awards qualify as a civil court matter under German law. In that regard, their procedural embedding in the U.S. might be a first indicator. Punitive damages are awarded by civil courts in regular civil proceedings. They are asserted by individuals, not by the state, and based on tort claims, not criminal charges. Consequently, the defeated party is not considered convicted. As regards content, punitive damages primarily focus on punishment and deterrence, which are typical functions of criminal penalties. Notwithstanding their penal functions, they form one pillar of the dualistic system of damages in the U.S. Accordingly, punitive damages can only be awarded in combination with compensatory claims, i.e. not on their own. Moreover, they also make up for the victim's legal costs<sup>9</sup> and the burden of bringing the matter before court.

At the same time, penal elements are rare but not absent in German civil law. Contractual penalties under Sec. 339 of the German Civil Code (abbr. BGB) allow to penalize the party in breach of the contract. Despite their penal effect, their civil nature has never been seriously doubted. The same is true for the fact that under the German law of general terms and

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<sup>9</sup> Contrary to the rule of loser-pays-all, which is applied in most European jurisdictions including the U.K., in the U.S. each party usually has to bear its own costs.

conditions voidness of a single clause affects the validity of the rest. Even from a German perspective, punitive damages are in consequence a civil court matter. This is in line with the prevailing opinion in literature and court practice.<sup>10</sup>

Nevertheless, it should be noted that some U.S. states have recently enacted so called split-recovery statutes under which damages are distributed among the plaintiff and the state.<sup>11</sup> If this trend continues to grow, the German position considering punitive damages a civil court matter might have to be reconceived. That would certainly be the case as soon as punitive damages are paid exclusively to the state, as some recent legislation proposals suggest.<sup>12</sup>

### **III. Punitive damages vs. German public policy (Sec. 328 Para. 1 No. 4 ZPO)**

#### **a) What is public policy?**

The concept of public policy is known in almost all jurisdictions. In Germany, it is usually referred to as *ordre public*. Generally speaking, public policy is understood as the common core of ideas and principles that is indispensable for the effective operation and social acceptance of a certain legal system. Public policy reflects a society's fundamental socio-economic and moral values. Their overall importance notwithstanding these values are subject to change in the course of time. In fact, public policy acts like a chameleon: Depending on the context, it may come in different colours. In this regard, context could be culture, jurisdiction and of course the area of law.

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<sup>10</sup> For an overview, see *Bentert*, Das pönale Element – ein Fremdkörper im deutschen Zivilrecht?, Diss., Berlin 1996, p. 55. In contrast, *Fritz* found in his recent dissertation (*supra* note 3) that punitive damages cannot be considered of civil nature and called for a rollback of German jurisdiction regarding damages for pain and suffering.

<sup>11</sup> See *Garrity*, Whose award is it anyway? Implications of awarding the entire sum of punitive damages to the state, *Washburn Law Journal*, Vol. 45, 395 (400).

<sup>12</sup> Such proposals have been raised, albeit unsuccessful, in Arizona, Kansas, New Mexico and Tennessee, among others.

Public policy plays a prominent role in the Conflict of Laws, also known as International Private Law. Article 6 of the Introductory Statute to the German Civil Code (abbr. EGBGB) controls the application of foreign substantive law in civil cases by stating that

A foreign legal norm may not be applied if its application would lead to a result that is obviously contrary to fundamental principles of German law. In particular, it may not be applied if it is incompatible with fundamental rights.<sup>13</sup>

As you can see, public policy acts as a gatekeeper here to keep away foreign law that appears absolutely unacceptable when measured against domestic legal standards. A well-known example would be polygamy, which is legally approved in some jurisdictions but contrary to German public policy since marriage is protected under the German constitution.

Using almost the same wording as Article 6 EGBGB, Sec. 328 Para. 1 No. 4 ZPO states

A foreign court's decision is barred from recognition if it would lead to a result that is obviously contrary to fundamental principles of German law, particularly if its recognition is incompatible with fundamental rights.<sup>14</sup>

Nevertheless, there is a considerable difference between the two. While Article 6 EGBGB governs the application of foreign substantive law in German courts, Sec. 328 Para. 1 No. 4 ZPO regulates recognition and enforcement of final and binding judgements made by courts of other

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<sup>13</sup> Author's translation.

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jurisdictions. The reciprocal respect for enforceable foreign judgements demands that they shall be denied recognition only in those rare instances where it would otherwise lead to absolutely intolerable results. This view is supported by Sec. 723 Para. 1 ZPO which directs that the German court shall not examine the legality of the foreign judgement.

**b) Are punitive damages contrary to German public policy?**

What is contrary to the fundamental principles of German law can be distilled from the constitution, statutes and existing case law. Not surprisingly, there is no single definition, which is why the specific area of law needs to be considered. So when asking whether recognition and enforcement of punitive damages is incompatible with German public policy, one will have to examine both the U.S. and the German law of damages as well as court practices in both jurisdictions.

As mentioned before, the U.S. law of damages has long been dualistic: On the one hand, damages serve to compensate the victim and on the other hand, they should punish the tortfeasor and deter him and others from similar behaviour. If you take this functional approach, the German concept of damages seems to be fundamentally different, at least since the Civil Code of 1900. Prima facie, the BGB introduced a purely monistic system, i.e. the only legitimate function of damages is compensating the victim for loss actually suffered.<sup>15</sup>

The German Federal Supreme Court applied very similar reasoning in a 1992 decision.<sup>16</sup> To this day it is the landmark case concerning the recognition and enforcement of U.S. punitive damages awards in Germany. The plaintiff in this case had been awarded \$400,000 in

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<sup>15</sup> *Behr*, Punitive Damages in American and German law – Tendencies towards approximation of apparently irreconcilable concepts, *Chicago-Kent Law Review*, Vol. 78, 105.

<sup>16</sup> BGHZ 118, 312.

damages by a U.S. court for sexual harassment. The defendant was a dual citizen and – before paying his debts – moved to Germany, which is why the victim requested recognition and enforcement of the judgement before a German court. The Federal Supreme court eventually denied judgement in his favor on the grounds of public policy, stating that under modern German civil law, damages may only restore the situation prior to the injury but neither punish the defendant nor enrich the plaintiff.<sup>17</sup>

However, this strict dogmatic rule has continually been softened since the German Civil Code was introduced in 1900. This development appears most prominent if you look at damages for pain and suffering. As early as 1955, the German Federal Supreme Court held that Sec. 847 BGB (now Sec. 253 Para. 2 BGB) was not an ordinary claim for damages but a claim *sui generis* bearing a twofold function<sup>18</sup>. It should adequately indemnify the victim for non-pecuniary losses, but also allow for the fact that the tortfeasor owes the victim satisfaction for what he did. The court literally gave up the monistic notion of damages by stating that beyond pure compensation, the victim had a right to satisfaction (*Genugtuung*). This judgement made way for an unparalleled evolution of the law of damages. In 1958, the Federal Supreme Court for the first time awarded damages for pain and suffering for intrusion into the right of personality.<sup>19</sup> Although clearly contrary to Sec. 253 Para. 1 BGB – which only permits awarding non-pecuniary damages where mentioned in the Code – this famous judgement was upheld by the Constitutional Court.<sup>20</sup> Interestingly, the Supreme Court restricted its newfound claim to cases of serious fault. This is a tortfeasor-oriented approach and can not be justified by purely compensatory ideas. Rather, it resembles punitive damages, which are limited to cases of extraordinary invidious conduct by the tortfeasor.

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<sup>17</sup> BGHZ 118, 312 (338).

<sup>18</sup> BGHZ 18, 149.

<sup>19</sup> BGHZ 26, 349.

<sup>20</sup> BVerfGE 34, 269.

Recent developments support this interpretation. In the well-known „Caroline“ cases the Supreme Court advanced its doctrine even further. A yellow press magazine had published a fake interview with Caroline Princess of Monaco, who sued the publisher for damages. Although she prevailed, she appealed the case. The Supreme Court reversed the judgement of the lower court arguing the amount of damages was insufficient.<sup>21</sup> In the end, Caroline was awarded almost €90,000 in damages. The similarities to punitive damages are striking – in fact, the Supreme Court expressly stated that besides satisfaction, deterrence was the main reason for its decision. Also, this judgement marks the beginning of a significant increase in the sums awarded by German courts in cases of non-pecuniary losses.

Personality rights are not the only area where damages are not purely compensatory any more. In cases of intellectual property infringement, German courts often award damages that are higher than what the plaintiff could have reasonably expected to earn in license fees (and which would therefore equal his actual loss). Instead, they allow him to recover what the defendant has gained by exploring the plaintiff's property right. By erasing the tortfeasor's profits, courts try to boost the public's perception that „tort does not pay“. Once more, this is a tortfeasor-oriented approach and less of compensatory, but more of penal nature. Not surprisingly, it is also one of the underlying concepts of punitive damages awarded by U.S. courts.

Labor law is another important area of non-compensatory damages in German civil law. In 1980, the German legislator included Sec. 611a into the Civil Code, after a European Community directive<sup>22</sup> had obliged member states to take measures to prevent discrimination based on sex in

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<sup>21</sup> BGHZ 128, 1.

<sup>22</sup> 1976/207/EEC.

the work field. After much controversy with the European Court of Justice – who found that the first version of Sec. 611a BGB did not provide for effective protection against discrimination – it was altered and the final version allowed pecuniary damages of up to three-months wages even if discrimination had taken place during the application process and no loss could be shown. Sec. 611a BGB was replaced by the General Equal Treatment Act (*Allgemeines Gleichbehandlungsgesetz, abbr. AGG*) in August 2006. Sec. 15 Para. 2 AGG provides for a claim which is not limited to three-months wages if the applicant would have been employed had he not been discriminated against. While the German legislator refuses to recognize the penal character of this claim<sup>23</sup>, European Community law<sup>24</sup> requires damages awarded under Sec. 15 Para. 2 AGG to not only be effective, but also deterrent.

The aforementioned shows that non-compensatory elements have been known to the German law of damages for a long time and continue to gain importance as a judicial tool for private enforcement of . In some cases, they expressly serve as sanction and deterrence. While not officially labelled punitive damages, they at least partially contain penal elements. The German Constitutional Court has once more approved this two-fold function in a recent decision.<sup>25</sup> Additionally, German courts have slowly given up their traditional reluctance towards awarding sums comparable to U.S. standards. As shown above, U.S. courts and legislators have at the same time undertaken efforts to limit the size of the awards to acceptable levels. Consequently, recognition and enforcement of punitive damages awards can no longer be generally held incompatible with German public policy.

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<sup>23</sup> Cf. the recent press release of the German Federal Department of Justice, [http://www.bmj.bund.de/enid/Presse/Pressemitteilungen\\_58.html?presseartikel\\_id=2497](http://www.bmj.bund.de/enid/Presse/Pressemitteilungen_58.html?presseartikel_id=2497)

<sup>24</sup> 2000/43/EC, 2000/78/EC, 2002/73/EC, 2004/113/EC.

<sup>25</sup> 1 BvR 1127/96, NJW 2000, 2187; also see annotations of Müller, DB 2001, 83.

#### **IV. Conclusion**

Provided that one agrees with the prevailing opinion which considers punitive damages to be civil remedies under German law and bears in mind the ongoing developments in the German law of damages, Sec. 328 ZPO does not generally prohibit recognition and enforcement of U.S. punitive damages awards. In particular, these awards can no longer be denied recognition on the grounds of public policy. German public policy regarding punitive damages has changed gradually and all the more since the precedent-setting decision of the Federal Supreme Court in 1991. This resembles a shift in the German understanding of the function of damages. Like it or not, non-compensatory and even punitive elements are now well-known to the German law of damages. This may certainly threaten dogmatic purity, but even the skeptic cannot deny it is legal reality. Hence, a rethinking in German courts is inevitable. Instead of denying recognition and enforcement in principle, German courts should come to case related decisions. Of course, excessive amounts awarded by U.S. courts may and should still be reduced to reasonable sums on the grounds of public policy. But ultimately, recognizing punitive damages awards is to become the rule rather than the exception.