

LEGAL AND ECONOMIC ASPECT OF LIABILITY FOR DAMAGES

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Abstract

The essence of the largest number of civil disputes is to determine the responsibility of the parties to the dispute in relation to the damage caused. The goal of determining responsibility is to sanction the perpetrator of the damage and compensate the injured party, but also to encourage individuals to take care in order to reduce the probability of damage and its consequences. In this sense, the economy insists on defining legal rules that would encourage individuals to behave in accordance with the principle of efficiency. The occurrence of damage and the extent of the consequences caused by the damage are conditioned by the attention taken by one or both parties in the event that causes the damage, and a unilateral and bilateral precautionary model is defined in economics. The unilateral model implies the possibility of taking measures of attention of one of the parties, the perpetrator of the damage or the injured party, while the bilateral model indicates the possibility of taking precautionary measures of both parties. The determination of liability is important due to the distribution of the burden of damage and its consequences. In addition to economic models of liability for damage, the paper analyzes the legal basis and conditions of liability within the legal system of the Republic of Serbia.

Keywords: liability, damage, unilateral model, bilateral model

1. Types of liability and their characteristics

Life in a community implies respecting norms that regulate different aspects of social life. Respecting those norms points to behavior by which the possibility of inflicting damage is avoided or reduced, while not respecting, i.e. violating them implies and entails liability. In everyday life, liability can manifest itself as moral, political, legal, etc.

Liability implies sanctions for the behavior that violates social norms. Traditional legal understanding is that the basic goals of liability and laws that regulate it is to compensate victims that suffered unjustly and deter further violations that would cause more harm. As a social phenomenon, liability can take upon different forms and contexts, depending on an accepted social value system, social context, degree of awareness in a community, and other factors.

The liability that occurs in cases of violation of legal norms, that is, when social behavior is harmful and inadmissible from a legal perspective represents a legal liability. Legal liability is a social category peculiar to men, and its existence is determined by the existence of the state coercion that implies social sanction, that is, negative consequences to a legally liable person. Next to state coercion and sanctions, legal liability implies the social condemnation of a delinquent. If state coercion is not followed by social condemnation it cannot be considered as a legal liability (Radišić, 2000: 180).

Civil liability. The liability that arose as a consequence of a violation of civil rights norms represents a special form of legal liability, that is, civil liability. Civil liability arises as a consequence of a violation of a known norm *Neminem laedere* that is present in almost all modern civil rights codifications and refers to the prohibition to harm others (Radišić, 2000: 180). Although it is related to the notion of indemnity, civil or property liability is a more narrow term than indemnity. Liability implies indemnity, but not all indemnity is a liability (Radišić, 2000: 182).

Contractual and non-contractual (tortious) liability for the damage. Damage occurred as a consequence of non-compliance with a contractual obligation, represents *contractual* damage, while the damage that is based on torts, is *non-contractual* (tortious) damage. Non-contractual damage conditions non-contractual liability resulting from general or *absolute* non-compliance with *Neminem laedere* norm, while *relative* non-compliance of the said norm conditions contractual damage and entails contractual liability (Radišić, 2000: 183).

Euro-continental civil codifications accept two concepts of damage liability (Babić, 2009: 173-174). According to the first, the *monistic* one, civil liability is unique and there is no difference between contractual and non-contractual liability. Supporters of this view think that necessary elements of liability are common for both types of liability and that liability is based on a violation of an earlier obligation, regardless of whether the obligation is regulated by a contract or the law. Contract violation represents a breach of contractual obligation, but the violation of a general legal obligation as well, so there is no difference in liability on that basis. According to the supporters of this view, the term “contractual liability” is wrong because every liability is tortious (Radišić, 2000: 183). Contrary to the monistic understanding, the *dualistic* thesis differs two types of civil liability (contractual and non-contractual) that are regulated by different rules. When it comes to the American legal system, conventional views are based on the complete separation of contractual and non-contractual areas. According to this view, obligations that are regulated by contract are based on promises, while non-contractual liability is based on the court decision and is imposed as a rule (Dobbs, 2006: 714). Different liability regimes in certain legal systems, differences in conceptual, and in the terminological determination of contractual and non-contractual liability, as well as the influence of those differences on the performance of the integral market, are subject of the comparative study

analysis¹ that the European Commission did so it could be determined whether the differences in the area of contractual and non-contractual liability is an obstacle in cooperation between country members or not.

Relationship between civil and criminal liability. Civil and criminal liability represent different forms of legal liability but they can have the same root cause and exist in parallel.

The existence of criminal liability is conditioned by the existence of illegal action, while civil liability can also be determined in behavior that doesn't have characteristics and markers of illegality. Civil liability is therefore a wider term than a criminal liability and the principle of enumeration is not applied, while criminal liability is limited because the number of criminal offenses is limited (*nullum crimen sine lege*). For criminal liability to exist, the proven guilt of a crime perpetrator is necessary. Civil liability can exist independently of guilt, that is, guilt is assumed, therefore the tortfeasor is obliged to prove their innocence (Radišić, 2000:189).

While civil liability is of a property nature and is not related to the tortfeasor identity, but the compensation for the inflicted harm, criminal liability is related to the tortfeasor identity, and only indirectly refers to their property (Radišić, 2000: 190).

Although criminal and civil liability are separate forms of liability today, that wasn't always the case. Up until the 19th century, damage indemnity was of a punitive nature and it represented sanction of a country.

2. Basis of liability

The damage occurred and loss caused by it, affects a person to whom the damage occurred (*casum sentit dominus*), and only exceptionally, when there are legally recognized reasons for it, property consequences of the damage are transferred to another person. For the damage to be attributed to someone, the existence of guilt of the one who caused the damage is necessary. Transfer, i.e. distribution of consequences of the damage and the damaging event itself, represents a reason for the intervention of the law. The basis for liability is legally acknowledged reason because of which the damage in the final outcome doesn't fall on the damaged person, but on the person liable (Karanikić-Mirić, 2012: 245).

The term "basis of liability" should provide an answer to the question of why is someone liable. In legislation RS, the idea of the plurality of basis of liability is accepted, although the law itself doesn't list all possible basis of liability for the caused damage. In the legal theory, there is no consensus on the issue of the basis of liability for the caused damage, that is, a reason for property liability. Reasons for that should be looked for in the confusion of reasons and bases of liability among many writers, as well as legislators (Radišić, 2000: 191).

¹ The study *The Interaction of Contract Law and Tort and Property Law in Europe*, Munchen: Sellier European Law Publishers, 2004, whose authors are C. von Bar, D. Urlich, has been done by engagement of legal experts across fifteen legal areas.

Assumptions of liability differ dependant on whether the liability is based on the guilt criterion or on the criterion of causing the damage. The Law of Obligations and Torts distinguishes three grounds of liability based on damage:

1. Liability based on guilt - subjective liability
2. Liability regardless of guilt - objective liability
3. Liability based on fairness

When in order to realize the liability we seek guilt of the tortfeasor, we are talking about *subjective liability*. Subjective liability is in legal theory related to the moral context of guilt, and a guilty plea is related to the mental state of the tortfeasor (Karanikić-Mirić, 2008: 188). If the defendant is liable for any damage caused by violation or interference with property rights, we are talking about *objective liability* for the caused damage. Objective liability represents technical, and not an ethical impression. Objectification of guilt means stripping it of its moral context which implies that anyone who acts wrongly is guilty (Karanikić-Mirić, 2008: 182). The Law of Contract and Torts accepted the principle of presumed guilt which means that a tortfeasor, a person who inflicted the damage, is liable for the damage and they are obliged to compensate it, unless they prove that it is not their fault the damage occurred.²

Guilt represents the basis of liability for the caused damage and it is the reason why final property consequences are a burden of the tortfeasor and not the person to whom the damage was caused (Karanikić-Mirić, 2009: 24). Subjective liability based on guilt can manifest itself in its harsher or milder form. The Law of Contract and Torts predicts that guilt exists when a tortfeasor caused the damage intentionally or negligently. Causing the damage intentionally represents harsher, while negligence represents a milder form of guilt. The basic division of guilt is the division of intent or intention (*dolus*) and negligence (*culpa*). Intention and negligence could be seen as mental states, states of human consciousness, but as a reason for attributing guilt to someone as well. In the judiciary, the liability for negligence and intention is based on the performed act, that is, the liability becomes absent if, for any reason, consequences of negligent or intentional actions are absent (Karanikić-Mirić, 2009: 115). If the action is caused intentionally and the tortfeasor is aware of consequences that will arise from it and agrees with their occurrence, it is a matter of *intent* that can manifest as *direct* or *eventual*. Carelessness or negligence represents a form of guilt which is mostly determined objectively (sometimes subjectively), where the behavior of the tortfeasor is compared with the behavior of other people so it could be determined whether the level of their attention is in line with the level of due attention, that is, the attention that is regular and usual in contact with other people. Negligence can be treated as regular (*culpa levis*) or as extreme or gross (*culpa lata*).

² Article 154, *Law on obligations*, “Official gazette SFRJ”, no. 29/78, 39/85, 45/89, “Official gazette SRJ”, no. 31/93 and “Official gazette SCG”, no. 1/2003 - Constitutional charter and “Official gazette RS” no. 18/2020.

In gross negligence, the tortfeasor doesn't have the attention in their actions that an average person would have, while in the case of regular negligence we differentiate the attention of a good host, the attention of a good businessman, and the attention of a good expert (Antić, 2012: 486).

The Law of Contract and Torts as well as the practice of law didn't define the concept of dangerous items or actions, that is, the law has a flexible framework that changes, encompassing new categories of harmful items and harmful actions (Shavell, 80: 2-6). Acknowledging the result of legal theory and practice that refer to harmful items and harmful actions, every moving vehicle, elevator, flower pot on a balcony above a street, work in a mine or a stone pit, etc. represent a danger for a human and its environment for which liability must be borne regardless of guilt. The fact that the tortfeasor is a holder of the harmful item and that they are engaged in harmful activity represents the basis of liability for the damage indemnity. Numerous legal systems prescribe precaution standards intending to create conditions for increased security in numerous activities that can have some form of damage as a consequence. So in the countries of the English-speaking area, the law prescribes the duty of reasonable caution, in Europe it prescribes *bonus pater familias* standard and other standards (Cooter, Ulen, 2016: 197).

There were conceptual differences in legal theory when it comes to determining the concepts of the harmful item and harmful action. Professor Konstantinović contemplates the harmful item in a broader sense, so it encompasses harmful action. Harmful action arises as a consequence of the use of the harmful item, therefore the idea of increased risk of danger without the use of the harmful item is unacceptable in his view. Causing damage without the use of the harmful item would mean that a person performs harmful actions with their body, which would, in the opinion of professor Konstantinović, represent liability based on guilt (Konstantinović, 1969: 134). In accordance with the paragraph above, Karanikić thinks that the danger a person can create without the use of the harmful item represents *normal* danger, in comparison to which other dangers can be *increased* and they entail objective liability (Karanikić-Mirić, 2013: 85).

Liability based on *fairness* arises from the fact that law and justice don't always coincide. In principle, every court ruling should be fair, and as that is not always the case, the Law of Contract and Torts predicted the basis of fairness as a correction to a subjective and objective basis of liability, which application can lead to unfair rulings.

3. Conditions of liability: legal and economic aspect

Liability caused by guilt, or subjective liability, considers guilt of the tortfeasor for the strongest reason for property liability. Conditions for exercising the right to indemnity for the damage in the case of *subjective liability* are damage existence, a causal relationship between the tortfeasor's action and harmful consequences, the

illegality of the tortfeasor's action, and guilt of the tortfeasor (Radišić, 2017: 216).

For indemnity for the damage in *subjective liability*, it is only necessary for the first two conditions to be fulfilled: damage existence and a causal relationship between the tortfeasor's action and harmful consequences.

Damage existence. The first and fundamental condition without which there is no indemnity is *damage existence*. If there is no damage there would be no civil liability for the action taken. The condition for one person (the damaged party) to sue the other (the tortfeasor) is that they suffered damage. The objective characteristic of damage is that it occurred as an adverse consequence that comes from the outer world (Orlić, 2017: 4). The fact that the inflicted damage must be compensated produces the obligation bond between the damaged party and the tortfeasor.

The causal relationship between the tortfeasor's action and harmful consequences. The existence of a causal relationship between the tortfeasor's action and damage, as well as the damage that occurred as a consequence of that action, represent the *general* condition of liability (Konstantinović, 1969: 80). Like the damage, a causal relationship has characteristics of objective nature. Originated from a relationship between two phenomena, it is expressed as physical, chemical, biological, or some other change that manifests itself in an objective world (Orlić, 2017: 4). If one fact is the cause, and the other the consequence of it, then a causal relationship (*causalitas*) exists. Harmful consequences can be predictable and unpredictable but from a standpoint of a causal relationship, it is important that the damage occurred, respectively, that the actions of the tortfeasor caused the damage.

The illegality of a tortfeasor's actions. If the actions of a tortfeasor violated some rules provided by positive regulations, we say that such an action is *illegal*. Illegal action can consist of doing and not doing, where what is meant by doing is taking an illegal action when such doing is prohibited, and not doing implies action that hasn't been taken. If the damage is caused in self-defense, with the consent of the damaged party, or in the case of performing public service within the powers provided by law, illegality does not exist (Radišić, 2000: 223). Illegality is thought of as a breach of obligations that are established by law, contract, or moral, and guilt is expressed through the illegal action so that *illegal activity is an indication of guilt, its external manifestation* (Radišić, 2001: 551).

The guilt of a tortfeasor. The damaged party can exercise the right for the damage indemnity if the action causing the damage can be assigned to the tortfeasor as guilt. Although it is the subject of analysis of many authors, in legal theory guilt is not clearly defined, neither is what being guilty exactly means (Karanikić, Mirić, 2009: 15). Karanikić, by talking about attempts to define the term "guilt", points to the complexity of it and the difficulty of succeeding in that endeavor, looking at it as *conduct that is wrong from the standpoint of established social expectations or as a mental state which deserves moral or social reprehension*. Guilt exists when a person doesn't act the way a reasonable and cautious person does in a certain situation.

4. Economic analysis and liability models

The goal of economic application in the area of law, that is, economic analysis, is an increase in efficiency of the legal system and creation of incentives that would enable that.

In the analysis of harmful events, the resulting damage, and its compensation, the goal of the economic application is reducing costs of damage and applying incentives to achieve that goal. For that purpose, the economic analysis of the law developed models in the area of liability that seek to determine, in a simplified way, the effects of enforcing certain rules and the consequences they create. A model developed for the purpose of liability analysis represents an *economic liability model*, which can be considered a *unilateral* or *bilateral* liability model, depending on whether precaution is taken by one or both parties (Cooter, Ulen, 2016: 205).

Unilateral precaution model. The starting assumption of the unilateral precaution model is the possibility of taking precautions by one of the parties, the tortfeasor or the damaged party. Whether, and which party will take precautions that would reduce harmful events or occurrence of damage, is conditioned by incentives, i.e. rules of the tort law.

We begin the unilateral precaution model analysis regardless of who takes precaution, the tortfeasor, or the damaged party. Taking precautions implies resource engagement (in the terms of time, money, etc.), which consumption would lead to an increased level of caution. An increased caution level leads to a decrease in the probability of the damage occurring, but the damage magnitude as well, that is, its expected monetary value. If we assign the probability of damage occurrence with $p(x)$, its expected monetary value to $A(x)$, by multiplying these quantities we get *the expected damage value*, $p(x)A$. The probability of damage occurrence $p(x)$ and expected damage monetary value $A(x)$ represent decreasing attention function (x). The starting assumption of the model is that the caution increase has decreasing marginal benefit in terms of the expected damage value. That means that the tortfeasor first invests in those precautions measures that result in greater effects, that is, they expect the most out of firstly implemented precaution measures in terms of reducing the risk of damage.

The goal of the economic liability model is to determine the efficient caution level that would bring total social costs to a minimum. Social costs represent the sum of the precaution costs and the costs of expected damage value. An additional monetary unit invested in the caution level that is below the efficient one decreases the expected damage for more than one monetary unit, so total social costs are reduced. A monetary unit invested in an increase in the caution level above the level of efficient attention decreased the expected damage for less than one monetary unit which leads to an increase in total social costs. By calculating a statement of total costs we can get a mathematical expression of the efficient caution level (Cooter, Ulen, 2016: 202):

$$SC = wx + p(x)A \quad (1.1)$$

$$W = -p(x^*)A \quad (1.2)$$

W - the marginal social cost,

$p(x^*)A$ - the marginal social benefit.

If the actual caution level is lower than the efficient caution level, the marginal social cost is lower than the social benefit. Inversely, in the case of actual caution level is higher than the efficient caution level, the social precaution cost will be higher than its social benefit. The analysis of the unilateral precaution model implies taking precautions by the damaged party (in the conditions where there is no liability of the tortfeasor) or the tortfeasor (in the conditions of an objective liability) considering that both parties determine the *probability* and the *intensity* of damage occurrence with their behavior (Mojašević, 2009: 117).

The accomplishment of the efficient caution level implies cost equalization of the cost of increased caution (marginal cost) by decreasing the cost of the expected damage (marginal benefit). In the goal of accomplishing the efficient caution level, it is necessary to create legislative incentives for taking precautions. Different rules of liability create different incentives that affect the choice of the tortfeasor and the damaged party to take appropriate precautions. Determining rules of liability that urge potential damaged parties and tortfeasors to achieve the efficient caution level can have a preventive effect on the probability of the damage occurring and the expected damage value.

In the *absence of liability*, the tortfeasor doesn't have an incentive for taking precautions. If the tortfeasor doesn't bear the consequences of their actions, they don't have an incentive to be careful which results in their negligence. The damaged party, considering that they don't have the right to full compensation, takes precautions and internalizes marginal costs, but the marginal benefits resulting from taking precautions as well. So, in the cases of the absence of tortfeasor liability, the damaged party has an incentive to take precautions and by doing so, they minimize the total expected damage costs (costs of taken precautions and the costs of expected damage).

In the conditions of *the objective tortfeasor liability*, the damaged party has the right to damage indemnity which encompasses costs of taken precautions and the cost of expected damage. Considering that the damaged party exercises the right to indemnity, they don't have an incentive to take precautions because by doing so they don't stand to gain any benefit, but they decrease the objective liability of the tortfeasor. Unlike them, the tortfeasor bears total costs of the damage occurred, and thus has an incentive for taking precautions.

Next to objective liability, the tortfeasor can be *subjectively liable for damage caused by negligence* (Karanikić, 2009: 187). In determining subjective liability, the behavior of the tortfeasor is compared to the standard of cautious actions. If we assume the precaution standard is equal to the efficient precaution level, and the court rules that the tortfeasor has taken a precaution level lower than the prescribed

standard then he would be liable for the damage caused and therefore borne the total costs. Taking a precaution level higher than the efficient one leads to costs increase because the cost of the added unit of precaution is higher than the decrease of the expected damage.

Stated rules of liability create incentives for establishing efficient precaution levels. If the damaged party takes precaution measures, the absence of tortfeasor's liability provides the damaged party with the incentive for efficient precaution levels. When the tortfeasor takes precaution measures and is obliged to the full compensation, objective and subjective liability provide them the incentive for achieving efficient precaution levels.

Bilateral economic precaution model. The starting assumption in the unilateral precaution model implied taking precaution measures by only one party in the harmful event occurrence, tortfeasor, or the damaged party. Determining liability based on this assumption is significant, but is often not realistic. As both parties are often liable for the damage occurrence, taking precaution by both parties is more realistic and more acceptable. The analysis of tortfeasor's liability, the damaged party liability, and the effect of liability rules on accomplishing efficient precaution levels is realized in the bilateral economic model of liability (Cooter, Ulen, 2016: 205 onwards). As with the unilateral precaution model, the bilateral model determines the costs of taking precautions and the expected damage. Costs function in the bilateral model, which implies undertaking precaution by both tortfeasor and the damaged party, has the following form:

$$SC = w_v x_v + w_i x_i + p(x_v, x_i) A \quad (1.3)$$

Taking precautions by both parties leads to a decrease in the total costs of harmful events (Cooter, Ulen, 2016: 205).

Different liability rules result in different incentives for taking precautionary measures to a potential tortfeasor and the damaged party.

In the case of the *absence* of liability of the tortfeasor and the damaged party, the bilateral liability model doesn't differ from the unilateral liability model. If they are not liable, the tortfeasor will not invest in precaution measures which implies taking precautions by the damaged party. The absence of liability, as in the unilateral model, leads to the externalization of the damage costs by the damaged party. Therefore, the fact that there is no tortfeasor's liability for the damage occurred, regardless of the liability model, will not condition taking precautions by the tortfeasor (Cooter, Ulen, 2016: 205 onwards).

Application of rules that prescribe *objective liability* of the tortfeasor and the right to a complete compensation to the damaged party, leads to costs externalization by the damaged party and causes costs internalization by the tortfeasor. In the conditions of objective liability application, the damaged party, considering they don't bear the costs, doesn't take any precaution measures, while the tortfeasor who is confronted with liability and the complete damage compensation is ready for taking the effective precaution level (Mojašević, 2009: 120).

The bilateral liability model implies that precaution measures are taken by both parties, the tortfeasor and the damaged party. As in the conditions of liability absence, the tortfeasor doesn't have an incentive to take precautions, which is the case with the damaged party in the conditions of objective liability (considering that they are fully compensated), the question of achieving efficient precaution levels and the level of caution that should be pursued arises. Creating an incentive for accomplishing the efficient precaution level is possible if both parties are fully liable for the damage that occurred. That implies the application of the rules of objective liability, i.e. negligence liability, that determines whether and to what extent parties acted with caution. Whether and to what extent parties acted cautiously is established by comparison of their behavior with the *legal standard of reasonable caution*. The legal standard of reasonable caution represents a measurement of guilt in the case of harm. If the tortfeasor and the damaged party both act in accordance with the legal standard of reasonable caution, they will not be liable for the damage that occurred. If their behavior deviates from the stated standard, liability resulted as a consequence of their negligence will be attributed to them. In the cases where the tortfeasor met the level of caution required, the position of the damaged party will be the same as in the case of the liability absence (Cooter, Ulen, 2016: 208).

5. Liability based on guilt

Application of the legal precaution standard enables a comparison of actual caution of the tortfeasor and the precaution that would be taken by a reasonable person. The legal precaution standard in the American law (legal RS system also recognizes the legal precaution standard) acquires content when applied in the practice of law. Positive economic theory analyzed the cases of the damage indemnity which rulings are of significance for both the practice of law and the legal theory. One of the more famous cases, which is often a subject of theoretical analysis, is the case of the United States v. Carroll Towing Co.³ It is a case of a boat owner accused of negligence because the boat pulled away and set sail from the dock where it was moored. The ship chartered to pull one of the boats out of the dock, did so improperly, which created the possibility that one of the boats at the dock pulls away, thus becoming a danger for objects around it. That is exactly what happened - the ship pulled away and collided with a tanker, which caused the damage to the hull of the ship and later sinking of the ship with all the cargo on it. One of the damaged parties was the government because the part of the cargo that was destroyed was a property of the government. Accusations of the owner of the sunken boat made in the lawsuit against the owner of the ship that was trying to pull the boat away, related to the negligence of the crew members that were pulling the boat away and their improper conduct. The owner of the ship pointed to the negligence of the boat owner who had an obligation to appoint one more crew member who would enable the safe towing of the ship from the dock as well as the mooring of other ships (Cooter, Ulen, 2016: 213).

³ Circuit Court of Appeals, Second Circuits, 159 F. 2d 169, 1947.

In the stated case, judge Learned Hand, after whom this rule was later named Hand's Rule, ruled as follows: "Since there are circumstances when any vessel can be separated from the place where it is anchored, and since, if that is the case, becomes a danger for objects around him, the obligation of the boat owner to prevent the damage is in the function of three variables: the possibility of the boat mooring, the magnitude and severity of the damage, and if the ship is moored, the obligation of taking precautions". The judge expressed these factors algebraically. The probability that the boat moores and inflicts damage is a value of P, the danger is a value of L, the obligation of taking precautions of B, and the liability depends on whether B is less than L multiplied with P, that is, whether $B < P \times L$. By applying this algebraic expression in the case of the moored boat, where the obligation of taking precaution is less than the probability of the boat mooring multiplied with the potential damage, which can arise as a consequence of mooring, points to the guilt of the boat owner. The guilt of the boat owner is in the fact that they didn't appoint one more crew member that would ensure safe towing of the boat, without any consequences to other vessels. The cost to be borne by the boat owner by appointing one more crew member is a lot less than the cost that occurred, which points to their guilt. Hand's Rule can be related to the economic precaution model that minimizes total costs of taking precaution measures and the expected damage, that is, the efficient precaution level. Hand's Rule enabled judges easier determination of the efficient precaution level in the practice of law. In the search for the answer to the question of whether a small increase in precaution has "cost justification", the positive answer indicates that the actual precaution level is not in accordance with the legal precaution standard, while a negative answer indicates that the tortfeasor met the legal precaution standard. In the first case, the tortfeasor is liable, while there is no liability of theirs in the second one.

Hand's Rule application implies that the individual making the decision has to know whether an increased precaution will cost more or less than an increase in expected costs caused by the accident. It must be taken into account that determining the expected costs of the accident is not simple and it requires information, which gathering is not easy nor free. Determination of precaution costs is a problem that the decision-maker faces. Determining the precaution costs and the damage costs represents the source of transaction costs.

6. Conclusion

Precise determination of liability is significant because of the burden distribution of the damage occurred. In the legal sense, being liable means being subjected to law. In the economic sense, being liable means to bear the damage costs emerged as the consequences of behavior displayed in a concrete case.

The goal of the economic liability analysis is determining an efficient caution level that tries to bring total social costs, that represent the sum of the precaution and

expected damage costs, to a minimum. Determining efficient caution level enables more rational resource use, while inefficient caution level taken leads to their waste. By acting as a rational individual, the tortfeasor chooses socially desirable precaution level and by doing so, internalises costs and benefits from the precaution level taken.

Achieving efficient caution level implies equalizing costs of increased precautions and reduced cost of the damage expected. In the purpose of achieving an efficient caution level, it is necessary to create legal incentives for taking precaution measures. Different rules of liability create different incentives that affect choices of the tortfeasor and the damaged party to take appropriate precaution. Determining rules of liability that encourage potential damaged parties and tortfeasors to achieve an efficient caution level can have a preventive effect on the probability of damage occurring and its expected cost.

If the actual caution level is lower than the efficient one, marginal social cost is lower than the social benefit. Vice versa, in the case of actual caution level being higher than the efficient one, its social costs will be higher than its social benefit.

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