WHOSE LAW SHOULD APPLY FOR FOREIGN TORTS?

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TRADE REFORM and tort reform are both important issues now before Congress. Largely overlooked is an interaction between our product liability laws and current patterns of international trade that hurts both American business and American consumers.

In the wake of the toxic gas leak disaster in Bhopal, India, in December 1984, there has been intense legal jockeying over whether the case would be tried in the United States. The plaintiffs have fought to have the case heard here. Union Carbide Corp. has sought a trial in Indian courts.

American substantive law is only a secondary reason for wanting the cases heard here. The real attraction is the American procedural rules that would be applied.[1]

Beyond much more liberal discovery, the plaintiffs would have enjoyed much more generous rules concerning damages.

Non-economic awards for "pain and suffering" and a broad definition of "consequential damages" are but two forms of damages that are given much greater recognition in American courts than elsewhere. Beyond compensation lies punitive damages, also a procedural issue and also unavailable in most other countries.

Contingent fee rules are likewise procedural. Contingent fee arrangements provide an important public service by allowing plaintiffs' lawyers to advance the costs of litigation, thus permitting major suits on behalf of less-than-wealthy plaintiffs. Although illegal almost everywhere else in the civilized world,[2] if a foreign case is handled here, the lawyers are permitted to work on a contingent fee basis.

Raising a Claim's Value

If the case is heard in India and that nation's ordinary practices are followed,[3] the consensus of informed observers is that by the most "liberal calculation," the total award against Union Carbide would be less than $75 million.[4]

An award from an American court, however, would be many times larger. Using data on comparable claims compiled by the Rand Institute of Civil Justice, Peter Reuter, senior economist at the Rand Corp., and I calculate that compensatory damages could be as much as $235 million.[5] Possible punitive damages dwarf even this figure.

If Union Carbide had been found to have acted with reckless disregard of the welfare of those around the Bhopal plants, a figure 10 times larger, indeed a figure limited only by the net worth of the company, would have been a reasonable target.

It was the specter of punitive damages that probably led Union Carbide to offer a settlement of $350 million,[6] close to the likely compensatory award from an American court but many times higher than what might be expected from an Indian court. And, for the plaintiffs, it was also the opportunity for punitive damages that probably led them to reject the offer.

Although the Bhopal victims' attempt to get American courts to accept jurisdiction over their claims is well known, it is merely the prototypical example, albeit the largest, of a growing class of cases. Numerous aircraft and drug companies, for example, have been sued in this country for products sold abroad and, in some instances, even manufactured and licensed there.[7]

The majority of claims brought in American courts by foreign plaintiffs ultimately are dismissed — as, it appears, will be the ultimate fate of the Bhopal claims. But "majority" and "ultimately" are important qualifications.

The lesson to American firms doing business in other countries is clear: Assume that American levels of liability can be imposed on goods and services sold abroad — and act accordingly.

Exporting Safety

Many Americans will welcome this higher level of corporate accountability. We don't want to export dangerous products and manufacturing processes that exploit the unprotected citizens of other countries.

But, high levels of liability inexorably raise the price of goods and services, making them less competitive.

Other developed nations, even those with higher per capita wealth than our own, have not adopted a liability regime like ours. They rely on a combination of government regulation and social insurance to protect their consumers, and they have many rules that discourage product liability litigation.

Less-developed nations have little choice; they cannot afford one. Compare our per capita gross national product of $15,000 with India's of $256, for example. They tolerate lower product safety and workplace safety than do we because they value economic development more highly than safety — just as we once did.

Losing Foreign Markets

Placing higher levels of liability on American firms for activities abroad handicaps them as they compete against firms of other nations that do not carry similarly expensive liabilities.

Products differ, of course, in the amount of damage they can cause. For some products, such as a bar of soap, the degree of risk is quite small, and the concomitant rise in price trivial. But for other products, substantial market share can be at stake: Liability insurance constitutes about 10 percent of the cost of general aviation aircraft manufactured in this country;[8] for certain machine tools, liability insurance is as much as 15 percent.[9]

Recently, some U.S. companies have flirted with the creation of undercapitalized foreign subsidiaries. But this will not provide real protection, as American courts will likely go behind the sham of such arrangements to hold the parent liable.

Unreachable Foreign Producers

At the same time that we seem to be in the process of exporting our high level of tort liability to countries that do not want it, we are, ironically, failing to insist that it be fully applicable to the goods we import. The problem is not the applicability of our laws. All goods sold in this country are subject to state product liability laws. The problem is enforcing these laws against foreign manufacturers.

Many foreign firms do not have an actual business presence in this country, and instead work through independent export agents or wholly owned subsidiaries that take title before the products are exported. Although these middlemen are subject to the jurisdiction of American courts, they are often small operations with few assets, making them all but judgment-proof. Many subsidiaries, too, have insufficient assets, and the parent company may decide to let the subsidiary go under rather than pay a large claim.

Thus, recovery often requires gaining jurisdiction over the foreign producer itself. There are two ways to get jurisdiction over the foreign firm itself. Neither works very well.

The test for "piercing the corporate veil" is control and capitalization: Did the parent control the actions of the subsidiary? And, was the subsidiary undercapitalized? Both questions require the kind of evidence often available only through discovery. Unfortunately, foreign courts are unlikely to allow the needed discovery.[1] In many countries, disclosure of corporate records is a crime.

The second way to get jurisdiction over a foreign firm is through a "long-arm statute," which reaches out to parties who, although never in this country, are legitimately subject to suit here. The judicial test is whether the party had "minimum contacts" with the jurisdiction. In this context, to quote the Supreme Court, the issue is whether "a corporation delivers its products into the stream of commerce with the expectation that they will be purchased by consumers in the forum State."[10]

In February of this year, the Supreme Court made it even more difficult to gain jurisdiction over foreign firms. In *Asahi Metal Industry v. Superior Court of California*," the court held that California had unfairly asserted jurisdiction over Asahi, a Japanese manufacturer of tire-valve assemblies, even though it sold 100,000 assemblies per year to a Taiwanese company, which used them in tire tubes that were, in turn, sold worldwide.

Even when American courts gain jurisdiction over the parent company, foreign courts often frustrate attempts to obtain evidence proving that the product was defectively designed or manufactured. As usual, the Japanese add a further twist to trade issues: Many of their manufacturers use wholly owned subsidiaries to conduct research and development.

Faced with this lack of cooperation, some American courts, as a sanction, will award judgment for the plaintiff; others will not. But enforcing the award is another matter. Unless the foreign firm has assets in this country, the assistance of the courts in the firm's home country again is needed. As these courts were hostile to the question of discovery in the first place, they often refuse to enforce the award, or they impose numerous obstacles to its enforcement.

Lowering a Claim's Value

Thus, it can take years of costly litigation before there is any prospect of even partial compensation from foreign defendants. This uncertainty and delay means that smaller claims (say under $100,000) are all but uncollectible. They are simply not worth pursuing, even under contingent fee arrangements. Larger claims are worth pursuing, but their settlement value is much reduced.

Unprotected consumers would be enough reason for concern, but the relative freedom of foreign producers from our tort law also puts U.S. goods at a price disadvantage against foreign products that need not be priced

Continued on following page

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Continued from preceding page

to include the cost of American levels of liability. Again, products differ in the amount of harm they can do, and thus in the amount their price must be raised to provide for potential lawsuits. But for some, the price increase can substantially reduce market share.

In principle, the inability to receive full compensation for the injuries caused by foreign products should reduce their attractiveness, even if they are lower-priced. Or, it should cause middlemen to insist on a higher markup on the product's price. However, knowledge among consumers about this lower level of liability protection is limited, and many consumers do not value the added protection, anyway. Moreover, many sophisticated buyers realize that their insurance will cover their economic losses and that premiums do not go up when they purchase foreign goods.

Thus, foreign firms often enjoy a substantial cost advantage, with American consumers and insurance companies subsidizing the lack of protection. Of course, there comes a point at which the foreign firm's sales grow to require a substantial business presence in this country, so that full product liability can be enforced. But, by then, the initial price advantage will have helped it to build market share.

There are many reasons to be concerned about high levels of tort liability in this country. Nevertheless, good consumer policy and good trade policy seem to require that foreign producers be brought under the full ambit of our product liability laws.

Limiting Forum Shopping

Congress has ample authority under its commerce and foreign policy powers to pass remedial legislation. In Bhopal-type cases, American interests can be protected without closing our courts to foreigners bringing actions against U.S. firms and without making major changes in American tort law.

The law already recognizes the dangers of forum shopping and seeks to deter it by applying the "substantive" law of the country in which the tort occurred. However, American procedural rules can be an equally strong attraction to our shores.

Recognizing the reality that procedural rules can be as outcome-determinative as substantive rules, we should ensure that, when foreign cases are tried here, the procedural as well as the substantive law of the country where the injury took place is applied.[1] No one would suggest that American courts use the forms, filing deadlines, etc., of a foreign court. But it is possible to aim legislation at the heart of the problem: liberal discovery, expansive damages and contingency fees.

Congress should consider legislation limiting the availability of all three — discovery, damages and contingency fees — to the same degree as they would be available in the country where the injury occurred. If liberal discovery, expansive damages and contingency fees are important to the citizens of other nations, their governments should make them available against all firms — not just American firms that can be sued in our own courts.

There is already a precedent for such statutes. Many states have "borrowing statutes" that apply the statute of limitations of the other state when a claim is filed in their courts and that state's statute establishes a shorter time limit for filing a suit.

Congress should also consider legislation ensuring that American courts have jurisdiction to enforce our product liability laws against defective products manufactured abroad. To prevent the misuse of undercapitalized middlemen and subsidiaries, it could enact a more far-reaching long-arm statute giving American courts jurisdiction over firms producing goods likely to reach this country, or a statute requiring the producer of any goods entering this country to consent to being sued here.

To facilitate the enforcement of judgments, Congress might require goods entering the country to provide proof of sufficient funds in the United States to cover probable injuries caused by them. (A certificate of insurance or a letter of credit might be used to satisfy this requirement.)

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Clearly, the suggestions made in this article intrude on state tort law and court procedure, areas that Congress has been reluctant to enter for various political and policy reasons. This is one issue, though, on which the antagonists in both the tort and trade reform debates — trial lawyers, consumer advocates and business — should be able to agree. It is in the interest of all Americans to develop legal rules that facilitate the free — and fair — exchange of goods and investments.

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(1) The concept of procedural rules, as used in this article, encompasses all non-substantive rules governing litigation. In this sense, it is a somewhat broader use of the term than is often employed in choice-of-law analysis.

(2) G. Crovitz, "Curbing the Medical Liability Crisis: The English Rule On Costs as an Alternative to the Contingency Fee," Washington Legal Foundation Working Paper Series, No. 11 (February 1987) pp. 18-22.

(3) There is some suggestion that the Indian government is changing its tort laws to make a larger award possible, if not likely.

(4) S. Adler, "Bhopal Journal: The Voiceless Victims," 1, 133, The American Lawyer (April 1985).

(5) D. Besharov and P. Reuter, "Averting a Bhopal Legal Disaster," Wall Street Journal, May 16, 1985, p. 32.

(6) This figure comes from news reports. Union Carbide apparently offered a structured settlement with an initial payment followed by installments to be paid over a number of years. Thus, the present discounted cash value of the offer was substantially lower.

(7) E.g., Dowling v. Richardson-Merrell Inc., 727 F.2d 608 (6th Cir.1984), aff'g, 545 F. Supp. 1130 (S.D. Ohio 1982).

(8) Trade Development, Office of Aerospace, International Trade Administration, A Competitive Assessment of the U.S. General Aviation Aircraft Industry (June 1986).

(9) Personal communication between Milton Copulos, of the Heritage Foundation, and the author, Oct. 14, 1985.

(10) World-Wide Volkswagen Corp. v. Woodson, 444 U.S. 286, 297-298 (1980) (citation omitted).

(11) 55 U.S.L.W. 4197 (Feb. 24, 1987).

(12) Possible exceptions involve goods also sold in the U.S. and injuries to U.S. nationals while abroad.

It is difficult to enforce American tort law against foreign manufacturers whose goods are imported into the country.