ECONOMIC ANALYSIS OF CONFLICT OF LAWS IN TORTS CASES: DISCRETE AND RELATIONAL TORTS*

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[This article examines the choice of law and jurisdiction rules applicable to torts which do not arise from contracts. It distinguishes torts between perfect strangers from those involving a relation between the parties. As regards the former, choice of law rules which support forum shopping do not affect incentives of plaintiff or defendant to be careful, but distort incentives to economise on costs of settlement. Lex loci delicti *choice of law rules and* St Pierre*-type jurisdictional rules are favoured. The relevance of choice of law flexibility to 'relational' torts is examined by reference to government interests, reasonable expectations, and hypothetical bargaining. Only the last has significant normative content.]*

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I INTRODUCTION

Both the confusion and fascination of conflictual doctrine derive from a tension between two central values.[1] The first is that doctrinal rules apply predictably, in general and across forums.[2] The second is that those rules operate justly, or at least that they are sufficiently flexible not to operate unjustly. Courts and regulators in England and Australia have made competing claims to these virtues in respect of recent reviews of conflictual rules. English legislation mandates a *lex loci delicti* choice of law rule in torts cases, subject to a constrained flexible exception.[3] Australia has updated the old rule in *Phillips v Eyre*,[4] without managing to dispose of the dilemmas that bedevilled its past.[5] English and Australian courts have also reviewed the defendant's ability to stay the exercise of jurisdiction. The House of Lords moved from the restrictive rule in *St Pierre v South American Stores (Gath & Chaves) Ltd*[6] to an expansive *forum non conveniens* doctrine.[7] The High Court of Australia retained but updated the old common law rules, holding that an Australian court should not decline jurisdiction unless it is a clearly inappropriate forum.[8]

In this article, we apply economic analysis to generate normative conclusions on the conflicting directions the law has taken. The need for economic analysis of conflictual doctrine is implicated by its two central values. The economic rationale for predictable rules is obvious. Although justice and economics may spring from different wells,[9] it is appropriate to consider the 'price' to be paid for just and flexible doctrine. For reasons of analytical coherence, we confine our analysis to torts which do not arise from contracts. We first analyse torts between perfect strangers. We then consider the effect that relations between plaintiff and defendant should have on legal rules. We distinguish the two contexts as 'discrete' and 'relational' torts.[10]

1 Law Commission, *Private International Law: Choice of Law in Tort and Delict*, Working Paper No 87 (1984) [4.18]; *Boys v Chaplin* [1971] AC 356, 389 (Lord Wilberforce) ('*Boys*').

2 *McKain v R W Miller & Co (SA) Pty Ltd* (1991) 174 CLR 1, 38 ('*McKain*').

3 *Private International Law (Miscellaneous Provisions) Act 1995* (UK) c 42, ss 11-12. To similar effect in Canada, see *Tolofson v Jensen* [1994] 3 SCR 1022; 120 DLR (4th) 289 ('*Tolofson*').

4 (1870) 6 LR QB 1.

5 *Breavington v Godleman* (1988) 169 CLR 41 ('*Breavington*'); *McKain* (1991) 174 CLR 1; *Stevens v Head* (1993) 176 CLR 433 ('*Stevens*').

6 [1936] 1 KB 382 ('*St Pierre*').

7 *The Atlantic Star v Bona Spes* [1974] AC 436 ('*The Atlantic Star*'); *MacShannon v Rockware Glass Ltd* [1978] AC 795 ('*MacShannon*'); *Amin Rasheed Shipping Corporation v Kuwait Insurance Co* [1984] AC 50; *The Abidin Daver* [1984] AC 398; *Spiliada Maritime Corporation v Cansulex Ltd* [1987] 1 AC 460 ('*Spiliada*').

8 *Oceanic Sun Line Special Shipping Co Inc v Fay* (1988) 165 CLR 197 ('*Oceanic*'); *Voth v Manildra Flour Mills Pty Ltd* (1990) 171 CLR 538 ('*Voth*').

9 Cf Richard Posner, 'Wealth Maximization and Tort Law: A Philosophical Inquiry' in David Owen (ed), *Philosophical Foundations of Tort Law* (1995) 99.

10 We are borrowing Ian MacNeil's description of contracts as either being *discrete*, where the exchange does not arise from or lead to significant relations between the parties, or *relational*, where the exchange does: Ian MacNeil, 'Contracts: Adjustments of Long-Term Economic Relations under Classical, Neoclassical and Relational Contract Law' (1978) 72 *Northwestern University Law Review* 854, 862–4.

Part II deals with discrete torts. We defend on efficiency grounds the application of *lex loci delicti* choice of law rules to these cases. We also defend one interpretation of *Phillips v Eyre*, which the High Court does not embrace. We explain why the rule in *St Pierre* makes sense when coupled with the efficient interpretation of *Phillips v Eyre*. Part III considers relational torts, contrasting state and party interests as bases for analysis. We also evaluate different means for ascertaining party interests.

II THE DISCRETE TORT IN PRIVATE INTERNATIONAL LAW

A *Introduction*

In this Part, we develop a theory of the appropriate choice of law and jurisdiction rules in cases of torts between perfect strangers. Section B reviews the economic analysis of tort law. Section C shows how choice of law has little impact on the cost of preventing discrete torts and the losses resulting from them. However, section D shows how rules which facilitate forum shopping increase the costs of settling claims arising from accidents. Section E examines traditional and modern choice of law and jurisdiction rules in light of the economic analysis. It argues in favour of a choice of law rule based on the *lex loci delicti* with substantially constrained grounds for the grant of stays.

B *The Economics of Care*

Economic analysis of tort law examines the extent to which tort rules minimise accident costs.[11] If social and private costs were always equal, parties would only engage in injury-causing behaviour if the marginal benefit of the behaviour exceeded its costs. However, the very occurrence of accidents demonstrates that this condition may not hold. Economists hold that the law addresses this inequality. Ronald Coase argued that an actor's decisions regarding resource allocation (including investments in care) would equate marginal benefits with marginal social costs, *provided* that any persons who bore the private costs of the actor's decisions could transact costlessly with the actor.[12] Coase's insight was that this result would hold irrespective of how tort laws allocate losses. Even in the absence of legal protection, the victim would be prepared to pay up to the amount of the expected private cost of the injury to compel the tortfeasor to take care. Efficiency is therefore independent of prior allocations of property rights.[13] Coase recognised that tort rules have efficiency effects where transaction costs

[11] See generally William Landes and Richard Posner, *The Economic Structure of Tort Law* (1987) and Steven Shavell, *Economic Analysis of Accident Law* (1987).

[12] Ronald Coase, 'The Problem of Social Cost' (1960) 3 *Journal of Law & Economics* 1.

[13] The allocation nonetheless has implications for the distribution of wealth between the parties. Distributive unfairness can be corrected by redistribution (eg taxes): Steven Shavell, 'A Note on Efficiency vs Distributional Equity in Legal Rule Making: Should Distributional Equity Matter Given Optimal Income Taxation' (1981) 71 *American Economic Review* 414; Mitchell Polinsky *An Introduction to Law and Economics* (2nd ed, 1989) 7–10, 119–27.

are positive.[14] Parties might not then enter the types of bargains possible in a world of costless contracting. Ideally, tort rules would allocate risks and burdens in a way that emulated the result in the 'Coasean' world.

Later scholars examined the use of tort liability rules as a means by which the law caused tortfeasors to internalise the costs of accidents.[15] Their work distinguished between the significance of legal rules in contracts and torts cases. Although it would be impossible for a pedestrian to contract with every possible injurer, many 'torts' cases — including products liability and industrial accidents — are situated within exchange contexts. The care a manufacturer or employer takes should be determined endogenously to the exchange. Those who value care will pay (directly or indirectly)[16] the contractual counterparty to take care. Coasean arguments point to the desirability of permitting parties to reach their own agreements concerning the proper law to which the contract should be subject.[17] Further analysis of choice of law issues arising in contractual cases is beyond the scope of this paper.

Legal rules assume greater significance in torts, where there are no market transactions. A substantial literature analyses the relative efficiencies of tort rules and the statutory compensation systems that commonly replace them. Although these systems may do a better job at compensating victims than tort rules do, they may not decrease accident costs. Economists can point to substantial, although hardly incontrovertible, support for the proposition that tort rules deter careless, socially costly behaviour.[18] The absence of strong evidence turns out to be of secondary importance to the choice of law problem. We are not suggesting that choice of law should be reconceived to eliminate rules disfavoured by normative economic analysis.[19] Moreover, we show below that it is not likely to have much effect on the prevention costs of, and damage caused by, discrete torts. By contrast, our analysis has much more to do with providing choice of law and jurisdiction rules that minimise the cost of settling accident claims.

C *Choice of Law in Discrete Torts: Ex Ante Analysis*

1 *Model*

The cost of accidents (denoted as C) can be defined as follows:

[14] Coase, above n 12.

[15] Guido Calabresi, *The Cost of Accidents: A Legal and Economic Analysis* (1970); Guido Calabresi and Douglas Melamed, 'Property Rules, Liability Rules, and Inalienability: One View of the Cathedral' (1972) 85 *Harvard Law Review* 1089; Landes and Posner, above n 11.

[16] As transaction costs rise, direct bargaining over the care to be taken will be impossible but, subject to information costs, consumers will pay more for products with a reputation for careful manufacture. It follows that workers will not demand higher wages where the employer provides a safe system of work, and so on.

[17] See generally Peter Nygh, 'The Reasonable Expectations of the Parties as a Guide to Choice of Law in Contract and in Tort' (1995) 251 *Recueil des Cours* 268.

[18] For an extensive review, see Gary Schwartz, 'Reality in the Economic Analysis of Tort Law: Does Tort Law Really Deter?' (1994) 42 *University of California Law Review* 377. It is this empirical support which instrumentally justifies the seeming unreality of rational maximisation assumptions.

[19] Cf Peter Kincaid, 'Justice in Tort Choice of Law' (1996) 18 *Adelaide Law Review* 191, 197–8.

$$C = C_i + C_{pa} + C_{da} + C_s$$

C_i is the expected cost of the injuries suffered by the plaintiff, and C_{pa} and C_{da} are the plaintiff's and defendant's costs of avoiding accidents. These components are 'ex ante' because they are determined before or at the time of the accident. C_s is the expected costs to the parties and the state(s) of settling the claim. These costs are 'ex post', since they inevitably follow the accident. The cost of accidents does not include the compensation paid by the defendant to the plaintiff. The fact that forum shopping increases the plaintiff's award does not make it inefficient, unless it affects the care exercised by the parties or the costs of settlement. The award of a higher sum is generally irrelevant to efficiency, since the defendant's private costs are offset by the plaintiff's private benefit.

Tort law should minimise the sum of these costs. A negligence rule should give an injurer an incentive to take care in cases where it is efficient to do so (ie where it reduces the social costs of accidents). The negligence standard generally compares the loss that would occur if the defendant does not take some posited level of care, adjusted by the accident's probability, with the cost of the care.[20] The economic logic is to induce the defendant to make efficient investments in care, thereby optimising C_{da}. Similarly, contributory negligence is intended to induce the plaintiff to optimise C_{pa}.[21] However, the extent to which a legal rule induces a party to act with care depends on the probability of that rule being applied, and the parties' beliefs about this probability. Perhaps if the parties knew with certainty which rule would apply, choice of law might be shaped to select the efficient rule. Where, however, parties know only that there is a probability of some other state's law applying, they may not act any differently.

We model an accident, in which the plaintiff is domiciled in state A. The defendant is domiciled in state B, but is present in state A when the accident occurs.[22] We assume that only the courts of states A and B will accept jurisdiction, and that only the law of these states will be applied. We examine the effect of three conflictual problems under two choice of law rules — apply the *lex loci delicti* (state A) or apply the *lex fori*.[23] Thus:

What is the *lex causae*?	**Forum applies *lex loci delicti***	**Forum applies *lex fori***
Plaintiff brings suit in A	Law of state A	Law of state A
Plaintiff brings suit in B	Law of state A	Law of state B

[20] Landes and Posner, above n 11, 58–62.

[21] Ibid 73–7.

[22] This model of a 'wandering defendant' is reversed below to analyse the case of a 'wandering plaintiff'.

[23] Few choice of law rules are quite so blatant as 'apply the *lex fori*': cf Friedrich Juenger, *Choice of Law and Multistate Justice* (1993) 101–3 (citing Brainerd Currie, *Selected Essays on the Conflict of Laws* (1963) 117–20). Choice of law rules with only indirect inclinations towards forum law, such as *Phillips v Eyre*, are likely to have even less effect on party incentives.

2 *Strict Liability*

If state A applies strict liability, and state B applies negligence, the plaintiff will not go forum shopping, as liability is easier to make out in state A. The defendant knows that any person he or she injures in state A will be able to invoke strict liability. Will the defendant take more care? Economic analysis suggests the defendant will not exercise more care. The comparison between a dollar spent on care and the amount saved on expected liability causes the defendant to exercise reasonable care, and no more. However, by subjecting the defendant to liability for the plaintiff's damage, whether or not the defendant is negligent, the law causes the defendant to consider the social cost of behaviour that is *not* negligent when deciding whether to engage in the activity.[24]

What if state B applies strict liability and state A applies negligence? Clearly, there is an incentive for the plaintiff to go forum shopping,[25] by bringing suit in state B and arguing for the application of its law. The incentive is strong where the defendant was not negligent. It is weak where the defendant was negligent but not nonexistent as strict liability is easier to prove. If the defendant knew with certainty that the plaintiff would sue in state B and that state B's law would be applied, this would affect the extent to which the defendant engaged in the relevant activity. However, the probability of forum shopping is less than unity. First, forum shopping may be more costly to the plaintiff than litigation in state A. Second, unless discretion is eliminated from the choice of law rule, the forum in state B may refuse to apply its law to its own domiciliary. When one combines (a) the costs to the plaintiff of forum shopping; (b) the lower probability of the forum in state B applying its law against the defendant; and (c) the improbability of an accident where the defendant is not negligent,[26] efficiency gains from applying the *lex fori* seem very unlikely.

3 *Undercompensation*

Assume that state A offers full compensation, but state B restricts recoverable heads of damage. The plaintiff will sue in state A. A rational defendant will be more careful[27] when entering state A than he or she is in state B, since the expected cost of acting negligently is higher. What happens when the *locus delicti* (state A) undercompensates relative to state B? The plaintiff has an incentive to sue in state B. Again, efficiency effects depend on the probability that a plaintiff, injured by a non-resident defendant, will go forum shopping, and the defendant's beliefs about that probability. If the defendant was certain that he or she would be sued in state B and subject to state B's law, the defendant would rationally act more carefully. However, as we saw above, successful forum

[24] Landes and Posner, above n 11, 64–71; Steven Shavell, 'Strict Liability versus Negligence' (1980) 9 *Journal of Legal Studies* 1.

[25] Many lawyers would not describe litigation in the place of one of the parties' domiciles as forum shopping. For present purposes, however, we merely show how the cost of accidents is affected by choosing a forum in order to maximise an award through the application of the *lex fori*.

[26] Recall that this is the circumstance where forum shopping is most likely.

[27] Increasing the proportion of the damage for which the defendant must pay changes the marginal benefit of investments in care.

shopping is uncertain, given costs and 'homeground advantage'. Forum shopping is most likely where compensation in the *locus delicti* is very low. The plaintiff has nothing to lose. In these cases, the defendant *may* have an incentive to act more carefully, depending on the defendant's estimate of the probability of forum shopping and the cost of extra care.

4 *Plaintiff Incentives and Defences (Herein of Contributory Negligence)*

We now study how forum shopping affects the plaintiff's incentives to take care. Two questions are in order — first, does the prospect of forum shopping have an effect on the *plaintiff's* incentive to take due care, and second, what effect do conflictual problems regarding defences (such as contributory negligence) have on those incentives?

The possibility of forum shopping is not likely to reduce the plaintiff's incentives to take care, even though forum shopping increases the plaintiff's award. In our example the defendant can be almost certain that if he or she injures anyone, it will be a local. Conversely, the plaintiff can be almost certain that if he or she is injured, a local will be responsible. The probability of being injured by (and thus being able to go forum shopping against) a non-resident injurer is low.[28] The probability, being low, is unlikely to affect the plaintiff's incentives to take due care. It is likely to be a perfect Bayesian equilibrium[29] for defendants to take care on the basis that they will injure a local, and for plaintiffs to take care on the basis that a local will injure them.

A similar conclusion applies to the impact of conflicts on defences such as contributory negligence.[30] Where state A has a contributory negligence rule, but state B does not, forum shopping in state B may occur if the plaintiff is contributorily negligent. Will this reduce the plaintiff's incentive to take care? The plaintiff, as we said, will choose a level of self care based on the belief that the injurer will be a local of state A (like him or her). Provided the local contributory negligence rule is effective, the plaintiff should take due care. If so, *forum shopping may not happen at all* because, other things being equal, the plaintiff will only go forum shopping where the plaintiff has *not* exercised due care (and therefore cannot sue locally). If due care is the plaintiff's equilibrium strategy, this will be infrequent.[31]

[28] In the event that the injurer is local, we assume forum shopping is impossible.

[29] A perfect Bayesian equilibrium is a solution concept in game theory. It requires that actions taken by a player are optimal given (a) a party's beliefs about other players, and (b) the actions taken by other players: Douglas Baird, Robert Gertner and Randall Picker, *Game Theory and the Law* (1995) 83–9.

[30] We do not study the effect of a conflict in which contributory negligence is a complete defence in A, and requires apportionment in B. The orthodox economic view is that while the rules may have other differences, the plaintiff should not be less careful under one or other: Landes and Posner, above n 11, 80–2. Cf Daniel Orr, 'The Superiority of Comparative Negligence: Another Vote' (1991) 20 *Journal of Legal Studies* 119. For simplicity, we assume in the text that the defence is a complete one.

[31] Cf Landes and Posner, above n 11, 72–3.

5 *Ex Ante Costs: A Review*

Conflict type	***Locus delicti***	**Defendant's domicile**	**Forum shopping?**	**Effect of forum shopping on incentives**
Strict liability	—	✓	Yes if D is not negligent	Probably none
Undercompensation	✓	—	Yes	Possible increase in D's care if damages in *locus delicti* are very low
Contributory negligence	✓	—	Yes if P is contributorily negligent	Probably none — equilibrium for plaintiff to be careful

A naive economic analysis might hold that forum shopping deters defendant negligence, or otherwise increases efficient accident prevention measures, by increasing damages awards. We have shown, however, that forum shopping has minimal impact on party incentives to take efficient precautions.[32] This conclusion should be confined to discrete torts, and not extended to contract cases. Forum shopping is likely to increase contracting costs if it increases opportunism within the contract.

How does our analysis change if the *plaintiff* is the visitor to state B? A choice of law rule slanted towards the *lex fori* may induce forum shopping if state A supplies the more generous rule. It is most unlikely to change any relevant incentive of the defendant. The defendant's best strategy is to make investments in care on the basis that they will injure a person domiciled in state B. The improbable invocation of a rule that is more generous to the plaintiff, domiciled in state A, or more demanding of the defendant is therefore unlikely to influence the defendant's choice of care. However, the plaintiff will assume that he or she will be injured by a domiciliary of state B. Will a more generous remedy in state A change the plaintiff's incentives? The plaintiff knows he or she can sue in state A, which is likely to favour local plaintiffs over foreign defendants. If both jurisdictions apply a contributory negligence defence, the plaintiff has no incentive to be careless. But what if state A does not apply a contributory negligence rule? The plaintiff may underinvest in care, *provided* he or she is not substantially undercompensated in state A. Thus, forum shopping in this case will lead to suboptimal investment in C_{pa}[33] — but the condition that a jurisdiction

[32] This conclusion also holds where the plaintiff goes forum shopping to avoid a statute of limitations in the *locus delicti*: see, eg, *McKain* (1991) 174 CLR 1. Neither party would at the time of the accident have any reason to expect a plaintiff to delay sufficiently so as to be out of time.

[33] This conclusion offsets any minor efficiency effects of forum shopping in the case of the wandering defendant.

both compensates in full *and* lacks a contributory negligence rule seems fairly unlikely.

D *Choice of Law and Jurisdiction in Discrete Torts: Ex Post Analysis*

Our analysis indicates that forum shopping has little influence on ex ante accident costs. If the analysis stopped there, there would be no basis for arguing that the *lex loci delicti* is the efficient rule. In this section, we argue that forum shopping is inefficient because it leads to excessive costs in the settlement of the plaintiff's claim. The best means to control it in discrete torts is for courts to apply a *lex loci delicti* rule. In the model that follows, we assume initially that substantive rules in the *locus delicti* and the forum are clear. What is unclear is whether or not the court in which the plaintiff brings suit will exercise jurisdiction, and, if it does, whether it will apply its own law, or some other.

Compared to a *lex loci delicti* rule, the application of forum law creates inefficient incentives. A plaintiff with a prospect of increased recovery will be prepared to spend a further L_p on litigation expenses:

$$L_p = P_f\ (S_f - S_d)$$

P_f is the probability that the forum accepts jurisdiction and applies its own law,[34] and S_f and S_d are the settlements that the plaintiff would obtain under the *lex fori* and the *lex loci delicti* respectively.[35] Thus, the plaintiff will be prepared to pay more for solicitors, the expenses of witnesses, and the like. The defendant has precisely the opposite incentive — the defendant will spend L_d to cause the forum to decline jurisdiction. L_d should, on our assumptions, equal L_p, given the zero sum nature of compensation. However, it may be possible for the defendant to do some forum shopping of his or her own, by anticipating the plaintiff's suit, and seeking declaratory relief.[36] If so, the amounts of L_d and L_p rise, since they no longer equal the difference between the awards in the forum and the *locus delicti*, but between the awards in the plaintiff's preferred and the defendant's preferred forums. These costs are wasteful, since they are being incurred to influence the eventual court order, which is zero sum. So, for example, the plaintiff will, under a rule favouring the *lex fori*, prefer to litigate in a pro-plaintiff forum even if it would be cheaper to litigate elsewhere. The defendant will apply for a stay or an injunction in order to remove the matter to a preferred forum, so avoiding the application of that forum's law, or to derail the case completely.

To some extent, the problem described is inherent in any litigation — both parties will spend money on influencing a zero sum outcome. However, economic analysis shows that it will be in the interests of both parties to settle, as of course most cases do. The major obstacle to settlement is information asymmetry

[34] P_f is in turn the product of two other probabilities: P_j (the probability the forum will accept jurisdiction) and P_l (the probability the forum will apply a choice of law that selects the *lex fori*), ie $P_f = P_j P_l$.

[35] The formula assumes that if the forum does not apply its own law, it applies the *lex loci delicti*. We presently ignore substance–procedure distinctions.

[36] See, eg, Larry Kramer, 'Rethinking Choice of Law' (1990) 90 *Columbia Law Review* 277, 314.

or differential optimism.[37] Assume C may litigate in either England or Texas.[38] In both jurisdictions, C will win on the merits. If C wins in England, the *locus delicti*, C recovers \$200,000 (S_d). If C wins in Texas, he or she recovers \$2,000,000 (S_f). The defendant, B, must decide whether or not to seek a stay on the ground of *forum non conveniens* in Texas (or an antisuit injunction in England). If B succeeds, the matter will not proceed in Texas, and C recovers S_d. If B fails, or does not apply for a stay, the matter will proceed in Texas, the court will (by assumption) apply forum law, and C will recover S_f. Assume further that both B and C believe that the probability of the *forum non conveniens* motion succeeding is 0.5 (P_f= 0.5) (that is, 'even money'). Should B move for a stay, C's expected outcome from litigating in Texas ($E(S_p)$) is:

$$E(S_p) = P_f S_f + (1 - P_f) S_d - L_p$$
$$= \$1{,}100{,}000 - L_p$$

B must decide whether or not to move for a stay. If he does not do so, P_f is effectively one, and he will have to pay S_f (\$2,000,000) with certainty. If he does, his outcome is:

$$E(S_d) = P_f S_f + (1 - P_f) S_d + L_d$$

$$= \$1{,}100{,}000 + L_d$$

Thus, unless L_d costs in excess of \$900,000, B should contest — even though the social gain from the forum application is nil. However, in this case, on the perfect information assumptions we have made, the parties will settle once C brings suit in Texas, but without the need for the costly stay application.[39] Both parties know their expected outcome. B will be better off if he or she offers more than \$1,100,000 - L_p, but less than \$1,100,000 + L_d, as will C. There is a surplus of $L_p + L_d$, which will be divided by bargaining.[40]

However, that outcome depends on B and C sharing similar beliefs about the value of P_f. Once expectations diverge, the chance of a stay application proceeding is much higher. If C thinks P_f is 0.7 (P_{pf} = 0.7) and B thinks P_f is 0.5 (P_{df}= 0.5), the outcome changes. E(S_p) (the plaintiff, C's expected recovery) is \$1,460,000 - L_p. $E(S_d)$ (the defendant, B's expected cost) remains \$1,100,000 + L_d. Unless $L_p + L_d \geq$ \$360,000, the parties will not settle. Assume each party's cost of litigation is \$150,000 (ie $L_p = L_d$ = \$150,000). C would be irrational to take less than \$1,310,000 and B would be irrational to pay more than

[37] See generally Richard Posner, 'An Economic Approach to Legal Procedure and Judicial Administration' (1973) 2 *Journal of Legal Studies* 399.

[38] The reader may substitute Victoria for England, and New South Wales for Texas, if desired; there is no analytical difference.

[39] If $L_d >$ \$900,000, the parties settle for \$2,000,000. If this condition holds for a substantial number of defendants, high-cost defendants may imitate low-cost defendants by making the lower settlement offer. If plaintiffs cannot pick the defendant's type, the parties may not settle.

[40] Baird, Gertner and Picker, above n 29, 245–6.

$1,250,000. Therefore, the stay application will proceed, at a socially wasteful cost of $300,000.[41]

Our analysis has assumed that the choice of law is certain once jurisdiction is resolved. It follows that parties will settle once the stay is decided or a forum agreed. This may be unlikely, unless the forum always applies the *lex fori* outright, or the stay court decrees the *lex causae*. Rules which hide *lex fori* preferences in legal necromancy — as the rule in *Phillips v Eyre* does — increase the likelihood of expectations diverging. The conceptual confusion of choice of law is highly likely to create uncertainty about choice of law outcomes. Thus, relaxing the assumptions about the certainty of choice of law means that actions are much less likely to settle even after jurisdiction is resolved. It is therefore crucial that at the time of the tort the choice of law rule is clear.

A choice of law rule oriented towards the *lex fori* will be inefficient because it will result in socially wasteful expenditure on the costs of pursuing the claim.[42] By contrast, a *lex loci delicti* rule, adopted by all jurisdictions for discrete torts cases, will substantially reduce inefficient expenditure. The plaintiff, not having an incentive to choose a forum to boost recovery, will choose the lowest cost forum (for the plaintiff) in which to litigate. Admittedly, that choice of forum may not minimise the *joint* costs of the parties. The plaintiff still has no incentive to consider the defendant's private costs. Thus, the stay application still has some role to play in cases where the reduction in the plaintiff's costs from the chosen forum is substantially outweighed by the defendant's greater costs. We shall return to this issue in section E. However, it follows from our analysis that substantive considerations — including 'juridical advantages'[43] — should be irrelevant where they arise under any law other than the *lex loci delicti*.[44]

E *Economic Analysis and Private International Law*

1 *Choice of Law*

In this section, we examine how our analysis compares with private international law doctrine. Although early 'vested rights' theories advocated *lex loci*

[41] To generalise our analysis, the parties will only settle if $(S_f - S_d)\ (P_{pf} - P_{df}) < L_p + L_d$. This assumes that the settlement process does not disclose new information which affects the values of P_{pf} and P_{df}.

[42] Peter North, 'Torts in the Dismal Swamp: Choice of Law Revisited' in Peter North (ed), *Essays in Private International Law* (1993) 69, 85.

[43] See, eg, *MacShannon* [1978] AC 795, 812; *Spiliada* [1987] 1 AC 460, 482–3.

[44] The clarity of the *lex loci delicti* depends on the *locus delicti* being clear. Various tests have been suggested — every element occurs within the jurisdiction, the last element occurs within the jurisdiction, and so on: see generally Edward Sykes and Michael Pryles, *Australian Private International Law* (3rd ed, 1991) 39. Cases where these tests are likely to yield different results are much more likely to involve torts arising from contracts. This is predictable — markets are a means by which factors of production move to their highest valued uses. Thus, products liability — a major case type in which these issues have been ventilated — may involve difficult choices between various *loci*: see, eg, *Distillers Co (Biochemicals) Ltd v Thompson* [1971] AC 348. By contrast, the spatial context of most discrete torts is often very clear, as in a road accident. The only cases likely to cause problems are cross-border torts: cf *Bier v Mines de Potasse d'Alsace* [1976] ECR 1735.

delicti, the most decisive early precedent in English law, *Phillips v Eyre*,[45] favoured instead a *double actionability* rule. In that case, Willes J said that the wrong must both be 'actionable', under the forum law, and not 'justifiable' by the law of the place where it was committed.[46] The test poses at least two problems. First, what do actionability and justifiability mean? Justifiability in the *locus delicti* might be as simple as a requirement that the act not be 'legally innocent',[47] or as demanding as a requirement that, if a suit was brought in the *locus delicti*, a court would uphold full recovery of the nature the plaintiff presently seeks in the forum. There are intermediate shades of meaning. Second, is the rule a choice of law rule or a threshold test which only establishes justiciability?

There has been some withering criticism of the double actionability rule,[48] but it is possible to articulate at least a partial defence, if one uses the most demanding definition of justifiability, and treats the double actionability rule as a (double) choice of law rule. Mason CJ explained such a rule in *Stevens*:

> Once the forum court has ascertained the precise extent of the substantive claim allowed under the lex loci, the court must then give effect to its own law, even if, for instance, the operation of the local legislation cuts down the extent of the claim which could otherwise be maintained. Thus, the forum reserves to itself the power to provide that part or even all of the claim arising under the lex loci is not to be pursued in its own courts.[49]

Such a rule is simply a more restrictive form of the *lex loci delicti* rule. Problems arising from reference to forum law are largely overcome by requiring identity between the two laws as a precondition of liability. Unless the plaintiff can recover under the *lex loci delicti*, a generous rule in the forum is irrelevant. Why then does one bother with the *lex fori*? Because this interpretation effectively requires substantial similarity between the *lex fori* and the *lex loci delicti*, the application by a forum of the foreign law of the *locus delicti* is likely to be beset by fewer errors. It seems a fair prediction that courts applying foreign law are more likely to make errors than in applying their own law, and will make more errors, the greater the difference between the foreign law and the domestic law.[50] A double actionability rule represents a control on costly judicial errors made in the application of foreign law. The probability of errors increases the likelihood of differential expectations and inefficient litigation expenditure. The policy of the rule is to resolve differences in favour of the defendant — that is, it prefers to make false negatives to false positives. Although it is probably true that the double actionability rule can apply harshly in this respect, the plaintiff chooses the forum. If the forum is ungenerous, the plaintiff can usually sue in the

[45] (1870) 6 LR QB 1.

[46] Ibid 28–9.

[47] See, eg, *Machado v Fontes* [1897] 2 QB 231.

[48] Law Commission, *Choice of Law in Tort and Delict*, above n 1; Australian Law Reform Commission, *Choice of Law Rules*, Report No 58 (1992).

[49] *Stevens* (1993) 176 CLR 433, 441.

[50] Juenger, above n 23, 83–6. As to the costs of errors, see Richard Posner, *Economic Analysis of Law* (4th ed, 1992) 549–52.

locus delicti. The double actionability rule thus conceals its own momentum towards the *locus delicti* as both the forum and the source of law.

However, we believe that the *lex fori* limb should not apply within a federation. First, error by judges in applying the *lex loci delicti* is much less likely within a federation. The cost of information regarding the laws of another state is much smaller than the cost of ascertaining the laws of another country.[51] The application by state courts of the *lex loci delicti* permits the plaintiff to choose the lowest cost jurisdiction in the federation as the forum. Cooperation between state courts seems an essential prerequisite to realising the advantages of federalism.[52]

For at least a century after *Phillips v Eyre*, the double actionability rule was interpreted, in both Australia[53] and England,[54] with a loose definition of justifiability, or as a threshold test, so converting it into a rule favouring the *lex fori*. The forum preference and the interpretive uncertainty encouraged wasteful investment in litigation. In *Boys*[55] the House of Lords, by a variety of reasoning, held that the plaintiff's damages ought, in that case, to be assessed by reference to the *lex fori*. A majority treated the assessment of damages as a matter of procedure, and therefore subject to the *lex fori*. Lord Hodson and Lord Wilberforce treated this issue as one of substance. They interpreted *Phillips v Eyre* to require the general application of the *lex loci delicti* as the *lex causae*. However, both proposed a flexible exception to apply the *lex fori* where the parties and the subject matter of the dispute were more closely connected with a legal system other than the *lex loci delicti*. The circumstances before them satisfied these requirements. The current English legislation embodies such principles.[56] We do not believe that the flexible exception can have any scope in discrete torts. Given that the parties are strangers, favouring the law of the forum or some other state could only be done by favouring one of the parties ex post.[57] There is no reasonable basis for doing so, and it would increase the costs of settling accident claims. We reconsider this issue in the context of relational torts in Part III.

The Australian choice of law rules were partially clarified by a trilogy of High Court decisions. Despite fractured reasoning in *Breavington*, majorities in *McKain*[58] and *Stevens*[59] supported Brennan J's restatement of the double actionability rule in *Breavington*:

51 *McKain* (1991) 174 CLR 1, 26.

52 See generally Martin Davies, 'Too Little Imagination or Too Much? *Phillips v Eyre* Revisited Yet Again' (1995) 3 *Torts Law Journal* 273, 293; *Stevens* (1993) 176 CLR 433, 462; *Thompson v Hill* (1995) 38 NSWLR 714, 716–18, 731–2 (Kirby P). See generally Posner, *Economic Analysis of Law*, above n 50, 635–48.

53 *Koop v Bebb* (1951) 84 CLR 629; *Anderson v Eric Anderson Radio & TV Pty Ltd* (1965) 114 CLR 20.

54 *Machado v Fontes* [1897] 2 QB 431.

55 [1971] AC 356.

56 See text accompanying n 3.

57 Cf Kincaid, above n 19, 205–6. Government interest analysis of choice of law often attempts to make this choice. We consider these issues in more detail, below Part III(C).

58 (1991) 174 CLR 1.

59 (1993) 176 CLR 433.

> A plaintiff may sue in the forum to enforce a liability in respect of a wrong occurring outside the territory of the forum if — 1. the claim arises out of circumstances of such a character that, if they had occurred within the territory of the forum, a cause of action would have arisen entitling the plaintiff to enforce against the defendant a civil liability of the kind which the plaintiff claims to enforce; and 2. by the law of the place in which the wrong occurred, the circumstances of the occurrence gave rise to a civil liability of the kind which the plaintiff claims to enforce.[60]

Thus, in *Breavington* the plaintiff was unable to recover damages in respect of a head of loss for which recovery was not available in the forum. The High Court has left open the proper rules in international cases.[61] However, the cases leave key matters unclear.[62] Martin Davies has demonstrated that it may still be open to argue that the double actionability rule is a threshold test, and that the *lex fori* is the choice of law rule.[63] That result would be inefficient — it may be even worse than a pure *lex fori* rule[64] — on the basis of our analysis. The case law also does not conclusively rule out a flexible exception.[65]

Of particular concern is the renascence of the substance–procedure distinction. In *McKain* and *Stevens*, the High Court permitted forum shopping in order to evade 'procedural' rules of the *locus delicti*: a statute of limitations and a limit on damages recoverable for non-economic loss.[66] Matters of procedure are traditionally governed by the *lex fori*, but the distinction has long been criticised as artificially expanding the scope of forum law.[67] We accept that a forum should apply its own procedural law. An advantage of a *lex loci delicti* rule is that the plaintiff will seek to litigate in the lowest cost forum. The forum's procedural laws are likely to have an important role in defining the forum's cost advantages, since they regulate litigation. To apply other procedural laws would decrease the ability of a plaintiff to make cost comparisons between different jurisdictions.

However, this principle is in need of limitation. Our explanation of the importance of procedural rules demands that they be restricted to 'rules which are directed to governing or regulating the mode or conduct of court proceedings.'[68] The distinction made in *McKain* between rules which destroy remedies (which are procedural) and rules which destroy rights (which are substantive) is vestigial formalism.[69] So, too, is the distinction between *Breavington*, in which a rule

60 *Breavington* (1988) 169 CLR 41, 110–1.

61 *McKain* (1991) 174 CLR 1, 38.

62 See generally *Thompson v Hill* (1995) 38 NSWLR 714, 735 (Clarke JA).

63 See generally Martin Davies, 'Exactly What Is the Australian Choice of Law Rule in Torts Cases?' (1996) 70 *Australian Law Journal* 711.

64 A clearer rule at least makes settlement more likely and therefore reduces the cost of litigation.

65 Davies, 'Australian Choice of Law Rule in Torts Cases?', above n 63, 717–9 (citing such Australian Supreme Court decisions as *Woodger v Federal Capital Press of Australia Pty Ltd* (1992) 26 NSWLR 732, 736 (Miles CJ) and *Nalpantidis v Stark* (1996) 65 SASR 454 which favour the exception).

66 *McKain* (1991) 174 CLR 1, 40–3; *Stevens* (1993) 176 CLR 433, 456–7.

67 Walter Wheeler Cook, '"Substance" and "Procedure" in the Conflict of Laws' (1933) 42 *Yale Law Journal* 333, 343–4.

68 *McKain* (1991) 174 CLR 1, 26–7 (Mason CJ); *Stevens* (1993) 176 CLR 433, 445.

69 *Stevens* (1993) 176 CLR 433, 452. All state legislatures have responded by declaring relevant rules to be substantive: see, eg, *Choice of Law (Limitation Periods) Act 1993* (Vic) s 5. Courts

denying the entitlement to recover damages for lost earnings capacity was held to be substantive, and *Stevens*, in which a rule limiting the damages recoverable for non-economic loss was held to be procedural. This approach facilitates forum shopping and erodes any gain from 'clarifying' the rule in *Phillips v Eyre*. The rule's uncertainty is likely to substantially decrease the probability of settlement. It was bizarre for the majority in *McKain* to claim that '[a]s the distinction has operated in practice free of injustice, there is no warrant for discarding it.'[70]

2 *Stay of Jurisdiction*

Another part of the common law conflictual tradition was the rule in *St Pierre*.[71] It substantially limited the defendant's right to object to the regular establishment of jurisdiction by the plaintiff. A stay would only be granted if the continuance of the action was oppressive, vexatious, or an abuse of process, and the stay would not cause injustice to the plaintiff. A balance of convenience was never a sufficient ground for a stay. The House of Lords, however, now embraces a doctrine of *forum non conveniens*.[72] A defendant need only show that there is a more appropriate forum than the English court. This issue is assessed by considering the connections of the parties and the subject matter, and questions of convenience and expense.[73] However, the old rule had a great deal in its favour. To put the *St Pierre* test in economic terms, the stay would only be granted where the marginal cost to the defendant to defend the action (relative to the forum to which the defendant seeks a transfer) is *substantially* greater than the marginal benefit to the plaintiff from prosecuting the action.[74] On the face of it the rule seems inefficient: the court should grant a stay whenever it is satisfied on the balance of probabilities that the defendant's marginal cost exceeded the plaintiff's marginal benefit. This is not so. If the choice of law rule is clear (as the judges no doubt assumed), the costs put in evidence would, to a significant extent, be misleading. They would be costs of proceeding to a trial *unlikely to occur*. The parties would, on our earlier economic analysis, be very likely to settle. It made sense for a court to grant a stay only in cases where the cost–benefit disparity was exceptional. At the least, the defendant's additional costs of proceeding in the forum, less the plaintiff's net benefit, would have to exceed both parties' costs of the stay application for it to have any social benefit at all.

have nonetheless ignored the provisions of statutes when conflictual problems arise: see, eg, *Nalpantidis v Stark* (1996) 65 SASR 454, 457–9. See also *Martin v Kelly* (1995) 22 MVR 115 (ignoring similar declaration in the *Wrongs Act 1936* (SA) s 35A(7)).

70 *McKain* (1991) 174 CLR 1, 44.

71 [1936] 1 KB 382, 398.

72 *The Atlantic Star* [1974] AC 436; *MacShannon* [1978] AC 795; *Amin Rasheed Shipping Corporation v Kuwait Insurance Co* [1984] AC 50; *The Abidin Daver* [1984] AC 398; *Spiliada* [1987] 1 AC 460.

73 *Spiliada* [1987] 1 AC 460, 476–8 (Lord Goff).

74 For clear statements of the significance of the cost of litigation to this process, see *Logan v Bank of Scotland (No 2)* [1906] 1 KB 141, 150; *Egbert v Short* [1907] 2 Ch 205, 213; *Maritime Insurance Co Ltd v Geelong Harbor Trust Commissioners* (1908) 6 CLR 194, 198. See also *Oceanic* (1988) 165 CLR 197, 245, 247-8, where Deane J points out that a weighing process is the essence of the inquiry.

The English move towards an increased role for *forum non conveniens* may be inefficient, at least in perfect stranger cases.[75] It means that there will be a greater number of applications in which the grant of stays will achieve no net saving in litigation costs, and greater delays before settlement can take place.[76] This in turn makes it a more costly rule. Thus, the route which Australian courts have taken — a requirement that a stay be granted only in circumstances where the court is a clearly inappropriate forum[77] — is likely to result in lower ex post accident costs. Courts may make fewer errors if they are not asked to make inter-jurisdictional comparisons on the basis of evidence adduced in interlocutory applications.[78] The Australian rule thus prefers the risk of the forum incorrectly holding itself not to be a clearly inappropriate forum, to the risk of incorrectly holding another forum to be more appropriate.

Similar comments apply to the transfer provisions in the cross-vesting legislation.[79] Section 5(2)(b) sets out the grounds for transfer of proceedings between superior courts. The first relates to the case where other proceedings are pending. The legislation favours the transfer to a single 'most appropriate' forum. Reducing the incidence of multiple proceedings reduces costs. The second ground permits courts to transfer proceedings in those cases where the only basis for jurisdiction is the cross-vesting legislation. This reduces the instances where legislation is manipulated for the purposes of forum shopping. Section 5(2)(b)(iii) provides for transfers necessary 'in the interests of justice'. There is some doubt about the correct position, as the *Voth* rule and the *Spiliada* rule find favour in different states.[80] We prefer the *Voth* rule,[81] on our earlier analysis, as the likely cost-minimising one.

It is, therefore, important to recognise how jurisdiction and choice of law interact. It has been suggested that the *St Pierre* principle 'places such a tight rein on the discretion of a court as to render it unable to deal justly with the problem of forum shopping, even in blatant cases.'[82] Our analysis suggests that this is not the whole truth. The *St Pierre* principle did not deal with the problem of forum shopping — that was the responsibility of the double actionability rule. *St Pierre* was intended to minimise the cost of litigation by reducing the number of stay

[75] Cf *Oceanic* (1988) 165 CLR 197, 251-2 where Deane J suggests that the difference between the rules may be minor.

[76] A Slater, 'Forum Non Conveniens: A View from the Shop Floor' (1988) 104 *Law Quarterly Review* 554.

[77] *Oceanic* (1988) 165 CLR 197; *Voth* (1990) 171 CLR 538.

[78] See generally *Voth* (1990) 171 CLR 538, 558: '[I]t is desirable to discourage the litigation of [which forum is more appropriate] as an interlocutory question by means of what has been described as a war of affidavits.'

[79] *Jurisdiction of Courts (Cross-Vesting) Act 1987* (Cth). There is equivalent legislation in all States and Territories.

[80] The leading case is *Bankinvest AG v Seabrook* (1988) 14 NSWLR 711 (favouring the *Spiliada* approach) which has been applied in various other states. Cf *Dawson v Baker* (1994) 120 ACTR 11 and authorities noted below in n 81.

[81] *Paul v Mid Coast Meat Co Pty Ltd* [1995] 1 Qd R 658, 663; *Baffsky v John Fairfax & Sons Ltd* (1990) 97 ACTR 1, 5–6. If, as seems reasonable, cost disparities between states are lower than those between countries, a *more* restrictive rule applying to transfers made pursuant to s 5(2)(b)(iii) may be more appropriate.

[82] *Oceanic* (1988) 165 CLR 197, 212.

applications, and establishing a rule concerning their outcome which was clear in its application. Together, the rules created strong incentives for parties to minimise the cost of settling claims out of court. Only if courts permitted the choice of law rule to be subverted into a de facto *lex fori* rule does the quoted conclusion hold. In that event, however, the choice between narrow and expansive grounds for stays is genuinely a hard one. One must decide whether more stay applications are worth the value of judicial control — itself highly imperfect because of the evidentiary limitations of interlocutory applications — of egregious cases of forum shopping.[83]

III THE RELATIONAL TORT IN PRIVATE INTERNATIONAL LAW

A *Introduction*

Is there a theoretical basis for deviating from the rule we favour for discrete torts when there is a non-contractual relation between the parties? Section B asks if government interest analysis rationalises the preference for flexibility in relational cases. We conclude that it rationalises little, if anything. Sections C and D advocate party interests as the basis for analysing relational torts. We reject 'reasonable expectations' as a normatively circular formulation of party interests, but we show the utility of hypothetical bargaining as a means of analysis.

The relational tort was a catalyst for early deviations from *lex loci*-type rules. *Babcock v Jackson*[84] in the United States, and the speech of Lord Wilberforce in *Boys*,[85] justify application of forum law where it is consistent with government interests in the circumstances. Mason CJ in *Breavington* (which involved a relational tort)[86] suggested that giving effect to the parties' 'reasonable expectations' was more important to the choice of law process than government interests.[87] Both approaches have received academic support.[88] The following sections compare their relevance to relational torts.

B *Government Interest Analysis*

Government interest analysis resolves conflicts by examining the interests of the states whose laws the parties have invoked. If only one state has an interest, its laws are applied; if both do, the court applies the *lex fori*. Neither of those decision rules advocates a choice of law principle on the basis of the interests of

[83] See generally North, above n 42, 76–7, 85.

[84] 12 NY2d 473; 191 NE2d 279 (NY Ct App, 1963) ('*Babcock*').

[85] [1971] AC 356, 390–1.

[86] The relation was between Breavington and Piercy. However, there was no suggestion that the existence of the relation should change the result. The case also involved a further discrete tort.

[87] *Breavington* (1988) 169 CLR 41, 77.

[88] See, eg, Currie, *Selected Essays*, above n 23; Robert Sedler, 'Interest Analysis and Forum Preference in the Conflict of Laws: A Response to the "New Critics"' (1983) 34 *Mercer Law Review* 593; Russell Weintraub, 'A Defense of Interest Analysis in the Conflict of Laws and the Use of That Analysis in Products Liability Cases' (1985) 46 *Ohio State Law Journal* 493. Regarding party expectations, see Nygh, above n 17; Kincaid, above n 19.

the parties, *except* to the extent that these are subsumed within state interests.[89] Many criticisms have been made of the theory,[90] including the severe problems in ascertaining state interests.[91] For example, the negligence principle might be thought to compensate plaintiffs injured by the defendant's want of care, and to deter defendants from failing to take due care. It seems logical that where both plaintiff and defendant are resident and domiciled in state A, they should have their local law apply to them if one negligently injures the other while they happen to be in state B. State A has an interest in seeing that its plaintiff is compensated, and an interest in deterring its domiciliaries from acting negligently.

The neatness of the analysis falls apart on closer examination. If, for example, the accident involves a motor vehicle in which both plaintiff and defendant are travelling, as *Babcock* did, state B's claim is very strong.[92] State B will want to see that persons who drive in its territory exercise due care, since, as we saw above, the expected social costs of negligent driving within the state will largely be borne by its domiciliaries. The laws of the *locus delicti* may be the most likely to correspond to the local state conditions.[93] Other attempts to give content to government interests, such as the chauvinistic notion that the interest of a state is to protect its plaintiff, become meaningless in the relational case since the protection comes at the expense of its defendant.

Interest analysis prefers state interests to party interests. Yet this is counter-intuitive. Private parties are the suitors in a torts case. In choosing between laws, party interests should be paramount.[94] Even if a state does *not* have an interest in applying its rule to a particular situation — a result that rarely holds, given the flexibility of the analysis in imaginative hands — it does not follow that the parties would not prefer that its rule apply in preference to some other. The law takes this approach in choice of law in contract cases, when an express choice exists. The law ignores the absence of objective connections between the chosen laws and the contract in question.[95] That rule may not suit torts cases, but it shows that choice of law should not be dominated by government interests.

One might argue that state A's law should apply because state A will otherwise pick up the social security bill.[96] The argument is problematic in cases where both jurisdictions offer recovery, but differ in magnitude. If the *lex loci delicti* offers a higher remedy than the law of the defendant's domicile, does the argument suggest that it is in state A's interests that the law of state B be applied? We suspect that a court is less likely to have the expertise to recognise which

89 Lea Brilmayer, 'Interest Analysis and the Myth of Legislative Intent' (1980) 78 *Michigan Law Review* 392.

90 See, eg, Lea Brilmayer, *Conflict of Laws* (2nd ed, 1995) chh 2, 4.

91 Ibid 77–84.

92 *Nalpantidis v Stark* (1996) 65 SASR 454, 479.

93 Posner, *Economic Analysis of Law* above n 50, 587.

94 See generally Kincaid, above n 19, 195–6.

95 See, eg, *BHP Petroleum Pty Ltd v Oil Basins Ltd* [1985] VR 725.

96 See Currie, *Selected Essays*, above n 23, 61. Cf Brilmayer, 'Interest Analysis', above n 89, 396, 412.

resolution is to be preferred on utilitarian grounds if it must look beyond the parties. The savings to one state's social security may or may not be more than offset by increased transaction costs in cases of torts arising from contracts, or by the increased costs of litigation under unclear conflicts rules.[97] It does not really matter whether we resolve it one way or another. What *is* important is that attempts to resolve conflictual problems on the basis of government interests are likely to involve a much more complex calculus (which may not be at all tractable) than party interests.[98]

C *Party Interests: Reasonable Expectations and Hypothetical Bargains*

As mentioned above, the use of party interests as the basis for the choice of law process was recently advocated by Mason CJ in *Breavington*:

> [F]or my part the interests of the parties themselves are likely to be more material [than government interests] in ascertaining whether another law has a closer connexion with the parties and the occurrence with respect to the issue to be litigated. The justice of the case turns very largely on the need to give effect to the legitimate or reasonable expectations of the parties.[99]

While we agree that party interests should override state interests, we have some difficulty with the concept of reasonable or legitimate expectations. What are they, and where do they come from? Answering this question raises two problems. First, the idea that the law fulfils reasonable expectations cannot escape the criticism that the law itself defines those reasonable expectations. Peter Kincaid addresses this problem. He argues that:

> [P]eople do not govern their affairs with respect to potential torts with an awareness of choice of law rules. Most people would not even know of the idea of such rules. ... People govern their actions and so curtail their freedom because of a set of standards to which they think they ought to (or must) conform. ... These standards are usually territorially-defined. ... The average lay person may not know or think much about law, but he or she is aware of one feature of the international legal order: territorial sovereignty. Everyone knows that each country has its own legal system and that to a large, if undefined, extent one is expected to obey the laws of the country one happens to be in.[100]

The argument leaves the circularity criticism untouched. Whatever else territorial sovereignty may be, it is fundamentally a legal concept which makes a statement about the application of laws and authority. To put it simply, the circularity argument tells us that the law should enforce the parties' reasonable expectation of the law. This may have the virtue of consistency, but then all tautologies do. It has no normative weight. We seek to define what the content of these expectations *should be*.

[97] This illustrates the general point made by economists that legal rules are rarely effective as a means of redistribution: see above n 13.

[98] See generally Nygh, above n 17, 289.

[99] (1988) 169 CLR 41, 77.

[100] Kincaid, above n 19, 200–1. The use of territorial sovereignty to define choice of law rules has of course been in decline since the days of the legal realists.

These problems are instantiated in Kincaid's analysis. He argues that a sovereignty-inspired preference for *lex loci delicti* might be relaxed 'where the environment is such that the parties would treat themselves as governed by another set of standards in their relations with each other.'[101] Kincaid refers to an environment's 'physical isolation' (presumably from the rest of the 'territory'). He refers to the invocation of the flexible exception in the Canadian case, *Tolofson*.[102] Kincaid defends, on an expectations basis, the conclusion that the plaintiff was bound by the *lex loci delicti* in his claim against the driver of the car. Yet he also defends the conclusion that the law of the plaintiff's domicile should apply in the plaintiff's claim against his father, the driver of the car in which he was travelling, on the same basis. It is hard to understand how two environments may be 'isolated' but nonetheless side by side in an automobile accident. There is no physical isolation, unless one counts the car's frangible chassis as the partition. There is no other form of isolation that the law does not itself define. In short, Kincaid's environment theory holds none of the weight he places on it. We do not disagree with his endorsement of the result in the case, but his attempt to give content to expectations does not succeed.

Second, reasonable expectations imply that there exists a point in time at which they can be ascertained, but no one has said what 'time' that is:[103] at the time the relation begins, at the time of injury, or at the time of suit? There is also a problem of objectivity. When one speaks of reasonable expectations, do we look for evidence of the expectations of the parties to the suit and act on these when they are reasonable? Or do we impute expectations to parties because judges think them reasonable? We cannot clearly decide which of these Mason CJ intended.[104] Legal doctrine simply cannot offer any preferred solution to these questions.

Peter Nygh adopts a very different theory of reasonable expectation in torts.[105] His theory is that reasonable expectations are best protected, first, by allowing parties the autonomy to select the law to which tortious matters are subject.[106] Second, Nygh recognises, in the absence of an agreed choice, 'the right of the injured party to select the most favourable law provided this does not subject the defendant to an unjust or unforeseeable result'.[107] The proviso is given substance primarily through a plea of *forum non conveniens*. We disagree with this approach for three reasons.

First, Nygh does not justify his second proposal on the ground of party expectations. He alleges an 'international consensus' that plaintiffs should be able to

[101] Ibid 203.

[102] [1994] 3 SCR 1022; 120 DLR (4th) 289.

[103] Michael Whincop, 'A Relational and Doctrinal Critique of Shareholders' Special Contracts' (1997) 19 *Sydney Law Review* 314, 332–3 (making a related point in the context of corporate law).

[104] *Breavington* (1988) 169 CLR 41, 75, 77.

[105] Nygh, above n 17.

[106] Such an approach justifies the invocation of the flexible exception in *Red Sea Insurance Company Ltd v Bouygues SA* [1995] 1 AC 190. Contract cases are beyond the scope of this paper.

[107] Nygh, above n 17, 350.

choose the most favourable law.[108] At best the argument is circular. At worst, the argument assumes uncritically the desirability of current practices. Second, Nygh essentially proposes a forum shopping charter, given his endorsement of forums applying their own law. We have argued that forum shopping increases the cost of settling accident claims. It is socially wasteful, as is the reliance on *forum non conveniens* as a defendant protection. Nygh claims that strict adherence to the *lex loci delicti* 'more often than not disadvantages the victim'.[109] Compared to a pro-plaintiff rule that is no doubt true, but Nygh provides no convincing normative justification for why the plaintiff should be favoured over the defendant. Nygh claims that defendants can foresee the risk of being sued for higher amounts and insure against it.[110] But reasonable foreseeability is an element of the substantive law; it is not and never has been the basis for choice of law.

Third, Nygh's propositions do not sit well with each other. If one enforces contracts where they exist, because the parties should have the autonomy to agree to them, a rule favouring plaintiffs is objectionable. Contracts are mutually beneficial, pro-plaintiff rules are not. A might contract with B to assume a substantial risk, but he or she will demand compensation in order to do so. That process cannot occur in discrete torts because there is no equivalent means for compensation. Our analysis suggests the need to find a means by which to break out of the circularity of reasonable expectations. A theory must explain not only the preference for *lex loci delicti* rules in discrete torts, but provide a coherent justification for a different rule in the case of relational torts. These criteria are only fulfilled by a theory of choice of law as a hypothetical bargain.

D *Choice of Law as Hypothetical Bargains*

The concept of hypothetical bargains has been used extensively over the last fifteen years by law and economics scholars.[111] One of the places where the ideas were actively worked out was in corporate law.[112] The hypothetical bargain concept explained the consistency between a theory of the corporation as a contractual structure,[113] and the fact that many important terms in the relation between managers and shareholders were not explicitly negotiated. The concept of a legal rule as a hypothetical bargain implied that legal rules should attempt to shadow the agreements that a majority of real parties would make if they had

[108] Ibid 360.

[109] Ibid 368.

[110] Ibid 369.

[111] See generally David Charny, 'Hypothetical Bargains: The Normative Structure of Contract Interpretation' (1991) 89 *Michigan Law Review* 1815.

[112] For a critique, with reference to the antecedents of the concept, see Melvin Eisenberg, 'The Structure of Corporation Law' (1989) 89 *Columbia Law Review* 1461, 1487–8; Melvin Eisenberg, 'Contractarianism without Contracts: A Response to Professor McChesney' (1990) 90 *Columbia Law Review* 1321.

[113] Michael Jensen and William Meckling, 'Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure' (1976) 3 *Journal of Financial Economics* 305; Frank Easterbrook and Daniel Fischel, *The Economic Structure of Corporate Law* (1991).

been able to negotiate in respect of the matter at no cost, while preserving the right for parties to substitute another rule for the legal 'default'.[114]

One of the problems with the hypothetical bargain approach is that it never indicates how to identify the population of contracting parties for which one is enjoined to determine majority preferences.[115] To take a corporate example, one might seek to ascertain the majority preferences in all corporations, or partition the rule according to corporation types (publicly traded corporations, close corporations, and so on). This partitioning procedure can be taken to its ultimate extent if the court provides a rule for which it thinks the *particular* counterparties would have contracted.[116] Majoritarian defaults for a larger population are described as untailored default rules; defaults that are set one contract at a time are described as tailored default rules.[117]

Any theory proposed to explain relational torts must explain why a general rule might be relaxed in the case of a relational tort, while also explaining the form of the inflexible rule that should be applied to discrete torts. An easy, but inadequate explanation would be: the *lex loci delicti* rule, or the double actionability and double choice of law rule, are efficient rules; efficient rules maximise wealth; therefore, parties would agree to them. Coleman, Heckathorn and Maser have criticised attempts to justify default rules in this way as a gratuitous cover for an efficiency argument.[118]

A better explanation runs along the following lines. Assume a hypothetical process of negotiation in which A must negotiate a contract with every other person in the world ('N'). A and N can select any choice of law rule, but they only have a contract if they choose the same rule. To simulate the circumstances of a discrete tort, assume that neither knows the domicile of the other, and that either can be injurer or injured. The main options would be the law of the plaintiff's domicile, the law of the defendant's domicile, the *lex fori* and the *lex loci delicti*. The domicile possibilities are unlikely to be the subject of agreement. A plaintiff would not take the risk that a defendant is domiciled in a low liability jurisdiction. The defendant would not take the risk that a plaintiff is domiciled in a high liability jurisdiction.[119] This is so because A and N do not know which of them will turn out to be the plaintiff, and which the defendant.

[114] Frank Easterbrook and Daniel Fischel, 'The Corporate Contract' (1989) 89 *Columbia Law Review* 1416. For a discussion of default rules see, eg, Ian Ayres and Robert Gertner, 'Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules' (1989) 99 *Yale Law Journal* 87; Richard Craswell, 'Contract Law, Default Rules, and the Philosophy of Promising' (1989) 88 *Michigan Law Review* 489. Ayres and Gertner support non-majoritarian default rules, but only where contracting costs are low. This is not relevant to torts cases.

[115] Ian Ayres, 'Empire or Residue: Competing Visions of the Contractual Canon' in Jack Balkin and Sanford Levinson (eds), *Legal Canons* (1997).

[116] Ibid.

[117] Ayres and Gertner, above n 114; Ian Ayres, 'Preliminary Thoughts on Optimal Tailoring of Contractual Rules' (1993) 3 *Southern California Interdisciplinary Law Journal* 1.

[118] Jules Coleman, Douglas Heckthorn and Steven Maser, 'A Bargaining Theory Approach to Default Provisions and Disclosure Rules in Contract Law' (1989) 12 *Harvard Journal of Legal & Public Policy* 639.

[119] This is especially true if domicile is manipulable, as it can be for companies. Plaintiffs might reasonably believe they are most likely to be injured by the agents of companies (truck drivers, sales staff, and the like).

The defendant would not agree to the *lex fori*, which is generally a plaintiff-favouring rule. However, forum shopping can be made a two-sided affair if the defendant can bring an anticipatory action for a declaratory judgment in a preferred forum.[120] Would we then find mutual agreement to the *lex fori*? The problem is that only one *lex fori* can apply at a time — one party must lose. The loser might be the person who invokes jurisdiction last.[121] Thus, each party has a chance of getting their preferred rule, provided they get to their forum first. Even if both parties thought they had an equal chance of winning, they are nonetheless likely to prefer another rule to the *lex fori*. The gains from getting to one's preferred forum first would be offset in whole or part by the risk of the losses if the other party got to his or her preferred forum first. If parties see matters in those terms, the *lex fori* may appear to offer very few advantages. Even though both parties would be better off settling out of court, the 'first-comer' *lex fori* rule would make some degree of wasteful litigation attractive to both parties. Each party not only wants to get to their preferred forum first, but wants to make the other believe that they are prepared to go to trial there if necessary.[122] The parties are therefore likely to prefer a rule which minimises litigation costs and which is less 'risky' in the sense that outcomes depend on post-accident 'moves'. This points to the *lex loci delicti* as the rule that a majority of parties would prefer to apply in discrete torts, with some control on disproportionate costs implemented through a stay rule, perhaps with a double actionability requirement for international torts. The parties can ascertain, on entering a jurisdiction, the standard of care they must take and the rights they will have if injured. The rule's tendency to standardise accident outcomes geographically may also decrease the uncertainty and therefore the cost of insurance.

This analysis is highly untailored. There is no reason to differentiate between a resident of a federation or a non-resident because of the irrelevance of identity in discrete torts.[123] How does the analysis change when identity *is* relevant, as when the parties are related? Can we justifiably partition non-contractual torts cases into two groups (one relational, the other discrete) in order to discover the choice of law rules?

There are two approaches to partitioning — a relatively untailored approach and a tailored approach. The first identifies that a relation exists between the parties and the legal system to which it has its most significant connections. For example, X's relation with her spouse would centre on the location of their mutual domicile. Where the parties to a tort have a pre-existing relation that should be a dominant consideration in determining the choice of law. We said earlier that, in the absence of knowledge regarding who was to be the plaintiff and who the defendant, parties would not select a choice of law rule based on *one*

120 See generally above Part II(D).

121 A part of this rule would be that there would be no entitlement to a stay application.

122 If that party was not so prepared, the other party would be able to refuse to settle on the basis of entitlements under that forum's law. This problem resembles the famous 'prisoner's dilemma' of game theory in which parties have individual incentives to prefer an option that is mutually disadvantageous.

123 MacNeil, 'Contracts', above n 10, 856–7.

of the party's connections. However, when the parties are substantially related that objection becomes weak. It is very likely that the parties would agree to the application of the law of the place implicated by their relation. They are likely to be more familiar with those laws (notice the relevance of information cost); they are likely to have insured in that jurisdiction; and that place is likely to be the forum in which litigation can be pursued at lowest joint cost.

The principle we express here resonates with the cases in which the courts have been called on to apply flexible exceptions. *Babcock*,[124] regarded as the harbinger of government interest analysis,[125] is an example. Our analysis suggests a different interpretation. We would reject the analysis that the *lex loci delicti* did not apply because the government of the *locus delicti* did not have an interest, but the *lex domicili* did. The interests of the government are difficult to discern in any way that does not invite refutation. Rather, the *lex loci delicti* did not apply because the parties would most likely agree to apply their mutual law to accidents inter se. The significance of relations explains why one might endorse this result in these sorts of cases but reject it where the parties are complete strangers but happen to share domicile. *Boys*[126] is a good example. There was no evidence of any relation — apart from common employment — and the parties were in different services. It was purely fortuitous that the defendant ran down a fellow citizen. As we saw above, each would rationally choose an investment in care based on the expectation of injuring or being injured by a Maltese domiciliary. That was their 'reasonable expectation'. There is no evidence that the defendant would agree to the application of English law should they adventitiously run over a fellow citizen.

Alternatively, one might ask which tort rules the actual parties would choose to apply to the tort.[127] There are problems with this approach. First, in non-contractual cases, there will often be little reliable evidence of what the actual parties want because the risk is relatively remote. There will rarely be 'similarly situated' contracts from which agreement might be reconstructed. Second, legal rules will rarely be used as behavioural influences in social and personal relations. The relationship between the two is much more likely to influence one of the parties to drive safely than is the prospect of a damages order.

Third, rule selecting approaches may increase moral hazard problems in other contracts. If H goes driving with W, to whom he is married, and W crashes the car in consequence of her negligence, a damages order is unlikely ever to be

[124] 12 NY2d 473; 191 NE2d 279 (NY Ct App, 1963). There are other examples: see, eg, *McElroy v McAllister* [1949] SC 110; *Tolofson* [1994] 3 SCR 1022; 120 DLR (4th) 289.

[125] *Olmstead v Anderson*, 428 Mich 1, 8; 400 NW2d 292, 299 (Mich Sup Ct, 1987); Brainerd Currie, 'Comments on *Babcock v Jackson*' (1963) 63 *Columbia Law Review* 1233; Michael Solimine, 'The Impact of *Babcock v Jackson*: An Empirical Note' (1993) 56 *Albany Law Review* 773.

[126] [1971] AC 356.

[127] This approach resembles a *rule-selecting* approach; whereas the untailored approach preferred in this article resembles a *jurisdiction-selecting* approach. The distinction was first made by David Cavers, 'A Critique of the Choice of Law Problem' (1933) 47 *Harvard Law Review* 173.

made. As between H and W, the damages order is a zero sum game.[128] However, the parties are likely to carry insurance. If so, the parties would, after the accident, argue that they would have contracted for the application of the law which maximised the plaintiff's recovery. This is a moral hazard problem. Fourth, if the court tailors the law from case to case, higher litigation costs would seem to be the likely result. The law will be unclear at the time proceedings begin. This, as we have shown, decreases the probability of settlement and results in higher litigation costs.

Hypothetical bargaining explains why one might relax a *lex loci delicti* rule applicable to discrete torts where there is a significant relation between the parties. The use of relational tort analysis should supersede the flexible exception in non-contractual torts. The court should not have a reverse discretion to apply the *lex loci delicti* to relational torts unless it also happens to be the place to which the relationship is most closely connected. Thus, in practice, the major differences between the flexibility exception and relational tort analysis are (1) the fact that unrelated parties (such as Boys and Chaplin) have their most substantial connections with a law other than that of the *locus delicti* does not displace the application of discrete tort methodology; and (2) once a sufficient relation is established, it is not open to a judge to refer the matter to the *lex loci delicti*, notwithstanding that it may increase the plaintiff's award. More importantly, relational tort analysis provides a theoretical basis for an area of law that might otherwise be dismissed as existing only to maximise the plaintiff's award.

What relations (other than contracts) suffice to establish the existence of a relational tort? Relational torts would include most cases in which the parties are injured together, for instance in the same automobile. Spousal and family relationships, friendship and sometimes common employment are clear cases.[129] Our reader, thinking of our analysis of *Boys*, may ask: 'Your examples are all very well, but how far do relations go? Does co-membership of Mensa, or the Fabian Socialists, or the Friends of Sviatoslav Richter count? Say, on a holiday to Denmark, I look up my third cousin Lauritz, whom I have not met before. What if he takes me on a drive and I'm injured. Where does your analysis leave me?' The relations that matter are those that transcend the space and the time of the tort. Our critic's relation with Lauritz is confined to their Danish drive. The relations we are interested in cannot be so easily tied to just that space or time. The more transitory the relation the more its analysis becomes coextensive with the discrete tort.

[128] This is a general truism about relations — the more significant the relation between the parties, the more the relation itself becomes a means of projecting exchange into the future: Ian MacNeil, 'The Many Futures of Contracts' (1974) 47 *Southern California Law Review* 691, 746–8.

[129] See, eg, *Nalpantidis v Stark* (1996) 65 SASR 454 (friendship); *Breavington* (1988) 169 CLR 41 (common employment between Breavington and Piercy).

IV CONCLUSIONS

In this article we have examined the law and economics of conflictual doctrine in tort cases. We have given an economic analysis of the effect of forum shopping on the costs of accidents. At least in non-contractual tort cases, forum shopping has its principal effects on the cost of litigation. It results in excessive expenditure on litigation by both parties to the action, and perhaps also by the state, given the greater number of hearings it invariably requires (such as challenges to jurisdiction). Forum shopping does not have significant effects on the incentives of parties to take care, either for themselves or others.

We have argued that the costs of accidents can be minimised by the combined effect of jurisdiction and choice of law rules. Jurisdiction rules should restrict the entitlement of a defendant to object to jurisdiction, while choice of law rules should minimise the plaintiff's incentive to choose a forum in order to maximise the award of damages. The extent to which the common law approximated these features depended very much on interpretation of the case law. Although we have given a partial defence of the double actionability rule, there is no doubt that a century of interpretation substantially weakened its ability to generate consistent outcomes across forums.

We have also demonstrated how hypothetical bargaining justifies both *lex loci delicti* and departures from it in relational cases. We argue that this theory provides greater explanatory force than government interest analysis or reasonable expectations. 'Justice' no longer needs to be achieved by making unpredictable exceptions to basic rules. With the right tools of analysis, conflicts of laws doesn't have to be so confusing after all, although it remains just as fascinating.