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The Rule of Liability for Loss of Use When Property Is Totally Destroyed: Some Economic Considerations

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In this article Professor De Alessi applies economic analysis to a California case which held that a tortfeasor who negligently destroys property which he rented is liable to the lessor for loss of use during the time in which a replacement is being procured. In arriving at the conclusion that the court may have made the correct decision despite the lack of economic considerations, a framework for economic analysis is suggested which may well be extendable to other factual situations.

I. Introduction

Both lawyers and economists have been interested in exploring the economic consequences of alternative rules of liability ever since Professor Coase, in a landmark essay, showed how economic theory could be used to provide significant insights into this problem.[1] Although the subsequent literature has been relatively extensive and unusually good,[2] much remains to be done both at the theoretical level by clarifying some of the finer points involved, and at the practical level by applying the analysis to particular classes of cases.

This article examines a change in the California rule of liability for loss of use when property is totally destroyed. In *Reynolds v.*

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1. Coase, *The Problem of Social Cost*, 3 J. Law & Econ. 1 (1960).

2. *See* G. Calabresi, The Costs of Accidents: A Legal and Economic Analysis (1970); McKean, *Products Liability: Trends and Implications*, 38 U. Chi. L. Rev. 3 (1970); Oi, *The Economics of Product Safety*, 4 Bell J. Econ. & Manag. Sci. 3 (1973).

Bank of America National Trust & Savings Association,[3] the Supreme Court of California agreed with plaintiff that precluding recovery for loss of use during the period reasonably required for replacement when personal property was totally destroyed was unfair and inconsistent. It was unfair because the owner of the wrongfully destroyed property was made to bear the cost of the loss, and it was inconsistent because other state rules allowed recovery under apparently similar circumstances. Economic considerations, however, suggest that the questions of fairness and consistency at best were handled superficially.

The decision is particularly interesting because it appears that the rule is gaining broad support. The federal government and numerous states are in accord with *Reynolds.*[4] Moreover, the theoretical considerations at issue are equally applicable to other classes of cases involving a change in the rule of liability.

Section II contains a brief summary of the facts and of the findings in *Reynolds.* Section III presents an economic analysis of pertinent issues which would have been helpful in the disposition of this and similar cases. Section IV contains a few concluding remarks.

II. THE FACTS

On November 12, 1955, in California, Wesley Reynolds rented a small airplane to Robert Duncan. On November 13 Duncan negligently ditched the plane in the Pacific Ocean. The plane was totally destroyed, and Duncan lost his life. Reynolds then brought suit against the Bank of America, the executor of Duncan's estate. The case was tried in the Superior Court of San Mateo County before a jury and resulted in a verdict for the plaintiff in the amount of $30,000, the purchase price of a new plane. In the course of the trial, Reynolds unsuccessfully sought to introduce evidence regarding loss of use or loss of profits during the time lag (allegedly a minimum of four months) involved in obtaining a replacement plane of similar make.

Reynolds appealed from the portion of the judgment denying recovery for loss of use. The district court of appeals reversed with an instruction to retry the issue of damages for loss of use.[5] Defendant requested a rehearing. When that was denied, he obtained a

3. 53 Cal. 2d 49, 345 P.2d 926 (1959).
4. For an index of the jurisdictions which have accepted the rule, see Annot. 18 A.L.R. 3d 497 (1968).
5. 335 P.2d 741 (Cal. Dist. Ct. App. 1959).

hearing before the Supreme Court of California.

The primary issue before the supreme court was clear: should the owner of personal property which has been wrongfully destroyed be limited in damages to the value of the property at the time of destruction, or should recovery include the loss of use or profit foregone during the period reasonably required for the replacement?[6]

Prior to *Reynolds,* the rule in California was that loss of use (presumably the wealth foregone) was not recoverable when personal property was totally destroyed.[7] Section 3333 of the California Civil Code, however, provided: "For the breach of an obligation not arising from contract, the measure of damages, except where otherwise expressly provided by this Code, is the amount which will compensate for all the detriment proximately caused thereby, whether it could have been anticipated or not."[8] Under section 3333, the owner of a motor vehicle damaged by the wrongful action of another person was found to be entitled to recover for the damage to the vehicle and for the loss of use during the period reasonably required to repair it.[9]

Predictably, plaintiff argued that the rule precluding recovery for loss of use was unfair and that it was inconsistent with other rules pertaining to loss of use. Defendant argued that prior cases supported his position.

Chief Justice Gibson, writing for the Supreme Court of California reasoned:

> There appears to be no logical or practical reason why a distinction should be drawn between cases in which the property is totally destroyed and those in which it has been injured but is repairable, and we have concluded that when the owner of a negligently destroyed commercial vehicle has suffered injury by being deprived of the use of the vehicle during the period required for replacement, he is entitled, upon proper pleading and proof, to recover for loss of use in order to "compensate for all the detriment proximately caused" by the wrongful destruction.[10]

6. The procedural issues involved in the case are disregarded for present purposes.

7. To buttress this position, defendant cited Pfingsten v. Westenhaver, 39 Cal. 2d 12, 244 P.2d 395 (1952); Lane v. Spurgeon, 100 Cal. App. 2d 460, 223 P.2d 889 (1950); Shook v. Beals, 96 Cal. App. 2d 963, 217 P.2d 56 (1950); Bedell v. Mashburn, 87 Cal. App. 2d 417, 197 P.2d 98 (1948); Tatone v. Chin Bing, 12 Cal. App. 2d 543, 55 P.2d 933 (1936).

8. CAL. CIV. CODE § 3333 (West 1970). The California statute remains unchanged.

9. Valencia v. Shell Oil Co., 23 Cal. 2d 840, 147 P.2d 558 (1944); Johnson v. Central Aviation Corp., 103 Cal. App. 2d 102, 229 P.2d 114 (1951); Tremeroli v. Austin Trailer Equip. Co., 102 Cal. App. 2d 464, 227 P.2d 923 (1951).

10. 53 Cal. 2d at 50-51, 345 P.2d at 927.

Accordingly, the trial court's judgment was reversed with instructions to try the issue raised by the plaintiff's claim for loss of use.[11]

III. ECONOMIC ANALYSIS

Reynolds has some interesting economic characteristics which are relevant to the disposition of this and similar cases, but which do not appear to have been examined in the course of the proceedings.

Taking the simplest point first, recall that the plaintiff argued, *inter alia,* that it would be unfair for him to bear the decrease in wealth resulting from loss of use. The defendant, however, could have countered that the rental price which he paid already included compensation for bearing such risk and, therefore, the plaintiff had no cause of action on this issue.[12] Prior to the decision in the instant case, California law clearly did not allow recovery for loss of use when property was totally destroyed as a result of negligence. Under this rule, a bailor could take out additional insurance to protect himself against the possibility of this loss or he could insure himself.[13] In either event, to survive in business a bailor would have had to take the probability of such losses into account in estimating rental costs. Thus, the existing rule of liability increased his cost of doing business and would have resulted in a suitably higher rental price.[14] Under open market conditions, that is, in the absence of collusion and of legal restrictions on entry and pricing, the interplay of buyers and sellers typically would have led to a rental price which would have included whatever compensation was necessary ex ante

11. In support of his conclusions, Chief Justice Gibson cited the following authority: Guido v. Hudson Transit Lines, 178 F.2d 740, 742-43 (3rd Cir. 1949); Buchanan v. Leonard, 127 F. Supp. 120, 122 (D. Col. 1954); Louisville & N. R. Co. v. Blanton, 304 Ky. 127, 200 S.W.2d 133, 138 (1947); Louisville & N. R. Co. v. Schuester, 183 Ky. 504, 209 S.W. 542, 543-45 (1919); Paguid v. Evening Journal Ass'n, 127 N.J.L. 144, 21 A.2d 667, 668 (1941); Park v. Moorman Mfg. Co., 121 Utah 339, 241 P.2d 914, 920-21 (1952); RESTATEMENT OF TORTS, § 927 (1939).

12. Although the argument might have been precluded by existing California law as stated in Anheuser-Busch, Inc. v. Starley, 28 Cal. 2d 347, 170 P.2d 448 (1946), the award of damages for loss of use when the rental price included compensation for bearing risk could be argued to constitute double recovery and thus be considered inequitable. *Cf. id.* at 451 (Traynor, J. dissenting).

13. A bailor could also recontract with the bailee, compensating him for making his own insurance arrangements. However, there is no evidence that this in fact occurred in the case at hand.

14. The expected loss is determined by the probability of loss, the amount of the loss if the event in fact occurs, and the probability that the court will enforce the rule. The greater the probability that the court will enforce the rule, the greater is the expected loss, and the higher is the increase in the rental price that will be necessary to compensate the bailor.

to compensate a bailor for the risk of loss under the existing rules of liability.[15]

It is possible, but immaterial to the merits of the case, that the plaintiff might have neglected to take out any or enough insurance or that his self-insurance turned out to be inadequate. In either event, he simply made a mistake in business judgment, a mistake for which it would have been difficult to hold the defendant accountable.

Turning to the more interesting question of consistency, the supreme court might well have decided to reconsider the existing rule of liability.[16] The holding by Chief Justice Gibson quoted earlier simply states that there are no logical or practical reasons for distinguishing between cases in which property is totally destroyed and those in which it is repairable.[17] This statement, however, provides no basis for deciding *which* rule should be changed. Although a reasonable man might well be satisfied with the court's sense of neatness and fair play, there are some economic considerations that might have been helpful in determining whether or not the distinction was logical and practical.

Professor Coase has shown that, if transaction costs[18] are zero, the rule of liability does not affect the output mix (the allocation of resources) except, perhaps, through changes in the distribution of wealth.[19] Thus, if bailors were liable for loss of use *and* if they could

15. The argument has to be addressed to the extent that any compensation at all occurred. In the absence of collusion and of legal restrictions on entry and contracting (*e.g.*, price control) both competitive and monopolistic market structures normally imply full compensation. This must be so, since firms unable to cover costs simply leave the industry.

16. In this event, however, it seems unfortunate that the change should be applied ex post to the case being considered rather than applied henceforth to all subsequent cases with similar characteristics. The latter approach, of course, would discourage litigation and increase the life expectancy of existing rules—and *that* may be inefficient on net balance.

17. A vehicle may be considered totally destroyed if the cost of repairing it is greater than the cost of replacing it less salvage, all values suitably discounted to the present. If a bailee is liable for loss of use only when property is repairable, he has less incentive to take precautions to prevent total destruction.

18. Transaction costs include negotiation, contracting, enforcement, and information costs.

19. This conclusion has become known as the "Coase Theorem." In the main example used by Coase to prove his point, whether cattlemen are liable for crop damage caused by straying cattle or whether farmers have to bear the cost will not affect either the size of the herd or the output of crops. If the initial assignment of liability rests on the higher cost producer of the remedy, both parties will gain if the higher cost producer will contract with the lower cost producer and compensate him for taking the appropriate remedy. For example, when the farmer is held liable, but it is more economic to reduce the size of the herd than to reduce the acreage tilled, both parties will gain if the farmer contracts with the cattleman and compensates him for reducing the size of the herd.

In the cattle example, the individual initially held liable will have to bear the cost of the remedy, and his wealth will be correspondingly lower. Thus, the initial assignment of insure and take suitable precautions more cheaply than bailees, they simply would do so. If bailors were liable but bailees could handle such matters more cheaply, however, it would benefit both parties to recontract and let bailees perform the necessary activities.[20] Symmetrically, if the bailees were liable and could undertake the necessary activities more cheaply, they would do so. If bailors could take the precautions more cheaply, it would pay both parties to recontract and let bailors perform the activities.[21] To restate the point in more general terms, recontracting will take place until each party performs each activity to the extent to which he enjoys a comparative advantage. In all four situations just discussed, the full rental price (the price including insurance) paid by a given bailee would be the same,[22] since the same least cost producers would perform the same services which would be paid for directly or indirectly, explicitly or implicitly, by the same bailees. Thus, both the allocation of resources *and* the distribution of wealth would be unaffected in the absence of transaction costs.

The introduction of third parties, such as a passenger or an innocent bystander, leaves part of the analysis unchanged. As before, each individual in the enlarged set of participants would un-

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liability affects the relative wealth of the parties. Since an individual's wealth is a major determinant of his demand for various goods and services, a change in his wealth implies a change in his demand functions. However, many of the changes in demand for a particular good or service registered by different individuals will be offsetting due to some individuals buying more of a good and other individuals buying less. Thus, the net effect on the market demand for various goods and services—and, therefore, on the output mix—typically will be small and its incidence and direction indeterminate without detailed study. Accordingly, for most purposes the allocation of resources can be assumed to be unchanged as a result of changes in the distribution of wealth. Coase, *supra*, note 1, *passim*.

20. Suppose that the cost of producing rental services, excluding liability coverage against loss of use, is $50 per flying hour, and that liability coverage can be provided at $4 per flying hour by least cost producers or at $10 per flying hour by all other producers. If bailors are liable and are also the least cost producers, they will offer airplanes at the full rental of $54. If bailors are liable but bailees are the least cost producers, it would cost the bailors $60 to provide both services. Accordingly, it would benefit both parties to recontract and let the bailees provide their own liability coverage. That is, the contract would provide that the bailor would rent the plane for $50 and that the bailee would assume liability for loss of use, purchasing insurance from other sources at a cost of $4 and paying a full rental price of $54. Alternatively, the bailor could contract to rent the plane for $54 and then contract separately to purchase the liability coverage from the bailee for $4, again yielding a full rental price to bailee of $54.

21. The hypothetical presented in note 20 *supra* can be extended easily to this situation. If bailees are liable and are also the least cost producers, they will simply rent the plane at $50 and provide their own liability coverage at $4, paying a full rental price of $54. If the bailees are liable but the bailors are the least cost producers, the bailees will contract to purchase liability coverage from the bailors, thereby paying a full rental price of $54.

22. Different individuals with different incomes, different risk aversions, and different accident proclivities would purchase insurance baskets differing in quality and amount. Accordingly, different bailees might well pay different full rental prices.

dertake each activity to the extent to which he held a comparative advantage, and the rule of liability would affect neither the full economic cost of the activity nor, wealth effects aside, the allocation of resources. The incidence of the costs, however, would be affected, thereby affecting the distribution of wealth. The rationale for this statement is as follows. If either the bailor or the bailee were liable for damages inflicted to or by third parties, the same analysis presented in the preceding paragraph applies: the actual rental price paid by bailees would allow for the possibility that compensation might have to be paid to or foregone from third parties. If third parties were liable instead, however, *they* either would have to forego or pay compensation as appropriate, and the full rental price paid by the bailee would be the net of these costs. Accordingly, the *wealth* of bailees, and of bailors to the extent that the increased quantity of rental services demanded at the lower price yielded higher profits, would be higher, and the wealth of third parties would be lower, than if bailors or bailees were liable.

Disregarding third party effects, which are not at issue in the instant case, if transaction costs are zero, the rule of liability would not affect who would bear the cost of the activities or who would do what, when, and how. Thus, the question of consistency would not exist: the rule of liability makes no difference in such a situation. Even if some redistribution of wealth occurred as a result of third party effects, the allocation of resources remaining unchanged, the question of consistency would be reduced to a question of equity. This is an important question, no doubt, but one on which economics can shed little, if any, further light.

In the real world, of course, transaction costs are positive and rising. The higher these costs are relative to the gains to be shared from recontracting, the less recontracting takes place.[23] Indeed, if these costs are high enough, no recontracting at all will occur. In this case, as Coase pointed out, positive transaction costs imply that the rule of liability affects not only the distribution of wealth, but also who does what and how, thereby affecting the allocation of resources.

If transaction costs are high enough to inhibit recontracting, efficiency criteria suggest that the least cost producers should be

23. In the numerical example given in notes 20 & 21 *supra*, the gains from recontracting when the individual liable is not the least cost producer are $6, the difference between the $10 incurred if the individual who is liable provides his own coverage and the $4 incurred if he purchases the service from the least cost producer. Accordingly, the parties will recontract if the costs of doing so are less than $6; they will be indifferent if contracting costs are exactly equal to $6, and they will not recontract if the costs exceed $6.

held liable,[24] though strict liability is not implied. This would place the incentive to undertake various activities on those individuals who could undertake them more cheaply, thereby releasing resources for other purposes. In a world of scarcity, this provides a good argument for taking efficiency considerations into account in deciding cases which affect the cost-reward structure faced by individual decision makers and thus affect their future behavior.[25] Indeed, it has been suggested that much common law can be explained as a slow process toward efficient solutions in response to changes in circumstances which affect the benefits and costs of undertaking various activities.[26]

In the instant case, efficiency considerations suggest the desirability of a rule of liability which minimizes the sum of accident and accident prevention costs. These costs would include the cost of replacing or repairing airplanes, installing and maintaining safety equipment, training pilots, taking precautions in the operation of the vehicle, engaging in transactions and litigation (broadly interpreted to encompass settlement), and loss of use. The choice of rule, therefore, would depend upon some determination of the actual transaction costs involved and of the comparative advantages and incentives of bailors and bailees in undertaking various activities, having due regard for the problem of moral hazard.[27] If the transaction costs were low enough, the choice of rule would not matter. These are empirical questions requiring detailed study of the insurance and rental market for airplanes, and will not be explored further in this paper.[28]

24. The example developed in notes 20, 21 & 23 *supra* can be used to cast light on this point as well. If the individual who is liable is not the least cost producer and contracting costs exceed the gains from recontracting ($6 in the example), he will provide the service himself, incurring the higher costs ($10 in the example). If the least cost producer were held liable instead, he would provide the exact same service at a lower cost of $4, and the difference between the two costs, $6, would represent the value of resources that would be released and thus would be available to produce other goods and services within the community.

25. It cannot be emphasized too strongly that the proposition is that efficiency considerations matter, *not* that they must be controlling.

26. R. Posner, Economic Analysis of Law 98-102 (1973).

27. If an individual can affect the probability and severity of an event by his behavior (*e.g.*, by taking fewer precautions) then the expected value of the consequences insured against will be higher with insurance than without it. Where applicable, this problem of "moral hazard" raises insurance costs and actually makes certain risks uninsurable.

28. A more careful consideration of the thing to be priced would be helpful. In the principal case, the value of the airplane at the time of loss was found to be $30,000. But this price reflected not only the physical characteristics of the plane (*e.g.*, a 1964 Piper PA-23 Supercustom Apache in good condition) but also such things as the time and place of delivery. Apparently, the $30,000 value embodied delivery in four to five months or longer at an unspecified location. At a higher price, however, a plane could be produced more quickly, or

General theoretical considerations, however, do suggest some of the advantages and disadvantages of a rule initially placing liability for loss of use on bailees. One obvious advantage is that the bailee has a comparative advantage in taking certain precautions, particularly as they relate to the operation of the vehicle (*e.g.*, turning back if the weather suddently deteriorates, or not performing dangerous stunts). If he is liable, he will have incentive to take the appropriate precautions. If the bailor is liable, in principle he can compensate the bailee to take these precautions. In practice, however, beyond some point policing and enforcing costs are likely to be prohibitive, and the bailor may find it cheaper to install more, but less economically efficient, safety features,[29] or to take out more insurance, or to do both.

Another advantage of holding the bailee liable is that he is in the better position to know how he is going to use the vehicle and has better information about his skills and assets. Accordingly, he is in a better position to choose the optimal amount of insurance he would like to buy. The bailor, if liable, would have to incur costs to acquire this information and to use it in discriminating among bailees, charging higher rental fees to the higher risk users. In general, to reduce these costs, bailors would be induced to insure with respect to the characteristics of the average user, and therefore would be taking out too much insurance in some cases and not enough in others. Although a bailee presumably would have the opportunity to take out *additional* insurance if he wished, transaction costs are relatively insensitive to the amount of insurance purchased; accordingly, these costs would be relatively high for small amounts of insurance, thereby discouraging at least some transactions. Moreover, if the higher risk bailee does not bear the full consequences of his actions, for example by paying higher insurance rates if he is careless, he would take a free ride at the expense of more careful bailees and would thus have less incentive to take suitable precautions.

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it could be purchased from present owners with a less pressing desire for it, or the prospective buyer of a new plane could be compensated to yield his place in the queue, or a plane of similar design could be substituted.

The earlier the delivery date of the plane, the higher will be the delivered price and the smaller the loss of use. One possible objective of a rule of liability, therefore, would be to minimize the sum of delivered price and loss of use. Indeed, such an approach could be used to give precise meaning to the terms "reasonable price" and "reasonable delivery period."

29. Thus, for example, one way to increase the probability that a vehicle, or any piece of equipment, is used with the appropriate precautions is to require the bailee to utilize the services of an operator, such as a pilot, skipper or driver provided by the bailor. Contracts with such provisions will be observed with greater frequency as the value of the equipment increases.

On the other side, the bailor has a comparative advantage in taking certain precautions, such as good maintenance. If he were liable, his insurance rates would depend in part upon his performance of these activities, and he would have the incentive to take appropriate precautions. With zero information costs, of course, bailees would know exactly the risks associated with renting from each alternative bailor. Rental prices would be affected accordingly, with lower rentals reflecting exactly the cost of the additional risks, and bailors would have exactly the same incentive regardless of the rule of liability. With positive information costs, however, this need not be the case.

Finally, a bailor, ceteris paribus, presumably could purchase insurance more cheaply than an individual could purchase the same insurance since risks are spread over the fleet and there are fewer transactions. Such a presumption, however, does not necessarily provide a case for holding bailors liable. As long as the difference between the price that would be paid by bailees and the price that would be paid by bailors exceeded recontracting costs between these two parties, if bailees were liable, bailors would simply purchase the insurance and resell it to bailees.[30]

In the absence of the appropriate empirical information, the preceding considerations do not yield an unequivocal conclusion. Nevertheless, a careful balancing of the various pros and cons seems to tilt slightly toward a rule for holding bailees liable. A tentative case for holding bailees liable for loss of use, whether property is fully or only partially damaged, can not be supported on the basis of some vague appeal to consistency, but can be supported on the ground that it provides bailees with the incentive, *inter alia,* to avoid the total destruction of assets.

A rule of caveat emptor has much in its favor. The greater the degree of competition among firms in the industry and the greater the repeat nature of the transactions, the greater is the incentive of producers to be responsive to consumer wants and to provide those amounts of insurance, information, and product characteristics in which they have a comparative advantage. Under these conditions, individual consumers will purchase those products with the price and quality characteristics, including risk, which they prefer, and they will undertake those precautions in which *they* have a comparative advantage.[31]

30. Co-insurance schemes should be observed under either rule of liability.

31. Indeed, Professor Oi has shown rigorously that, under certain plausible conditions which include relatively high recontracting costs, a rule of *producer* liability would lead to

IV. Conclusion

Reynolds raised the question of whether the owner of wrongfully destroyed personal property could recover for loss of use during the period reasonably required for replacement. The California Supreme Court ruled in the affirmative on the grounds that to preclude recovery was unfair, because the owner of wrongfully destroyed property would otherwise have to bear the loss, and because it was inconsistent with other state rules which allowed recovery under apparently similar circumstances. In reaching its decision, however, the court neglected important economic considerations.

Since existing law precluded recovery for loss of use when property was totally destroyed, bailors would have taken the probability distributions and the amounts of such losses into account in calculating the cost of doing business (experience is a hard taskmaster), and, given that bailees had not recontracted with bailors to provide their own insurance coverage, rental prices implicitly would have included an insurance premium appropriate to the risk. Accordingly, bailors arguably were already compensated for loss of use and should have no cause of action on the issue. Given the existing rule of liability, the court's decision provided the bailor with double recovery. On the question of fairness, the plaintiff's position at best was weak.

Turning to the question of consistency, the observation that other state rules permitted recovery under apparently similar circumstances provided no indication as to *which* set of rules should be changed.[32] In view of its decision, the court presumably believed either that the rule of liability did not matter or that recovery for loss of use was desirable whether property was totally destroyed or repairable. Although the court justified its decision partly on grounds of consistency, perhaps, as in the development of so much common law, it merely took a common sense step toward a more economically efficient arrangement.

Economic efficiency requires that each activity be undertaken by the least cost producer, thereby releasing resources to society for other purposes. If transaction costs are zero, it has been shown that the least cost producer of any activity will be hired to perform it by whomever is liable. Under these conditions, the rule of liability is

the increased production of *riskier* product grades (in response to increased consumer demand for them) than would exist in the absence of such a rule. Oi, *supra* note 2, *passim*.

32. The court clearly could not use the instant case to change the rule of liability for loss of use when property is repairable. If it believed it to be incorrect, however, it is not obvious that extending it to totally destroyed property would have improved matters.

irrelevant for efficiency purposes; the output mix will be independent of the rule applied except, perhaps, as a result of changes in the distribution of wealth.[33] If transaction costs are zero, therefore, efficiency criteria do not dictate which rule should be changed. If transaction costs are high enough to inhibit recontracting, however, resources will be wasted unless the least cost producer is held initially liable. Under these conditions, the choice of which rule to change is significant. In order to identify the rule of liability which promotes efficiency, therefore, the court could usefully have examined the obstacles to recontracting raised by actual transaction costs and the comparative advantage of bailor and bailees in the insurance and rental market for airplanes.

In the absence of such information, a weak but plausible case can be made to suggest that the court's decision was justifiable on efficiency grounds. First, transaction costs typically are positive, and the nature of the rental business suggests that they may be significant enough to inhibit recontracting. Accordingly, the rule of liability would have an impact.[34] Second, bailees undoubtedly have a comparative advantage in taking many precautions (*e.g.*, not undertaking dangerous maneuvers), including those that would leave property repairable rather than destroyed. If, as appears to be the case, bailees in fact are the least cost producers, then efficiency criteria suggest that they be held liable. Thus, the court may have reached the right decision for the wrong reasons.

Had the court taken the appropriate economic considerations into account, there would be greater assurance that it had reached the correct decision on efficiency criteria. Perhaps more importantly, in the process it would also have acquired better information for weighing the issues of equity and consistency.

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33. To the extent that changes in the rule of liability affect the distribution of wealth, the issue of equity becomes relevant. If equity and efficiency criteria point to the same rule, obviously there is no conflict. If they do not, then the gains from more equitable solutions have to be weighed against efficiency losses, a balancing act to which economics cannot provide the answer.

34. *See* note 19 *supra*.