3. CONTRACTS WITH PROTECTIVE EFFECTS TOWARDS THIRD PARTIES

von Bar, 'Liability for Information and Opinions Causing Economic Loss to Third Parties' in Markesinis (ed), *The Gradual Convergence* (1994) 98; Canaris, 'Die Reichweite der Expertenhaftung gegenüber Dritten' ZHR 163 (1999) 206; Ebke, 'Die Haftung des gesetzlichen Abschlussprüfers in der Europäischen Union' ZVglRWiss 100, 2001, 62; Martiny, 'Pflichtenorientierter Drittschutz beim Vertrag mit Schutzwirkung für Dritte' JZ 1996, 19; Musielak, 'Die Haftung der Banken für falsche Kreditauskünfte' VersR 1977, 973; Puhle, *Vertrag mit Schutzwirkung zugunsten Dritter und Drittschadensliquidation* (1982); Schlechtriem, 'Schutzpflichten und geschützte Personen' in *Festschrift für Dieter Medicus* (1999) 529; Schneider, 'Die Reichweite der Expertenhaftung gegenüber Dritten' ZHR 163 (1999) 246; Sonnenschein, 'Der Vertrag mit Schutzwirkung für Dritte—und immer neue Fragen' JA 1979, 225.

(a) Preliminary Observations

The somewhat cumbersome term '*Verträge mit Schutzwirkung für Dritte*' or 'contracts with protective effects towards third parties' was chosen to distinguish this type of contract from the classic contract for the benefit of a third party. We are here concerned with a new institution created by the courts, more often than not in close co-operation with academic writers in order to overcome two narrow (some might say defective) provisions in the tort section of the Code. The first is § 823 I BGB, which is one of the main tort provisions of the BGB and which does not allow recovery in tort for negligently inflicted pure economic loss. The second is § 831 BGB, which establishes a weak rule of vicarious liability allowing the master to avoid liability for the torts committed by his servants whenever he can prove that he selected them and supervised carefully. (For details in English see *The German Law of Torts*, chapter 3, p 693 *et seq*.) In one sense this development, having been prompted by 'defects' in the German Code itself may hold little interest for the common lawyer. As we shall note in the paragraphs that follow, this is not necessarily true since the German reasoning (rather than the German conceptualism) does contain interesting ideas even for the common lawyer. But even if this development were of purely Germanic interest, we would have to deal with it in a book which aims at providing common lawyers with an introduction to the German law of contract. (See also, *The German Law of Torts*, pp 58–64; 301 *et seq*.)

(b) Cases Involving Personal Injury or Physical Damage

The problem that gave rise to this jurisprudential development has already been alluded to. What made its solution possible was the realisation that in each contract one finds a cluster of obligations. Some of them are primary obligations (*primäre Leistungsansprüche*); others are secondary or collateral obligations which often take the form of duties of protection (*Schutzpflichten*). The old English decision of *Cavalier v Pope* ([1906] AC 428) neatly illustrates the difference.

In that case the husband took out a lease in a property but it was his wife who was injured due to its defective state. She had no contract with the lessor and, as the law then stood, the courts took the view that she could not succeed in tort either. In such a case, German lawyers would have given the injured woman a remedy (see RGZ 127, 218). Their reasoning proceeds along the lines we have indicated. In the absence of specific circumstances to the contrary, the woman might not be seen as a third party beneficiary of the contract of lease, in the sense of being allowed to bring a claim demanding the specific performance of the *primary* obligation of the lessor to deliver the leased premises. Nor would she in turn be liable to perform the *primary* obligation of the promisee/lessee, ie paying the agreed rent. She would however be brought under the 'protective umbrella' of the contract in such a way as to make the lessor liable to her for any breach of his *secondary* obligations to keep the premises in a safe condition.

A similar construction can apply to the contract of sale. Here too the distinction is between primary and secondary obligations. The primary obligations include the duty to deliver the sold item and to pay the purchase price. But if the item is dangerous, if the warnings are inadequate, or if the area where the sale takes place is unsafe, then the vendor may incur additional liability; and not only towards the purchaser, but other parties that are with him (how the range of persons is kept under control is explained below). The 'vegetable leaf' case (BGHZ 66, 51, reproduced in *The German Law of Torts*, case no 112, p 789) offers a well-known illustration.

In that case the fourteen year-old plaintiff accompanied his mother when she went to do her shopping in her local supermarket. While she was queuing to pay, he went round the counter to help pack the goods and slipped on a vegetable leaf that was lying on the floor and injured himself. Though no money had yet exchanged hands and thus, technically speaking, no contract had yet been concluded between the mother and the shop, the court took the view that (a) the doctrine of *culpa in contrahendo* afforded the mother contractual protection and (b) this extended to include her accompanying child in accordance with the doctrine that we are here examining. The judgment was clear about the advantages that this contractual approach offered to the plaintiffs; but it was also clear that it would not be extended to all persons who entered into the shop and slipped on such debris. The potential customer would thus have to be distinguished from the potential thief, although how each future case would be decided the court—quite properly—refused to speculate.

Likewise, if a manufacturer of a dangerous chemical enters into a contract with a haulage firm to transport the chemical and fails to give proper warnings about how it should be handled, he may be liable to the carrier's employees who are injured while handling the dangerous substance (BGH NJW 1959, 1676). Such reasoning has been extended to numerous situations involving liability to injured workers in the context of building contracts (BGHZ 33, 247, case no 63); leases (RGZ 102, 231; RGZ 91, 21, case no 64); contracts for medical services (see: BGHZ 2, 94, case no 52; OLG Düsseldorf NJW 1975, 596, case no 65); carriage contracts (RGZ 87, 64) and many more. One situation, almost anticipated by the Code, deserves to be mentioned and to serve as the last illustration of the points made so far.

Its origin lies in § 618 BGB, which gives employees some of the advantages of the contract and tort regimes. This basically obliges the employer 'to fit up and maintain rooms, equipment and apparatus which he has to provide for the performance of the

service' he expects from his employee and 'so to regulate matters' to ensure that the employee is protected against danger to life and health 'as far as the nature of the service permits'(§ 618 I BGB). Sub-paragraph 3 of § 618 BGB then states that §§ 842–846 BGB (taken from the law of tort) apply *mutatis mutandis*, thus extending some of the advantages of the law of tort to the contractual action. (In the UK, see the Health and Safety at Work Act 1974, especially sections 2 and 33 for the regulatory system, although note that this does not give rise to a general action for breach of statutory duty (section 47(1)(a)). Instead, breaches of specific duties imposed by the health and safety regulations can be a ground for an action for breach of statutory duty (again, section 47(1)(a) of the 1974 Act). See generally, Markesinis, Deakin & Johnston, *Markesinis and Deakin's Tort Law* (5th edn, 2003), pp 559–71, for coverage of the common law and an introduction to the statutory duties. For detailed coverage of the latter, see Redgrave, Hendy and Ford, *Health and Safety* (3rd edn, 1998).) These protective duties, which the Code imposes on the employer for the benefit of his employee, have thus been extended to the situation where a tenant entered into a contract with a plumber to do some work to her gas system. The work was defectively done and the tenant's daily help was injured. The Court took the view that her daily help was also included in the list of protected persons envisaged by § 618 BGB and that these persons must have been within the contemplation of the defendant firm, which was thus liable for the injuries sustained by the daily help (see also, BGHZ 33, 247, case no 63).

Even this summary account of the case law is sufficient to show the success with which this new notion met in practice. At the academic level, however, it was met by two concerns. First, how should one explain this new institution doctrinally, and secondly, how should one set out workable parameters that would not allow the expansion of liability to undermine the notion of contract. On the first score, the ingenuity of German academics was considerable.

Thus first, the *Reichsgericht* tried to base this outcome on a broad interpretation of the contract, the implied intentions of the parties or, even, the ultimate aim of the transaction (see RGZ 87, 289, 292; 98, 210, 213; 106, 120, 126; 127, 218), and for a time this practice was continued by the *Bundesgerichtshof* (BGHZ 1, 383, 385–6, case no 66; 5, 378, 384; BGH NJW 1956, 1193). Under the influence of the late Professor Larenz (*Schuldrecht*, I (1st edn, 1953), p 16, III; *Larenz*, in NJW 1956, 1193) the new notion was increasingly separated from the traditional *Vertrag zugunsten Dritter* (regulated by the BGB) and based on the more amorphous idea of good faith contained in § 242 BGB. For the courts however this was a non-problem. What they were concerned with was doing justice to each case, leaving the theoretical justification of their result either undecided (BGHZ 56, 269, 273) or even treating it as irrelevant (BGH NJW 1977, 2073, 2074, case no 67). Somewhat unusually then we encounter here a judicial attitude which many outside observers often detect in the judgments of state courts in the US.

The second concern—how to define workable parameters for the new notion in a way that would not totally destroy the notion of contract as a *vinculum iuris* between two persons—proved more difficult to satisfy. Once again, we shall see that these academic concerns have not been totally shared by the courts, which have proceeded to create a substantial and fairly bold case law. In this domain academics have, with rather greater consistency than the courts, insisted that three requirements be satisfied

before the contractual umbrella can be opened to include the plaintiff/third party. (For rich references, see Sonnenschein, 'Der Vertrag mit Schutzwirkung für Dritte—und immer neue Fragen' JA 1979, 225 and Martiny, 'Pflichtenorientierter Drittschutz beim Vertrag mit Schutzwirkung für Dritte' JZ 1996, 19.) We must look at them in turn.

First, there must be an especially close relationship between the third party/plaintiff and the promisee (contractual creditor), usually referred to as 'proximity of performance' (*Leistungsnähe*).

Secondly—and this is a requirement that has been loosely construed by the courts—the promisee (contractual creditor) must have some interest in protecting the third party/plaintiff. (The usual jargon states that the creditor must be responsible for the third party for better or for worse: *Wohl und Wehe*.)

Finally, the promisor (contractual debtor) must have been able to foresee that the third party/plaintiff would suffer damage in the event that he—the contractual creditor/promisor—performed his obligation badly.

A useful illustration of this approach is provided by BGH NJW 1964, 33, case no 69. Here the court held that a contract of lease had protective effects towards fellow tenants only where the tenant was responsible for the well being of the third person. Such a close personal relationship existed, for instance, in RGZ 102, 232, case no 69, where the plaintiff was the husband of the tenant. Note that in that case the protective effect of the duty of care is founded on a direct application of § 328 BGB; the full emancipation of the contract with protective effects was still to come. The decision also highlights the scope of § 278 BGB and thus one of the main reasons for framing the action in contract rather than tort (§ 831 BGB). BGH NJW 1964, 33, case no 69, contains a summary of the position of the *Bundesgerichtshof* in cases involving physical damage. The Court stated:

> It accords with the sense and purpose of the contract and the principle of good faith that the only persons to whom the debtor owes his contractual duty of care and protection are those who are brought into contact with his performance by the creditor and in whose welfare the creditor has an interest because he himself is bound to take care and protect them, like the members of a man's family or the employees of an entrepreneur. To extend the contractual debtor's responsibility in this way is justified because he must know that the safety of the limited and compact group of persons to whom the contractual protection ensures is of as much concern to the creditor as his own.

See, for a further illustration for the desire of the courts to emphasise the narrow limits of the doctrine: OLG Düsseldorf NJW 1975, 596, case no 65, where once again the protective ambit of the contract is limited by using the criterion of the personal responsibility of the creditor for the third party. BGH NJW 1968, 1929, case no 70, likewise, is a decision which utilises the criterion of close personal ties to keep the floodgates shut. In this case a 'sub-buyer' contended that good faith required that he ought to be included in the protective scope of the contract between buyer and seller. The court stated that commercial certainty would be endangered if the contract with protective effects were to be applied in the commercial sphere between tradesmen:

> Still, this court has frequently emphasised that it is only within narrow limits that contractual duties of care are to be extended outside the circle of the actual parties to the contract . . . The distinction between direct and indirect victims should be maintained. The general rule is that

contractual liability is annexed to the tie that binds the creditor to his contractual partner. If these principles are forgotten, a contractor will be unable to tell, and so calculate, what risk he is undertaking, and it will be difficult to justify holding him liable. Thus it is by no means enough that third parties 'come into contact' with the performance of the debtor through the creditor. In modern commercial transactions involving long chains of dealers this is almost always the case. The concept of 'contract with protective effect for third parties' must be restricted not only as regards the subjects, ie, those third parties who are drawn into the protected area, but also as regards its objects, ie, the terms of the contract from which it is sought to draw such protective duties. The meaning and purpose of a contract, once it is construed in accordance with the principle of good faith (§ 157 BGB), will only justify the extension of the duties of care and protection to third parties if the principal creditor himself owes them protection and care and is in some sense responsible for their weal and woe (see BGHZ NJW 1964, 33 [= case no 69]). This will normally be so only in rather personal situations, such as exist in the family or in employment or in tenancy. An especially strict test must be applied if the protective effect is to apply to property damage and economic loss. . . . Doubtless tradesmen do think it important to take care of their customers' interests, but not in the sense of owing them 'protection and care'. . . .

(c) Economic Loss Cases

The above mentioned controlling device 'of a close personal relationship' has not always been interpreted so strictly. This has been the case where the concept of contracts with protective effects towards third parties has been considered in situations involving pure economic loss. It is to this development, therefore, that we must now turn our attention. The attentive reader will, of course, have noticed by now that the cases that supported the new notion of contracts with protective effects towards third parties initially dealt with physical damage and, as stated repeatedly, aimed at overcoming the limitations of § 831 BGB. In the mid-1960s however a new development started with the well-known *Testamentfall* decision (BGH NJW 1965, 1955; JZ 1966, 141, with an important note by Professor Werner Lorenz. The facts of the case have become too well known and thus do not deserve to be repeated.) The importance of the decision lay perhaps less in the fact that it made a negligent and inactive notary liable to the testator's frustrated beneficiary, but more significantly because it chose to do so in terms which, in effect, extended the notion of *Verträge mit Schutzwirkung für Dritte* to cases involving pure economic loss. The genie was out of the bottle and, arguably, about to become mischievous.

Three reasons lay behind this decision. First was the fact that pure economic loss is not recoverable in a tort action (§ 823 I BGB). Secondly, the defendant notary must have known that the timely performance of his obligation was of essence both to the deceased testator and to his daughter (the plaintiff who, as a result of the notary's negligence did not become the sole heiress of her father's estate but took it jointly with her niece according to the rules of 'community of heirs': *Erbengemeinschaft*). Finally, and just as crucially, the daughter was the only person likely to suffer damage because of the defendant's non-performance of his obligation. (The same of course applies to cases of negligent acts on behalf of notaries or attorneys. See: OLG Bremen NJW 1977, 638.)

Once the dam was thus breached and economic loss could be recovered through a tort claim dressed up in contract clothes, the question was where would the new

development stop. In Professor Kötz's words ((1990) 10 *Tel Aviv Univ Studies in Law* 195, 202) for economic loss 'the signs are on the wall. The distinction between harm to protected interests and mere pecuniary harm, while still fundamental, begins to wear thin at times.' The law concerning the liability of sub-contractors to building owners, the law concerning the liability of suppliers of negligent certifications or valuations and the law concerning tort recovery for damage caused to defective but not dangerous products would seem to support this assertion. Here we shall only look at the first two factual situations; and to these one must also add the types of economic loss recoverable under the related notion of *Drittschadensliquidation*, which will be discussed below (section 4).

In *construction contracts* the major participants are linked by a chain of contracts; and the question that often has to be asked by the courts is the one that confronted the House of Lords in *Junior Books v Veitchi* ([1983] 1 AC 520) and the Supreme Court of California in *J'Aire Corporation v Gregory* (598 P 2d 60 (1979)): can the sub-contractor be made liable to a party other than the contractor (with whom he is in privity of contract) for economic losses caused by his shoddy work? The tortious solution reached by the common law courts would probably be reached in Germany by applying the notion of *Vertrag mit Schutzwirkung für Dritte*. The reason why one qualifies this answer with the word 'probably' is only due to the fact of the dearth of German case law. For Professor Kötz (at 206), the reason for this (fortunate) result may be the fact that 'it is common practice in the German construction industry to include in the contract between owner and the main contractor a provision by which the main contractor's warranty claims against the sub-contractor are assigned to the owner.' The advantage of such an approach—as indeed of all contractually-flavoured solutions—is that the plaintiffs take the claim subject to equities so that the sub-contractor can set up all defences against the owner that would have been available to him in a suit brought by the main contractor. (For German law, see §§ 334 and 404 BGB and cf the discussion of some confusing English decisions in *The German Law of Torts*, p 333 *et seq*. See also, the complicated saga of sub-contractors, defences of contributory negligence and the existence of (concurrent) duties of care in contract and tort in *Barclays Bank plc v Fairclough Building Ltd (No 1)* [1995] QB 214 (concerning the claim by the building owner against the head contractor) and *(No 2)* [1995] IRLR 605; [1995] PIQR P152 (concerning the action by the first sub-contractor against its own sub-contractor). This case illustrates a need for careful thinking about the nature of such claims and how defences thereto should properly be analysed.)

The situation with *negligent certifications* is both more intriguing and more controversial; and it is here that the German courts have arguably over-stretched the notion of contract with protective effect towards third parties as a result of abandoning the *Wohl und Wehe* requirement and replacing it with a much more open-ended question. ('. . . in what circumstances the objective interests involved permit the inference that the parties [debtor/creditor] have [even] implicitly stipulated a duty of care towards third parties.' (BGH NJW 1984, 355, 356, reproduced in *The German Law of Torts*, case no 22, p 275.) Since the case from which this statement comes offers a good illustration of this trend, its facts should be looked at in some detail.

The defendant, a professional valuer of land, was asked by S to advise him on the value and rental income of a particular building. The instructions were given at a meeting attended by a banker, S, and the plaintiff who subsequently bought the

premises. The defendant did not know whether S and the plaintiff were intending to purchase the building jointly. In a subsequent letter (addressed to another party but placed before the court) he accepted that he believed that S had probably made the inquiry on behalf of a consortium interested in purchasing the premises. The defendant's valuation concerning the rental income proved greatly exaggerated, due to the fact that he had failed to realise that some of the apartments in the building were subject to rent control restrictions. When the error was discovered the contract of sale was rescinded by entry into a new contract; but the purchaser/plaintiff, in trying to effect the unfortunate transaction, had also incurred considerable expenses which he now claimed as damages from the defendant/valuer. The BGH first agreed with the Court of Appeal that there was no question here of a contract in favour of third parties in the sense of § 328 BGB, since only S had a right to demand the performance of the primary obligation to supply the expert valuation. The Court then continued:

> [However] this consideration alone does not exclude the locus standi of the plaintiff to pursue his claim for damages since it is necessary, in addition, to consider whether the plaintiff is included in the area protected by the contract. For it is recognized today . . . that the contractual obligation may create duties of care towards third parties who themselves are not entitled to demand performance of the principal obligation. As this Senate has stated (. . . [references] . . .) this consideration applies also to contracts with officially appointed and sworn experts . . . Duties of care can also be created in favour of those persons who are not mentioned by name to the other contracting party [debtor]. Nor is it necessary that the contracting party [debtor] should know the exact number of persons to whom a duty of care is owed. The Federal Court has recognized in its case law a duty of care towards third parties even if the [debtor] owing the duty of care was ignorant of the number and the names of the persons to whom the duty was owed (. . . [references] . . .). It is essential, however, that the group to whom the duty of care is owed should be capable of being determined objectively . . .

The judgment contains many interesting insights into the abandonment of the *Wohl und Wehe* requirement and for that reason it is reproduced below; but it is not the only one that has opted for such a broadening of the contractual protection. Just as indicative of this trend is the so-called *Danish Consul* case (BGH NJW 1982, 2431, reproduced in *The German Law of Torts*, case no 21, p 273), which can serve as the last of our examples. There an expert valuer of land supplied the Danish Consul in Munich with inaccurate information concerning the commercial value of a certain area of land. The Consul passed this information on to a Danish bank, which, in reliance thereon, invested money in a building project to be carried out on this land. Even though the loan was secured by a land charge, the bank suffered considerable loss due to the incorrect expert valuation. In the opinion of the *Bundesgerichtshof*, the bank was in the position of a third party beneficiary of a contract that had come into existence between the expert valuer and the Danish Consul. For this purpose, it was not necessary to spell out an express or implied agreement between the promisor (the valuer) and the promisee (the Danish Consul) as to the inclusion of the third party (the bank) within the sphere of protection of this contract, for the expert could have foreseen that his statement would serve as basis for an investment decision. (Comparing this reasoning with the English cases discussed below, it is strongly arguable that the supply of that information on to the bank would have meant that, even if a duty had been owed to the Consul, it would have been highly unlikely to have been held to be

owed to the bank as well (by analogy with *Caparo Industries plc v Dickman* [1990] 2 AC 58 and the purpose of the advice or statement given (below).)

In the abstract, the decisive question may be reduced to the following formula: 'is the group of persons to be contractually protected capable of description by objective standards?' ('. . . *sofern die zu schützende Personengruppe objektiv abgrenzbar ist.*') It goes without saying that such criteria are more easily stated than applied to concrete situations. It also makes no difference to reassure German lawyers that they have not been alone in dealing with such difficult demarcation questions. *Caparo Industries plc v Dickman* demonstrates that this is not so. German lawyers, however, are unique in having placed what are essentially tort problems into contractual settings in order to overcome structural deficiencies of their Code. Methodologically, this result is not very neat; but to the extent that it shows that the promisor/defendant is not more extensively liable towards the plaintiff/third party than he is towards his co-contractor/debtor, they may have something to teach to the common lawyer. (For a thorough discussion of the banking cases in English see: von Bar, 'Liability for Information and Opinions Causing Pure Economic Loss to Third Parties: A Comparison of English and German case law' chapter 3 in Markesinis (ed), *The Gradual Convergence*. See also, *The German Law of Torts*, p 295 *et seq.*)

The concerns about indeterminate liability noted in the foregoing exposition of the German cases have also marked the development of English tort law in the field of negligent misstatements. Various control devices have been discussed by the courts in a wide variety of contexts and a brief summary will be given here (see generally, Markesinis, Deakin & Johnston, *Markesinis and Deakin's Tort Law* (5th edn, 2003, pp 114–131 (especially 114–24)). Thus, in *Hedley Byrne & Co v Heller & Partners* [1964] AC 465 some of their Lordships spoke of the voluntary assumption of responsibility by the defendant bank, on which the claimants relied (sein particular, the judgment of Lord Morris of Both-y-Gest at 503). Thus, in *Hedley Byrne* itself, the fact that the statement had explicitly been made 'without responsibility' allowed the defendant to escape liability (such exclusions would today be subject to section 2(2) of the Unfair Contract Terms Act 1977 and would have to satisfy a 'reasonableness' test). However, as has subsequently been pointed out by Lord Oliver in *Caparo* (above at 607), the phrase 'voluntary assumption of responsibility' 'was not intended to be a test for the existence of the duty for, on analysis, it means no more than that the act of the defendant in making the statement or tendering the advice was voluntary and that the law attributes to it an assumption of responsibility . . . [but] it tells us nothing about the circumstances from which such attribution arises.'

Thus, subsequent efforts have focused more carefully on a contextual analysis: in what circumstances has the advice been offered or the service been rendered? To put the matter another way, was there a 'special relationship' between the parties, such as to give rise to a duty of care? This language bears distinct similarities to the approach of the German cases discussed above. Many of the successful claims in this area have related to situations where the category of recipients of the relevant statement or advice was small and obvious to the defendant: see *Esso Petroleum Co Ltd v Mardon* [1976] QB 801 (concerning pre-contractual representations as to likely business generated by a petrol station) and *Smith v Eric S Bush*; *Harris v Wyre Forest DC* [1990] 1 AC 831 (where surveyor's valuation reports were prepared under a contract with a third party but would clearly be relied on by the prospective purchaser). By contrast,

the *Caparo* case (above) illustrates that a different definition of the purpose of the exercise carried out in giving the advice can lead to the opposite result: thus, by describing the purpose of the annual audit of a publicly listed company's accounts as the protection of the collective interest of the shareholders in ensuring the effective management of the company, a claim by a successful purchaser of the company that the audit had been negligent failed. This was because such reliance on a 'statement . . . put into more or less general circulation and [which] may foreseeably be relied on by strangers to the maker of the statement for any one of a variety of purposes which the maker of the statement has no specific reason to contemplate' fell outside the duty as defined by the purpose of auditing the accounts (*per* Lord Bridge, at 620–1).

This raises the spectre of open-ended liability, but the interpretation adopted by the House of Lords has been criticised strongly (see eg, Percival, 'After *Caparo*: Liability in Business Transactions Revisited' (1991) 54 *MLR* 739): after all, it is only the party engaged in the take-over that ended up over-bidding that lost out as a result of such advice (while the other shareholders who sold to that other party were bought out at a premium)—this hardly resembles indeterminate liability concerns. Perhaps Hoffmann J provides the best rationalisation of the case law in *Morgan Crucible v Hill Samuel* [1991] Ch 295, at 305, where he emphasised the different economic relationships between the parties. Typically, the English cases have not been sympathetic to parties claiming to have relied on negligent misstatements made during arm's length commercial negotiations (unless they amount to misrepresentations, on which see chapter 6, sections 3 and 4, p 302) and the *Caparo* situation could be said to fall within this category. However, when the nature of the market is one where the party relying on the advice or statement is at a disadvantage in obtaining the relevant information (such as in *Esso v Mardon* (above) or in the surveyor cases such as *Smith v Eric S Bush*), then the relationship between the parties is such that a duty to take care will be held to exist.

Finally, similar control device difficulties can be seen in the cases that have expanded the *Hedley Byrne* principle into the field of the negligent performance of a service (begun with *Henderson v Merrett Syndicates Ltd* [1995] 2 AC 145). Cases such as *White v Jones* [1995] 2 AC 207 raise the difficult question of determining the extent of such a tortious duty, which Lord Goff stressed is shaped by the underlying contract between (in *White v Jones*) the testator and the defendant solicitor. In so doing, a key question is the identification of the intended beneficiaries of the performance of such services, which again is strongly redolent of the notion developed in German law that 'the group of persons to be contractually protected [must be] capable of description by objective standards': compare *Goodwill v British Pregnancy Advisory Service* [1996] 1 WLR 1397; *MacFarlane v Tayside Health Board* [2000] 2 AC 59 and *Rees v Darlington Memorial Hospital NHS Trust* [2002] 2 WLR 1483 (all concerning failed vasectomies or sterilisation operations, yet receiving different answers as to who counted as the 'intended' or only 'incidental' beneficiaries of the performance of the (contractual) service). (On the sterilisation cases, see the comparative discussion in *The German Law of Torts*, pp 178–91 and 194–8.)

One thing that emerges clearly from this summary of the English position is that the English courts, while prepared to broaden the application of this area of the law, remain concerned to keep such liability within fairly strict boundaries and still insist on a strong nexus between the provider of the advice or the service and the recipient

who relies thereon. In this respect, while the moves towards the appropriate control criteria do seem similar to those used in the German cases, it would appear that the English approach remains somewhat more restrictive.

The trend of lessening the requirement of the creditor's interest in the protection of the third party has been continued in many decisions confirming BGH NJW 1984, 355. We may briefly discuss BGHZ 127, 378, reproduced in *The German Law of Torts*, p 280, case no 23, annotated at 293 *et seq*. The decision deals with the problem whether and to what extent the co-responsibility of the contractual partner of the surveyor should be taken into account in an action by the third party/purchaser of the land. In this instance the site owner, who intended to sell the property, commissioned a report from a surveyor to estimate the value of the house. The surveyor over-valued the house. This was because he negligently relied on the misleading information given to him by the site owner. The third party/purchaser relied on the surveyor's report and bought the house at an unrealistic price. The court allowed the action of the third party. The actual result of the decision surely appears reasonable. In the final analysis, however, the BGH took another step in the direction of an extra-contractual liability for certain cases of economic loss. The court sought to derive this result from the intention of the parties to the contract of employment of the surveyor which was given protective effect towards the third party/purchaser. The BGH resorted to two fictions to achieve the 'desired' result on the basis of contract.

The first was that the site owner had a real interest in including the buyer in the protective scope of the contract. In fact he had not, since he and the purchaser were on opposite sides of the bargain, and as a result the survey gave rise to a conflict of interests. (While the site owner is clearly interested in a favourable valuation, the purchaser/plaintiff is interested in a valuation at the lower end of the scale). It is therefore difficult to argue that the site owner wished to benefit the third party/plaintiff. Such an intention could be 'discovered' only if one could show that, had the parties openly discussed the issue, they would have agreed that good faith required that the site-owner also contracted for the benefit of the purchaser. Such a construction, however, is so unconvincing that in reality it shows that it is the law that is imposing on the surveyor such a duty towards the purchaser and not the will of the parties.

The second fiction is even more striking. It is inherent in the derivative nature of the third party's cause of action that the promisor/surveyor can rely, vis-à-vis the third party, on any defences available to him against the promisee (§ 334 BGB, which in the UK corresponds to section 3(2) of the Contracts (Rights of Third Parties Act) 1999). In an action by the site owner, the surveyor could have objected that the promisee/site owner who commissioned the report had acted contrary to good faith in concealing a crucial defect of the property. The BGH held that the promisor could not avail himself of this defence as against the third party/purchaser. The court relied on a device—which is not always available—to solve this problem, namely implied term reasoning. Thus, it assumed that in the contract that created the 'duty of care' towards certain third parties, the surveyor tacitly waived his right to avail himself of any defence against the plaintiff/potential purchaser which he, the contractual debtor, had against his contractual partner (the person commissioning the report). This waiver, the BGH stated, was justified by the fact that the expert knew that his performance was intended to form the basis of the financial calculations of the purchaser of the land (who, one might add will—reasonably—rely on the report). It goes without saying

that these considerations might also justify imposing liability in these circumstances under the *Hedley Byrne* principle (eg, as in *Smith v Eric S Bush*, above). However, it is more difficult to see how this result, imposing liability, can be derived from applying the concept of a contract in favour of the third party. For not only is this result incompatible with the traditional model of a contract in favour of third parties; it is also doubtful that the surveyor would have accepted such a waiver had it been discussed before entering into the contract. Once again, such analysis indicates that the duty is imposed by law and does not flow from the will of the contracting parties (*quaere* what the result would be if an attempt were made by the surveyor expressly to exclude liability by stating this clearly in his report: this device failed in *Smith v Eric S Bush* as a result of section 2(2) of UCTA 1977—in the context of a business-consumer relationship, where the consumer had no opportunity to renegotiate terms, etc. See especially, the judgment of Lord Griffiths [1990] 1 AC 831, 857–60). It also casts new doubt on the whole construction of a contract with protective effects towards the purchaser (see Ebke, JZ 1998, 991, 993, who suggests that 'implied term' reasoning is in such cases used to make up for the exclusion of pure economic loss from the list of protected interests in § 823 I BGB).

In the light of the above, it comes as no surprise to discover that some academic commentators have argued in favour of abandoning the contract with protective effects as theoretical basis of the decisions of the court—at least in cases such as the present one. But the BGH remains to be convinced and has yet to give any signs that it is about to change its present stance (see eg, Canaris, ZHR 163 (1999) 206, and JZ 1995, 441). Professor Canaris submits that at least in situations like the present one, the theoretical basis of the liability of the 'expert' for negligent misstatements in German law ought to be *culpa in contrahendo* (now § 311 II and III BGB). Such an analysis would entail a number of advantages, such as a better explanation of the independence of the action from the contract between the person who commissioned the statement and the expert. It would also cater for the need to limit liability in relation to third parties by disclaimers etc. One is reminded here of the reasoning in *Smith v Eric S Bush* (as discussed above).

However, as Professor Schlechtriem remarked it is not so much the theoretical basis that counts. What really matters is that the specific criteria for imposing liability receive attention and are developed rationally on a case-by-case basis. (See his 'Schutzpflichten und geschützte Personen' in *Festschrift für Dieter Medicus* (1999), p 529.) Against this background, the comparative study of each other's systems can provide useful insights to both of them and make the lawyer—student or practitioner—understand better what he is trying to achieve. Another and perhaps more important lesson that can be drawn from comparing liability for negligent misstatements is that, in this field of 'professional negligence,' the traditional compartmentalisation of obligations into contractual and tortious bases very often lacks explanatory power. (See further Coester and Markesinis, 'Liability of Financial Experts in German and American Law: An exercise in Comparative Methodology'(2003) *Amer J Comp L* 275–309.)

(d) Summary and Comparative Epilogue

To summarise, it can be stated that German courts have deployed the concept of a contract with protective effects in two quite different groups of cases.

In the first category, the function of the *Vertrag mit Schutzwirkung* is to frame certain protective duties of care as collateral obligations under the contract (or in pre-contractual situations as *culpa in contrahendo*) in order to avoid the weak vicarious liability rule contained in § 831 BGB. The well-known decision in *Cavalier v Pope* provides an excellent English illustration of the problem that has to be solved. These cases involve physical damage to property or to the person, and clearly this aspect of the concept is of less interest to English lawyers.

The second type of situation in which the notion of *Vertrag mit Schutzwirkung* has been used is however much more interesting and it concerns the so-called 'liability of experts.' Here the absence (in Germany) of a tortious exception to the rule that pure economic loss is not recoverable in tort (such as the *Hedley Byrne* principle) has prompted German courts to extend contractual reasoning. It suffices here to point out that this category of liability causes great *conceptual* difficulties in both systems but the control mechanisms applied by the courts are quite similar from a pragmatic point of view. (For a more detailed account, see notes to cases 19–24, p 265 *et seq*, and case 27, p 328 *et seq* in *The German Law of Torts*.)

The contents of this chapter should reveal both the strengths and weaknesses of German law. To the common law observer, it is really little short of amazing to see the lengths German lawyers have gone to in order to overcome some defective provisions in their Code. Common law students repeatedly ask the question 'why did not German law abrogate the unfortunate provision of § 831 BGB and choose instead to go to such lengths to by-pass its unwanted consequences?' Such a question of course ignores the special force that the Codes have and the dangers of amending them in a piecemeal manner, but it nevertheless adequately expresses the perplexity experienced by foreign observers. Another concern that common lawyers tend to voice is however less easy to answer. Do we really need all these variations of the contract *in favorem tertii*, and in particular, is it still really necessary to retain both the institution of *Vertrag mit Schutzwirkung für Dritte* and *Drittschadensliquidation* (to be discussed next), especially now that the former institution has been extended to cover economic loss as well? The German writings leave the foreign observer impressed with their ingenuity; but they also fail to convince entirely that the *Vertrag mit Schutzwirkung für Dritte* is giving effect to the intentions of the parties rather than imposing obligations in law on the parties, which are perhaps more easily explained on an extra-contractual basis. More importantly, perhaps, the relaxation of the conditions necessary in order to discover contracts with protective effects towards third parties has not only caused concern within German academic circles; it has led some English observers of the German scene to dismiss it rather more summarily than it deserves (see Beatson, 'Reforming the Law of Contracts for the Benefit of Third Parties? A Second Bite at the Cherry (1992) 45 *CLP* 1, and Barker, 'Are we up to Expectations? Solicitors, Beneficiaries and the Tort/Contract Divide' (1994) 14 *OJLS* 137). For, despite its propensity towards theoretical constructions, German law in this area has some interesting lessons to offer to those who are willing to look behind the different conceptualism. Here are two examples; and others were noted in the preceding pages, especially whenever the German solutions were compared to those adopted by French law.

The first point has already been noted in passing when we talked about defences available to the promisor/debtor. In daily life the problem that confronts the courts is

not only how to make one of the contracting parties liable to a stranger. Just as important is another question: how to ensure that the contractual debtor is liable towards the third party in exactly the same way as he would be liable towards his co-contractor, the promisee. If the liability is different in nature, all manner of issues will be affected: jurisdiction (internal and international), standard of care, period of limitation, exemption clauses, etc. To impose liability *simpliciter* could mean that one side of the triangle (debtor/third party) was subject to one set of rules while the other (creditor/debtor) was subject to another. The contractual solutions of German law ensure that this does not happen (§ 334 BGB). But even where they are not available (or not attractive) to common lawyers, more accustomed to handling problems through tort law and the notion of duty of care, they should still be of use to them in so far as they suggest that the fashioning of the tort duties must be determined by the underlying contract (see eg, *White v Jones*, above, for this very point). Equally, it is important to remember which contract is the one that matters for these purposes; and as we saw in the relevant section of the German law, the contract that should matter is the one between promisor and promisee (and not, as some English decisions have implied, the relationship between promisor and third party). On this point, the general rule of German law seems clear and convincing. Yet, as the discussion of the baffling decision BGHZ 127, 378 (reproduced in *The German Law of Torts*, case no 23) shows, there may be cases where the third party may be entitled to recover more than the promisee.

Secondly, German lawyers have also rendered service to legal science by analysing the contractual link thoroughly and distinguishing between primary and secondary obligations. The importance of this can be seen when comparing the Germanic approach with the French in the context of the well-known '*blood transfusion*' case. (Civ GP 1955.1.54.) In that case, the *Centre National de Transfusion Sanguine* entered into a contract with a hospital to supply it with blood to be transfused to its patients. Some of the blood so provided was infected by syphilis and one of the patients who received it sued the Centre and was allowed to claim damages on the ground that he was a third party beneficiary of the contract concluded between the *Centre* and the hospital. This *stipulation pour autrui* is analogous to the German *Vertrag zugunsten Dritter*. In theory, it means that the promisor (the *Centre*) is liable to the third party for the performance of the primary obligation in such a way that he could be sued by the patient for non-delivery of the blood. Clearly, this was not intended by the parties; and if such an action were brought it would have failed. This, in reality, was a tort situation, and should have been solved through Article 1382 CC. Why the contractual approach was preferred can only be matter of speculation. Often, in French law contractual solutions offer procedural advantages to plaintiffs. But if a contractual solution were needed, the Germanic *Vertrag mit Schutzwirkung für Dritte* offers a neater approach.

4. *SCHADENSVERLAGERUNG* AND TRANSFERRED LOSS

Büdenbender, 'Wechselwirkungen zwischen Vorteilsausgleichung und Drittschadensliquidation' JZ 1995, 920; von Caemmerer, 'Das Problem des Drittschadensersatzes' ZHR 127 (1965) 241; Oetker, 'Versendungskauf, Frachtrecht und Drittschadensliquidation' JuS 2001, 833; Peters, 'Zum Problem der Drittschadensliquidation' AcP 180 (1980) 329; Ries, 'Grundprobleme der Drittschadensliquidation und des Vertrags mit Schutzwirkung für Dritte' JA 1982, 453; von Schröter, 'Die Haftung für Drittschäden' Jura 1997, 343; Tägert, *Die Geltendmachung des Drittschadens* (1938).

(a) Preliminary Observations

The doctrine of transferred loss is meant to ensure that the defaulting party in the contract does not benefit from his fault in those cases where the loss has been shifted from the creditor to a third party. If this exception to the notion of relativity of contracts had not been accepted, the defaulting party would not be liable to his creditor since the latter has suffered no loss; nor would he be liable to the third party in contract in the absence of any contractual link between them. Likewise, since the harm involved is pure economic loss, in German law there would be no chance of an action in tort. Thus, what makes it necessary to create a new mechanism is the fact that in some cases the party who has suffered the loss has no right to claim and the party who has the right to claim has suffered no loss. From this situation emerged the notion of *Drittschadensliquidation*, which allows the contractual creditor to claim (liquidate) the loss suffered by the third party as a result of the non-execution or faulty execution of the contract by the contractual debtor. This theoretical analysis is best understood through some concrete examples, although perhaps one can state that what all these cases have in common are two factors. First, there is a 'fortuitous' shift of liability as the loss is transferred from the contractual creditor to the third party. Secondly, the fear of opening of the floodgates (the 'shop-soiled argument of the timorous' as Professor John Fleming has called it in his *Introduction to the Law of Torts* (2nd edn, 1985), p 3) does not arise here precisely because only one person can suffer loss in these cases.

The case law probably goes back to a decision of the Court of Appeal of Lübeck, which allowed an agent to claim damages for loss suffered by his 'undisclosed' principal (Seufferts Archiv, II (1857) 36, 37). It will of course be remembered from chapter 2 that German law does not recognise the concept of undisclosed agency, so in such a situation the principal who suffered the loss had no right to claim for its compensation. Allowing the agent to claim for the third party's loss accounts for the name of the device: *Drittschadensliquidation*) (see for details: von Caemmerer, ZHR 127 (1965) 241).

Recovery of third party loss is not governed by any provision of the BGB. Some commissioners had proposed a general rule as to when third party loss is recoverable, but it was not in the end included (see Mugdan, *Die gesamten Materialien zum Bürgerlichen Gesetzbuch*, II (1899), pp 517–18). The majority was of the opinion that the problem was too controversial. Like the English Law Commission in 1996 (Report No 242), the BGB Commission one hundred years earlier decided to leave the question unanswered and expressed the conviction that the courts would be able to develop a solution outside the code. It is important to note from the outset that recovery of third party loss is possible only in special cases. Like English law, the BGB proceeds on the assumption that every party to a contract may only recover his own loss. This is usually referred to as the 'doctrine of the creditor's interest' (*Dogma des Gläubigerinteresses*)—an equivalent to the English notion of the compensatory nature of damages. The concept of *Drittschadensliquidation* is thus an exception to the doctrine of the creditor's interest.