Private or International? Two Economic Models for Private International Law of Torts

Ralf Michaels
Duke University Law School

Follow this and additional works at: http://lsr.nellco.org/duke_fs

Recommended Citation
http://lsr.nellco.org/duke_fs/18

This Article is brought to you for free and open access by the Duke Law School at NELLCO Legal Scholarship Repository. It has been accepted for inclusion in Duke Law School Faculty Scholarship Series by an authorized administrator of NELLCO Legal Scholarship Repository. For more information, please contact tracy.thompson@nellco.org.
Private or International?
Two Economic Models for Private International Law of Torts
Ralf Michaels*

I. INTRODUCTION ................................................................. 2

II. TWO PARADIGMS AND TWO MODELS ............................... 5
   A) THE PRIVATE/INTERNATIONAL DISTINCTION ...................... 6
   B) THE PRIVATE LAW PARADIGM.............................................. 12
   C) THE INTERNATIONAL LAW PARADIGM ................................. 14
   D) THE IMPACT OF INTERNATIONAL LAW ON PRIVATE LAW ...... 17
   E) SUMMARY ......................................................................... ERROR! BOOKMARK NOT DEFINED.

III. FIRST PROBLEM: LOCUS DELICTI OR COMMON DOMICILE? ...... 18
   A) THE DEBATE IN PRIVATE INTERNATIONAL LAW .................. 19
   B) ECONOMIC ANALYSIS UNDER THE PRIVATE LAW PARADIGM ........ 20
   C) ECONOMIC ANALYSIS UNDER THE INTERNATIONAL LAW PARADIGM .... 24
   D) THE IMPACT OF THE COMMON DOMICILE EXCEPTION ON SUBSTANTIVE LAW .... 26

IV. SECOND PROBLEM: PARTY AUTONOMY ................................ 26
   A) THE DEBATE IN PRIVATE INTERNATIONAL LAW .................. 27
   B) ECONOMIC ANALYSIS UNDER THE PRIVATE LAW PARADIGM ........ 29
   C) ECONOMIC ANALYSIS UNDER THE INTERNATIONAL LAW PARADIGM .... 34
   D) THE IMPACT OF PARTY AUTONOMY ON SUBSTANTIVE LAWS ........... 37

V. THIRD PROBLEM: CROSS-BORDER TORTS .............................. 38
   A) THE DEBATE IN PRIVATE INTERNATIONAL LAW .................. 39
   B) ECONOMIC ANALYSIS UNDER THE PRIVATE LAW PARADIGM ........ 40
   C) ECONOMIC ANALYSIS UNDER THE INTERNATIONAL LAW PARADIGM .... 46
   D) THE IMPACT OF CROSS-BORDER TORT RULES ON SUBSTANTIVE LAWS .... 49

VI. BRINGING THE PRIVATE AND THE INTERNATIONAL TOGETHER 53
   A) RELATIONS BETWEEN THE MODELS............................... ERROR! BOOKMARK NOT DEFINED.
   B) THE IMPACT OF CHOICE OF LAW ON SUBSTANTIVE LAW ............ 58

VII. CONCLUSION ........................................................................ 58

*  Associate Professor, Duke University School of Law; Lloyd Cutler Fellow, American Academy in Berlin (Fall 2005), Michaels@law.duke.edu. Many thanks for extremely valuable suggestions are due to Giesela Rühl.
I. Introduction

Private international law is generally considered a discipline in dire need of a methodological approach. There is an amazing discrepancy between different approaches to choice of law between the United States and the rest of the world\(^1\), but also within the United States\(^2\), as well as within Europe, as the debate between traditional conflict of laws and the country of origin principle shows\(^3\). Widespread agreement only exists, at least among outsiders, that private international law does a poor job at leading to good and predictable results. In the United States, critics point out that judges do what they want. In Europe, critics argue that private international law rules are technical and arbitrary. Some criticisms of traditional choice of law are economic in nature. The forum law preference in the United States is said to lead to inefficient forum shopping and plaintiff-favoring laws, the traditional choice of law rules in Europe clash with the ideal of a common market, promoted by the country of origin principle.

Can law and economics bring more scientific, objective foundations? After a slow start\(^4\), interest in the economics of choice of law has risen sharply. We now have a whole book\(^5\) as well as contributions to two encyclopedias\(^6\) and a whole number of law review articles\(^7\). Almost all of them are normative\(^8\) and efficiency-oriented\(^9\), they set out to yield

---

criteria for better, more efficient, conflict of laws norms. But alas, the existing studies already show discrepancy of views or economic approaches that mirrors the discrepancy in the doctrine\(^{10}\). Some authors focus on individual interests, others on state interests. Some authors emphasize formal issues (predictability for parties, regulatory advantages for states), others on substantive issues (optimal incentives for parties, maximizing governmental interests). Some favor cooperation between states to overcome regulatory prisoners’ dilemmas, others favor regulatory competition to overcome national peculiarities. In short, the normative proposals from the science of economics differ as widely as those from traditional doctrine.

It is unlikely that the differences in result should be caused exclusively by flawed economics, or by different factual assumption\(^{11}\) (although both are no doubt present in some analyses). Rather, at least in part, different outcomes are likely results of different paradigmatic models chosen by different authors. The formulation of the question would then be determinative for the answer; different answers would be the consequence from different questions asked. The differences in the economic analysis of private international law would replicate the differences in doctrinal conceptions of private international law\(^{12}\). Rather than resolve problems of private international law, economic analysis would reformulate them.

If this hypothesis is plausible, it does not follow that an economic analysis has no role to play in private international law. Quite to the contrary, the economic analysis then provides a useful heuristic on private international, both on the importance of deciding for one or the other paradigm, and on the plausibility of arguments within each paradigm. What we should doubt, however, is that economics alone can provide directly translatable prescriptions for private international law norms.

This article is devoted to the economic analysis of private international law in one area, namely tort law. Tort law is interesting for an economic analysis for various reasons:

---

8 For a positive and empirical analysis see Michael E. Solimine, *An Economic and Empirical Analysis of Choice of Law* (supra n. 7)

9 For critique (and an alternative approach) see Christian Kirchner, *An economic analysis of choice of law and choice of forum clauses*, in this volume, ___.


11 The importance of empirical studies (albeit limited to actual behavior of judges, lawyers, and litigants) to back up analyses is emphasized by Solimine, *The Law and Economics of Conflict of Laws* (supra n. 5), 218 f.

First, no area of private international law has seen more turmoil and changes than the law of torts, few rest on less stable foundations today. Second, tort law stands on the borderline between (public) regulatory interests of states and (private) individual interests in private ordering. Finally, party autonomy, a favorite tool in law and economics, has a necessarily reduced role to play in the area of tort law (although an economic analysis may well suggest broader applications than currently accepted by doctrine.)

The first object of this article is to provide an analysis of three particular questions in the private international law of torts – the common domicile exception to lex loci, party autonomy, and cross-border torts – from an economic perspective. I will focus on efficiency, despite the intrinsic problems with the concept as a normative goal\(^\text{13}\), because most other studies do. I ignore questions of jurisdiction, and I assume that substantive laws of states are not openly discriminatory against foreigners\(^\text{14}\). Private international law norms act as independent variable in this analysis\(^\text{15}\). Normative implications are such as to guide a global legislator passing private international law norms, obviously a counterfactual institution on the global scene, but a realistic possibility for example in the European Union. Although the analysis is detailed, the point is to provide plausible economic considerations and arguments for a legal debate rather than full-fledged abstract economic models. As a consequence, my economic arguments, like those of most other authors in the field, are non-formal and methodologically somewhat eclectic.

This article differs from others however insofar as I make arguments on each of these questions not within one but within two economic paradigms, a private law paradigm and an international law paradigm. This relates to the second object of this article. I want to test the hypothesis that different paradigms lead to different outcomes, that the different results within different economic paradigms are congruent with the different views within traditional doctrinal private international law, and that therefore the debate whether private international law is “private” or (public) “international” law, is replicated in the economic analysis of private international law, and. If this is so, it suggests that the choice of one paradigm or another cannot only be justified in passing in a short introduction, as is the case in many economic analyses. Rather, for a robust normative analysis, this choice must be central to an economic analysis.

These two objectives determine the structure of this article. I first present the debate between a private and an international law paradigm in doctrine and economics (II.a), and


\(^{15}\) For positive analysis of the development of private international law see Solimine, An Economic and Empirical Analysis of Choice of Law (supra n. 7) (arguing that interest analysis enables states and interest groups to incorporate more plaintiff-friendly and forum-citizen-friendly laws); see also Stewart E. Sterk, The Marginal Relevance of Choice of Law Theory, 142 U. PA. L. REV. 949 (1994) (arguing that judges will ignore choice of law approaches and instead focus on substantive considerations in deciding cases).
present two economic models of private international law: a private law model (II.b), and an international law model (II.c). A third model extends the international law model and accounts for incentives from private international law norms not only for individuals, but also for state legislators (II.d). I then analyze three different questions of private international law in tort – the common domicile exception to lex loci (III), party autonomy (IV), and cross-border torts (V). I do so, for each problem, from four perspectives, using the models introduced in II. After summarizing the debate in traditional doctrine (a), I provide an economic model based on a private law paradigm (b), an economic model based on an international law paradigm (c), and finally an economic analysis that looks at the incentives of choice of law rules on the substantive legislation of states (d). Finally, I analyze the relationship between the two models, first the connections – overlap of result, compromise between both paradigms, sublation (VI.a) – and then the impact of one on the other (VI.b), before I offer some conclusive remarks on the potential of law and economics for private international law (VII).

II. Two Paradigms and Two Models

Choice of law is a peculiar subject for an economic analysis, for various reasons. First, economic analysis and choice of law have a lot of similarities. Both are meta-disciplines; they do not regulate, but instead provide tools to decide which of a variety of legal rules should be chosen, applied. In this sense, economic analysis could be one method of choice of law: the applicable law should simply be the most efficient law, as Leflar’s “better law approach” indeed postulates16. Somewhat surprisingly, authors on the economics of private international law usually reject the approach out of hand17.

Secondly, private international law can be the object of economic analysis. This requires some adaptation of the economic method18. Traditionally, economic analysis usually tries to find the optimal solution within a framework, within one legal order (whether domestic law or international law). Choice of law on the other hand, understood as a (hypothetical

---


17 See e.g. Trachtman, Economic Analysis of Prescriptive Jurisdiction (supra n. 7), 42; O’Hara & Ribstein, From Politics to Efficiency (supra n. 7) 1178 f.; Whincop & Keyes, POLICY AND PRAGMATISM (supra n. 5), 21 f. (generally), 90 (with regard to tort law); Peter Mankowski, Europäisches Internationales Privat- und Prozessrecht im Lichte der ökonomischen Analyse, in: CLAUS OTT & HANS-BERND SCHÄFER (EDS.), VEREINHEITLICHUNG UND DIVERSITÄT DES ZIVILRECHTS IN TRANSNATIONALEN WIRTSCHAFTSRÄUMEN, 118, 127 f. (2002). But see Kramer, Rethinking Choice of Law (supra n. 7), 339; Guzman, New Foundations (supra n. 7), 898 f. (establishing “the globally efficient substantive law” as the goal); Solimine, The Law and Economics of Conflict of Laws (supra n. 5), 215 (arguing that the emphasis on efficiency in economic analyses of choice of law suggests a better law approach).

universal) meta-law, is not situated within any such framework\textsuperscript{19}; it transcends substantive law. This leads to a problem: If economic analysis looks for efficiency, the question is how that efficiency should be defined. Is it domestic efficiency between the individuals of each society? Is its efficiency between all societies? Or is it global efficiency between all individuals worldwide? These problems for an economic analysis can be understood from an analysis of what choice of law, or private international law, actually is.

\textbf{a) The Private/International Distinction}

Private international law can be conceived as an extension of private law or of international law. The dichotomy is not a pure one; rather, three kinds of relation between the private and the international model are possible: overlap, compromise, and sublation (i). The same is true for the economic analysis. Similarly, economic models of private international law can be based on a private law paradigm or an international law paradigm (iii). Finally, both paradigms can be combined in a model in which state substantive laws are dependent variables (iv).

\textit{i) Private International Law: Private or International?}

Private international law has traditionally been hard to situate between private law on the one hand and (public) international law on the other\textsuperscript{20}. European law, at least since Savigny\textsuperscript{21}, has been dominated by a private law conception\textsuperscript{22}; a brief flirt with more public law inspired approaches in the seventies\textsuperscript{23} has, on this level, been largely

\textsuperscript{19} Siehr, \textit{Ökonomische Analyse des IPR} (supra n. 4), 270.


\textsuperscript{22} Gerhard Kegel & Klaus Schurig, \textit{INTERNATIONALES PRIVATRECHT} § 1 V, p. 23 f. (9th ed., 2004).

ineffective. This conception of private international law is not “merely formalist”, as opponents sometimes claim. Europe has its own kind of “interest analysis”\(^\text{24}\). But the interests that are analyzed are largely individual interests\(^\text{25}\); state interests in substantive policies are relatively unimportant. On the other hand, US conflict of laws traditionally focuses on the conflict of laws as the conflict of sovereigns, who want their own laws to be applied. This is an international law conception, focusing on interests of states. The reason for applying foreign law is here frequently comity, an obscurely antiquated kind of politeness that one sovereign accords another sovereign\(^\text{26}\). The relevant criterion to determine the applicable law is the governmental interest, the relative weight of respective governments’ interest in having their own laws applied.

Of course, real world approaches to conflict of laws are neither fully private nor fully international. We see three types of relations: overlap, compromise, and sublation.

First, there is an overlap between “private” and “state” interests: Private and international models may suggest similar solutions, and some considerations can be seen as private and state interests at the same time. For example, Kegel and Schurig argue that the “interest in order” (\textit{Ordnungsinteresse}) in consistent application of law is both an interest of the state and of individuals\(^\text{27}\). As a consequence, both private and international law conceptions of private international law frequently reach similar results.

Secondly, the divergence between models does not necessitate a strict dichotomy. Real world methods are compromises. Even predominantly private or predominantly international conceptions allow, exceptionally, for other interests. Thus, in German private international law state interests do play a role, even if that role is limited\(^\text{28}\). In particular, the theory of internationally mandatory laws has a strongly international / public law flavor. On the other hand, most approaches in the United States do not follow a pure governmental interest approach, but allow also for the consideration of private interests. The Second Restatement, the dominant approach in US conflicts law, provides

\begin{quote}
\textit{Richtlinienkollisionsrechts – “Amerikanisierung” des Gemeinschafts-IPR?}, 12 \textsc{Europäisches Wirtschafts- und Steuerrecht} 301 (2001) (for relations with third states); Michaels, \textit{EU Law as Conflict of Laws} (supra n. 3) (for relations between member states).
\end{quote}

\textsuperscript{24} The foundational article is Gerhard Kegel, \textit{Begriffs- und Interessenjurisprudenz im IPR}, in: \textsc{Festschrift Lewald}, 259 (1953); see also id., \textit{The “Crisis” of Conflict of Laws}, 112 \textsc{Rec. des Cours}, 91 (1964-II); Klaus Schurig, \textit{Kollisionsnorm und Sachrecht} (1980).

\textsuperscript{25} Kegel & Schurig, IPR (supra n. 22), § 2 II, pp.134 ff.; Christian v. Bar & Peter Mankowski, I \textsc{Internationales Privatrecht}, § 1 no. 12 (2003); Axel Flessner, \textit{Interessenjurisprudenz im IPR} (1990) (cf. the critique by Klaus Schurig, \textit{Interessenjurisprudenz contra Interessenjurisprudenz im IPR - Anmerkungen zu Flessners Thesen}, 59 \textsc{Rabelsz} 229 [1995]).


\textsuperscript{27} Kegel & Schurig, IPR (supra n. 22), § 2 II 3.

\textsuperscript{28} Kegel & Schurig, IPR (supra n. 22), § 2 IV; Jan Kropholler, \textsc{Internationales Privatrecht}, § 5 I.1, p. 31 f. (4\textsuperscript{th} ed. 2001).
an eclectic mixture of public and private concerns with no clear guidelines for their relative weight\textsuperscript{29}. 

Finally, we see sublation of the distinction between a private law paradigm and an international law paradigm. Given that the distinction between private and public law is problematic even in domestic law, it is doubtful whether it can be upheld at all in private international law, given that the discipline is intrinsically both private and international\textsuperscript{30}. Rather, one approach can be translated into the other and vice versa. On the one hand it is possible to translate all private interests into state interests, provided we are ready to see governmental interests as the interests in furthering a particular state’s conception of justice between individuals. For example, US cases occasionally propose state interests that somehow trump substantive law state policies in the interests of individuals, for example the interest of states in being good market places\textsuperscript{31}. The European Court of Justice argued in its Ingmar decision that the mandatory application of European rules about indemnification of commercial agents was required by a common market (a public interest)\textsuperscript{32}, but of course all differences in private law will ultimately have some relevance for the market\textsuperscript{33}. On the other hand we can translate all state interests into private interests, provided we are ready to see the furtherance of private interests as the function of the state. This underlies the debate about whether Art. 7(2) of the Rome I Convention protects private rights, or only public interests\textsuperscript{34}.

It is clear that the choice between a “private law” and an “international law” conception of private international law is not a decision that determines, directly, the answers to specific questions in the field. Within each model numerous differentiations are possible, neither is inherently consistent. At the same time the distinction is not irrelevant. Whether we start from a private law paradigm or an international law paradigm (or a paradigm somewhere between the two) determines the relation between rule and exception, and it determines the kind of arguments to be used and their respective force in legal argument.

\textbf{ii) Economics: Welfare of States or Individuals?}

Do we see the same dichotomy, and the same set of relations – overlap, compromise, sublation – in economics? We might hope that economic analysis could help us with this conundrum. In a way, the public/private distinction should play no role for the economic

\textsuperscript{29} For critique see e.g. William A. Reppy Jr., Eclecticism in Conflict of Laws: Hybrid Method or Mishmash?, 34 MERCER L. REV. 645, 655 ff. (1983)

\textsuperscript{30} Supra n. 20; see also v. Bar & Mankowski, I IPR (supra n. 25), § 4 no. 83.

\textsuperscript{31} Cf. e.g. Lilienthal v. Kaufman, 239 Ore. 1, 25 (1964): “the policy of both states, Oregon and California, in favor of enforcing contracts, has been lost sight of in favor of a questionable policy in Oregon” (Goodwin, diss.).


\textsuperscript{34} See v. Bar & Mankowski, I IPR (supra n. 25), § 4 no. 89-98 with numerous references. The authors argue for restricting Art. 7 to public interests.
analysis (of private law), if only because of the particular assumptions with which it brings private and public together: Private law rules can be seen as public regulation that gives parties incentives for efficient conduct. Thus, on the one hand economic analysis focuses on the interests of individuals, given that its core actor is the rational agent. On the other hand, economic analysis, at least in its prescriptive variant, has a place for the public, in that its goal is the maximization of social welfare. Public and private interests are combined. On the one hand, the relevant public interest is the maximization of the sum of private interests. On the other hand, private interests are relevant only insofar as their fulfillment enhances social welfare. Legal rules should set incentives so that individual actors, by pursuing their own interests, also maximize the common good. From this perspective, tort law, to stay with the topic of this paper, contains both private and public aspects: Insofar as its rules are not the results of agreement between individuals, tort law belongs to the area of public ordering. On the other hand, insofar as tort law assigns liability for voluntary acts, it can be seen as belonging to the area of private ordering.

Yet once we apply economic analysis to private international law, the problem we have seen in traditional doctrine reappears, the problem of whether a private law or an international law paradigm is appropriate. Even if we agree that economic analysis focuses on the incentives rules create for the conduct of rational agents and on the overall sum of benefits and losses to these agents, the question remains: who are the agents whose interests are to be maximized? States or individuals? For a private law paradigm the answer seems clear: an economic analysis of private international law should focus on individuals as rational agents, and set choice of law rules so as to give the optimal incentives to these individuals, in order to maximize global social welfare, defined as the sum total of all individual benefits. Different legal regimes only appear as different private law regimes that can be tested for their efficiency, and choice of law rules must be shaped so as to enable parties to minimize their costs while maximizing their benefits. For those who see the conflict of laws as an extension of public international law, studies will focus on interests of and incentives for states in enforcing and shaping their laws. Indeed, most studies on the economic analysis of (public) international law, at least in the United States, are based on a Realist perspective in which states are the only

---


37 See, e.g., Whincop & Keyes, *Policy and Pragmatism* (supra n. 5), 4 (with a nominalist argument: “as befits private law, we emphasize parties and party interests”); O’Hara & Ribstein, *From Politics to Efficiency* (supra n. 7), 1152.

relevant actors. In this paradigm, choice of law rules must be shaped so as to enable states to maximize their interests. Finally, it is possible to combine both approaches and to focus on incentives for states in order to maximize global efficiency for individuals. Such an analysis would have to look at the incentives created by conflict of law rules for states as legislators of substantive rules.

But is it appropriate or even possible to look at states instead of individuals as rational actors? Is this in accordance with the credo of (classical and neo-classical) economics, “methodological individualism”? How can it be that for example an author like Trachtman simultaneously endorses methodological individualism and focuses on states as actors? This question entails two answers, one theoretical (is it possible to create a model in which states are rational actors?), one practical (is such a model appropriate?)

The question on the level of modeling is easier to answer. It is obviously possible to focus on states as actors. This is so because it is irrelevant for a model whether its variables are accurate descriptions of their real life counterparts, as long as it is possible to attribute the actions relevant for the model to these variables. We frequently speak of the actions of “states”, and the policies and interests of states (as incorporated in their laws), although we know that states do not really act as individuals and do not really have interests of their own. The assumption of states as monolithic actors is then a simplifying assumption like other simplifying assumptions in economic analysis. For example, economic analysis frequently treats firms as individuals although they are not individuals. States are different insofar they are not under the same kind of competitive pressure, but they are similar insofar both firms and states are incapable of building preferences of their own.

The more pertinent question is whether a model that focuses on states as actors can ever be appropriate. This is a crucial question, and I will get back to it towards the end. For now, five considerations suggest that such a model should not be rejected a priori, at least for private international law. First, private international law deals with the conflict of laws between states. In other words, its objects are laws, and the actors who are assumed to have caused these laws are states. Conceiving of states as monolithic actors for an economic model does not seem inappropriately simplistic because the same

39 Sykes, The Economics of Public International Law (supra n. 38), Sec. 3.A “States as Rational Actors”.

40 Methodological individualism was a cornerstone especially of the Austrian and Chicago schools of economics; in the form of “new institutional economics”, it has also entered the study of institutions. This does not mean that methodological individualism is universally followed by economists studying institutions.

41 Joel Trachtman, The Methodology of Law and Economics in International Law, 6 INTERNATIONAL LAW FORUM DU DROIT INTERNATIONAL 67 (2004). For Trachtman’s own explanation see id., Economic Analysis of Prescriptive Jurisdiction (supra n. 7), 21 (2000): “Even an approach based on methodological individualism must recognize that individual preferences are sometimes (in fact, often) expressed through the state.” Of course, this is where new institutional economics picks up; see supra n. 40.

42 Sykes, The Economics of Public International Law (supra n. 38), sec. 3.A “States as Rational Actors”.
simplification occurs in private international law, too. Private international law norms designate the law of a state, not the views of the legislator versus those of the courts, etc. A second point is connected to the first one: The main normative criticism against a concept of the state as a monolithic actor comes from the theory of public choice: Legislation and adjudication in the name of states are really carried out by individuals with special interests and under special influence from certain subgroups of society. In other words, individuals acting in the name of the state do not properly represent the interests of its people. This may well be true. But arguably, this is a problem of substantive law that is not enhanced by private international law, and it is one that should be left to the economic analysis of lawmaking. It may thus be justified to assume that laws define the maximization of domestic social welfare. (A separate question is the impact of public choice considerations on the formulation of choice of law rules by the states; this question is not addressed here, because choice of law rules are treated as independent variables). Thirdly, in a world with imperfect information we might work from an assumption that states have the best abilities to determine (domestically) efficient rules for individuals. State preferences can then be used as proxies for sums of individual interests within one state. Fourthly, while law and economics may postulate that overall social welfare maximization should trump all other public considerations, actual substantive laws do effectuate other considerations than the maximization of social welfare, and these other considerations are responsible for a number of differences between the laws of different countries which in turn are the object of private international law. This leads to a fifth consideration. In democratic states such

---

43 Cf. for a comparable point Joel P. Trachtman, *Economic Analysis of Prescriptive Jurisdiction* ( supra n. 7), 21, 77: “[I]f choice of law and prescriptive jurisdiction is not about governmental preferences, then it is not about law, as law is the expression of governmental preferences”.


46 Cf. Trachtman, *Economic Analysis of Prescriptive Jurisdiction* ( supra n. 7), 16

47 Cf. Guzman, *New Foundations* ( supra n. 7), 896.


49 Trachtman, *Economic Analysis of Prescriptive Jurisdiction* ( supra n. 7), 5 f. It may well be that regulatory competition is a superior discovery mechanism for efficient rules. The point here is only one about plausibility.

preferences rest, presumably, on the voters’ decisions. Public choice can account for imperfections in the democratic process, but it is not normally used to deny the legitimacy of democratic lawmaking altogether. Rather, the enforcement of democratically enacted laws may in itself be considered a relevant factor in an efficiency analysis even between individuals.

**b) The Private Law Paradigm**

We have seen that economic analysis of private international law can take place within two different paradigms, a private law paradigm and an international law paradigm. The relevant considerations for the analysis depend on the relevant considerations within each of these paradigms. In a private law paradigm, private international law of torts is an extension of substantive tort law. Therefore, this section first sums up some basic insights from economic analysis of tort law (i) and then looks at its implications for private international law (ii).

**i) Basic Economics of Tort Law**

Tort law, from the perspective of welfare economics, is not concerned with preventing “wrongful” behavior in any moral sense, but rather with welfare maximization. In his seminal 1970 study on “The costs of accidents”, Guido Calabresi recognized the reduction of costs as one of two primary goals of accident law (the other being justice). Reduction of costs means reduction of “the sum of the costs of accidents and the costs of avoiding accidents”, thus suggesting that the avoidance of accidents, because in itself costly, is not the only goal of the law, but rather only desirable when its costs do not outweigh its benefits. Reduction of accident costs as a goal includes three subgoals. The first subgoal is the reduction of “primary” accident costs. These are the costs to victims from accidents that take place, but also the costs to injurers from exercising care in order to avoid accidents. A second subgoal is the reduction of “secondary” costs, notably by risk spreading. Finally, a third subgoal is the reduction of “tertiary” costs, the costs of administering the treatment of accidents (which includes the costs of effectuating the primary and secondary goals). These costs are calculated on a global scale, meaning that costs to individual A may be outweighed by benefits to individual B; the relevant criterion is Kaldor/Hicks efficiency.

---

Cf. O’Hara & Ribstein, *From Politics to Efficiency* (supra n. 7), 1155


Guidabesi, *THE COST OF ACCIDENTS* (supra n. 53), 226 ff., 73 f.
How are these goals achieved from a welfare economics perspective? With regard to primary costs, rules of tort law should set incentives through liability rules so that parties (both injurers and victims) engage in conduct insofar as it is beneficial (because social benefits are higher than its social costs) and refrain from conduct insofar as it is not (because social benefits are lower than its social costs). Regarding secondary costs, arising especially from risk awareness (and a consequent desire to spread risks), the issue of insurance becomes relevant. Because insurance lies outside the area of tort law, secondary costs will be neglected in this article. Finally, with regard to tertiary costs, liability rules, even if they set the optimal incentives in the abstract, may nonetheless be inefficient if the cost of their administration is so great that either private parties do not bring suits that would be beneficial and injurers therefore engage in moral hazard, or if such suits are brought but their costs are higher than the benefits they provide. An efficient liability regime reduces the sum of primary, secondary and tertiary costs, but conflicts between these goals are possible.

ii) Consequences for Private International Law

A private law paradigm of an economic analysis of private international law will apply these considerations to the design of choice of law rules. Private international law rules should do two things: they should reduce the costs of accidents, and they should enable individuals to coordinate their conduct.

Regarding primary costs, the multistate situation provides a plurality of potentially applicable laws. The applicable law will be determined with two considerations. The first consideration is similar to that in substantive law: Which law is best at reducing costs, which law is the “better law”? Social welfare can no longer be calculated with regard to one national economy, especially if the parties come from different countries, but this poses no big problem: Because for a private law paradigm focusing on individuals national economies should be irrelevant, the goal is maximization of global social welfare. It does not matter much whether the parties are from the same state and litigate over an accident that took place in that state, or whether the injurer is from Germany, the victim from Japan, and the accident happened in the United States. A problem exists however because in a multistate situation different laws may be efficient for different contexts, regional peculiarities, etc. This can be the case because different societies have different preferences, or because different levels of care are efficient for different territories. This suggests that, ceteribus paribus, the most efficient law in a given situation will be the law passed by the legislator with a regulatory advantage.

---

57 Cf. Schäfer & Ott, ÖKONOMISCHE ANALYSE (supra n. 55), 140 f.
58 Kramer, Whincop & Keyes, POLICY AND PRAGMATISM (supra n. 5), 3 (“the policies that underlie what we think of as ‘substantive’ private law areas should, where suitable, inform the private international law rules that apply in these areas.”), 89 ff. (for non-market torts).
59 Already Siehr, Ökonomische Analyse (supra n. 4), 274.
60 See e.g. Shavell, ECONOMIC FOUNDATIONS (supra n. 50), 202 f., 205 f.
61 Richard A. Posner, ECONOMIC ANALYSIS OF LAW (supra n. 201), § 21.17, pp. 602-603 (6th ed., 2003); for discussion see Solimine, An Economic and Empirical Analysis of Choice of Law (supra...
The second consideration refers to predictability. If we assume perfect information, parties will know in advance which law will apply and what the content of that law is, they can then adapt their conduct accordingly. If however we assume that information is costly to obtain, then primary costs will be reduced if the applicable law is easy to predict, because individuals can adapt their conduct to the applicable laws and exercise the optimal level of care at lower costs. Predictable rules also help reduce tertiary costs. They reduce the post-accident costs of determining the applicable law, reduce the costs of litigation, and thereby enable victims to bring claims they are entitled to, and enable injurers to defend themselves against unfounded claims at lower costs.

In short, for this paradigm the most important consideration is predictability of the applicable rule – ex ante so parties can optimize their conduct vis-à-vis the incentives from the applicable tort rules, and ex post, so parties can settle in the shadow of a defined law, or can litigate matters of substantive law without regard to the choice of law rules, and courts do not face substantial additional costs. Not surprisingly, party autonomy is the preferred instrument even beyond its traditional application to private international law of contracts. Where party autonomy is unsuitable, proponents of private law paradigms often propose the easily predictable lex loci delicti rule. This high emphasis on predictability is in accordance with goals of traditional methods of choice of law, both in the United States and in Europe (although there, typically, the emphasis is less exclusive). Policy considerations that led to the demise of lex loci delicti in the United States and, to some extent, in Europe, have little influence on this paradigm because regulatory state interests are considered nonexistent, irrelevant, or even presumably pernicious.

**c) The International Law Paradigm**

**i) Basic Economics of International Law**

Structurally, the economics of international law look very similar to the economics of private law (just as international law in its early formulation by Grotius looked very similar to, and was in fact based on, private law). The economic analysis of international law also assumes that actors are rational in the sense that they maximize their own

---

62 Whincop & Keyes, POLICY AND PRAGMATISM (supra n. 5), 91 f.
64 Whincop & Keyes, POLICY AND PRAGMATISM (supra n. 5), 5 f. (general), 78 ff. (for “market torts”); id., 25 Austral. J. Leg. Phil. 1, 17-22 (2000); O’Hara & Ribstein, FROM POLITICS TO EFFICIENCY (supra n. 7), 1186 ff. (general), 1210 ff. (for “market torts”).
65 Whincop & Keyes, POLICY AND PRAGMATISM, (supra n. 5), 97 ff.; O’Hara & Ribstein, FROM POLITICS TO EFFICIENCY (supra n. 7), 1216-1218.
66 See, e.g., Kegel & Schurig, IPR (supra n. 22), § 2.II.3.c, p. 143 (predictability only one among many interests); for a short analysis of the tension between predictability and fairness see Kropholler, IPR (supra n. 28), § 4 IV, pp. 29-31.
utilities; its normative goal is efficiency, and the instrument to achieve it consists in rules that set optimal incentives for the actors or that mimic contractual agreements between them, so that they engage in welfare-enhancing and refrain from welfare-reducing conduct.

Despite the structural similarities, the model must play out quite differently when applied if the relevant actors are not individuals but states. Individuals may be assumed to form preferences prior to their interaction with others (although this assumption may be counterfactual)\(^{67}\) and therefore maximize their own utilities. States can also be modeled as rational in the sense that they care about their own costs, welfare and interests, and not those of other states. But what are state preferences, and what do states maximize in private international law? Three answers are offered. The first: States do not want to maximize anything, but they want to minimize the costs of regulation. The efficient choice of law solution is then the one that designates the law of the state with a regulatory advantage to be applicable. This concept underlies Richard Posner’s concept of regulatory advantage: the applicable law should be the law of the state that can regulate most efficiently\(^{68}\). A second answer, perhaps the most frequent one, focuses on societies’ welfare and argues that this is what states want to maximize\(^{69}\). Each state is then interested in maximizing benefits and minimizing costs to its own citizens, or to its own economy. A third more complex answer focuses on the effectiveness of states’ own policies as embodied, especially, in their legislation\(^{70}\). In this concept states want to maximize the effectiveness of those laws that they care about, and minimize the effectiveness of foreign laws in situations in which this impairs their own policies. Even when states have policies that are inefficient or even look irrational, these rules become relevant for a global efficiency analysis. Just as an economic analysis of private law will accept individuals’ preferences as given, whether they appear sound or not, so an economic analysis of international law must accept the policies of states as their preferences, whether they appear to make sense or not.

Regardless of the definition of state interests, another important question is whether global efficiency should be defined in terms of Pareto efficiency or Kaldor/Hicks efficiency. Kaldor/Hicks efficiency, already problematic between individuals\(^{71}\), becomes

---

\(^{67}\) This foundation of law and economics has not been without critics; see only, for a philosophical critique, Martha C. Nussbaum, *Flawed Foundations: The Philosophical Critique of (a Particular Type of) Economics*, 64 U. CHI. L. REV. 1197 (1997).


\(^{71}\) Amartya Sen, *On Ethics and Economics*, 33 n. 4 (“it is little consolation to be told that it is possible to compensate [the losers] fully, but [‘good God!’] no actual plan to do so’); Coleman, *The grounds of Welfare* (supra n. 50), 1517 (“That certain states of affairs are potentially Pareto superior has as much bearing on how they should be treated as the fact that I am potentially
more problematic internationally. One reason is that differences both in wealth and in preferences between states are often much larger than within one society\textsuperscript{72}. More importantly, an argument for Kaldor/Hicks in domestic settings is largely unavailable in the international arena. Within one state, the avoidance of distributional questions is sometimes justified with regard to the tax system which is deemed superior for (re-)distribution\textsuperscript{73}. International law however does not operate within a system that enables redistribution through a tax system or some other side payment system from one national economy to the other\textsuperscript{74}. States therefore have no reason to accept rules that are detrimental to them unless they can hope, in the long run, to be compensated for them. Similarly, it is questionable whether a global legislator should be entitled to pass choice of law rules that benefit some states while hurting others.

There is a second reason why Kaldor/Hicks efficiency is a less attractive criterion for multistate situations: States, at least when they are democratic, are accountable to their own citizens. An analysis of international law that forces one society to bear costs so that another society can benefit will not only gain little support within a democratic system, it is also problematic if we assign value to democratic accountability\textsuperscript{75}. What this means is that if states themselves decide about their conflict of laws rules there may be situations in which each state would be justified to apply its own law, because the move to applying a foreign law would leave it worse off. For a global legislator this suggests that choice of law rules stripping a state from jurisdiction to apply its law to a situation in which it is interested can be justified as Pareto efficient only if the state is compensated, either by acquiring the right to regulate other at least equally important situations, or through side payments.

\textbf{ii) Consequences for Private International Law}

What then is the task of choice of law rules in a model that focuses on states as rational agents? Structurally, it is very similar to a private law model: Choice of law should make sure that legislative jurisdiction lies with the state that values it most, and it should help overcome coordination problems between states\textsuperscript{76}. But because states, not individuals, are the relevant actors, the analysis looks quite different from that in a private law paradigm.

First, choice of law rules should maximize the sum of all benefits from the pursuance of government policies. This suggests applying the law of the state that has the regulatory

---


\textsuperscript{73} Shavell, \textit{Economic Foundations} (supra n. 50), ch. 27, pp. 647-660.

\textsuperscript{74} Cf. Guzman, \textit{New Foundations} (supra n. 7), 898 f.


\textsuperscript{76} In addition it should give legislators an incentive to pass efficient rules; this is addressed infra at d).
advantage and/or that cares most about a particular transaction. Because maximization of a state’s welfare is not the same as maximization of global welfare (defined as the sum of all individual utilities), a certain conduct may benefit the overall welfare of state A but reduce the overall welfare of state B. Regardless of whether the conduct is efficient globally (of whether the benefits outweigh the costs), state A will ceteris paribus want to encourage the conduct, state B will want to deter it. In order to be efficient, choice of law rules should make sure that the state that has more to lose from application of the other law (or more to win from application of its own law) will see its law applied. This ensures that transaction costs between states are minimized, because no further agreements between states are necessary to reallocate jurisdiction.

If states are thought only to maximize their own welfare, and if the efficiency criterion is Kaldor-Hicks efficiency, then the results will not be very different from those in a private law paradigm. Global efficiency between state economies will then equal global efficiency between individuals. If the relevant criterion is Pareto efficiency, a mechanism for side payments or redistribution between states must be found. Finally, once we focus on the effectiveness of states’ policies, the questions for private international law become more complex. In cases that affect the policy interests of more than one state (true conflicts), choice of law rules must find a way to make these rules commensurable in order to determine which state has the greatest interest in regulation.

It becomes clear that the most important consideration in this paradigm is not predictability for parties, but rather effectiveness of state policies. (Of course, predictability for parties may be necessary for the effectiveness of state policies, too.) There is a preference in the international law paradigm, as in the private law paradigm, in “private” ordering. But where the actors are states, of course private ordering is achieved not between individuals but between states, through treaties. Outside of treaties, the applicable law can be determined as the result of a hypothetical bargain between states (based on the Kaldor/Hicks criterion for efficiency) or by the forum (based on the Pareto criterion). In the international law paradigm, substantive policies are more important than predictability for individuals, so some authors prefer “muddy” entitlements of jurisdiction.

**d) The Impact of International Law on Private Law**

A variation brings both models together. The overall goal is global efficiency between individuals, but the incentives are not those for parties but instead those for states to pass efficient substantive laws. In this model it is assumed that states are rational in the sense that they pass substantive laws that are efficient domestically though possibly inefficient globally. They pass these laws not in a vacuum, however, but instead in light of the

---

77 Joel Trachtman, _Economic Analysis of Prescriptive Jurisdiction_ (supra n. 7), 34 ff. (2001).

78 Trachtman, _Accuracy in Allocation_ (supra n. 7), 1047 ff.


80 Trachtman, _Economic Analysis of Prescriptive Jurisdiction_ (supra n. ), 45 ff.
applicable choice of law rules. Substantive laws are no longer exogenous factors, but rather dependent variables. Choice of law rules are efficient in such a model if they give incentives to states to pass rules that in turn maximize individual efficiency. In addition to the state-state relation reflected in the state-based model, and the individual-individual level reflected in the individual-based model, we would thus account for the state-individual relation.

Traditional analyses of regulatory competition, if they focus on private international law at all, typically emphasize party autonomy as a tool for competition because it is a cheaper tool for exit than physical relocation. But party autonomy is insufficient for three reasons: First, it may not be available in all circumstances. Tort law is one example: parties will frequently not be able to agree ex ante on the applicable law. Second, party autonomy may not always lead to applicability of the most efficient law. The reason is that parties have no interest in taking third party externalities into account. Thirdly, it is still unclear whether states actually have an incentive to improve their laws in the light of party autonomy. The opposite may well be true: states may have fewer incentives to change their laws if parties can simply opt out of them. A fuller analysis of regulatory competition has to take all choice of law rules into account. It must analyze, positively, what effects choice of law rules have on legislators and thereby, indirectly, on individuals. It might then be able to give normative guidelines for optimal choice of law rules.

III. First Problem: Locus Delicti or Common Domicile?

How do these paradigms play out in specific problems? A first problem on which these findings can be tested is the relation between place of the tort and common domicile as connecting factors for torts. The history of private international law has been, to a large degree, a struggle between more territorial and more personalist approaches. We see a remnant of this struggle in the proper law for torts. Assuming for now that the generally applicable law is the law of the place of the tort, as it is in many jurisdictions, the question is whether an exception should be made when both parties have the same domicile. This problem can be addressed from four perspectives: traditional doctrine (a), economic analyses based on the private law paradigm (b) and on the international law paradigm (c), and finally, briefly, from the perspective of the incentives set by private international law norms for substantive law (d).

---

81 See Eva-Maria Kieninger, WETTBEWERB DER PRIVATRECHTSORDNUNGEN IM EUROPÄISCHEN BINNENMARKT (2002); Parisi & Ribstein, Choice of Law (supra n. 6), 241.
84 I ignore here the related exception for common nationality instead of domicile; see Kegel & Schurig, IPR (supra n. 22), § 18 IV 1.b, p. 733.
a) The Debate in Private International Law

In private international law doctrine we can distinguish three basic answers to the question. Under the first model, lex loci always governs, and the law of the common domicile never displaces the law of the place of the accident. This was the situation in many European countries and is still the law in Canada and Australia. The arguments for this rule are predictability for the parties (an individual-focused argument) and territorial sovereignty (a state-focused argument). Under a second model, the common domicile will always trump the place of the accident as connecting factor. This solution can be found in Germany and England as well as in the Japanese and the Rome II proposal. Sometimes limited exceptions are made for “rules of the road”, “rules of safety and conduct”, and the like.

The last-mentioned exceptions bring this second model closer to the third model. This model, influential in the United States, distinguishes between so-called conduct-regulating and loss-allocating (better: loss-distributing) rules. For loss-distributing rules, courts will apply the law of the common domicile. With regard to conduct-regulating rules on the other hand the law of the place of the accident remains applicable. The distinction between both types of rules is hard to make objectively, because all rules contain both elements. On the one hand, every tort rule has a loss-distributing effect because it distributes the injury costs from an accident. On the other hand every tort rule inevitably has a conduct-regulating effect, because it changes incentives for parties and therefore regulates, if slightly, their conduct. A rational driver will drive marginally more carefully if she is liable to her guest, than when she is protected by a guest statute or a

---

85 See the references for France and Austria in Kegel & Schurig (supra n. 22), § 18 IV 1.b, p. 733.
87 John Pfeiffer Pty Ltd v Rogerson (2000) 172 ALR 625 (for interstate cases); Regie Nationale des Usines Renault SA v Zhang [2002] HCA 10 (for international cases)
91 Scoles et al., CONFLICT OF LAWS (supra n. 2), §§ 17.36 ff., pp. 790 ff.
statute of intra-familial immunity. The criterion to distinguish is therefore not the objective effect but rather the particular rule’s primary purpose and function \(^{92}\). Loss-distributing rules are rules whose primary purpose (and effect) is not the pre-accident regulation of conduct, but the post-accident distribution of losses between parties; examples include in particular guest statutes and rules on intra-milial or charitable immunity. Conduct-regulating rules on the other hand have as their main purpose (and effect) the regulation of conduct, and the distribution of losses is only a means to that end; examples include not only “rules of the road”, but also rules on punitive damages. The argument for the distinction usually rests on different governmental interests: while interests in conduct regulation are typically territorial, interests in loss distribution are typically personalist \(^{93}\).

**b) Economic Analysis under the Private Law Paradigm**

An analysis requires two steps: is the distinction between loss-distributing and conduct-regulating rules economically sound, and is the common domicile exception sound for some or all tort rules.

**i) “Loss-distributing” rules**

The European regulation proposal starts from an understanding of tort law whose main goal is the compensation of victims, in other words: the redistribution of losses from victim to injurer, without consideration as to regulation of conduct \(^{94}\). For most economists this makes little sense. For them all tort rules provide incentives for conduct \(^{95}\), and the problem is caused by loss-distributing rules \(^{96}\). It is therefore no surprise that their distinct treatment has found little support among analysts in the private law paradigm. Most scholars treat loss-allocating rules similarly to conduct-regulating rules \(^{97}\). The main reason they give is that conflicts rules should be simple and predictable,


\(^{93}\) Symeonides, *Territoriality and Personality* (supra n. 83).

\(^{94}\) Rome II Proposal (supra n. 89), 12 (referring to “the modern concept of the law of civil liability which is no longer, as it was in the first half of the last century, oriented towards punishing for fault-based conduct: nowadays, it is the compensation function that dominates, as can be seen from the proliferation of no-fault strict liability schemes.”)

\(^{95}\) This is also true for no-fault strict liability schemes; see the analysis by Schäfer & Ott, *ÖKONOMISCHE ANALYSE* (supra n. 55), 203 ff.


that it is impossible to distinguish between conduct-regulating and loss-distributing rules in a simple and predictable way, and that the emphasis of such rules as tort rules lies in the regulation of conduct. This conclusion follows almost necessarily from the premises: if economic analysis only looks at the incentives caused by rules and ignores their distributive effects, then all rules must be seen as conduct-regulating.

A second possibility would be to avoid application of loss-distributing rules altogether as much as possible, under the assumption that their application will frequently be inefficient. Loss-distributing rules can hardly be efficient with regard to primary costs because they are not meant to give strong incentives for accident-avoiding behavior and are therefore likely to give either no or wrong incentives. They could sometimes be justified with regard to secondary costs insofar as they help reduce societal costs, by spreading risks either equally or to those with deep pockets, but while some of the rules characterized as loss-distributing have such goals of spreading risks and costs, many do not. Finally, some such rules can be defended because they reduce tertiary costs by avoiding expensive litigation. For example, one goal of guest statutes and statutes on intra-familial immunity is the avoidance of fraudulent claims against insurers. Again however, many loss-distributing rules do not do this either. Indeed, many “loss-distributing” rules aim at fairness in distribution, yet fairness and (re-)distribution are both irrelevant from an efficiency perspective.Absent any other considerations, the efficient rule about distribution is to “let losses lie where they fall”, because redistribution is costly. Any other loss-distributing rules is presumably inefficient, because it causes positive transaction costs while achieving only effects of wealth distribution which are irrelevant for efficiency.

Application of such rules could be avoided under a better law approach. Loss-distributing rules that favor plaintiffs (“making poor plaintiffs whole”) should not be applied if they raise costs of care for injurers and/or tertiary costs more than they reduce accident costs to victims. Loss-distributing rules that favor injurers (immunities) should not be applied if they lead injurers to exercise unduly low levels of care. Avoiding the applicability of such rules would be in accordance with general attitudes towards these rules which are often seen as the result of interest group lobbying rather than of sound economic policies.

However, what sets at least some “loss-distributing” rules apart from “conduct-regulating” rules is not that they do not set incentives for efficient conduct regarding accidents, but rather that they encourage the risk-enhancing conduct because it provides other benefits. For example, rules on charitable immunity are certainly conduct-regulating because it may well be that charitable immunity makes torts more likely

---

98 For example rules that give full compensation to prevent accident victims from becoming “public wards”.


100 But see for the general rejection of this approach by economists supra n. 17.

because organizations that enjoy such immunity have less incentives to properly choose and overview their employees and representatives. In isolated view, charitable immunity may look inefficient. But if charitable immunities would refrain from charitable conduct altogether unless they were granted immunity, and if the benefits from the charitable conduct outweighed the marginal costs from those accidents caused by the immunity, then the rule may well be efficient\textsuperscript{102}. Guest statutes may be similarly efficient. Good Samaritans provide benefits to society: at low costs to the driver (who only needs to stop twice, to pick up and to let go the guest), great benefits come to the guest (he saves transportation costs)\textsuperscript{103}. If guest statutes encourage such conducts they may well be efficient. Intra-familial immunity statutes\textsuperscript{104} may have the benefit of maintaining matrimonial peace, which may outweigh the additional accident costs\textsuperscript{105}.

Assuming for the moment that these rules actually achieve these purposes, such rules can obviously be efficient even if they raise accident costs because they reduce other costs. This could be an argument to treat them differently from “ordinary” tort rules. Where a prior relation between injurer and victim exists (like in interspousal immunity) it would make sense to treat these rules together with that prior relation (marriage or contract), so costs and benefits can be dealt with comprehensively within the law applicable to these relations. Where a relation is created in close connection with the tort (like in the case of guest statutes) it may make sense to treat them as quasi-contractual. But even where no prior relation between the parties exists, it may make sense to look at their common domicile instead of the place of the accident. For example, in Schultz v. Boy Scouts the court argued that plaintiff, as domiciliary of New Jersey, were beneficiaries from the defendant’s charitable conduct and could therefore be expected to bear the costs from the conduct\textsuperscript{106}.

The problem with “loss-distributing” rules is, of course, that it is impossible in the abstract to determine whether they are efficient outside the reduction of accident costs, whether they are not efficient but further other societal goals, or whether they are simply the result of special interest group lobbying. In private international law, this problem can be dealt with either by a case-by-case analysis (under a better law approach), or by a general presumption, which places loss-distributing rules in one of these categories.


\textsuperscript{103} If guest statutes were recharacterized as (implied) contracts, the problem of their perceived inefficiency would cease: guests would be presumed to waive rights to compensation in exchange of the transport.


\textsuperscript{105} Cf. the cost-benefit analysis in State v. Rhodes, 61 N.C. 453, 459 (1868): “We will not inflict upon society the greater evil of raising the curtain upon domestic privacy to punish the lesser evil of trifling violence.”

ii) The Common Domicile Exception to Lex Loci

The distinction between conduct-regulating and loss-distributing rules becomes irrelevant if both should be treated similarly. It can be shown that a common domicile exception should apply both for conduct-regulating and loss-distributing rules. First look at the typical justification of the rule, lex loci. The place of the accident has the advantage over the forum or the place(s) of the parties' domicile that it can typically be determined ex ante. If parties can expect that one particular law will be applied to them in all cases, then they save information costs (because they only need to learn about the content of one law) and they will neither overinvest nor underinvest in safety precautions with a view to other potentially applicable laws. In theory this one law could be any law. Yet normally the only place that is common to plaintiffs and defendants who meet as strangers is the place of the accident. It follows that application of lex loci typically reduces primary costs more than application of another law.

This may not be true if a prior relation exists between the parties. If the tort arises out of a contract it may make sense to apply the law of the contract to the tort as well. Parties may be able to specify their respective rights and duties in the contract, and if they can choose the applicable law they can reflect its distributive impact in the contract price. Even if the prior relation is not a contract, however, the law that governs the relation may be more appropriate for tort actions between the parties. For example, partners in a marriage may know the duties of care applicable to them under the law governing their law of marriage, application of lex loci to a tort between them may be inefficient because, in order to adapt their conduct to the requirements of that law, they would have to bear information costs.

What now if the parties meet as strangers but share a common domicile? Provided that the parties have adapted their conduct to the rules of the place of the tort, application of the law of their common domicile will not have an effect on primary accident costs. It will, however, significantly reduce tertiary costs: Because both parties know their own law best, and because (if they litigate in their common domicile state) the court does not have to bear the costs of ascertaining and applying foreign law, application of the law of the common domicile reduces tertiary costs. This suggests that application of the law of the common domicile is presumably superior to application of the law of the place of the accident even for conduct-regulating rules.

The result rests on the assumption that application of lex domicilii has no impact on the conduct of the parties because they expect lex loci to apply. The assumption is not necessarily justified. If the injurer can expect with some probability that a law other than that of the place of the tort will apply, notably the law of the common domicile, he may deviate from the standard of care required by that law. He will take more care if the expected liability to the victim under the stricter law of the common domicile is greater than the difference between the marginal costs of the added care and the gains from the reduction in liability to a victim under the law of the place of the conduct. He will take less care if the expected benefit from a reduced level of care is greater than the expected liability towards victims under the law of the place of the conduct and the expected

107 Infra IV.
liability to a co-domiciliary remains zero under the less strict common domicile law. This is only the case if the probability of the victim being a co-domiciliary is sufficiently high, and if the rule in question is in fact (as opposed to just according to its policy) actually conduct-regulating.108 Yet even if injurers do expect that lex loci will apply, this does not mandate the application of the law of the place of conduct, because presumably the injurer’s conduct in this situation is still efficient on a global scale (even if inefficient for the local economy of the place of the conduct).

This suggests that application of the law of the common domicile is efficient even for conduct-regulating rules. The main reason is that on the one hand tertiary costs can be reduced considerably, on the other hand the impact on primary costs will often be either negligible (if the parties do not expect lex loci to apply) or beneficial (if both injurers and victims expect with positive probability that the standard of care is determined by their home law). Only the economic analysis of “rules of the road” looks different and justifies exceptional application of the rules of the lex loci even between co-domiciliaries. Rules of the road only work well if everyone complies with them. The rule of driving on the right hand side for example has no intrinsic regulatory goal other than to solve a coordination problem. The expectation that more than one law may apply creates the wrong incentives, because it is inefficient if some individuals have the incentive to break out of these rules.

c) Economic Analysis under the International Law Paradigm

i) “Loss-distributing” rules

The existence of loss-distributing rules, so difficult to understand for a private law paradigm, does not present a great problem for an international law paradigm. The reason is simply that the economic analysis within this paradigm presumes the rationality of states’ policies and laws and only aims at efficient coordination between their policies and laws. This means that loss-distributing rules are either simply assumed to maximize national welfare (even though we know that they may not) or they are assumed to represent the policy preference of the state’s society. First, loss-distributing rules may simply further other policy goals than the reduction of accident costs, as seen before. Second, they may not reduce any costs at all and be inefficient in this sense but incorporate policy preferences, for example distributive ideals, of a given state. Third, they may be the result of lobbying, but even then the fact that they result from the political process gives them legitimacy.

ii) The Common Domicile Exception to Lex Loci

Does the parallel with interest analysis also suggest that a common domicile exception is efficient for and only for loss-distributing rules? Again it may make sense first to look at the justification of lex loci. For an international law paradigm the state on whose territory the accident occurs is said to have a comparative regulatory advantage; it can determine

108 If lex loci has a negligence rule it will only be efficient for an injurer to behave negligently if the benefits from the reduced level of care are significant. If lex loci has a strict liability rule the incentives may look different.
the appropriate rules of standard of care with the lowest costs\(^{109}\). With words reminiscent of Montesquieu, Judge Posner argued that “the tort law of the state where the accident occurs is likely to be the law most closely attuned to conditions in the state affecting safety, such as climate, terrain, and attitudes towards safety” \(^{110}\). This seems true only insofar as local conditions are relevant, and that in turn is true only for conduct-regulating rules\(^{111}\). Similarly, that state is said to have the greatest interest in the regulation of conduct, because both the conduct and its effects are local matters. Again this is not so indifferently. For example, when two Germans go hiking in the Swiss Alps, Germany is more interested than Switzerland in regulating their conduct. The place of the accident is more interested in regulating conduct when this conduct is relevant to the state’s economy – either because it puts local assets or citizens at risk, or because it is relevant for the state’s economy (Mallorca is interested in the conduct of foreign tourists because this conduct may deter other foreign tourists from coming). As a general rule, however, one may be able to say that the state of the place has both a regulatory advantage and the greatest interest in the regulation of conduct.

What are the economic advantages of the common domicile? From a state-based perspective it is easy to see why the state of the place of the accident would gladly trade the power to determine loss-distribution between foreigners away, if it would receive the power to determine loss-distribution between its own domiciliaries when they are involved in accidents elsewhere in return. The state of the common domicile may be assumed to have a “regulatory” advantage – because it knows better the respective needs of injurer and victim it can better (cheaper) determine the best distribution of losses between them. In addition the common domicile state has an interest in pursuing its distributive policies between its own domiciliaries. This finding is enhanced by the insight that, as we have just seen, the policies behind loss-distributing rules are often not directly related to the accident. If for example a state has granted immunity to a charitable organization registered in the state but active worldwide, it will be interested to expand this immunity as far as it can.

Are conduct-regulating rules different? Interestingly, one author in the international law paradigm argued against such a distinction. William Baxter thought that the state of the common domicile has a greater interest even with regard to conduct-regulating rules. Because most accidents will be local, he argued, the knowledge of injurers that they might injure out-of-staters under a different liability regime would not influence their care, therefore the policies of the place of the accident would not be significantly impaired. The state of the common domicile, on the other hand, would have a predominant interest in loss-distribution between its citizens\(^{112}\). At first blush the argument seems puzzling. If the place of the accident does not care very much for the

\(^{109}\) Posner, ECONOMIC ANALYSIS OF LAW (supra n. 52), 602 f.

\(^{110}\) Kaczmarek v. Allied Chemical Corp., 936 F.2d 1055, 1058 (7th Cir. 1988).

\(^{111}\) In Kacmarek the law of the place of the accident was not to be applied because “the relationship between these factors and the liability of [the defendant was] tenuous”; ibid.

\(^{112}\) Baxter, Choice of Law and the Federal System (supra n. 7), 13; cf. Kramer, Rethinking (supra n. 7), 317; for critique see O’Hara & Ribstein, From Politics to Efficiency (supra n. 7), 1173-1174.
very few accidents between foreign co-domiciliaries, why should the place of the common domicile care more for the very few accidents between its own citizens in other states? The argument makes sense however when we look at the regulatory interests at stake. If accidents between foreign co-domiciliaries are rare, then, as we saw before, it will be inefficient for foreign drivers to adapt their conduct with a view to the possible application of their home law. This means that the regulatory policies of the place of the injury are indeed not impaired at all as long as the number of cases in which foreign law will be applicable is considerable.

**d) The Impact of the Common Domicile Exception on Substantive Law**

It turns out then that for the first problem a private law paradigm and a public law paradigm lead to similar results. A common domicile exception is justified with regard to loss-distributing rules. It is also justified with regard to conduct-regulating rules, unless the number of cases in which the exception plays out is sufficiently high or the rules are “rules of the road”. Both states and individuals have an interest in coordination with regard to those rules that impact incentives for individuals. The assumption is that accidents between co-domiciliaries from another state will be so rare that they impair neither the parties’ expectations, nor (for that reason) the regulatory interests of the state of the injury.

If this assumption is met, the choice of law rule will have little impact on legislators. The law of the common domicile will have its law applied to more cases than only the cases on its territory. Yet because all distributive effects remain within its own economy it has no reason to change its substantive law with a view to these cases. The same is true for the place of the accident. The few cases that it loses from the scope of its regulatory power are unlikely to have any spillover effects on its own citizens or territory. Only if the cases it loses are numerous enough to cause foreign actors to exercise less care there may be a pressure to lower standards of care for in-staters as well in order to enable them to compete with out-of-staters on the same territory.

**IV. Second Problem: Party Autonomy**

A second controversial question in private international law is whether parties should be allowed to determine, autonomously, the applicable tort rules. Obviously such a determination is not possible in a great number of cases, at least not by ex ante agreement, simply because no relation between injurer and victim exists prior to the accident. This does not mean that party determination of the applicable law is never possible. First, parties can determine the applicable law after the accident occurred. Secondly, parties can determine the applicable law before the accident, provided that they are already in a relation, whether based on a contract or otherwise. Thirdly, parties may be able to determine the applicable law through a contract-like device whereby, for example in the area of product liability, the producer/injurer designates a specific law to be applied to him, and the consumer implicitly agrees to application of this law by buying the product. Again, these questions can be addressed doctrinally (a), in an economic analysis from a private law (b) and international law paradigm (c), and from the point of view of regulatory competition (d).
**a) The Debate in Private International Law**

For some time, private international law saw party autonomy with general suspicion: Enabling parties to determine the law to which in turn they would be subject seemed contradictory. These considerations became less prevalent in the 20th century in the area of contract law, but survived largely with regard to other areas, notably tort law.

Proponents of choice in tort law argue that party autonomy enhances predictability and makes litigation easier. Opponents point out that tort law is different because it produces obligations against everyone, unlike contract law that produced obligations only between the parties, and that tort law has more regulatory purposes. In contract law, party autonomy is restricted with regard to two considerations: overriding public interests, and the protection of weaker parties (consumers, employees). While there is less debate generally in tort law, there is little doubt that similar restrictions would apply. Thus, delictual claims from competition law or antitrust law are not subject to party autonomy, because these areas protect public interests.

Post-event agreements on the applicable law are widely accepted, even if choice of law provisions do not explicitly mention them. This is true in particular for choice of the law of the forum, which is possible not only in common law countries, but also, through procedural dispositions, in Germany. The choice of other laws than forum law is less widely allowed as a conflicts rule, but certainly possible within the parties’ general freedom to dispose of their respective rights and duties through contract.

Pre-event determination of the applicable law (where agreement is factually possible) is more problematic. An express rule in codifications is rare. This rule exists, however, in many legal systems as part of a broader rule for connected claims in contract and tort.
which links choice of law in torts to the law applicable to the contract (or another relationship). Such a rule can be found in Art. 41(2) no. 1 of the German Code, Art. 3(3), 2nd sentence of the Rome II Proposal, and in Art. 8(3) of the proposal by the Japanese Study Group of the New Legislation of Private International Law. Because the law applicable to contracts can be determined through party agreement, parties can then indirectly also choose the applicable tort law. Proponents in the literature point to the advantages of party autonomy that are not restricted to contract law, while opponents emphasize that tort law fulfills functions very different from those of contract law and should therefore not be included.

Finally, while some legal systems allow the plaintiff to determine the applicable law after the accident, no law expressly enables the injurer to select the applicable law. Of course, injurers can select the applicable law indirectly by determining the place of conduct (and possibly also the place of injury). Traditional doctrine is quite critical of such indirect choice and may treat it as evasion of the normally applicable law. An interesting proposal for choice has been made in the United States to allow producers to choose the applicable product liability law. Producers would be subject to only one law, and consumers could have a choice between different levels of protection (that would presumably come with different prices). One author has made two international law arguments against this solution: The lack of territorial connection “makes a mockery of the territorial basis of state sovereignty” (in other words, it cannot be up to buyers and sellers to choose the sovereign whose laws apply), and the principle “falls short as concerns the republican principle” – consumers are unlikely to play a significant role in

---

121 Supra n. 89.
122 For Germany see v. Bar & Mankowski, I IPR (supra n. 25), § 7 no. 73; v. Hein, Rechtswahlfreiheit (supra n. 114), 600 f.
123 v. Hein, Rechtswahlfreiheit (supra n. 114), 595 f.
124 Klaus Schurig, Die sogenannte akzessorische Anknüpfung und das Renvoiproblem, in STEPHAN LORENZ ET AL. (EDS.), FESTSCHRIFT HELDRICH, 1021, 1027 (2005).
125 Nygh, Reasonable Expectations (supra n. 114), 365-367; see also infra V.a.
the passing of the laws that later get chosen\textsuperscript{127}. One can easily add a private law argument: like with party autonomy in contracts, consumers may lack information and expertise to properly assess the risks under different regimes properly.

\textit{b) Economic Analysis under the Private Law Paradigm}

\textbf{i) Party Autonomy in General}

Economic theory usually prefers party determinations, especially in contractual agreements, to determinations by central authorities, especially through regulation\textsuperscript{128}. Agreements are deemed superior because parties can assess their own preferences better than a central authority could and because price negotiations force the parties to communicate their preferences more accurately than a regulator could guess them. All of this should be valid, \textit{mutatis mutandis}, for choice of law as well\textsuperscript{129}. Choice of law agreements enable the parties, first, to choose the law that is best for them (and thereby reduce primary costs), and second, to avoid the costs from uncertainty about the applicable law (and thereby reduce primary and tertiary costs). At first blush this seems so trivial that one eminent conflicts scholar has voiced her surprise that law and economics even bothers to prove it\textsuperscript{130}.

Contractual agreements are only efficient to the extent that a) no negative third party externalities are involved, and b) information asymmetries unequal bargaining power (like, for example, between consumers and producers) do not lead to welfare losses for one of the parties\textsuperscript{131}. These requirements are presumably met if parties derogate from non-mandatory contract rules\textsuperscript{132}. Party autonomy becomes interesting however once mandatory norms come into play. To the extent that such norms protect third party interests, party autonomy is only efficient if the social benefits from choosing another law are higher than the social costs from such a choice. On the other hand, to the extent that such mandatory norms are in themselves inefficient party autonomy can be efficient because it enables parties to choose more efficient norms.

\begin{footnotesize}
\begin{enumerate}
\item[128] But see Duncan Kennedy & Frank Michelman, \textit{Are Property and Contract Efficient?}, 8 Hofstra L. Rev. 711, 739 ff. (1980).
\item[131] See for these two reasons not to enforce contracts Shavell, \textit{Economic Foundations} (supra n. 50), 320-322.
\item[132] For the economic functions of non-mandatory (contract) rules see Schäfer & Ott, \textit{Ökonomische Analyse} (supra n. 55), 426-428.
\end{enumerate}
\end{footnotesize}
How does this apply to private international law of torts? One could argue that tort law always protects third party interests, because it lays down obligations against the world. Notwithstanding, from a private law paradigm perspective, party autonomy will presumably be efficient as long as party autonomy does not have direct third party effects. This should regularly be the case, as choice of law agreements designate the applicable law only as between the parties.

Information asymmetries and party welfare losses present bigger problems. If a state makes a right non-derogable, it may do so because it thinks that derogation would be inefficient, or it may do so for other policy reasons than efficiency, for example paternalism. If the basis is the state’s assessment of efficiency as between the parties, then the possibility to choose another law is desirable because such a choice suggests to the state that its assessment was wrong. Importantly, for an efficiency-focused analysis the same is true if the state pursues other goals than efficiency, for example distributive policies. Because such goals are irrelevant from an efficiency perspective, parties should, in a model that focuses only on efficiency, be able to opt out of it. Indeed most analysts consider party autonomy a chance for parties to avoid the paternalism (and the protection of special interests) imbedded in inefficient rules. For example Whincop and Keyes argue: “If tort rules are mandatory on a domestic basis, choices of foreign law are the only way to contract on other, preferred terms. This is especially important when consumers have heterogeneous preferences for tort rules.”

Notably, these arguments – heterogeneous preferences, mandatory norms as results of special interest group lobbying – would apply similarly to a single state situation within domestic law. Not surprisingly, some authors advocate party autonomy even for purely domestic transactions. Consumers within one country have heterogeneous preferences, too, they also suffer from inefficient laws. It seems fair therefore to say therefore that this view uses choice of law and party autonomy as a way to circumvent undue restrictions on freedom of contract stemming from mandatory law. This would also enhance the other

133 Cf. Schurig, Akzessorische Anknüpfung (supra n. 124), 1027 with references.
134 See, explicitly, EGBGB Art. 42 2nd sentence; Rome II Proposal (supra n. 89), Art. 10(1) 3rd sentence.
135 Whincop & Keyes, POLICY AND PRAGMATISM (supra n. 5), 78.
137 For their own mistrust in mandatory rules see Whincop & Keyes, POLICY AND PRAGMATISM (supra n. 5), ch. 4, pp. 52 ff. Elsewhere (ibid. 187), Whincop & Keyes argue that “[p]arty autonomy is not desirable simply for liberal reasons, but because it provides an opportunity to limit the consequences of rules that are sometimes wrong.” But it is hard to see how the reason they name – the preference of private ordering over public regulation – is not “simply liberal”. See also ibid. 9 (“to permit parties to make the choice … is not only likely to result in economically efficient outcomes, but in more liberal ones”), and the foreword by Richard A. Posner, ibid., xiv, xv: “The party-centered approach corresponds to the emphasis in economics on the free market”. For critique see Richardson (supra n. 5), 200-201.
role attributed to party autonomy, to foster regulatory competition\(^\text{138}\). In this context, it is argued that party autonomy not only enables circumvention of mandatory norms but in turn may put pressure on the formulation of such norms. Of course the opposite may be true as well: the ability of parties to opt out of inefficient laws reduces the need for legislators to abolish these laws\(^\text{139}\). In either case, the traditional hierarchy of the state over the individual is turned upside down; private ordering regulates state law.

**ii) Post-event Determination through Contract**

The easiest case can be made for the efficiency of post-accident choice of the applicable law. Of course, the potential of cost reduction is limited at this stage as regards primary and secondary accident costs. Determination of the applicable law does not create a surplus with regard to primary accident costs, because it does not influence the incentives for accident-avoiding conduct\(^\text{140}\). For similar reasons post-event choice of law has negligible effects on secondary costs, because risk averseness is no longer relevant after the accident occurred\(^\text{141}\). A choice of law agreement would be futile for these costs, because one party would simply gain what the other one loses from a shift in the applicable law. At this point injurer and victim have largely antagonistic interests after the event as regards the substantive content of the respective laws.

A significant common interest in a post-event choice lies, however, in the reduction of tertiary costs, caused by a) uncertainty about the applicable law\(^\text{142}\), b) costs of ascertaining the content of the applicable law\(^\text{143}\), and, possibly, c) costs of applying that law\(^\text{144}\). This suggests that post-event party determination of the applicable law can be efficient at least as between the parties. It will be so generally if the choice reduces costs

---


\(^{139}\) O’Hara, Opting out (supra n. 82).

\(^{140}\) Whincop & Keyes, *Policy and Pragmatism* (supra n. 5), 92, 187.

\(^{141}\) I neglect risk awareness regarding the content of an unknown law that is elected or opted out of.

\(^{142}\) Whincop & Keyes, *Discrete and Relational Torts* (supra n. 97), 380 (1998); id., *Policy and Pragmatism* (supra n. 5), 93; O’Hara & Ribstein, *Conflict of Laws and Choice of Law* (supra n. 6), 643 (2000).

\(^{143}\) These are only costs if the normally applicable law would be harder to ascertain than than the chosen law, for example if the parties choose forum law.

\(^{144}\) Whincop & Keyes, *Discrete and Relational Torts* (supra n. 97), 381 f.; id., *Policy and Pragmatism* (supra n. 5), 97 (for international conflicts only); but see the critique by Richardson, *Policy versus Pragmatism?* (supra n. 5), 199.
also for the court, because the chosen law is either (as frequently) the law of the forum\textsuperscript{145} or a law that applies otherwise in the litigation, for example for contract claims. Provided parties choose the same law for their contractual and noncontractual relations\textsuperscript{146}, there are two additional advantages\textsuperscript{147}: issues do not have to be characterized as tort or contract, and problems of dépeçage will not occur\textsuperscript{148}.

Absent welfare losses to the parties, a post-event choice of law is only inefficient if the benefits to the parties are outweighed by negative third party externalities, most frequently additional costs to the court. As a consequence, choice of a law other than that of the forum or that applicable to another part of the litigation can be assumed to be efficient if the parties are forced to internalize the additional costs of ascertaining the content of the applicable law, for example through procedural rules\textsuperscript{149}. Otherwise, the court could react with dismissal of the case on forum non conveniens grounds\textsuperscript{150}.

\textbf{iii) Pre-event Party Determination through Contract}

Is it efficient to let parties designate the applicable law ex ante, provided they can do so? Such a choice has the same effects on tertiary costs as post-event agreements, but unlike those, it may also have effects on primary and secondary costs. A pre-event choice of law agreement, by determining the applicable law, also determines the respective duties of care for injurer and victims, as well as the amount of damages; it therefore has an impact on the incentives for the parties’ conduct. In addition, such an agreement reduces the insecurity, inherent in a multistate situation, about the applicable law and thus about what the optimal conduct for each party is; by making sure that risk-averse persons will not over-invest in precautions from fear that the harsher law may apply, it reduces secondary costs as well. Finally, if the chosen law is the same as the law applicable to contract relations, freedom to choose the applicable tort law enables the parties to reflect, in their contract, the distributive effects from the applicable law. Parties can reflect the costs from one torts regime versus the other in the contract prize.

How then could pre-event determination ever not be efficient? If the normally applicable tort rule is efficient, they will not have an incentive to spend money on negotiations for another rule to which one of the parties will object (because it would be less beneficial to it). If, on the other hand, the normally applicable tort rule is inefficient, there seems to be no reason to deny parties the possibility to achieve a mutual gain by contracting out of this rule. Restrictions are justified only for two reasons: negative third party externalities

\textsuperscript{145} Siehr, \textit{Ökonomische Analyse des IPR} (supra n. 4), 290.
\textsuperscript{146} They may not always want this, or may not always be able to do this (for example if the applicable contract law is CISG); see v. Hein, \textit{RABELSZ} 64 (2000) 602.
\textsuperscript{147} This is true as well outside choice of law agreements when the applicable law of torts is determined parallel to the applicable contract law; supra.
\textsuperscript{148} The significance of these advantages is an empirical matters; for doubts see Schurig, \textit{Akzessorische Anknüpfung} (supra n. 124), 1028-1030.
\textsuperscript{149} Wagner, \textit{Fakultatives Kollisionsrecht} (supra n. 118), 41 f.
and the avoidance of welfare losses to the parties. In many cases parties have no incentive to choose a law with negative third party externalities because their choice is ineffective vis-à-vis third parties. Where they have such incentives party autonomy should be restricted. For example, parties are barred from choosing the applicable antitrust law (including private rights of action). A more important restriction is the avoidance of welfare losses to the parties.

For an efficiency analysis these risks of third party externalities and of welfare losses to the parties must be weighed against the costs of inefficient mandatory substantive tort rules. In the abstract it is impossible to assess the relative weight. Amongst authors in the private law paradigm, however, there seems to be an assumption that the costs of inefficient mandatory substantive tort law are higher. This is in accordance with their general preference of private ordering over public regulation.

**iv) Pre-event determination by injurer: Products Liability**

The proposal to let the injurers choose the applicable tort law, introduced above, is based on economic considerations. First, injurer choice reduces production costs because injurers can benefit from an economy of scales, as they are only subject to one tort law regime. A Japanese carmaker could subject all his cars to the product liability regime of Nigeria and would not have to account for the laws of all countries where its cars are sold or where they may cause injuries. Second, because consumers get a choice between different tort regimes at different prices, heterogeneous consumer preferences can be accounted for. A Japanese-built car subject to the product liability regime of Nigeria might be cheaper than a Japanese-built car of the same quality subject to the products liability regime of Japan. Risk-averse consumers could go for the Japanese-law car, while more risk-neutral consumers might prefer the car underlying the regime of Nigeria. Third, because different regimes should lead to different prices, the market would not only determine constant prices for the different liability regimes, but also reveal which regimes are better (for producers and consumers combined) than others, thus enabling regulatory competition. If Japanese law is inefficient, for example because it sets levels of precaution too high, thus raising the price of cars too much, producers would no longer select it. Fourth, because injurers could choose the applicable law without moving production, transaction costs would be low. Japanese carmakers would not have to

---

151 Suppose injurer A, if engaging in harmful conduct, would cause harm to victims B and C of 5 each, and would make a benefit from the conduct of 8 (so the conduct is inefficient); suppose also that A would be liable under the normally applicable law of X, but not under the normally inapplicable law of Y. An agreement between A and B on applicability of law Y as between them for a price below 3 would make it profitable for A to engage in the conduct. But in this case C would not be worse off, because he would be fully compensated under the still applicable law of A.

We might argue, alternatively, that the fact that B agrees to the law of Y for a price lower than 3 suggests that his real harm is only 2. This would make the conduct efficient, and if the law of state X is a negligence rule implementing the Learned Hand formula, it could mean that now A would no longer have a claim. However, the reason for this loss would not be the choice of law agreement between A and B, but only B’s valuation of his right not to be harmed as evidenced by the agreement.
produce in Nigeria or use Nigeria as exclusive point of first sale in order to attain applicability of Nigerian law.

There are again two potential types of problems with this model – negative third party externalities, and the risk of welfare loss for the parties. As regards the first, the question arises whether the choice could also apply against bystanders who did not buy the product. If not, the producer still faces the risk of several laws that are applicable against him. But this does not mean that the producer must raise his level of care. He may also decide to bear liability for injuries to bystanders under the stricter law of the place of the accident, if the costs are lower than the benefits from the chosen law. The alternative would be to apply the chosen law also between injurer and bystander, but give the bystander a claim against the purchaser. Yet this would make the purchaser the bystander’s insurer, and it is doubtful whether he is the cheaper insurer than the producer and whether he is willing to be subject, as injurer, to the strict law of the place of the accident if he opted out of this law as potential victim. In any event, liability to bystanders may make choice of law by the injurer less effective, but can be dealt with in a way that avoids negative third party externalities.

The second problem is the risk of welfare loss for the purchaser, especially due to potential information asymmetry. Purchasers are likely to know the law they select well, while consumers face high information costs in order to learn properly about the content of that law. Arguably, such a choice would have to be subject to the same restrictions as choice of law agreements in contracts of adhesion. Insofar as mandatory product liability rules are more efficient than freely negotiated conditions, the producer’s ability to opt out of such regimes is likely to be equally inefficient; again it would be necessary to prove that either the legislator’s assessment was wrong, or that the legislator aimed for other, inefficient goals. Whether party autonomy should be allowed depends on whether the efficiency risk from information asymmetry is higher than the risk that parties may be stuck with inefficient tort rules.

**c) Economic Analysis under the International Law Paradigm**

**i) Party Autonomy in General**

State-focused paradigms of (private) international law usually do not even consider party autonomy. Insofar as they conceptualize conflicts of laws only as conflicts between states over the right to regulate a certain conduct, parties do not even enter the picture as relevant actors. Of course, states may have a policy of providing freedom of contract, and this policy may be furthered if parties make use of this freedom, thus enhancing utilities of the state granting this freedom. But party autonomy adds the ability for parties to opt

---


153 Perlman, *Products Liability Reform* (supra n. 126), 508 n. 17.

154 Krauss, *Product Liability and Game Theory* (supra n. 127), 810-811; cf. also Whincop & Keyes, *Policy and Pragmatism* (supra n. 5), 82 f. Krauss points to a follow-up problem of public choice. While party autonomy should normally avoid public choice problems, here the problem is that producers as repeat players may lobby the legislator of the chosen law for sub-optimal tort regimes. Cf. however ibid. 819-820.
out of provisions that are not normally disposable and insofar can be said, at least generally, to go beyond the states’ policy of granting freedom of contract.

From a state-based perspective, choice of law agreements look suspect insofar as they extend to mandatory norms and thus go beyond a state’s own policy to grant freedom of contract. This is so for two reasons, closely related to the reasons a state has to make norms mandatory in a domestic context. First, mandatory tort rules that a state considers efficient may be undermined if parties are free to choose the applicable law. This is the case in the two cases mentioned above – negative third party externalities, and information asymmetries or problems from unequal bargaining power. Arguably, by making tort rules mandatory the state assesses that the costs from opting out of a regime are higher than the benefits. Second, party autonomy is unattractive for a state-based paradigm if states pursue other goals than wealth maximization through their tort law. An inefficient regulation is even more likely to be undermined by the parties’ choice of law agreement than an efficient one, yet at the same time such an inefficient regulation may be particularly important to the state as an expression of the will of society as expressed in the electoral process.

This does not mean that party autonomy cannot be efficient at all in an international law paradigm. First, party autonomy may not undermine state policies if no regulatory interests are at stake, or if the chosen law can be presumed to contain similar regulatory norms. Second, states may encourage party autonomy in order to enhance their domiciliaries’ competitiveness in international markets, an argument to distinguish between domestically and internationally mandatory norms. Finally, party autonomy may encourage regulatory competition between states and thereby enhance efficiency between states\(^{155}\). Of course the latter point is problematic in an international paradigm\(^ {156}\). First, it implies that states are forced by competition to change their laws and thus their preferences. This contradicts the assumption in classical economics that the preferences of rational agents determine the search for efficiency, and not the other way round. Second, regulatory competition will often mean that some states win and some states lose. This is compatible with Kaldor/Hicks efficiency, but not with Pareto efficiency, which, as we have seen, has some attraction for an international paradigm. States may however profit from the signaling effect of party autonomy, it suggests to them which laws parties consider efficient or otherwise attractive.

### ii) Post-Event Determination

Post-event determination of the applicable law is relatively unproblematic from an international-law paradigm. Regulatory interests in conduct-regulating rules are unaffected by such a determination. This means that there are neither benefits to the state whose law is selected, nor costs to the state from whose law the parties derogate. The regulatory interests of tort rules play out prior to the accident only, and opportunistic conduct with a view to a later choice of a more attractive tort regime is unlikely to

\(^{155}\) Whincop & Keyes, POLICY AND PRAGMATISM (supra n. 5), 5; Solimine, The Law and Economics of Conflict of Laws (supra n. 5), 222.

\(^{156}\) Cf. Trachtman, Economic Analysis of Prescriptive Jurisdiction (supra n. 7), 25-30.
succeed because of the antagonistic interests of the parties in the post-event situation. This leaves only the distributive effects of tort rules and is therefore particularly relevant for loss-distributing rules. Here party autonomy could be inefficient if a state had an explicit policy against autonomy in tort law. But arguably, in that case the state would not leave regulation to private parties at all, and would rather enforce its policies directly, through administrative or criminal law. If a state has the policy to regulate through tort law, this implies the policy that the rights and duties under the law are disposable for the parties. After all, the plaintiff could refrain from suing altogether, the parties could settle. This leaves the costs of litigation which can be reduced through party autonomy. Because party autonomy typically goes hand in hand with a general cost reduction, it also furthers state interests. If the parties choose the law of the court to be the applicable law, they also reduce court costs for the forum state.

iii) Pre-Event Determination through Contract

Pre-event determination of the applicable law on the other hand is problematic for a state-based paradigm. By opting out of a mandatory legal regime the parties deprive the state of its ability to regulate the respective conduct. Of course, depriving one state of its power to regulate for the benefit of another is not automatically inefficient between states. If the parties choose the law of state B instead of the normally applicable law of state A, state A is made worse off by the choice in the individual case if it had an interest in regulating the conduct in question and if state B regulates the conduct in a way that hampers these interests. But the costs to state A may be outweighed by the benefits to state B, enabling Kaldor/Hicks efficiency. Moreover, parties in another case may choose the law of state A instead of the normally applicable law of state B and thereby make up for the costs to state A from the choice of law in the first case, enabling Pareto efficiency. It is possible but unlikely that party autonomy will lead to efficiency in this way. The reason is that parties do not choose the applicable law according to the strength of the relative interests of states in regulating them, but rather according to their own interest in maximizing their own utilities. To the extent that private and public interest diverge, therefore, there is a chance that party autonomy does not enhance efficiency as between states.

If states are only interested in maximizing social welfare within their own borders, party autonomy will often be efficient. Take two states, state A with an injurer-friendly law, and state B with a victim-friendly law. Party determination of the applicable law is by definition welfare-enhancing to injurer and/or victim (unless information asymmetries lead to welfare losses). It indirectly enhances social welfare in one or both home states, and is thereby Pareto efficient as between states. A problem will only arise if the choice creates negative third party externalities in one state, for example the state of the injury, that are not compensated through tort law. For example, country A may derive a large portion of its income from tourism because of its natural beauty. For this reason, country A may have a very strict law of torts, hoping that tourists, though not liable for destroying the natural habitat per se, will nevertheless act carefully so they do not injure individuals. Tourists may regularly want to opt for a less strict law of torts to apply between them, and therefore act less carefully and destroy the natural habitat.
Party autonomy is not usually efficient as between states, however, if states pursue other interests through tort law than to maximize their own social welfare. In such cases it is less likely that parties, by choosing the applicable law of torts and thereby maximizing their own utilities, maximize the utilities of the states whose citizens they are at the same time. For example, a state may be interested, for moral reasons, in strictly regulating its own citizens. If one of its citizens now opts for the application of another, less strict law, and then engages in conduct that does not make her liable under the chosen law though it would have made her liable under the law of her own state, she thereby benefits her own state’s welfare, but she does not further the interests of her own state. It may well be that the injury to her own state’s interest is greater than the benefit to the state whose law was chosen, which may not have had a great interest in the application of its own law.

iv) Pre-event determination by Injurer: Product Liability

The arguments against pre-event determination of the applicable law through contract apply even stronger with regard to pre-event determination by one party in the product liability context. States with regulatory interests are the states of the parties’ domiciles, the state where a product is produced and where it is sold, and the state where the accident occurs. If none of their laws applies, this creates considerable costs to their policies. The state whose law is chosen on the other hand has very little regulatory interest in the application of its law to a situation with which it has few connections, and it is likely to benefit only marginally from the fact that its law is chosen frequently, because producers do not have to invest in the state in order to benefit from its laws157. Of course the state may pass very defendant-friendly laws, hoping to benefit indirectly from the choice of its laws. But application of these laws is likely to create less benefits to that state than costs to the other states.

d) The Impact of Party Autonomy on Substantive Laws

Unlike in the first problem, in the second problem we see a partial overlap and partial discrepancy between the two models of economic analysis. Under an individual-based paradigm party autonomy should be allowed widely, both for post-event and pre-event choice, with the exception only of unilateral determination by the injurer (in the products liability example). Under a state-based paradigm on the other hand party autonomy should by and large be restricted to post-event choice of the applicable law. In the individual-focused paradigm, party autonomy is the rule, with exceptions only for negative third party externalities and (to a limited degree) the reduction of welfare losses to the parties. In the state-focused paradigm the exclusion of party autonomy is the rule and its availability the exception where no state policies are at stake.

The difference between both paradigms lies exactly at the point where party autonomy could have an impact on the substantive laws of states. Because the connection between party autonomy and regulatory competition is analyzed at length elsewhere in the literature, some remarks should suffice here. Presuming that states benefit from the application of their own laws, states will have an incentive to make it more likely that

157 Cf. Ribstein, Contractual Choice of Law (supra n. 129), 435 ff.
their laws are chosen. However, this will not necessarily lead them to make their laws more efficient, or more just. This is the case if parties choosing the laws are in equal bargaining positions and no negative third party externalities occur. In this case the parties will choose the most efficient law, and legislators have an incentive to make their laws as efficient as possible. If however plaintiffs / victims can choose the applicable law, or if they have information of bargaining advantages, states will have an incentive to make their laws more victim-friendly – allegedly a development in the United States\textsuperscript{158}. If on the other hand defendants / injurers can choose the applicable law, or if they have information or bargaining advantages, states have an incentive to make their laws more injurer-friendly. The first mover has an advantage. First, he sets the terms against which negotiation or choice takes place. Second, provided he chooses a certain law for a number of transactions, he is, as a repeat player, likely to be more familiar with the law. Thirdly, as repeat player he may have more incentives and more possibilities to lobby the legislator of the chosen law. As a consequence, legislators have an incentive to cater their laws more to the first mover.

Thus, provided again that states benefit from the application of their own laws, party autonomy can have impacts on the substantive laws of states and lead to regulatory competition. Whether this competition leads to a “race to the top”, a “race to the bottom” or something else however depends crucially on the respective choice of law regime. This should enable policymakers to use choice of law rules to change substantive laws. In the United States, the proposal to let injurers determine the applicable law, either directly (as in the example above) or indirectly (through choice of law regimes applying the law of the place of conduct), is in direct connection with a policy of tort reform, aimed at reducing liability risks. This is directly opposed to suggestions in the seventies to use plaintiffs’ choice of the applicable law in order to make laws more plaintiff-friendly\textsuperscript{159}. In both cases the status quo is considered inefficient, and choice of law rules are constructed so as to achieve efficiency.

V. Third Problem: Cross-border torts

Perhaps the biggest problem in choice of law is the situation that conduct and injury occur at different places\textsuperscript{160}, a more frequent situation in times of internationalized economy and global communication networks. In the doctrine the question of the applicable law is in dispute (a). For an economic analysis under a private law paradigm (b) and an international law paradigm (c) there are tensions between the interests of injurers and place of conduct on the one hand and victims and place of injury on the

\textsuperscript{158} Cf. McConnell, \textit{Products-Liability-Reform} (supra n. 138); Krauss, \textit{Product Liability and Game Theory} (supra n. 127) (arguing that states have an interest in making their own laws more plaintiff-friendly for suits of in-staters against out-of-state defendants).


\textsuperscript{160} For a comprehensive analysis see Jan v. Hein, \textit{DAS GÜNSTIGKEITSPRINZIP IM INTERNATIONALEN DELIKTSRECHT} (1999).
other. This makes this problem the most interesting one for an analysis of the impact that choice of law has on substantive state laws (d).

**a) The Debate in Private International Law**

In the doctrine four basic models exist. First, the law of the place of conduct might apply. This is the essence of Art. 8(1) of the Japanese proposal and is reappearing in disguise, at least in the European Union, under the country of origin principle. This solution is justified, usually, with the injurer’s interests – he knows where he acts and can be expected to know and comply with this place’s laws, but not with the (potentially multiple) laws of places where his conduct may cause injuries. A second approach applies the law of the place of the injury, the general solution under Art. 3(1) the Rome II proposal. This was justified under the vested rights theory in the US on formal grounds: the injury was the last event necessary for the action to be born. Substantively, the argument is typically protection of the victim: while the injurer can control for conduct and effects, the victim should be able to rely on the protections of his home law. The general development has been towards application of the law of the place of injury; a frequent argument is that the law now emphasizes compensation over deterrence and punishment.

Two other solutions combine both places. A third possibility leads to cumulative application: liability is incurred only if both laws provide for it. A somewhat similar solution (cumulative application of lex loci delicti) existed formerly in English law and, for German defendants, German law; it is still the law in Japan. This is obviously justified by a desire to protect defendants, especially forum domiciliaries, and has been criticized for that. A fourth possibility leads to alternative application: liability is incurred if either of the two laws provides for it. The determination could be made by the judge (this used to be the law in Germany and has been proposed for the United States), or

---

161 Supra n. 89.

162 See Michaels, *EU Law as Conflict of Laws* (supra n. 3), also for differences.

163 Another argument – conduct does not lead to liability unless it causes injury – was inconclusive. Injury that is not caused by conduct does not lead to liability either. See Kegel & Schurig, IPR (supra n. 22), § 18 IV.1.a)(aa), p. 723.

164 Rome II Proposal (supra n. 89), 12; Kropholler, IPR (supra n. 28), § 53 IV.2.b), p. 498.; cf. supra n. 94. Accordingly, some have proposed to apply the law of the place of conduct to one type of tort and the law of the place of the injury for others, depending on the type of tort. See the references in Kegel & Schurig, IPR (supra n. 22), § 18 IV.1.a)(aa), p. 724.


167 E.g. Reichsgericht, 54 RGZ 198, 205.

168 Weintraub, COMMENTARY 3rd ed. (supra n. 159).
by the plaintiff’s choice of one of the two laws. If the plaintiff chooses, the law can provide presumptively for the place of conduct, as in Germany (EGBGB Art. 40(1)), or the place of the injury, as in Italy (Law no. 218 of 31 May 1995, Art. 62(1)), and enable choice of the respective other law. The European proposal does not contain such a rule generally, for two reasons: It would go beyond the victim’s legitimate expectations, and it would lead to unpredictability. The proposal does however provide for the plaintiff’s choice for a specific tort: injuries to the environment (Art. 7). One reason for this solution is sympathy with the plaintiff; while critics see no reason to treat victims in international torts better than those in domestic torts. Another argument focuses on regulatory interests: “Applying exclusively the law of the place where the damage is sustained could give an operator an incentive to establish his facilities at the border so as to discharge toxic substances into a river and enjoy the benefit of the neighbouring country’s laxer rules. This solution would be contrary to the underlying philosophy of the European substantive law of the environment and the “polluter pays” principle.”

**b) Economic Analysis under the Private Law Paradigm**

**i) Litigation and Information Costs**

Cross-border torts pose the most difficult of the three problems for an economic analysis. The main reason is that tertiary accident costs, a decisive factor for the first two problems, remain largely unaffected by whether the law of the place of conduct or the law of the place of injury applies. Tertiary costs will be higher under a cumulative or alternative application of both laws: parties and courts must ascertain the content of both unless it is clear that liability lies under one (for alternative application), or no liability lies under one (for cumulative application). Letting the plaintiff choose between both laws is unlikely to reduce costs significantly. The parties must still determine the content of both laws in order to determine their litigation chances. Costs to the parties are reduced only if they estimate that the cost of determining the content of one of the laws is higher than the expected utility of ascertaining its content. Only the court saves costs because it needs only ascertain the content of one law.

169 Rome II Proposal (supra n. 89), 11-12.

170 Kegel & Schurig, IPR (supra n. 22), § 18 IV.1.aaa), p. 725.

171 Kropholler, IPR (supra n. 28), § 53 IV.2, p. 498; c. v. Bar & Mankowski, IPR (supra n. 25), § 7-105.

172 Rome II Proposal (supra n. 89), at 19 f.

173 Of course tertiary costs will be reduced if the applicable law coincides with the forum. In order to attain such coincidence a policymaker could change either the rules on jurisdiction or those on the applicable law to attain coincidence; which of them is more efficient is beyond the scope of this paper.


175 See Schurig, *Günstigkeitsprinzip* (supra n. 174), 706 f.
The main issue should then be primary costs. This has several components: a) the costs of having to ascertain the content of the rule, b) the potential costs from having to comply with more than one set of rules, and c) the costs arising from application of a rule. All sets must be analyzed with regard to injurers and victims because the reduction of accident costs depends on setting the right incentives both for injurers and for victims who may well be the cheaper cost-avoiders\textsuperscript{176}.

With regard to the first two sets of costs it is impossible to say in the abstract which of them reduces costs. If the law of the place of conduct is applicable, the injurer will face low costs for ascertaining the content of the applicable law (because it is typically his home law) and because only one set of laws will apply to him. The victim on the other hand faces high costs of ascertaining the content of the applicable law. Furthermore, several laws may apply to the victim if he must take precautions against injurers in different countries. If on the other hand the law of the place of injury applies, the injurer will face high costs for ascertaining its content and because several laws apply to his conduct. The victim on the other hand faces low costs of ascertaining the content of the applicable law, and only this one law applies to him. Which of the costs are higher cannot be said in the abstract.

Some argue that the place of injury is more predictable for both parties because the injurer generally knows and has some control over the place of injury while the victim may not know where the harmful conduct occurs\textsuperscript{177}. In other words, the injurer is the cheaper cost-avoider with regard to information and control costs. Although intuitively plausible this intuition cannot be generalized. In the case of a polluting plant for example the place of conduct is easy to predict and control for both injurers and victims, while the place of injury depends on many contingencies like wind, vulnerability of different crops, etc. With regard to control, the internet provides another good counterexample: filtering software enables injurers to avoid certain markets for their potentially tortious conduct, but it also enables victims to bar information from certain countries and thereby avoid accidents\textsuperscript{178}. It is not clear generally whether it is cheaper for injurers to control accidents happening to victims at certain places than it is for victims to control for accidents happening from injurers at certain places\textsuperscript{179}.

\textbf{ii) Incentives}

What about the costs arising from application of the rules? Assume an injurer causes some injuries in its home country A and some in another country B. Lantermann and Schäfer argue that a place of injury rule is superior. They argue that under a place of

\textsuperscript{176} See only Shavell, ECONOMIC FOUNDATIONS (supra n. 50), 182 ff.; Schäfer & Ott, Ökonomische Analyse (supra n. 55), 221 ff.

\textsuperscript{177} O’Hara & Ribstein, \textit{From Politics to Efficiency} (supra n. 7) 1217; cf. Hamburg Group (supra n. 90), 11.


\textsuperscript{179} Although O’Hara & Ribstein consider that the place of the conduct has a regulatory advantage for the regulation of conduct, they prefer a place of injury rule (\textit{From Politics to Efficiency}, supra n. 7, 1217, see also supra n. 97).
conduct rule the injurer will overinvest or underinvest in care with regard to the injuries in another state, depending on whether the law of the place of conduct is stricter or less strict than that of the place of injury. Under a place of injury rule he will exercise a level of care between the levels of the place of conduct and the place of injury.180

The argument causes problems even for unilateral accidents because it does not distinguish sufficiently between the optimal level of care in a given country and the liability regime in this country. The globally optimal level of care will frequently lie between the nationally optimal levels in different countries. But this is not a function of different laws, it is a function of different factual situations. How high the optimal level of care is in a country depends on facts (the costs of building fences, the value of assets at risk of being injured, etc.) that are unaffected by the applicable law. As a consequence, injurers will only exercise the optimal level of care if the applicable liability regime or regimes give them the right incentives to do so.

Assume that the liability regimes in A and B can either be strict liability regimes or negligence regimes.181 We can now distinguish four cases. In the first case both countries have strict liability regimes. Here choice of law does not matter; the injurer will exercise optimal care regardless of the applicable law.

In the second case country A has a strict liability regime while country B has a negligence regime. Now the injurer will exercise the globally optimal level of care under a place of conduct rule, because the applicable strict liability regime of country A forces him to internalize all accident costs. The injurer will overinvest in care under a place of injury rule if the due level of care under country B’s liability regime is higher than the global optimum, but the injurer’s marginal costs of raising his level of care from the global optimum to that of country B’s regime are lower than the sum of benefits from avoiding all liability costs with regard to injuries in country A and the benefits from the reduction of accidents in country A. He will underinvest in care under a place of injury rule if the due level of care under country B’s liability regime is lower than the global optimum but his marginal costs of raising the level of care from that of country B to the global optimum would be higher than his marginal benefits from reducing accident costs in country A. (Remember that he will not internalize the marginal benefits from a reduction of accident costs in country B, because he will not be liable for accidents there anyway once he reaches the due level of care of country B’s laws).

The third case in which country A has a negligence regime while country B has a strict liability regime adds additional complexity. No place of injury rule leads to largely the same result as in the second case: the injurer may overinvest or underinvest in care depending on the due level of care under country A’s law and its impact on his marginal costs and benefits. A place of conduct rule may be similarly inefficient. It will normally lead the injurer to exercise the due level of care under country A’s law which may be too high or too low globally. If the due level of care under the law of A is too low, he will underinvest in care. If the due level of care under the law of A is too high, he will

180 Supra n. 129.
181 Cf. Shavell, ECONOMIC FOUNDATIONS (supra n. 50), 180-182 for the efficiency or negligence regimes and strict liability regimes for unilateral torts.
exercise a globally optimal level of care only if the marginal benefits (the reduction in costs for care) are higher than the liability costs.

Finally, in the fourth case in which both country A and country B have negligence regimes with different levels of due care, the injurer may either underinvest or overinvest under either choice of law regime. Under a place of conduct rule he will again adopt the due level of care of country A which may be too high or too low on a global level. The analysis of a place of injury rule is more complex. Assume for now that the due level of care is higher in country B than in country A182. Now the injurer avoids liability to victims in country A by exercising the due level of care of country A’s laws, and he avoids all liability by exercising the due level of care of country B’s laws. As between these two the injurer will exercise the due level of care of country B’s laws if the marginal benefits of avoiding all liability costs are higher than the marginal costs of raising the level of care. Provided that the expected injury costs in state B are sufficiently high this may often be the likelier outcome. Injurers would then frequently exercise more care than the global optimum. This result will occur more frequently if plaintiffs get to choose the applicable law.

Presuming both countries A and B have negligence regimes and set the due level of care at the nationally optimal level, the global optimum must lie between the two due levels of care. Does the injurer ever have an incentive of exercising a level of care X between those of the laws of countries A and B? He does not have such an incentive under a place of conduct rule, and he has such an incentive under a place of injury rule only under two conditions: First, the marginal costs of raising the level of care from the standard of country B to X must be lower than the marginal benefits from a reduction of accident costs in country A. (Note that X in this case is likely to be lower than the globally optimal level, because the injurer can externalize some of the costs of his conduct to victims in B to whom he is not liable.) Second, the further marginal costs of raising the level of care from X to the standard of country A (and thereby avoiding all liability) must be higher than the liability costs at X (which equal the accident costs in country A at the level of care X). Whether indeed this is the case depends on the respective values of the variables. Space forbids a detailed analysis of this case (or the other cases) here, but it should be clear that the globally optimal level of care may or may not be reached183.

---

182 The analysis applies mutatis mutandis if the due level of care is stricter in country B than in country A, because under a place of injury law it does not matter which of the two countries is the place of conduct.

183 For illustration of the fourth case (two negligence regimes) see the following table.

<table>
<thead>
<tr>
<th></th>
<th>Liability under country A</th>
<th>Liability under country B</th>
<th>Total expected costs for injurer under a place of injury rule</th>
</tr>
</thead>
<tbody>
<tr>
<td>care = 0</td>
<td>CA_d(A)</td>
<td>CA_d(A)</td>
<td>CA_d(A) + CA_d(B)</td>
</tr>
<tr>
<td>due level of B</td>
<td>CA_d(A)</td>
<td>0</td>
<td>CC_B + CA_d(A)</td>
</tr>
<tr>
<td>X (B&lt;x&lt;A)</td>
<td>CA_x(A)</td>
<td>0</td>
<td>CC_x + CA_x(A)</td>
</tr>
<tr>
<td>due level of A</td>
<td>0</td>
<td>0</td>
<td>CC_B</td>
</tr>
</tbody>
</table>
The findings are therefore quite limited. It is clear in this model (and at the same time trivial) that a globally optimal level of care will be reached if the choice of law rule designates a system with strict liability. If one or more negligence regimes are designated however, it may or may not be the case that the injurer exercises the right level of care. A place of conduct rule leads the injurer to exercise too much or too little care, depending on whether the due level of care under the law of A lies above or below the global optimum. A place of injury rule will frequently lead the injurer to exercise too much care. This is so if one of the countries has a negligence regime that sets the due level of care above the global optimum and if the marginal benefits from avoiding liability under that law (plus the marginal benefits from reducing liability under the other state’s regime if that law is a strict liability regime) are higher than the marginal costs of exercising care at that level instead of at the global optimum.

iii) Cumulative Application of several laws

So far it has been assumed that the question of liability is only one of the due level of care on a continuum. Legal orders may however set up specific duties for injurers, either in per se negligence rules, or as actual requirements. For example, state A may require plants to use filters of a certain kind to avoid liability, state B may require plants to use certain specific fuels that have the same effect. Assume that violation of these duties leads to per se negligence, or strict liability. If the applicable law is determined by the place of the injury, an injurer will be liable to victims in A unless he uses the filters required under that law and he will be liable to victims in B unless he uses the special fuel. In order to avoid liability the injurer will have to comply with two different regimes and therefore have to overinvest in care. Under a place of conduct rule on the other hand he only has to comply with one set of rules. As long as the requirements in different countries are equivalent, this rule would then be more efficient. This is presumably the case for the country of origin principle in the EU, which only applies with regard to areas of the law that have been harmonized.

It should be noted that the same situation may arise on the side of the victim. Under a place of conduct rule, the victim may face different kinds of injurers. For example, plants in state A may use filters and thereby get rid of toxic substance X but not Y, plants in state B may use a special fuel and thereby get rid of toxic substance Y but not X. If the applicable law is determined by the place of conduct, the victim will have to overinvest in care because, in order to avoid accidents, he will have to invest in the prevention of both X and Y.

As long as injuries only lead to a duty to compensate an injurer could simply decide to ignore the requirements of the law of state B and just pay compensation. He will have an

---

Costs of care are defined as $CC_{\text{standard of care}}: 0 < C_{A} < C_{X} < C_{B}$

Total costs of accidents are defined as the sum of costs of accidents in country A and costs of accidents in country B: $C_{\text{standard of care}} = C_{A_{\text{standard of care}}} + C_{B_{\text{standard of care}}}$; $C_{A_{\text{standard of care}}} > C_{X_{\text{standard of care}}} > C_{B_{\text{standard of care}}}$ AND $C_{A_{\text{standard of care}}} > C_{A_{\text{standard of care}}} > C_{X_{\text{standard of care}}} > C_{B_{\text{standard of care}}}$

Level X of care will be attained if $(C_{X} - C_{B}) < (C_{A_{\text{standard of care}}} + C_{A_{\text{standard of care}}})$ AND $(C_{B_{\text{standard of care}}} - C_{X_{\text{standard of care}}}) > C_{A_{\text{standard of care}}}$.

---

incentive to do so if B has a strict liability system, but not usually if it has a negligence system, because the marginal benefits from complying with the requirements will frequently be higher than the marginal costs. He cannot even do so if the law of state A grants victims a property right instead of a liability right, by giving victims the power to enjoin the conduct altogether unless it complies with the requirements of the law. A similar problem arises if the law of state B provides for punitive damages. By granting injunctions or punitive damages, the law of the place of the injury effectively regulates beyond the injuries to its own state, it regulates the whole conduct. As a consequence, the injurer must comply with this law, in addition to the laws of other places of injury. This combination may lead to inefficient overinvestment in care.

Applicability of injunctions and punitive damages is not necessarily inefficient, they may counter inefficient underinvestment in care by injurers. Injunctions give victims in state B a property right to enable them to engage in Coasean bargaining with the injurer over the injurer’s right to engage in his conduct. Such a property right can be efficient if it prevents the injurer from engaging in globally inefficient conduct where transaction costs would otherwise prohibit an agreement between the victims and the injurer and where full compensation cannot be attained. But transaction costs may prevent such bargaining.

iv) Firms as Injurers and competitive markets

What if injurers are firms that produce in state A and sell in states A and B, so they cause accidents in both states? Accident costs will have an impact on the price of products because they are part of the costs associated with production. This does not change the incentives for the parties to exercise care, but it has an impact on the price of products: They will be more expensive the higher the expected liability is. This in turn has implications for the efficiency of choice of law rules. If a place of injury rule creates higher costs for injurers than a place of conduct rule, then injurers involved in cross-border activities will have to raise the price for their product or they will have to reduce production.

The latter may seem desirable from an efficiency position. As long as negligence regimes do not account for the level of activity, producers have an incentive to produce too much and thereby cause too many accidents because they do not have to internalize the additional accident costs provided they exercise the due level of care. This tendency would be countered if in turn injurers faced higher liability costs as a consequence from the plurality of applicable laws under a place of injury rule. But only firms that create accidents outside their place of conduct would face these additional costs, while domestic firms would be subject only to their own law. Domestic firms would therefore not only have the mentioned incentive to produce too much. In addition, the fact that their costs

185 Shavell, ECONOMIC FOUNDATIONS (supra n. 50), 207-209.
186 For this problem in general see Shavell, ECONOMIC FOUNDATIONS (supra n. 50), 193 ff.; Schäfer & Ott, ÖKONOMISCHE ANALYSE (supra n. ), 131-133.
associated with production would be higher than those of firms that cause cross-border injuries, they would have a competitive advantage over those firms. And this in turn would prevent full competition and thereby create efficiency losses. In state B, domestic firms from B would have a competitive advantage over firms from state A.

If on the other hand the applicable law is the law of the place of conduct, injurers from state A do not face these additional costs. A priori this seems to put them on an equal playing field with domestic firms from state B. Firms from state A might however profit from less strict liability regimes under their home laws than domestic firms; this might give them a competitive advantage over domestic firms and likewise prevent full competition and create efficiency losses. They might also be subject to stricter regimes, putting them at a competitive disadvantage. Two additional considerations must be kept in mind, however. First, foreign firms may face additional transaction costs from cross-border trade (although some of these may be made up for by efficiency gains due to economies of scale from their cross-border trade). Second, even if foreign firms have a competitive advantage over domestic firms, the fact that a place of conduct rule makes it easier for them to enter foreign market leads to more market participants and therefore presumably to more competition. This suggests that a place of conduct rule leads to more competition and therefore efficiency gains, provided the liability regime in the place of conduct is not severely laxer than that in the place of injury. In the EU this is guaranteed through harmonization.

c) Economic Analysis under the International Law Paradigm

i) Regulatory Advantage

O’Hara and Ribstein consider that “the place of conduct arguably has a regulatory advantage in generating conduct rules, while the place of injury and of the parties’ domiciles might be better situated to decide issues that allocate losses…” If this is true then a place of conduct rule should be efficient in an international law paradigm. It is not clear, however why the place of conduct should have this regulatory advantage, it may have an advantage in enforcing regulations, but this is not the same as regulatory advantage. In fact, the place of conduct has better information about the costs of care for injurers, but the place of injury has better information about the expected injuries and about the cost of care for victims. If anything it appears therefore that the place of injury has a regulatory advantage, because it can better assess the risk involved with particular kinds of conduct. Optimal regulation would of course be achieved by cooperation between both places, but cumulative or alternative application of liability regimes would not achieve such cooperation and would therefore be less efficient.

---

188 Cf. Sykes, The Economics of Public International Law (supra n. 38), sec. 5.B.viii “Conflicts of Law”.

189 O’Hara & Ribstein, From Politics to Efficiency (supra n. 7), 1217.
ii) Substantive Policies

Which choice of law rules maximize state interests? This depends again on whether we define state interests as the maximization of domestic welfare or as something more. If social welfare is nothing more than the sum of all individuals’ costs and benefits, and if either the relevant efficiency criterion is Kaldor Hicks or Pareto efficiency with an effective system of side payments between states, then the result is congruent with the result from the private law paradigm. The choice of law rule that is most efficient as between parties must then also be the most efficient one between states, because it will create the highest degree of global welfare, and states can then redistribute.

This leaves the third goal, the maximization of governmental policies. This approach takes seriously the reality that states may pursue other goals than efficiency (domestic or global) and that these goals are relevant for an economic analysis insofar as they determine the states’ “individual” preferences. An economic analysis will now equal interest analysis. Thus if only one state is interested in regulation, it is obviously efficient, both under Pareto and Kaldor/Hicks criteria, to give jurisdiction to that state. A problem arises however if both states are interested. For example, state A may have very lax liability rules in order to protect its producers while state B has very strict liability rules, possibly even coupled with punitive damages rules, to protect its own victims. A move away from a system in which each state applies its own law cannot be Pareto efficient in this case without side payments. Each state would lose if the other state’s law applied. But it is likewise doubtful how a Kaldor/Hicks efficient solution can be found. The regulatory interests of state B may not be impaired under a place of conduct rule if the non-application of its laws has no impact on the incentives for the parties. But in most cases the benefits to one state from application of its laws will be the costs to another state from non-application of its laws. The criticism in traditional doctrine of conflicts theories like comparative impairment or weighing of interests190 as essentially unpredictable191 apply exactly to attempts of maximizing efficiency in private international law, too. Outside an actual agreement between states on choice of law these policies are non-commensurable, so it will be difficult to determine which is the more efficient rule.

A place of injury rule would be superior if an interest in regulation lay only with the place of effects, not the place of conduct. It is on this basis that there seems to be some consensus that a place of injury rule is generally superior to a place of conduct rule192. The reason, in a nutshell, is that regulatory interests of states are primarily directed at the regulation of markets. This is the background for the rise of the effects doctrine in choice

---

191 O’Hara & Ribstein, From Politics to Efficiency (supra n. 7), 1174; Allen & O’Hara, Second Generation Law and Economics (supra n. 4), 1014, 1031-33 (1999).
192 Cf. Peter Mankowski, Wider ein Herkunftlandprinzip für Dienstleistungen im Binnenmarkt, 24 IPRAX 385 (2004); Virgós & Garcimartín, Estado de origen v. estado de destino (supra n. 20).
of law. States, so the intuition goes, would prefer a situation in which every state has a monopoly on the regulation of conduct that affects its own markets over a situation in which every state has a monopoly on the regulation of conduct that takes place in its own state. The reason is that states have an interest in setting common rules under which a national market works, and will be more able to regulate markets under a place of injury rule than under a place of conduct rule. This is not obvious. The place of conduct may have an equally strong policy of allowing certain conduct and keeping it free from liability (provided the place or its economy benefits from it) as the place of injury may have an interest in banning the conduct or assessing damages for it, regulation is not only the prevention of conduct. There is however an advantage in a place of injury rule over a place of conduct rule in that it enables more than one state to have a say in the regulation of conduct. If conduct takes place in state A and causes accidents in states A and B, then every affected state could regulate the conduct in part.

### iii) Cumulative Application

The problem of cumulative applicability of several liability regimes under a place of injury rule creates two problems for efficiency. The first is one of coordination. All states may share the same regulatory goal, but they face the problem of agreeing on the means by which to enforce the policy. For example, if it is indeed true that internet activities necessarily have a worldwide impact, states might have a common interest in uniform regulation of this conduct, yet under a place of injury rule they would have to coordinate their efforts to do so. The second problem is one of anti-commons, or holdout. If each of several states can effectively prevent certain conduct from taking place, cooperative agreement will be difficult because each state has an incentive to hold out and try to reap benefits from cooperation (through choice of law treaties, or through reciprocal comity) disproportionate to its effective interest in the matter. The result may well be a prisoners’ dilemma: all states would be better off by allowing more conduct to take place, but each individual state has an incentive to enforce its own policies.

It may seem therefore that a place of conduct rule has an advantage because it avoids such holdouts. But two arguments may counter this. First, the resulting prisoners’ dilemma may well justified not with Kaldor/Hicks efficiency but with Pareto efficiency. The move to a place of conduct system would leave two groups of states worse off than before: states with many victims and few injurers, and states with a high due level of care. A second reason counters the potential preference for place of conduct rules. As we have seen, cumulative applicability of laws under a place of injury rules leads not only to coordination and holdout problems for states, but also to disadvantages for injurers. Injurers may now react to these disadvantages by withdrawing from

---


194 This point, obvious in interest analysis, is also made in economic analyses: Guzman, *New Directions* (supra n. 7), 916 ff.


international conduct. We see such a development in the internet: the risk of firms to be liable in every single country worldwide leads some to incorporate geographical filtering software that enables them to provide content domestically, or only to countries they choose. While such a development may be unattractive from an individual / private law perspective, it looks attractive from the perspective of states because it solves coordination problems and reduces the number of true conflicts.

iv) Firms as Injurers and competitive markets

If as the private law paradigm suggests a place of conduct rule favors firms engaged in cross-border commerce and thereby enhances competition it may be clear why an international paradigm would favor a place of injury rule. Of course intensified cross-border commerce should enhance the social welfare of all states, so it should be in the interest of states as well. But this is not certain. Under a place of conduct rule victims in state B may not be able to recover for injuries caused by an injurer in state A, while the benefits from the conduct will all be reaped by state A. The global welfare enhancement may not be Pareto efficient between states.

Where states pursue policies other than the maximization of welfare those policies may well be undermined under a place of conduct rule. States will be unable to enforce their policy preferences on their home markets. In addition, states may be under pressure to make their own laws more efficient in order to enable their own firms to compete with foreign firms who would otherwise have a competitive advantage. Not surprisingly, the decline of international commerce may be bad for individuals, for all state economies combined, and for globalization, but it may be good for other state policies than the maximization of welfare.

d) The Impact of Cross-Border Tort Rules on Substantive Laws

We have now a discrepancy between the private law paradigm and the public law paradigm. The private law paradigm made a place of conduct rule more plausible, the international law paradigm on the other hand favors a place of injury regime. This is not surprising. The private law paradigm, focusing on the private parties, favors the ability of individuals, especially producers, to act under only one liability regime in a global market and thereby to avoid protective national policies. The international law paradigm on the other hand, focusing on states, favors the interests of states (and possibly communities) in organizing and thereby preserving national markets. The discrepancy makes it particularly interesting in this context to analyze how the two paradigms interact, how choice of law rules will impact national legislation.

I assume that the conduct takes place in state A, while a variable portion of the injuries take place in state B. I also assume that the injurer is a domiciliary of A, and that all his benefits from his conducts are similarly benefits to the economy of state A, while the injuries in state B are injuries of citizens (voters and taxpayers) of B. In this situation all

social benefits from the conduct flow to the economy of state A. I assume that the level of activity is irrelevant for the risk of injuries, so I only look at level of care.

i) Unilateral Accidents

I first assume that only injurers can prevent accidents, and that states can adopt the following liability regimes\(^{198}\): no liability, negligence with differing levels of required care, and strict liability. Assume that all injurers are situated in state A. Thus state A has the injurer and possibly a number of victims, state B has only victims. Now states are likely to adopt liability regimes so as to maximize domestic social welfare. State B will reap no benefits from the conduct (because the conduct takes place in state A), while suffering all costs from the injuries to citizens of state B, minus the amount that its citizens can claim from the injurers. State A on the other hand will reap all benefits from the injurer’s conduct, and suffer all the costs due to injuries to domiciliaries from state A, plus the costs due to those injuries to domiciliaries from state B who get compensation. (Whether victims in state A are compensated or not is irrelevant for efficiency because this concerns only redistribution within state A’s economy). It can easily be seen that the factors determining social welfare in state A and in state B are quite different. Moreover, it can be seen that the choice of law rule will have an effect not only on the incentives of individual parties, but also on the domestic economies of the states. While, for example, an injurer may be indifferent between a system of strict liability and a system of negligence, his economy may well not be, if a system of strict liability means that more money will pass to another state than a system of negligence. Consequently, while the state would be indifferent between a system of negligence and one of strict liability in a purely local economy, it will not be indifferent for transnational activities. What is the impact of different choice of law rules on liability regimes for unilateral accidents?

The first sample case is not a “true” conflict of laws case at all, and only serves as standard reference case. Assume that all injuries occur in state A, none in state B. In this case, the law of state A is both the law of the conduct and the law of the effects. Under neither rule of choice of law will the law of state B ever apply. This is irrelevant to state B, because state B has no interest in the application of its law. On the other hand state A has an incentive to adopt an efficient liability regime. Not surprisingly, for purely domestic cases the choice of law rule is irrelevant.

Let us assume now all injuries are felt in state B. The injury costs are borne by state B and the costs of care are borne by state A. Under a place of conduct rule, state B has no incentives to pass any laws (because its laws will be inapplicable), while state A has an incentive to pass a no liability regime, because any costs from such care are not outweighed by any benefits to the state economy. Under a place of injury rule state A has no incentives to pass any laws while state B will adopt a strict liability regime. We can now compare what the injurer’s conduct will be under either of these two regimes – the law of the place of conduct, or the law of the place of accident. Under a place of conduct rule he will not exercise any care, because he will not be liable for any damages. Under a place of injury rule on the other hand he will internalize all costs of his conduct, and so

\(^{198}\) This means in particular that state can neither enjoin certain conduct altogether nor assign punitive damages.
will take the globally optimal level of care. Clearly, the law of the place of the injury is superior in this context. Just as strict liability between individuals forces the injurers to internalize all costs, so a place-of-injury rule for choice of law forces the economy of the state of conduct to internalize all costs of conduct by its citizens.

There are, however, many activities that cause injuries both in the state of the conduct and in other states. Assume that 50% of the injuries are felt in state A, and 50% are felt in state B. Again state B has no incentives under a place of conduct regime, while it will opt for a strict liability regime under a place of injury rule, because its interests are still similar to those of the victims and this enables its victims to recover for all their accidents. State A on the other hand is more interesting. Because state A bears all of the costs of care but bears only half of the injury costs, the locally optimal level of care will be lower than the globally optimal level of care. Under a place of injury regime state A will be indifferent between a strict liability rule and a negligence rule. Under a place of conduct regime on the other hand state A will adopt a negligence regime and set the due level of care at the locally optimal level so that the marginal costs of care equal the marginal reduction of injury losses in state A, regardless of those in state B. As a consequence, the injurer will always adopt the local due level of care provided by state A’s law. The reason is that adopting the domestically optimal level of care shields the injurer from all liability in state A, while liability to state B is reduced only marginally by exercising a higher level of care. Whenever more than 50% of the injury occur in state A, any decrease in the level of care will hurt domestic social welfare in state A more than reduce costs in state B.

Up until here, we can therefore conclude the following: The law of the place of injury is always globally superior to the law of the place of conduct if some of the injury occurs outside the state of conduct (otherwise it is equally efficient). It is globally optimal if 100% of the injury takes place outside the state of conduct, or if 100% of the injury occurs inside the state of conduct, provided states cannot have stricter liability regimes than strict liability. If some of the injury occurs in the state of conduct and some in the state of injury, a place of injury rule is superior.

**ii) Bilateral Accidents**

How do bilateral accidents change this picture? Again we can distinguish three cases. First, if all injuries occur in state A, that state has an incentive to pass optimal liability rules that give optimal incentives to both plaintiffs and defendants. In this situation, a strict liability regime without a defense of comparative or contributory negligence is inefficient; it induces victims to take no care at all, even where the costs of such care would be more than outweighed by the reduction to the overall risk. A negligence regime is efficient, because victims must assume that the injurer will take due care and will therefore take care themselves. Similarly efficient is a strict liability regime or a negligence regime together with a rule for contributory or comparative negligence. The content of the law of state B is irrelevant and will not depend on the choice of law rules.

---

199 Shavell, ECONOMIC FOUNDATIONS (supra n. 50), 183 ff.
However, this changes when all injury occurs in state B. Because state B does not profit from expenses on care by its citizens (the victims), the law of state B will provide for strict liability without the defense of comparative or contributory negligence, if its law is applicable under a place of injury rule. State A on the other hand has an incentive to adopt a no-liability regime, because the conduct is not harmful at all within its economy, under a place of conduct rule. In this case neither a place of conduct rule nor a place of injury rule leads to efficient incentives for the parties. To determine which of them is superior would require knowing whether strict liability without defense or no liability is the more efficient liability rule. This in turn depends on whether injurers or victims are the cheaper risk-avoiders – a plausible criterion for substantive law rules, but unattractive for a choice of law rule.

The interesting case is of course the third case in which 50% of the injuries occur in state A and 50% in state B. Under a place of conduct rule, state A will have a rule of negligence together with a rule on comparative or contributory negligence. The due level of care for the injurer will be too low from a global level, and as a consequence the due level of care for the victim will be too high. Under a place of injury rule state A has an incentive to do the same, because however no costs can be reduced with respect to victims in state B, the divergence from the global optimum will be less extreme. State B on the other hand will still have a liability regime granting strict liability with no contributory negligence, regardless of how many of the injuries occur in state B, under a place of injury rule. This choice of law rule is inefficient. It gives victims in state B no incentive to exercise any care at all. At the same time victims in state A will have an incentive to exercise a high level of care in order to avoid accidents if they expect the injurer to take too little care. How much care the injurer will take depends on the circumstances.

### iii) Punitive Damages and extraterritorial regulation

So far it may appear as though a place of injury rule is superior to a place of conduct rule. The main reason is that under the assumptions so far underregulation is easier than overregulation, because states cannot have stricter liability regimes than strict liability. This changes once punitive damages and injunctions are introduced. In all examples above, state B does not profit at all from the injurer’s conduct, but faces the risk of undercompensation to its citizens, if only because some of them may not be able to recover for evidentiary reasons. State B therefore has an incentive to ban the conduct altogether, or to assert punitive damages, if its law is applicable under a place of injury rule.

Normally punitive damages are considered inefficient except in two situations: first if injurers are likely to escape some liability, and second (controversially) to deter conduct that is thought generally socially undesirable, regardless of whether it brings individual benefits. Both these situations, rare in the domestic context, may appear frequently in the cross-border tort situation. First, if injurers comply with the requirements of the laxer of two laws, they escape some liability under the harsher of the

---

two laws, and the legislator of the latter may use punitive damages to set optimal deterrence. Secondly, from the perspective of one state conduct that is globally efficient may be deemed socially undesirable because it produces its benefits outside this state.

From the perspective of global efficiency the optimal level of punitive damages can be determined. But the place of injury has no benefits from the conduct, it has no incentive to set punitive damages at the optimal level. We may see here a reason why punitive damages from foreign law are exempt from the applicable law in many choice of law regimes. There is reason to expect that states will set punitive damages at a too high level. But it should also become clear that the complete banning of foreign punitive damages can be both overinclusive and underinclusive. It can be overinclusive insofar it bans punitive damages that would be globally beneficial. In the 50% example above, it would be beneficial if state B’s punitive damages rule were applied insofar as it asserts double damages. Nonenforcement of this rule (by a court in state A, or a court in a neutral state C) would lead to an overall liability regime that does not give enough incentives for the injurer to exercise the globally optimal level of care. On the other hand, the rule can be underinclusive, insofar it focuses only of foreign punitive damages. If the courts of state B were to adjudicate litigation between victims from state B and the injurer, they would not have any reason, under choice of law, not to apply state B’s super-punitive damages rule. The risk of such litigation might deter the injurer from his conduct altogether, although the conduct can be globally efficient. What would be needed, therefore, is a multilateral choice of law rule that restricts punitive damages at an appropriate level, but does so for all international transactions, regardless of the forum.

VI. Bringing the Private and the International Together

The three examples have shown the complexity of economic analyses of choice of law even within each paradigm. Even questions that are relatively easy in domestic law, for example the comparison of negligence and strict liability regimes, become difficult once they appear in a conflict of laws setting. But the analysis becomes even more complex once we realize that different paradigms may yield different answers. This makes it necessary to address the question, asked in the beginning, as to the relation between both paradigms.

   a) Results

The economic analysis within different paradigms suggests that results are sometimes similar, sometimes not. Within both paradigms a common domicile exception to lex loci appears efficient. Party autonomy is frequently efficient under a private law paradigm, much less so under an international law paradigm. Finally, while the details are not exactly determinable, generally a private law paradigm supports a place of conduct rule in order to empower markets, while an international law paradigm supports a place of injury rule in order to maintain state policies. (The dispute between the European Union, favoring a country of origin rule, and the member states, favoring a place of injury rule, can thus easily be explained – the member states are afraid of losing influence, the Union is interested in creating the common market).
It appears plausible now that the paradigm discrepancy of private international law between private and international law paradigms is replicated in the discrepancy between individual-focused and state-focused models in economic analysis. The private law paradigm in economic analysis leads to results favored by private law conceptions in doctrine: hard and fast rules, preference of party autonomy, preference of free markets over protective state policies, regulatory competition. The international law paradigm in economic analysis on the other hand leads to results favored by international law conceptions in the doctrine, especially governmental interest analysis: discretionary principles, only limited use of party autonomy, preference of protective state policies over free markets, cooperation between states and comity.

The differences are not surprising. In part they are functions of the different assumptions between the models. Thus inefficient substantive laws were to be avoided in a private law paradigm, while they represented preferences of states as rational actors in an international law paradigm. Between individuals, Kaldor/Hicks seems to provide the uncontested criterion for global efficiency, while Pareto efficiency is more attractive between states. Finally, if we consider the public/private distinction as a struggle between states on the one hand and individuals on the other, it is not surprising that a model that only focuses on individuals as actors will enable individuals to avoid constraints from states, while a model that only focuses on states as actors will enable states to constrain individuals.

A second reason for the differences is psychological. Some results within individual paradigms are not necessary; they are functions of preconceptions that come with choosing a certain paradigm. For example, there is an assumption among authors writing in a private law paradigm that the risk of third party externalities from party autonomy is smaller than the public choice risk from inefficient mandatory laws. Authors in an international law paradigm on the other hand seem to assume that the public choice risks are smaller than the risks coming from parties undermining state policies. These assumptions are partly in need of empirical testing, partly questions of evaluations. Yet neither follows necessarily from the paradigm within which it becomes relevant.

b) Relations between the Models

More interestingly, the two paradigms of economic analysis replicate not only the two doctrinal paradigms of private international law. At the same time the three connections described before between the private and the international law paradigm – compromise, overlap, sublation – can be replicated as well in economic models.

i) Overlap

First, both models overlap. Some rules are efficient both as between individuals and as between states. This is true for the first problem (common domicile rule), and for parts of the second problem: post-event determination through party autonomy (both are for it). We can assume that overlap will happen when either state interests are not different from individual interests (for example for party autonomy without third party externalities and welfare losses to the parties), or where, for different reasons, both paradigms support one solution over the other. For example, generally applying the law of the place of the accident for torts is likely to be the efficient solution both with regard to individuals and
to states. It is in accordance with individuals’ expectations and therefore both enables individuals to optimize their conduct, and enables states to optimize the incentive-setting of legal rules. At the same time, the state on whose territory an accident occurs will likely both have the greatest interest in its regulation and be the most efficient regulator. But the overlap does not help very much. The questions on which both paradigms agree may be the least interesting. One of the results, the general attraction of party autonomy, is not surprising, given on the one hand the preference that economic analysis has for contracting, and given on the other hand the (assumed) nonpolitical character of many tort law rules. That the common domicile rule can be justified as efficient in both a private law and an international law paradigm may be more surprising at first but seems in tune with general developments in choice of law away from territoriality.

ii) Compromise

In fact, under the analysis presented here both paradigms lead to different results in many other areas. The private law paradigm favors pre-event party autonomy in tort law because it benefits predictability for individuals, the international law paradigm opposes it because it undermines the regulatory interests of states. The private law paradigm favors a place of conduct rule because it enhances competition and reduces the impact of state policies, the international law paradigm favors a place of injury rule because it enables states to regulate their own markets and protect domestic firms from foreign competition.

Perhaps this is the boundary between private international law and public international law? On the one hand, authors in the private law paradigm, like Whincop and Keyes or O’Hara and Ribstein, focus on the classical areas of private law: contracts, “everyday” torts, property, etc. They seem to assume that in areas like contract law countries pursue less regulatory goals, and because each system has equal numbers of, e.g., sellers and buyers, all rules are likely to be neutral between the two groups and therefore presumably more or less efficient. As a consequence the content of the rules plays a much less important role than clarity and predictability, and differences between legal systems, if they existed at all, were considered irrelevant for interpersonal efficiency. If there are policy differences, the problem is not national preferences but rather problems of public choice, which can be overcome through regulatory competition. On the other hand authors in the international law paradigm like Trachtman and Guzman focus on regulatory areas of the law like antitrust, securities regulations, which would be considered, from a Continental European perspective, as public law. Here the assumption is that the content of the substantive rules of different states, but also their freedom to determine such policies, played a great role. States actually pursue economic strategies depending on the strength of their industries, and legal regimes are very different because different economies may have significantly more exporters or more importers, so substantive rules are likely to be twisted in favor of one group or the other. We might then

---


follow that both paradigms are not really in conflict but rather apply to different areas of the law, private law on the one side and public law on the other.

Or perhaps the relationship between both paradigms is one of rule and exception. Indeed, neither the private law nor the international law paradigm are seen as exclusive, both allow exceptionally for the other paradigm. Thus O’Hara and Ribstein leave an exception from the private law paradigm for public law matters, especially criminal law.\textsuperscript{203} On the other hand, Trachtman leaves an exception from the international law paradigm for areas with no or attenuated governmental preferences; here he allows party autonomy.\textsuperscript{204} Obviously, this reflects differences in traditional private international law. Savigny, who could be considered the ancestor of individual-based approaches, wrote for a legal environment in which different countries had structurally very different legal systems, yet largely agreed on the apolitical substance of private law. Consequently, a main task of private international law was a question of technical coordination. Indeed, Savigny’s approach assumed the equivalence and gradual convergence of legal systems in the Western world were equivalent; where this was not given, his system had to allow for exceptions. Brainerd Currie on the other hand, perhaps the extreme proponent of an international law paradigm, was confronted with a legal landscape in which different states of the U.S. had similar methodologies, but differences in individual rules, and these differences were often inspired by political differences. In this system, almost every difference between laws represented a difference in regulatory ideals. Where policies were similar, Currie saw no true conflict of laws and considered the solution a largely technical matters. In this sense, the difference between Savigny and Currie concerned mainly the relation between rule and exception.

The problem for compromise is that the boundary must be drawn somewhere, and it is difficult to devise objective criteria as to where it should be drawn. Tort law is a good example: Is it primarily private law, so a private law paradigm should prevail? This can be argued where tertiary costs are high and regulatory interests, including incentives to parties, are low, for example because no significant differences between different laws exist. Or is it primarily public law, so an international law paradigm should prevail? This would be the case where states pursue strong regulatory interests with their laws, possibly in explicit opposition to the laws of other states.

If we do not have a meta-paradigm, the boundary must be taken from one of the two paradigms. Indeed, each paradigm provides for such a conflicts rule. Trachtman wants to draw the border from the side of the state. For him all law is “public law”, and “[t]he proper distinction to draw is not between private and public law, but in the degree to which law implicates state preferences.”\textsuperscript{205} Whincop and Keyes on the other hand draw the boundary from the side of private parties when they emphasize the need for party autonomy precisely as a tool to avoid inefficient state preferences and deny it only in order to avoid negative externalities. We end up with a new conflict, that between

\textsuperscript{203} O’Hara & Ribstein, From Politics to Efficiency (supra n. 7), 1217 n. 312.
\textsuperscript{204} Trachtman, Economic Analysis of Prescriptive Jurisdiction (supra n. 7), 20 f.
\textsuperscript{205} Trachtman, Economic Analysis of Prescriptive Jurisdiction (supra n. 7), 21.
international and private, between state and individual, and the neutral conflicts rule to resolve it is nowhere to be found.

iii) Sublation

Finally, it may well be that a boundary between both models cannot be drawn because the distinction between both is an illusion. This result would replicate the demise of the public/private distinction in private law thinking. It would seem particularly appropriate for the economic analysis which explicitly sets out to overcome doctrinal distinctions like the one between public and private law.

On the one hand we may collapse the international law paradigm into the private law paradigm. Guzman, although he adopts an international law paradigm, can effortlessly use global efficiency between individuals for his analysis. At the same time however, his model can justify cooperation among states – the international law equivalent to private ordering – but not determine criteria for choice of law rules outside of cooperation. In order to do so he would need criteria for a cost/benefit analysis. If we take those criteria from efficiency among individuals, we undermine our assumption that states can define for themselves, collectively, what social welfare is. If however we define domestic social welfare broader, as the sum of all individual preferences including those that are collectively formed, the international law paradigm collapses into a private law paradigm.

On the other hand we may collapse the private law paradigm into an international law paradigm. This can be seen easily if we assume that a) our normative goal is Kaldor-Hicks efficiency between states instead of Pareto, and b) states’ only interest is the maximization of welfare. Under these assumptions, as we have seen, the globally efficient solution between states will be similar to the globally efficient solution between individuals. Now states will either negotiate amongst themselves the most efficient choice of law rules or will enable their citizens, by granting them party autonomy, to do so on their behalf. The private law paradigm collapses into an international law paradigm.

Yet if we so combine these models they become inconclusive. We can then deduce both sets of results that we found before within each of the models. This suggests that the frictions that seemed to exist between the paradigms can be shown to exist within each paradigm as well. A private law paradigm cannot be conceptualized without international law considerations, because otherwise the relevance of, and need to choose between, national laws could not be explained. An international law paradigm on the other hand cannot be conceptualized without private law considerations, because otherwise the relevance of individual actors and the need to give them incentives for efficient conduct could not be explained.

This does not mean that the choice between the two paradigms is irrelevant. Even though each of them is inconclusive on many relevant issues, the choice of a model determines the relative strength and weakness of arguments. For example, a private law paradigm may emphasize regulatory competition, while an international law paradigm may emphasize cooperation between states. None of these is intrinsic to the paradigms: cooperation can be justified in a private law paradigm, and regulatory competition can be justified in an international law paradigm. But the fact that they are typically not suggests that the choice of a paradigm brings with it a certain baggage of preconceptions that let us
focus on some aspects in an economic analysis while dismissing others as irrelevant. What this suggests is that the choice of the appropriate model is a more decisive step than is sometimes acknowledged.

c) The Impact of Choice of Law on Substantive Law

One way of bringing the paradigms together is of course to include the incentives for states to pass efficient rules into the analysis. This is the strategy pursued by theories of regulatory competition. While these theories often only look at party autonomy, a proper analysis must also include other choice of law rules. For example, if a place of conduct rules benefits foreign firms over domestic firms, it will put pressure on a state to pass more firm-friendly norms in order to avoid competitive disadvantages for its own firms. On the other hand, domestic societies may decide to maintain their economically inefficient rules even if this gives them a disadvantage at the global market place. We would gain a price mechanism and achieve some kind of commensurability between the goal of welfare maximization and other goals a state might pursue. The state would have to decide how much welfare loss maintaining certain policies is worth to it.

It is not clear ex ante however whether this leads to more efficiency, either between individuals or between states. If parties can choose the applicable tort law they may be able to avoid inefficient and efficient state laws alike; if they cannot choose the applicable law they may be stuck with inefficient or efficient state laws. If choice is granted states may face pressure to make their laws more attractive for choice by parties, but they have no better way nor incentive to distinguish efficient choice from choice that is inefficient because of information asymmetries or negative third party externalities. If a place of conduct rule favors injurers it may lead to more efficiency between individuals because states will pass more injurer-friendly rules, but it may also lead to liability standards that are too lax. If a place of injury rule favors local state policies it may lead to more efficiency between states, but it may also give states an incentive to create unduly inefficient laws and lead to holdout problems and unnecessary policy clashes. Commensurability between state interests and individual interests may be reached, but there is no neutral definition of efficiency that can guarantee that this commensurability achieves efficiency.

VII. Conclusion

What does all of this suggest? It seems that economic analysis cannot resolve the important underlying policy questions in private international law through an efficiency analysis. Economic analysis can determine what is efficient within a paradigm, but it then needs to make certain assumptions about which costs should be taken into account and which costs should not matter. Economic analysis cannot tell us for what situations one of the two paradigms is appropriate and cannot draw the boundary except on an ad hoc basis. If it tries to overcome these problems by incorporating everything, economic analysis will become inconclusive. Economic analysis can predict the incentives that certain choice of law rules will have on the conduct of states and individuals, but it cannot give us criteria as to whether the incentives lead to global efficiency?
Does this mean that economic analysis has no role to play in private international law? Obviously the opposite is true. Economic analysis provides tools for a much more rigorous analysis of the impact that choice of law rules have on the conduct of individuals and states. Economic analysis can show that private international law is neither merely a neutral and technical meta-law that designates the applicable law according to some transcendent criterion, nor only incorporates ex post (or even ex ante) justice. Rather, private international law plays an active role in the regulation of international transactions not unlike that of substantive law. And economic analysis can enable us to quantify the incentives of choice of law rules and set them into relation with conflicting incentives.

We should use all of these insights for a more informed analysis of private international law rules. What we should not do is to replace the illusion of a merely technical and neutral private international law with the illusion of a merely technical and neutral economic analysis, replace the possibly elusive notion of “conflicts justice” with the equally ambiguous notion of “global efficiency”. Before we can make strong normative claims of “efficiency”, we should use economic analysis for the more modest task of positively analyzing the effects that different choice of law regimes will have, and leave normative decisions to the political process. The choice of one or the other paradigm is not an ad hoc decision but ultimately a political decision. As a consequence, we should not choose a paradigm on an ad hoc basis and then think of the results the paradigm yields as scientific findings. Rather we should use the results from the paradigms in order to enlighten us which paradigm is more attractive for one situation or the other. Once we realize the regulatory force of private international law, we also realize that the ultimately political debates about the goals of regulation cannot remain in the sphere of substantive law or at the level of the state, but rather must be taken up at the level of private international law and at the level of global society as well. Law and economics can guide us towards better regulation, but the ultimate choices must be made elsewhere.