Tort-Eating Contest

By MICHAEL KRAUSS
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Life in America is less risky than ever; we have proportionately fewer accidents and live longer lives. Yet the business of tort law is thriving. Outlays, including the costs of litigation, consume upwards of 2.8% of GDP, and the share of that going to plaintiffs' lawyers is roughly $50 billion.

Product liability costs are especially acute. The price of new extension ladders, for example, incorporates such a significant premium to cover excess liability concerns that many consumers continue to use rickety old versions. Why is this so?

Early product-liability suits tended to involve products manufactured near where they were bought and used, and lawsuits alleging defective products set local individual plaintiffs against local defendants. Here a jury might be tempted, perhaps out of sympathy, to transfer wealth to an individual plaintiff at a company's expense, regardless of the merits of the claim. But the temptation to impose large costs on a local company might be offset by jurors' consideration of the consequences to their community -- especially if the corporation employs many local workers or otherwise has a large local presence.

Today product liability suits typically set an indigenous individual plaintiff against an out-of-state corporate defendant. Here juries tempted to engage in wealth transfers can do so at marginal expense to their local economies. They can, in short, act like West Virginia's Sen. Robert Byrd -- bring home the bacon locally at a cost borne by consumers across the nation.

But the Byrd strategy can succeed only if price increases to absorb the costs of product liability rules in, say, West Virginia are also paid by consumers in other states. Suppose, however, that national manufacturers could price products differently from state to state as a function of the costs -- including the liability costs of doing business in that particular state. Each state would have a greater incentive to conduct its legal business in such a way as to optimize the consequences of its product liability regime.

This kind of price discrimination is not currently possible. Why? A manufacturer might want to charge higher prices in West Virginia to cover the legal "premium" it must pay for unavoidable product-liability rules there. It wouldn't work. Mountaineers could simply purchase the product in neighboring Maryland and bring it back home -- and current jurisdictional rules essentially provide that West Virginia tort law will apply to all accidents occurring there, regardless of where the consumer bought the product.

West Virginia consumers, in other words, obtain the same tort "coverage" -- but for a lower premium -- if they buy the product in Maryland. As a result, manufacturers aren't able to lower the price of their products in Maryland to reflect that state's less onerous (or ridiculous) product liability rules, because they may end up incurring the higher liability costs of West Virginia. I believe this helps to explain the product liability mess in the U.S. We have more product liability than we want because of a beggar-thy-neighbor "Byrd Effect."

Suppose, however, a federal law declared that the laws and rules governing product liability applicable to a given product are the rules of the state where that product was first sold at retail.

Thus, if a West Virginian bought his lawn mower in Maryland, it would be Maryland law that determined product liability, even if an accident involving an alleged defect happened later in West Virginia. (Labeling is generally easy and would provide reliable identification of the state of first sale.) Manufacturers could now price goods in each state to reflect that state's liability rules -- allowing consumers to pay for the liability protection they wanted. Competition would provide consumers with knowledge of what this all means. West Virginia retailers 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 might not want to pay for this extra protection. Suppose that the West Virginia retail price of a lawn mower includes a premium reflecting the outlays required by a product liability rule requiring full compensation to a consumer injured through his own misuse of a product. The consumer might say, "Thanks but no thanks. I'll take my chances," and buy his lawnmower in Maryland, where this "misuse protection" is not bundled into the purchase price. West Virginia retailers lose sales; and if the losses became apparent, these retailers would be well placed to pressure political representatives to modify liability rules so as to better reflect consumers' actual preferences.

It is important to see that a federal choice-of-law rule respects state sovereignty. A federal rule would leave West Virginia's product liability law in that state's hands. But it would provide a powerful incentive for West Virginia to be more responsive to its citizens' actual risk preferences.

Product liability law should be allowed to evolve as a partial expression of each state's view of the allocation it wishes to make of the risks of living. Currently these rules are skewed toward more liability than many states (maybe all states) might consider optimal, were they to internalize the costs of their tort rules. A federal jurisdictional rule might change this -- preserving states' rights while going a long way toward mitigating the torts "crisis."

Mr. Krauss teaches law at George Mason University Law School. This oped was adapted from a longer article in The Brigham Young Law Journal.