Product Liability and Game Theory: One More Trip to the Choice-of-Law Well

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Abstract

Modern scholarship defends the view that current choice-of-law trends are conducive to a balanced approach to product liability law, in which each state's substantive law is unlikely to favor plaintiffs or defendants. This paper takes issue with that scholarship. Using the insights of game theory, this essay explains why American product liability law under current choice-of-law constraints results in systematic and increasingly pro-plaintiff adjudication. Federalizing the substantive law is the usual remedy offered for "prisoners' dilemma" problems in the states. This paper criticizes the idea of substantive federal product liability law, and proposes in its stead a federal choice-of-law rule developed either legislatively or through the courts. A federal choice-of-law rule, if correctly crafted, would be compatible with constitutional mandates *and* suitable for the resolution of the game theoretic problem. Several possible federal choice-of-law rules are examined, but only one, a "law of first retail sale" rule, passes the needed constitutional *and* game-theoretic musters. Practical and jurisprudential implications of this rule are also fleshed out in the paper.

Introduction

Life in America is less risky, by any objective account, than it has ever been: we have proportionately fewer accidents, and live longer lives, than ever in the past.[2] Yet the business of tort law, which forcibly re-allocates certain kinds of risks, is thriving as never before. This is especially true for that subset of tort law that is product liability.[3]

This paper contends that much of the expansion of product liability[4] law is quite possibly *not* due to an increase in misfeasance by defendants, or to an increase in risk-aversion by plaintiffs. Rather, this expansion may be the product, to a significant extent, of a beggar-thy-neighbor legal arrangement intrinsically biased in favor of certain classes of local plaintiffs suing certain classes of out-of-state defendants.[5] This inequity results from the unwitting creation of what is known in game-theoretical terminology as a "prisoners' dilemma". This prisoners' dilemma has arguably played out as sub-optimal liability doctrines across the country.

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[2] Aaron Wildavsky, Searching for Safety 7 (1988).

[3] Tillinghaust-Towers Perrin, Tort Costs Trends: An International Perspective, (1995). But see Marc Galanter, Shadow Play: The Fabled Menace of Punitive Damages, 1998 Wis. L. Rev. 1, 5-11 (arguing that the concern over high awards is misplaced). Galanter's article and other similar work tend to focus on punitive damages, which are not at the heart of this paper. For a telling quantitative rebuttal of defenses of current punitive damages rules, see Jonathan M. Karpoff & John R. Lott, Jr., On the Determinants and Importance of Punitive Damages Awards, 42 J.L. & Econ. 527, 540-45 (1999) (suggesting that punitive damage awards vary in an arbitrary manner).

[4] By "product liability" in this paper I refer to legal recourse when an alleged defect in a tangible product causes property damage or personal injury.

[5] Professor Michael W. McConnell made this basic point in *A Choice-of-law Approach to Products-Liability Reform*, *in* W. OLSON (ed.) NEW DIRECTIONS IN LIABILITY LAW 88 (1988). Professor McConnell's initiative inspired this research project.

This paper identifies the game-theoretic dilemma, criticizes recent scholarship that has misidentified one of its causes as one of its cures, and sketches the parameters and implications of an effective structural solution. The solution, unlike many substantive tort reform proposals[6], has the advantage of preserving state jurisdiction over tort law. In addition to its "Occam's Razor" characteristics, this avoids many coordination and knowledge problems that otherwise might prove insoluble.

Part I of this paper traces the modern upsurge in product awards, and contrasts the predicament of product liability with the prevailing situation in other areas of tort law. Part I goes on to explain how this predicament is likely a manifestation of a prisoners' dilemma, particularly in light of the peculiar confluence of the *Erie Railroad* doctrine and its progeny.

In Part II, a fundamental theoretical solution to this prisoners' dilemma is sketched. Part II shows how current state-based product liability law, accompanied by the two generic choice-of-law rules currently prevailing in the states, in fact exacerbates the dilemma instead of resolving it. As a central feature of this part of the paper, Part II discusses an influential belief in current legal scholarship, according to which the dominant American choice-of-law rule is in fact helpful in resolving the game-theoretic problem. This paper squarely rebuts that thesis. Because of this rebuttal, recent problems in product liability law are easier to understand and, it is contended, finally amenable to solution.

[6] See, e.g., Product Liability Reform Act of 1997, S. 648, 105th Cong. § 2(a)(2) (1997) (listing "[e]xcessive, unpredictable, and often arbitrary damage awards" as a factor motivating the bill).

Having established both the existence and the cause of the prisoners' dilemma, the paper moves on in Part III to a presentation of reasons why federal pre-emption of product liability law is *not* its most advantageous resolution. Part III also refutes the claim that a federal "libertarian rule" (disallowing all "inalienable"[7] state liability régimes, and in effect mandating freedom of contract in matters of product liability law), proposed by several law-and-economics scholars,[8] would be an adequate or even appropriate remedy.

Part IV makes the constitutional and game-theoretic case for a federal choice-of-law solution to the prisoners' dilemma. Several alternative rules are examined through two filters – that of constitutional legitimacy and that of efficacy. Though each choice-of-law option offers some advantage, only one, a federal "state of first retail sale" rule, turns out to adequately meet legitimacy concerns while simultaneously resolving the product liability prisoners' dilemma. Too many competing proposals sacrifice one or the other of these concerns. But no reform is without risks. Part IV goes on to explore several prospective shortcomings of the "state of first retail sale" rule. The paper finds none of these deficiencies to be incurable to its successful implementation, though some of them require important exceptions or "ground rules". Then again, the implementation of the "first retail sale" choice-of-law rule would require adjustments to several ancillary areas of the law – federal diversity jurisdiction primary among them. These adjustments are detailed in the concluding portion of Part IV.

[7] On "inalienability rules" in general, see , *Property Rules vs. Liability Rules*, *in* Bouckaert & De Geest (eds.) 2 Encyclopedia of Law and Economics, Elgar, 2000, at 782.
[8] *See*, e.g., Paul H. Rubin, TORT REFORM BY CONTRACT, 1998

I. State Product Liability and National Markets: A Prisoners' Dilemma

A. The Liability Upsurge

Reliable data on the expansion of tort liability in America is hard to come by, in part because the overwhelming majority of filed tort suits settle before trial and verdict.[9] Several serious estimates of the growth of tort have nonetheless been attempted. One thorough study reckoned that between 1930 and 1994 the total cost of tort liability in America grew at a pace almost four times greater than the rate of growth of the economy. From 1984 to 1994 alone, tort liability in America increased by 125%.[10] In one state, Alabama, the rate of expansion of punitive damage awards from 1980 through 1985 was 440 times the rate of state job growth.[11] Tort outlays (including the costs of litigation) now consume upwards of 2.6% of gross product in several states, according to another report.[12]

The number of tort suits filed in state courts does seem to have leveled off,[13] but record awards in individual cases are set almost every year. The year 2000 witnessed a staggering $145 *billion* award in the *Engle v. R. J. Reynolds Tobacco*

[9] Only about 2 to 3% of filed tort suits ever make it to trial. In fiscal year 1996-97, the most recent for which Department of Justice statistics are available, 47,221 tort cases were resolved in some way in federal courts. Of these, only 1,516, or about 3%, were decided by jury or bench trial. Marika F.X. Litras and Carol J. DeFrances, Bureau of Justice Statistics, Federal Justice Statistics Program, Federal Tort Trials and Verdicts, 1996-97 2 (Feb. 1999). Statistics are similar in state courts. In the nation's 75 largest counties in 1996, the most recent year for which Department of Justice Statistics are available, only 2% of tort cases were disposed of in court. These dispositions included jury and bench decisions as well as directed verdicts and judgments *non obstante verdicto*. DeFrances and Litras, Bureau of Justice Statistics Bulletin, Civil Justice Survey of State Courts, 1996, Civil Trial Cases and Verdicts in Large Counties, 1996 2 (Sept. 1999). Many settlements are, of course, confidential and therefore never reported.

[10] Tillinghaust-Towers Perrin, Tort Costs Trends: An International Perspective (1995).

[11] Keith J. Ward & Ass., A Study to Address Relationships Between Economic Development and the Need for Tort Reform, Birmingham, (Mar. 15, 1993).

[12] The Economics of Civil Justice Reform in Massachusetts, Boston (1997).

Co.,[14] Florida class-action lawsuit against tobacco companies. Nor was *Engle* a Y2K anomaly. While enormous awards remain rare exceptions,[15] they are increasingly common. The total dollar value of 1999's top ten awards was *twelve times* the 1997 amount – only the largest 1997 award would have made the 1999 "top ten" list. Every one of *Lawyers' Weekly*'s "top ten verdicts of 1999" exceeded $100 million, and the top two verdicts surpassed $1 billion.[16] Leading the 1999 list was a $4.9 billion jury verdict against General Motors in a case where a GM vehicle burned after being rear-ended by a drunk driver traveling at 70 mph.[17]

The trend continued in 2001. The largest tort verdict that year was $3 billion, against cigarette maker Philip Morris, in *Boeken v. Philip Morris, Inc.*, a California suit. According to *Lawyer's Weekly*, this verdict was larger than the 10 largest non-class action awards in 2000 combined.[18] LAWYERS WEEKLY USA reported in 2001

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[13] *See* Bureau of Justice Statistics, U.S. Dep't of Justice, Special Report # NCJ-153177, Tort Cases in Large Counties 1992, at 1; and Bureau of Justice Statistics, U.S. Dep't of Justice, Bulletin # NCJ-173426, Civil Trial Cases and Verdicts in Large Counties, 1996, at 1.

[14] 122 F.Supp. 2d 1355,1358 (S.D. Fla. 2000). The *Engle* damages award is the largest in U.S. history. This class –action lawsuit, in a Florida state court was brought on behalf of all Florida smokers (estimated at 700,000) against tobacco companies. The judgment, which has been appealed, has been harshly criticized for allowing the claims of such a diverse group to go forward, and for the amount of the award. Defense lawyers claim that "reversible error was committed nearly every day" of the trial, during which the presiding judge admitted to being a member of the plaintiff class. *See e.g. Big Gets Bigger: Husband-Wife Team Takes on the Tobacco Goliath and Walks Away with a Monster Jury Award*, NAT'L L.J., Feb. 19, 2001, at C14. The trial judge upheld the entire $145 billion award, denying the defendants' post-verdict motions for remittitur, to set aside the verdict, for a directed verdict, and to decertify the class. Engle v. R.J. Reynolds Tobacco Co., 2000 WL 33534572 (Fl. Cir. Ct.). Defendants have appealed the order denying the motions and upholding the award. *Big Gets Bigger, Id*.

[15] *See* Theodore Eisenberg, *The Predictability of Punitive Damages*, 26 J. Legal Stud. 623, at 633-37 (punitive damages are quite rare).

[16] *See* Bill Ibelle, *Murderers, Rapists and Terrorists Dominate Top Ten*, LAWYERS WEEKLY USA January 8, 2001 at B3-B4. The 1999 top verdict was $4.9 billion, the second largest in 1999 was $1.2 billion, and the top verdict in 1998 was $1.5 billion. *Id.* at B3. LAWYERS WEEKLY tracks verdicts to individual plaintiffs, omitting class action verdicts. *Id.*

[17] Anderson v General Motors, BC 116 926 (Super. Ct., Los Angeles), Aug. 26, 2000. M. Cronin Fisk, The Biggest Jury Verdict Of 1999: A Typical Verdict Last Year Was Way Up, But Nothing Like This One", 2/28/00 NAT'L L.J. A1. See also Record Tobacco Verdict Tops Year's Large Awards, LAWYERS WEEKLY USA, Jan. 7, 2002, at http://www.lawyersweekly.com/usatopten2001.cfm

[18] *Id*. *See also* Bill Ibelle, *Murderers, Rapists and Terrorists Dominate Top Ten*, LAWYERS WEEKLY USA January 8, 2001 at B3-B4.

that the median Top Ten awards in the prior four years showed a "clear upward progression" – the leveling off in 2000 was quite simply unrepresentative.[19] Tort awards are clearly growing in size, possibly exponentially, even after discounting for judges' post-trial award reductions.[20]

A losing tort defendant must of course forfeit both the plaintiff's award and the defendant's own attorney's fees and costs.[21] For their part, tort plaintiffs typically surrender from 33% to 40% of any award to their attorneys, and are liable in addition for the costs of expert witnesses and the like. Indirect social costs (the opportunity cost of the time spent by conscripted jurors, judges' salaries, courthouse construction costs, etc.) considerably add to the actual "load" of tort.[22] As a result, at most only about half the direct cost of tort adjudication makes its way into plaintiffs' pockets.[23]

Tort awards impact corporate defendants in particular ways. Depending on the elasticity of supply and demand for a firm's products and for its factors of

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[19] *Id.* at B4. *See also* Franklin Strier, *Making Jury Trials More Truthful*, 30 U.C. Davis L. Rev. 95, at 163 (1996) (unpredictable damage awards are increasingly perceived to damage American commerce); John C. Jeffries, *A Comment on the Constitutionality of Punitive Damages*, 72 Va. L. Rev. 139 (1986) (claiming that our civil litigation system is near a crisis point).

[20] Trial judges often reduce these jury awards through conditional remittitur decisions (ordering a new trial unless the plaintiff consents to take an amount the judge believes is the highest that an unbiased jury could have granted). Thus, in *Anderson*, the award was reduced to a "mere" $1.2 billion by the judge. Appellate courts also reduce excessive trial court verdicts if they have no legal support. Nonetheless, the *in terrorem* effect of gigantic awards, which after all might not be reduced on appeal, inevitably impacts both settlement talks and therefore the proclivity to launch new lawsuits. And the documented evolution of judicial passivity in the face of lawless jury behavior gives reason for concern that revisions of jury verdicts are on the decline. *See* Renee Lettow Lerner, *The Transformation of the American Civil Trial: The Silent Judge*, 42 Wm. & Mary L. Rev. 195 (2000) (exploring the history of judicial intervention in the jury process).

[21] Defendants, of course, do not benefit from the contingency fee approach to legal expenses; by definition, there is no tort award given to a successful defendant. As a result, the cost of defense may play a role in settlement negotiations. *See* Jonathan T. Molot, *How U.S. Procedure Skews Tort Law Incentives*, 73 IND. L.J. 59, 69-70 (1997) (while defendants must pay by the hour for their defense, contingent-fee arrangements enable plaintiffs to reduce the financial risks of litigation).

[22] *See e.g.* Alexander Tabarrok and Eric Helland, *Court Politics: The Political Economy of Tort Awards*, 42 J.L. & ECON.157 (1999).

production (capital and labor), the cost of corporate tort liability is ultimately borne in varying degrees by employees, shareholders, and consumers of its products. Many observers believe there is a linear relationship between liability and safety – i.e., that increased corporate tort liability always produces more safety at higher prices, so that the only question a society has to answer is "*how much* safety are you willing to pay for."[24] But increased liability does not increase consumer safety or raise retail prices as a matter of course. To see this, realize that in a competitive industry, if a firm is held liable for damages caused by a design or manufacturing flaw it could efficiently have avoided, it will *not* be able to recoup the amount of the tort award by increasing the price of its goods or services above the competitive level. If the firm attempted to raise prices to recoup the costs of its negligence, a more efficiently organized firm be able to undercut its prices, taking market share away from the negligent corporation.[25] Prices will not increase, and the culpable firm will "eat" the liability award, i.e., suppliers of capital and labor will pick up the tab for the mistaken production decision.

On the other hand, if liability is imposed for a product already laden with all cost-effective safety features a tort award will affect corporate behavior somewhat

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[23] *See* Michael J. Saks, *Do We Really Know Anything About the Behavior of the Tort Litigation System—And Why Not?*, 140 U. Pa. L. Rev. 1147, 1282-83; JAMES S. KAKALIK & NICHOLAS M. PACE, COSTS AND COMPENSATION PAID IN TORT LITIGATION 67-68 (1986)**.**

[24] *See, e.g.*, Ralph Nader and Joseph A. Page, *Automobile Design Liability and Compliance with Federal Standards*, 64 GEO. WASH. L. REV. 415, 458 (1996) (erroneously claiming that in the context of auto design litigation, the cost of underdeterrence would be life and limbs, while the cost of overdeterrence would merely be a financial burden).

[25] Whether or not the liability here is styled in "negligence" or in, say, "design defect", if the claim is that the corporation *should have* (not merely "could have") produced a better product, the claim is one of negligence. See *infra*, note 26.

differently. Liability might lead to the adoption of "wasteful" design attributes;[26] or it might merely result in the bundling of a "tort insurance premium" as part of the price of an unchanged good.[27] If juries impose the premium uniformly on all firms in an industry, the supply curve for the product, and therefore its market price, will be affected.[28]

Clearly, some modifications made in order to minimize liability may be for the better. Surely it is beneficial for manufacturers to undertake cost-effective quality control. If tort liability is needed to provide the incentive to engage in this quality control because of some market imperfection, so be it.[29] Even so, many changes wrought by modern tort law are arguably contrary to the public interest. Fear of substantial, "bet the company" liability for certain risks of products, if these risks are in fact exceedingly small or for some other reason not economically worth preventing, has undoubtedly led firms to avoid activity that might have achieved much social good. This is because the company cannot internalize all the value it

[26] Liability can lead to the adoption of safety measures that cost more than they save in accidents. The original formulation of this concept, the famous "Hand Formula," may be found in United States v. Carroll Towing Co., Inc., 159 F.2d 169, 173 (2d Cir. 1947) (measuring the reasonable duty of care as a function of three variables: the probability that the harm will occur, the gravity of the resulting harm, and the burden of adequate precautions).

[27] The choice between the addition of ''idiotproofing' and the mere increase in pricing is complex, and depends *inter alia* on the firm's guesses about future liability trends.

[28] Uniform imposition of a "strict liability tax" would require that tort law be substantively uniform across the country. *See* generally, Michael Krauss, *Restoring the Boundary: Tort Law and The Right to Contract*, CATO INSTITUTE, POLICY ANALYSIS #347, 1999. Tort rules should *not* be identical for populations with different risk preferences, but as the present paper shows, *infra*, there are good reasons to believe that national uniformity will be precluded for reasons that have nothing to do with heterogeneity of risk preference.

[29] The profit motive, *even absent any tort liability*, furnishes appropriate design and manufacturing incentives to competitive producers – they will be able to reap profits by producing a better (read, efficiently safer) widget. If, however, consumers are invincibly ignorant of design and manufacturing details, which concededly is occasionally the case, then absent tort liability no producer will find it worth its while to adopt an efficient safety innovation. *See* M. POLINSKY, INTRODUCTION TO LAW AND ECONOMICS, ch. 4.

produces.[30] If liability increases enough it may conclude that it internalizes all the product's risks, and even more. A report in *Science* indicates that liability concerns have led some firms to delay research on an AIDS vaccine, while others have abandoned HIV research altogether.[31] *Bendectin*, the only treatment proven effective against Nausea and Vomiting in Pregnancy (NVP),[32] is no longer produced because the expected cost of defending against (and losing the occasional)[33] tort suit was greater than the expected profits for this non-defective drug's patent holder.[34]

Products never developed may not be consciously "missed", though society is in fact less well off than it might have been even if we are unaware of gains we would have enjoyed.[35] And we most assuredly pay directly and indirectly, for built-in "excess liability" premiums as well as superfluous "safety" features, bundled with goods we purchase. Thus, power tools arguably now carry pointless warnings that no one reads but that all purchasers fund. The price of new extension ladders

[30] Much of this good takes the form of consumer surplus.
[31] *Is Liability Slowing AIDS Vaccines?*, SCIENCE, Apr. 10,1992, at 168-169.
[32] NVP is otherwise known as "morning sickness". In its most extreme form, known as "hyperemesis gravidarum," NVP can cause severe complications in a pregnancies. *See* Richard Chudacoff, M.D., *Hyperemesis Gravidarum*, http://pregnancy.about.com/gi/dynamic/offsite.htm?site=http%3A%2F%2Fwww.surrogacy.com%2Fmedres%2Farticle%2Fhyperem.html (site visited Feb. 8, 2002).
[33] Merrell-Dow Pharmaceuticals, the manufacturer of Bendectin, suffered an initial judgment for the plaintiff, but this was ultimately thrown out and the court entered judgment for the defendant in Oxendine v. Merrell Dow Pharmaceuticals, Inc., 1996 WL 680992, 35 (D.C. Super. 1996); *see also* Raynor v. Merrell Pharmaceuticals Inc., 104 F.3d 1371 (D.C. Cir. 1997) (upholding trial court j.n.o.v.). Although Merrell Dow also suffered a substantial judgment in Texas, *see* Ellen Joan Pollock, *Jury Orders Merrell-Dow to Pay Couple $33.8 Million in Suit over Nausea Drug*, 10/7/91 WALL ST. J. B7, this was also ultimately reversed on appeal, Merrell Dow Pharmaceuticals, Inc. v. Havner, 953 S.W.2d 706 (Tex.,1997)..
[34] *See e.g.* Joseph Sanders, *The Bendectin Litigation: A Case Study in the Life Cycle of Mass Torts*, 42 HASTINGS L.J. 301 (1993). Since the manufacturer of Bendectin enjoyed a monopoly position, it was presumably able to extract much of the consumer surplus of the drug. That it nonetheless ceased manufacturing it is eloquent circumstantial evidence of the excessiveness of liability.
[35] *See* Michael Krauss, *Loosening the Food and Drug Administration's Drug Certification Monopoly: Implications for Tort Law and Consumer Welfare*, 4 GEO. MASON L. REV. 457 (1996) for a generalized study of the effects of this consumer ignorance. The technical problem is that consumer

incorporates such a significant liability premium that many consumers continue to use rickety old versions.[36] These premiums generate wasteful financial transfers.[37] For some products, the amount of the liability premium built into the price of a product may be less than the state sales tax. In other cases, however, it may represent a substantial percentage of what would otherwise be the market-clearing price.[38]

The alleged side-effects of tort law extend beyond product liability, of course. It is argued that fear of excessive medical malpractice liability has caused doctors to order redundant and expensive diagnostic tests[39] and operations[40] that are not justifiable on medical grounds alone. High malpractice insurance premiums are said to lead competent physicians to retire prematurely, leaving whole geographic areas underserved. But these claims are disputed – and in the latter case the refusal of state medical insurance cooperatives to establish claims-based premium structures is sometimes cited as the basis for the premature retirement problem.[41] Indeed, a

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welfare losses are estimated using demand curves, which can reliably be estimated only for existing products.

[36] *See* Michael Krauss, "*Tort Law, Moral Accountability and Efficiency*", 2 JOURNAL OF MARKETS AND MORALITY 114 (1999); *See, e.g.*, John Heinzl, *Wacky Warnings: The best common sense product labels*, THE GLOBE AND MAIL B4, Jan. 18, 2001; David Tarrant, *Warning: Disbelief May Ensue*, THE DALLAS MORNING NEWS 1C, Sept. 5, 2001.

[37] This liability in no way disciplines manufacturers or retailers for misfeasance, but has as its sole purpose to transfer money from a "producer-insurer" to an injured "consumer-insured". As discussed *supra*, TAN 24-28, transfer-based liability is very expensive insurance that will either lead to excessive price increases or to inefficient design changes.

[38] In the case of many vaccines the transfer premium is clearly over 100%. *See* Richard L. Manning, *Changing Rules in Tort Law and the Market for Childhood Vaccines*, 37 J.L. & ECONOMICS 247 (1994); John P. Wilson, *The Resolution of Legal Impediments to the Manufacture and Distribution of an AIDS Vaccine*, 34 SANTA CLARA L. REV. 495, 513-514 (1994) (*citing* ALAN R. NELSON, AMERICAN MEDICAL ASS'N., IMPACT OF PRODUCT LIABILITY ON THE DEVELOPMENT OF NEW MEDICAL TECHNOLOGIES 1 (1988)).

[39] Baldwin *et al., Defensive Medicine and Obstetrics*, 274 J. AM. MED. ASS'N 1606-1610 (1995); Daniel Kessler and Mark McClellan**,** *Do Doctors Practice Defensive Medicine?* QUARTERLY JOURNAL OF ECONOMICS 111 (1996): 353-90.

[40] L. Dubay, et al., The Impact of Malpractice Fears on Cesarean Section Rates, 18 J. HEALTH ECON. 491-522 (1999)

[41] *See* Gary M. Fournier & Melayne Morgan McInnes, *The Case for Experience Rating in Medical Malpractice*, 6/1/01 J. RISK & INS. 255 (physicians, especially rural obstetricians, are choosing to limit

respectable academic literature suggests that there may be too *little* medical malpractice liability.[42]

Whatever the truth is on this account, product liability suits, unlike medical malpractice and other areas of tort, are subject to an intrinsic bias that substantially increases the likelihood of unwarranted liability. The expansion of class action product litigation,[43] as well as "creative" individual product liability lawsuits[44] has been remarkable. From automobiles[45] to asbestos[46] to breast implants[47] to intrauterine devices[48] to heart valves[49] to prescription medicines[50] to, most recently, cigarettes and

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practice or self-insure rather than pay soaring premiums unrelated to their own claims experience); *Echo Malpractice Mess*, 1/3/02 CHARLESTON GAZETTE & DAILY MAIL P4A (physicians are leaving West Virginia because lawsuits are increasing cost of insurance coverage); AMERICAN POLITICAL NETWORK AMERICAN HEALTH LINE, Vol. 6 No. 9, *Provider News Pennsylvania: Doctors Protest Malpractice Premium Cost*, Apr. 23, 2001 (Pennsylvania Medical Society asserts that 11% of Pennsylvania physicians have either moved out of state, retired prematurely, or scaled back their practices due to skyrocketing malpractice insurance rates); Patricia Post-Reilly, *Malpractice Maelstrom: Skyrocketing malpractice insurance premiums have doctors and healthcare professionals here—and around the state—clamoring for reform*, 12/17/01 LANCASTER NEW ERA/INTELLIGENCER J./SUNDAY NEWS 1 (high jury awards pushing up insurance rates and forcing physicians to retire early, move to more rate-friendly states, or limit patient access to medical care).

[42] *See*, *e.g.*, David M. Studdert, Eric J. Thomas, Bret I. W. Zbar, Joseph P. Newhouse, Paul C. Weiler, Jonathon Bayuk, and Troyen A. Brennan, *Can the United States Afford a "No Fault" System of Compensation for Medical Injury?*, 60 SPG LAW & CONTEMP. PROBS. 1 (1997); Paul C. Weiler, *Fixing the Tail: The Price of Malpractice in Health Care Reform*, 47 Rutgers L. Rev. 1157, 1165 (1995); PAUL C. WEILER ET. AL., A MEASURE OF MALPRACTICE: MEDICAL INJURY, MALPRACTICE LITIGATION, AND PATIENT COMPENSATION 61-76 (1993); PHILIP SLAYTON AND MICHAEL J. TREBILCOCK, EDS., THE PROFESSIONS AND PUBLIC POLICY (1978).

[43] See, e.g, Victor E. Schwartz, Mark A. Behrens, and Leah Lorber, *Federal Courts Should Decide Interstate Class Actions: A Call for Federal Class Action Diversity Jurisdiction Reform*, 37 HARV, J. ON LEGIS. 483 (2000).

[44] Illnesses and accidents that in the past would have been seen as the result of assumption of risk (e.g., smoking), or of contributory negligence (e.g., driving while inebriated and without buckling one's seat belt), today result in the filing of lawsuits against the manufacturer who provided the cigarette, or who "allowed" the car to be driven without an automatic seat belt.

[45] *See* George L. Priest, *Understanding the Liability Crisis*, 37 Proc. Am. Acad. Pol. Sci. 196, 198 (1988);

[46] See Linda S. Mullenix, Beyond Consolidation: Postaggregative Procedure in Asbestos Mass Tort Litigation, 32 WM. & MARY L. REV. 475 (1991).

[47] *See* David L. Bernstein, *The Breast Implant Fiasco*, 87 Calif. L. Rev. 457 (1999) (reviewing Marsha Angell, M.D., The Clash of Medical Evidence and the Law in the Breast Implant Case (1996)).

[48] See Sylvia A. Law, Tort Liability and the Availability of Contraceptive Drugs and Devices in the Unites States, 23 N.Y.U. REV. L. & SOC. CHANGE 339 (1997).

[49] See Attorneys in Heart Valve Case Awarded $10.25 Million, 10 INSIDE LITIG. 13, *13 (1996).

firearms,[51] manufacturers have been exposed to relentless (and relentlessly increasing) liability claims. The Rand Corporation found that product liability suits comprise an ever-larger percentage of all federal tort litigation.[52] *Quantum* of damages has increased in tandem with numbers of lawsuits: 31% of product liability claims now result in awards in excess of $1 million, while such large awards remain exceptionally rare for non-product-related suits. Punitive damage awards are also vastly more likely in products cases.[53]

That product liability is becoming relatively more hazardous for defendants than other tort cases is not fortuitous. Upon examination, it appears that recent trends are in part a function of current choice-of-law rules.

B. Goods, Services and Choice of Law

Some tort suits (for instance, automobile collision[54] and professional malpractice cases) target services (driving, doctoring, lawyering, etc.) performed by a defendant. Lawsuits such as these typically pit an individual local plaintiff against an individual local defendant. When litigated before a local jury, this type of case creates no systemic predisposition against either party. What is sometimes termed a

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[50] See Paul D. Rheingold, Fen-Phen and Redux: A Tale of Three Drugs: The Story of How Fen-Phen and Redux Came to be Used by 6 Million Americans is Chilling, 34 JAN. TRIAL 78, *78 (1998).

[51] On the latter, see Michael Krauss, FIRE AND SMOKE: GOVERNMENT LAWSUITS AND THE RULE OF LAW, INDEPENDENT INSTITUTE, 2000.

[52] currently sixteen percent.

[53] *See* Michael L. Rustad, *Unraveling Punitive Damages: Current Data and Further Inquiry*, 1998 Wis. L. Rev. 15, 29 (1998) (*citing* Deborah Hensler & Erik Moller, INSTITUTE FOR CIVIL JUSTICE (RAND), *Trends in Punitive Damages: Preliminary Data from Cook County, Illinois and San Francisco, California* (1995) (DRU-1014-ICJ); Erik Moller, INSTITUTE FOR CIVIL JUSTICE (RAND), *Trends in Civil Jury Verdicts Since 1985* (1996); Erik Moller, INSTITUTE FOR CIVIL JUSTICE (RAND), *Trends in Punitive Damages: Preliminary Data from California* (1995) (DRU-1059-ICJ)) (while the overall incidence of punitive damages is small as a percentage of all jury awards, punitive damages are more frequent in business tort and intentional tort cases, are clustered in certain jurisdictions, and are rising overall)..

[54] 31.9% of all state tort trials in the nation's 75 largest counties involved automobile accidents, according to the Rand study (p. 2).

"public choice" problem[55] is absent: the plaintiff cannot persuasively tell a jury that a victory will bring "outside" money into the locality, nor can the defendant insist that a victory by the plaintiff would export "local" money. Other kinds of bias (against the social class, race, etc. of either party) are of course possible in these cases, as they are in all lawsuits. Race and class biases, although troubling and requiring remediation when they occur, are not intrinsic to a party's status as plaintiff or defendant, however. In any case parties can attempt to guard against them through challenges to the jury venire.[56]

Other sorts of tort actions, however (for example, negligence claims invoking *respondeat superior*)[57] set *individual* local plaintiffs against *corporate* local defendants. Because juries are composed only of individuals, corporate defendants might experience prejudice here: a jury may be tempted to transfer wealth from an entity that does not feel pain to a suffering person with whom they can identify. In many cases, however, such temptations may be offset by the jury's desire to maintain employment and economic activity in their locality. It is very hard to predict how these offsetting incentives ultimately unfold in any given case– they might conceivably result in rough structural equality between plaintiff and defendant over the long run.[58]

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[55] "Public Choice" problems arise from the realization that money transfers from "the many" to "the few" provoke more intense support from the "soaking few" than they do opposition from the "soaked many". As a result, "rent-seeking", i.e., inefficient transfers from the many to the few, will be heavily valued in the public arena in mass democracies. *See* J. BUCHANAN & G. TULLOCK, THE CALCULUS OF CONSENT: LOCIGAL FOUNDATIONS OF CONSTITUTIONAL DEMOCRACY 31-39, 1965.

[56] Batson v. Kentucky, 476 U.S. 79, 88 (1986) (racial bias in jury selection violates equal protection clause).

[57] *Respondeat superior* holds an employer vicariously liable for negligent behavior by an employee while on the job. *Hern v Nichols*, 91 Eng. Rep. 256 (Ex. 1708)

[58] *See* Neal Miller, *An Empirical Study of Forum Choices in Removal Cases Under Diversity and Federal Question Jurisdiction*, 41 AM. U. L. REV. 369, 408-409 (1992) (respondent attorneys indicated

Early product liability suits tended to be of this kind. Most products were manufactured near their place of consumption, as transportation costs made far-flung markets unreachable. Thus, most lawsuits about products set local individual plaintiffs against local corporate defendants.[59] With the advent of "paradigm shifters"[60] such as assembly-line production, interstate highways and electronic auction markets, markets for goods (though not services) have today become largely national. Modern product liability suits characteristically set an *individual local* plaintiff against a *corporate out-of-state* defendant, before (by definition) individual local jurors.[61]

Christopher C. DeMuth of the American Enterprise Institute corroborated this trend by examining published New Jersey product liability cases in 1900 and at twenty-year intervals through 1980.[62] New Jersey is an "active" product liability state[63], and also a very heavy manufacturing state.[64] Thus, defendants in New Jersey product liability cases are, one would suppose, more likely to be local than is the case

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out-of-state status was more frequently the cause of jury bias than corporate status or type of business); Tabarrok and Helland, *supra* note 22 at 161-64.

[59] E.g., Osborne v McMasters, 41 N.W. 543, (Minn. 1889) (early Product liability suit, opposing victim and local apothecary, who had mislabeled a drug, resulting in poisoning of the victim).

[60] *See* Thomas Kuhn, The Structure of Scientific Revolution, (1970).

[61] Theodore Eisenberg, *Judicial Decisionmaking in Federal Products Liability Cases, 1978-1997*, 49 DePaul L. Rev. 323, 326 (1999) ("Plaintiffs, their lawyers, and most other observers of the legal system believe the jury to be more sympathetic to plaintiffs, on average, than the judge. Plaintiffs therefore route a weaker set of cases to juries.").

[62] Source: C. DeMuth, "*Should Product-Liability Law be Nationalized?*", Unpublished manuscript, on file at the American Enterprise Institute.

[63] New Jersey has pioneered many shifts in favor of individual plaintiffs against corporate defendants. See, e.g., Henningsen v Bloomfield Motors, 161 A.2d 69 (1960) (holding that a waiver of the right to sue for a manufacturing defect in a new product was void); Beshada v Johns-Manville, 447 A.2d 593 (1982) (holding that a manufacturer could be liable for a "defective" design even if no one in the world had a better design to offer); O'Brien v Muskin, 463 A.2d 298 (1984) (holding that a trespasser who dived into a four-foot deep above-ground swimming pool could sue the manufacturer of that pool, and that a court could declare that above-ground pools were all intrinsically defective).

[64] Production manufacturing per worker in New Jersey is 25 percent above the national average. *See* STATISTICAL ABSTRACT OF THE UNITED STATES, 2000, Table 1231.

elsewhere. DeMuth found that, even in New Jersey, there was an increasing tendency to sue out-of-state defendants:

TABLE I
Location of Manufacturing Facilities for New Jersey Products Cases

Period	All defendants are in-state	At least one defendant is from out-of-state
1900-01	1	0
1920-21	0	0
1940-41	7	3
1960-61	8	5
1980-81	9	16

1. Choice of Law and the *Erie Railroad* rule

Though modern products are as a rule manufactured in few locations, for national distribution, they are subject to more than fifty[65] separate bodies of product liability law. Product liability law is not one of the named areas of federal competence under our Constitution.[66] Like state tort law in general, and despite various legislative enactments, product liability law has its roots in the *common law*.

[65] Fifty states, District of Columbia, Puerto Rico, Guam, etc.
[66] *See* JOHN E. NOWAK AND RONALD D. ROTUNDA, CONSTITUTIONAL LAW §§ 3.1-3.3 (5th ed. 1995). This is not to imply that federal pre-emption under a named legislative power, such as Interstate Commerce, is impossible. It is merely to assert that the default authority over product liability resides with the states.

It was not proclaimed *ab nihilo* by legislative bodies, but “declared” and modified incrementally by state courts.[67]

Lawsuits may be initiated in, or removed to, federal court even if they involve state law questions, provided that federal “diversity” jurisdiction exists. This will occur whenever a case implicates plaintiffs who are from different states than every defendant, if the amount in controversy exceeds $75,000 per plaintiff.[68] Following the crucial United States Supreme Court decision in *Erie Railroad v Tompkins*,[69] state substantive law governs product liability suits tried in federal court for reasons of diversity. The Court recognized that without such a rule, federal “diversity” law would quickly swamp state law, and would in effect nationalize areas of jurisdiction left to the states.[70] In other words, federal diversity jurisdiction only provides *procedural* protection, not *substantive* uniformity. A citizen of one state has no fundamental right to be immune from the laws of other states. Diversity jurisdiction was *not* designed to authorize federal imposition of substantive solutions to legal problems.[71] Rather, it was meant to assure out-of-state litigants that their state citizenship would not carry prejudice.

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[67] Robert Cooter, *Decentralized Law for a Complex Economy: The Structural Approach to Adjudicating the Law Merchant*, 144 U. PENN. L. REV., 1643 (1996), at 1650. Louisiana and Puerto Rico, as Civil law jurisdictions, derived tort law from basic doctrinal categories in a non-statutory way very similar to that of the Common law. See K. ZWEIGERT & H. KÖTZ, AN INTRODUCTION TO COMPARATIVE LAW, (2nd ed., Oxford U. Press, 1987), v.2,at 289 ff.

[68] *See* 28 U.S.C. § 1332. In class actions as well, the jurisdictional minimum must be met on a per-plaintiff basis in most cases; aggregation of plaintiffs’ claims for the purpose of meeting the jurisdictional minimum is only permissible when plaintiffs “unite to enforce a single title or right, in which they have a common and undivided interest.” Zahn v. International Paper Co., 414 U.S. 291, 294 (1973) (*quoting* Troy Bank of Indiana v. G.A. Whitehead & Co.,, 222 U.S. 39, 40-41 (1911)).

[69] 304 U.S. 64 (1938).

[70] *Erie Railroad*’s purpose was arguably to preserve a viable, principled federal private law system. Supreme Court cases subsequent to *Erie* arguably unwittingly undermined this effort. This paper briefly discusses the implications of *Klaxon v Stentor Electric*, *infra* TAN 171.

[71] This procedural protection has been substantially diminished by judicial interpretation of federal statutes, allowing state courts to retain jurisdiction unless diversity is complete (i.e., unless each

Though various states' rules may be similar on any given subject matter, the multiplicity of laws with which manufacturers must reckon itself generates costs. In some subject areas these costs may create inefficiencies, as has been noted by Judge Posner[72] and by others.[73] Choice-of-law rules at times operate to exacerbate such inefficiencies, as will be shown below. In other areas, however, national corporations cope rather well with legislative diversity, from state highway codes (UPS trucks run in every state) to contract rules (Exxon/Mobil Corp. easily deals with the mix of franchise laws with which it must comply).[74]

The diversity of state product liability law might be thought equally advantageous. Justice Brandeis prominently recognized that states offer competing laboratories in which solutions to problems can be tried and tested:

> "It is one of the happy incidents of the federal system that a single courageous State may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country."[75]

Justice Brandies suggests that the coexistence of different state laws would result in the rewarding good laws and the "weeding out" of inefficient legislation. However, this can only be achieved if the structural context for the application of these laws allows for real competition among them. Unfortunately, for product liability rules, that does not prove to be the case.

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plaintiff is from a different state from each defendant). A case study of this problem may be found in Michael I. Krauss, *The American Torts Crisis meets NAFTA: The Loewen Case*, 9 GEO. MASON L. REV. 1 (2000).

[72] R. Posner, The Federal Courts 179 (1985).

[73] E.g., *see* Bruce Kobayashi & Larry Ribstein, *An Economic Analysis of Uniform State Laws*, 25 J. OF LEG. STUD. 131 (1996)

[74] Even though the Uniform Commercial Code is relatively standard, there are variations and contracts for services are still governed by state common law.

[75] *In* New State Ice Co. v Liebmann, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting).

C. Product Liability Law And The "Prisoners' Dilemma"

In the typical product liability case, a consumer purchases a product, is allegedly injured while using it, and sues its manufacturer[76] to recover damages resulting from that injury. Most purchases assuredly still take place close to home, almost all product use takes place near home or workplace,[77] and no state is home to a majority of manufacturers' head offices or factories. The concurrence of these factors suggests that the typical product liability suit is initiated by a plaintiff who has been injured in her home state, which is also the state in which the allegedly defective product was purchased. In the vast majority of cases, however, the product was designed and manufactured in another state.

Assume for a moment that the victim sues in her home state, that this forum state's court agrees it has personal jurisdiction over the suit, and that it concludes that its own substantive product liability law applies to resolve the dispute.[78] Such a suit would pit a local individual plaintiff against an out-of-state corporate defendant, in the local plaintiff's court and subject to the local plaintiff's law. The fact that a lawsuit is initiated in a local court, by a local plaintiff, against a 'foreign' defendant, does not imply that the law as applied to the lawsuit will be unreasonable. After all, laws of the forum state must be generally applicable, i.e., they must apply equally to

[76] The retailer may also be sued, but recovery is typically against the manufacturer; because the retailer is typically local, its inclusion as a codefendant may be used to destroy diversity and prevent removal to federal court. *See, e.g.*, Guerrero v. General Motors Corp., 892 F.Supp. 165 (S.D.Tex.1995) (local retailer's presence as codefendant destroyed diversity even though this was sole factor preventing removal).

[77] Even for automobiles, most driving takes place near one's home, i.e., in one's state of residence.

[78] It matters not, here, whether or not the defendant manufacturer removes the case to federal court on diversity grounds. In any case the Federal court will apply the forum state's substantive law to the dispute. In any case, removal to a federal court can currently be (and often is) prevented with ease, merely by joining a local defendant (say, the retailer) to the lawsuit. This joining destroys "complete diversity", and thus precludes removal under current interpretations of federal law.

in- and out-of-state defendant manufacturers (under pains of constitutional sanction).[79]

Consider, however, a scenario in which the forum state's product liability rules are ambiguous in some way that bears on the dispute at hand.[80] Assume, for example, that a defendant in a product liability suit offers a legal argument that is powerful, but not *clearly* dispositive, and that if the forum court agreed with this argument it would take the case from the jury and declare the local plaintiff's suit groundless. At the margin, will the local judge be tempted to transfer wealth in-state by rejecting this argument, thereby (to the extent the case has precedential value) creating a product liability régime with a vaguely more pro-plaintiff posture? Of course, the previous legal rule may well have been optimal; if it was, then the incremental move now made would leave the state's law in a relatively inefficient state.[81]

To illustrate, the previous state of the law might have incorporated a "consumer misuse" defense, the functional equivalent of tort law's contributory or comparative negligence defenses. Under the consumer misuse defense, plaintiffs injured by defective products they have misused may not recover, or their recovery

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[79] *See* U.S. CONST. art I, § 8, cl. 3; CITY of Philadelphia v. New Jersey, 437 U.S. 617, 626-27 (1978) (holding that under the Commerce Clause, articles from out of state must be treated the same as those in-state, unless there is some reason apart from their origin to treat them differently); New England Power Co. v. New Hampshire, 455 U.S. 331, 339 (1982) (New Hampshire could not, consistently with the Commerce Clause, restrict the sale of power to within its own borders). *But see* Maine v. Taylor, 477 U.S. 131, 151 (1986) (upholding a state ban on importation of baitfish, stating that as long as a state does not attempt to place itself in a position of economic isolation, it retains broad authority to regulate the health and safety of its citizens and the integrity of its natural resources).

[80] In reality the nature of the legal system is such that litigated cases are often 'interstitial', raising issues in a slightly different way than they have ever been raised before. Easy cases don't usually make it to trial – the party likely to lose, and her attorney, will have little incentive to keep fighting. Those cases that do make it to trial often involve either an acute difference of outlook on the facts of the case or a "gap" in the law. *See* H.L.A. HART, THE CONCEPT OF LAW 2D ED. 100-23 (1994).

may be reduced.[82] This defense is arguably desirable, *inter alia*, to minimize moral hazard by imparting appropriate incentives to consumers. After all, joint care (in manufacture *and* in use of a product) is clearly needed to minimize the social costs of accidents. But what standard will be used to measure "consumer misuse"? Should the plaintiff's misuse be fatal to her case if it was "foreseeable" by the manufacturer? Should it matter whether the misuse was drunk driving, or traveling at 100 mph, or not fastening one's seat belt, or all of the above?[83] What if the considerable cost of this inefficiency can be transferred to shareholders, workers and consumers *across the nation*,[84] while the relatively slight immediate benefit of the shift in state law accrues *inside the state*? After all, the manufacturer *could* have designed the product to make that foreseeable misuse more difficult or even impossible… A local plaintiff will be highly motivated to nudge the "consumer misuse" defense toward an arguably socially non-optimal result, requiring precious little care on her part but expensive redundancy in design. Would the judge, and the jury, be tempted to make the shift?

Chief Justice Richard Neely of the West Virginia Supreme Court disclosed, in a 1988 book, that he had felt motivated to adjust product liability rules in precisely this way whenever such an adjustment would transfer money into West Virginia.[85] Justice Neely then "walked the walk", implementing this reasoning in *Blankenship v*

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[81] If the previous state of the law was suboptimal, then it should have been changed, regardless of the citizenship of the parties to the dispute.

[82] *See, e.g.*, Venezia v. Miller Brewing Co., 626 F.2d 188, 192 (1st Cir. 1980) (Even under the most expansive theories of products liability, a manufacturer is not an insurer and cannot be held to a standard of duty of guarding against all possible types of accidents and injuries in any way causally related to the design and manufacture of its products); *see also* Bolen, *The Basis of Affirmative Obligations in the Law of Tort*, 53 U. Pa. L. rev. 337, 343 (1905) (a purchaser who subjects an article to a use for which it is unfit and unsafe is liable for his own injury therefrom).

[83] *See, e.g.*, Ellsworth v. Sherne Lingerie, Inc., 495 A.2d 348, 356-57 (Md. App. 1985) (plaintiff whose inside-out nightgown touched a stove burner and ignited while she was making tea had used the nightgown for a reasonably foreseeable purpose, though possibly careless).

General Motors.[86] *Blankenship* was a "crashworthiness", or "secondary collision" case in which his court adopted a pro-plaintiff rule even though it found the defendant's argument more sensible. A plaintiff who had negligently caused his GM vehicle to crash alleged that its poor design aggravated the injuries he otherwise would have suffered in the collision. It is of course always possible to allege *some* defect or other in any vehicle's design. In "crashworthiness" cases the typical plaintiff's additional difficulty is establishing "cause in fact" – i.e., demonstrating the extent to which the purportedly defective automobile design actually worsened her injury. Since no crash can be replicated exactly, it is difficult for the plaintiff to establish how a "well-designed" car would have fared during this precise collision. Sometimes the plaintiff invokes a "perfect car" that could withstand this (and perhaps most any) crash. In that case, what should the court do if this perfect car is not in fact currently made by any manufacturer?

Two general approaches to the secondary collision problem had emerged in pre-*Blankenship* case law across the country:

- The first, following *Huddell v. Levin*,[87] required plaintiff to "offer proof of an alternative, safer design, practicable under the circumstances, … [and] of what injuries, if any, would have resulted had the alternative, safer design been used." The costs of producing prototypes is usually prohibitive, especially if no existing automobile had the design features the plaintiff requests. Failing such proof,

[84] *See supra*, TAN 24.
[85] R. Neely, The Product Liability Mess (1988).
[86] 406 S.E.2d 781 (W. Va., 1991)
[87] 537 F.2d 726 (3rd Circuit, 1976)

Huddell holds that plaintiff may not reach the jury with her design defect claim.

- The second approach (following *Mitchell v. Volkswagenwerk, A.G.*)[88] shifts to the defendant the burden of proving that the alternative design appealed to by the plaintiff is *not* feasible, or would *not* have reduced injuries. Any such proof would of course be rebuttable, so getting to the jury on this issue is assured, as long as the plaintiff locates one "expert" who states that a better design would have prevented her injury.

Acknowledging the *Huddell* doctrine as more efficient, because it minimized the chance that the judicial system would engage in uninformed second-guessing of design standards in a competitive market,[89] the West Virginia Supreme Court in *Blankenship* nonetheless opted for *Mitchell*. The court justified its position because West Virginia consumers were as a practical matter already paying to reflect inappropriate liability payouts to plaintiffs in those states that had adopted *Mitchell*, markups every time a new car was purchased in West Virginia. Justice Neely reasoned that West Virginians should benefit from the inefficient rule, since consumers in other states would similarly pay most of its cost. Aware of the implications of his idea, and wanting to make his state a safe place for injured local plaintiffs, Justice Neely went on to announce that henceforth, "in any crashworthiness

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[88] 669 F.2D 1199 (8th Circuit, 1982)

[89] *See, e.g.*, Richard A. Posner, *A Theory of Negligence*, 1 J. OF LEGAL STUD. 29, 74-76 (1972).

case where there is a split of authority among states on any issue, … we [will] adopt the rule that is most liberal to the plaintiff."[90]

The dilemma sketched by Justice Neely, and empirically confirmed by Eric Helland and Alex Tabarrok[91] is an illustration of the classic "prisoners' dilemma" of game theory.[92] A "prisoners' dilemma" is a predicament in which a number of individuals, acting independently, are each rationally impelled to make choices that, when combined with the other individuals' equally rational choices, generates a very poor outcome for each individual.[93]

This prisoners' dilemma springs from the fact that local plaintiffs and out-of-state defendants are typically the protagonists. If each state's judicial system crafted product liability rules that were designed to maximize national output, commerce among the states would be less risky, investment decisions would not be skewed, in countless other ways costs of doing business would be lowered, and consumer surplus in the various states would be collectively maximized. This is represented by the

[90] *Blankenship*, 406 S.E.2d at 785-786.
[91] Eric Helland and Alexander Tabarrok, *Exporting Tort Awards*, 23 REGULATION, NO. 2, at 21 (2000). The authors found that elected state judges are biased against out-of-state corporate defendants. They found no such bias in federal diversity actions.
[92] *See* Robert Axelrod, The Evolution of Cooperation (1984).
[93] The name "prisoners' dilemma" refers to a simple illustration of the problem, in which two partners in crime are interrogated separately by the police. If each suspect keeps quiet, both will get light punishments, since the police has little evidence. Suppose, though, that each prisoner is told that she will get off without *any* punishment (but her accomplice will get 'the max') if she implicates the accomplice and the latter remains silent. On the other hand, if the accomplice rats the suspect out while she stays silent, the reverse scenario will occur. Finally, if both accomplices confess, each will get a heavy punishment (though less than 'the max'). Schematically, the dilemma looks like this (figures in brackets representing years in prison for A and B, respectively):

	B keeps silent	B "gives it up"
A keeps silent	2,2	0,10
A "gives it up"	10,0	7,7

In this case, each prisoner has an incentive to confess and implicate her partner, provoking the worst collective outcome for the two suspects. Police routinely exploit this dilemma -- acting individually upper left hand box in Table II below. But if all states had such even-handed rules, any individual state could extract profits ("rents") for local residents by "defecting", i.e., by adopting rules that exploit defendants, most of which are located out-of-state. If all states had exploitative rules, then costs of production would be needlessly high, investment decisions would be distorted, and consumer surplus would be lowered.

The temptation to defect is illustrated in the following table which imagines a simple scenario with two states, A and B:[94]

TABLE II
PRISONER'S DILEMMA AS CONCEPTUALIZED BY JUSTICE NEELY

State B **Þ [2nd payout]**

State A **ß [1st payout]**	**Legally Neutral, Optimal Rule**	**Rule That Exploits Out-of-State Defendant**
Legally Neutral, Optimal Rule	**40, 40**	**-10, 55**
Rule That Exploits Out-of-State Defendant	**55, -10**	**5, 5**

The matrix demonstrates that state A optimizes its return (the first number in the pair), regardless of what state B does, if state A adopts a rule which exploits out-of-state defendants. (The absolute numbers are arbitrary – other rank-preserving figures would also illustrate the dilemma). If state B has a neutral rule, state A's payoff increases from 40 to 55 by adopting a discriminatory rule. If state B has a discriminatory rule, state A increases its payoff from -10 to 5 by discriminating in turn. If states A and B cooperate, promising to adopt neutral rules for mutual benefit, each state's agents have incentives to defect from the agreement.

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without guarantees about the other's behavior, A and B are each led to confess, though after they do this they are each in an inferior situation from their own perspectives.

State A is better off adopting a discriminatory rule no matter which rule B in fact adopts, even though the exploitative rule by A causes a net social loss (of 35, given the figures in the table) when compared to neutral rules for both states.[95] State B has symmetrical incentives to adopt a discriminatory rule no matter which rule A adopts. The expected ("dominant") outcome is thus the lower right-hand corner, in which both states have adopted exploitative, non-efficient rules. This result is "Pareto-inferior"[96] to the upper left-hand corner outcome, which maximizes benefits.

A product liability prisoners' dilemma is unlikely to be neutralized by industrialization in contemporary America. Even in populous and highly industrialized states like New Jersey, the great majority of products consumed are produced outside the jurisdiction, and the majority of products produced are destined for out-of-state consumption.[97] Under such conditions courts will have an incentive to provide "Equal Protection" by exploiting both in-state *and* out-of-state manufacturers. As will be shown below, such behavior will not (contrary to intuition, and to influential recent scholarship) jeopardize the attractiveness of the state as a site for manufacturing.[98] The fact that New Jersey has arguably blazed a trail in product liability "innovations",[99] yet has been successful in attracting manufacturing facilities, does not negate the existence of the "prisoners' dilemma".

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[94] To conceptualize this nationally, "state A" might be the "forum state", while "state B" might be "all other states."
[95] Total payoff in top left box: 80 (40 + 40). Total payoff in bottom left box: 45 (55 -10).
[96] I.e., it is worse from each party's subjective perspective (absent weird envy or some similar pathology). *See* HENRY N. BUTLER, ECONOMIC ANALYSIS FOR LAWYERS 77 (1998) (explaining the concept of Pareto efficiency as subsuming the premise of subjective evaluation of welfare).
[97] This is not the case for some localized products, e.g., milk in some states. If such products have distinguishing characteristics, then this would give way to a testable hypothesis -- that liability rules for such products would implement these characteristics and tend to be less exploitive.
[98] *See infra*, TAN 122 ff.
[99] *See supra*, note 64.

Nor is the dilemma likely to be resolved by state legislative action. For reasons analogous to those underlying the judicial prisoners' dilemma, state legislatures are unlikely to adopt rules clarifying product liability doctrines in ways favorable to out-of-state interests.[100] In fact, the bulk of legislative tort reforms have concerned matters such as automobile accidents and medical malpractice, both of which tend to involve *in-state* defendants.[101]

Note, finally, that this prisoners' dilemma implicates both the selection of the law applicable to an individual case and the interpretation of that law. One would expect to see more adverse interpretations of the same law against out-of-state defendants than against in-state defendants. This tendency is likely exacerbated in jurisdictions where judges are elected and must run for contested re-election.[102]

II. Price Discrimination: A Resolution of The Prisoners' Dilemma

Chief Justice Neely's strategy, which Alex Tabarrok's preliminary data indicates is replicated nationwide, depends crucially on the existence of a national market for products. For it is only if price increases in Virginia and Maryland, for example help absorb the cost of inefficient rulings in West Virginia that the Neely strategy can succeed. Current product liability law would not create a prisoners' dilemma if manufacturers could durably price products differently from state to state, as a function (*inter alia*) of the costs (including liability costs) of doing business in

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[100] R. Epstein, *The Political Economy of Product Liability Reform*, 78 AM. ECON. REV. 311 (May 1988 special issue).

[101] Get statistics on this.[ASA – I will give you a tort reform handbook from which you can make statistics]

[102] Tabarrok and Helland, *supra* note 22, at 163.

that particular state. If state price discrimination were possible, each state would have a greater incentive to conduct its legal business as if in an "autarky", i.e., as if it bore virtually all of the consequences of its legal decisions.[103]

The matrices of Table II would be quite different in an autarky, since any inefficient legal change by courts or legislatures in state A would result in increased prices *in that jurisdiction only*. Because the costs of A's legal change could not be directly externalized to other states,[104] State A would have little strategic interest in making the change. If the costs of discriminating against out-of-state firms were essentially internalized, then given the figures used in Table I above, the results of State A's or State B's adoption of an inefficient pro-local plaintiff rule are reflected in the following matrix:

[103] *See* McConnell, *supra* note 5. Of course, price discrimination would not really establish absolute autarky. *See infra*, note 104.

[104] It is important to realize that even in an 'autarkial' state, A's legal rules might still impact on other states. Thus, depending on the elasticity of demand for products, increased local liability in State A could result in increased prices in State A, decreased amount demanded in State A, therefore increased unemployment in State B (the state of manufacture), decreased tax base in State B, etc. Alternatively, if State A had a large population, a liability increase in that state might result in a *national* design modification instead of a *localized* price increase, if there are significant manufacturing economies of scale. This type of externality is not morally unobjectionable – for, unlike Justice Neely's strategy, state A's legal change was not *intentionally* accomplished in order to subsidize consumers in state A by consumers in other states. In addition, this kind of externality is in fact commonplace -- every time we purchase something we increase demand for it slightly, and thus increase the price others must pay marginally.

TABLE III
AUTARKIAL INCENTIVES
« STATE B (SECOND NUMBER)

STATE A (FIRST NUMBER) ¯	**RULE THAT IS OPTIMAL AND LEGALLY NEUTRAL**	**RULE THAT EXPLOITS OUT OF STATE DEFENDANT**
RULE THAT IS OPTIMAL AND LEGALLY NEUTRAL	**40, 40**	**40, 5**
RULE THAT EXPLOITS OUT OF STATE DEFENDANT	**5, 40**	**5, 5**

In this scenario, which uses the same payout amounts as in Table II, neither State A nor State B has an incentive to adopt an inefficient rule that is hostile to out-of-state defendants.[105]

Substantive product liability rules are in a sense the dependent variables here. One important independent variable is the choice-of-law rule implemented in the state – what substantive rule of law is applied by a court in a multi-jurisdictional product dispute? If the choice-of-law rule allows a state to externalize the costs of its judicial decision, it is wanting under this analysis. If on the other hand the choice-of-law rule is conducive to autarky, then it is acceptable. Unfortunately, as the next section indicates, neither of the two basic types of choice-of-law rule currently in force across the states (and therefore also in federal courts)[106] passes muster.

[105] To the extent that each state would see its own shareholders and employees affected by its decision (see TAN note 24, *supra*), the disincentive would be exacerbated.
[106] *See infra*, TAN 171-174.

A. Autarky and Existing Choice-of-law Rules.

1. *Lex Loci Delictus*

Consider the traditional choice-of-law rule for torts.[107] That rule, styled *lex loci delictus*, provides that the substantive law of the state in which a tortious act occurs governs any lawsuit arising from the tort. Since a tort cannot exist absent injury,[108] *lex loci* essentially applies the law of the place of injury to determine liability.

Thus, say a consumer in state A travels to state B to purchase a product manufactured in state C. The consumer then returns home to use the product in state A. If the product's use results in injury to the consumer, who then sues the manufacturer, courts in state A will both assume jurisdiction and (if they abide by *lex loci*) apply the substantive product liability law of state A to determine whether the manufacturer is liable for the injury.[109] Courts in other states, if they had personal jurisdiction for some reason, would of course also apply state A's substantive product liability law if they followed *lex loci*.

If courts everywhere adopted *lex loci delictus*, then they would all apply the laws of state A to regulate accidents occurring in state A, and the laws of state B to govern accidents occurring in state B. It might seem that an "autarkial" situation exists in such a situation. Consumers in state A would, one might argue, have to pay "A prices" for their goods, while consumers in state B paid "B prices", each set of

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[107] REST. (FIRST) OF THE LAW OF CONFLICT OF LAWS § 377.

[108] At least this is so for non-intentional torts. *See* W. PAGE KEETON, ET AL., EDS., PROSSER AND KEETON ON THE LAW OF TORTS, 5TH ED., § 30 (1984)..

[109] *See*, *e.g*., Philip Morris Inc. v. Angeletti, 752 A.2d 200, 230-33 (Md.,2000) (Maryland applies the *lex loci delicti* rule as set forth in the First Restatement in all tort actions, and the place of the harm is defined as the place of the last action contributing thereto)..

prices reflecting *inter alia* a given “liability premium”. Despite the facade of autarky, however, arbitrage will preclude a resolution to the prisoners’ dilemma under *lex loci*. Arbitrage is possible because out-of-state purchase is likely.

Imagine that state B has product liability rules that favor defendants, as compared with those of state A. Say a manufacturer decides to charge higher prices for goods wholesaled in state A, in order to cover the “premium”[110] it must pay for unavoidable liability.[111] If this happened, consumers in state A could simply purchase their products *sans* premium from merchants in state B. *Lex loci* provides that the law of state A applies to all accidents occurring in state A, regardless of the location of retail sale. Thus, consumers in A would obtain the same tort “coverage” for a lower premium if they purchase their product in state B instead of shopping in their home state, A. Manufacturers will not be able to adjust the price of goods sold in state B, to reflect B’s less stringent product liability rules, because lower-priced goods sold in state B may possibly bring upon themselves the higher liability of state A. *Lex loci delictus*, in sum, does not allow for segregation of these distinct liability risk pools into distinct premium pools. Insurance theory leads us to predict that this inability to segregate risk pools will lead to avoidance of the insurance premium by higher risk insureds. *Lex loci* is therefore not conducive to an autarkial solution.[112]

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[110] This premium may be a literal insurance premium, or it may be a reserve set aside by a self-insuring manufacturer to cover expected liability costs.

[111] As stated earlier, prices will increase to reflect liability costs only if those costs do not represent cost-efficient design or manufacturing changes. For efficiently avoidable liability, i.e., negligence, a manufacturer will simply not be able to pass costs on in a competitive market. See TAN note 24, *supra*.

[112] *See* George L. Priest, *The Current Insurance Crisis and Modern Tort Law* 96 YALE L.J. 1521, 1540-41 (1987).

Might *lex loci* tend, at a minimum, to encourage manufacturers to leave high-liability State A and relocate to low-liability State B? If such a tendency existed, and if by hypothesis the correct liability level was that chosen by State B, then this *would* alter incentives at the margin, perhaps sufficiently to avoid the prisoners' dilemma entirely. Alas, there is no reason to believe an inducement to relocate is created by *lex loci delictus*. After all, under this rule a manufacturer's liability in no way depends on the location of its manufacturing facilities. A manufacturer's exposure to liability for accidents occurring in state A will be the same, whether its product is produced in state A or in some other state. Indeed, if state A believes it is successfully siphoning money from other states through its beggar-thy-neighbor product liability rules, as Justice Neely's strategy implies, it might choose to use part of its "rent" to subsidize manufacturers to locate or remain there.[113] If this happens, *lex loci* might indirectly *discourage* plant location in low-liability locations.

In sum, under *lex loci delictus* the dominant strategy in states A and B would tend to be Justice Neely's: a consistently and increasingly more stringent product liability régime than national and state welfare would mandate. Empirically, this impossibility of reacting to product liability distortions by changing manufacturing sites or by tailoring wholesale prices to new legal developments is borne out: manufacturers report that they consider state product liability rules as a factor to which they are unable to adjust.[114]

[113] If lawyers and plaintiffs capture the entire "rent" from the Neely strategy, this bribe could be accomplished through a tax on tort income or on tort contingent fees.

[114] G. EADS & P. REUTER, DESIGNING SAFER PRODUCTS: CORPORATE RESPONSES TO PRODUCT LIABILITY LAW AND REGULATION 107 (1983). Of course, adoption of confiscatory liability rules may be a sign of a general climate hostile to business – but then it would be this climate, not the product liability rule or choice-of-law, that would attract or repel investment. *See* U.S. Chamber Institute for Legal Reform, Chamber Releases Report Card on State Liability Systems – Survey of Corporate

2. "Interest Analysis"[115]

As a choice-of-law rule, *lex loci delictus* has been supplanted by "interest analysis" in a majority of states.[116] Under "interest analysis", spurred by the work of Brainerd Currie,[117] the forum court determines which substantive law to apply to a multi-jurisdictional dispute by ascertaining which state has the greatest "interest" in determining the outcome of the case.[118] Using "interest analysis" notably allows a forum state to apply its own law to accidents occurring outside its boundaries.[119]

Counsels Ranks All 50 States, Press Release 1/22/2002, available at http://www.litigationfairness.org/newsroom_release_012202.html

[115] This section groups together states that have abandoned the *lex loci* rule of the First Restatement. Technically, these states might be strict "interest analysis" states, or they might have adopted the Second Restatement, which refers to "interests" as well as to other factors in making "most significant relationship" decisions. This essay groups these states together, following the view that both "modern" approaches tend to favor forum law more frequently than does the traditional *lex loci* rule, and that neither is particularly discernible from the other in practice. *See*, e.g., Michael Solimine, *An Economic and Empirical Analysis of Choice of Law*, 24 Ga. L. Rev. 49 (1989); Borchers, *The Choice-of-Law Revolution: an Empirical Study*, 49 Wash. & Lee L. Rev. 357 (1992).

[116] *See* Russell Weintraub, *Choice-of-law for Product Liability: Demagnetizing the United States Forum*, 52 ARK. L. REV. 157, 163-164 n.29 (1999); COMMENTARY ON THE CONFLICT OF LAWS 319- 21 (3d ed. 1986) and SUPP. 1991 at 66 (listing 35 states plus the District of Columbia and Puerto Rico that have adopted the "modern" approach); *see also* Casey v. Manson Constr. & Eng'g Co., 428 P.2d 898 (1967); Fuerste v. Bemis, 156 N.W.2d 831 (Iowa 1968); Mitchell v. Craft, 211 So.2d 509 (Miss.1969); Kennedy v. Dixon, 439 S.W.2d 173 (Mo.1969); Ingersoll v. Klein, 262 N.E.2d 593 (1970); First Nat'l Bank in Fort Collins v. Rostek, 514 P.2d 314 (1973); Brickner v. Gooden, 525 P.2d 632 (Okla.1974); Pevoski v. Pevoski, 358 N.E.2d 416 (1976); Johnson v. Spider Staging Corp., 555 P.2d 997 (1976); Gutierrez v. Collins, 583 S.W.2d 312 (Tex. 1979); Bishop v. Florida Specialty Paint Co., 389 So.2d 999 (Fla.1980); Adams v. Buffalo Forge Co., 443 A.2d 932 (Me. 1982); Lee v. Ford Motor Co., 457 So.2d 193 (La.Ct.App. 1984), *cert. denied*, 461 So.2d 319 (La. 1984); Morgan v. Biro Mfg. Co., 474 N.E.2d 286 (1984); Ehredt v. DeHavilland Aircraft Co. of Canada Ltd., 705 P.2d 446 (Alaska 1985); Johnson v. Pischke, 700 P.2d 19 (1985); Bryant v. Silverman, 703 P.2d 1190 (Ariz. 1985); O'Connor v. O'Connor, 519 A.2d 13 (1986); Hubbard Mfg. Co. v. Greeson, 515 N.E.2d 1071 (Ind.1987); Harper v. Silva, 399 N.W.2d 826 (1987); Travelers Indem. Co. v. Lake, 594 A.2d 38, 47 (Del. 1991); Hataway v. McKinney, 830 S.W.2d 53, 59 (Tenn. 1992); Motenko v. MGM Dist., Inc., 921 P.2d 933 (Nev. 1996); Amiot v. Ames, 693 A.2d 675 (Vt. 1997); Phillips v. General Motors Corp., 995 P.2d 1002 (Mont. 2000).

[117] Currie, Selected Essays on the Conflict of Laws 1963.

[118] Brainerd Currie (ed.), Selected Essays on the Conflict of Laws 189 (1963).

[119] *See, e.g.* Hataway v. McKinney, 830 S.W.2d 53, 60 (Tenn. 1992) (fact that diving accident occurred in Arkansas was merely a "fortuitous circumstance"; court decides that Tennessee law should apply, since other states would apply *their* own law).

Theoretically, "interest analysis" also allows a forum state to *decline* to apply its own law to accidents occurring *inside* its boundaries.[120]

Courts typically use "interest analysis" to conclude that the forum state's 'interest' in compensating its citizens for injuries suffered while they are out-of-state exceeds the 'interest' of the *lex loci* state in determining the juridical consequences of events occurring inside its own borders.[121] Such "protection" is of course only required if the *lex loci* state happens to have liability rules that favor the defendant. Thus, "interest analysis" is often seen to exacerbate the prisoner's dilemma.

In a provocative article,[122] Professor Bruce Hay asserts, to the contrary, that the rise of "interest analysis" actually helps *neutralize* the prisoners' dilemma created by *lex loci*, because it encourages manufacturers to locate in low-liability areas. Succinctly, here is Hay's argument:

1. Assume state A, whose rules result in extensive manufacturers' liability, and state B, a more pro-defendant jurisdiction. Assume that the conflicts rule in state A is *lex loci delictus*. As discussed above, manufacturers are unable to price their products differentially in states A and B to reflect liability potential in each state, because of the adverse selection caused by insurance arbitrage.[123]

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[120] *See*, for a rare instance of this, Schultz v Boy Scouts of America, Inc., 480 N.W.2d 679 (N.Y., 1985) (New York court applies New Jersey charitable immunity rule to dismiss suit by New Jersey plaintiff against New Jersey corporate defendant, for sexual abuse committed in New York and New Jersey by one of its employees; New York law contained no charitable immunity exception, but the court refused to extend its protection to the plaintiff.)

[121] *See*, e.g., Phillips v. General Motors Corp., 995 P.2d 1002 (Mont. 2000) (auto accident occurred in Kansas, in a vehicle purchased in North Carolina: Montana court asserts that it has a supreme interest in allowing Montana plaintiffs to avail themselves of Montana's uniquely pro-plaintiff rules in order to recover from the non-Montana defendant)

[122] Bruce Hay, Conflicts of Law and State Competition In The Product Liability System, 80 GEO. L. J. 617 (1992).

[123] *See supra*, TAN 110-112.

2. It has already been shown that under *lex loci* manufacturers have no incentive to relocate their plants.[124] But under "interest analysis", as long as the state of manufacture constitutes *one additional "interest"* favoring the application of that state's law, then at the margin this might tip the scales in favor of the law of the state of manufacture.
3. For instance, a citizen of pro-defendant state B, injured in state B by a product manufactured in pro-plaintiff state A, might under "interest analysis" persuade the courts of state B to invoke the product liability rules of state A.[125] But if the manufacturer were to relocate to state B, there would be no grounds at all for courts in B to apply state A's laws to this case. Thus interest analysis, at the margin, encourages firms to relocate to low-liability states. This helps counteract the local court's natural tendency to favor a local plaintiff.
4. Hay correctly concludes that a ready-made empirical test for his hypothesis about the effects of interest analysis already exists.: if he is correct, then states with low manufacturer liability will over time tend to abandon *lex loci delictus* and adopt "interest analysis" as their choice-of-law rule as a way to lure manufacturers into their jurisdiction.[126] Courts with pro-plaintiff product liability rules would, on the other hand, be expected to stick with *lex loci.*

Honorably falling on his sword, Professor Hay admits that his test fails – his hypothesis is rebutted by "facts on the ground." States that have adopted "interest

[124] *See supra*, TAN 113.

[125] Courts in state B, it is somewhat dubiously hypothesized, will find their desire to transfer wealth from A exceeds their desire to apply the pro-defendant rule they in fact believe to be the best rule of product liability.

[126] Note, obviously, that accidents occurring in pro-defendant State B will already be subject to state B's laws under *lex loci*.

analysis" tend to be *high*-liability states wishing to promote recovery by their own citizens for accidents occurring in less pro-plaintiff jurisdictions. States that have conserved *lex loci* tend to be pro-defendant states.[127] Contrary to Hay's prediction, *plaintiffs* fare better in "interest analysis" states, on average.[128] Why is this so?

Professor Hay also seems to have, in the first place, neglected the fact that the *status quo ante, lex loci*, will obtain unless that doctrine is overturned by a (therefore) activist court. Activism in one field is arguably the result of a legal philosophy, which may breed activism in other fields. States that have declined to abandon *lex loci delictus* are, under this view, also less likely to modify common law substantive product liability rules, many of which originally favored defendants. States whose substantive rules result in less frequent manufacturer liability do not adopt "interest analysis" for the same reason they do not change their substantive product liability rules.

A good illustration of "interest analysis" in action can be found in *Duncan v Cessna*.[129] In *Duncan*, plaintiff's decedent and husband, a resident of Texas, was killed in New Mexico during the crash of a Cessna aircraft in which he was taking a flying lesson. The victim had traveled to New Mexico to contract with the flight school, and had signed in that state a release holding the school harmless for the general risks of flying. The release did not name the Cessna Corporation, but did state that it protected "any other corporations or persons whomsoever responsible therefore, whether named herein or not". Under New Mexico law, this release would

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[127] *See* Hay, *supra* note 122 at 649.
[128] *See* Phillips v General Motors, *supra* note 121 [state decides to adopt interest analysis solely because it will allow more substantial recovery by its citizens than would *lex loci*]; *see also* Michael Solimine, *An Economic And Empirical Analysis Of Choice-Of-Law*, 24 GA. L. REV. 49 (1989)

have benefited Cessna, which presumably could therefore charge lower aircraft lease rates to New Mexico flight schools.

But plaintiff sued in her home state, Texas. The forum court held that Texas law, which did not allow Cessna to avail itself of the release, should apply to the accident because of "interest analysis". New Mexico, the Texas court wrote, had little "interest" in seeing its law applied, because defendant Cessna was a Kansas corporation and New Mexico, *locus* of neither party, was therefore presumably indifferent to the outcome of the litigation. On the other hand, Texas, wrote the Texas court, was acutely "interested" in compensation for injured Texas residents.

The Texas court conveniently overlooked the fact that New Mexico may have a distinct interest in allowing lease terms in the state to reflect the state's legal rules. [In other words, New Mexico, like all states, has an "interest" in autarky.] The forum court's refusal to apply New Mexico law to the case prevented New Mexico from achieving this result. Unless it can somehow restrict New Mexico flying lessons to New Mexico domiciliaries, Cessna no longer has a basis for charging lower equipment lease rates to charter firms in New Mexico.

Texas succeeded, through "interest analysis", in having New Mexicans "share the pain" of Texas law. It did this by seeing "interest" as a synonym for the kind of distributive preference voiced by Justice Neely in West Virginia. But this distributive preference is *incompatible* with neutral tort adjudication, in which the legal system should precisely be indifferent as to the victor.[130] This notion of "interest" exacerbates the prisoners' dilemma.

[129] 665 S.W.2d 414 (TX, 1984).
[130] *See See* Michael Krauss, *Tort Law and Private Ordering,* 35 ST. LOUIS U. L. J. 623 (1992).

The tendency to use "interest analysis" to favor locals is illustrated in a different way by *Rutherford v Goodyear Tire & Rubber.*[131] In *Rutherford*, plaintiff was injured in his home state of Indiana following the explosion of a tire mounted in Kentucky, in the assembly plant of defendant automobile manufacturer. Indiana's statute of repose[132] barred the suit, so plaintiff sued in Kentucky, whose statute of repose was more favorable. Applying interest analysis, the Kentucky court, in a result that favored its local "resident", the auto plant, declined to apply Kentucky law. The court stated that that Kentucky had no "interest" in applying its substantive product liability law in a way that would hold Kentucky manufacturers liable for injuries to non-Kentuckians. The Kentucky court therefore chose to apply Indiana law, including Indiana's statute of repose.

The reader might object here that *Rutherford* appears to *confirm* Hay's hypothesis – the location of the plant in Kentucky led the local court to be less pro-plaintiff than it might perhaps otherwise have been. But in this one case where Professor Hay seems to be corroborated, *the same solution would have resulted from lex loci delictus*.[133] Indeed, plaintiff's optimal tactic might have been to sue in Indiana and persuade the Indiana court to apply Kentucky law (or at least the Kentucky statute of repose). Indiana uses *lex loci* and not "interest analysis", however, and so would have been precluded from applying any Kentucky law. Crucially, Indiana would have had to adopt "interest analysis" for the plaintiff to succeed under this

[131] Rutherford v Goodyear Tire & Rubber, 943 F.Supp.789 (W.D. Ky, 1996).

[132] A statute of repose quiets any litigation after a given period – here, a given period after the assembly of the automobile. Statutes of repose are similar to statutes of limitation, except that the latter (but not the former) may be suspended (or "tolled") by such factors as the age of the victim or the defendant's leaving the jurisdiction. *See* Keeton, *supra* note 108 § 30.

[133] The injury occurred in Indiana.

strategy.[134] This is powerful confirmation that adopting "interest analysis" tends to benefit local plaintiffs, not defendants.

Plaintiffs choose the forum state, which will therefore typically be the jurisdiction in which they believe they have the greatest chance of recovery. The forum state is also the state making the choice-of-law decision. Plaintiffs will choose a low-liability forum state only if there really is no other choice. If plaintiff's home state and the state where the accident occurred are the same low-liability state, odds are that the law of that low-liability state will apply regardless of whether it uses *lex loci* or "interest analysis". In such cases, "interest analysis" will favor local (typically plaintiffs') interests. Only when plaintiff's preferred state has for some reason barred the suit would interest analysis *ever* favor defendants.

Thus, Professor Hay's hypothesis fails. Indeed, pro-plaintiff jurisdictions have occasionally refused to use "interest analysis" rule to protect *their own* firms from *out-of-state* plaintiffs, thereby demonstrating a commitment to pro-plaintiff ideology[135] that is hard to square with Hay's predicted reasons for adopting "interest analysis". For example, in *Gantes v Kason Corporation*,[136] an accident in Georgia fatally injured a Georgia woman, resulting in a wrongful death suit by her Georgia family against the New Jersey manufacturer of the machine allegedly responsible for her death. Georgia's statute of repose precluded the suit, so the plaintiff sued in New Jersey. The New Jersey court applied its own law to hold the manufacturer liable,

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[134] *See supra*, note 121, for an instance where a state adopts "interest analysis" explicitly for this purpose.

[135] See George L. Priest, *The Invention of Enterprise Liability: A Critical History of the Intellectual Foundations of Modern Tort Law*, 14 J. LEGAL STUD. 461 (1985).

[136] 679 A.2d 106 (N.J., 1996).

stating that its concern for injured victims (wherever they may live) overrode its fear of discouraging manufacturing in the Garden State.

This does give rise to one marginally relevant observation. Clearly, at the margin firms have an incentive to locate in "interest analysis" states (like Kentucky[137]) that clearly discriminate against out-of-state residents, rather than in "interest analysis" states (like New Jersey) that apparently maintain a pro-plaintiff predisposition in every respect. This incentive is most surely overwhelmed by other factors, as New Jersey's and Kentucky's relative industrial bases tend to indicate.

B. A Note On Countervailing Tendencies

To claim that the two current "choice-of-law" rules each preclude autarkial solutions to the prisoners' dilemma is not to deny that any countervailing tendencies against excessive liability exist.[138] Such factors include the following:

- Judges and juries are subject to more than redistributive economic appeals. Religious and other normative beliefs about individual responsibility, for example, clearly influence both legal and factual determinations. Juries, notably, have resisted many attempts to extract money from tobacco companies, even though plaintiffs were local, because they believed the decision to start and continue to smoke was voluntary.[139]

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[137] *See Rutherford v Goodyear*, *supra* note 131

[138] To see this, imagine an extreme state of affairs in which, for instance, courts tend to hold firms liable without requiring any proximate causation: General Motors might be liable whenever anyone dies in a car crash involving a GM car, regardless of the cause of death and of the existence of any defect. That such absurd results have not occurred suggests that countervailing forces prevent a complete degeneration of product liability law.

[139] Krauss, FIRE AND SMOKE, *supra* note 51.

- State and federal constitutional protections preclude overt takings from out-of-state defendants.[140]
- Appointed state judges are arguably not subject to "rent-seeking" pressures as intense as those affecting elected judges.[141]
- Out-of-state manufacturers can lobby state legislatures to enact pro-defendant tort reform -- and here it is worthwhile to note that political contributions from outside the state are permitted in every jurisdiction.[142]

III. Autarky Through Federal Pre-emption

Prisoners' dilemmas are, in the jargon of game theory, "coordination problems" – if players could reliably harmonize their activity, a Pareto-superior solution would be within reach. Coordination problems can be resolved, generally speaking, in one of two ways: either through the centralized imposition of the optimal solution from outside the group, or *via* an alteration of incentives so as to induce each player to spontaneously act in the socially appropriate way. The search for an autarkial product liability system might conceivably involve either form of coordination.

Federalization of substantive product liability law represents the first kind of solution. If decision-making takes place at the national level, where (by definition) most all costs are borne by "local" residents, strategies such as Justice Neely's would

[140] BMW v. Gore, 517 U.S. 559, 571 (1996) (a state's power to impose burdens on interstate commerce is limited both by the Commerce Clause and by the need to respect the interests of other states); *but see* Michael I. Krauss, *The American Torts Crisis meets NAFTA: The Loewen Case*, 8 GEO. MASON L. REV. 1 (2000).

[141] Tabarrok and Helland, *supra* note 22, at 163.

be pointless. This approach has been advocated by numerous observers,[143] and is put forward on a regular basis in Congress.[144] Nor is there any real constitutional obstacle to federal action – because a national market now exists for products, and because product liability law helps regulate economic transactions, federal legislation could easily be defended as an exercise of the "interstate commerce" power.[145]

This paper will not address the black-letter constitutional question. This is because the paper's claim is that, even if it is constitutional, a federal dislocation of the states' product liability jurisdiction is inappropriate because of the coordination and knowledge problems it would entail. Nor would a purely "negative" intervention by federal authorities – i.e., the nullification of compulsory state rules, setting the stage for the establishment of contractual *laissez-faire* -- be appropriate. The next section makes this argument, after which the question of federal choice-of-law intervention will be introduced.

A. Pre-Emption and Legal Coordination Problems[146]

Product liability law only recently emerged as a somewhat distinct field from tort law, which of course is state-based.[147] Should a set of federal statutes come to

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[142] G. Schwartz, *Considering the Proper Federal Role in Tort Law*, 38 ARIZ. L. REV. 917, at 936-7 (1996).

[143] See, e.g., Schwartz & Mahshigian, A Permanent Solution for the Product Liability Crisis: Uniform Tort Law Standards, 64 DEN. U. L. REV. 685 (1988); Reed & Watkins, Product Liability Tort Reform: The Case for Federal Action, 63 NEB. L. REV. 389 (1984).

[144] *See, e.g.,* 132 CONG. REC. S12751-01 (daily ed. Sept. 17, 1986) (statement of Sen. Kasten) (on Product Liability Reform Act); 142 CONG. REC. H3184-07 (daily ed. Mar. 29, 1996) (statement of Rep. Bliley) (on Commonsense Product Liability Legal Reform Act of 1996); *see also* H.R. Res. 423, 106th Cong. (Feb. 15, 2000) (limiting the product liability of non-manufacturer product sellers).

[145] Sen. Spence Abraham's piece in *Policy Review*, to be cited here.

[146] Coordination problems bedevil other areas of federal legislation, of course. My claim is not that Product liability is unique in this regard, but rather that it is wise to avoid creating additional legal coordination problems since other means of achieving autarky are available.

[147] The emergence of product liability law as a distinct discipline is conventionally dated to the early 1960's, when a series of influential cases (mostly from California) advocated a departure from several

occupy this field and pre-empt state law, then unless all of tort law was federalized courts would be obliged to conjugate federal and state law whenever lawsuits raise both product liability and tort issues. For example:

- if a manufacturer is liable under federal product rules and, say, an employer is liable to an injured worker under a state exception to workers' compensation protection,[148] is the liability of these two parties "joint and several" or merely "several"?[149]
- How should a plaintiff's products suit against the manufacturer of an allegedly defective car be harmonized with her tort case against the driver who allegedly failed to reasonably control that car?[150]
- How would common-law doctrines (developed by state courts, and subject to revision by those courts) coordinate with federal law, which would be statutorily based and therefore "frozen", i.e., beyond the scope of judicial tinkering?[151]

crucial tort doctrines when products caused injury. *See*, e.g., Greenman v Yuba Power Products, 377 P.2d 897 (Cal. 1963).

[148] In Ohio, this exception is particularly stubborn; the Ohio Supreme Court recently struck down as unconstitutional in its entirety a statute attempting to limit such employer liability. Johnson v. BP Chemicals, Inc., 707 N.E.2d 1107, 1114 (Oh.1999).

[149] Multiple defendants are "jointly and severally" liable when any one of them can be called on to pay the entire tort award. Some states, like California, have extended the concept of joint and several liability. Of course, the seminal California case is Summers v. Tice, 199 P.2d 1 (Cal. 1948); *see also* American Motorcycle Ass'n v. Superior Court, 578 P.2d 899 (cal. 1978). New Mexico, on the other hand, has abolished joint and several liability by statute, with narrow exceptions. N.M.S.A. § 41-3A-1 (2001).

[150] See William Powers, Some Pitfalls of Federal Tort Reform Legislation, 38 ARIZ. L. REV. 909 (1996).

[151] *See* U.S. v. Standard Oil, 332 U.S. 301, 313 (1947) (federal courts may not create new common law).

- How would this federal legislation mesh with state tort reform? Would it shift the locus of lobbying efforts to Washington, thereby altering both federal and state political processes?[152]
- Would a federal 'codification' of product liability law inevitably lead to a pre-emption of all state tort law? If a federal takeover of all of tort law were inevitable and feasible, would this not lead to a invasion of contract law as well?[153] Would the disappearance of the states as the principal *locus* of private ordering be in our interests?[154]

B. Pre-Emption and Knowledge Problems

Beyond the difficulties of coordination and the risk of massive federal intrusion on state responsibility for private ordering, uncertainty about the content of "perfect" product liability legislation argues strongly against pre-emption by Washington. Endless and intricate calculations of utility functions, risk preferences and moral attitudes[155] of individuals is needed to determine *the* correct allocation of the risks of products among manufacturers and consumers. There is no particular

[152] One explanation for Congress' constant revisiting of the product liability reform issue is that keeping the issue potentially "on the table" makes it easier for members of both federal political parties to engage in fundraising from their respective "allies." *See* J. Abramson, *Product-Liability Bill Provides Opportunity for Long-Term Milking of PAC's by Congress*, WALL ST. JOURNAL, June 21, 1990, at A16.

[153] *See* Gary Schwartz, *Considering the Proper Federal Role in American Tort Law*, 38 ARIZ. L. REV. 917 (1996). Much of Tort law consists of the determination of the boundary between Tort and contracts. *See also* Krauss, *supra* note 130.

[154] Krauss, *supra* note 140.

[155] Moral attitudes are directly related to opinions about 'black letter' issues in product liability. For instance, virtually all observers agree that "causation" should be required if manufacturers' liability is adjudged. But what 'causes' a product to injure a consumer – is it consumer misuse, insufficient "idiot-proofing" of safety devices, third party negligence, or manufacturer cost cutting? As practitioners know, many (perhaps most) accidents involving products involve a combination of these factors. Deciding which constitutes *the* legal cause of an injury is in no small part a moral issue. If one believes that individuals are primarily responsible for their own fate, conscious misuse of a product by an injured consumer may be decisive. If one sees consumers as lacking free will, acting

reason to believe, in fact, in a 'one-size-fits-all' solution across the nation. It is apparent that moral views and risk preferences vary across individuals and regions. As Michael Greve has written, "topography and climate aside, no one would mistake Texas for New York, or Nebraska for Massachusetts."[156] *Diversity* creates a knowledge problem, and lessens the chance that we will find the one "correct" product liability rule.

State legislation, if properly arranged so that costs and benefits are autarkial, is conducive to a competition that will produce the information needed to determine and reflect collective preferences. If a state's product liability rules are too generous to plaintiffs, or to manufacturers for that matter, and if the costs of these rules are essentially reflected within that state, the impact of these rules will eventually lead to a demand for change. The cost of a product might rise tremendously, for example, if prices in one jurisdiction had to incorporate a high premium to cover accidents that would be easily avoidable if only the consumer had used reasonable care.[157] Consumers in that state might, if given a choice, prefer product liability rules in competing jurisdictions that call for a degree of "assumption of risk" they find more acceptable. Competition for good laws among states can serve the same purpose as

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largely as unthinking pawns in a game played by powerful commercial interests, corporate cost cutting in shaping design and manufacturing processes will be more important.

[156] Greve, *Federalism after the Election*, AEI FEDERALISM OUTLOOK #4, December 2000, at 2.

[157] Thus, in O'Brien v Muskin , 463 A.2d 298 (NJ, 1983), the New Jersey Supreme Court implied that all above-ground pools were socially inappropriate products. The court hinted that the manufacturers of such pools should therefore insure users against all hazards. If price differentiation were possible, such pools would cost much more in New Jersey than elsewhere. This would create powerful lobbies to modify the New Jersey rule, unless of course Garden State residents are truly as averse to the risks of above-ground pools, and as indifferent to summer swimming, as its Supreme Court apparently supposes.

competition among products.[158] *Lack of competition* is a second knowledge problem afflicting federal product liability legislation.

By contrast, federal legislation is the imposition of one product on all. As one commentator noted, "[t]he choice between state authority and federal authority is the choice between competition and monopoly."[159] A federal private law rule forced on the country had better be "the right" one (and there had better be *one* "right" solution for our diverse population) – for it is *much* more expensive to opt out of a *country's* laws than it is to use "voice" and "exit" when dissatisfied with one's *state*[160]. As the federal legislature experiences less competition, it *learns over time* much more slowly. *Learning over time* (a third knowledge problem) clearly favors state action over federal legislation.

C. Federal Imposition Of Contractual *Laissez-Faire*.

Under a more-or-less libertarian view,[161] *any* compulsory assignment of product liability risks is undesirable. After all, products are sold, not found on the beach by strangers. The majority of product liability litigants are separated by one or two degrees of contractual behavior. According to this view, federal law should merely prohibit all binding product liability regulations. States could propose "default" rules, of course, and these might diminish transaction costs if they are

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[158] Cite here to Austrian teachings, Hayek, Mises, etc. *See* LUDWIG VON MISES, SOCIALISM: AN ECONOMIC AND SOCIOLOGICAL ANALYSIS (TRANSL. BY J. KAHANE) (1951).

[159] Harvey Perlman, Product liability Reform in Congress: An Issue of Federalism, 48 OHIO ST. L. J. 503 (1987), at 507.

[160] *See, e.g.,* Ilya Somin, *Revitalizing Consent*, 23 Harv. J.L. & Pub. Pol'y 753, 795-798 (2000)..

[161] Peter Huber, Liability: The Legal Revolution and its Consequences 195, New York, Basic Books, 1988; Paul Rubin, Tort Reform By Contract 24, Washington, D.C., AEI Press, 1993.

popular, but in any event parties would be free to contractually opt out of state default rules and to create their own agreed-upon allocation of risks.

The doctrine of freedom of contract is appealing as a general matter,[162] but any federally implemented libertarianism would be difficult to envisage, for at least four reasons:

- As was averred earlier,[163] any federal pre-emption, including forced "liberation" from state rules, implicitly signifies that there is no collectively felt need to establish *local* safety standards that manufacturers may not waive. But it is difficult to know *ex cathedra* in Washington that shifting risks to manufacturers, or to consumers, would produce a true collective good. Indeed, the libertarian view assumes away any real collective good here. But states are much more likely to be sensitive to the existence of (and desirous of implementing) any local collective goods than is the federal government.[164]
- A forced "libertarian rule" would contradict longstanding notions of public policy in all fifty states.[165] For example, under a purely contractual régime, General Motors might market automobiles with the following legally binding[166] statement:

  > "Warning: we have determined that, under current production and quality control procedures, one in every 500,000 vehicles we make will fail

[162] FRANCIS H. BUCKLEY, ED., THE FALL AND RISE OF FREEDOM OF CONTRACT (1999).
[163] *Supra*, TAN 156
[164] This comment is "constitutional", not substantive. The thrust of the argument, in a nutshell, is that autarky is preferable to "anarchy". Local collectivities should be able to set a standard of liability that I might vehemently oppose (e.g., "GM is liable for every person injured in any accident in a GM vehicle"), *as long as* the costs of that rule were for all intents and purposes internalized inside the collectivity.
[165] *See*, e.g., Henningsen v Bloomfield Motors, 161 A.2d 69 (N.J., 1960) (holding that manufacturers are not free to waive liability for manufacturing defects). *Henningsen* has been adopted in every state.
[166] The waiver would presumably be binding on purchasers, who would be bound to secure the consent of their passengers

catastrophically during its first year of use, without any fault by the driver. The parties hereby agree that General Motors will not be liable for injuries proximately caused by such failures."

Although there is no reason to believe GM would find it advantageous to issue such a disclaimer,[167] there is also no reason to believe that any legislature (at the federal or state levels), state supreme court or jury would enforce a "warning – we might have botched it" sticker if any firm ever *did* print one. In addition to the common law of product liability in all states, widespread adoption of the Uniform Commercial Code (which, for example, states that disclaimers impliedly contradicting express warranties are unenforceable[168]) is tough to reconcile with a contractual *laissez-faire.*

- It is in any case difficult to imagine that manufacturers would attempt to elude default rules and renounce liability for defective products, because manufacturers are *much* more efficient bearers of certain subsets of unilateral risk than are consumers.[169] Any "warning – we might have botched it" sticker would under this rationale be the result of limited consumer rationality[170] and of intrinsic asymmetries in information, and on this account unworthy of enforcement.
- Finally, non-contracting parties (e.g., pedestrians hit by automobiles) will without doubt suffer always constitute some percentage of the victims of

[167] Brand capital would almost certainly be affected by an unwillingness to stand behind defective products. *See also* immediately *infra*, TAN 169.
[168] U. C. C. §2-316
[169] Croley & Hanson, *Rescuing the Revolution: the Revived Case for Enterprise Liability*, 91 MICH. L. REV. 683 (1991), at 766-767. Hidden manufacturing defects come to mind.
[170] There are several articles on systematic irrational behavior. The most famous cases are presented in ALLAIS, M. *Fondements d'une théorie positive des choix comportant un risque et critique des postulats et axiomes de l'école Américaine*, COLLOQUES INTERNATIONAUX DU CENTRE NATIONAL DE LA

defectively manufactured products. *Some* non-contractual product liability rule will always be needed for this reason alone.

IV. Autarky Through Federal Choice-of-Law Legislation

If neither federal product liability legislation nor federal nullification of state common law rules is appropriate, is there *any* role for federal legislation in resolving the current "prisoners' dilemma"? This essay strongly argues that uniform, i.e., federally imposed product liability *choice-of-law* rules would be both legitimate and constructive. Choice-of-law rules could resolve the "prisoners' dilemma" by moving state law toward autarky, without shutting down the states' laboratories of private ordering.

It was argued above that federal imposition of substantive rules of private ordering is inappropriate. If this is so, does it not follow that imposition of federal choice-of-law rules are equally illegitimate? Such was the position of the Supreme Court in *Klaxon v Stentor Electric Mfg. Co.*[171] *Klaxon* held that federal courts must not develop or follow any national choice-of-law rule in their application of the *Erie* doctrine. But *Klaxon* has been, almost from its publication, witheringly criticized. Virtually no one claims the decision is required by the Constitution. Professors Hart and Wechsler maintained, to the contrary, that *Klaxon* in fact subverted the constitutional principle of *Erie*. *Erie*, they argued, was meant to assure predictability of the law in each state – the law would be the same for transactions occurring in a

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RECHERCHE SCIENTIFIQUE 40 (1953), 257-332; and Amos Tversky and Daniel Kahneman, *Judgment under Uncertainty: Heuristic and Biases*, SCIENCE, 185 (1974), 1124-1131.

[171] Klaxon v Stentor Electric Mfg. Co., 313 U.S. 487 (1941)

state, regardless of the type of court hearing a suit. But *Klaxon* undermined predictability by increasing uncertainty about the applicable law, depending on the location in which a lawsuit was filed.[172] As Professor Hart pointed out separately, federal courts freed from parochial interests are in an ideal position to resolve conflicts between states, but such neutral resolution is possible only if stable, *common* choice-of-law rules are implemented by the federal courts.[173]

Unfortunately but predictably, the case law implementing *Klaxon* has allowed that judgment to be used to promote truly arbitrary selection of state law by individual plaintiffs in products cases, in clear violation of the spirit of *Erie*. Thus, in *Ferens v John Deere & Co*, a Pennsylvania plaintiff was injured in Pennsylvania while using farm machinery purchased in Pennsylvania and manufactured by Deere in Illinois. Plaintiff had missed Pennsylvania's two-year statute of limitation, and so sued in federal court in Mississippi, which has a six-year statute of limitation, obtaining personal jurisdiction on the grounds that Deere markets its products in that state. The case was quickly transferred to Pennsylvania on *forum non conveniens* grounds, under 28 U.S.C. §1404(a). But the Supreme Court held that since no federal conflicts rule had been adopted (as per *Klaxon)*, Mississippi's conflicts rule (which required the applications of Mississippi's long limitation period) must be applied, since it was the federal court of original jurisdiction. The court in effect allowed and encouraged plaintiffs to stop off in one state and pick up favorable rules on their way to the obvious eventual forum court.[174] Cases like these, made possible by the lack of a

[172] *See* Fallon, Meltzer & Shapiro, Hart and Wechsler's The Federal Courts and the Federal System, 688 (4th ed., 1996).
[173] Henry Hart, *The Relations Between State and Federal Law*, 54 Colum. L. Rev. 489, at 515 (1954)
[174] See, e.g., Ferens v John Deere & Co., 494 U.S. 516 (1990).

federal choice-of-law rule, have made a shambles of the laboratory of federalism. It is time to contemplate a change.

In the next section, the elements contributing to the legitimacy of a federal conflicts rule will be briefly catalogued. The focus of the paper will next shift to the discovery of the optimal content of such a rule, and to the implications of its implementation for product liability law and for related legal doctrines.

A. A Federal Choice-of-law Rule Is Legitimate

The constitutional scheme for allocating product liability authority among the states, given current national marketing arrangements, is no longer complete without new federal choice-of-law rules. This authority cannot reside the states, tempted as each one is by choice-of-law rules that favor its own citizens over out-of-staters, in violation of the territorial basis of sovereignty. Authority to make choice-of-law rules compatible with the Privileges and Immunities and Full Faith and Credit Clauses of the Constitution resides in the Congress,[175] or (failing Congressional action) through the interpretive power of the Supreme Court.[176] Indeed, the current dearth of federal choice-of-law rules at both legislative and judicial levels arguably constitutes an abdication of federal constitutional duty.[177]

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[175] The Full Faith and Credit Clause includes the following: "Congress may by general Laws prescribe the Manner in which such Acts, Records and Proceedings shall be proved, and the Effect thereof." U. S. CONST., art. 4, § 1. Congress may, it is generally agreed, thus specify which state's law gets full effect in different classes of cases. See Walter Cook, *The Powers of Congress Under the Full Faith and Credit Clause*, 28 YALE L. J. 421 (1919), at 425-426; Laycock, *supra* note 178 at 331.

[176] For example, the Court might declare unconstitutional state choice-of-law rules which have the purpose or the effect of subverting the principles of legitimacy sketched above. The Court might also, more problematically perhaps, impose its own choice-of-law rule, if it found that only one such rule was legitimate under the Constitution.

[177] Laycock, *supra* note 178 at 331. I am not, here, adopting this view as my own. If choice-of-law rules are mandated by the Full Faith and Credit clause of the Constitution, they are presumably required in the field of Contract as much as in Tort or Product liability. It is enough, for my purposes, to claim that it is constitutionally *permissible* to have a federal choice-of-law rule, under the commerce clause.

As has been pointed out elsewhere at length,[178] three fundamental principles both justify and circumscribe legitimate federal authority over choice-of-law:

- *The principle of equal American citizens*. Each state must as a general matter treat citizens of sister states on an equal basis with its own citizens.[179] This implies that states may not adopt or exploit existing choice-of-law rules in order to favor local citizens over citizens of sister states. Yet, in practice if not in theory[180] *lex loci* and (especially) "interest analysis" conflict rules, at the state level, have each contributed to violations of this principle.

- *The principle that states are territorial*. The allocation of sovereignty among states is territorial. This fundamental principle is so obvious that the Constitution mostly assumes it to be the case.[181] State

[178] See Douglas Laycock, Equal Citizens of Equal and Territorial States: the Constitutional Foundations of Choice of Law, 92 COLUM. L. REV. 249 (1992)

[179] This is one of the corollaries of Article IV's "Privileges and Immunities" and "Full Faith and Credit" Clauses. U.S. CONST. art. IV, § 1 (Full Faith and Credit); U.S. CONST. art. IV, § 2 cl. 1 (Privileges and Immunities).

[180] To be more precise, *lex loci delictus* and interest analysis provide incentives to adopt substantive product liability rules that disregard the interests of out of state individuals and corporations, in order to favor state residents. The rules themselves do not violate the "no discrimination" rule.

Thus, *lex loci* will apply the law of the place of the accident, regardless of who the parties to the accident are. In other words, the choice-of-law rule is neutral on its face regarding the residency status of the parties. If a state declined to decide a case involving an accident inside its borders, involving two non-citizens, then the differential treatment of the non-resident would result from rules of personal jurisdiction, not from the choice-of-law rule.

Interest analysis seems more prone to direct discrimination against out of state parties, in large part because it is so much more malleable. The ultimate discrimination against outsiders is due to the substantive product liability rules resulting from the (often selective) application of the "interest analysis", however.

[181] Consider for example the Constitution's restrictions on new states:
"No new State shall be formed or erected within the Jurisdiction of any other State; nor any State be formed by the Junction of two or more states, or Parts of States, without the Consent of the Legislatures of the States Concerned as well as of the Congress." U. S. Const. Art. IV, § 3, cl. 1.
The word "jurisdiction" is clearly a synonym for territory. A state's authority to govern – its 'jurisdiction' – is a *place* within which no new state can be formed. When the Constitution states that no new state shall be formed "within the jurisdiction" of another, it does not mean "within the reach of

constitutions and acts of admission to the Union do make the territorial basis for state sovereignty explicit.[182] The implication of the territoriality principle is that a state's claim to regulate behavior or to govern a dispute must be based on issues related to its territory. A state's "interest" in extending the territorial reach of its own law to the entire country, for the purpose of subsidizing its citizens by consumers throughout the nation, is not sufficient to legitimize a state rule under this principle. Federal choice-of-law rules must take the territorial principle into account, refusing to select laws on grounds unrelated to the basis of state sovereignty.

- *The principle of republicanism*. Choice-of-law rules should, ideally, encourage (or, at the very least, not *discourage*) civic participation in determination of policy. Most autarkial situations are compatible with republicanism – by confining the major effects of a state's rules to its boundaries, autarky strongly encourages citizens to modify rules they find unsuitable and to defend those of which they approve. Republicanism also implies relatively convenient access to knowledge of laws, and to lawmakers. If the costs of a New York law are borne by Virginians (who have no political standing to modify it), the republican principle would not be satisfied.

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the interests of another", for then every state's creation would be in breach of this rule. It can only mean "within the territory" of another. See Laycock, 92 *Colum. L. Rev*. 249 (1992) at 317.

[182] The territorial definitions of states are specified in their organic acts – for examples, see Laycock, *supra* note 178 at 318. As the Supreme Court held early on, "Title, jurisdiction, sovereignty, are therefore dependent questions, necessarily settled when boundary is ascertained….", Rhode Island v Massachusetts, 37 U.S. (12 Pet.) 657 (1838), at 733.

These principles have important implications. They suggest, first and foremost, that "interest analysis" may not measure up under the territorial principle. After all, interest analysis was essentially developed to extend the reach of state law to embrace events that occurred in a different state. Interest analysis might not therefore be a legitimate federally imposed choice-of-law rule for product liability. [It certainly would not resolve the prisoners' dilemma, of course, but territoriality presents a second reason not to select it.] *Lex loci* does respect the territorial principle: the fact that an accident happened inside the territory of a given state is a constitutionally sound reason to use that state's rules to determine legal obligations arising from the accident. But as practiced, *lex loci* has contributed to the prisoners' dilemma under which states are tempted to exploit residents of sister states. This exploitation is violative of the first principle of legitimate state action. *Lex loci* could therefore also not be legitimately imposed by Washington as a choice-of-law rule for product liability.

Federal action to impose product liability choice-of-law is, in sum legitimate, appropriate, and arguably even required. Which choice-of-law rules, then, reconcile sound principles of federalism with the need to resolve the product liability "prisoners' dilemma"? There are several plausible contenders, to be sure. The federal government might, for example, allow the manufacturer total discretion over the choice of the state whose law is applicable to each product it sells. Or Washington might establish the "law of place of manufacture", or of the "intended place of consumption" as mandatory choice-of-law rules. Each of these contenders for national choice-of-law has distinct advantages. But each also has drawbacks which preclude its use. In the end, a "state of first retail sale" choice-of-law rule best reconciles our constitutional structure to current national markets.

B. Which Federal Choice-of-law Rule is Legitimate and Effective?

1. "Manufacturer's Choice"

One effort to resole the prisoners' dilemma through choice-of-law was first proposed by Dean Harvey Perlman. It was clearly inspired by the competition for incorporation of business associations. It consists of a simple federal rule that would allow manufacturers to dictate which among the various states' product liability régimes will apply to their products.[183]

Companies at present must choose among incorporation statutes by selecting a state of incorporation. They are free to choose any state, even if this state is one in which neither its facilities nor its head office is based. States, it is said, compete to have the most efficient incorporation statutes.[184] Delaware, clearly the current frontrunner in this contest, derives both registration fees and other "royalties" (court costs, lawyers' salaries) from its success.[185]

Dean Perlman is eager to export this régime to product liability. Under his proposal, a manufacturer incorporated in Georgia, for example, and producing in Florida a product sold at retail to Mrs. Smith in South Carolina, could designate Virginia law for all disputes arising from the use of the product by Mrs. Smith. Under the Perlman proposal, Virginia need have no territorial connection with the product,

[183] See Harvey Perlman, Product liability Reform in Congress: An Issue of Federalism, 48 OHIO ST. L. J. 503 (1987)
[184] Roberta Romano, The Genius of American Corporate Law, Washington, D.C., AEI Press 1993.
[185] *See* Erin A. O'Hara and Larry E. Ribstein, *From Politics to Efficiency in Choice-of-law*, 67 U. CHI. L. REV. 1151 (2000).

the accident, or the victim. If the firm's choice of law were adequately published (perhaps through some marking on the product's packaging), Virginia product liability law would apply. The product would presumably be priced to reflect expected liability. Consumers dissatisfied with the manufacturer's choice of "liability state" could of course decline to purchase the product at the price offered – if the dissatisfaction were severe enough, the price might drop, or the "liability state" might change (or both).

Under this proposal, a manufacturer could also conceivably offer an array of "liability packages". Acme Corporation could sell, and consumers could purchase, Acme widgets with a choice of Alabama-to-Wyoming liability rules. Each widget would be priced to reflect expected liability costs under the chosen state's laws, much as some car buyers can select different kinds of warranties when purchasing their vehicles. Consumers would presumably consider product liability régimes bundled with the product when deciding whether the "price is right". A poor choice-of-law by the manufacturer would lead to financial losses – "too much" liability sold "too cheaply" might bankrupt the firm, while "too little" liability might be reflected by a drop in sales, as consumers are drawn to products from competitors offering more "generous" product liability packages. Multiple choices (Pontiacs sold with New Jersey or Virginia "liability package" options, etc.) are therefore possible. In practice, however, adverse selection problems are such that each manufacturer might select a single state's law to apply to its products, thereby also saving legal costs by specializing in the cases and legislation of one state.[186]

[186] K. Spier, Incomplete Contracts in a Model with Adverse Selection Search Term End and Exogenous Costs of Enforcement (Dec. 1988) (unpublished manuscript).

Dean Perlman's proposal has the advantage of allowing consumers in every state to freely select, and to personally internalize the cost of, their liability rules. If they wish to own a product manufactured by company X, consumers will buy, bundled with it, state Y's legal rules; if they want another state's rules they may have to select a product made by X's competitor. Perlman's proposal would in essence allow manufacturers to ensure that all their products, sold nationwide, are governed by the same liability rules. As long as those rules remain relatively stable,[187] a manufacturer would be able to price products with confidence that buyers are purchasing an optimally chosen package of risks. This does achieve a measure of autarky, though at an individual rather than a state level.

Despite this attribute, the Perlman proposal's non-compliance with legitimacy requirements of federal choice-of-law[188] is disturbing. This proposal treats the several states' citizens equally, but makes a mockery of the territorial basis of state sovereignty. No tie to territory is needed to select a given state's product liability law.[189] Neither the consumer nor the producer has any necessary territorial link to the state whose law is applied. The consumer never impliedly accepted the state's sovereignty by, say, traveling to it, or by using the product in it. Only a clause buried in a sales contract, which itself likely as not took place in a state other than the one whose law is chosen, links the plaintiff to the governing law state. That link appears too feeble to be able to rely on territorial sovereignty.

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[187] Manufacturers would presumably avoid choosing the product liability law of a state the law of which is relatively unstable and arbitrary, because of the risk premium that would have to be bundled into the price. To the extent that states derive "rents" from having their legal rules selected, Dean Perlman's proposal provides an additional incentive for stability of legal rules.
[188] *See supra*, TAN 178 ff.

In addition, Perlman's rule arguably fails the republican principle: a consumer is unlikely to be either conversant with or active in affecting the chosen state's liability rules, as might be the case if the consumer voted in or consciously shopped the state in question. Perlman's choice-of-law proposal bears a close resemblance to federal imposition of contractual *laissez-faire*, discussed above.[190] It is therefore subject to the weaknesses of the *laissez-faire* proposal. Thus, asymmetrical knowledge about the content of liability rules would likely be more pronounced than is presently the case. Say a Marylander buys a product in Virginia – suppose that Hawaii law is chosen by the manufacturer to govern product liability isues, following the Perlman rule. It is relatively easy to anticipate that a Marylander might know something about her own state's laws (she is or can relatively easily become a participant in Maryland's political process), or even about the laws of Virginia, which she has after all deliberately visited to go shopping. But she might be totally ignorant of Hawaii's legal structure. Indeed, one result of this asymmetry is that a manufacturer might become a much more influential political player on (say) the Hawaii product liability scene than it would normally be. The manufacturer would almost surely be a more active player than would be consumers living out-of-state, and might well be more interested in the law than would consumers in-state. After all, the latter have no care for *Hawaii* law – they care about the law chosen by the manufacturers of the products they purchase! This turns the republican principle

[189] This makes the Perlman solution even less legitimate than the current competitive system regarding incorporation. Incorporation is a self-referential act – that is, by incorporating in a state, a company acquires *ipso facto* a tie to that state – the tie of "birth".

[190] *See supra* TAN 161 ff. Under Dean Perlman's proposal, no state could impose any product liability rule for any product sold within its jurisdiction. There is only one significant difference between the Perlman plan and the *laissez-faire* proposal: under Perlman's proposal manufacturers could not invent

on its head. Manufacturers would in significant ways be the real "citizens" – they would be expected to become more heavily involved in that state's political process than would be physical persons.

In addition, firms might choose the product liability law of a state with more pro-defendant rules than would be demanded by consumers, especially if they believe that consumers are unable to accurately perceive and measure state liability rules when making purchasing decisions because of political estrangement or lack of geographic proximity. This could provoke a 'race to the bottom', instead of an efficiency competition among rules as is the case for incorporation laws.[191]

Put another way, the reason why Delaware-dominated "freedom to charter" works well is the presence of a small number of very powerful, fully informed marginal shareholders, typically institutional investors, whose presence arguably deters races to the bottom in incorporation choices. There is little reason to believe that consumer markets, unlike investment markets, exhibit characteristics of full information by powerful players. Shareholders choosing a state of incorporation have an incentive to choose the state offering the most efficient rules for corporate governance (including rules that help to mitigate agency costs prevalent within corporations). Corporate managers will not have similar incentives to choose states with efficient product liability laws. Of course, if consumers knew perfectly what the liability rules for each product implicitly cost them, rules that are too generous to manufacturers would be penalized by consumer demand and would require lower sale prices, thereby counteracting manufacturer incentives to race to the bottom. But this

liability rules from whole cloth, but would be limited to those in effect in an American jurisdiction. This constraint is so minor as to make Perlman's plan very close indeed to *laissez-faire.*

thermostatic effect would require an unrealistically high level of consumer knowledge, of information technology, of firm production processes and internal decisions, and of underlying risks.[192] Unlike institutional investors, consumers have too little stake in any individual product to make a significant informational investment.

It is therefore questionable whether individual states would have any incentive to 'get it right' when enacting their product liability rules under these conditions. States would essentially be 'selling' product liability rules to manufacturers. Would they receive a percentage of each sale as an incentive to enact a popular rule? Would political agency costs prevail? Would states derive any other kind of 'seignorage' from the development of widely used rules, analogous to Delaware's incorporation fees?[193]

Finally, and quite apart from all these questions, the Perlman solution is politically problematic. The greater the information asymmetry between manufacturer and consumer that a choice-of-law rule produces, the less likely it is that Congress would adopt any such rule, or that courts would enforce the resulting contractual allocation of risk.

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[191] *See* Schwartz, *supra* note 142 at 938.
[192] *See* Romano, *supra* note 184 at____.
[193] *See* Kobayashi & Ribstein, *supra* note 73 (claiming that the incorporation state's attorneys will tend to dominate litigation, receiving a form of seignorage, and would therefore be proxies advocating the adoption of efficient rules). With the advent of interstate practice of law, however, it is not obvious that *states* would be able to procure significant royalties from enacting favored product liability legislation. Court fees rarely if ever absorb the full social costs of dispute resolution. And bar admission fees do not appear to be a significant revenue item.

2. Law of Head Office or of Most Significant Employment

William Niskanen proposed in 1995 a choice-of-law rule under which liability for a manufacturer's products would be governed by the product liability law of the state in which that manufacturer had the largest number of employees.[194]

Niskanen's plan in fact comes even closer than does Dean Perlman's to the "choice of incorporation" régime of corporate law. Corporations would presumably choose to locate manufacturing facilities in jurisdictions whose product liability rules were most attractive to them. This proposal, unlike Perlman's but in the vein of current incorporation practice, would likely provide significant 'seignorage' to states that adopt attractive liability rules. "Getting it right" would thus arguably result in a substantial increase in manufacturing activity, an attractive proposition lacking in the Perlman proposal. Niskanen's plan actually turns on its head the perverse incentives currently provided in *lex loci* states, which (as we have seen) leave a corporation fully indifferent between locating in high-liability or low-liability locations.[195] Finally, and contrary to Perlman's proposal, the Niskanen plan does tie liability to a territorial feature, and to a state's political process. After all, manufacturers would have to be "residents" (if not "citizens"[196]) of the state whose law is chosen. Those corporate residents, as well as their workers and those who derive their income from them, would have a political stake in, and a strong incentive to understand, local product liability laws.

As with the Perlman proposal, though, and unlike *lex loci delictus*, Niskanen's plan requires no *consumer* act of "submission" to the state's territory. Conformity

[194] Niskanen, *Do Not Federalize Tort Law* 4 REGULATION 34 (1995).
[195] *Supra*, TAN 113
[196] Unless the state of incorporation is chosen instead of the state of manufacturing activity.

with the republican principle is lacking. In no sense does a purchaser actively "choose" any legal rule. In no sense does she have a conscious territorial tie to the state writing the rule. As stated above, this de-emphasis on citizens' informed choices also makes the Niskanen proposal arguably less likely to be adopted by Congress or enforced by courts.

In addition, the Niskanen plan may have "Public Choice" problems. Whereas Perlman allows both defendant and plaintiff to be 'strangers' to the state whose law is being applied, the Niskanen arrangement makes it likely that the manufacturer of a product is closer to the *locus* of the determination of relevant liability rules than are purchasers. This has intrinsic political implications. An auto manufacturer in Michigan, for example, would likely be very persuasive if it argued that that state should adopt more pro-defendant product liability rules.[197] As Niskanen would apply Michigan rules to sales by that manufacturer throughout the country, the plan would in effect violate the neutrality principle, the first principle of legitimacy sketched out above: it would prefer in-state to out-of state interests.[198]

The Niskanen proposal predicts that manufacturing states will not be tempted by a 'race to the bottom' – presumably because consumers would at the margin decline to purchase widgets produced in inefficiently pro-defendant states, preferring *ceteris paribus* those made in more plaintiff-friendly jurisdictions. This noble hope assumes a consumer information level that is hard to reconcile with the Niskanen proposal's republican failings – a populace not involved in the elaboration of a law is

[197] Schwartz, *supra* note 142 at 938.
[198] Here, though, the in-state interests would be those of manufacturers, not consumers. Indeed, under Niskanen's proposal one could imagine a strategy similar to that of Justice Neely: a state supreme

for that reason less likely to be familiar with it. In this sense the Niskanen plan share's the weaknesses of the Perlman proposal. In addition, competition is unlikely to remedy these problems in a systematic way, because of the collection of small frictions that are so often barriers to free entry. For instance, pharmaceutical companies may have patent monopolies on certain medications. Under the Niskanen plan, such companies might have a distinct interest in choosing a pro-defendant state for their manufacturing. Even if that state's rules were inefficiently pro-defendant, the patent monopoly would preclude competitors from manufacturing the same product in a different state.

3. Law of Intended Place of Consumption

Professor John Kozyris has proposed a product liability choice-of-law rule specifying the law of the "intended place of use" of a product.[199] The most important benefit of this idea is that it is territorially and politically legitimate. The vast majority of people injured by products are consumers or persons in privity with consumers -- by definition these people have a territorial connection to the jurisdiction whose law is applied. Kozyris's plan thus tends to apply legal rules that are in a meaningful way chosen by the plaintiff. By opting to use the product in a given jurisdiction, a plaintiff has in essence assented to that jurisdiction's exercise of sovereignty over the accident. It will be frequently, though of course not always, the case that the plaintiff is a citizen of that state; in that capacity he will also have

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court might always choose the liability rule or interpretation which favored the defendant, reasoning that losses to in-state consumers are more than outweighed by gains to in-state workers.

[199] Kozyris, *Choice-of-law for Product Liability: Whither Ohio?*, 48 OHIO ST. L. J. 377 (1987). Note that Kozyris was proposing that a state adopt this rule. However, there is no reason not to analyze his proposal as a potential federal solution.

opportunity to take cognizance of, and for political input into, the jurisdiction's legal rules.

Kozyris's plan (unlike Perlman's and Niskanen's) would certainly not result in uniform pricing for all the products of any given manufacturer. A firm's products would be subject to fifty-two different liability régimes. But it is not clear that this is a predicament. A natural consequence of federalism is that companies know they are subject to different rules in different jurisdictions. Differential pricing of a company's products in different states is not in and of itself incompatible with autarky.

Unfortunately, that's the fatal defect of Kozyris's proposal: it does not resolve the prisoner's dilemma. Since two products sold at the same location might be intended for use in two different states, a vendor could not charge different prices (to reflect different *ex ante* liability outcomes) without conducting a rather expensive inquiry into the purchaser's intent.[200] Higher up the chain of distribution, at the manufacturer's level, it will be even more difficult to discriminate when pricing units of production. Differential pricing of products to reflect liability rules is therefore unlikely. Accordingly, a retailer in a given state is likely to charge all purchasers the same price, though different legal rules will apply to different purchasers. Because of this, purchasers in high liability states are at the margin more likely to cross state lines to purchase a product, then subsequently claim the benefit of their home state's law if an injury relating to the product arises. This arbitrage will inhibit differential pricing just as under *lex loci* – a manufacturer will understand that expected liability from

[200] The investigation would not be expensive for certain products, e.g., automobiles, where the state of intended use corresponds roughly to the state of registration. See on this point the discussion *infra*.

sales in a state are not a function of that state's liability rules. A pro-plaintiff-state's law will be applied at the expense of the low-liability state, as currently occurs. This is in violation of the equality principle, as it encourages strategic behavior similar to that practiced by Justice Neely.[201]

C. Law of Place of First Retail Sale

1. Attributes of The Rule

This choice-of-law rule would apply to each product the liability rule of the state of that product's first retail sale. Thus, if a Virginian traveled to Maryland to purchase a lawn mower, Maryland law would determine product liability for that tool, even though the eventual lawn mowing accident occurred in Virginia.

The key characteristic of this rule is that it allows a manufacturer to effectively calculate expected liability for each retailer's product, given that the state of retail sale (unlike the state of intended consumption) for each product can be known in advance. This overcomes the prisoners' dilemma, because no interstate arbitrage is possible. *Every* product sold at retail in Maryland will be subject to Maryland product liability law, regardless of where the purchaser lives. If some other state has a more pro-plaintiff (or pro-defendant) product liability régime, and if the purchaser desires the greater *ex ante* liability recovery (or the lower price, respectively) that rule provides, she will have the incentive to purchase the product in that other state. However, under the "first retail sale" rule, unlike *lex loci* or "interest analysis", a purchaser seeking high-liability protection will have to pay for it as part of the purchase price. She will not be able to externalize much of the cost of this

[201] *See supra*, TAN 86

protection to consumers in other states. In addition, all purchasers, from in-state and out-of-state, will have authorized the application of the law of the state of retail sale by traveling to that state to buy the product. This satisfies the territorial requirement.

This rule would create a more fully autarkial product liability system. Consumers would choose the amount of liability protection they wanted and pay for that level accordingly. In addition, the intrinsic asymmetry of access to knowledge of the applicable liability rule, as between consumers and manufacturers, would diminish greatly due to retail competition. Retailers in high-liability states would have a keen incentive to explain to consumers how they receive greater protection (in return for a higher purchase price), much as current retailers of name-brand products have an incentive to stress the reasons why the brand they sell carries a premium price as compared to generics.

Of course, consumers may not desire the protection offered them by a high-liability home state. Suppose, for instance, that the retail price includes a premium reflecting the expense of a state product liability rule that requires full compensation to consumers injured during misuse of a product. Careful consumers might prefer to pay less for the product in a neighboring state where this "protection" is not bundled into the purchase price. Home state retailers would lose sales to careful consumers in this scenario. Note, though, that if this does happen these retailers are well placed and relatively easily organized, in compliance with and furtherance of the republican principle, to make political representations with the aim of modifying the local liability rule to better reflect undistorted[202] consumer preferences. In this way, the "state of first retail sale" rule allows for input by local residents, and channels their input through easy-to-organize local merchants. The "state of first retail sale" rule actually enhances the republican principle through this channeling mechanism, much as NAFTA allows foreign producers to "represent" the masses of domestic consumers in their judicial endeavors to overturn trade barriers.[203]

Nor would consumers be held captive by their own state's "state of first retail sale" rule as is the case for the Kozyris proposal. Consumers could escape local rules through republican "voice" (by joining local retailers and lobbying for a change of liability rules, as just mentioned) or through relatively inexpensive "exit" (by purchasing their products in another state).[204] If a state provides more – or less – liability than residents of a given state want, there will be fewer retail sales in that state. Profit-maximizing businessmen will have an even greater incentive to join forces with consumers to optimize state law, given the exit option.

2. Potential Problems With the Rule

a) Will Producers Take Into Account Differential Product Liability Laws?

If the nationwide prisoners' dilemma typified by Justice Neely is resolved, product liability law might assume a greater variety than it does at present. There is no particular reason to believe that New Yorkers have the same attitude toward collective risk-aversion as do Montanans, for example. It seems likely that communities would be freer to ratify their collective preferences under the 'law of first retail sale' rule than they are currently. Current choice-of-law rules make West Virginians pay the same premium as New Jersey residents for the rules Garden State

[202] I.e., preferences not altered by the pathologies of a "prisoners' dilemma".
[203] *See* Krauss, *NAFTA Meets U.S. Tort* Law, supra note 140.
[204] Under the Kozyris option, the 'exit' strategy is much more expensive – the consumer would have to move, or to use the product in a different state, in order to fulfill this strategy.

courts have fashioned – and this has led West Virginia to self-consciously abandon rules its own institutions had developed. There is no reason why this would happen under the proposed choice-of-law.

If laws and interpretations begin to vary across the country, in a relatively autarkial fashion, will producers, wholesalers and retailers consider these variations when pricing their products? It is hard to see why they would not. Providers of goods and services already consider risks shaped by state law whenever autarky reigns.[205] There is little reason to believe consideration would not be given to differential product liability rules.

One *caveat* to this prediction is required, though. If manufacturers respond to liability awards, *not* by increasing price but by increasing quality control (even above efficient levels), placing superfluous additional warnings on products, making them absurdly idiot-proof, etc., then it may be prohibitively costly to adjust these features for each state of sale. In other words, the natural knowledge-producing laboratory that is inter-state competition notwithstanding, prices may be "sticky" for mass produced goods if returns to scale make it more efficient for manufacturers to standardize production processes than to vary price levels. In every case, of course, a manufacturer selling redundantly safe products is vulnerable, especially in more pro-defendant states, to effective competition by competitors who have tailored production to those states' demand. If prices are "sticky" because of manufacturing

[205] E.g.: life insurance (different laws on suicide by state, taken into account by actuaries in determining likelihood of claims); auto insurance (different liability rules helping to determine premiums); apartment rent prices (multi-state developers use different pricing policies to take account of each state's rent control and other related laws); firearm sales prices (Maryland requirement of ballistics test with each firearm surely factored into sales price of handguns in Maryland). In each of these cases, autarky is possible (one's zip code is used to determine insurance premiums; handguns may not be purchased outside one's state of residence; etc.)

processes, one might expect more specialized retailing – some products might simply not be offered in different states. This outcome is still somewhat autarkial, though less so than if price alone were the dependent variable.

On the other hand, it is theoretically possible that, as a result of the adoption of a "first retail sale" rule, the content of all product liability rules will change in the same direction. When the original prisoners' dilemma is resolved, both prisoners change their behavior – they clam up. Similarly, some increased degree of assumption of risk by consumers might be observed nationwide as inefficient over-insurance provoked by the current prisoners' dilemma disappears. Consumer misuse might become dealt with more severely than it is currently, throughout the land. If this occurred, products would not display different state liability premiums. But this would not be a flaw in the "place of retail sale" rule any more than the prisoners' silence would be. Rather, it would indicate that preferences for product liability rules are in fact homogenously less risk-averse than appeared to be the case under the old choice-of-law rules, and that the prisoners' dilemma had merely provoked the compulsory bundling of unwanted insurance nationwide.

b) Will Consumers Understand The Law They Choose?

Bruce Hay argues that a 'place of first retail sale' rule "might produce national liability levels that are lower than most states prefer".[206] Hay writes that consumers systematically underestimate the risks of the products they purchase. Thus, they would tend to irrationally decide to save a little now, by choosing to purchase in low-liability states, only to lose a lot later when an accident occurs. What consumers "really" want, Hay argues, is to be obliged to pay extra premiums and avail themselves of the most favorable liability rules.

This is a difficult critique to rebut, relying as it does on the existence of counterfactuals that cannot be verified by examining purchasing choices. Asymmetries of information are undeniable. But asymmetries of information are quite different from the intrinsic irrationalities Hay supposes to exist. Even if people are unreasonable in the way Hay states, they would arguably be *more likely* to understand their "true" preferences thanks to the education provided by differential pricing, which the "state of first retail sale" rule promotes. Retailers have a strong business incentive, under this proposal, to instruct purchasers on the risks and benefits of the varying levels of protection they are purchasing with their product, and to encourage them to act sensibly.

Hay's assertion about consumer irrationality seems to be based on the oft-verified impression that people tend to underestimate low probability risks.[207] However, in a large national market competing retailers would have an incentive to provide consumers with information about the likelihood of injury from certain products. If differential production methods across states are not feasible, disparities in accident rates will to a significant extent result from moral hazard problems: consumers may reduce their levels of caution in states that fully excuse consumer misuse, for instance. States with risk-averse residents will applaud these heightened liability rules, which will in turn increase the probability of accidents and the risk

[206] *See* Hay, *supra* note 122 at 646.
[207] *See* Tversky & Kahneman, *supra* note 170.

premiums in those states. Thus, residents face the correct trade-off: increased coverage in case of an accident, in exchange for a higher probability of accidents and a higher price for insurance. It is entirely possible that with different levels of underlying aversion to risk, different states will choose different coverage/insurance premium combinations. At the moment, residents of risk-averse states arguably purchase too much “insurance”, from an economic point of view, because their greater coverage comes at a low “insurance premium” subsidized by consumers elsewhere.

Risk aversion does appear to differ among people and across areas. Poll after poll indicates, for example, that Canadians are in the main content with a level of socialized health care protection that Americans are by and large keen to assume privately.[208] Under the ‘first retail sale’ proposal (unlike the Perlman plan, for example), states have a sizeable incentive to promote product liability protection levels that reflect “true” risk aversion levels, because by doing so they promote retail activity, sales tax revenues, employment, etc. in the state. These incentives would arguably go a long way to overcome the problem of ignorance complained of by Hay, if such a problem in fact exists.

c) What About Correspondence Contracts?

When a consumer travels to another state to purchase a product, she clearly assents to that state’s jurisdiction in a meaningful way. What if she merely picks up a phone, mails a letter, or uses her computer to purchase a product from an out of state

[208] *See* Mark A. Rothstein, *Health Care: Public and Private Systems in the Americas*, 17 COMP. LAB. L.J. 612, 618-19 (1996). *But see* Carolyn Hughes Tuohy, *Principles and Powser in the Health Care Arena: Reflections on the Canadian Experience*, 4 HEALTH MATRIX 205, 220-21 (1994) (claiming that numerous polls show Canadians and Americans each prefer a Canadian-style Medicare system).

reseller? Is her assent to the foreign jurisdiction as transparent? Is it as constitutionally legitimate?

These are difficult questions to answer. Consumers who purchase by mail order arguably know they are in some way outside the protection of their home state's law – the insistence that their purchase not be subject to the home state's sales tax is a nice illustration of their awareness of this issue.[209] Presumably, federal regulations could oblige mail order and Internet vendors to prominently exhibit the name of the host state, with (in Internet cases) hyperlinks to federally approved summaries of that state's product liability rules. This would make acquiescence to the retailer's state's law more informed than is, for example, currently the case for service contracts. That the latter are nonetheless enforceable[210] indicates that the former should perhaps be enforced as well.

Allowing internet merchants to identify the "first retail sale" state does somewhat resemble Perlman's proposal, however – and objections analogous to those made to that plan would apply.[211] Alternatively, federal law could mandate that the state of first retail sale is the state to which the mail-order or internet product is *shipped*. Each consumer need only be familiar with the product liability rules governing the location of her mailing address, with which she would typically have territorial and political links. This would oblige residents of a state to physically travel to (at least to open a postal address in) a state other than their state of residence if they wish to avail themselves of that other state's liability rules. Whether this

[209] *See, e.g.*, Michael S. Greve, *E-Taxes: Between Cartel and Competition*, 8 AEI FEDERALIST OUTLOOK (Sept. 2001) *available at* http://www.federalismproject.org/outlook/9-2001.html.
[210] *See, e.g.*, ThunderWave, Inc. v. Carnival Corp. 954 F.Supp. 1562 (S.D.Fla.1997).
[211] *Supra*, TAN 183-189

revised solution is an advantage or not is debatable: "exit" by consumers dissatisfied with their home state's products rule is made slightly more expensive,[212] and mail order firms would be obliged to charge different prices to different zip codes under this scheme. On the other hand, affirmative acceptance of a pro-defendant state's sovereignty is easier to infer when a conscious act of travel is undertaken; and making the "exit" option a bit more difficult also makes it more likely at the margin that a consumer will favor political "voice", which would arguably help supply the public good of legal improvement where warranted.

It seems likely that simplicity is best served by applying the liability rules of the *state of delivery* to mail order and Internet purchases. On the other hand, for *telephone* orders from "brick-and-mortar" establishments, accompanied by delivery by that establishment to a purchaser in a nearby state, the state of sale should prevail as before. This would ensure that states contiguous to pro-plaintiff jurisdictions retain a powerful motivation to gauge the satisfaction neighboring citizens have with their liability rules.

d) What About Sales of Used Products?

Many products (from soap to food) are sold at retail only once. Other goods, from lawn mowers to automobiles, are commonly resold. The '*first* retail sale' rule should continue to apply the first state of sale's laws regardless of the place of resale.

This might take some buyers of second-hand products by surprise. On the other hand, products sold at the retail level more than once are in general easily engraved with a marking ("VA", "MD", etc.), perhaps next to their serial numbers or

[212] It is presumed that it is more costly to set up an address in another state than it is to travel there to shop.

Underwriters' Laboratories® logo, identifying applicable law. Second-hand purchasers are already in the habit of acquiring residual warranty coverage and (in the case of automobiles) California emissions eligibility. In both these cases the resale buyer takes his product with the attributes given to it at the first retail sale.

It is true that the second-hand purchaser has made less of a commitment to the state of first retail sale, at least if it is different from the state of resale. But the prominence of the state indicator does create an understanding that a *previous* purchaser has validly consented to a given state's jurisdiction. Remember that retailers' publicity will presumably have emphasized the benefits of their states' (and the costs of other states') product liability rules. This will also have an impact on the resale value of the product. An item governed by the law of a state with a short "statute of repose", for example, might have a different resale price than an item governed by the product liability rule of a state without this limitation.[213] Again, these attributes are both knowable and communicable by retailers and manufacturers.

e) What To Do About Third Party Victims?

Original purchasers under the 'first retail sale' rule can be said to assent to the sovereignty of that state. So would, vicariously, those in privity with these purchasers – subsequent purchasers, renters of the product, etc. consciously contract with someone who has therefore in a way transferred this assent.[214] What, though, of

[213] An issue of transition exists – what about durable goods previously sold with no marking? Two solutions are conceivable. *Lex loci delictus*, etc. could be maintained for these products. Alternatively, all products could be deemed "sold" on the date of adoption of the federal choice-of-law legislation, at the location of their current owners. I prefer this second option, which would concededly entail short-term labeling costs but would avoid all the problems inherent in *lex loci*.

[214] This is because the rental or resale price would reflect the liability rules in effect.

injured strangers? What legal structure should be applied to the New Jersey child, injured in New Jersey by a stone hurled from her next-door neighbor's cheap lawn mower, if that neighbor had traveled to Pennsylvania to purchase the mower (say, to benefit from lower prices caused by Pennsylvania's more pro-defendant product liability rules)?

This is a *conceptually* important problem, but it is not *empirically* ubiquitous. The overwhelming majority of product liability plaintiffs are purchasers and people in privity with purchasers. All the same, in cases where the plaintiff is a true "stranger" to the purchase of the defective product, the 'first retail sale' rule has problems of legitimacy. It would be simply impermissible to apply to this injured New Jersey resident a foreign law to which neither that resident nor his agents have in any way assented.

The lone exception to the "state of first retail sale", then, would be for true third parties. For them, *lex loci delictus* should apply. Only *lex loci* meets legitimacy requirements for these strangers. While statistically a small component of product liability, true third parties would in addition be rhetorically important in the adoption of any legislative plan. Excluding them from the rule of "first retail sale" diffuses objections along those lines. At the same time, the low likelihood that a true stranger will be injured minimizes the prisoners' dilemma that *lex loci* allows. As true strangers constitute an extremely small percentage of product liability plaintiffs, this exception to the "state of first retail sale" rule would *not* preclude meaningful differential pricing of products by manufacturers according. After all, in precious few cases could upstream sellers predict that a product will victimize a stranger as opposed to a consumer.

3. What Federal Coordination is Required to Make this Plan Work?

The 'state of first retail sale' plan is compatible with federalism. It fulfils what is arguably a federal constitutional duty to facilitate true state control over private ordering by eliminating the prisoners' dilemma of current product liability law. It removes the distortion of state law caused by the temptation to free ride on others, and by the resentment that others are free-riding. It does this while superimposing no uniform federal rule of liability on states. It allows a state's product liability and general tort rules to "mesh". Nevertheless, *some* federal coordination will be required to make this choice-of-law system operational. The following areas, among others, must surely be addressed:

a) Common Labeling Requirements.

The federal government could mandate labeling requirements for products, establishing a consistent way to communicate the state of first retail sale to initial (and, as appropriate, subsequent) purchasers. Of course, there is some chance this requirement would spawn a needless bureaucracy, as has been the case to some extent with food labeling. As an alternative, the federal statute introducing the rule of first retail sale choice-of-law could limit its application to products whose state identification is "clearly" labeled. A common law would develop to allow interested parties to determine "clear" labels. This would of course encourage clear labeling while allowing manufacturers leeway in discovering efficient ways to label diverse products. Manufacturers have a comparative advantage over governments in so doing.

Under a common law rule manufacturers would have strong incentives to use their talents to label products in such a way as to trigger the federal choice-of-law rule, because the capacity to avoid "beggar they neighbor" product liability rules benefits them greatly.

b) Rules For Goods Purchased Abroad.

Federal legislation should determine the law applicable to goods purchased at retail abroad. Possibilities include the state of residence of the first purchaser and the country of first retail sale. The latter seems preferable: if an American consumer goes to Scotland to buy whiskey, we can assume that he has a chance to observe that one cannot succeed in Scotland on the claim (attempted occasionally in this country) that whiskey manufacturers "deliberately cause addiction" to their product.[215]

c) Expansion Of Federal Diversity Jurisdiction.

It is important to recognize that the *adoption* of a "state of first retail sale" choice-of-law rule does not guarantee its sincere *enforcement* by state courts.

Suppose a New Jersey court, to comply with the new federal choice-of-law rule for product liability, would have to apply Pennsylvania law (because a New Jersey plaintiff had traveled to Pennsylvania to purchase the allegedly defective product). If Pennsylvania law differs from the New Jersey forum's law in a significant way,[216] the forum court might be tempted to "misread" the applicable law. As was clarified above, the prisoners' dilemma applies to more than just the choice of *law* – it concerns the *interpretation* of this law as well. The moral hazard of

[215] The analogous claim is, of course, popular in tobacco suits, although many courts have rejected it. *See*, *e.g*., Barnes v. American Tobacco Co., 161 F.3d 127 (3d Cir. 1998)..
[216] E.g., New Jersey law might allow full recovery of damages when the injured consumer has misused the product; Pennsylvania law might deny or reduce recovery in such cases.

"nullification by interpration" must be contained; otherwise, manufacturers will have no confidence that the choice-of-law system will be genuine. If this confidence is lacking, autarkial pricing will not be possible.

Of course, a lawsuit by a New Jersey plaintiff against an out-of-state manufacturer might be removable to federal court, which would be charged with applying the applicable state (i.e., Pennsylvania) law under *Erie Railroad*.[217] Unfortunately, case law currently requires *complete* diversity for removal to be an option.[218] As a result, plaintiffs have been able to assure a state court forum by joining an in-state defendant (typically, the retailer of the offending product), even if they do not intend to enforce any judgment against the local defendant.[219] *Strawbridge v. Curtiss* must be revised, by the Supreme Court or by federal statute, to spell out that federal jurisdiction exists at the option of *any* out-of-state defendant if a case is filed in state court. This modification has been recently adopted by the House of Representatives as part of a federal class action reform package – the change could easily be extended to all products suits.[220] Alternatively, or perhaps additionally, federal law could provide that when the forum court and the "first retail sale" court are alleged to be different, there is a right of appeal from state trial court to the

[217] Erie Railroad v. Thompkins, 304 U.S. 64 (1938); 28 U.S.C. § 1332 (2000); *See Supra*, TAN *69*

[218] *See* Strawbridge v. Curtiss, 7 U.S. 267 (1806). Complete diversity is at most a statutory, not a constitutional, requirement; *see* State Farm Fire & Casualty Co. v. Tashire, 386 U.S. 523 (1967) (Art. III, § 2 allows diversity jurisdiction as long as some of the parties are diverse); *see also* Senate Select Committee v. Nixon, 366 F.Supp 51, 55 (D.D.C. 1973) (Congress may impart as much or as little of the judicial power as it deems appropriate and the Judiciary may not thereafter *sua sponte* recur to the Article III storehouse for wider jurisdiction).

[219] *See* Krauss, *supra* note 140.

[220] *See, e.g*, H.R. 2341, 107th Cong. § 5 (2001) (allowing any defendant to remove an interstate class action to federal court, regardless of the presence of local codefendants and without the permission of codefendants).

supreme court of the state of first retail sale, with a "loser pays" fees rule to discourage strategic behavior.

Conclusion

Product liability law must be allowed to evolve as an expression of each state's considered view of the allocation it wishes to make of the risks of living. Currently, states' product liability rules are quite possibly skewed toward more liability than some states (maybe even every state) might consider optimal were the consequences of this liability not externalized to others beyond state borders. Product liability law today is a classic "prisoners' dilemma".

Some critics have proposed federalizing product liability law to resolve this dilemma. However, in addition to the harm a federal takeover would inflict on the traditional constitutional division of powers, uniformity of product liability law is undesirable for substantive reasons. Our ignorance about the desires of consumers, and the comparative advantage of expressing collective moral values in decentralized assemblies, make the laboratory of states a much preferred setting for torts in general, and for product liability in particular.

Through adoption of federal choice-of-law, it is possible to resolve the prisoners' dilemma while respecting substantive federalism. This paper has sketched the reasons for such a plan, the variations it could take, and the best way to make it operational.

With a federal administration and a Congress interested both in tort reform and federalism, it may now be possible to reconcile these two principles. Choice-of-law, a federal duty long neglected, is worth a serious look now.