

Exporting Tort Awards

BY ERIC HELLAND AND
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BOTH OF US RECENTLY MOVED TO CALIFORNIA AND brought along used cars. Even though our imported cars passed the California smog test, the state government forced us to pay a \$300 “smog fee.” Our

outrage was only slightly mollified when we realized that the tax makes an excellent illustration of a phenomenon we have discussed in our research, the tendency of state governments to discriminate against out-of-state residents. (Our outrage was further mollified when the California State Supreme Court recently declared this law unconstitutional.)

TAX EXPORTING PARALLELS

DISCRIMINATION AGAINST OUT-OF-STATE RESIDENTS IS common, although it is usually done more subtly than with the “smog fee.” States that attract a lot of tourists, for example, tend to rely more heavily than other states on hotel, food, and other taxes that fall primarily on out-of-state visitors. Land tends to be taxed more heavily in states that export resources like coal, gold, or timber. Similarly, states that export a lot of electricity tend to have high taxes on electricity. (On tax exporting see the articles “Tax Exporting and State Revenue Structures” by M. N. Gade and L. C. Adkins in the *National Tax Journal* and “Economic Regulation, Competitive Governments, and Specialized Resources” by M. T. Maloney et al. in the *Journal of Law and Economics*).

The reasons for “tax exportation” are not hard to see.

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State residents will vote for politicians who raise the ratio of resident services to resident taxes. A convenient way of raising this ratio is to shift taxes onto out-of-state residents. In a series of papers indicated in the readings list, we examine whether tax exporting also occurs in the state courts. In most court cases, the plaintiff sues in the state in which he or she lives but defendants are often corporations headquartered out-of-state. If tort awards are exported, therefore, we would expect to see larger awards, all else equal, against out-of-state defendants than against in-state defendants.

INCENTIVES TO EXPORT TORT AWARDS

IN SEARCHING FOR “TORT EXPORTING” WE HAVE TO BE careful to control for factors other than residency that might cause awards against out-of-state defendants to be larger than against in-state defendants. Out-of-state firms, for example, are more likely than in-state firms to be large and awards against large firms may be higher than against small firms because of a bias against deep pockets rather than because of a bias against out-of-state residency. We use several techniques to control for other factors, the most important of which is to divide our sample of trials into those decided in states which elect their judges and those decided in states with nonelected judges. If tort exportation exists, it is most likely to occur where judges are elected.

From the Judge's Mouth Elected judges, just like other politicians, have an incentive to shift costs from in-state to out-of-state residents (i.e., from in-state plaintiffs to out-of-state defendants) because only in-state residents are potential voters. Some evidence that judges might act that way is provided by Richard Neely, a retired West Virginia Supreme Court judge, who in his book *The Product Liability Mess* was unusually frank about his judicial incentives and actions:

As long as I am allowed to redistribute wealth from out-of-state companies to injured in-state plaintiffs, I shall continue to do so. Not only is my sleep enhanced when I give someone's else money away, but so is my job security, because the in-state plaintiffs, their families, and their friends will reelect me. (p. 4)

And, Neely continues, "it should be obvious that the in-state local plaintiff, his witnesses, and his friends, can all vote for the judge, while the out-of-state defendant can't even be relied upon to send a campaign donation" (p. 62).

Neely's second quote provides another reason to expect

tions. Although business organizations, such as the Chamber of Commerce, can lobby on behalf of large corporations in an effort to elect more restrained judges, their efforts suffer from a free-rider problem. No corporate plaintiff knows for certain where or when he will be sued, let alone which judge will preside over the relevant case. Thus, although contributing to all elections might on average produce more restrained judges, individual defendants have little incentive to contribute and instead free ride on the contributions of others. (Contributions to a judge's reelection chest, which occur after a trial has begun, are heavily monitored and are unlikely to be anywhere near as effective as contributions made much earlier in the process.) Trial lawyers by contrast know that they will have repeated dealings with most judges on the bench. In short, the marginal benefit of a contribution is much higher for a trial lawyer than for an out-of-state corporation.

The evidence on contributions is consistent with the theory that trial lawyers are an elected judge's primary contributors. Trial lawyers are by far the most important contribu-

tors to judicial campaigns. One study by the Florida Bar Association, for example, estimated that at least 80 percent of all campaign contributions to Florida judges are made by lawyers.

The campaign contribution theory implies that awards should be higher in states that have a partisan judicial election system. To reach the conclusion that awards against out-of-state defendants will be especially high we need the supplementary hypothesis that local defendants

(voters) will discipline judges who raise in-state awards. In-state defendants may be able to counter the campaign contributions of trial lawyers through their votes, but no such counter is available to out-of-state defendants.

An Example: *Pennzoil v. Texaco* In December 1985 a Texas jury awarded the Pennzoil Corporation more than \$10 billion dollars in damages (\$7.53 billion in compensatory damages and \$3 billion in punitive damages)—at the time the largest jury award in history. The Pennzoil case provides an extreme example of the combined effects of campaign contributions, tax exporting, and judicial elections. For example, when Texaco lawyers complained about large campaign contributions from Pennzoil's attorneys to judges ruling in their case, the lead Pennzoil attorney replied that no impropriety was involved because he had contributed money to almost every judge. The Texas court of appeals agreed with the reasoning of Pennzoil's attorney, noting: "It is not surprising that attorneys are the principal source of contributions in a judicial election.... A candidate for the bench who relies solely on contributions from nonlawyers must reconcile himself to staging a campaign on something less than a shoestring. If a judge cannot sit on a case in which a contributing lawyer is involved

"Not only is my sleep enhanced when I give someone else's money away, but so is my job security, because the in-state plaintiffs, their families, and their friends will reelect me." —Judge Richard Neely

that tort awards will be exported in states that elect their judges. Elected judges, again just like other politicians, must raise significant amounts of campaign funds. Importantly, the random assignment of judges to cases means that the most consistent contributors to judicial campaigns are trial lawyers. At any given moment some trial lawyers are working for the plaintiff and others for the defense. In general, however, all trial lawyers are interested in larger awards: larger awards mean larger fees, whether one works for the plaintiff or the defense. Consider two judges, both of whom rule in the plaintiff's favor equally often but one of whom tends to be more generous in the granting of awards. Defense and plaintiff's lawyers will both prefer that the more generous judge be elected because generous judges increase the demand for both plaintiff and defense lawyers. Judges who grant large awards will find fund-raising easier than their more "stingy" colleagues will. Thus, even if every judge applies the law with no consideration whatsoever for political factors, we can expect that over time generous judges will be selected for in states with an elected judiciary.

The Money Trail Unlike other participants, trial lawyers engage in repeated interactions with the same judges and so have the most incentive to make campaign contribu-

as counsel, judges who have been elected would have to recuse themselves in perhaps a majority of the cases filed in their courts (*Texaco v. Pennzoil*, 729 S.W. 2d 768, 843-844 [1987], *cert. dismissed*, 485 U.S. 994 [1987]).”

It is also interesting to note that Pennzoil never made a contribution to the judge who presided over their lawsuit. But Pennzoil’s lead attorney had not only contributed large sums—he was on the steering committee of the judge’s election campaign. Overall, Pennzoil lawyers gave hundreds of thousands of dollars to members of the Texas judiciary.

The Pennzoil case also illustrates bias against out-of-state residents. Despite the name, Texaco is a New York City corporation whereas Pennzoil is based in Houston where the trial was held. The \$11 billion award in favor of Pennzoil immediately bankrupted Texaco. It seems unlikely that a Houston judge and jury would have acted similarly had New York-based Texaco sued Pennzoil for a similar tort. In fact at trial, Pennzoil’s lawyers made New York vs. Texas

mores a key issue, repeatedly arguing that whatever the case in New York, in Texas a handshake was as good as a signed and sealed contract. Texaco repeatedly tried to move the trial to New York, and whenever they were able to do so (usually for short periods of time) they received rulings in their favor. The Pennzoil case is outstanding because of the size of the award but in other respects it is characteristic. (On the *Pennzoil v. Texaco* trial, see *Oil and Honor* by T. J. Petzinger.)

What about Juries? The theory articulated above focuses on judicial incentives or characteristics. Judges decide only a minority of tort cases directly (i.e., in nonjury trials) and occasionally decide cases by overruling juries. In the *Pennzoil v. Texaco* case, many people thought the judge would overrule the jury’s outrageous verdict and were shocked when he let the ruling, and the transfer of resources from the out-of-state defendant to the in-state plaintiff, stand. Our thesis does not require, however, that elected judges make blatantly biased rulings or that they often interfere in jury decisions. Judges have significant control over the trial outcome even without making use of their highest powers. Judges must interpret the law for juries, instruct the juries, allow or disallow objections, rule on motions and counter motions, limit or not limit the lawyers to certain theories of liability and damages, and so forth. Our thesis requires only that, compared with other judges, judges elected in a partisan electoral system make marginal changes in rulings that tend in the direction of supporting larger awards.

EVIDENCE

THE ELECTORAL HYPOTHESIS IS INTRIGUING, AND RICHARD Neely’s statement provides some support for the hypothesis, but perhaps Neely’s actions while on the bench were

unrepresentative or perhaps he is exaggerating. Perhaps the Pennzoil case is an anomaly. To test more systematically whether state courts exhibit bias against out-of-state defendants, we used data on more than 7,000 personal injury tort cases (A. Tabarrok and E. Helland, “Court Politics: The Political Economy of Tort Awards”). In each case, we identified whether the defendant was a corporation and if so whether the corporation was headquartered in-state or out-of-state. We then compared awards in states that appoint their judges with awards in states that elect their

Judges have significant control over trials even without using their highest power. Judges interpret the law, instruct juries, rule on objections and motions, and limit lawyers to certain theories.

judges in nonpartisan elections and in states that elect their judges in partisan elections. (In a nonpartisan electoral system judges are not allowed to run under the affiliation of any political party. In a partisan electoral system judges are identified by political party.) Table 1 summarizes the different types of judicial selection mechanisms for state courts.

Partisan Elections the Key We found few differences between awards in states that appoint their judges and awards in states that elect their judges on nonpartisan ballots. The differences between these states and those that use partisan elections, however, were shocking. Table 2 compares awards

Table 1

Judicial Selection in the United States

Partisan Elections

Alabama, Arkansas, Illinois, Mississippi, New York, North Carolina, Pennsylvania, Tennessee, Texas, West Virginia

Elected on Nonpartisan Ballot

Georgia, Idaho, Kentucky, Louisiana, Michigan, Minnesota, Montana, Nevada, North Dakota, Ohio, Oregon, Washington, Wisconsin

Appointed

Alaska, Arizona, California, Colorado, Connecticut, Delaware, Florida, Hawaii, Indiana, Iowa, Kansas, Maine, Maryland, Massachusetts, Missouri, Nebraska, New Hampshire, New Jersey, New Mexico, Oklahoma, Rhode Island, South Carolina, South Dakota, Utah, Vermont, Virginia, Wyoming

Source: A. Tabarrok and E. Helland, “Court Politics: The Political Economy of Tort Awards,” *Journal of Law and Economics* XLII (1999): 157.

Table 2

The Average Tort Award in Partisan and Non-Partisan States

	Partisan	Nonpartisan	Difference in Awards Due to Electoral System
Out-of-state defendant	\$652,720	\$384,540	\$268,180
In-state defendant	\$276,320	\$207,957	\$68,363
Difference in awards due to defendant headquarters	\$376,400	\$176,583	(\$199,817)

Source: A. Tabarrok and E. Helland, Court Politics: The Political Economy of Tort Awards, *Journal of Law and Economics* XLII (1999): 157

in two different ways. Reading across row 1 tells us that the average award against an out-of-state corporation was \$652,720 in a state that uses partisan elections to select its judges but only \$384,540 in a state that uses nonpartisan selection methods (appointed or elected on a nonpartisan ballot). Awards against out-of-state corporations were thus higher by \$268,180 in partisan than in nonpartisan electoral systems. Row 2 makes the same calculation when the defendant was located in-state. Awards were again higher in states using partisan elections but only slightly, by \$68,363. Combining these two pieces of evidence suggests that awards in general are slightly higher in partisan states, but the main difference is that the bias against out-of-state corporations is especially high in partisan states.

The same conclusion can be reached by reading down the columns of Table 2. What we see in this case is that awards are higher against out-of-state defendants in both partisan and nonpartisan states. This could be because of bias against out-of-state corporations in both electoral systems, but it might also be representative of a deep-pockets effect. As noted above, out-of-state corporations tend to be wealthier than in-state corporations or other defendants. Judges and juries therefore may be biased against out-of-state corporations not because they are foreign but because they are large. What we can say for certain, however, is that out-of-state corporations pay on average \$376,400 more than in-state corporations in partisan states but only \$176,583 more in nonpartisan states. The bias against out-of-state corporations is thus much larger in partisan than in nonpartisan states. This suggests that Neely’s allegation that elected judges facilitate redistribution is accurate.

The bottom right-hand corner of Table 2 presents the “difference in difference” figure that summarizes our findings. The bias against out-of-state corporations is on average \$199,817 larger in partisan than in nonpartisan states.

Awards are higher in partisan states because more cases in those states lead to exceptionally large awards (rather than each case leading to a somewhat higher award). To demonstrate this we divided awards into eight categories: awards of

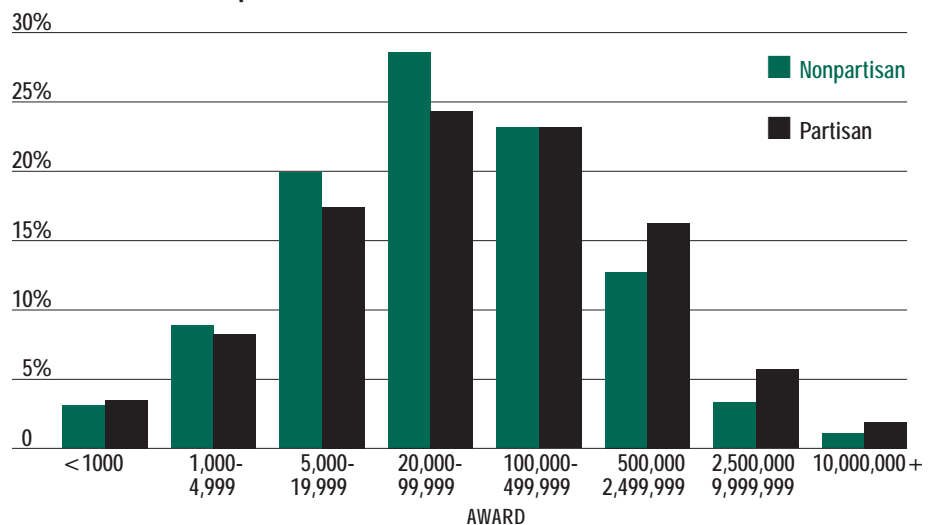
less than \$999; awards ranging from \$1,000 to \$4,999, \$5,000 to \$19,999, \$20,000 to \$99,999, \$100,000 to \$499,999, \$500,000 to \$2,499,999, and \$2,500,000 to \$9,999,999; and finally, awards of more than \$10,000,000. We then calculated the percentage of awards in each category. The graph in Figure 1 shows the percentage of awards in each category in nonpartisan and partisan states, respectively, vs. the size of award.

Figure 1 indicates that nonpartisan and partisan states have about the same percentage of cases in the less than \$1,000 dollar range but nonpartisan states have a greater percentage of cases in the \$1,000 to \$99,999 ranges. Nonpartisan and partisan states also have about the same percentage of cases in the \$100,000 to \$499,999 range. Partisan states, however, have significantly more cases in the greater than \$500,000 ranges. It is the greater percentage of large awards that pulls the average award up in partisan states. These results suggest that the majority of cases are decided similarly in partisan and nonpartisan states. Cases potentially involving a lot of money, however, are decided differently. When plaintiffs win these cases they are awarded significantly more money in partisan than in nonpartisan states.

Testing Other Factors To test the results from our differences in means study we ran a battery of additional studies. First, we asked whether other factors, such as differences in the types of cases or differences in injuries, could account for our findings. As a matter of theory, the possibility that other factors might be generating our results is low. We find that awards are not only higher in partisan election states but that they are especially high when the defendant is an out-of-state corporation. If partisan election states had more product liability or medical malpractice cases than other

Figure 1

Partisan vs. Nonpartisan Awards



states, or if for some reason injuries tended to be more serious in those states, it could explain higher awards in general in those states. But it is difficult to explain why either of these factors would generate especially high awards against out-of-state defendants.

Nevertheless, we performed a test similar to the above after controlling for case types, injury levels, and major differences in tort law such as caps on punitive damages (see our article, “Court Politics”). We continued to find that awards against out-of-state defendants were much larger on average in partisan election states than in states where judges are appointed or are elected in a nonpartisan electoral system.

A second paper on this subject (“The Effect of Electoral Institutions on Tort Awards,” available online) adds three important pieces of evidence. First, we replicated the results using a much larger data set. Thus, our results were not due to statistical fluke. Second, we controlled for any potential bias due to selection effects. Third, and most importantly, we controlled for all differences in tort law across the states. We discuss the second and third changes in greater detail.

One criticism of the results presented above is that trial outcomes do not inform a researcher about all litigation because more than 90 percent of all legal actions settle before a trial. Thus, in statistical jargon, the sample of cases that go to trial is not random. Our initial study looked only at trial awards. So it is possible that some factor we were not aware of was altering the types of cases that would settle in just such a way that trial awards against out-of-state-defendants in partisan election states looked larger than in other states. Admittedly this possibility was slim but the more important and improbable a result the more incumbent it is upon researchers to support that result by eliminating alternative explanations. When we controlled for selection effects we continued to find that awards against out-of-state defendants were much larger in partisan election states than in other states.

A second criticism of the difference between states that elect and states that do not elect judges is perhaps more problematic. Could it be that states with partisan judicial elections have differences in their laws that lead to larger awards? If the cause of larger awards is a more generous (from the plaintiff’s perspective) set of liability rules in states with partisan judicial elections, then reforming the electoral system will have a limited effect. We had already controlled for major differences in tort law across the states, but each state has its own system of tort law, which is partially based on legislation and partially based on unwritten interpretations of the common law. It is not easy, therefore, to document the many ways in which the law of tort differs across the U.S. states. Instead of fruitlessly

trying to document these differences we controlled for differences in tort law by taking advantage of a peculiar aspect of American federalism. In cases involving citizens of different states, aptly called diversity of citizenship cases, *federal judges apply state law to decide disputes*.

The Constitution (Art. III, Sec. 2(1)) gives the federal courts the power to decide controversies between citizens of different states. Historically, federal diversity jurisdiction was supported by out-of-state businesses that feared they would be disadvantaged in pro-plaintiff/pro-debtor state courts. For over a century, federal judges decided diversity of citizenship cases based on federal common law. The Supreme Court, however, overturned that rule in the 1938 case *Erie Railroad v. Tompkins*. Since 1938 diversity cases have been decided on the basis of state law.

Diversity of citizenship cases, therefore, provide an ideal natural experiment. Federal judges are appointed and have life tenure. Thus, our test becomes do federal judges make the same decisions as elected state judges when both apply the same law?

The problem is not just out-of-control judges or greedy lawyers. When tort law puts almost no limit on punitive awards or on the absurdity of claimed harms is it any surprise that lawyers and judges can use the system to pillage defendants?

To be precise, we gathered a sample of diversity of citizenship cases and asked whether awards were higher against out-of-state defendants in partisan election states when federal judges made decisions or only when state judges made decisions. If awards were higher on average against out-of-state defendants in partisan election states regardless of whether federal or state judges presided, then we would conclude that differences in law were driving our results. If, on the other hand, awards were higher only when state judges were trying cases, it would follow that our results were due not to differences in law but to differences in judicial incentives driven by the electoral system.

Our results were robust. When federal judges rule, we found no statistically significant differences in awards against out-of-state defendants in partisan election states. We only observed such differences in the sample of cases decided by state judges. Moving an otherwise average case from a nonpartisan to a partisan state in the state courts raises the expected award by some 23 percent (about \$233,000). Moving a case from a nonpartisan to a partisan state in the federal courts, however, does not systematical-

ly increase the award. We are confident, therefore, that incentives and not differences in case types, injuries, law, or other factors are responsible for the much higher awards against out-of-state defendants in partisan election states.

CONCLUSION AND DISCUSSION

OUR STUDIES PROVIDE EVIDENCE THAT IN STATES THAT select their judges using partisan elections the courts are significantly biased against out-of-state defendants. When surveyed, lawyers who removed their cases from state to federal court under federal diversity jurisdiction rules consistently maintain that one of the key reasons for removal is fear that the state courts are biased against out-of-state defendants (see N. Miller, "An Empirical Study of Forum Choices in Removal Cases under Diversity and Federal Question Jurisdiction," in the *American University Law Review*). Prior to the studies noted in this paper, however, little data existed to support the fears of lawyers. Indeed, a large legal literature exists arguing that any bias that once might have existed in the state courts is a thing of the past and that today there is no need to maintain federal jurisdiction over diversity of citizenship cases. The results in this paper caution strongly against such a view. Although the evidence of judicial bias is strong in the states where judges are selected by partisan election, we found little evidence that the federal courts were biased. Diversity jurisdiction is thus a useful and significant aspect of U.S. federalism.

Removing a case to federal court, however, can be quite difficult and is not an option for every out-of-state defendant. If diversity exists, a defendant may *remove* the case to the federal courts but only if the amount in dispute is at least \$50,000. Diversity, moreover, must be "complete." If any of the defendants reside in the same state as the plaintiff, diversity does not exist. A plaintiff in a product liability case, for example, could potentially avoid removal by suing a local distributor as well as the product's manufacturer. Moreover, every defendant must join in a notice of removal; if even one defendant prefers to litigate in state court, removal will not occur. Since the plaintiff has many ways to "defeat" diversity, removing a case to the federal courts can often be expensive and time consuming (for a further discussion of the ways in which diversity can be defeated, see *Law of Federal Courts* by C. A. Wright).

Is abandoning partisan elections a step in the right direction? Our evidence shows that the "merit system," basically appointment by the governor followed by an up or down retention election by the people, reduces awards. But before abandoning partisan elections it is important to remember that our study looks only at tort awards. Elected judges may be a useful bulwark against monopoly government, especially in criminal cases. We would caution against using our results to abandon partisan elections before considering all of the effects, good and bad, of electing judges.

Are all judges in partisan election states biased against

out-of-state corporations? Of course not. It is safe to say that most judges, whether elected or appointed, rule without bias. But all it takes to drive awards sky-high is a single judge willing to steer juries toward multi-million-dollar awards. It is no accident that lawyers from across the United States fly to Alabama to file their class action suits. The problem is not just out-of-control judges and greedy lawyers. When tort law puts almost no limit on punitive awards or on the absurdity of claimed harms is it any surprise that lawyers and judges can use the system to pillage defendants? Limit awards to scientifically proven compensatory damages and the electoral system might become a less significant determinant of awards.

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