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# Interest Groups, Contracts and Interest Analysis

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Interest analysis does not stand up well under economic analysis. Richard Posner has noted that the territorial approach to choice-of-law rules reflected in the *First Restatement* enabled states at least roughly to exercise their comparative regulatory advantages.<sup>1</sup> Moreover, a system of rules enables parties to better predict the outcomes of disputes. This better facilitates settlement than a standard as difficult to apply as interest analysis. Most fundamentally, trying to determine the interest of a state separate from the generally conflicting private interests of politicians, voters, and other elements of the political process is utterly foreign to contemporary public choice economics. In fact, the seemingly outmoded *First Restatement* approach generally makes better economic sense, among other reasons because, as discussed below in Part II, it enables states to limit the effectiveness of rent-seeking through interest group bargains. Though the *First Restatement* rules are imperfect and rest on a questionable theoretic foundation, they are not as arbitrary as advocates of interest analysis think.

Part I argues, in light of public choice theory, that interest analysis increases the inefficiency of laws by enhancing interest groups' ability to extract benefits from less powerful out of state groups. Part II proposes to respond to this problem with a version of the *First Restate-*

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1. RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 587 (4th ed. 1992) (advocating application of the *First Restatement's* "territorial" approach to choice of law partly on the ground that the jurisdiction local to the transaction has a comparative regulatory advantage in determining the appropriate rules).

ment rule-based approach, modified so as to better foster interstate competition by enabling parties to choose their governing law to a greater extent than any existing choice-of-law approach permits. Part III applies our analysis to some of the cases discussed in this Symposium.

#### I. THE PROBLEM: PUBLIC CHOICE THEORY AND INTEREST ANALYSIS

Interest analysts claim to be primarily concerned with facilitating the state's interest in passing a law. As David Currie points out, this is really a matter of statutory interpretation.<sup>2</sup> Traditional interest analysis assumed that all laws had one or more of three primary purposes: 1) protecting defendants; 2) compensating plaintiffs; and 3) regulating conduct.<sup>3</sup> This analysis fails to take into account many potential interests that a state might have and to recognize that most states attempt to balance (albeit in different ways) the same concerns. However, this artificial approach at least allowed some ex ante predictability regarding the outcomes of disputes.

Courts applying interest analysis attempt to discern in light of the legislature's purpose whether it would have wanted the law applied to the facts of a particular multistate dispute. But public choice theory shows that the legislature's real intent cannot easily be gleaned by concocting some hypothetical public purpose. Laws may instead promote the wealth or utility of strong interest groups that can organize cheaply and effectively to raise and spend money and other political resources.<sup>4</sup> These groups may not be the public, or even the majority, but rather small minorities whose members share the burdens as well as benefits of political action because they overcome members' temptations to "free ride" on the work and money of others.<sup>5</sup> Thus, laws may not be efficient even in the limited "Kaldor-Hicks"<sup>6</sup> sense that the proponent group's gains from the law outweigh losses to the rest of society.<sup>7</sup>

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2. Transcript, *Choice of Law: How It Ought To Be*, 48 MERCER L. REV. 639, 649, 652 (1997).

3. See LEA BRILMAYER, CONFLICT OF LAWS 67 (2d ed. 1995).

4. See generally MANCUR OLSON, THE LOGIC OF COLLECTIVE ACTION (1965).

5. For discussions of the importance of free riding in interest group theory see ROBERT MCCORMICK & ROBERT TOLLISON, POLITICIANS, LEGISLATIONS AND THE ECONOMY (1981); Robert Tollison, *Public Choice and Legislation*, 74 VA. L. REV. 339 (1988).

6. See Jonathan Macey, *Promoting Public-Regarding Legislation Through Statutory Interpretation: An Interest Group Model*, 86 COLUM. L. REV. 223, 228 n.28 (1986).

7. The task of determining whether a law in fact benefits a narrow interest group rather than the public as a whole is often impossible. Legislators rarely if ever acknowledge any but a public interest motive. See Macey, *supra* note 6, at 223. Moreover, markets are rarely either perfectly competitive or perfectly monopolistic, and the

Interest analysis not only ignores public choice theory but may, in the light of this theory, exacerbate the problem of inefficient laws. At some point the "tax" imposed on weaker interest groups becomes so large that it exceeds the cost of organizing voters in opposition to the law.<sup>8</sup> But, where the losers reside outside the enacting state, they lose their voting weapon (although, to be sure, other forms of political pressure can cross state lines), which makes it harder for them to overcome the winner's inherent advantage. Interest analysis makes it more likely that laws will be applied against such outsiders. For example, suppose state C has few manufacturers and wants to impose more products liability than is optimal (*i.e.*, more than consumers would be willing to buy). The legislature may pass the law in the absence of voting pressure from those aligned with manufacturers. Interest analysis helps promote this result by ensuring application of the law by state C courts to local consumers, but not necessarily against local manufacturers, most of whose customers may live outside the state. Even if the court is willing to apply local law to an out of state plaintiff, the latter may be deterred from taking advantage of the bias by the need to travel and hire local counsel. Thus, interest analysis facilitates inefficient laws by imposing the costs of those laws on people and firms who have no direct vote.<sup>9</sup>

Interest analysis poses difficulties even when legislation is Kaldor-Hicks efficient. Consider, for example, Oregon's spendthrift law,<sup>10</sup> which was applied in *Lilienthal v. Kaufman*,<sup>11</sup> a case discussed in this Symposium. As pointed out by Richard Posner in his defense of the *First Restatement*, state laws serve the differing environments of the various states.<sup>12</sup> This is obviously true of speed limits, but might even be true of spendthrift laws. Suppose that spendthrift laws make sense in rural areas where most contracting is between parties who know one another and therefore know whether the other party is a spendthrift. In contrast, spendthrift laws may be less suited to large communities

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elasticities of supply and demand in any market are usually unknown. Thus, it is difficult to determine the incidence of burdens and benefits to legislation once market effects are taken into account.

8. See Gary Becker, *A Theory of Competition Among Pressure Groups for Political Influence*, 98 Q. J. ECON. 371 (1983).

9. For a similar argument, see Michael W. McConnell, *A Choice of Law Approach to Products Liability Reform*, in *NEW DIRECTIONS IN LIABILITY LAW 90* (Walter Olson ed. 1988). But see Bruce Hay, *Conflicts of Law and State Competition in the Product Liability System*, 80 GEO. L.J. 617 (1992) (arguing that interest analysis leads to less expansive products liability than did the *First Restatement*).

10. OR. REV. STAT. § 126.280 (1961) (repealed 1973).

11. 395 P.2d 543 (1964).

12. POSNER, *supra* note 1.

because anonymity allows spendthrifts to take advantage of sellers who have no advance notice that they are dealing with a spendthrift. Thus, a relatively rural state such as Oregon may protect its spendthrifts, while a state with more large urban communities such as California may not. *Lilienthal*, by allowing an Oregon spendthrift to reach into a more urban state to take advantage of a California creditor, was arguably an inefficient application of an otherwise efficient law.

In sum, interest analysis causes two fundamental types of problems. First, interest analysis may increase the likelihood of rent-seeking legislation. Second, where different state laws are efficient in different environments, interest analysis impedes states' abilities to effectuate their comparative regulatory advantages.

## II. THE SOLUTION: A MODIFIED *FIRST RESTATEMENT* APPROACH

The original *Restatement of Conflicts* (the "*First Restatement*")<sup>13</sup> has been denounced by most modern choice-of-law scholars as an arbitrary set of rules based on unsound theory.<sup>14</sup> The initial theoretical justification for the *First Restatement* is, indeed, faulty. But the *First Restatement* does offer a promising starting point, particularly in light of public choice theory, if it is modified to make better use of parties' contracts regarding choice of law.

The *First Restatement* is premised on the theory that substantive legal rights vest in a particular state, and only that state can determine the extent of the rights. For example, tort rights vest according to the law of the state where a person is injured, the validity of contracts is determined by the place where the contract was formed, and rights to real property are created only at the situs of the property. But there is no *a priori* reason why states' powers should stop at their borders as prescribed by vested rights theory.<sup>15</sup> Moreover, the exclusive focus on the state's sovereign powers ignores the parties' interests in prescribing rules governing their relationship and thereby maximizing the value of their bargains.

The *First Restatement* might nevertheless be an efficient approach despite its vested rights foundation. In torts, for example, courts and legislators near the place of an accident are often most aware of local conditions and therefore are the rulemakers who are best situated to determine appropriate levels of care. Also, contracting parties are likely

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13. RESTATEMENT OF THE LAW CONFLICT OF LAWS (1934).

14. See generally LEA BRILMAYER, CONFLICT OF LAWS 25-31 (2d ed. 1995).

15. See Transcript, *supra* note 2, at 652 (comments of Professor Currie criticizing American Law Institute's assertion that governing law was "brooding omnipresence in the sky").

to have notice of the law of the place of contracting and may be unduly burdened by having to inquire into the home state of everyone with whom they do business. Moreover, applying the law of the place of contracting affords an opportunity to exit from laws that unduly burden particular transactions or that attempt to transfer wealth from weaker to stronger interest groups. Thus, although interest analysis may take care of the "hard cases" under the *First Restatement*, it does so by undermining a fundamentally sound set of rules.

The *First Restatement* is, however, far from perfect. To the extent the imperfections apply to rare interstate fact scenarios, the costs of the *First Restatement* are relatively low. Where the *First Restatement* causes systematic problems, it can be reformulated to remove the imperfections. We propose two types of changes. First, and perhaps most fundamentally, courts should enhance party choice by enforcing contractual choice-of-law and forum clauses rather than forcing parties to reside or contract in another state in order to avail themselves of its rules.<sup>16</sup> This approach would increase the efficiency of legal rules by enhancing parties' ability to avoid burdensome laws through exit and thereby empower individuals who might otherwise have little "voice" in the political process.<sup>17</sup>

Second, even where contractual choice of law is not likely to be effective, the *First Restatement* should be modified in some cases to better promote efficient jurisdictional competition. Specifically, the courts should choose the applicable law so as to maximize the parties' ability to determine the laws governing their behavior prior to the conduct that gives rise to litigation.

As an example of how this approach would be applied, consider a case based on a defective product. Under our approach, courts should apply the law of the point of sale.<sup>18</sup> This rule would permit manufacturers to choose where to sell the product and how much to charge based on the applicable liability rule, and allow consumers to determine the applicable law by choosing where to buy. Manufacturers could avoid oppressive liability regimes by refusing to sell in states that adopt such rules. Manufacturers would not be subject to forum rules whose application the

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16. See generally Larry E. Ribstein, *Choosing Law By Contract*, 18 J. CORP. L. 245 (1993). As discussed in the foregoing article, enforcement of contractual choice of law may depend on enforcement of the parties' contractual choice of forum because courts have strong incentives to enforce the law of the forum and, as discussed below, this result is encouraged by application of interest analysis.

17. See generally ALBERT O. HIRSCHMAN, *EXIT, VOICE, AND LOYALTY* (1970); Charles M. Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416 (1956).

18. See McConnell, *supra* note 9 for a similar argument.

manufacturer could neither predict nor exit just because the product happened to be used or resold in the forum. Where the manufacturer claims its product was resold in a state without its consent, or even contrary to its consent, the court might determine under principles similar to those that apply under long-arm statutes whether the manufacturer subjected itself to the state's law. Though a point-of-manufacture rule might seem better from the manufacturer's standpoint, consumers could not easily determine what law will apply, particularly where the product is sold by a little-known company or one that owns or buys from factories all over the world. Moreover, the manufacturer is usually in a better position than the consumer to contract around the default rule, such as for the law of the place of manufacture. Because in competitive markets manufacturers ultimately will bear some of the consumers' information and contracting costs, manufacturers as a whole might prefer a default rule that does not impose significant costs on consumers.

Our approach is likely to differ most sharply from interest analysis with respect to application of forum law. The forum can be any state that has enough contacts with defendants to create a predicate for jurisdiction. These contacts may be so insubstantial that a defendant who does not wish to be subject to a state's laws cannot easily structure its affairs to avoid application of the law. By contrast, under our rule, the applicable law is more likely to be one that the parties deliberately selected, or at least could have assumed would apply if they had considered the matter.<sup>19</sup> Interest analysis promotes jurisdictional competition for litigation over conduct or contracting that has already occurred.<sup>20</sup> By contrast, our rule promotes competition over the rules that will govern the parties' future conduct or contracts. Because the parties can tailor their conduct in light of existing laws, a rule that promotes competition over such laws is more likely to lead to efficient rules than one that promotes competition for litigation over past conduct or contracts.

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19. In other words, as discussed above, although the competition-maximizing rule satisfies minimum jurisdictional contacts, these contacts are not enough to satisfy our rule. See Transcript, *supra* note 2, at 711 (comments of Professor Lewis arguing that the Constitution should apply to choice of law as it does to jurisdiction).

20. See *Ferens v. John Deere Co.*, 494 U.S. 516, 527 (1990) (noting Mississippi's incentive to attract litigation through long statute of limitations).

## III. APPLICATION TO SPECIFIC CASES

In this Part we apply our analysis to a few of the cases discussed in the Symposium. We consider three: *Erwin v. Thomas*,<sup>21</sup> *Hurtado v. Superior Court of Sacramento County*,<sup>22</sup> and *Rosenthal v. Warren*.<sup>23</sup>

A. *Erwin v. Thomas*

Residents of Washington who were injured in Washington by a truck owned and operated by Oregonians sued in Oregon.<sup>24</sup> Oregon allows recovery for loss of consortium while Washington does not.<sup>25</sup> The court held that there was a "false conflict" and therefore applied forum law, reasoning that, as Washington sought only to protect Washington defendants from consortium claims and Oregon protected only Oregonian plaintiffs, "neither state has a vital interest in the outcome of this litigation and there can be no conceivable material conflict of policies or interests if an Oregon court does what comes naturally and applies Oregon law."<sup>26</sup>

Applying the law of the place of the tort in this case would maximize competition. The court's interest analysis amounts to an ad hoc finding of an unprovided for case followed by application of the law of the state where the suit happened to have been brought. It is far from clear why the court concluded that Washington's judicial no-consortium rule was only for the protection of Washington resident defendants. If, as the court said, Washington has made the policy judgment that defendants should not have to pay for the loss of consortium,<sup>27</sup> why would the legislature want this policy applied only to Washingtonians? Given that this analysis is ad hoc, people cannot determine the law applicable to their conduct until after it has caused an injury and the case has been tried and appealed. Indeed, systematic choice of forum law by default encourages ex post jurisdictional choice by forum shopping.<sup>28</sup> States may compete for litigation by giving plaintiffs damages for loss of consortium litigation. This would benefit in-state trial lawyers at the expense of defendants, many of whom may be nonresidents. By contrast,

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21. 506 P.2d 494 (1973).

22. 522 P.2d 666 (1974).

23. 475 F.2d 438 (2d Cir. 1973).

24. 506 P.2d at 495.

25. *Id.*

26. *Id.* at 496-97.

27. *Id.* at 496.

28. See Transcript, *supra* note 2, at 716 (comments of Professor Felix noting the forum-shopping problem).



applying the law of the place of the tort, because it is usually the place of plaintiff's residence, allows people to choose where to live and where to travel based on governing law. To the extent that consortium laws make a difference to people, as by reinforcing the marriage relationship or penalizing tortfeasors, our rule facilitates competition toward more efficient laws rather than toward more litigation and forum shopping.

*B. Hurtado v. Superior Court of Sacramento County*

Mexican citizens sued California residents in California for wrongful death of a Mexican citizen in a California automobile accident.<sup>29</sup> The court held that Mexico had no interest in applying its damage limitation rule,<sup>30</sup> which was intended to protect Mexican defendants. Moreover, California had an interest in deterring wrongs in the state as well as in protecting survivors of decedents.<sup>31</sup> As a consequence, the California forum should apply its own damage rule.<sup>32</sup>

Under our approach, the court reached the right result (place of the tort) for the wrong reason (interest analysis). The court's reasoning matters because application of the same reasoning could produce the wrong result—application of California law to the death of a Californian in a Mexican accident. This would therefore prevent any effective competition among states regarding damage limitation. For example, under our approach, Mexico could apply low personal injury ceilings to local accidents in order to encourage tourism. Though this idea was derided by Symposium participants,<sup>33</sup> jurisdictions should be able to compete on this basis as long as the costs and benefits of the rule are brought to bear on the participants in the political process that enacts the law. The idea of a competition may seem far-fetched in the *Hurtado* scenario, but the same choice-of-law rule would promote competition in the more realistic context of, for example, the location decision of a firm that engages in repeated litigation.

*C. Rosenthal v. Warren*

A New York citizen sued, in the federal court in New York, a Massachusetts hospital and surgeon who had a worldwide practice.<sup>34</sup> The court refused to apply a Massachusetts damage limitation in

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29. 522 P.2d at 668.

30. *Id.* at 670.

31. *Id.* at 671.

32. *Id.* at 670-71.

33. See Transcript, *supra* note 2, at 718-19.

34. 475 F.2d at 439.

wrongful death cases,<sup>35</sup> and this was upheld on appeal.<sup>36</sup> The court, applying New York conflicts law and after reviewing the case law, including that dealing with guest statutes, concluded that “the strong New York public policy against damage limitations has triumphed over the contrary policies of sister states in every case where a New York domiciliary has brought suit.”<sup>37</sup> Although Massachusetts was both the place of tort and place of contract, the court said that “[i]t is thus impossible to say with any certainty what the parties’ actual ‘expectations’ as to choice of law were.”<sup>38</sup> The parties’ conduct was not “patterned upon the Massachusetts death limitation,”<sup>39</sup> the insurance policy had no locality limitation,<sup>40</sup> and the doctor and the hospital attracted a worldwide clientele.<sup>41</sup> In any event, the court dismissed as irrelevant any expectations the parties might have had, stating that the “contractual type of approach to multistate tort problems has been ‘summarily rejected by the New York Court of Appeals.’”<sup>42</sup> Instead, the court held that New York’s interest in protecting its domiciliaries would outweigh any interest Massachusetts had in the outmoded approach to limiting damages for all wrongful death in malpractice and all other types of tort cases.<sup>43</sup> Nor was Massachusetts’ interest sufficient to compel New York to recognize it as a matter of full faith and credit.<sup>44</sup>

Under our approach this type of case presents some difficulty. Given the parties’ direct dealings and the contractual nature of malpractice, this is not clearly a tort case, as the court assumes, but rather a hybrid of tort and contract. But this particular case is easy because the place of tort and the place of contract are the same.<sup>45</sup> Instead of being irrelevant as the court suggests, *ex ante* expectations should be the key to solving the conflicts problem.<sup>46</sup> As noted above, the place-of-contract rule most readily gives notice of the applicable law at the outset of the

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35. *Id.* at 438.

36. *Id.* at 443.

37. *Id.*

38. *Id.* at 444.

39. *Id.*

40. *Id.*

41. *Id.*

42. *Id.*

43. *Id.*

44. *Id.* at 446.

45. *Id.* at 440.

46. Expectations are also potentially relevant to the defendant’s ability to insure. See Transcript, *supra* note 2, at 707. As the court pointed out, defendants had a national clientele and, apparently, a national insurance policy. However, the type of policy, and accordingly the cost of insurance, might have been dictated by the uncertainty of the conflicts rule.

parties' dealings. Although the parties presumably are equally able to determine the law of each party's domicile, or of the forum, or of where the contract is to be performed, once interest analysis departs from a place-of-contract rule the parties cannot know in advance which of these various laws will be applied. The parties can agree to a choice-of-law clause, but this is not a complete solution even if the parties are sure the clause will be enforced because whether the costs of negotiating and contracting for the clause are justified depends on the default rule.

This case illustrates the potential advantages of promoting competition. The wrongful death limit, instead of being an anachronism as the court assumes, may reflect a victory of defense-oriented interest groups, such as doctors, against plaintiff interests, particularly including the plaintiffs' bar. By contrast, the New York rule may represent the opposite outcome.<sup>47</sup> But neither rule is clearly efficient. Rather, the efficient outcome is most likely to emerge from a competition between the rules fostered by the appropriate choice-of-law rule.

#### V. CONCLUSION

Interest analysis, viewed in the light of contemporary public choice theory, is far from the "modern" approach its advocates claim. Rather, analyzed in light of modern public choice theory, it can be seen to promote a perverse sort of jurisdictional competition that results in inefficient rules. We would substitute rules based loosely on the *First Restatement* that promote an efficiency-maximizing form of jurisdictional competition. The cases discussed in this Symposium demonstrate the weakness of interest analysis and the strengths of our approach. In this case, it is the old ways that work best.

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47. These conclusions would, of course, have been clearer if the damage limitation had applied only to malpractice actions.