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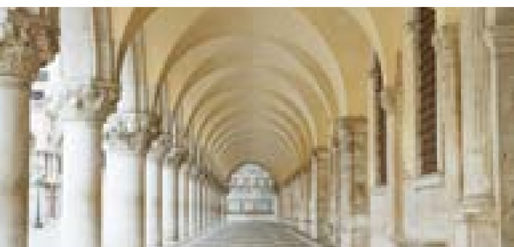

The Landmark Ruling on Punitive Damages in Italy – What Now?

by Lorenzo Vismara, Gen Re, Milan

It's been more than a year since the Italian Court of Cassation delivered its startling ruling on punitive damages. Since then, we have been paying close attention to see how the Italian compensation system would react in order to make assumptions on how this delicate issue might develop in the future.

What was behind the decision?

Following a motocross racing accident in Italy, an American reported serious physical harm, including cranial injuries. Claiming his injuries were attributable to the faulty manufacture of the helmet he was wearing, the injured party sued the Italian manufacturer (AXO Sport SpA), the importing and distributing company (Helmet), and the American retailer (NOSA) using legal proceedings in the United States.

During the trial, NOSA reached a settlement agreement with the injured party. They then successfully took court action against AXO in America, seeking indemnification for the settlement paid to the injured party.

When payment was not received from AXO, NOSA applied to the Court of Appeal in Venice for recognition of the ruling that had decided the outcome of the matter. The Court found in favour of NOSA, which prompted an appeal by AXO to the Court of Cassation.

AXO claimed that recognizing the ruling is incompatible with public order in Italy on three counts, including the punitive (not just the compensatory) function of the charge.

However, the Court of Appeal in Venice upheld the NOSA request pursuant to Article 64 of Law No. 218/1995 and enforced the ruling.[1] The Court of Appeal clearly considered the circumstances that had been discussed between the parties regarding punitive damages. However, it deemed that the agreement did not imply the settlement or transference of punitive damages, but only that *"NOSA Inc. requested any claim for punitive damages to be dropped with a view to bringing overall relations*

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About This Newsletter

Aimed at property/casualty claims assessors, these articles address various aspects of modern claims assessment – facts and trends relating to the international claims assessment scene, case depictions and information on day-to-day claims assessment practice.

between the parties to a close. ... In the case in question, given the severity of injuries to the person (cranial injuries), a settlement payment of one million euros ... cannot be defined in itself as abnormal."

What was so surprising about the decision?

There are many aspects of this decision that came as a surprise. Let's start with the "principle of law" outlined by the Court of Cassation:

"Under the current legal system, civil liability law is intended not only to remedy the financial loss of the injured party, but also to provide a deterrent and to punish transgressions. .... The U.S. institution of punitive damages is therefore not at odds with the Italian legal system. However, for a foreign ruling containing a punitive element of such a kind to be recognised, it must be based on law and normative grounds that guarantee that the potential sentence is typical and predictable, and that there are maximum limits in place. The national enforcing court must focus solely on the effects of the foreign ruling and on their compatibility with public policy."

This passage illuminates two surprising aspects of the decision.

1 – Firstly, there has been a major change in the interpretation of the concept of civil liability compared to how it was described just over three years ago by the United Sections of the Court of Cassation. It said, *"the progressive autonomy of civil liability law as a distinct discipline from criminal liability has wiped out the deterrent and punitive functions, promoting reintegration and restorative justice"* – so the Court at that time maintained that it was not possible to enforce U.S. judgements requiring the payment of punitive damages.[2]

Conversely, in sentence no. 16601/2017, the Court changed direction referring to a *"sanctioning and deterrent"* function of the compensation. In reaching these conclusions, the Court cited several legal precedents, emphasising that *"measures have been introduced here and there in recent decades that aim to define compensation as a sanction in a very broad sense."* In support of this statement, the Court described a range of legal references including various provisions, e.g. Legislative Decree no. 30 of 10 February 2005, Article 125 on the subject of industrial property and Article 187.11(2) on the subject of financial intermediation, and the new Article 96(3) of the Italian Code of Civil Procedure, which stipulates that the losing party may be ordered to pay an *"equitably determined sum"* as a sanction for abuse of process.

2 – Secondly, in sentence no. 16601/2017, it explicitly states that the Italian legal system is not incompatible with the institution of punitive damages of U.S. origin (although it may be more correct to say "Anglo-Saxon" origin) – a statement that changes the previous legal case law on punitive damages.

Although some were quick to celebrate a full and unconditional embrace of this type of compensation by the Italian Supreme Court (compensation that had been alien to the legal system and regulatory, legal and jurisprudential traditions), a closer reading of the ruling by the Court of Cassation does, in fact, lead to different and more moderate considerations.

At this point, we should note that the Court reached the conclusions in question through complex legal reasoning geared towards highlighting a modification of the concept of public policy. It describes an evolution of the policy that begins with *"a tool to protect national values and oppose the movement of case law"* and becomes a vehicle to promote *"the search for principles shared by EU member states in relation to fundamental rights."* Here the Court also states that *"with regard to procedural public policy and without prejudice to the effectiveness of the fundamental rights of defence, if the system has become wider and thus facilitates the circulation of international legal institute, which cannot be said with regard to substantive public policy."* Therefore, the questions that must be asked when assessing the possibility of a foreign legal institution entering the national legal system will be based on an assessment as to whether the institution *"is in open contradiction with the embedded values and norms that are relevant for the purposes of enforcement."*

What principles should be used?

By taking this complex but logical legal path, the Court does not exclude the possibility that punitive damages set out in foreign rulings could be introduced into the Italian legal system, as it had done in the past. Instead, it imposes a series of limitations based on the fundamental principles of:

- Legality, which *"postulates that a foreign ruling involving punitive damages must come from an established normative source, which is to say that the judge has made the ruling on adequate normative grounds ... in brief, there must be a law, or similar source, that regulates the matter 'in line with the principles and solutions' of that country to an effect that does not stand in contrast with the Italian legal system."*
- Typicalness, or subject-specificity, which means that the foreign law must define in advance which cases punitive damages are to be awarded
- Predictability, the foreign law must be predictable, requiring *"clarification of the quantitative limits of disciplinary compensation."*
- Proportionality, for which the Courts of Appeal will have to verify *"that compensatory and punitive damages are in proportion, and that punitive damages are proportionate to the wrongful conduct in question."* The Court stresses that the proportionality of compensation in each respect is *"a cornerstone of civil liability."*

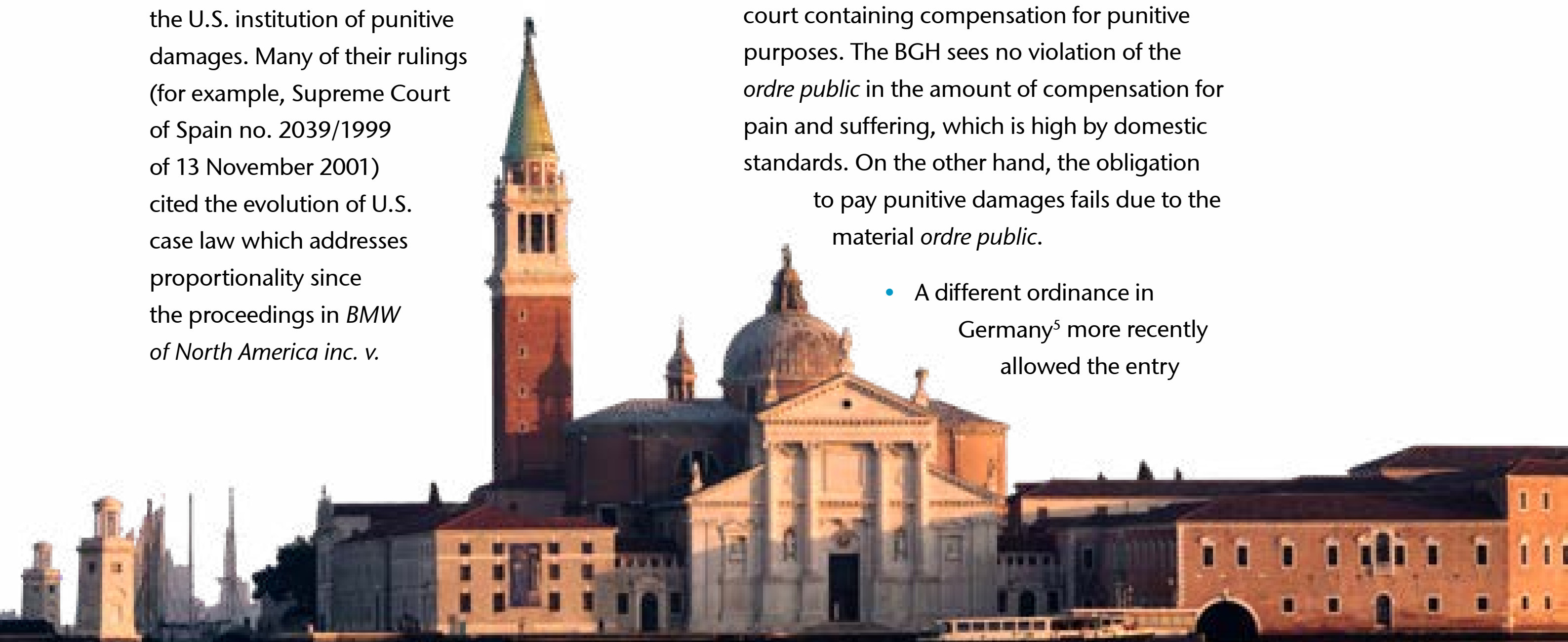
Regarding the last requirement, "proportionality," we should note that observance of this principle was deemed essential by all Supreme Courts of the EU when they dealt with the U.S. institution of punitive damages. Many of their rulings (for example, Supreme Court of Spain no. 2039/1999 of 13 November 2001) cited the evolution of U.S. case law which addresses proportionality since the proceedings in *BMW of North America inc. v. Ira Gore jr.* 20-5-1996. Nonetheless, it is still not uncommon in the U.S. for rulings at the state level to continue awarding punitive damages at a ratio well in excess of 1:1.

In our opinion, the Italian Court of Cassation made a rather wise decision when considering the above points. Rather than taking an entrenched position against a wave of foreign institutions, the Court carefully analysed the evolution of its own system; legislators often use instruments of pressure and coercion within the civil system and as a deterrent to better regulate the whole system (for example, Article 96(3) of the Italian Code of Civil Procedure). The introduction of such institutes as punitive damages is now permitted, although the field of action is limited to hypothetical outcomes that would probably be residual given the precise limits and significant principles referred to above.

What about other countries?

This ruling appears quite advanced compared to other EU legislation, where the institution of punitive damages has been approached with extreme and obvious distrust. No other EU jurisdiction seems to draw the line more clearly and stringently than the Italian Court of Cassation. Examples include:

- The French Court of Cassation[3] confirmed that punitive damages do not contradict the French legal system as such, but then prevented the recognition of a foreign ruling due to the lack of proportionality.
- Similarly, Germany's Federal Court of Justice ("BGH")[4] blocked a judgement by a Californian court containing compensation for punitive purposes. The BGH sees no violation of the *ordre public* in the amount of compensation for pain and suffering, which is high by domestic standards. On the other hand, the obligation to pay punitive damages fails due to the material *ordre public*.
- A different ordinance in Germany[5] more recently allowed the entry



of an Italian sentence containing sanctions under Article 96(3) of the Italian Civil Code of Procedure. Accordingly, the enforceability of a foreign decision about the plaintiff's obligation to compensate for unquantified disadvantages due to abusive or deliberate litigation does not violate the German *ordre public*.

Furthermore, we believe it necessary to point out that, although the statements made in sentence no. 16601/2017 are revolutionary in some respects, the verdict has not allowed significant punitive damages to enter the system. The case in question concerned admitting a recovery action by a U.S. company against an Italian company for a sum that had been awarded as compensation to an injured person out of court. The amount paid was to provide settlement for all damages, possibly including any punitive elements, without these being explicitly mentioned and quantified. There was also no possibility of the sums paid being disproportionate given the injuries suffered by the victim were significant.

Having traced the scope of possible application of sentence no. 16601/2017 with respect to rulings coming from other countries, it immediately became necessary to compare this ruling with national law to decide which existing rules in our system could be applied in what one might call punitive mode with full approval of the Court of Cassation.

Which two rules are key?

Limiting this enquiry to the areas of greatest interest in the insurance world, two pieces of legislation immediately came to our attention: Article 8(4) of Law no. 24/2017 (known as Gelli Law)[6] and Article 96(3) of the Italian Code of Civil Procedure, mentioned above.

According to the first rule, if a party does not participate in a mandatory attempt at settlement, the judge in charge of the decision may rule that any party that did not participate must pay for the consultancy and litigation costs whatever the outcome of the ruling in addition to a pecuniary fine, which is to be equitably determined in favour of the party present at the settlement hearing.

Although this rule has not yet been applied in practice to the best of our knowledge, it is immediately clear that it does not compensate one party but punishes the other party due to the latter's behaviour – in this case an omission. This could occur in a dispute concerning medical malpractice. The sanction provided for by this rule can be issued against any subject involved in a civil proceeding, which means that it may also affect an insured party or an insurance company.

The second rule is intended to punish the losing party in cases of abuse of process. As established by the Constitutional Court of the Italian Republic in sentence no. 152/2016, it is by nature *"not compensatory (or rather not exclusively) but more punitive with the goal of reducing litigation."* In this case, too, the party receiving the sanction may be an insurance company. The Court of Milan Monitoring Centre has also commented on this sanction, derived from what is known as vexatious litigation, by dismissing the 2018 compensation for damage tables in favour of payment criteria pursuant to Article 96(3) of the Code of Civil Procedure. Here, based on an analysis of various legal precedents, a settlement is generally determined with reference to the parameter of the compensation paid by the defendant in court with the option of increasing or decreasing this figure by 50% due to abuse of procedural rights by the unsuccessful party.

In our opinion, both of these rules are in line with what has been highlighted by the Court of Cassation and are therefore susceptible to being applied for deterrent and punitive purposes while following the clear intent of the legislator. However, it is important to consider the essential element of proportionality that is emphasised in several passages of sentence no. 16601/2017 by the United Sections – a criterion and principle that appears to permeate our entire compensation system and which we consider to be an impenetrable barrier against those who would like to see the ruling in question used for punitive purposes against the system and to administer sanctions.

We believe that this last consideration is expressly endorsed by the Court, which clearly states in

sentence no. 16601/2017 that opening civil liability law in our legal system towards a multi-functional reading does not mean that:

"the Aquilian institution has altered its own essence, nor that the observed tendency toward the goals of punishment and deterrence will henceforth give Italian judges indefinite leeway to increase the amount of damages at their discretion in contractual or extra-contractual liability cases. Any imposition of fines requires statutory intermediation pursuant to the supremacy of the rule of law set forth in Article 23 of the Constitution (in connection with Articles 24 and 25), which requires that certain fields be regulated only by statute, thus preventing uncontrolled judicial subjectivism."

What will need to be monitored?

It is our view that this clear line of demarcation absolutely precludes "punitive" interpretations and applications of institutions already present in our legal system, such as the rules governing compensation for damages.[7] This is because we believe the unambiguous reference to the principle of proportionality should be clear to the legislator who, nevertheless, may find that the ruling in question provides new opportunities to place deterrent clauses in different areas of civil law when creating legislation.

In this respect, we believe that the (re)insurance industry will have to monitor this area carefully. If it is true that the Italian Insurance Code (Article 12) rules out the option to secure sanctions that are in some way comparable to punitive damages – as well as a clear and understandable choice of underwriting opportunities – then it is also true that ill-defined rules easy to categorise as punitive might find a certain level of application in the world of insurance. Indeed, this has already happened in the two laws from the Italian system mentioned here.

It will be up to individual companies to implement behaviour and procedures that protect them from possible sanctions, paying particularly close attention to the diligent and timely management of claims and litigation as well as an underwriting policy that produces contractual texts with clear and unequivocal boundaries of the risk being covered.

Endnotes

1 Sentence no. 15350 of 22 July 2015.
2 Rulings no. 1183/2007 and 1781/2012.
3 Sentence no. 09-13303 of 1 December 2010.
4 BGH IX of 4 June 1992, IX ZR 149/91.
5 BGH IX of 22 June 2017, IX ZB 61/16.
6 Lorenzo, The "Gelli Law" – A New Era for Medical Liability in Italy, Nov. 2017, http://www.genre.com/knowledge/blog/the-gelli-law-a-new-era-for-medical-liability-in-italy-en.html.
7 Articles 1223, 1226, 2056 and 2059 of the Italian Civil Code.

About the Author

Lorenzo Vismara *is a Claims Manager in Gen Re's Milan office. He also holds a law degree. Lorenzo can be reached at Tel. +39 02 7621 1826 or lorenzo_vismara@genre.com.*

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General Reinsurance
Milan Branch
Via Manzoni 37
20121 Milan
Tel. +39 02 7621 181

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