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

Michael I. Krauss[*]

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 article takes issue with that scholarship. Using the insights of game theory, this article 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 Prisoner's Dilemma problems in the states. This article criticizes the idea of preemptive substantive federal product liability law and proposes in its stead a federal choice-of-law rule developed either legislatively or by the courts. A federal choice-of-law rule, if correctly crafted, would be both compatible with constitutional mandates and conducive to 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 article.

TABLE OF CONTENTS

* Professor of Law, George Mason University. mkrauss@gmu.edu. I am grateful to Michael Abramowicz, Cynthia Conner, Michael Greve, Craig Lerner, Michael McConnell, George Priest, Joyce Sadka, Alex Tabarrok and the Honorable Stephen Williams for comments on earlier drafts. I also acknowledge workshop participants at George Mason University School of Law, Case Western University Law School, the American Enterprise Institute, and the Canadian Law and Economics Association. Research support from the George Mason University Law and Economics Center is gratefully acknowledged. Aureliano Sanchez-Arango and Robert Crisell provided excellent research assistance.

I. 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 in the past.[1] Yet the business of tort law, which forcibly reallocates certain kinds of risks, is thriving as never before. This is especially true for that subset of tort law that is product liability.[2]

This article contends that much of the expansion of product liability[3] is quite possibly not due to increased misfeasance by defendants or to increased risk-aversion by plaintiffs. Rather, this expansion may be the product, to a significant extent, of a beggar-thy-neighbor[4] 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 Prisoner's Dilemma. This Prisoner's Dilemma has arguably played out as sub-optimal liability across the country.

This article identifies the game-theoretic dilemma, criticizes recent scholarship that misidentifies one of its causes as one of its cures, and sketches the parameters and implications of an effective structural solution. The proposed solution, unlike many substantive tort reform plans,[6] has the advantage of preserving state jurisdiction over tort law. In addition to its Occam's Razor characteristics, the

1. AARON WILDAVSKY, SEARCHING FOR SAFETY 7 (1988).

2. *See* ROBERT W. STURGIS, TILLINGHAST-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 works tend to focus on punitive damages, which are not at the heart of this article. 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 Damage Awards*, 42 J.L. & ECON. 527, 540–45 (1999) (suggesting that punitive damage awards vary in an arbitrary manner).

3. In this article, "product liability" refers to legal recourse when an alleged defect in a tangible product causes property damage or personal injury.

4. In beggar-thy-neighbor arrangements, collective action fails because of each party's temptation to free-ride on the efforts of others. *See generally* ANTHONY DE JASAY, SOCIAL CONTRACT, FREE RIDE (1989).

5. Professor Michael W. McConnell made this basic point in *A Choice-of-Law Approach to Products-Liability Reform*, *in* 37 PROC. ACAD. POL. SCI. NO. 1, at 90 (Walter Olson ed., 1988). Professor McConnell's initiative inspired this research project.

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).

proposal avoids many coordination and knowledge problems that otherwise might prove insoluble.

Part II of this article 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 II goes on to explain how this predicament is likely a manifestation of a Prisoner's Dilemma, particularly in light of the peculiar confluence of the *Erie Railroad* doctrine and its progeny.

Part III shows how current state-based product liability law, accompanied by the two generic choice-of-law rules currently prevailing in the states, exacerbates the dilemma instead of resolving it. As a central feature of this part of the article, Part III considers an influential theme of current legal scholarship, which holds that the dominant American choice-of-law rule is helpful in resolving the game-theoretic problem. This article squarely rebuts that thesis. As a result of this refutation, recent trends in product liability law are easier to understand and, it is contended, are finally amenable to solution.

Having established both the existence and the cause of the Prisoner's Dilemma, the article explains in Part IV why federal preemption of product liability law is not the best way to resolve it. Part IV also contests the claim that an imposed "libertarian rule" (i.e., a federal statute disallowing all "inalienable"[7] state regimes, thereby in effect mandating freedom of contract in matters of product liability law), proposed by at least one law-and-economics scholar,[8] would be an appropriate remedy.

Part V makes the case for a federal choice-of-law solution to the Prisoner's Dilemma. Several alternative choice-of-law rules are examined through two filters—that of constitutional legitimacy and that of game-theoretic efficacy. Though each choice-of-law option offers some advantage, only one, a federal "state of first retail sale" rule, seems to effectively meet legitimacy concerns while simultaneously resolving the product liability Prisoner's Dilemma. Competing proposals, it turns out, tend to sacrifice one or the other of these concerns.

7. On "inalienability," or mandatory legal rules, in general, see Michael I. Krauss, *Property Rules vs. Liability Rules, in* 2 ENCYCLOPEDIA OF LAW AND ECONOMICS 782 (Boudewijn Bouckaert & Gerrit de Geest eds., 2000).

8. *See, e.g.*, PAUL H. RUBIN, TORT REFORM BY CONTRACT (1993).

But no reform is without risks. Part V goes on to explore prospective shortcomings of the "state of first retail sale" rule. The article finds none of these deficiencies to be fatal to its successful implementation, though some require some tinkering with its basic modalities. 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 last section of Part V. A brief conclusion follows in Part VI.

II. STATE PRODUCT LIABILITY AND NATIONAL MARKETS: A PRISONER'S DILEMMA

The "tort crisis" has arguably affected different areas of tort law differently. In this Part, an explanation will be offered for this uneven evolution of tort law. Product liability law, unlike some other areas of tort, will be shown to suffer from a particularly acute Prisoner's Dilemma.

A. The Liability Upsurge

Many people, both inside and outside the legal community,[9] feel that all of tort law, not just that component of it covering liability for defective products, is out of control. 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.[10] Several serious estimates of the growth of tort have

9. *See* PHILIP K. HOWARD, THE DEATH OF COMMON SENSE (1994); WALTER K. OLSON, THE LITIGATION EXPLOSION (1991); PATRICK M. GARRY, A NATION OF ADVERSARIES: HOW THE LITIGATION EXPLOSION IS SHAPING AMERICA (1997).

10. Only about two to three percent 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 1516, or about three percent, were decided by jury or bench trial. Marika F.X. Litras & Carol J. DeFrances, U.S. DEP'T JUSTICE, *Federal Tort Trials and Verdicts*, BUREAU OF JUSTICE STATISTICS BULLETIN, Feb. 1999, at 2 [hereinafter *Federal Tort Trials*]. Statistics are similar in state courts. In the nation's seventy-five largest counties in 1996, the most recent year for which Department of Justice statistics are available, only two percent of tort cases were disposed of in court. These dispositions included jury and bench decisions as well as directed verdicts and judgments *non obstante veredicto*. Carol J. DeFrances & Marika F.X. Litras, U.S. DEP'T JUSTICE, *Civil Trial Cases and Verdicts in Large Counties*, BUREAU OF JUSTICE STATISTICS BULLETIN (Civil Justice Survey of State Courts, Washington D.C.), Sept. 1999, at 2 [hereinafter *Civil Trial Cases*]. Many settlements are, of course, confidential and therefore never reported.

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.[11] Though it was already near crisis in the mid-1980s,[12] from 1984 to 1994 alone tort liability in America increased by 125%.[13] In Alabama, the average punitive damages verdict in one small rural county increased to $12.9 *million* from 1989 to 1996.[14] Tort outlays (including the costs of litigation) now consume upwards of 2.6% of gross product, according to another report.[15]

The number of tort suits filed in state courts does seem to have leveled off,[16] but record awards in individual cases are set almost every year. The year 2000 witnessed a staggering $145 billion award in *Engle v. R.J. Reynolds Tobacco Co.*,[17] a Florida class action lawsuit against tobacco companies. Nor was *Engle* a Y2K anomaly. While

11. *See* STURGIS, *supra* note 2.

12. John Calvin Jeffries, Jr., *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).

13. STURGIS, *supra* note 2; *see also* Health Care Liability Alliance, *U.S. Tort Cost Growth Rate Slows: Tort System in U.S. Still Most Expensive in Industrial World*, *at* http://www.hcla.org/html/tillhast.htm (last visited Oct. 17, 2002); STURGIS, *supra* note 2, app. 2, *available at* http://www.hcla.org/tortno.htm (last visited Oct. 17, 2002) (table of tort system costs from 1975 to 1994).

14. *Hearing Before the Senate Committee on the Judiciary on S. 1554, Fairness in Punitive Damages Awards Act*, 105th Cong. (1998) (statement of Professor George L. Priest), *available at* http://judiciary.senate.gov/oldsite/glpriest.htm [hereinafter Priest].

15. *See, e.g.*, BEACON HILL INSTITUTE, TAXATION BY LITIGATION: THE ECONOMICS OF CIVIL JUSTICE REFORM IN MASSACHUSETTS 2 (1997) (Tort costs 2.55% of state product in Massachusetts); STURGIS, *supra* note 2 (tort system cost 2.3% of gross domestic product, or $161 billion, in 1995).

16. *See* Steven K. Smith et al., U.S. DEP'T OF JUSTICE, *Tort Cases in Large Counties*, BUREAU OF JUSTICE STATISTICS SPECIAL REPORT # NCJ-153177 (Civil Justice Survey of State Courts, Washington D.C.), Apr. 1995, at 1.

17. 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. *Id*. 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 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., No. 94-08273 CA-22, 2000 WL 33534572 (Fla. Cir. Ct. Nov. 6, 2000). Defendants have appealed the order denying the motions and upholding the award. *See Big Gets Bigger*, *supra*, at C14.

enormous awards remain rare exceptions,[18] 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 USA's* "top ten verdicts of 1999" exceeded $100 million, and the top two verdicts surpassed $1 billion.[19] 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.[20]

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.*,[21] a California suit.[22] According to *Lawyers Weekly USA*, this verdict was larger than the ten largest non-class action awards in 2000 combined.[23] *Lawyers Weekly USA* reported in 2001 that the median top ten awards in the prior four years showed a "clear upward progression"—the leveling off in 2000 was simply unrepresentative.[24] Tort awards are clearly growing in size, possibly exponentially, even after discounting for judges' post-trial award reductions.[25]

18. *See* Theodore Eisenberg et al., *The Predictability of Punitive Damages*, 26 J. LEGAL STUD. 623, 633–37 (1997) (stating that punitive damages are quite rare).

19. *See* Bill Ibelle, *Murderers, Rapists and Terrorists Dominate Top Ten*, LAW. WKLY. USA, Jan. 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.*

20. Anderson v. Gen. Motors, No. BC 116926 (Super. Ct. L.A. Aug. 26, 2000); Margaret Cronin Fisk, *The Biggest Jury Verdict of 1999: A Typical Verdict Last Year Was Way Up, But Nothing Like This One*, NAT'L L.J., Feb. 28, 2000, at A1.

21. No. BC 226593 (Super. Ct. L.A. Aug. 9, 2001).

22. *See Record Tobacco Verdict Tops Year's Large Awards*, LAW. WKLY. USA, Jan. 7, 2002, *at* http://www.lawyersweeklyusa.com/usatopten2001.cfm.

23. *Id.*

24. Ibelle, *supra* note 19, at B4; *see also* Franklin Strier, *Making Jury Trials More Truthful*, 30 U.C. DAVIS L. REV. 95, at 163 (1996) (arguing that unpredictable damage awards are increasingly perceived to damage American commerce).

25. 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, Alabama rural punitive damage verdicts averaging $12.9 million are reduced to an average of $800,000 by the Alabama Supreme Court. *See* Priest, *supra* note 14. Appellate courts also reduce excessive trial court verdicts if they have no legal support. Nonetheless, the *in terrorem* effect of gigantic awards, which of course 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

A losing tort defendant forfeits both the plaintiff's award and the defendant's own attorney's fees and costs.[26] Meanwhile, tort victims typically surrender from thirty-three to forty percent of any award to their attorneys and are also responsible for the costs of expert witnesses and the like. Indirect social costs (the opportunity cost of conscripted jurors' time, judges' salaries, etc.) add to the "load" of tort. Less than half the social cost of tort adjudication is likely to be converted into victim compensation.[27]

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 production, 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 greater safety at higher prices.[28] But this belief is unfounded—increased liability increases neither consumer safety nor retail prices as a matter of course. To see this, recognize 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,[29] it will *not* be able to recoup the amount of the tort award by increasing the price of its goods or

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, 263–264 (2000) (exploring the history of judicial intervention in the jury process).

26. 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) (explaining that while defendants must pay by the hour for their defense, contingent-fee arrangements enable plaintiffs to reduce the financial risks of litigation).

27. *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); Alexander Tabarrok & Eric Helland, *Court Politics: The Political Economy of Tort Awards*, 42 J.L. & ECON. 157, 172–73 (1999).

28. *See, e.g.*, Ralph Nader & Joseph A. Page, *Automobile-Design Liability and Compliance with Federal Standards*, 64 GEO. WASH. L. REV. 415, 458 (1996) (erroneously claiming that "[i]n 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").

29. If the defect could have been efficiently prevented, then the defendant is being held liable for negligence. The original formulation of this concept, the famous "Hand Formula," may be found in *United States v. Carroll Towing Co.*, 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).

services above the competitive level. If the firm attempted to raise prices to recoup the costs of its negligence, competitors would undercut these prices, taking market share away from the negligent corporation.[30] Prices will not increase, and the negligent 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 differently. Liability might lead to the adoption of "wasteful" design modifications,[31] or it might result in the bundling of a "tort insurance premium" as part of the price of an unchanged good.[32] If juries impose the premium uniformly on all firms in an industry, costs and therefore the supply curve for the product will shift, and market price will obviously be affected.[33]

Some design 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.[34] But 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—risks, in fact, exceedingly small or for some other reason

30. 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.

31. Liability can lead to the adoption of safety measures that cost more than they save in accidents.

32. The choice between the addition of "idiot proofing" and the mere increase in pricing is complex, and depends *inter alia* on the firm's guesses about future liability trends.

33. Uniform imposition of a "strict liability tax" would require that tort law be substantively identical across the country. *See generally*, Michael I. Krauss, *Restoring the Boundary: Tort Law and the Right to Contract*, CATO INST., POL'Y ANALYSIS 347 (1999) (suggesting the need to limit liability rules to their appropriate realm, allowing for contract to allocate voluntarily assumed risks). But tort rules should *not* be identical for populations with different risk preferences. As the present article shows, *infra* Part IV.C, there are good reasons to believe that national uniformity will be precluded for reasons that have nothing to do with heterogeneity of risk preference.

34. 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 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 worthwhile to adopt an efficient safety innovation. *See* A. MITCHELL POLINSKY, AN INTRODUCTION TO LAW AND ECONOMICS 15–24 (1983).

not economically worth preventing—has undoubtedly led firms to avoid activity that might have achieved much social good.[35] If liability increases enough, the result may be 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.[36] Bendectin, the only treatment proven effective against Nausea and Vomiting in Pregnancy (NVP),[37] is no longer produced because the expected cost of defending against groundless tort suits[38] was greater than the expected profits from this non-defective drug.[39]

35. This is because the company cannot internalize all the value it produces. Much of the social good produced by corporations takes the form of consumer surplus—consumers value the products they purchase more than the they value the money they use to make the purchase. This consumer surplus is not captured by the corporation, unless it can perfectly price-discriminate in selling its product. *See, e.g.*, WALTER NICHOLSON, MICROECONOMIC THEORY: BASIC PRINCIPLES AND EXTENSIONS 620–22 (6th ed. 1995) (explaining that "[i]f each buyer can be separately identified by a monopolist, it may be possible to charge each the maximum price he or she would willingly pay for the good. This strategy of perfect . . . price discrimination would then extract all available consumer surplus, leaving demanders as a group indifferent to buying the monopolist's good or doing without it."). But perfect price discrimination is rare and difficult to sustain. *See id.* (noting that "[p]erfect price discrimination poses a considerable information burden for the monopoly—it must know the demand for each potential buyer . . . [or at least meet the] less stringent requirement . . . [of] separate[ing] its buyers into relatively few identifiable markets . . . and pursue a separate monopoly pricing policy in each market."); *see also* OX SHY, INDUSTRIAL ORGANIZATION: THEORY AND APPLICATIONS 75 (1995) ("Note however, that in order to be able to charge consumers different prices, a firm must possess the means for making arbitrage . . . impossible.").

36. Jon Cohen, *Is Liability Slowing AIDS Vaccines?*, SCIENCE, Apr. 10, 1992, at 168–69.

37. NVP is otherwise known as "morning sickness." In its most extreme form, known as "hyperemesis gravid arum," NVP can cause severe complications in pregnancies. *See* Richard Chudacoff, M.D., *Hyperemesis Gravidarum*, *at* http://www.surrogacy.com/medres/article/hyperem.html (last visited Oct. 1, 2002).

38. Merrell Dow Pharmaceuticals, the manufacturer of Bendectin, lost one case in the District of Columbia, but the plaintiff's judgment was ultimately thrown out and replaced with a j.n.o.v. for the defendant in *Oxendine v. Merrell Dow Pharmaceuticals, Inc.*, Civ. No. 82-1245, 1996 WL 680992, *35 (D.C. Super. Ct. Oct. 24., 1996). *See also* Raynor v. Merrell Pharm. Inc., 104 F.3d 1371 (D.C. Cir. 1997) (upholding trial court j.n.o.v.). Merrell Dow also lost one case in Texas, *see* Ellen Joan Pollock, *Jury Orders Merrell Dow to Pay Couple $33.8 Million in Suit over Nausea Drug*, WALL ST. J., Oct. 7, 1991, at B7, but this judgment was also reversed on appeal. *See* Merrell Dow Pharmaceuticals, Inc. v. Havner, 953 S.W.2d 706 (Tex. 1997).

39. *See, e.g.*, Joseph Sanders, *The Bendectin Litigation: A Case Study in the Life Cycle of Mass Torts*, 43 HASTINGS L.J. 301, 318–19 (1992). 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 the drug is powerful circumstantial evidence of the excessiveness of liability.

Products never developed may not be consciously "missed," though society is in fact less well off than it might have been even if citizens are unaware of gains they would have enjoyed.[40] And we assuredly pay directly and indirectly for "excess liability" premiums as well as superfluous "safety" features, bundled with goods we purchase. Thus, power tools now carry arguably pointless warnings that no one reads but that all purchasers fund.[41] The price of new extension ladders incorporates such a significant liability premium that many consumers continue to use rickety old versions.[42] These liability premiums generate wasteful financial transfers.[43] For some products, the amount of the 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.[44]

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[45] and operations[46] that are not justifiable

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

41. *See, e.g.*, John Heinzl, *Wacky Warnings: The Best Common Sense Product Labels*, GLOBE & MAIL, Jan. 18, 2001, at B4; David Tarrant, *Warning: Disbelief May Ensue*, DALLAS MORNING NEWS, Sept. 5, 2001, at 1C.

42. *See* Michael I. Krauss, *Tort Law and Private Ordering*, 35 ST. LOUIS U. L.J. 623, 648 (1991).

43. The transfer is wasteful because it 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 at *supra* text accompanying notes 27–35, transfer-based liability is very expensive insurance that will either lead to excessive price increases or to inefficient design changes.

44. 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. & ECON. 247, 273 (1994); *see also* John P. Wilson, *The Resolution of Legal Impediments to the Manufacture and Administration of an AIDS Vaccine*, 34 SANTA CLARA L. REV. 495, 513–14 (1994) (citing ALAN R. NELSON, AMERICAN MEDICAL ASS'N, IMPACT OF PRODUCT LIABILITY ON THE DEVELOPMENT OF NEW MEDICAL TECHNOLOGIES 1 (1988)).

45. *See* Laura-Mae Baldwin et al., *Defensive Medicine and Obstetrics*, 274 J. AM. MED. ASS'N 1606, 1606–10 (1995); Daniel Kessler & Mark McClellan, *Do Doctors Practice Defensive Medicine?*, 111 Q.J. ECON. 353, 359 (1996).

46. *See* Lisa Dubay et al., *The Impact of Malpractice Fears on Cesarean Section Rates*, 18 J. HEALTH ECON. 491, 491–522 (1999).

on medical grounds. High malpractice insurance premiums are said to lead competent physicians to retire prematurely, leaving whole geographic areas underserved. But these claims are disputed—notably, the refusal of state medical insurance cooperatives to establish claims-based premium structures is sometimes cited as the basis for the premature retirement problem.[47] Indeed, very respectable academic literature suggests that there may be too *little* medical malpractice liability.[48]

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,[49] as well as "creative" individual product liability lawsuits[50] has been remarkable. From automobiles[51] to asbestos[52] to breast

47. See Gary M. Fournier & Melayne Morgan McInnes, *The Case for Experience Rating in Medical Malpractice Insurance: An Empirical Evaluation*, 68 J. RISK & INS. 255, 274 (2001) (physicians, especially rural obstetricians, are choosing to limit practice or self-insure rather than pay soaring premiums unrelated to their own claims experience); Editorial, *Echo Malpractice Mess*, CHARLESTON GAZETTE & DAILY MAIL, Jan. 3, 2002, at P4A (physicians are leaving West Virginia because lawsuits are increasing the cost of insurance coverage); Ovetta Wiggins, *Doctors to Protest Premium Increases*, PHILA. INQUIRER, April 23, 2001, at B1 (Pennsylvania Medical Society asserts that eleven percent of Pennsylvania physicians "have either moved out of state, retired [prematurely], or scaled back their practices [due to] 'skyrocketing' malpractice insurance rates."); Patricia Poist-Reilly, *Malpractice Maelstrom: Skyrocketing Malpractice Insurance Premiums Have Doctors and Healthcare Professionals Here—and Around the State—Clamoring For Reform*, LANCASTER NEW ERA/INTELLIGENCER J./SUNDAY NEWS, Dec. 17, 2001, at 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).

48. *See, e.g.*, David M. Studdert et al., *Can the United States Afford a "No-Fault" System of Compensation for Medical Injury?*, 60 LAW & CONTEMP. PROBS. 1, 33–34 (1997); Paul C. Weiler, *Fixing the Tail: The Place of Malpractice in Health Care Reform*, 47 RUTGERS L. REV. 1157, 1165 (1995); Richard L. Abel, *The Real Tort Crisis—Too Few Claims*, 48 OHIO ST. L.J. 443, 448 (1987); PAUL C. WEILER ET AL., A MEASURE OF MALPRACTICE: MEDICAL INJURY, MALPRACTICE LITIGATION, AND PATIENT COMPENSATION 61–76 (1993); THE PROFESSIONS AND PUBLIC POLICY (Philip Slayton & Michael J. Trebilcock eds., 1978).

49. *See, e.g.*, Victor E. Schwartz et al., *Federal Courts Should Decide Interstate Class Actions: A Call for Federal Class Action Diversity Jurisdiction Reform*, 37 HARV. J. ON LEGIS. 483, 488 (2000).

50. 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.

51. *See* George L. Priest, *Understanding the Liability Crisis*, *in* NEW DIRECTIONS IN LIABILITY LAW 196, 198 (Walter Olson ed., 1988).

implants[53] to intrauterine devices[54] to heart valves[55] to prescription medicines[56] to, most recently, cigarettes and firearms,[57] 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.[58] The amount of damages has increased in tandem with the number of lawsuits: 31% of product liability claims in federal courts now result in awards in excess of one million dollars, nearly twice the frequency for non-product-related suits.[59] Punitive damage awards are much more likely to be substantial in products cases.[60] 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.

52. *See* Linda S. Mullenix, *Beyond Consolidation: Postaggregative Procedure in Asbestos Mass Tort Litigation*, 32 WM. & MARY L. REV. 475, 477 (1991).

53. *See* David L. Bernstein, *The Breast Implant Fiasco*, 87 CAL. L. REV. 457, 459–66 (1999) (reviewing MARSHA ANGELL, THE CLASH OF MEDICAL EVIDENCE AND THE LAW IN THE BREAST IMPLANT CASE (1996)).

54. *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, 383 (1997).

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

56. *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).

57. On the latter, see MICHAEL I. KRAUSS, FIRE AND SMOKE: GOVERNMENT, LAWSUITS AND THE RULE OF LAW (2000).

58. This statistic is currently at sixteen percent. *Federal Tort Trials*, *supra* note 10, at 3.

59. *Id.* at 5.

60. *Civil Trial Cases, supra* note 10, at 9 (punitive damages vastly more likely to exceed $250,000 in product liability cases than in all other categories of tort cases save medical malpractice); *see also* Michael L. Rustad, *Unraveling Punitive Damages: Current Data and Further Inquiry*, 1998 WIS. L. REV. 15, 29 (citing DEBORAH HENSLER & ERIK MOLLER, INST. FOR CIVIL JUSTICE (RAND), TRENDS IN PUNITIVE DAMAGES: PRELIMINARY DATA FROM COOK COUNTY, ILLINOIS AND SAN FRANCISCO, CALIFORNIA (1995) (DRU-1014-ICJ)); ERIK MOLLER, INST. FOR CIVIL JUSTICE (RAND), TRENDS IN CIVIL JURY VERDICTS SINCE 1985 (1996); ERIK MOLLER, INST. 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.).

B. Goods, Services, and Choice of Law

Some tort suits (for instance, automobile collision[61] and professional malpractice cases) target services (driving, doctoring, lawyering, etc.) performed by a defendant. Lawsuits such as these typically pit an indigenous individual plaintiff against an indigenous individual defendant. When litigated before a local jury, this type of case creates no systemic predisposition against either party. What is sometimes termed a "public choice" problem[62] is absent: the plaintiff cannot persuasively charge the jury to bring "outside" money into the locality without harming anyone locally. Other kinds of bias (against the social class, race, etc. of either party) are of course possible in these cases, as in all lawsuits. Race and class biases, although alarming 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 these biases through challenges to the jury venire.[63]

A second type of tort suit—exemplified by negligence claims invoking *respondeat superior*[64]—sets indigenous individual plaintiffs against indigenous corporate defendants. Because juries are composed only of individuals, corporate defendants might experience systemic prejudice here: a jury may be tempted to transfer wealth from an entity that does not "feel pain" to a physically suffering person with whom they can identify. On the other hand, such temptations may be offset by the jury's desire to maintain employment and economic activity in their locality, especially if the defendant corporation maintains a large local presence. It is very hard to predict how these offsetting incentives will ultimately unfold in any given case: they might result in

61. According to a Department of Justice study, 31.9% of all state tort trials in the nation's seventy-five largest counties involved automobile accidents. *Civil Trial Cases, supra* note 10, at 2.

62. "Public choice" problems, arising 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," such as inefficient transfers from the many to the few, will be heavily valued in the public arena in mass democracies. *See* JAMES M. BUCHANAN & GORDON TULLOCK, THE CALCULUS OF CONSENT: LOGICAL FOUNDATIONS OF CONSTITUTIONAL DEMOCRACY 31–39 (1965).

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

64. *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).

corporate status, in and of itself, being of little consequence over the long run.[65]

Early product liability suits tended to be of this second kind. Most products were manufactured near their place of consumption, as transportation costs made far-flung markets unreachable. Thus, many lawsuits concerning allegedly defective products set local individual plaintiffs against local corporate defendants.[66] With the advent of "paradigm shifters"[67] such as assembly-line production, interstate highways, and electronic auctions, markets for goods (though not services) have today become largely national. Modern product liability suits characteristically set an indigenous individual plaintiff against a corporate out-of-state defendant.[68]

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.[69] New Jersey is an "active" product liability state,[70] and also a heavy

65. *See* Neal Miller, *An Empirical Study of Forum Choices in Removal Cases Under Diversity and Federal Question Jurisdiction*, 41 AM. U. L. REV. 369, 408–09 (1992) (Attorneys responding to a survey indicated that out-of-state status was more frequently the cause of jury bias than corporate status or type of business.); Tabarrok & Helland, *supra* note 27, at 161–64.

66. *See, e.g.,* Osborne v. McMasters, 41 N.W. 543 (Minn. 1889) (early product liability suit against a local apothecary, who had mislabeled a drug, resulting in poisoning of the victim).

67. *See* 2 THOMAS J. KUHN, INTERNATIONAL ENCYCLOPEDIA OF UNIFIED SCIENCE: THE STRUCTURE OF SCIENTIFIC REVOLUTION (2d ed. 1970).

68. *See* Theodore Eisenberg, *Judicial Decisionmaking in Federal Products Liability Cases, 1978–1997*, 49 DEPAUL L. REV. 323, 326 ("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.").

69. Christopher C. DeMuth, Should Product-Liability Law Be Nationalized? (Sept. 1985) (unpublished manuscript, on file with the author).

70. New Jersey has pioneered many shifts in favor of individual plaintiffs against corporate defendants. *See, e.g.*, O'Brien v. Muskin Corp., 463 A.2d 298 (N.J. 1983) (superceded by statute); Roberts v. Rich Foods, Inc., 654 A.2d 1365 (N.J. 1995) (holding that a trespasser who dove 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); Beshada v. Johns-Manville Sales Corp., 447 A.2d 539 (N.J. 1983) (holding that a manufacturer could be liable for a "defective" design even if no one in the world had a better design to offer); Henningsen v. Bloomfield Motors Inc., 161 A.2d 69 (N.J. 1960) (holding that a waiver of the right to sue for a manufacturing defect in a new product was void).

manufacturing state.[71] Thus, one would suppose that defendants in New Jersey product liability cases are more likely to be local than is the case elsewhere. DeMuth found that, even in New Jersey, there was an increasing tendency to sue out-of-state defendants:

TABLE 1[72]
LOCATION OF MANUFACTURING FACILITIES FOR NEW JERSEY PRODUCTS CASES

Period	All Defendants Are In-State	At Least One Defendant Is from Out-of-State
1900-1901	1	0
1920-1921	0	0
1940-1941	7	3
1960-1961	8	5

This trend links product liability litigation to diversity jurisdiction. Exploration of this link reveals the importance of choice of law to the product liability issue.

Although modern companies generally manufacture their products in a small number of locations, for national distribution, they are subject to more than fifty[73] separate bodies of product liability law. Product liability law is not one of the named areas of federal competence under our Constitution.[74] Like state tort law in general, and despite various legislative enactments, product liability law has its roots in the common law. It was not proclaimed *ab nihilo*

71. Production manufacturing per worker in New Jersey is twenty-five percent above the national average. *See* U.S. CENSUS BUREAU, STATISTICAL ABSTRACT OF THE UNITED STATES, tbl. 1231 (2000).

72. DeMuth, *supra* note 69, at 50.

73. Each of the fifty states, District of Columbia, Puerto Rico, Guam, etc., has its own rules.

74. *See* JOHN E. NOWAK & RONALD D. ROTUNDA, CONSTITUTIONAL LAW §§ 3.1–3.3 (5th ed. 1995). This is not to imply that federal preemption 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.

by legislative bodies but "declared" and modified incrementally by state courts.[75]

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.[76] Following *Erie Railroad Co. v. Tompkins*,[77] state substantive law governs product liability diversity suits tried in federal court. In *Erie*, the Supreme Court recognized that without preserving state law in such cases, federal diversity law would in effect nationalize areas of jurisdiction that were meant to be left to the states.[78] 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.[79] Rather, it was meant to assure out-of-state litigants that their state citizenship would not convey prejudice.

Though various states' rules may be similar on any given subject matter, the multiplicity of laws with which manufacturers must

75. *See* Robert D. Cooter, *Decentralized Law for a Complex Economy: The Structural Approach to Adjudicating the New Law Merchant*, 144 U. PA. L. REV. 1643, 1649–50 (1996). 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* 2 KONRAD ZWEIGERT & HEIN KÖTZ, AN INTRODUCTION TO COMPARATIVE LAW: THE INSTITUTIONS OF PRIVATE LAW 366–73 (Tony Wier trans., 2d ed. 1987).

76. *See* 28 U.S.C. § 1332 (2002). 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. Int'l Paper Co., 414 U.S. 291, 294 (1973) (citing Troy Bank of Ind. v. G.A. Whitehead & Co., 222 U.S. 39, 40–41 (1911)).

77. 304 U.S. 64 (1938).

78. *Erie Railroad*'s purpose was arguably to preserve a viable, principled private law system in which the laboratory of state laws survives and thrives. Supreme Court cases subsequent to *Erie* arguably unwittingly undermined this effort. This article briefly discusses the implications of *Klaxon Co. v. Stentor Electric Mfg. Co.*, 313 U.S. 487 (1941). *See infra* text accompanying notes 200–07.

79. 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 plaintiff is from a different state from each defendant). A case study of this problem may be found in Michael I. Krauss, *NAFTA Meets the American Torts Process:* O'Keefe v. Loewen, 9 GEO. MASON L. REV. 69 (2000).

reckon generates costs. In some subject areas, these costs may create inefficiencies, as has been noted by Judge Posner[80] and by others.[81] 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, doubling-up trailers in some and tripling them in others when permitted) to contract rules (Exxon/Mobil Corporation presumably deals with the mix of franchise laws with which it must comply).[82]

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."[83]

Justice Brandeis suggests that the coexistence of different state laws would result in rewarding good laws and "weeding out" 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.

C. Product Liability Law and the Prisoner's Dilemma

In the typical product liability case, a consumer purchases a product, is allegedly injured while using it, and sues its manufacturer[84] to recover damages resulting from that injury. Most

80. *See* RICHARD A. POSNER, THE FEDERAL COURTS 178 (1985).

81. *See, e.g.*, Larry E. Ribstein & Bruce H. Kobayashi, *An Economic Analysis of Uniform State Laws*, 25 J. LEGAL STUD. 131, 134–37 (1996).

82. Even though the Uniform Commercial Code is relatively standard, state variations exist; moreover, state common law still governs contracts for services. *See also* Jonathan R. Macey, *Federal Deference to Local Regulators and the Economic Theory of Regulation: Toward a Public-Choice Explanation of Federalism*, 76 VA. L. REV. 265, 267 (1990).

83. New State Ice Co. v. Liebmann, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting).

84. 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. Gen. Motors Corp., 892 F. Supp. 165, 166 (S.D. Tex. 1995) (local retailer's presence as codefendant destroyed diversity, even though this was sole factor preventing removal).

purchases take place close to the home; almost all product use takes place near the home or the workplace;[85] 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 typically 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.[86] Such a suit would pit an indigenous plaintiff against an out-of-state corporate defendant, in the local plaintiff's court and subject to the local plaintiff's state 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 applied to the lawsuit will be unreasonable. After all, laws of the forum state must apply equally to in- and out-of-state defendant manufacturers (under pain of constitutional sanction).[87]

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.[88] Assume, for example, that a defendant in a product liability suit offers a legal argument that is powerful, but not clearly

85. Even for automobiles, most driving almost certainly takes place near one's home and in one's state of residence.

86. Whether the case proceeds in state court or whether the defendant manufacturer removes the case to federal court on diversity grounds, the federal court will apply the forum state's substantive law to the dispute. In any case, removal to a federal court currently can 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. *See* Carden v. Arkoma Assocs., 494 U.S. 185, 187 (1990); Strawbridge v. Curtiss, 7 U.S. (3 Cranch) 267 (1806).

87. U.S. CONST. art I, § 8, cl. 3; City of Philadelphia v. New Jersey, 437 U.S. 617, 617, 626–27 (1978) (under the Commerce Clause, out-of-state and in-state goods must be treated the same, "unless there is some reason apart from their origin to treat them differently"); New England Power Co. v. New Hampshire, 455 U.S. 331, 331, 339 (1982) (New Hampshire could not, consistent with the Commerce Clause, restrict the sale of power to within its own borders.). *But see* Maine v. Taylor, 477 U.S. 131, 131, 151 (1986) (upholding a state's ban on importation of fish on grounds that the state "retains broad regulatory authority to protect the health and safety of its citizens and the integrity of its natural resource") (citing Baldwin v. G.A.F. Seelig, Inc., 294 U.S. 511, 527 (1935)).

88. Those cases that make it to appellate courts often involve a "penumbra" in the law. *See* H.L.A. HART, THE CONCEPT OF LAW 100–23 (2d ed. 1994).

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 regime 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.[89]

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 may be reduced.[90] This defense is arguably desirable, inter alia, to minimize moral hazard[91] 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?[92] What if the considerable cost of this misuse can be shifted to shareholders, workers, and consumers across the nation[93] while the immediate benefit of the shift in state law accrues to a plaintiff located inside the state? A local plaintiff will be highly motivated to

89. 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.

90. *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* Francis H. 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).

91. When an allocation of risks increases the likelihood of the risk materializing, a moral hazard is created. An extreme example is the insured's incentive to burn his home when he has been allowed to insure it for an amount greater than its market value.

92. *See, e.g.*, Ellsworth v. Sherne Lingerie, Inc., 495 A.2d 348, 356–57 (Md. 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).

93. *See supra* text accompanying notes 28–30.

nudge the "consumer misuse" defense toward an arguably non-optimal social result, requiring precious little care on her part but expensive redundancy in design. Would the local judge, and the local jury, be tempted to join with the plaintiff in this enterprise?

Chief Justice Richard Neely of the West Virginia Supreme Court disclosed in a 1988 book that he was disposed to adjust product liability rules in precisely this way whenever such an adjustment would transfer money into West Virginia.[94] Justice Neely did not merely raise this issue theoretically—he "walked the walk," implementing his reasoning in *Blankenship v. General Motors Corp.*[95]

Blankenship was a "crashworthiness," or "secondary collision" case in which the West Virginia Supreme Court adopted a pro-plaintiff rule even though it found the defendant's argument more sensible.[96] A plaintiff who had negligently caused his GM vehicle to crash alleged that its poor design aggravated the injuries 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 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 hard for the plaintiff to establish how a "well-designed" car would have fared during this precise collision. Sometimes the plaintiff appeals to 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 problem of secondary collisions had emerged in pre-*Blankenship* case law across the country:

- One "school," following *Huddell v. Levin*,[97] required the 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."[98] In practice this might require

94. RICHARD NEELY, THE PRODUCT LIABILITY MESS: HOW BUSINESS CAN BE RESCUED FROM THE POLITICS OF STATE COURTS (1988).

95. 406 S.E.2d 781 (W. Va. 1991).

96. *Id.*

97. 537 F.2d 726 (3d Cir. 1976).

98. *Id.* at 737.

the (expensive) creation and testing of prototypes equipped as the plaintiff advocates. Failing such proof, *Huddell* holds that plaintiff may not reach the jury with her design defect claim.

- The second approach, which follows *Mitchell v. Volkswagenwerk, AG*,[99] shifts to the defendant the burden of proving that the alternative design is *not* feasible, or would *not* have reduced injuries. Any such proof would be rebuttable by the plaintiff, who would therefore be assured to the jury on this issue, as long as he/she located one "expert" who states that a better design would have prevented her injury.

Acknowledging *Huddell* 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,[100] the West Virginia Supreme Court in *Blankenship* nonetheless opted for *Mitchell*.[101] The court justified its position on the ground that West Virginia consumers were, as a practical matter, already paying markups every time a new car was purchased in West Virginia to reflect inefficient liability payouts to plaintiffs in those states that had adopted *Mitchell*.[102] Justice Neely reasoned that West Virginians might as well derive benefit from the inefficient rule, since consumers in other states would be paying most of its cost.[103] Aware of the implications of his idea, Justice Neely went on to announce that henceforth, "in any crashworthiness case where there is a split of authority on any issue, . . . we [will] adopt the rule that is most liberal to the plaintiff."[104]

The dilemma sketched by Justice Neely, and empirically confirmed by Eric Helland and Alex Tabarrok,[105] is an illustration of

99. 669 F.2d 1199 (8th Cir. 1982).

100. *See, e.g.*, Richard A. Posner, *A Theory of Negligence*, 1 J. LEGAL STUD. 29, 74–76 (1972).

101. *Blankenship*, 406 S.E.2d at 786.

102. *Id.*

103. *Id.*

104. *Id.* at 785–86.

105. Eric Helland & 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.

the classic Prisoner's Dilemma of game theory.[106] A Prisoner's 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, generate a very poor outcome for each individual.[107]

This particular Prisoner's Dilemma springs from the fact that local plaintiffs and out-of-state corporate defendants are typically combatants in a product liability suit. If each state's judicial system crafted efficient product liability rules, commerce among the states would be facilitated, investment decisions would not be skewed by liability concerns, in many other ways costs of doing business would be lowered, and national consumer surplus would be maximized. This is represented by the upper-left-hand box in Table 2 below.

Imagine that all states had such even-handed rules. In that case, 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 such exploitative rules, of course, then costs of production would be needlessly high, investment decisions would be distorted, and consumer surplus would be lowered.

The temptation to defect from an efficient to an inefficient rule is illustrated in Table 2, which imagines a simple scenario with two states, *A* and *B*:[108]

106. *See generally* ROBERT AXELROD, THE EVOLUTION OF COOPERATION (1984).

107. Prisoner's 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 have little evidence. Suppose, though, that each prisoner is told that she will get off without any punishment (but her accomplice will get the maximum) 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	10, 0
***A* "gives it up"**	0, 10	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 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.

108. To conceptualize this nationally, state *A* might be the forum state, while state *B* might be all other states.

TABLE 2
PRISONER'S DILEMMA AS CONCEPTUALIZED BY JUSTICE NEELY
State *B* → [2d payout]

State *A* ↓ [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 own reward (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, state A's agents have incentives to defect from the agreement. It turns out that state B has identical incentives.

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.[109] 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"[110] to the upper left-hand corner outcome, which maximizes benefits.

A product liability Prisoner's Dilemma is unlikely to be neutralized by industrialization in contemporary America. Even in

109. Total payoff in top left box: 80 (40 + 40). Total payoff in bottom left box: 45 (55 –10).

110. A Pareto-inferior position is one in which a reallocation could be made that would hurt no one and help at least one party. In other words, the bottom right hand box is worse from each party's subjective perspective (absent bizarre 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).

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.[111] 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.[112] The fact that New Jersey has arguably blazed a trail in product liability "innovations,"[113] yet has been successful in attracting manufacturing facilities, is eloquent corroboration of the vitality of the Prisoner's Dilemma.

Nor is the dilemma likely to be resolved by state legislative action. For reasons analogous to those underlying the common law Prisoner's Dilemma, state legislatures are unlikely to adopt rules clarifying product liability doctrines in ways favorable to out-of-state interests.[114] In fact, the bulk of substantive legislative tort reform has concerned matters such as automobile accidents and medical malpractice, both of which tend to involve in-state defendants.[115]

Note, finally, that this legal Prisoner's 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

111. 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 exploitative.

112. *See infra* text accompanying notes 134–37.

113. *See supra* note 70.

114. *See* Ricard A. Epstein, *The Political Economy of Product Liability Reform*, 78 AM. ECON. REV. 311, 311–15 (1988).

115. *See generally, e.g.*, NANCY K. BANNON, AMA TORT REFORM COMPENDIUM (1989) (detailing tort reforms currently in effect, almost none of which are related to product liability); American Tort Reform Association, *Tort Reform Record*, *at* http:// www.atra.org/wrap/files.cgi/7469_record602.htm (June 30, 2002) (Six of forty-five pages of tort reforms relate to product liability. Though fifty states have enacted tort reform of one kind or another, only seventeen states have enacted any kind of reform relating to product liability. Note that one of these states (California) in September 2002 abrogated its only product liability reform. Many of the other sixteen states have minimal reforms, for example relating to affidavits. The overwhelming majority of the "reforms" listed under product liability are minor and superficial.).

jurisdictions where judges are elected and must run for contested re-election.[116]

III. PRICE DISCRIMINATION: A RESOLUTION OF THE PRISONER'S DILEMMA

Chief Justice Neely's beggar-thy-neighbor 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, say, Virginia and Maryland help absorb the cost of inefficient rulings in West Virginia that the Neely strategy can succeed. Current product liability law would not create a Prisoner's 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 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 internalized the consequences of its legal decisions.[117]

The matrices of Table 2 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,[118] 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 1 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:

116. *See* Tabarrok & Helland, *supra* note 27, at 163.

117. *See* McConnell, *supra* note 5, at 97. Of course, price discrimination would not really establish absolute autarky. *See infra* Part V.C.2.a.

118. It is important to realize that even in an autarkical state, *A*'s legal rules might still *indirectly* impact 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, arguably, not morally objectionable; 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. Indeed, 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 3
AUTARKICAL INCENTIVES
↔ State *B* (Second Number)

↓ State *A* [1st number]	**Legally Neutral, Optimal Rule**	**Rule that Exploits Out-of-State Defendant**
Legally Neutral, Optimal Rule	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 2, neither state *A* nor state *B* has an incentive to adopt an inefficient rule hostile to out-of-state defendants.[119]

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 rules currently in force in the states (and therefore also in federal courts)[120] passes muster.

A. Autarky and Existing Choice-of-Law Rules

1. Lex loci delictus

Consider the traditional choice-of-law rule for torts.[121] 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.

119. To the extent that each state would see its own shareholders and employees affected by its decision, *see supra* text accompanying note 28, the disincentive would be exacerbated.

120. *See infra* text accompanying Part IV.

121. RESTATEMENT (FIRST) OF CONFLICT OF LAWS § 377 (1934).

Since a tort cannot exist absent injury,[122] *lex loci* essentially applies the law of the place of injury to determine liability.

Suppose that 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.[123] 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 "autarkical" 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 prices reflecting inter alia a given "liability premium." Despite the façade of autarky, however, *arbitrage* will preclude a resolution to the Prisoner's Dilemma under *lex loci*. Arbitrage is implemented by out-of-state purchase.

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";[124] it must pay for unavoidable liability there.[125] If this happened, consumers in state *A* could simply purchase their products at lower cost 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

122. At least this is so for unintentional torts. *See* W. PAGE KEETON ET AL., PROSSER AND KEETON ON THE LAW OF TORTS § 30 (5th ed. 1984).

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

124. 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.

125. 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 supra* text accompanying note 28–30.

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 incur 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.[126] *Lex loci* is therefore not conducive to an autarkical solution.

Might *lex loci* at least tend, at the margin, 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 efficient liability level was that chosen by state *B*, then this *would* alter incentives, perhaps sufficiently to resolve the Prisoner's Dilemma. 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 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.[127] 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. Anecdotally, the impossibility of reacting to product liability distortions by changing manufacturing sites or tailoring wholesale prices to new legal developments is borne out: prices are essentially uniform throughout the country, and high-liability states continue to attract industry.[128]

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

127. 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.

128. Mercedes Benz had no reason not to locate its car plant in high-liability Alabama—its liability for Alabama accidents is the same regardless of where its factories are based. Some

2. *"Interest analysis"*[129]

As a choice-of-law rule, *lex loci delictus* has been supplanted by "interest analysis" in a majority of states.[130] Under "interest analysis," spurred by the work of Brainerd Currie,[131] 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.[132] Using "interest analysis" notably allows a forum state to apply its own law to accidents

high-liability states (California, New Jersey) are heavily industrialized, while others (West Virginia, Alabama) are much less so. Clearly liability rules are not determinants of factory location. Of course, adoption of extreme product liability rules might be a sign of a general anti-business climate, which *would* deter relocation. But then it would be this climate, not the product liability choice of law rule, that repelled investors.

129. 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" and 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.*, Patrick J. Borchers, *The Choice-of-Law Revolution: An Empirical Study*, 49 WASH. & LEE L. REV. 357, 358 (1992); Michael E. Solimine, *An Economic and Empirical Analysis of Choice-of-Law*, 24 GA. L. REV. 49, 51 (1989) (states grouped as "lex loci" or "modern theories" jurisdictions).

130. *See* Russell J. Weintraub, *Choice of Law for Products Liability: Demagnetizing the United States Forum*, 52 ARK. L. REV. 157, 163–64 n.29 (1999); RUSSELL J. WEINTRAUB, COMMENTARY ON THE CONFLICT OF LAWS 319–21 (3d ed. 1986 & Supp. 1991) (listing thirty-five states, plus the District of Columbia and Puerto Rico, that have adopted the "modern" approach); *see also* Ehredt v. DeHavilland Aircraft Co. of Canada Ltd., 705 P.2d 446 (Alaska 1985); Bryant v. Silverman, 703 P.2d 1190 (Ariz. 1985); First Nat'l Bank in Fort Collins v. Rostek, 514 P.2d 314 (Colo. 1973); O'Connor v. O'Connor, 519 A.2d 13 (Conn. 1986); Travelers Indem. Co. v. Lake, 594 A.2d 38, 47 (Del. 1991); Bishop v. Fla. Specialty Paint Co., 389 So. 2d 999 (Fla. 1980); Johnson v. Pischke, 700 P.2d 19 (Idaho 1985); Ingersoll v. Klein, 262 N.E.2d 593 (Ill. 1970); Hubbard Mfg. Co. v. Greeson, 515 N.E.2d 1071 (Ind. 1987); Fuerste v. Bemis, 156 N.W.2d 831 (Iowa 1968); Lee v. Ford Motor Co., 457 So. 2d 193 (La. Ct. App. 1984), *cert. denied*, 461 So. 2d 319 (La. 1984); Adams v. Buffalo Forge Co., 443 A.2d 932 (Me. 1982); Pevoski v. Pevoski, 358 N.E.2d 416 (Mass. 1976); Kennedy v. Dixon, 439 S.W.2d 173 (Mo. 1969); Mitchell v. Craft, 211 So. 2d 509 (Miss. 1969); Phillips v. Gen. Motors Corp., 995 P.2d 1002 (Mont. 2000); Harper v. Silva, 399 N.W.2d 826 (Neb. 1987); Motenko v. MGM Dist., Inc., 921 P.2d 933 (Nev. 1996); Morgan v. Biro Mfg. Co., 474 N.E.2d 286 (Ohio 1984); Brickner v. Gooden, 525 P.2d 632 (Okla. 1974); Casey v. Manson Constr. & Eng'g Co., 428 P.2d 898 (Or. 1967); Hataway v. McKinley, 830 S.W.2d 53, 59 (Tenn. 1992); Gutierrez v. Collins, 583 S.W.2d 312 (Tex. 1979); Amiot v. Ames, 693 A.2d 675 (Vt. 1997); Johnson v. Spider Staging Corp., 555 P.2d 997 (Wash. 1976).

131. BRAINERD CURRIE, SELECTED ESSAYS ON THE CONFLICT OF LAWS (1963).

132. *Id.* at 189.

occurring outside its boundaries.[133] Theoretically, "interest analysis" also allows a forum state to decline to apply its own law to accidents occurring inside its boundaries.[134]

Courts typically use "interest analysis" to conclude that the forum state's "interest" in compensating its own 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.[135] 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 used to further exploit out-of-state parties, i.e., to exacerbate the Prisoner's Dilemma.

In a provocative article,[136] Professor Bruce Hay asserts, to the contrary, that the rise of "interest analysis" actually helps *neutralize* the Prisoner's Dilemma created by *lex loci* because it encourages manufacturers to locate in low-liability areas. A succinct version of Hay's argument follows:[137]

- 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

133. *See, e.g., Hataway*, 830 S.W.2d at 60 (concluding that the occurrence of a diving accident in Arkansas was merely a "fortuitous circumstance" and holding that Tennessee's (the forum's) law should apply to the accident, since other states would similarly have applied their own law).

134. This is exceedingly rare—courts invariably use interest analysis to extend the reach of their substantive law. For a rare instance where a forum used interest analysis to parochially *decline* to apply its own law, see *Schultz v. Boy Scouts of America, Inc.*, 480 N.E.2d 679, 683–85 (N.Y. Ct. App. 1985) (applying a New Jersey charitable immunity rule to dismiss a suit by a New Jersey plaintiff for sexual abuse committed in New York and New Jersey by an employee of a New Jersey corporate defendant, even though New York law contained no charitable immunity exception).

135. *See, e.g.*, Phillips v. Gen. Motors Corp., 995 P.2d 1002, 1015 (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 non-Montana defendant).

136. Bruce L. Hay, *Conflicts of Law and State Competition in the Product Liability System*, 80 GEO. L.J. 617 (1992).

137. *Id.* at 627–31.

in each state because of the adverse selection caused by arbitrage.[138]

- It has already been shown that under *lex loci* manufacturers have no incentive to relocate their plants.[139] 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 would tip the scales in favor of applying the law of the state of manufacture.
- 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*.[140] 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.

Professor Hay correctly concludes that a ready-made empirical test for his hypothesis about the effects of "interest analysis" already exists.[141] If he is correct, then states with low manufacturer liability will tend to abandon *lex loci delictus* over time and adopt "interest analysis" as their choice-of-law rule as a way to lure manufacturers into their jurisdiction.[142] 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 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.[143] Contrary to Hay's

138. *See supra* text accompanying notes 124–26.

139. *See supra* text accompanying note 127.

140. Hay, *supra* note 136, at 629.

141. *Id*. 647–49.

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

143. *See* Hay, *supra* note 136, at 649.

prediction, *plaintiffs* fare better in "interest analysis" states, on average, than do defendants.[144]

Why is this so? Several factors appear to be in play. Professor Hay seems to have, in the first place, neglected the fact that the *status quo ante*, *lex loci*, will survive until 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, which were originally more favorable to defendants. In short, 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.

Secondly, Professor Hay seems unconcerned with the reasons why "interest analysis" was adopted by these activist courts. A good illustration of "interest analysis" in action can be found in *Duncan v. Cessna Aircraft Co.*[145] In *Duncan*, the plaintiff's decedent and husband, a resident of Texas, had traveled to New Mexico to contract with a flight school and was killed in New Mexico during the crash of the Cessna aircraft in which he was taking his flying lesson.[146] The decedent's wife then signed a release in return for receipt of $90,000 from the flying school.[147] The release did not name the Cessna Corporation but did state that it precluded liability by "any other corporations or persons whomsoever responsible therefore, whether named herein or not."[148] Under New Mexico law, this release would have benefited Cessna, which presumably could therefore charge lower aircraft lease rates to New Mexico flight schools.[149]

But the 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."[150]

144. *See* Phillips v. Gen. Motors Corp., 995 P.2d 1002, 1015 (Mont. 2000) (deciding to adopt interest analysis because it will allow Montana law to apply to the out-of-state accident, thereby affording substantial recovery and because "Montana is interested in fully compensating Montana residents."); *see also* Solimine, *supra* note 129.

145. Duncan v. Cessna Aircraft Co., 665 S.W.2d 414 (Tex. 1984).

146. *Id*. at 418.

147. *Id*.

148. *Id*.

149. *Id*. at 420.

150. *Id*.

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.[151] On the other hand, Texas was acutely "interested" in compensation for injured Texas residents.[152]

The Texas court conveniently overlooked the fact that New Mexico may have a distinct interest in allowing release 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 a distributive preference toward in-state plaintiffs, as articulated by Justice Neely in West Virginia. But this distributive preference is incompatible with neutral tort adjudication, in which the legal system is indifferent as to the victor.[153] This notion of "interest" exacerbates the Prisoner's Dilemma.

The tendency to use "interest analysis" to favor locals is illustrated in a different way by *Rutherford v. Goodyear Tire & Rubber Co.*[154] In *Rutherford*, the plaintiff was injured in her home state of Indiana when her car was hit by the vehicle of a fellow Indianan. The accident occurred following the explosion on the latter car of a tire originally mounted on the spare tire wheel in Kentucky at an automobile assembly plant.[155] Indiana's statute of repose[156] barred the suit, so plaintiff sued in Kentucky, whose statute of repose was more favorable. Applying "interest analysis", the

151. *Id.* at 421.

152. *Id.* at 422.

153. *See generally* Krauss, *supra* note 42.

154. 943 F. Supp. 789 (W.D. Ky. 1996).

155. *Id.* at 791.

156. 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* PROSSER ET AL., *supra* note 122, § 30.

Kentucky court, in a result that favored its local resident, the auto plant, declined to apply Kentucky law.[157] The court stated 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-residents.[158] The Kentucky court therefore chose to apply Indiana law, including Indiana's statute of repose.[159]

The reader might protest that *Rutherford* appears precisely to confirm Hay's hypothesis—the location of the plant in Kentucky led the local court to be less pro-plaintiff than it might otherwise have been. But in this one case where Professor Hay's vision might seem to be corroborated, the same solution would have resulted from *lex loci delictus*.[160] Indeed, plaintiff's optimal tactic under "interest analysis" 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 Kentucky law. Crucially, Indiana would have had to adopt "interest analysis" for the plaintiff to succeed under this strategy.[161] This is powerful substantiation that adopting "interest analysis" tends to benefit local plaintiffs, not defendants.

Finally, Professor Hay neglects the fact that 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." 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 *declined* to use the "interest analysis" rule to protect resident firms from out-of-state plaintiffs, thereby

157. *Rutherford*, 943 F. Supp. at 793.

158. *Id.* at 792.

159. *Id.* at 791–92.

160. The injury occurred in Indiana. *Id.* at 791.

161. See *Phillips v. General Motors Corp.*, 995 P.2d 1002 (Mont. 2000), for an instance where a state adopts "interest analysis" explicitly for this purpose.

demonstrating a commitment to pro-plaintiff ideology[162] that is very hard to square with Professor Hay's predicted reasons for adopting "interest analysis." For example, in *Gantes v. Kason Corp.*,[163] 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, stating that its concern for injured victims (wherever they may live) overrode its fear of discouraging manufacturing in the Garden State.[164]

The contrast between *Rutherford* and *Gantes* gives rise to one relevant observation. At the margin, firms have an incentive to locate in those "interest analysis" states (like Kentucky[165]) that clearly discriminate against out-of-state residents, rather than in those other "interest analysis" states (like New Jersey) that apparently maintain a pro-plaintiff predisposition in every respect. This very slight incentive can obviously be overwhelmed by other factors, as New Jersey's and Kentucky's relative industrial bases would tend to indicate.

B. A Note on Countervailing Tendencies

To claim that both of the currently prevailing "choice-of-law" rules inhibit autarkical solutions to the Prisoner's Dilemma is not to deny the existence of *all* countervailing tendencies against liability.[166] Such factors include the following:

162. *See generally* 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) (explaining that an ideological commitment to a pro-plaintiff product liability regime is the best explanation for the change in legal rules).

163. 679 A.2d 106, 107 (N.J. 1996).

164. *Id.* at 111–12.

165. *See Rutherford*, 943 F. Supp. 789. Recall, though, that the same result would have obtained in *Rutherford* under *lex loci delictus.*

166. Imagine an extreme state of affairs in which courts tend to hold firms liable without requiring any proximate causation. General Motors would, in such a regime, 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 surely provide a check against complete degeneration of product liability law.

- 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 in many states, for instance, 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.[167]
- State and federal constitutional protections preclude overt takings from out-of-state defendants.[168]
- Appointed state judges are arguably not subject to "rent-seeking" pressures as intense as those affecting elected judges.[169]
- Out-of-state manufacturers can lobby state legislatures to enact pro-defendant tort reform—and political contributions from outside the state are permitted in every jurisdiction.[170]

These countervailing forces notwithstanding, it seems clear that current choice-of-law rules do not inhibit the Prisoner's Dilemma of product liability. The shift from *lex loci delictus* to "interest analysis" has been a shift from one conflicts rule favoring local plaintiffs to a different rule that favors local plaintiffs even more. If the states have not been able to resolve these conflicts satisfactorily, federal substantive intervention might appear to be a fruitful option. That option is explored in the next section.

IV. AUTARKY THROUGH FEDERAL PREEMPTION

Prisoner's Dilemmas are, in the jargon of game theory, "coordination problems"—if players could reliably harmonize their activity, a Pareto-superior[171] solution would be within reach.

167. KRAUSS, *supra* note 57, at 27.

168. BMW of N. Am., Inc. v. Gore, 517 U.S. 559, 571 (1996) (noting that 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* Krauss, *supra* note 79, at 91–92, 98.

169. Tabarrok & Helland, *supra* note 27, at 163.

170. Gary T. Schwartz, *Considering the Proper Federal Role in American Tort Law*, 38 ARIZ. L. REV. 917, 936–37 (1996).

171. *See supra* note 110.

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 autarkical 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 costs are "internalized," strategies such as Justice Neely's would be pointless. Nationalization of product liability law has been advocated by numerous observers[172] and is put forward on a regular basis in Congress.[173] Furthermore, there is no insuperable 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 be defended as an exercise of the "interstate commerce" power.[174]

This article will not address the constitutional question, because its claim is that, even if it were constitutional, federal dislocation of states' product liability jurisdiction is inopportune. Substantive federal preemption would entail severe coordination and knowledge problems. Nor would a purely "liberal" intervention by federal authorities—i.e., the nullification of compulsory state rules, allowing free contractual allocation of the risks of product use—be appropriate. The next section makes this argument against both kinds of federal intervention. Next the question of federally imposed choice-of-law rules will be introduced.

172. *See, e.g.*, O. Lee Reed & John L. Watkins, *Product Liability Tort Reform: The Case for Federal Action*, 63 NEB. L. REV. 389 (1984); Victor E. Schwartz & Liberty Mahshigian, *A Permanent Solution for Product Liability Crises: Uniform Federal Tort Law Standards*, 64 DENV. U. L. REV. 685 (1988).

173. *See, e.g.*, 132 CONG. REC. S12,751-01 (statement of Sen. Kasten on Product Liability Reform Act); 142 CONG. REC. H3184-07 (statement of Rep. Bliley on Common Sense Product Liability Legal Reform Act of 1996); *see also* H.R. 423, 106th Cong. (2000) (limiting the product liability of non-manufacturer product sellers); *see also*, *Small Business Liability Reform Act of 1999*: *Hearing on H.R. 2366 Before the Committee on the Judiciary*, 105th Cong. (1999) (statement by Rep. Henry Hyde).

174. Senator Spencer Abraham, *Litigation Tariff: The Federal Case for National Tort Reform*, POL'Y REV., Summer 1995, *at* http://www.policyreview.org/summer95/thabra.html.

A. Preemption and Legal Coordination Problems[175]

Product liability law only recently emerged as a somewhat distinct field from tort law, which is state based.[176] Should federal statutes occupy this field and preempt state law, 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 new federal product rules and, say, an employer is liable to an injured worker under a state exception to workers' compensation protection,[177] is the liability of these two parties "joint and several" or merely "several"?[178]
- How should a plaintiff's federal products suit against the manufacturer of an allegedly defective car be harmonized with her state tort case against the driver who allegedly failed to reasonably control that car?[179]
- How would common-law doctrines developed by state courts and subject to revision by those courts, coordinate with federal statutes, which would presumably be beyond the scope of judicial fine-tuning?[180]

175. Coordination problems bedevil other areas of federal legislation, of course. This article's contention 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.

176. The emergence of product liability law as a distinct discipline is conventionally dated to the early 1960s when a series of influential cases (mostly from California) advocated a departure from several crucial tort doctrines when products caused injury. *See, e.g.*, Greenman v. Yuba Power Prods. Inc., 377 P.2d 897, 900–02 (Cal. 1963); *see also* Reed & Watkins, *supra* note 172, at 390.

177. 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. *See* Johnson v. BP Chems., Inc., 707 N.E.2d 1107, 1114 (Ohio 1999).

178. 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 beyond its traditional bounds. *See* Summers v. Tice, 199 P.2d 1 (Cal. 1948); *see also* Am. Motorcycle Ass'n v. Superior Court, 578 P.2d 899, 904–05 (Cal. 1978). New Mexico, on the other hand, has abolished joint and several liability by statute, with narrow exceptions. *See* N.M. STAT. ANN. § 41-3A-1 (Michie 2001).

179. *See* William Powers, Jr., *Some Pitfalls of Federal Tort Reform Legislation*, 38 ARIZ. L. REV. 909 (1996); Schwartz & Mahshigian, *supra* note 172, at 944.

180. *See* United States v. Standard Oil Co. of Cal., 332 U.S. 301, 313 (1947) (holding that 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 Congress, thereby altering both federal and state political processes?[181]
- Would federal "codification" of product liability law inevitably lead to a preemption of all state tort law? If a federal takeover of all of tort law were inevitable and feasible, would this not lead to an invasion of contract law as well?[182] Would the disappearance of the states as the principal *locus* of private ordering be in our interests?[183]

B. Preemption and Knowledge Problems

Federal preemption of substantive product liability laws spawns at least three major knowledge problems.

First, beyond the difficulties of coordination and the risk of federal intrusion on state responsibility for private ordering, uncertainty about the content of "perfect" product liability legislation argues strongly against preemption by Congress. Endless and intricate calculations of utility functions, risk preferences, and philosophical outlooks[184] of individuals would be needed to

181. One explanation for Congress's 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* Jill Abramson, *Product-Liability Bill Provides Opportunity for Long-Term Milking of PACs by Congress*, WALL ST. J., June 21, 1990, at A16.

182. *See generally* Schwartz, *supra* note 170, at 945. Much of tort law consists of the determination of the boundary between tort and contract. *See also* Krauss, *supra* note 42, at 627–28.

183. Krauss, *supra* note 79, at 98 (wondering whether jury bias against out-of-state corporations may be analogized to a state tax on those firms, in violation of the Commerce Clause of the Constitution; countering that federal preemption of state private law may have dire consequences).

184. Such outlooks are directly related to opinions about black letter issues in product liability. For instance, virtually all observers agree that "causation" should be required for manufacturers to be liable. 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 philosophical issue. If one believes that individuals are primarily responsible for their own fate, conscious misuse of a product by an injured consumer may be a decisive argument against product liability. If one sees consumers as lacking fully free will, acting largely as unthinking pawns in a game played by powerful commercial interests, corporate cost cutting

determine *the* correct allocation of the risks of products among manufacturers and consumers. There is no particular reason to believe 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, albeit in a somewhat different context, "topography and climate aside, no one would mistake Texas for New York, or Nebraska for Massachusetts."[185] *Diversity* creates a knowledge problem and lessens the chance that we can find one "correct" product liability rule.

Lack of competition is a second knowledge problem afflicting federal product liability legislation. State legislation, if properly arranged so that costs and benefits are autarkical, is conducive to a competition that will produce the information needed to determine and reflect diverse 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, their impact 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 used reasonable care.[186] 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 competition among products.[187]

in shaping design and manufacturing processes may be determinate.

185. Michael S. Greve, *Federalism After the Election*, AEI FEDERALIST OUTLOOK NO. 4, at 2 (Dec. 2000), *available at* http://www.aei.org/fo/fo12346.htm.

186. Thus, in *O'Brien v. Muskin Corp.*, 463 A.2d 298 (N.J. 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, including injuries to felonious trespassers. Suppose that *O'Brien* had not been legislatively overruled. If price differentiation were feasible because of autarky, 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 averse to the risks of above-ground pools, and indifferent to summer swimming, as the New Jersey Supreme Court apparently supposed.

187. *See, e.g.*, Robert Bish, *Federalism: A Market Economics Perspective, in* PUBLIC CHOICE AND CONSTITUTIONAL ECONOMICS 351–68 (James Gwarney & Richard Wagner eds., 1988); LUDWIG VON MISES, SOCIALISM: AN ECONOMIC AND SOCIOLOGICAL ANALYSIS (J. Kahane trans., 1951); Jeremy Shearmur, *From Dialogue Rights to Property Rights: Foundations for Hayek's Legal Theory*, CRITICAL REV., WINTER–SPRING 1990, at 106–32.

By contrast, substantive federal legislation imposes one product on all, all at once. It does not allow for *learning over time*, a third knowledge problem. As one commentator noted, "The choice between state authority and federal authority is the choice between competition and monopoly."[188] 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.[189] As the federal legislature experiences less legal competition than do the states, it learns over time much more slowly.

C. Federal Imposition of Freedom of Contract

Under a more or less libertarian view, *any* compulsory assignment of product liability risks, by any level of government, is undesirable. After all, products are sold, not found on the beach by strangers. Sales are contracts, presumably freely negotiated. 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; these default rules might diminish transaction costs if they are popular. But in any event parties would be free to contractually opt out-of-state default rules and to agree upon their own allocation of risks.[190]

The doctrine of freedom of contract is appealing as a general matter,[191] but federally implemented libertarianism would be highly problematic for at least four reasons:

- As was averred earlier,[192] any federal preemption, including forced "liberation" from state product liability rules, implicitly signifies that there is no collectively felt need to establish local safety standards that manufacturers

188. Harvey S. Perlman, *Products Liability Reform in Congress: An Issue of Federalism*, 48 OHIO ST. L.J. 503, 507 (1987).

189. *See, e.g.*, Ilya Somin, *Revitalizing Consent*, 23 HARV. J.L. & PUB. POL'Y 753, 795–98 (2000).

190. PETER W. HUBER, LIABILITY: THE LEGAL REVOLUTION AND ITS CONSEQUENCES 195 (1988); RUBIN, *supra* note 8, at 24.

191. THE FALL AND RISE OF FREEDOM OF CONTRACT at 1–2 (F.H. Buckley ed., 1999).

192. *See supra* text accompanying note 181.

may not waive. But this cannot be known. It is difficult to appreciate *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. But states are much more likely to be sensitive to the existence of (and desirous of implementing) local collective goods than is the federal government.[193]

- Mandatory freedom of contract would contradict longstanding notions of public policy in all fifty states.[194] For example, under a purely contractual regime, General Motors might market automobiles with the following legally binding[195] statement:

> Warning: We have determined that, under current production and quality control procedures, one in every 500,000 vehicles we make will fail 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,[196] 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

193. The thrust of this contention, in a nutshell, is that autarky is preferable to "anarchy." Local collectivities should be able to set a standard of liability that one might vehemently oppose (e.g., "GM is liable for every person injured in any accident in a GM vehicle," or "GM is never liable for any costs of accidents," or something in between), as long as the costs of that rule are, for all intents and purposes, internalized inside the collectivity.

194. *See, e.g.*, Henningsen v. Bloomfield Motors, 161 A.2d 69, 84–102 (N.J. 1960) (holding that manufacturers are not free to waive liability for manufacturing defects). *Henningsen* has essentially been adopted in every state, through *Restatement (Second) Torts* § 402A. Even states declining to adopt a form of § 402A have in practice endorsed *Henningsen*. *See, e.g.*, Matthews v. Ford Motor Corp., 479 F.2d 399 (4th Cir. 1973) (applying Virginia law, and holding that contractual limitation of the right to recover consequential damages for product liability is prima facie unconscionable).

195. The waiver would presumably be binding on purchasers, who would be bound to secure the consent of their passengers.

196. Brand capital would almost certainly be affected by an unwillingness to stand behind defective products. *See also infra* text accompanying notes 198–99.

product liability in all states, widespread adoption of the Uniform Commercial Code (which, for example, states that disclaimers impliedly contradicting express warranties are unenforceable[197]) is tough to reconcile with contractual laissez-faire.

- In any case, it is difficult to imagine that manufacturers would attempt to renounce liability for defective products, because manufacturers are much more efficient bearers of certain subsets of unilateral risk than are consumers.[198] A "warning—we might have botched it" sticker would under this rationale be the result of limited consumer rationality[199] and of intrinsic asymmetries in information.
- Finally non-contracting parties (e.g., pedestrians hit by automobiles) will always constitute some percentage of victims of defectively manufactured products. Some non-contractual product liability rule will always be needed for this reason alone.

If neither uniform federal product liability legislation nor federal abrogation of all state product liability rules is appropriate, there remains an important federal role in helping resolve the Prisoner's Dilemma. This role can be achieved through federal choice-of-law legislation.

V. AUTARKY THROUGH FEDERAL CHOICE-OF-LAW LEGISLATION

This article contends that uniform, federally imposed product liability choice-of-law rules would be both legitimate and constructive. Choice-of-law rules could resolve the Prisoner's

197. U.C.C. § 2-316 (1977).

198. Stephen P. Croley & Jon D. Hanson, *Rescuing the Revolution: The Revived Case for Enterprise Liability*, 91 MICH. L. REV. 683, 766–67 (1993). Hidden manufacturing defects come to mind.

199. There are several articles on systematic irrational behavior. The most famous cases are presented in M. ALLAIS, *Fondements d'une théorie positive des choix comportant un risque et critique des postulats et axiomes de l'école Américaine*, *in* COLLOQUES INTERNATIONAUX DU CENTRE NATIONAL DE LA RECHERCHE SCIENTIFIQUE 40, 257–332 (1953); Amos Tversky & Daniel Kahneman, *Judgment Under Uncertainty: Heuristics and Biases*, 185 SCIENCE 1124 (1974).

Dilemma by moving state law toward autarky, without shutting down the states' laboratories of private ordering.

It might be argued that, if federal imposition of substantive rules of product liability is inappropriate, imposition of federal choice-of-law rules is equally illegitimate. Such was the position of the Supreme Court in *Klaxon v. Stentor Electric Manufacturing Co.*[200] *Klaxon* held that federal courts must not develop or follow any national choice-of-law rule in their application of the *Erie* doctrine.[201] But *Klaxon* has been 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*.[202] *Erie*, they argue, was meant to assure predictability of the law in each state, i.e., the law would be the same for transactions occurring in a state, regardless of the type of court hearing a suit.[203] But *Klaxon* undermined predictability by increasing uncertainty about the applicable law, depending on the location in which a lawsuit was filed.[204] As Professor Hart pointed out separately, federal courts freed from parochial interests are in an ideal position to resolve conflicts between states, but neutral resolution is possible only if federal courts implement stable, common choice-of-law rules.[205]

Unfortunately, case law implementing *Klaxon* has allowed for 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.*,[206] a Pennsylvania plaintiff was injured in Pennsylvania while using farm machinery purchased in Pennsylvania and manufactured by Deere in Illinois.[207] Plaintiff had missed Pennsylvania's two-year statute of limitations 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

200. 313 U.S. 487 (1941).

201. *Id.* at 496–97.

202. *See* RICHARD H. FALLON ET AL., HART AND WECHSLER'S THE FEDERAL COURTS AND THE FEDERAL SYSTEM 688 (4th ed. 1996).

203. *Id.*

204. *Id.*

205. Henry M. Hart, Jr., *The Relations Between State and Federal Law*, 54 COLUM. L. REV. 489, 515 (1954).

206. 494 U.S. 516 (1990).

207. *Id.* at 519

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 suit was originally filed there. The Court in effect allowed and encouraged plaintiffs to stop over in one state and pick up favorable rules on their way to the obvious eventual forum.[208] Cases like these, made possible by the lack of a 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 legitimacy of a federal conflicts rule will be briefly sketched. The focus of the article then shifts to the determination 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, requires federal choice-of-law rules. Choice-of-law authority cannot reside in the states, tempted as each one is by choice-of-law rules that favor its own citizens over out-of-staters. Authority to make choice-of-law rules compatible with the Privileges and Immunities and the Full Faith and Credit Clauses of the Constitution resides in the Congress[209] or, failing Congressional action, in the interpretive power of the Supreme Court.[210] Indeed, one author has gone so far as to maintain that the dearth of federal

208. *See, e.g.*, Ferens v. John Deere Co., 494 U.S. 516, 517 (1990).

209. 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. IV, § 1. Congress may, it is generally agreed, thus specify which state's law gets full effect in different classes of cases. *See* Walter Wheeler Cook, *The Powers of Congress Under the Full Faith and Credit Clause*, 28 YALE L.J. 421, 425–26 (1919); Douglas Laycock, *Equal Citizens of Equal and Territorial States: The Constitutional Foundations of Choice of Law*, 92 COLUM. L. REV. 249, 331 (1992).

210. For example, the Court might declare unconstitutional state choice-of-law rules that 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.

choice-of-law rules arguably constitutes an abdication of a federal constitutional duty.[211]

As has been pointed out by Douglas Laycock,[212] three fundamental principles both justify and circumscribe the exercise of legitimate federal authority over choice of law:

- *The principle of equal American citizens.*[213] Each state must, as a general matter, treat citizens of sister states on an equal basis with its own citizens.[214] This implies that states may not adopt or exploit choice-of-law rules in order to favor local citizens over citizens of sister states. Yet, in practice if not in theory,[215] *lex loci* and (especially) "interest analysis" rules, at the state level, have each contributed to violations of this principle.[216]
- *The principle that states are territorial.*[217] The allocation of sovereignty among states is territorial. This fundamental principle is essentially assumed by the Constitution.[218] State constitutions and acts of admission

211. Laycock, *supra* note 209, at 331. I need not, here, adopt Laycock's view. If choice-of-law rules are mandated by the Full Faith and Credit Clause of the Constitution, they are presumably required in contract law as much as in tort law or product liability. It is enough, for my purposes, that it is constitutionally *permissible* to have a federal choice-of-law rule, under the Commerce Clause.

212. *Id.* at 250–51.

213. *Id.*

214. This is one of the corollaries of Article IV's Privileges and Immunities and Full Faith and Credit Clauses. *See* U.S. CONST. art. IV, § 1, § 2, cl. 1.

215. *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. But these rules are facially non-discriminatory.

Thus, *lex loci* applies the law of the place of the accident, regardless of who the parties to the accident are. 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. However, the ultimate discrimination against outsiders is due to the substantive product liability rules resulting from the (often selective) application of the "interest analysis."

216. *See supra* text accompanying notes 135, 143, 216.

217. Laycock, *supra* note 209, at 251.

218. 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

to the Union do make the territorial basis for state sovereignty explicit.[219] 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.*[220] Choice-of-law rules should, ideally, encourage (or, at the very least, not discourage) civic participation in determination of policy. Most autarkical 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 all Virginians (who have easy access to it, nor political standing to modify it), the republican principle would not be satisfied.

These three principles suggest, first and foremost, that "interest analysis" is inappropriate as a choice-of-law rule for product liability.

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. *See* Laycock, *supra* note 209, at 317. A state's authority to govern—its "jurisdiction"—is a *place* within which no new state can be formed. *Id*. When the Constitution states that no new state shall be formed "within the jurisdiction" of another, it does not mean "within the reach of the interests of another," for then every state's creation would be in breach of this rule. *Id*. It can only mean "within the territory" of another.

219. The territorial definitions of states are specified in their organic acts. *Id*. at 317; *see, e.g., id*. 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, 733 (1838).

220. Laycock, *supra* note 209, at 288–89.

"Interest analysis" does 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" certainly does not resolve the Prisoner's Dilemma, of course; territoriality presents a second reason not to select it.

Lex loci delictus 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 Prisoner's Dilemma under which states are tempted to exploit residents of sister states. This exploitation violates the first principle of legitimate state action, the principle of equal citizenship. *Lex loci* could therefore also not be legitimately imposed by Congress as a choice-of-law rule for product liability.

Federal action to impose product liability choice of law is legitimate, appropriate, and arguably even required.[221] But neither of the currently prevalent rules is suitable. Which choice-of-law rules, then, reconcile sound principles of federalism with the need to resolve the product liability Prisoner's Dilemma? There are several plausible contenders. The federal government might, for example, allow manufacturers discretion over the choice of the state whose law is applicable to each product it sells. Or, Congress 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. 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 our national markets.

B. Which Federal Choice-of-Law Rule Is Legitimate and Effective?

1. "Manufacturer's choice"

One effort to resolve the Prisoner's Dilemma through choice of law was proposed by Dean Harvey Perlman. It was clearly inspired by the competition for incorporation of business associations. It consists of a federal rule that would allow manufacturers to state which

221. Perlman, *supra* note 188, at 509

among the various states' product liability régimes will apply to their products.[222]

Companies at present 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.[223] Delaware, the current frontrunner in this contest, derives both registration fees and other "royalties" (court costs, lawyers' salaries) from its success.[224]

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.[225] Under the Perlman proposal, Virginia need have no territorial connection with the product, the accident, or the victim.[226] 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. Products would presumably be priced to reflect expected liability. Consumers dissatisfied with the manufacturer's choice of "liability state" could 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 Perlman's proposal, a manufacturer could 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. Purchasers would select widgets priced to reflect their desired liability protection under the chosen state's laws, much as car buyers can decide on different kinds of warranties when purchasing vehicles. Consumers would presumably consider product liability regimes 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"

222. *Id.*

223. ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW 1–13 (1993).

224. *See* Perlman, supra note 188; *see also* Erin A. O'Hara & Larry E. Ribstein, *From Politics to Efficiency in Choice of Law*, 67 U. CHI. L. REV. 1151, nn. 28, 37, 355. (2000).

225. Perlman, *supra* note 188, at 507–09.

226. *Id.*

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 certainly 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.[227]

Dean Perlman's proposal has the advantage of allowing consumers in every state to freely select and to internalize the cost of their liability rules. If they wish to own a product manufactured by company *X*, consumers might have to 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,[228] a manufacturer would be able to price products with confidence that buyers are purchasing a voluntarily selected package of risks. This does achieve a measure of autarky, though at an individual rather than a state level.

Notwithstanding this attribute, the Perlman proposal does not comply with other legitimacy requirements of federal choice of law.[229] Perlman's 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.[230] Neither the consumer nor the producer has any necessary territorial link to the state whose law is applied. The consumer never impliedly submits to that state's sovereignty by, say, traveling to it or by using the product in it. Only a clause buried in a sales contract, which may have been completed in a state other than the governing law state, links the plaintiff to that state.

227. Kathryn E. Spier, *Incomplete Contracts and Signaling*, 23(3) RAND J. ECON. 432, 433 (1992).

228. Manufacturers would presumably avoid choosing the product liability law of a state whose law is relatively unstable and arbitrary, because of the risk premium that would have to be bundled into its 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.

229. *See supra* text accompanying notes 221–27.

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

In addition, Perlman's rule falls short as concerns 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 or deliberately shopped in the state in question. And under Dean Perlman's proposal no state could impose any product liability rule for any product sold within its jurisdiction. Perlman's choice-of-law proposal in fact bears a close resemblance to federal imposition of contractual laissez-faire, discussed above.[231] 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, and suppose that Hawaii law is chosen by the manufacturer to govern product liability issues, following the Perlman proposal. 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 purposely 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 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 evolution of Hawaii law than would citizens of that state. After all, the latter have no interest in *Hawaii* product liability law per se—they care about the law chosen by the manufacturers of the products they purchase! This turns the republican principle on its head. Manufacturers would in significant ways be the real "citizens"—they could quite naturally be expected to become more heavily involved in that state's political process than physical persons. Hence, 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

231. *See supra* Part IV.C. There is only one significant difference between the Perlman plan and the laissez-faire proposal: under Perlman's proposal, manufacturers could not invent 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.

proximity. This could provoke a "race to the bottom," instead of an efficient competition among rules, as is the case for incorporation laws.[232]

Put another way, the reason why Delaware-dominated "freedom to charter" works well is that a small number of very powerful, fully informed marginal shareholders, typically institutional investors, are present, and their presence 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, rules that are too generous to manufacturers would be penalized by consumers and would require lower sale prices, thereby counteracting manufacturer incentives to race to the bottom. But this 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.[233] Unlike institutional investors, consumers have too little stake in any individual product to make significant informational investments.

It is therefore questionable whether 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"[234] from the development of widely used rules, analogous to Delaware's incorporation fees?[235]

232. *See* Schwartz, *supra* note 170, at 938.

233. *See* ROMANO, *supra* note 223, at 82.

234. The profits accruing to the government providing an economic public good (such as a currency, or a set of incorporation statutes) are commonly known as seignorage. *See generally* Stanley Fischer, *Seignorage and the Case for the National Money*, J. POL. ECON., April 1982, at 295.

235. *See* Ribstein & Kobayashi, *supra* note 81, at 144, 180 (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

Finally, and quite apart from 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 seems that Congress would adopt any such rule or that courts would enforce the resulting contractual allocation of risk.

2. Law of head office or of most significant employment

William Niskanen proposed in 1996 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.[236]

Niskanen's plan appears to come even closer than does Dean Perlman's to the "choice of incorporation" system 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 akin to current incorporation practice, would likely provide significant "seignorage" to states that adopt attractive liability rules. "Getting it right" would arguably result in a substantial increase in manufacturing activity, an attractive proposition lacking in the Perlman proposal. Niskanen's plan in point of fact turns on its head the perverse incentives currently imparted by *lex loci* rules, which (as we have seen) leave a corporation fully indifferent between locating in high-liability or low-liability locations.[237] Finally, and contrary to Perlman's proposal, the Niskanen plan ties liability to territoriality and to a state's political process. After all, manufacturers would have to be "residents" (if not "citizens"[238]) of the state whose law is chosen. Those corporate residents, as well as their employees and those who depend on them, would have a political stake in, and a strong incentive to understand, local product liability laws.

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. *Id.* at 180.

236. William A. Niskanen, *Do Not Federalize Tort Law: A Friendly Response to Senator Abraham*, 1 MICH. L. & POL'Y REV. 105, 109–10 (1996).

237. *See supra* text accompanying note 128.

238. If the state of incorporation is chosen instead of the state of manufacturing activity, then citizenship, not mere residency, would be required.

As with the Perlman proposal, though, and unlike *lex loci delictus*, Niskanen's plan requires no *consumer* act of republican "submission" to the state's territory. In no sense does a purchaser actively "choose" any legal rule. In no sense does she have a willful territorial link to the state writing the rule. As noted above, this de-emphasis on citizens' informed choices also makes the Niskanen proposal unlikely 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 much 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.[239] 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:[240] it would prefer in-state to out-of state interests. Here, though, the in-state interests would be those of manufacturers, not consumers.[241]

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 goods 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 for that reason less likely to be familiar with it. In this sense, Niskanen's plan shares a weakness of Perlman's. It should be noted that 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

239. *See* Schwartz, *supra* note 172, at 938.

240. *See supra* text accompanying notes 213–16.

241. Indeed, under Niskanen's proposal one could imagine a strategy similar to that of Justice Neely: a state supreme 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.

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 opting for the law of the "intended place of use" of a product.[242] The best thing about this plan 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 not always, the case that the plaintiff is a citizen of that state; in that capacity, he will also have opportunity to take cognizance of, and political action affecting, the jurisdiction's legal rules.

Kozyris's plan (unlike Perlman's and Niskanen's) would not likely result in uniform pricing for all the products of any given manufacturer. A firm's products would be subject to different liability regimes in each jurisdiction. Again, this is not 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 intrinsically incompatible with autarky.

Unfortunately, the fatal defect of Kozyris's proposal is that it does nothing to 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.[243] Higher up the chain of

242. P. John Kozyris, *Choice of Law For Products Liability: Whither Ohio?*, 48 OHIO ST. L.J. 377, 383–85 (1987). Note that Kozyris was proposing that states adopt this rule. However, there is no reason not to analyze his proposal as a potential federal solution.

243. The investigation would not be expensive for certain products, e.g., automobiles,

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, only to 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 sales in a state is 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 violation of the equality principle encourages strategic behavior similar to that practiced by Justice Neely.[244]

C. Law of Place of First Retail Sale

1. Attributes of the rule

This effort to reconcile constitutional mandates with the need to solve the Prisoner's Dilemma 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 would occur 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 Prisoner's 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 consumer lives or uses the product. 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,

where the state of intended use corresponds roughly to the state of registration. On this point, see the discussion *supra* Part V.B.3.

244. *See supra* text accompanying notes 89–95.

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 protection to consumers in other states. This satisfies the equality requirement. 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 autarkical 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 outlays required by a state product liability rule that requires full compensation to consumers injured through their own 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 loss does occur, retailers are well placed and relatively easily organized, in compliance with and in furtherance of the republican principle, to make political representations with the aim of modifying the local liability rule to better reflect undistorted[245] consumer preferences. In this way, the "state of first retail sale" rule allows for input by local residents and channels their (otherwise diffuse and minute) interests through easy-to-organize local merchants. The "state of first retail sale" rule

245. Undistorted consumer preferences are those that are not altered by the pathologies of the Prisoner's Dilemma.

actually enhances the republican principle through this channeling mechanism.[246]

Under the "first retail sale" rule, consumers are not held captive by their own state's product liability rule as is the case for the Kozyris proposal. Consumers could escape local rules through republican "voice" (by joining with 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).[247] 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 Prisoner's Dilemma epitomized by Justice Neely's approach to product liability is resolved, this field of law might assume a greater variety than it does at present. There is, for example, no particular reason to believe that New Yorkers have the same attitude toward collective risk-aversion as do Montanans. It seems likely that communities would be freer to ratify collective preferences under the "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 courts have fashioned, and this has led West Virginia to self-consciously abandon rules that its own institutions had developed. There is no reason why this would happen under the "first retail sale" plan.

But if significant variations among laws across the country begin to occur, 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

246. Channeling of interests is a sought-after means of empowering citizens. Class actions are one obvious way to channel minute claims that otherwise would likely not be heard. Less obvious is the standing given to foreign exporters under American trade treaties. These corporations' new ability to sue in U.S. court for violations of their treaty rights is in reality a way to channel the otherwise too-diffuse interests of American consumers. *See* Krauss, *supra* note 79, at 91–94.

247. Under the Kozyris option, the "exit" strategy is much more expensive—the consumer would have to move or use the product in a different state in order to fulfill this strategy.

shaped by state law whenever autarky reigns.[248] 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 adjusting 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, notwithstanding the natural knowledge-producing laboratory that is interstate legal competition, prices may be "sticky" for mass-produced goods if returns to scale make it more efficient to standardize production processes than to vary price levels. In every case where this happens, though, a manufacturer selling redundantly safe products is vulnerable to effective competition by competitors who have tailored production to those states' demand. If prices are "sticky" because of manufacturing processes, one might expect more specialized retailing—some products might simply not be offered in different states. This outcome is still autarkical, though less thoroughly 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 Prisoner's Dilemma is resolved, both prisoners change their behavior in identical ways—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 Prisoner's Dilemma disappears. Consumer misuse might, for instance, be uniformly dealt with more severely than is often currently the case. If this occurred, products would not display different state liability premiums. But this uniformity would not be a flaw in the "first retail sale" rule any more than the prisoners' silence would be. Rather,

248. Many obvious examples come to mind. Actuaries clearly consider different state laws on suicide in determining the likelihood of life insurance claims, and therefore in setting premiums. Different liability rules help to determine auto insurance premiums. Apartment rental rates charged by multi-state developers must take account of each state's rent control and other related laws. Maryland's requirement of ballistics tests with each new handgun sold has surely raised the sales price of handguns in that state, accounting for a drop in sales. *See* Melody Holmes, *Maryland Handgun Sales Drop 8% in First Half of 2002*, WASH. POST, August 22, 2002, at SM03. In each of these cases, legal autarky is possible (one's zip code is used to determine insurance premiums; real estate is immobile; etc.).

uniformity would indicate that preferences for product liability rules are in fact consistently less risk-averse than appeared under the former choice-of-law rules. The current Prisoner's Dilemma may merely provoke the compulsory bundling of unwanted insurance nationwide—if this were the case, the disappearance of this costly insurance would be a positive development.

b. Will consumers understand the law they choose? Professor Bruce Hay argues that a "first retail sale" rule "might produce national liability levels that are lower than most states prefer."[249] Professor Hay believes 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 more for products than they would have voluntarily chosen to do, and then avail themselves of the most plaintiff-friendly liability rules.[250]

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

Professor Hay's assertion about consumer irrationality may be based on the oft-verified belief that most people underestimate low probability risks.[251] However, in a 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 because of design economies of scale, any disparities in accident rates will to a significant extent result from moral hazard problems: consumers may

249. *See* Hay, *supra* note 136, at 646.

250. *Id*. at 646.

251. *See generally* Tversky & Kahneman, *supra* note 199.

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 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. These signals should tend to awaken any dormant risk preferences. However great the national irrationality, in other words, it should be minimized under the "first retail sale" rule. Presently, by contrast, 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. In brief, inaccurate manifestations of preferences are encouraged by the Prisoner's Dilemma. If Professor Hay is right that our "true" preferences are for copious and expensive insurance, it seems best to develop institutions that would not camouflage these preferences but would in fact encourage their accurate expression.

Risk aversion does appear to differ among people and across areas. Poll after poll indicates, for example, that most Canadians demand a high level of expensive government protection from risks of illness, while most Americans are keen to assume many of those risks privately.[252] Under the "first retail sale" proposal (unlike the Perlman plan, for example), states have a sizable incentive to promote product liability protection levels that reflect their citizens' true risk aversion levels. By doing so, they promote, among other things, retail activity, sales tax revenues, and employment in the state. These incentives might arguably go a long way to overcome the problem of irrational ignorance complained of by Professor Hay, if indeed such a problem actually exists.

c. What about correspondence contracts? When a consumer travels to another state to purchase a product,[253] she clearly assents to that

252. *See* Mark A. Rothstein, *Health Care: Public and Private Systems in the Americas*, 17 COMP. LAB. L.J. 612, 618–19 (1996).

253. Such travel is relatively inexpensive in most states. *See, e.g.*, U.S. BUREAU OF THE CENSUS, *Locations Maps: Locations of Selected Major Cities*, *in* UNITED STATES CENSUS FOR 2000, *at* http://www.census.gov/population/cen2000/atlas/censr01-102.pdf (last visited Oct. 17, 2002). This Census report maps all of the metropolitan areas in the country. A casual

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 reseller? Is her submission to the foreign law as transparent? Is application of that state's laws 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 alertness to this issue.[254] Presumably, federal regulations could oblige mail order and Internet vendors to prominently exhibit the name of the host state with (for Internet purchases) hyperlinks to federally approved summaries of that state's product liability rules. This would make acquiescence to the retailer's state law more informed than is, for example, currently the case for service contracts. That the latter are nonetheless enforceable[255] suggests that the former should perhaps be enforced as well.

Allowing Internet merchants to identify a "first retail sale" state does move the proposal somewhat toward Perlman's plan, however—and objections concerning territoriality and republican participation, analogous to those made to that plan, would apply.[256] 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 requirement would oblige residents of a state to physically travel to a state other than their state of residence (in order to pick up their

examination of the map reveals that *every* metropolitan area in 40 states and the District of Columbia, and some metropolitan areas in Texas, are less than a "three hours" drive from a state border. Only in nine states (Alaska, Arizona, Arkansas, California, Hawaii, Iowa, New Mexico, Oregon, and Washington) is the largest metropolitan area more than three hours' drive from a state border. Eighty percent of the nation's population lives in one of the forty states whose population centers are close to state lines. *See* U.S. BUREAU OF THE CENSUS, *Ranking Tables for States: 1990 and 2000*, *in* UNITED STATES CENSUS FOR 2000, *at* http://www.census.gov/population/cen2000/phc-t2/tab01.pdf

254. *See, e.g.*, Michael S. Greve, *E-Taxes: Between Cartel and Competition*, 8 AEI FEDERALIST OUTLOOK (September 2001), *at* http://www.federalismproject.org/outlook/9-2001.html (last visited Oct. 17, 2002).

255. *See, e.g.*, ThunderWave, Inc. v. Carnival Corp., 954 F. Supp. 1562, 1564–65 (S.D. Fla. 1997).

256. *See supra* text accompanying notes 229–32.

purchased product) if they wish to avail themselves of that other state's liability rules. Whether this 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, since 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 "foreign" state's sovereignty is easier to infer when a conscious act of travel is undertaken. In addition, making the "exit" option a bit more costly 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. However, for orders from "brick-and-mortar" establishments, accompanied by physical delivery from that establishment to a purchaser in a nearby state, the state of the seller should prevail as in the original proposal. 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? Countless products, from absinthe to zinfandel, are sold at retail only once. Other goods, such as lawn mowers or automobiles, are commonly resold. The "first retail sale" rule would continue to apply the first state of sale's laws regardless of the place of resale.

This choice-of-law rule might therefore 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.) identifying applicable law, perhaps next to their serial numbers or to their *Underwriters' Laboratories*® logo. Second-hand purchasers are already in the habit of acquiring residual warranty coverage and (in the case of automobiles) California emissions eligibility second-hand. In both 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 marking 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 diffusion of information about state product liability rules 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.[257] Again, these attributes are knowable, and retailers and manufacturers will have an incentive to publicize them under the "first retail sale" proposal.

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, as would, vicariously, those in privity with these purchasers. Second-hand purchasers, renters of the product, passengers in a car, family members and others knowingly transact with a purchaser. In a way, this purchaser can be said to have transferred her assent to a state product liability rule, much as is done contractually.[258] What, though, of 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 problem is conceptually important, 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," the "first retail sale" proposal has undeniable 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 her agents have in any way assented.

257. An issue of transition exists—what about durable goods previously sold with no marking? Two solutions are conceivable. *Lex loci delictus* 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*.

258. Thus, for example, second-hand purchasers are affected by existing warranty coverage, physical condition, contract limitations, etc.

The lone exception to the "first retail sale" rule, then, should be for true third parties. For them, *lex loci delictus* should apply, as it is the only choice-of-law rule that satisfies legitimacy requirements.[259]

While true third parties constitute a small subset of product liability plaintiffs, their protection would be rhetorically important in the adoption of any legislative plan. Excluding them from the rule of "first retail sale" diffuses objections that the proposal is unfair. At the same time, the insignificant *ex ante* likelihood that a true stranger will be injured minimizes the Prisoner's Dilemma permitted by *lex loci*. This exception to the "first retail sale" rule would not preclude meaningful differential pricing of products by manufacturers. 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 "first retail sale" choice-of-law plan is compatible with federalism. It fulfils what is arguably a federal constitutional duty to make possible true state regulation of private ordering by eliminating the current Prisoner's Dilemma in product liability law. It removes the distortion of state law caused by the temptation to free ride on residents of other states, and by the resentment that other states are free riding. It does this while superimposing no uniform federal rule of liability on the laboratory of states. It allows a state's product liability and general tort rules to "network" as they should.

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 name of 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.[260] As an

259. Third parties have not submitted in any way to any legal regime other than that of the place of the injury. *See supra* notes 211–21 and accompanying text.

260. *See generally* Competitive Enterprise Institute, *Health & Safety at CEI: Food Labeling*, *at* http://www.cei.org/sections/section15.cfm (last visited Oct. 17, 2002); The Independent Institute, *Theory, Evidence, and Examples of FDA Harm*, *at* http://www.fdareview.org/harm.shtml (last visited Oct. 17, 2002) (suggesting that the costs of FDA labeling and other requirements far outweigh the benefits).

alternative to a government agency, the implementing statute imposing the "first retail sale" choice-of-law rule might limit its application to products whose state identification is "clearly" labeled. A common law would then develop to allow interested parties to determine "clear" labels. This would encourage clear labeling while allowing manufacturers latitude 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 thy neighbor" product liability rules allows them to price their products accurately.

b. Rules for goods purchased abroad. Federal legislation should determine the law applicable to retail goods purchased 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 successfully sue in Scotland on the theory (advanced occasionally in this country)[261] that whiskey manufacturers "deliberately cause addiction" to their product.

c. Expansion of federal diversity jurisdiction. It is important to recognize that the mere adoption of a "first retail sale" choice-of-law rule does not guarantee its effective enforcement.

Suppose that 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,[262] the forum court might be tempted to "misread" the Pennsylvania law. As explained above, the Prisoner's Dilemma applies to more than just the choice of law—it concerns the interpretation of this law as well.[263] The risk of "nullification by interpretation" must be contained; otherwise, manufacturers will

261. The analogous claim is, of course, popular in tobacco suits, although many courts have rejected it. *See, e.g.*, Barnes v. Am. Tobacco Co., 161 F.3d 127 (3d Cir. 1998).

262. For example, 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.

263. *See supra*, text accompanying note 116.

have no confidence that the choice-of-law system will be genuine. If this confidence is lacking, autarkical 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's (in the example, Pennsylvania's) law under *Erie Railroad*.[264] Unfortunately, case law requires complete diversity for removal to be an option.[265] As a result, plaintiffs have been able to guarantee 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.[266] *Strawbridge v. Curtiss*[267] 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 approved by the House of Representatives as part of a federal class action reform package—the change could easily be extended to all products suits.[268] Alternatively, or perhaps additionally, federal law could provide that when the forum state and the "first retail sale" are alleged by either party to be different states, there is a right of appeal from state trial court to the federal Circuit Court of Appeal, with a "loser pays" fees rule to discourage strategic behavior.

264. Erie R.R. Co. v. Tompkins, 304 U.S. 64 (1938); 28 U.S.C. § 1332 (2000); *see supra* text accompanying note 77–78.

265. *See* Strawbridge v. Curtiss, 7 U.S. (3 Cranch) 267, 267–68 (1806). Complete diversity is at most a statutory, not a constitutional, requirement. *See* State Farm Fire & Casualty Co. v. Tashire, 386 U.S. 523, 530–31 (1967) (holding that Article III, § 2 allows diversity jurisdiction as long as some of the parties are diverse); *see also* Senate Select Comm. v. Nixon, 366 F. Supp. 51, 55 (D.C. 1973) (ruling that Congress may impart as much or as little of the judicial power as it deems appropriate and that the Judiciary may not thereafter sua sponte recur to the Article III storehouse for wider jurisdiction).

266. *See* Krauss, *supra* note 79, at 98, for one particularly egregious example of a plaintiff's abusive retention of state court jurisdiction despite diversity. The foreign defendant, forced before a Mississippi court because of a fictitious incomplete diversity, has treated the judgment against it as a violation of international law.

267. 7 U.S. (3 Cranch) 267 (1806).

268. *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).

VI. CONCLUSION

Product liability law must be allowed to evolve as a partial 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 likely 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 Prisoner's Dilemma. As such, it is a subset of tort whose rapid recent expansion both requires and permits a structural solution.

Some specialists 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 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 Prisoner's Dilemma while respecting substantive federalism. This article 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.