# No. 15-41172

## In the United States Court of Appeals
## For the Fifth Circuit

UNITED STATES OF AMERICA, EX REL., JOSHUA HARMAN,
*Plaintiff-Appellee*,

v.

TRINITY INDUSTRIES, INC.; TRINITY HIGHWAY PRODUCTS, L.L.C.,
*Defendants-Appellants*.

Appeal from the United States District Court for the
Eastern District of Texas, Marshall Division; No. 2:12-CV-00089

# BRIEF OF THE CATO INSTITUTE AS AMICUS CURIAE IN SUPPORT OF APPELLANTS

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## STATEMENT OF INTEREST

The Cato Institute was established in 1977 as a nonpartisan public policy research foundation dedicated to advancing the principles of individual liberty, free markets, and limited government. Cato's Center for Constitutional Studies was established in 1989 to promote the principles of limited constitutional government that are the foundation of liberty. Toward those ends, Cato publishes books and studies, conducts conferences, produces the annual *Cato Supreme Court Review*, and files *amicus* briefs.

This case is important to Cato because of its significance for individual liberty and free markets. Cato supports a properly functioning civil tort system as an alternative to government regulation. Indeed, protection against fraud is essential to a functioning marketplace. But excessive civil liability—like excessive regulation—threatens to drive companies from the market, thus depriving the public of the benefits of innovation and competition.

All parties have consented to the filing of this brief. Fed. R. App. P. 29(a). No party's counsel authored this brief in whole or in part; no party or party's counsel contributed money intended to fund preparing or submitting the brief; and no person, other than *amicus*, its members or its counsel, contributed money intended to fund its preparation or submission. Fed. R. App. P. 29(c)(5).

## SUMMARY OF THE ARGUMENT

Although legal protections against force and fraud are necessary to ensure a functioning market, excessive liability can create risk and impose undesirable costs on businesses, thus harming the market, innovation, and public safety. The costs of this judgment may fall directly on Appellants, but the ultimate injury will be to society as a whole.

## ARGUMENT

Legal liability affects market behavior. As rational economic actors, businesses account for the potential costs of such liability and alter their behavior accordingly: "No one doubts, for example, that a profit-maximizing firm will tend to ignore social costs that are not reflected in financial outflows, or that it will take account of costs that are reflected in financial outflows and, perhaps, change its behavior in response." Daryl J. Levinson, *Making Government Pay: Markets, Politics, and the Allocation of Constitutional Costs*, 67 U. Chi. L. Rev. 345 (2000).[1]

This is intuitive. Product liability rules, for example, may remove dangerous products from the marketplace or prevent them from being introduced in the first place. *See* A. Mitchell Polinsky & Steven Shavell, *The Uneasy Case for Product*

[1] For a general work on the economic impact of liability rules, see Harold Demsetz, *When Does the Rule of Liability Matter?*, 1 J. Legal Stud. 13 (1972), which discusses how legal liability affects resource allocation in light of the Coase Theorem.

*Liability*, 123 Harv. L. Rev. 1437, 1454 (2010) (discussing the role for product liability law when consumers might not recognize the benefits of safety features).

These effects often benefit society. The free market requires protections against force and fraud. *See, e.g.*, Stephanos Bibas, *The Myth of the Fully Informed Rational Actor*, 31 St. Louis U. Pub. L. Rev. 79 (2011) ("Free markets require only the most modest regulation to prevent force, threats, fraud, and deceit; governments need not go much further to help buyers assess the substantive desirability of deals."); Richard A. Epstein, *Living Dangerously: A Defense of* Mortal Peril, 1998 U. Ill. L. Rev. 909, 910 (1998) (noting "the common-law defenses of duress, fraud, infancy, and incompetence" to contracts).

At its best, our tort system operates as "a flexible, free-market based, and cost-effective alternative to a burdensome and expensive European-style regulation scheme, social insurance scheme, or a combination of the two." Michael L. Rustad, *Torts As Public Wrongs*, 38 Pepp. L. Rev. 433, 549 (2011).

The False Claims Act fits within this framework. The federal government, no less than other market participants, should be protected against fraud.

But although legal liability can support the market and benefit the public, erroneous or excessive liability can undermine markets and injure public welfare. There is an optimal level of deterrence, and over-compensation injures the public in the same manner as under-compensation. *See* Bruce Chapman, *Corporate Tort*

*Liability and the Problem of Overcompliance*, 69 S. Cal. L. Rev. 1679, 1681 (1996) (arguing that "tort law induces excessive levels of corporate care"). In evaluating liability, "it is wrong to consider only those instances where it may do some good, albeit at a high cost, while ignoring the frequent instances where its use is either costly or harmful." Richard A. Epstein, *The Case for Field Preemption of State Laws in Drug Cases*, 103 Nw. U.L. Rev. 463, 470 (2009).

Rational businesses must incorporate the potential costs of litigation and liability into the price of their products. Even if pricing goods to reflect expected harms helps consumers make efficient purchasing decisions, additional price increases due to litigation costs or excessive liability is a distortion that injures consumers who forego purchases as a result. *See* Polinsky & Shavell, *supra*, at 1471 (discussing litigation-cost price distortion in analyzing product liability). Taken to a logical extreme, increased prices resulting from increased risk of product liability "could be so high that it would discourage most consumers from purchasing the product and consequently cause the manufacturer to withdraw the product from the marketplace or to go out of business." *Id.* at 1472. Such a product withdrawal would mean that consumers who would have purchased and enjoyed the product in the absence of excess liability rules will be worse off.

In a variety of contexts, scholarship recognizes that risks of liability can harm the public good by depriving consumers of innovative products. For example,

one author argued that innovation in digital streaming was chilled by ambiguities in the application of the Copyright Act: "[T]he chance (even if remote) that a court could find liability, multiplied by the massive retroactive damages that can result under the Copyright Act . . . yields a discounted penalty that is unacceptably high, especially for a cash-poor and risk-averse start-up business, as technological innovators often are." Jonah M. Knobler, *Performance Anxiety: The Internet and Copyright's Vanishing Performance/Distribution Distinction*, 25 Cardozo Arts & Ent. L.J. 531, 577 (2007); *see also* Alexander E. Silverman, Symposium Report, *Intellectual Property Law and the Venture Capital Process*, 5 High Tech. L.J. 157, 160 (1990) (noting that the threat of litigation can deprive a start-up of financing and that preventative measures reduce venture capitalists' return on investment).

Similarly, risks of tort liability have deprived the public of beneficial drugs: "Drug companies often impose additional hurdles to the availability of these unapproved drugs because they are worried about tort liability and their ability to recover the costs for the new treatments." Richard A. Epstein, *Against Permititis: Why Voluntary Organizations Should Regulate the Use of Cancer Drugs*, 94 Minn. L. Rev. 1, 18 (2009); *see also* Epstein, *The Case for Field Preemption*, *supra*, at 470 ("Where the regulatory process lets drugs correctly on the market, litigation remains costly even if it vindicates the defendant. Worse still, litigation has disastrous consequences if safe and useful drugs are subject to extensive tort

liability."). The California Supreme Court, not particularly known for a pro-business tilt, has discussed several such examples, including when "[d]rug manufacturers refused to supply a newly discovered vaccine for influenza on the ground that mass inoculation would subject them to enormous liability." *Brown v. Superior Court*, 751 P.2d 470, 479 (Cal. 1988).

Although the immediate effects of an erroneous judgment fall on a single defendant, the broader costs are imposed on society as whole, as other businesses potentially facing similar liability account for the same risks.

This case illustrates the potential for excessive liability to undermine the functioning of markets. As Appellants' brief details, although this False Claims Act suit purports to recover for injuries to the United States, the "victim" denies that it has been defrauded: "An unbroken chain of eligibility for Federal-aid reimbursement has existed since September 2, 2005 and the ET-Plus continues to be eligible today." ROA.4306; *see also In re Trinity Indus., Inc.*, No. 14-41067 (5th Cir. Oct. 10, 2014) (per curiam) (noting that this letter "seems to compel the conclusion that FHWA, after due consideration of all the facts, found the defendant's product sufficiently compliant with federal safety standards"). No public good is served by imposing liability in such a situation.

To the contrary, the potential costs to the market and to public welfare are extraordinary. This is the largest False Claims Act judgment in history, and

businesses producing (or considering producing) products that receive federal reimbursement must account for this additional risk. The remedy provisions of the False Claim Act—which include treble actual damages and civil penalties—make the dangers of erroneously-imposed liability particularly severe.

Some businesses will respond by withholding innovative products from the marketplace, either by not improving existing products or by not entering the market at all. Others may merely increase the price of their products to reflect the additional risk, increasing the amount of federal reimbursement that must paid. Either way, if this judgment is affirmed, its costs will be borne not merely by Appellants but by society as a whole.

## CONCLUSION

Although legal liability plays an important role in the functioning of the free market, excessive liability distorts the market and harms the public welfare. *Amicus* respectfully suggests that the judgment should be reversed.

Respectfully submitted,

By: */s/ William R. Peterson*

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## CERTIFICATE OF SERVICE

I hereby certify that on March 28, 2016, a true and correct copy of the above and foregoing Brief of the Cato Institute as Amicus Curiae in Support of Appellants was forwarded to all counsel of record by the Electronic Filing Service Provider, if registered, otherwise by email, as follows:

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## CERTIFICATE OF COMPLIANCE

1. This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because: this brief contains 1,530 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because: this brief has been prepared in a proportionally spaced typeface using Microsoft Word 2007 in Times New Roman 14 pt. font.

Dated: March 28, 2016.

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