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Liability for negligent misstatement inducing a contract in South Africa and Germany

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TABLE OF CONTENTS

INTRODUCTION

The law in the area of negligent misrepresentation has undergone major changes during this century, in the legal systems of both South Africa and Germany. Which remedies does one have if financial loss is caused because another made a false statement?

The legal system in South Africa stands in the tradition of Roman, Roman-Dutch and English law, while Germany derived its civil law from Roman principles. Neither of these historical legal backgrounds provided a complete answer to the question posed above, and if there were answers, they have been subjected to many changes and uncertainties due to the growing complexity of cases. The complexity is increased by the fact that misrepresentation overlaps both the law of contract as well as delict and this challenges the distinction between the two of them. Through the development of given legal principles, it is now an established rule in South African and German law that an action exists for the recovery of damages which were caused by negligent misrepresentation in the pre-contractual sphere.

The object of this dissertation is to depict the development of this remedy and to compare the adequacy and precedence of the existing rule in South Africa and Germany.

For the sake of getting familiar with the subject, some basic terms must be explained beforehand.

Both English and South African courts have defined a misrepresentation as

'A (false) statement, or assertion, made by one party to the other, before or at the time of the contract, of some matter or circumstance relating to it.'[1]

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[1] Hutchinson, 'Damages for non-fraudulent misrepresentation' at 4, and cases cited there.

Misrepresentation is accordingly a species of misstatement which induces a contract, whereas a simple misstatement is made outside a contractual context[2]. This distinction is a very narrow one, and courts have often used both terms synonymously. In fact, a broader understanding is necessary, since the making of a misrepresentation can have the form of an express, verbal statement, but it may also be implied from conduct[3]. There are other forms of misstatements, however, which have to be distinguished, as they either do not amount to a misrepresentation or go beyond its scope.

Contractual terms, the first alternative, are statements of fact that are made during the course of pre-contractual negotiations, or are embodied in a contractual document. Here it must be asked whether the statement amounts to a term of contract (warranty) or constitutes a mere representation. The classical test for distinguishing warranties from representations is that attributed to Lord Holt: 'An affirmation at the time of a sale is a warranty, provided it appear on evidence to have been so intended.'[4] In practice this test is guided by a number of considerations that could well be described as 'no more than applied common sense'[5], such as: the importance of the truth of the statement; at what stage of the transaction it was made; whether it was a state of fact or of opinion; whether it was made in answer to a question by the representee; whether the representor had any special skill or knowledge which put him in a better position to know the truth as compared to the representee; and so on[6].

The distinction between a term and a mere representation becomes important for the choice of available remedies: the breach of term leads to a contractual remedy, while representation may invoke delictual liability.

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[2] *Cf.* Carole Lewis, S.A.L.J. 1992 (3) 381 at 383.

[3] See in general Hudson 'Making Misrepresentations' 1969, 85 L.Q.R. 524.

[4] *Pasley v Freeman* (1789) 3 Term. Rep. 51 at 57. The test has been adopted by South African courts: *Naude v Harrison* 1925 C.P.D. 84 at 90.

[5] *Esso v Mardon* (1976) 2 W.L.R. 583 (D.A.) at 600 (Ormrod L.J.).

[6] *Cf* Hutchinson, 'Damages for non-fraudulent misrepresentation' at 6.

A 'puff', the second alternative, is merely a general laudation by a contracting party that does not amount to misrepresentation and therefore has no legal consequences[7].

The translations in German for 'misrepresentation' relate throughout to the contractual context of error, mistake and inducement to contract on the basis of such misperceptions. Misrepresentation, in German law, means the making of a factually incorrect statement to another that causes error[8]. It will be described later, in connection with the German law of obligations[9], in which different forms misrepresentation may occur. But it may already be understood from the broad definition that basically all conduct, innocent or wilful, can constitute a misrepresentation. It is the context that may demand liability, on different grounds: delict, contract, or quasi-contractual.

PART A: SOUTH AFRICAN LAW

The South African law of negligent misrepresentation was formed on the basis of English and Roman-Dutch law. The early South African cases on misrepresentation reflect a struggle for dominance between the legal ideas of these two branches, before a distinct legal rule was firmly established as South African law.

In order to give a better understanding of the South African legal system, concerning the here relevant area of law, the inheritance of English and Roman-Dutch concepts must be explained.

I The legal history: English, Roman and Roman-Dutch law

1. The inheritance of legal concepts from England

a) From writ of deceit to warranty

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[7] *Cf* Hutchinson, 'Damages for non-fraudulent misrepsentation' at 8.
[8] Markesinis, Vol. I at 198.
[9] *Infra* Part B.

The early English law knew a 'writ of deceit' which granted the remedy of damages for fraudulent misrepresentation. This action of deceit was available when fraud occurred in the course of legal proceedings, but it was soon extended to matters 'on the case' and to relationships of confidence. From this 'writ of deceit' evolved the concept of warranty: sellers would warrant their title and quality of wares and were held liable in the action of deceit if their statement proved to be false.

The nature of the warranty was apparently contractual as the use of express words was required. On the other hand it showed a tortious character, as a breach of warranty was remedied on the basis of deceit. In fact, the seller's liability was based on the deception of the buyer who had been put off guard through the warranty. In order to limit the number of actions based on deceit the formal requirements of a warranty were held up strictly, and the principle of *caveat emptor* placed the burden to see for the validity of a warranty on the plaintiff. Once the formal requirements for a valid warranty were met, knowledge or ignorance of the truth on the part of the warrantor was irrelevant. Thus, liability was based on misrepresentation. This allowed the development of liability in tort also for non-fraudulent misrepresentation.

The rule of *caveat emptor* suffered its first major breach as the requirement of formal words for constituting a warranty fell away[10]. Deceit was then seen in the fact that the buyer had reasonably and legitimately put his trust in a false affirmation. Consequently, sellers were in effect being held liable in tort for innocent misrepresentation, albeit in a limited class of case[11].

Later, the tortious character of warranty was shed and shifted to the more contractual environment of assumpsit. This was a check on the tortious liability, which might otherwise have become extended to all affirmations of fact, even if made innocently.

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[10] See Hutchinson, 'Damages for non-fraudulent misrepresentation' at 41.

[11] Hutchinson, 'Damages for non-fraudulent misrepresentation' at 41.

What was a classical warranty before, became then a term of contract in the form of an assumpsit[12]. It became relevant to distinguish between terms and representation as it was not then accepted that material affirmations could also be treated as implied warranties. A warranty was understood to amount to an undertaking, a voluntary acceptance of responsibility for the statement, based on consensus[13]. Consequently, the demarcation line for a warranty came to be the test of intention of the parties. Misrepresentations inducing a contract, thus, fell out of the range of warranties. The basis for liability began to shift from deception to consensus of the parties, and the law of warranty was transferred almost entirely from deceit to the domain of contract. Thus, there was little relevance left for the tortious aspect of it, as a representation obviously lacked the intention to warrant and thus also the capacity to contain deceit. Any contractual remedies were open for warranties alone, whereas representation remained with the tort of deceit.

b) Expansion of deceit to negligence?

After warranty had been moved to the contractual sphere by making the distinction between assumpsit and mere representation[14], deceit had a very minor role left to play. This changed when the action of deceit was extended to non-contractual situations by the case of *Pasley v Freeman*[15]. According to that the action of deceit could be maintained 'upon a false affirmation or false representation, independently of a relationship of contract or of confidence between the parties', yet, only if the representor knew his statement to be untrue. As understood by the majority in *Pasley v Freeman*, a fraudulent statement was one made (a) with the knowledge of its falsity, and (b) with intent to deceive or injure[16].

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[12] Hutchinson, 'Damages for non-fraudulent misrepresentation' at 42.
[13] *Cf* Hutchinson 'Damages for non-fraudulent misrepresentation' at 43.
[14] *Stuart v Wilkins,* (1778) I Doug. 18.
[15] (1789) 3 Term. Rep. 51
[16] At 56-58.

Liability for innocent or negligent misrepresentation was thus excluded not only from contractual remedies but also from tortious liability[17].

After the decision in *Pasley v Freeman* attempts were made to include negligence in the delictual liability. The courts of equity[18] and common law courts[19] tried to dilute the requirement of fraud. These attempts originated in the fact that negligence had not yet emerged as a tort in its own right; negligence as a legal concept was not developed.

As a first step, the element of intend to deceive became obsolete several years after *Pasley v Freeman*[20]. The requirement of knowledge of the falsity of the statement, though, remained and became the object of different interpretations.

One of them being that the notion of recklessness was expanded to encompass negligence. The idea was that lack of reasonable grounds for belief in the truth of a statement was sufficient to give rise to the action in deceit[21].

These attempts were destroyed by the decision of the House of Lords in *Derry v Peek*[22], holding that mere negligence did not suffice to found an action in deceit.

The facts of the case were as such that the directors of a tramway company had issued a prospectus containing a statement that by a special Act which incorporated the company they had the right to use steam power instead of horses. But indeed, the special Act said that the carriages might be moved by steam power only with the consent of the Board of Trade. The plaintiff took shares in the company on the faith of this statement. The Board of

[17] Confirmed by *Derry v Peek*, (1889) 14 App. Cas. 337 (H.L.).
[18] *Evans v Bicknell* (1801) 6 Ves. 174, at 182-3.
[19] *Cf* Hutchinson 'Damages for non-fraudulent misrepresentation' at 222, cases cited under fn 85, 86.
[20] *Foster v Charles* (1830) 7 bing. 105; *Corbett v Brown* (1831) 8 Bing. 33; *Polhill v Walter* (1832) 3 B & Ad. 114; *Derry v Peek* at 371.
[21] *Peek v Derry* (1887) 37 Ch. D. 541 (C.A.) at 566.

Trade afterwards refused their consent to the use of steam power and the company was wound up. The plaintiff brought an action of deceit against the directors founded upon the false statement. The House of Lords held that the defendants were not liable, the statement having been made by them in the honest belief that it was true.

As to the requirements for an action of deceit[23] the House of Lords points out that there must be proof of fraud, and nothing short of this would suffice. Fraud would be proved if it is shown that a false representation has been made (1) knowingly, or (2) without belief in its truth, or (3) recklessly, careless whether it be true or false. Once fraud was proved the motive (intent) of the person guilty would be immaterial. While the Court of Appeal had ruled that the mere lack of reasonable grounds for the belief in the truth of a statement sufficed to found an action in deceit, the House of Lords demands what was already decided in *Pasley v Freeman*: a lack of honest belief in the truth of the statement.

Thus, mere negligence to found an action in deceit was ruled out, another ground for liability for non fraudulent misrepresentation had to be found. Such then was the inheritance of South African law from the English side.

2. Roman and Roman-Dutch law [24]

Roman and Roman-Dutch law is the second important source of influence for South African law.

In Roman law two main strings of actions govern the recovery of damages: the aedilician actions and the *Lex Aquiliae*.

a) Aedilician actions

Aedilician actions are divided into the *actio redhibitoria* (setting aside a contract of sales) and the *actio quanti minoris* (recovering a portion of the

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[22] (1889) 14 App. Cas. 337 (H.L.).

[23] At 374.

[24] See the presentation in Hutchinson 'Damages for non-fraudulent misrepresentation' at 50.

purchase price), granting a financial restoration if a seller made a *dicta promissumve* with regard to the object of purchase, which proved to be untrue. The term *dicta promissumve* has been interpreted in different ways by Roman and Roman-Dutch authorities but was never clearly explained. It appears to be the strongest view that it could be considered as term of contract, intended to being made good. No distinction was drawn between statements and mere representation. Only if a statement had the character of an appraisal or permissible laudation, it was considered a puff that did not amount to the quality of a *dictum promissumve*[25]. In the decision of *Phame v Paizes*[26] this view is confirmed. Here, the Appellate Division describes the meaning of a *dictum promissumve* as a 'material statement made by the seller to the buyer during the negotiations, bearing on the quality of the *res vendita* and going beyond mere praise and commendation'. The aedilician remedies operate thus irrespectively of intent or *culpa* on the part of the seller. They are available *ipso facto* by operation of law if the quality of the *res vendita* falls short of the *dictum*, and there is no need to invoke warranty or term of contract or to aver the breach of either[27]. The field of application for *dicta et promissa* is limited to contracts of sale and has thus a much narrower range than warranty or misrepresentation[28].

Negligence was in this context therefore no issue.

b) *Lex Aquilia*[29]

It is relevant only in the context of delict. The most important historical concept here is that of *damnum iniuria datum*, imposing liability for patrimonial damage flowing from the physical infringement of a thing or a person[30]. When a person suffered harm, which was not caused by a physical

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[25] See Hutchinson, 'Damages for non-fraudulent misrepresentation' at 64, 66, 68 referring to Voet.
[26] 1973 (3) SA 397 (A) 418.
[27] *Phame v Paizes* at 417.
[28] *Wastie v Security Motors (Pty.) Ltd.* 1972 (2) SA 129 (C).
[29] Act from 287 BC; see Neethling at 8, 9.
[30] Van den Heever, 'Aquilian Damages' at 28.

infringement, Roman law did not offer any criterion by which the act could be evaluated[31]. The nature of the act (and its effects) was thus of primary importance, which is the reason why the Roman law of delict is called casuistic. However, fault (either intent or negligence) on the part of the wrongdoer was already stated as a requirement for liability, albeit being of secondary importance[32].

In Roman-Dutch law the dimensions of aquilian liability were extended in several ways. The here relevant aspect is that of granting the *actio in factum*. According to that the requirement of physical impairment was no longer insisted upon[33]. Whether the aquilian action in Roman-Dutch law had developed into a general remedy for the culpable and wrongful causing of patrimonial damage can be disputed[34], but the tendency was apparently in favour of it[35]. One further action which originated in Roman-Dutch law and which is applicable to the specific situation of intentional misrepresentation is the *actio doli*[36]. In so far as this action covers the wrongful and culpable causing of patrimonial damage, it may quite easily be subsumed under the aquilian action[37]. At the same time it shows a clear distinction from the contractual remedies for misrepresentation: the intentional misrepresentation excludes the aedilician actions for the lack of the will to guarantee or promise anything[38].

c) Summary

As far as negligent misrepresentation is concerned the following situation was given under Roman-Dutch law: non-intentional misrepresentation was classified as *dictum et promissa*, thus actionable under the aedilician remedies and granting financial redress. Intentional misrepresentation gave

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[31] Neethling at 10.
[32] Neethling at 10 fn. 42; Van den Heever, 'Aquilian Damages' at 26, 27.
[33] Voet 20.1.11.
[34] Neethling at 10.
[35] See Van Warmelo at 131; *The Cape of Good Hope Bank v Fisher* (1886) 4 SC 368, 379.
[36] See Van der Merwe and Olivier at 228-229.
[37] Neethling at 248.
[38] Voet 4.3.4.

rise to delictual liability. Whether or not negligent misrepresentation fell under the aquilian liability would depend on whether the requirement of physical damages is seen as obsolete[39].

II South African law in process under the influence of English and Roman-Dutch concepts

1. Early South African law

The early South African law is marked by the struggle for dominance between English and Roman-Dutch legal concepts.

a) Damages for misrepresentation under contractual remedies

In the field of contractual remedies the question prevailed whether the aedilician actions would grant damages for misrepresentation. The conventional interpretation of *dicta et promissa* seemed to include also representations, but the English concept of distinguishing between warranty (term) and representation, being applicable to all contracts, overshadowed this. Consequently, the notion of *dicta et promissa* was reinterpreted according to the test of intention for warranties and the requirement of an *animus contrahendi* was accepted as also forming part of South African law[40]. *Dicta* were now classed as representations, and *promissa* as warranties. In *Ramos v Jackson* [41] the Cape Provincial Division clearly confirmed the dominance of the English approach by stating that no damages whatsoever could be granted for innocent misrepresentations.

The question of damages under the aedilician action (*actio quanti minoris)* was raised in *Hall v Milner*[42] and in *Phame v Paizes*. According to the

[39] As understood by De Villiers CJ in *The Cape of Good Hope Bank v Fisher*, referring to Voet and Matthaeus, see Neethling at 11.
[40] *Naude v Harrison* 1925 C.P.D. 84 at 90, 91; *Bell v Ramsey* 1929 N.P.D. 265 at 272.
[41] 1955 (1) P.H., A.C. (C).
[42] 1959 (2) S.A. 304 (O).

latter, the aedilician remedies operate irrespectively of intent or *culpa* on the part of the seller.

In *Hall v Milner* a claim for restitutional damages was allowed and the exception to it, based on innocent misrepresentation inducing a sale, dismissed. The *actio quanti minoris* (or: the claim for restitutional damages) was allowed with reference to Roman-Dutch law according to which *dicta promissumve* included statements which today would be qualified as mere representation, treating them as terms of the sale[43]. Although confined to the contract of sale, the judgement suggests the possibility of a generalisation of aedilician relief to recover restitutional damages for innocent misrepresentation[44]. The broad interpretation of the term *dicta promissave* gave rise to opposition and doubts about its correctness, until the Appellate Division had the opportunity for clarification of the law in *Phame v Paizes*. The claim was based on the same grounds as in *Hall v Milner*: damages under the *actio quanti minoris* for an innocent misrepresentation. In the unanimous judgement innocent misrepresentation was held to entitle the purchaser to the *actio quanti minoris*, without touching on the question of damages. The meaning of *dictum et promissum* as it had been seen in *Hall v Milner* equated 'any statement by the vendor during the negotiations which bears upon the quality or value of the *res vendita* and which can reasonable be construed as intended to be acted upon by the buyer' to 'a part and parcel of the relevant contract of sale'[45]. In *Phame v Paizes*, Holmes J.A. was critical of that classification of *dicta promissave* as terms of the sale. For him, it was sufficient that the statement would go beyond mere praise and commendation. It was thus 'both unnecessary and confusing to try to fit a *dictum et promissum* into some modern juridical niche like warranty or term, and then to draw conclusions therefrom as to the buyer's rights'[46].

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[43] *Hall v Milner* at 311, 312.
[44] Hutchinson, 'Damages for non-fraudulent misrepresentation' at 115, 116.
[45] *Hall v Milner* at 310, 312.
[46] *Phame v Paizes* at 416.

Quite clearly Holmes J.A. excludes the idea of an innocent misstatement giving rise to an action for damages *per se* but only to a reduction of the price if the purchaser founds the action on *quanti minoris*. Therefore: an innocent misrepresentation must amount to a *dictum et promissum* within the aedilician concept[47]. According to the legal rule at that stage, innocent misrepresentation therefore did not give a right to damages outside of the aedilician conditions.

Likewise, cases of negligent misrepresentation were excluded from the contractual remedies. There, the plaintiff could either sue on the basis of *quanti minoris* in order to obtain restitutional damages, or he could claim breach of warranty. Both possibilities excluded misrepresentation *per se* as foundation for the right for it did not in itself constitute a *promissum*, nor did it amount to a term of contract like a warranty, for the lack of *animus contrahendi*.

b) Negligence as a wrong in delict

The English law of tort has been described as knowing different torts with independent wrongs, rules and remedies. It was therefore necessary to develop the tort of negligence besides the conventional one of deceit[48]. The Roman-Dutch concept had a much broader approach, based on fault, which included *dolus* and *culpa* likewise[49]. South African law follows the latter and classifies negligence merely as a mode of committing the wrong of *damnum injuria datum*[50]. As Watermeyer J in *Perlman v Zoutendyk*[51] puts it, 'in general all damage caused unjustifiably (*injuria*) is actionable, whether caused intentionally (*dolo*) or by negligence (*culpa*)'.

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[47] *Phame v Paize* at 415 G, H.
[48] Hutchinson, 'Damages for non-fraudulent misrepresentation' at 206, 207; *Donoghue v Stevenson* 1932 A.C. 562 (H.L.).
[49] Compare Van Warmelo at 131.
[50] Hutchinson, 'Damages for non-fraudulent misrepresentation' at 205.
[51] 1934 CPD 151, 155.

In the law of delict, in general, the focus of attention shifts from an action or statement itself to the manner in which it was made. In the context of delictual liability the inducement to contract is therefore merely one possible form of damage which might flow from misrepresentation. However, several problems emerge from the application of the law of delict to that particular field.

2. Liability for negligence and the duty of care

As said above, early South African law understood negligence as one form of delictual conduct, which was governed by its own principles. On the other hand, the duty of care concept is an English idea. It is one of the prerequisites, necessary to constitute liability for negligence[52]. When negligence was accepted as a tort in its own right by the decision in *Donoghue v Stevenson*[53], the requirement of a breach of a duty of care replaced the original element of intention to deceive. As English law traditionally distinguished the tort of deceit from other torts, like negligence, it followed naturally that the requirement of a duty of care would also be examined with regard to precedent. On the other hand, English courts attempted quite early to find a common denominator underlying all the existing duty situations and to develop a general principle[54].

South African law was influenced by this conflict, although the Roman-Dutch concept already appeared to be wide enough to encompass a duty of care not to act negligently.

a) The duty of care in English law

The development of the duty of care started after *Derry v Peek*[55]. The effect of this decision, as then understood, was confirmed and explained again by

[52] The English action for negligence is based on a duty of care, breach of that duty and consequent damage. The aquilian action demands fault (*dolus* or *culpa*), wrongfulness and patrimonial loss.
[53] 1932 A.C. 562 (H.L.).
[54] *Cf* Hutchinson, 'Murphy's Law: the recovery of pure economic loss in the tort of negligence' at 4.
[55] (1887) 37 Ch. D. 541 (C.A.) at 566.

the Court of Appeal in *LeLievre v Gould*[56]: in cases like *Derry v Peek* and *LeLievre v Gould*, that is, cases of false statements causing financial loss, there was no duty enforceable in law to be careful. Negligent misrepresentation could give rise to an action only if a duty lied upon the defendant not to be negligent, and in that class of cases the House of Lords considered that the circumstances raised no such duty. By ruling that, the Court of Appeal in *LeLievre v Gould* rejected the earlier attempt in *Heaven v Pender*[57] to generalise the duty of care and followed a categorical approach. The latter dealt with the duty to prevent injury of the person or property of another and proposed that such a duty in principle arose if there was a certain proximity to another person (or to his property)[58]. Seeing no reason to follow the principle of *Heaven v Pender*, the Court of Appeal made clear that an action, apart from deceit, does not lie unless a duty of care results from a contract[59].

The decision of *Donoghue v Stevenson* is famous for the neighbour principle, which develops further the idea of a general duty of care as pronounced in *Heaven v Pender*. As Lord Atkin says: 'You must take reasonable care to avoid acts or omissions which you can reasonably foresee would be likely to injure your neighbour' – The 'neighbour' being 'persons who are so closely and directly affected by my act that I ought reasonably to have them in contemplation as being so affected when I am directing my mind to the acts or omissions which are called in question'[60].
It might have seemed at the time that principle had triumphed over precedent. Yet, the type of cases in which the principle-approach is favoured, and of which *Donoghue v Stevenson* is one, deals with physical injury done to person or property by an act or omission. It was not intended to apply the principle to cases that lie outside of that scope, namely, cases

[56] (1893) 1 Q.B. 491 (C.A.) at 501 (per Bowen L.J.).
[57] (1883) 11 Q.B.D. 503 (C.A.) at 509.
[58] See *LeLievre v Gould* at 504.
[59] *LeLievre v Gould* at 504 (Smith L.J.)
[60] *Donoghue v Stevenson* at 580.

of misstatements, causing economic loss[61]. For that constellation the neighbour principle and 'reasonable foreseeability' as only criterion seemed to be too wide.

The decision in *Candler v Crane*[62] brought some further clarification about the quality and preconditions of a legal duty of care. In that case, a firm of accountants and auditors prepared a company's accounts and balance sheet. The accounts had been prepared negligently, but without any fraud on the part of the defendants, and did not give a true statement of the financial position of the company. In relying on the accuracy of the draft accounts, the plaintiff subscribed money for shares in the company and suffered loss when the company went into liquidation. The plaintiff based his claim for damages on negligence, or, alternatively, the breach of a duty to give accurate information. Since the plaintiff had invested his money on the basis of the draft accounts, the question of liability for negligence in the pre-contractual field arose. It is notable that the issue is not seen as narrowly connected to deceit anymore.

Candler v Crane was decided with 2:1, holding against a duty of care in the given circumstances. In their majority judgement, Cohen L.J. and Asquith L.J. ruled that due to the absence of a contractual or fiduciary relationship between the parties, the defendants owed no duty to the plaintiff to exercise care in preparing the accounts, and the plaintiff, therefore, could not maintain against them an action for negligence (sounding in tort)[63]. The main reason for the denial of a duty of care was the precedent of *LeLievre v Gould*, which the judges considered as binding (and according to which in absence of contract, fiduciary relationship or fraud, no damages for misrepresentation could be granted; however, negligent misrepresentation could give rise to an action if a duty not to be negligent existed), unless it could be shown to have been overruled or was to be distinguished.

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[61] See Hutchinson 'Murphy's Law: the recovery of pure economic loss in the tort of negligence' at 5.
[62] A.E.L.R. (1951) Vol. 1 at 426, (C.A.).
[63] *Candler v Crane* at 437.

In opposition to that the plaintiff relied on two important developments that had taken place between *LeLievre v Gould* and *Candler v Crane*:

(a) liability for negligence was being accepted when a careless statement caused physical injury[64].

(b) *Donoghue v Stevenson* recognised that the courts could, with caution, develop new duties of care under the principle of proximity, also in the field outside of contract[65].

Candler v Crane's case introduces a turning point in English law:

The majority judgement tries to cement what seemed to be unquestioned law: a restrictive approach that hesitated to develop the 'legal duty' as *LeLievre v Gould* and *Derry v* Peek mention it; on the other hand there is the dissenting judgement that advances strong arguments in favour of a duty, but has received growing attention only later, when it became a driving force to interpret the law differently.

According to the majority's opinion, *LeLievre v Gould* has not been overruled by other cases:

Nocton v Ashburton merely qualifies it to this extent that after the passage 'in the absence of contract with the plaintiffs' the further words 'or in some circumstances where a fiduciary relationship exists between defendant and plaintiff' ought to be written in[66].

Donoghue v Stevenson does not overrule it either since it points out merely that the law governing the duty owed by A to B in the absence of fraud, contract or fiduciary relationship has been built up piecemeal, in disconnected slabs exhibiting no organic unity of structure. There are certain categories but no common denomination between them. Although Lord Atkin in *Donoghue v Stevenson* suggests such a common denominator in form of the neighbour principle[67], the majority in *Candler v Crane* does not believe that this is meant to be so broad as to include not

[64] *Cf* Hutchinson, 'Damages for non-fraudulent misrepresentation' at 231, cases cited at fn. 132.
[65] *Donoghue v Stevenson* at 579.
[66] *Candler v Crane* at 438.

only physical injury but also conduct of any kind, through any means (including negligent misstatements), causing damage of any kind whether physical or not, to anyone who could bring himself within Lord Atkin's definition of a 'neighbour'. Allegedly the neighbour principle has never been applied where the damage complained of was not physical. Also, if Lord Atkin thought his formula was inconsistent with *Gould*'s case he would have said so. Instead, he seemed to accept the distinction between liability in tort for careless misstatements and other forms of carelessness. With these reasons the claim of the plaintiff in *Candler* was rejected.

In the view of the dissenting Denning L.J. the 'great question' in the case is whether the defendants owe a duty of care to the plaintiff. In principle, Denning L.J. tends to accept this, but considers the relevance of preceding authority to this case first. He suggests to distinguish *LeLievre v Gould* with regard to the decisions in *Donoghue v Stevenson* and *Nocton v Ashburton*.

In *Donoghue v Stevenson* the erroneous view was exposed that no one who was not a party to a contract could sue on it or on anything arising out of it - not even in tort[68]. On the basis of this wrong perception Bowen L.J. concluded in *LeLievre* that in English law no one can be held responsible in the absence of contract, for drawing a certificate carelessly, unless he intended to deceive[69]. The neighbour or proximity principle corrects this view.

A second error lay, according to Denning L.J. in an over-interpretation of *Derry v Peek* in the sense that an action would never lie for a negligent statement even though it was intended to be acted on. This interpretation led the judges in *LeLievre* to deny the correctness of *Cann v Willson*, in which the House of Lords held that a duty of care existed even in the absence of contract[70]. *Nocton v Ashburton* set out that *Derry v Peek* was an action wholly and solely of deceit, founded on fraud alone, that it was

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[67] *Candler v Crane* at 438.
[68] *Donoghue v Stevenson* at 581.
[69] *LeLievre* at 502.

treated by the House of Lords on merely that footing, and that it therefore did not allow any conclusions for the law concerning negligence[71].

In his following re-examination of the law as to negligent statements Denning L.J. considers whether a duty to be careful could arise only out of contract or a fiduciary relationship, and whether liability for a breach of duty was possible only if it resulted in physical damage to person or property. His considerations were in the later development of a duty to use words with care of extreme influence.

It took a few years before the House of Lords overruled the decision of *Candler v Crane* in *Hedley Byrne v Heller*. Although the particular claim was dismissed due to a disclaimer of liability between the parties, the judgement pronounces on the conditions under which an action for negligence will lie. The decision approves *Cann v Willson*, applies *Nocton v Ashburton* and the view of Denning L.J. in *Candler v Crane*, but it also checks the unqualified neighbour principle that required reasonable foreseeability of harm alone in order to impose liability. A duty of care is accepted if 'in the ordinary course of business or professional affairs, a person seeks information or advice from another, who is not under contractual or fiduciary obligation to give the information or advice, in circumstances in which a reasonable man so asked would know that he was being trusted, or that his skill or judgement was being relied on, and the person asked chooses to give the information or advice without clearly so qualifying his answer as to show that he does not accept responsibility, then the person replying accepts a legal duty to exercise such care as the circumstances require in making his reply[72].

This broad 'definition' amounts to a 'special relationship' being the decisive criterion to constitute the duty. Given its requirements, even financial damage might be recovered. The action for negligence, as thus pronounced

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[70] (1888) 57 L.J.Ch. at 1037 (Chitty J.).
[71] (1914) A.C. at 970, 971 (Lord Shaw of Dunfermline).
[72] *Hedley Byrne* at 575.

by the House of Lords, is a tortious one that has through its development adopted similar features of a contractual remedy; but in fact the duty out of 'special relationship' exists totally independent from any contractual relationship between the parties.

b) Influence on South African law

The tolerance towards liability for negligent misstatement in Early South African law was checked after the decision of the House of Lords in *Derry v Peek*[73], which was (wrongly) interpreted as to rule out the recovery of damages caused by a negligent misstatement. In fact it only clarified the essentials of the delict of deceit, stating that negligence in itself could not constitute the necessary fraud. The way to liability for negligence was still open by means of a legal duty of care[74]. Yet, in a case decided shortly after *Derry v Peek*, DeVilliers C.J. remarked *obiter* that 'independently of contract, a false representation causing damage is not actionable unless it is fraudulent[75], thus contradicting his own judgement in *Cape of Good Hope Bank v Fisher* and the Roman-Dutch rule that either *dolus* or *culpa* sufficed for aquilian liability.

c) Separation of South African law from English influence

In the 1930s a development of breaking away from English doctrine set in. The judgement of *Van Zyl v African Theatres Ltd*[76] acknowledged that there was 'a good deal to be said in favour of liability for negligent misstatements which cause damage'. Shortly after that the same judge expressed a clear approval of the broader Roman-Dutch rule in *Perlman v Zoutendyk*[77], recognising liability for negligent statements that cause financial loss. The underlying principle of Roman-Dutch law is that 'in general all damage caused unjustifiably (*injuria*) is actionable, whether

[73] (1889) 14 App. Cas. 337 (H.L.).
[74] See *LeLievre v Gould* at 501.
[75] (1894) 11 S.C. 33 at 36.
[76] 1931 C.P.D. 61 at 66.
[77] 1934 C.P.D. 151 at 328.

caused intentionally or by negligence[78]. With the judgement of *Perlman v Zoutendyk* the doors in South African law were opened to liability in delict for negligence, even if merely economic loss was caused.

In comparison to English law, these results were reached less reluctantly. After the general allowance of an action for negligent misstatements the courts now focused on limiting liability and to develop guidelines to control its scope. It proved not to be easy to reach a consensus in this field. One obstacle was raised by the uncertainty how to impose liability for negligent words and under which circumstances there existed a legal duty to use words with care. To specify such a duty was the central matter of concern for further development. In *Herschel v Mrupe*[79] the Appellate Division delivered a judgement that contains a variety of proposals concerning that topic. The case was that the defendant innocently but incorrectly informed the plaintiff that she was insured with a certain company. The plaintiff who instituted an action against that company was of course not successful and suffered loss because the action had to be withdrawn. The Appellate Division decided by a majority of four to one that the action should fail, but all five separate judgements gave their distinct view concerning a duty of care:

One suggestion was that a duty to guard against reasonably foreseeable harm arose only when one could be held accountable for creating the danger of harm through his own conduct. The present case did not give reason for liability though, since the plaintiff had made the inquiry herself and then assumed that the answer given was correct[80], therefore the risk of suffering harm was on her.

Fagan J.A. emphasised the requirement of reasonableness in order to limit liability for negligent statements. Referring to *Perlman v Zoutendyk* and *Cape Town Municipality v Paine*[81] he repeats the 'general principle'[82] that

[78] 1934 C.P.D. 151 at 155.
[79] 1954 (3) S.A. 464 (A.D.).
[80] Hoexter J.A. at 491, 492.
[81] 1923 A.D. at 207.
[82] At 494.

'accountability for unintended injury depends upon *culpa* – the failure to observe the degree of care which a reasonable man would have observed. With the application of that criterion the risk of the one who relies upon the accuracy of a statement becomes a more relevant factor since 'the average prudent man is often inaccurate[83]'.

Obviously this reasoning is carried by a tendency to attempt to limit the wide field of liability in such cases – the plaintiff is charged with the uncertainty that results from his difficulty to have sufficient insight into the defendant's knowledge, whereas the standard for proving reasonableness on the defendant's side is rather low.

Van den Heever J.A. stressed that negligence was not only established upon the standard of a prudent and reasonable man, but likewise by the necessity of a duty of care towards the harmed person[84]: there had to be an unlawful 'invasion of rights recognised by the law as pertaining to the plaintiff; apart from that, loss lies where it falls'[85]. This approach seems to bring more clarity than the nebulous requirements of the **reasonable-man** test. Van den Heever J.A. elaborates on the requirements for a 'duty' not to invade another person's rights: the law protects rightful interests only against 'concealed dangers' against which there is no reasonable opportunity of guarding oneself in the normal course of one's lawful pursuits[86]. Concerning the interest to obtain correct information between private individuals, Van den Heever J.A. cannot imagine by what right one can demand that the other is the guarantor of its correctness, unless there is a contract, fraud or statutory provision[87].

Schreiner J.A. finds no better way to express his view by referring to Andrews J. in the judgement of *International Products Company v Erie Railway Company, 56 A.L.R. 1377, 1381*:

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[83] At 494.
[84] With reference to *Donoghue v Stevenson* at 485 G.
[85] At 490 A.
[86] At 490 H 491.
[87] At 491 B.

'Liability in such cases arises only where there is a duty, if one speaks at all, to give the correct information. And that involves many considerations. There must be knowledge, or its equivalent, that the information is desired for a serious purpose; that he to whom it is given intends to rely and act upon it; that, if false or erroneous, he will because of it be injured in person or property. Finally, the relationship of the parties, arising out of contract or otherwise, must be such that in morals and good conscience the one has the right to rely upon the other for information, and the other giving the information owes a duty to give it with care (...) When such a relationship as we have referred to exists may not be precisely defined. All that may be stated is the general rule. In view of the complexity of modern business each case must be decided on the peculiar facts presented. The same thing is true, however, in the usual action for personal injuries. There whether negligence exists depends upon the relations of the parties, the thing done or neglected, its natural consequences, and many other considerations. No hard and fast line may be drawn'.

Applying these rules, Schreiner J.A. finds that the defendant had not acted negligently, and that the relationship between the parties was not such as to give rise to a duty of care[88].

3. First extension: the duty of care concerning the use of words

Throughout the development of negligent misrepresentation runs a distinction between negligence in deeds and in words.

The context of this problem is related to the fact that the negligent use of words does not directly lead to a physical impairment of another person's rights, but normally causes financial injury. Whether purely economic loss can be recovered as a damage under the law of delict is an issue that will be regarded separately.

a) The reluctance to impose a duty to use words with care in English law

As the route to acceptance of liability for negligence has been described above, the question of negligent use of words has been touched already to some extend.

The attempt in *Candler v Crane* to extend Lord Atkin's neighbour principle[89] into the field of negligent statements failed. Yet, the dissenting

[88] At 481.

judgement of Denning L.J. prepared the way for the final turn that came about with *Hedley Byrne v Heller*[90], when the duty to speak with care was unequivocally recognised. Several legal obstacles had to be overcome before this could happen.

(1) One obstacle was the decision of the House of Lords in *Derry v Peek*. It has already been described above how it was interpreted as to limit delictual liability to cases of fraud, how this influenced South African law despite the broader Roman-Dutch understanding of delictual liability, and how this interpretation was finally put aside by *Donoghue v Stevenson* and *Hedley Byrne v Heller*.

(2) Before the decision in *Hedley Byrne v Heller* there was a rule that there could be no liability in negligence for causing pure economic loss, unless it accompanied physical loss[91]. since the use of words normally does not lead to physical impairment of another person's right, but causes financial damage, this legal rule stood strongly against the acknowledgement of a duty to speak with care. The decision of *Candler v Crane* clearly confirms that. Although the question is not fully answered in English law yet, the decision of *Heley Byrne v Heller* opened doors for the acceptance of a duty of care concerning words. The House of Lords held that the nature of the harm shoud not in itself prevent recovery, as 'neither logic nor common-sense' require to interpose physical injury[92].

(3) One further obstacle was that of the so-called contract-tort *catena* fallacy[93]. According to that no one could sue against another out of delict if that other person had acted in fulfilment of a contractual duty towards a third person. In other words: no one who is not a party to a contract can sue on it or on anything arising out of it. This fallacy is said to have been exposed by *Donoghue v Stevenson*[94].

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[89] *Donoghue v Stevenson* at 580.
[90] (1964) A.C. 465 (H.L.), 517.
[91] Atiyah 'Negligence and Economic Loss' at 248.
[92] (1964) A.C. 465 (H.L.) 517 at 602.
[93] *Cf* P.H. Winfield 'Duty in Tortious Negligence' at 4111.
[94] *Cf* Denning L.J. in *Candler v Crane* at 431.

b) Effect and development in South Africa

Coming from the Roman-Dutch understanding of aquilian liability, there was room in South African law for imposing liability for the negligent use of words[95].

Under English influence, South African law took a conservative attitude towards negligent misstatements after the decision of *Derry v Peek*[96]. As said earlier, this judgement was directed against the acceptance of negligence as a basis for tortious liability in general, not specifically against the negligent use of words.

Only with the decisions in *Perlman v Zoutendyk*[97] and *Herschel v Mrupe*[98] did South African courts recognise liability for negligent misstatements, returning to the old Roman-Dutch rule. The arguments that were put forward in the five separate judgements in *Herschel v Mrupe* have been discussed above[99]. In his leading judgement Van den Heever does not distinguish the treatment of words from that of actions, as long as either one of them is the cause of harm[100]. Therefore the same principle applies for both: There is no right by which one can demand that the other is held liable, unless there is a contract, fraud or statutory provisions[101].

Schreiner J.A. in his judgement put an emphasis on the peculiar problems presented by negligence in word. In his opinion there is not justification for assuming a universal application of the general principles of liability on any possible conduct, the law of negligence has not been authoritatively stated with reference to the field of spoken or written words[102]. The difference between the law concerning words and deeds is the difficulty to generalise the former. Therefore, in the view of the various ways that human speech

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[95] *Cf Cape of Good Hope Bank v Fisher* (1886) 4 S.C. at 368.
[96] See *Dickson & Co v Levy* (1894) 11 S.C. 33 at 36.
[97] 1934 C.P.D. 151 at 328.
[98] 1954 (3) S.A. 464 (A.D.).
[99] *Supra* 2.c) at 19.
[100] At 490, 491.
[101] At 491 B.
[102] At 477 D-G.

may produce harm of various kinds to various people, a good deal of judicial caution has shown itself in the approach to the subject[103]. One reason for this caution can be seen in the fact that other legal rules such as the law of defamation and fraud already offer remedies in relation to words. Another reason why words should maybe not simply be treated as a from of conduct is that for the use of words there is no general idea as to the reasonable use of them, whereas experience shows what the reasonable conduct (e.g. to drive a car) looks like[104].

Instead, whether to impose liability for negligent misstatements or not depends on a specific case-to-case inquiry of the circumstances.

The criteria which would guide the examination of circumstances from case to case are those that Schreiner J.A. quotes from *International Products Company v Erie Railway Company*[105].

4. Second extension: pure economic loss

Pure economic loss is a form of patrimonial loss that (a) does not result from damage to property or impairment of personality or (b) does in fact flow from damage to property or impairment of personality, but which does not involve the plaintiff's property or person[106]. The first mentioned form is usually the result of a negligent misstatement. Whether such damage could be recovered under the law of delict at all was thus a crucial question for an action that was based on liability for negligent misstatement.

a) English law

Prior to the decision of the House of Lords in the *Hedley Byrne*[107] case it was generally assumed and could be discerned from several lines of authority that in principle liability in the tort of negligence did not extend to

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[103] At 478 B.
[104] At 478 E,F.
[105] See *supra* 2.c) at 20.
[106] Neethling at 280.
[107] (1964) A.C. 465 (H.L.).

pure economic loss[108]. This is known as the exclusionary rule[109] which provides for a rigid distinction between physical and financial loss, and at the same time separates the classical domain of delict from that of contract. Although there is no necessary connection between negligent misstatements and purely economic loss, there is a great probability that statements lead to non-physical damage. The link of these issues was seen in *Candler v Crane*. Only the dissenting Denning L.J. could not think that once a duty to use words with care exists, liability would depend on the nature of the damage[110], although in some cases of financial loss there may not be a sufficiently proximate relationship to give rise to a duty of care. Negligent misstatement and pure economic loss were the issues in *Hedley Byrne* as well, and this time the claim was in principle successful. Actually the judgement relies upon a line of old cases in which no distinction was drawn between negligence in act and in word, nor between physical and economic loss[111]. Of the statements of their Lordships, one of Lord Devlin is very progressive in that regard: he thought that it would be nonsensical to base liability or no liability upon the fact that the loss was economic rather than physical[112]. And Lord Hodson believed that it is difficult to see why liability as such should depend on the nature of the damage[113]. With *Hedley Byrne* the tort of negligence had broken through two very significant barriers at one stroke: the one limiting it to negligent acts, as opposed to words, the other confining it within the bounds of physical harm to person or property. The criteria for a duty of care were qualified from the test of reasonable foreseeability of harm to the requirement of a 'special relationship' between the parties, out of which a duty to take care (also in words) and to prevent any type of harm, could arise. However, what conclusions were to be

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[108] *Cf.* Atiyah, 'Negligence and economic loss' at 248.
[109] *Cf* Hutchinson, 'Murphy's Law: Recovery of pure economic loss in negligence' at 10.
[110] Candler at 179.
[111] *Shiells v Blackburne* 1789 (1) HB 1 158, 126 ER 94; *Wilkinson v Coverdale* 1793 (1) Esp 75, 170 ER 284; *Gladwell v Steggall* 1839 (5) Bing (NC) 734, 132 ER 1283.
[112] *Hedley Byrne* at 517.
[113] *Hedley Byrne* at 509.

drawn from *Hedley Byrne* was not at all agreed on[114], as it was unclear to what extend the distinction between physical and financial loss had been scattered. Various suggestions have been presented by writers and the development subsequent to *Hedley Byrne* been described[115], but concerning the impact of English law on South African law, the breakthrough that came about with *Hedley Byrne* is the relevant aspect. The recent English law actually shows a return to the exclusionary rule, favouring precedent over principle[116].

b) South African law

As mentioned before, Roman law knew the *actio in factum* for the recovery of economic loss[117]. It is disputable though, whether it was to be understood as a general action for mere economic loss negligently caused, since it would have left liability without control of scope and the independent *actio doli* without much meaning. Therefore it can rather be understood in the sense that the *actio in factum* only lay for the pecuniary damage caused by negligently procuring the loss of a specific thing belonging to the plaintiff, without causing physical damage to it.

In Roman-Dutch law aquilian liability has been imposed for causing mere economic loss[118], albeit not under a general rule.

In early South African law it was understood that by the time of Voet the aquilian law had been extended beyond the degree that was permitted under Roman law; the *actio in factum* was no longer confined to cases of damage done to corporal property, but was extended to every kind of loss suffered in consequence of a wrongful act[119]. From that it becomes clear that a general rule of liability for negligent misstatement causing pure economic

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[114] *Cf.* various suggestions by Atiyah 'Negligence and economic loss' at 258 *et seq.*
[115] *Cf.* Hutchinson, 'Murphy's Law: Recovery of pure economic loss in negligence' at 16.
[116] Hutchinson, 'Murphy's Law: Recovery of pure economic loss in negligence' at 25 *et seq.*
[117] *Supra* 2.b) at 8.
[118] Voet, 9.2.10, 11; *cf.* Neethling at 280.
[119] De Villiers C.J. in *Cape of Good Hope Bank v Fisher* (1886) 4 S.C. 368 at 376.

loss was adopted[120]. Still, in the practice of the courts in the late nineteenth century aquilian liability was confined to culpable acts causing physical injury to person or property. These constraints were done away with in the twentieth century by the interpretation of the element of wrongfulness and its adjustment to cases of negligence in word and causation of pure economic loss. However, this development was retarded by the strong influence of English law, as English law did not know the generalising tort-element of *culpa*, which enabled Roman and Roman-Dutch lawyers to impose liability in a much broader way.

The distinction between physical and purely financial harm does not feature prominently in the historical sources of South African law, but it was made in the late nineteenth century in a time in which English courts were about to come to the same decision. After clinging to the English concept of duty of care and foreseeability of harm as foundation for liability in negligence for some time, wrongfulness was soon promoted again as device to determine liability for culpable conduct[121]. In *Matthews v Young* the foundations are laid for the modern approach to claims involving economic loss: whilst the nature of the harm does not in itself rule out the recovery, it brings into play the element of wrongfulness, the presence of which, unlike in most cases involving physical injury, cannot be taken for granted. The trend away from English law of category and precedent grew stronger when Watermeyer J remarked in *Perlman v Zoutendyk*[122] that this former narrow view of liability for negligence seemed to be falling into disfavour, as was evident from the decision of the House of Lords in *Donoghue v Stevenson*. The decision in *Perlman v Zoutendyk* re-affirmed old Roman-Dutch principles, or, how critical voices would call it: took the general test for a duty of care (reasonable foreseeability) out of its context of physical injury to person or property and applied it without qualification to a claim

[120] *Cf* Mc Kerron, 'The Law of Delict' at 8 and 34.
[121] *Matthews v Young* 1922 AD 492.
[122] 1934 CPD 151.

for pure economic loss[123]. The effect of the judgement was, however, that liability for negligent statements causing economic loss became a generally accepted option in the law of delict.

The need to confine this principle was met by the requirement to establish wrongfulness in each case.

The courts find the wrongfulness of an act causing pure economic loss almost always in the breach of a legal duty[124], although it is also possible that wrongfulness is based on the infringement of a subjective right. From the judgement of Schreiner J.A. in *Herschel v Mrupe* it becomes obvious that the considerations on the question of pure economic loss are closely related to the criterion for establishing a duty of care not to act negligently. In fact, as conditions for such a case he proposes nothing more than what would be valid and needed in order to test whether in that particular case a duty of care exists[125].

The five different judgements delivered in *Herschel v Mrupe* caused such legal uncertainty that it took the courts two decades before they were prepared to impose liability for a negligent misstatement causing financial loss[126]. Obviously this hesitation is due to the uncertainty about the factors that control the ambit of such liability. This period of uncertainty was terminated when the Appellate Division[127] had to consider the matter and decided in favour of the principle that aquilian liability is extended to the field of negligent misstatements causing economic loss, and that it is the task of the courts to control its ambit and to examine in every given case whether the conduct was unlawful, *i.e.* whether it constituted a breach of duty[128].

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[123] McKerron, 'Liability for mere pecuniary loss in an action under the lex aquilia'at 1.

[124] Neethling, 'Law of Delict' at 281 and cases there cited *e.g. Coronation Brick (Pty) Ltd v Strachan Construction Co (Pty) Ltd* 1982 4 SA 371 (D) 384-387; *Franschoekse Wynkelder (Ko-op) Bpk v SAR und H* 1981 3 SA 36 (C) 40-41.

[125] *Supra* 2.c) at 19.

[126] *Suid-Afrikaanse Bantoetrust v Ross en Jacobz* 1977 (3) SA 184 (T) 187; *EG Electric Co (PTY) Ltd. v Franklin* 1979 (2) 702.

[127] In *Administrateur, Natal v Trust Bank van Afrika Bpk* 1979 (3) SA 824 (A).

[128] *Administrateur v Trust Bank* at 825 H, 826 H.

Similar to the decision in *Hedley Byrne v Heller* this judgement took away some of the strict distinction between physical and economic loss, yet, it did not remove this difference entirely. The allowance of recovery in principle does not mean a renouncement of the necessity to establish wrongfulness of conduct, or the breach of a duty, respectively.

5. Third extension: the duty in the contractual context

The whole development of liability for negligence has been marked by the separation from the contractual remedies. All attempts to extend liability for negligence to the use of words and to the causation of pure economic loss have led to a purely tortious doctrine in English as well as in South African law. With allowing the recovery of pure economic loss under the law of delict a first strong incursion into the domain of contractual remedies has been performed.

Negligent misstatements may also create an interference with the sphere of contract, as the statement may have been made during pre-contractual negotiations, leading to the conclusion of a contract[129].

Can the duty not to act negligently extend to the area of inducing a contract?

As English and South African law both require special circumstances that justify the imposition of a legal duty or the acceptance of wrongfulness, respectively, it can be suggested that a contract is the prototype of a special, close relationship between the parties, thus, creating a duty to take care[130].

Maybe it is the fear of confusing delictual and contractual remedies that has prevented the acceptance of this conclusion for long, although it seems so close at hand.

a) English law

[129] Other constellations like misstatements between parties already in a contractual relationship, or by interference of a third party with an existing contractual relationship, shall not be taken into consideration here.

In England a distinction has to be drawn between the relevant sources of law. First of all there is the position at common law, which shall be considered primarily, second, the Misrepresentation Act 1967 creates a statutory remedy in damages for negligent misrepresentation which induce a contract.

(1) Common law

In *Hedley Byrne* the duty-of–care principle was applied to the defendant's misstatement that induced a contract between the plaintiff and a third person. This constellation obviously does not lead to a situation of conflicting delictual and contractual remedies. The case appeared to be seen differently when a misstatement was made in the course of pre-contractual negotiations between the parties. 'Where there is a contract there is no difficulty as regards the contracting parties: the question is whether there is a warranty'[131].

This opinion implies that either delict or contractual remedies are applicable, but no concurrence possible.

With the decision in *Esso Petroleum v Mardon*[132] the situation changed. The *Hedley Byrne* principle was applied and extended to the contractual field:

A statement, made in the course of pre-contractual negotiations and inducing the contract, amounted to a contractual warranty and also represented a negligent misstatement, giving rise to a duty of care. Liability was therefore founded on breach of warranty as well as on the tort of negligence[133].

The requirements of a warranty were fulfilled for the statement was a factual one on a crucial matter made by a party who had, or professed to have, special knowledge and skill with the intention of inducing the other party to enter into the contract. At the same time the statement was a

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[130] See Hutchinson, 'Damages for non-fraudulent misrepresentation' at 330.
[131] Lord Reid, *Hedley Byrne* at 483.
[132] 1976 (1) Q.B. 801 (C.A.).

negligent misrepresentation made by a party holding himself out as having special expertise in circumstances which gave rise to the (delictual) duty to take reasonable care – this duty existed before the contract and survived the making of the written contract which was the outcome of the negotiations.

The judgement even goes so far as stating that 'measure of the damages for breach of the warranty and for the negligent statement was the same whether the action was founded in contract or in tort'[134].

Ever since the decision in *Esso Petroleum v Mardon* this view has been regarded as unquestionable law[135].

(2) Misrepresentation Act

Section 2 (1) of the Misrepresentation Act 1967 provides that

> 'Where a person has entered into a contract after a misrepresentation has been made to him by another party thereto and as a result thereof he has suffered loss, then, if the person making the misrepresentation would be liable to damages in respect thereof had the misrepresentation been made fraudulently, that person shall be so liable notwithstanding that the misrepresentation was not made fraudulently, unless he proves that he had reasonable ground to believe and did believe up to the time the contract was made that the facts represented were true.'

The scope of application of the section is limited to the parties to a contract. Where a third person is to blame, the right to damage will depend on the *Hedley Byrne* principle.

Although the wording of section 2 (1) does not say so explicitly, the intention of the legislature is presumably that the provision applies only to misrepresentations made during the course of pre-contractual negotiations and inducing a contract between the parties.

With regards to the loss, section 2 (1) covers theoretically cases where the causation of loss is quite unconnected with the conclusion of the contract, but it seems more likely that the courts will interpret it to mean that the loss

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[133] *Esso Petroleum* at 802.

[134] *Esso Petroleum* at 802.

[135] See *Laurence v Lexcourt Holding Ltd.* (1978) 1 W.L.R. at 1128; *Howared Marine Ltd. v A. Ogden & Sons* (1978) 2 W.L.R. 515 (C.A.).

should be caused by entering into a contract induced by the misrepresentation[136].

Section 2 (1) does not require that the representation was made negligently. Rather, liability will be imposed if the representor fails to discharge the onus of proving that he had reasonable grounds for believing that his statement was true. This reversal of the burden of proof is due to the fact that under normal circumstances the representor would be in a better position to know the true facts than the representee.

The reference to fraud may lead to the conclusion that section 2 (1) adopts each and every rule applicable to the action of deceit. However, given the different nature of deceit and negligence, it seems more likely that only the major requirements, such as a false statement of fact, inducement to contract, reliance and consequent damage, are to be applied[137]. This is especially relevant for the measure of damages, which is applied according to the tort measure[138]: the factor of remoteness of damage is seen differently for deceit and for negligence. In negligence actions, the defendant has to make reparation only for damage which he could reasonably have foreseen, but in actions of deceit he has to make reparation for all the actual damage directly flowing from the fraudulent conduct.

(3) Relationship with common law

As the decision in *Esso v Mardon* has created an expansion of the action of delict into the field of pre-contractual negotiations, the remedies offered by common law rule and by section 2 (1) Misrepresentation Act concur. Where a representee has a choice between the two remedies, he will probably be better advised to proceed under section 2 (1), since there is no need to prove a 'special relationship'; it is enough if the parties entered into a contract, and secondly, the burden of proof is reversed and placed on the representor.

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[136] *Cf Gosling v Anderson* (1972) 223 E.G. 1743, at 1745.

[137] See Hutchinson, 'Damages for non-fraudulent misrepresentation' at 358 *et seq.*

[138] *Cf* the Official Reports of the Standing Committee G, ii, 54 (23/2/1966).

b) South African law

From the judgement of Schreiner J.A. in *Herschel v Mrupe*[139] it appears that a situation of pre-contractual negotiations between (later) contracting parties can very well give rise to a duty of care not to act negligently, provided that this relationship, 'arising out of contract or otherwise'[140] fulfils certain criteria.

The general opinion was in favour of a remedy for negligent misstatements inducing a contract[141], but the decision in *Hamman v Moolman*[142] went into the totally opposite direction.

The parties were involved in negotiations that finally led to the purchase of land. During these pre-contractual negotiations the defendant made false statements about the approximate boundaries of the plot. In consequence the sale was cancelled and the property re-transferred. The plaintiff alleged that the statements were made recklessly as to whether they were true or false; alternatively the claim was based on negligent misstatement.

As the Court *a quo* had admitted the claim on the grounds of *dolus*, not dealing with the question of negligence, the Appellate Division dealt with the latter only *obiter*, discussing the issue but not deciding upon it.

In the Court's opinion 'the existing law grants what appears to be adequate protection in the field of contract to a party to whom a misrepresentation is made'[143]. It is suggested that a contracting party should safeguard himself against loss by requiring the representor to guarantee the truth of his representations. The Court further states that 'although pure logic (does) not appear to be opposed in principle to a conclusion that in appropriate circumstances an action might be maintained to recover pecuniary loss caused by hones but carelessly made verbal misrepresentation, there is as

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[139] 1954 (3) 464 (A.D.) at 480.
[140] *Cf* Schreiner J.A. as he quotes from *International Products Company v Erie Railway Company* 56 A.L.R. 1377, in *Herschel v Mrupe* at 480.
[141] *Cf* Hunt, 'Damages for negligent misrepresentation inducing contract' at 241.
[142] 1968 (4) S.A. 340 (A.D.).
[143] *Hamman v Moolman* at 348 E.

yet in our law no authoritative determination or generally accepted definition of the principle to be applied in deciding in what circumstances such an action will lie in the field of contract[144]. The practical difficulties of extending the law of negligence to the contractual field outweigh the alleged necessity of a remedy of that kind.

After the Appellate Division in *Administrateur, Natal v Trust Bank van Afrika Bpk* recognised the right to claim for damages in delict when pure economic loss arose from a negligent misstatement, but expressively excluded such a right when the statement had induced a contract[145], the position was reversed by the decision in *Kern Trust v Hurter*[146]. Before going into that, some background shall be put to the decision of *Hamman v Moolman*.

Already before the release of the judgement the idea of liability for negligent misstatements in the contractual context was an issue of debate, initiated by *Hedley Byrne v Heller*. That is not astonishing, given the wide ranged *dictum* that a legal duty to exercise care may result from a special relationship between the parties, irrespectively of the existence of a contractual or fiduciary obligation[147].

McKerron[148] addresses this question in his discussion of *Hedley Byrne v Heller*. He considers it essential to preserve the 'well-established' distinction between a warranty (leading to a course of action for damages under law of contract) and a mere representation which, unless fraudulent will not give rise to an action for damages (in delict, of course). In order to keep up this distinction McKerron suggests to treat a negligent misrepresentation inducing a contract differently from other negligent misrepresentations with the result that he rejects delictual liability for contract-inducing statements. McKerron admits that policy considerations

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[144] *Hamman v Moolman* at 348 G.
[145] 1979 (3) S.A.L.R. 824 at 826 H.
[146] 1981 (3) SA 607 (C).
[147] *Hedley Byrne* at 575.
[148] 'Liability for negligent misstatements: Hedley Byrne v Heller' (1963) 80 S.A.L.J. at 483.

and reasons of logic[149] may lead to a reverse conclusion, but justifies his view on the grounds that a party to a contract can always protect himself by insisting that a representation be made a term of contract[150].

In critical response to McKerron, Hunt[151] reaches the opposite conclusion, supporting delictual liability for negligent misstatements inducing a contract. Among several reasons for his opinion he most strongly argues against the necessity to keep up 'the well-established distinction between warranty... and a mere representation'. This so, because of dogmatic or historical reasons: that distinction was a remainder of English, but not of Roman-Dutch law. The broader Roman-Dutch concept of *dicta et promissa* was likewise important in South African law, and accordingly one could not insist on the warranty – representation distinction alone. Practical difficulties to decide whether the facts of a case establish a warranty or mere representation may lead to inequitable results: a plaintiff who succeeds in crossing the 'shadowy line' will get the considerable remedy of positive damages (for breach of warranty), he who fails will get nothing[152]. After all, the term-representation distinction would remain anyway, since the measure of damages for breach of term is quite different from that for negligent misrepresentation. The first is a positive and the second a negative *interesse*.

Hunt expressed further critics after the decision in *Hamman v Moolman* had been released in 1967[153]. He points out that the *obiter dictum*, as it was pronounced by the Court, lacks consistency or support with its background of judicial and academic opinion.

Last but not least a legal revolution had taken place in England, which finally did away with the idea that damages are not recoverable for any save

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[149] 'It may seem illogical to allow recovery in respect of a misrepresentation made by a third party while denying it in respect of misrepresentation made by a party to the contract.', McKerron, 'Liability for negligent misstatements' at 489.

[150] *Cf. Hamman v Moolman* .

[151] 'Damages for negligent misrepresentation...'(1964) 81 S.A.L.J. at 241.

[152] Hunt, 'Damages for negligent misrepresentation inducing contract' at 242.

[153] 'No damages for negligent misrepresentation inducing contract?' 1968 (85) S.A.L.J. at 379.

a fraudulent misrepresentation[154]. Against this background the judgement in the *Hamman v Moolman* case renders itself as not understandable.

With regard to the arguments of the Appellate Division in this case Hunt remarks that

(1)There is apparently no 'old practice and ancient formulae' that would forbid a remedy for negligent misstatements inducing contract, especially not in the face of Roman-Dutch law, where the distinction of term – representation is not made and where the recovery of pure economic loss was granted early in Roman law. Thus, the basic principle of liability for negligence is wide enough to cover negligent misrepresentation made in the foundation of contract[155].

(2) The argument that a purchaser could safeguard himself by demanding a warranty is a surprising approach in a contract system built upon the foundation of good faith and *caveat venditor* – even English law, the legal home of *caveat emptor* – has abandoned what in English law certainly was 'old practice and ancient formulae'[156]. Policy reasons demand that loss should fall upon the representor whose *culpa* has disturbed the economic balance. Finally, *Hamman v Moolman* claims a certain legal rule that would lead to surprising results: *quanti minoris* type 'damages' are recoverable for innocent (non-negligent) misrepresentation, but where there is fault delictual damages cannot be recovered[157].

In conclusion of the different considerations that were pronounced in the time around *Hedley Byrne* and *Hamman v Moolman*, one can summarise that the legal situation neither in England nor in South Africa in itself posed a serious obstacle to the acceptance of liability for negligent misstatement in the pre-contractual field.

The decision of *Kern Trust v Hurter*[158] took the last hurdle that was in the way for imposing liability for negligent misstatements inducing a contract.

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[154] *Hedley Byrne v Heller* and S 2 (1) Misrepresentation Act 1967.
[155] Hunt, 'No damages for negligent misrepresentation inducing contract?' at 382, 383.
[156] *Ibid.* at 383.
[157] *Ibid.* at 383.
[158] 1981 (3), 607.

The judgement addresses the subject first of all from a purely dogmatic side: the general rule in South African law is that delictual liability exists where *culpa* gives rise to injury to person, property or to purely financial loss[159]. *Hamman*'s counter-proposal is simply an allegation that adequate protection existed in the field of contract, rendering it unnecessary to extend delictual liability. However, the traditional contractual remedies, *i.e.* cancellation of the contract or a reduction of the purchase price, could not compensate the plaintiff for the loss suffered by him as a result of the defendant's negligence. Only a remedy which is based on *culpa* could give an adequate way to recover the loss[160]. Otherwise the loss caused by a negligent misstatement would fall on the party who reasonably relied on that statement rather than on the party whose carelessness gave rise to the loss.

Other aspects also speak in favour of the acceptance of extended liability in principle:

Although English law needs not to be followed slavishly, the similarities between their 'duty of care' concept and the South African principles governing delictual liability (wrongfulness, *culpa*) encourage to take England as an example. There, the *Hedley Byrne* principles were extended to the pre-contractual field in *Esso v Mardon*. The same extension was later enacted as statute by the Misrepresentation Act 1967.

Different cases, decided by courts in Canada, Australia and new Zealand, following the lead of the House of Lords in the *Hedley Byrne* case, illustrate that the acceptance of an action for negligent misstatement in the contractual field in principle does not mean that such an action lies irrespective of the circumstances[161], like for example the nature of the misstatement or questions of causality[162]. In *Kern Trust v Hurter* the only repercussion upon the law of contract is seen in the possible violation of the distinction between a term and a representation, but even this would not

[159] *Cf* at 612 H, 613 A; the latter clarified in *Administrateur, Natal v Trust.*
[160] *Kern Trust v Hurter* at 613 D.
[161] *Cf Kern Trust v Hurter* at 615 A *et seq.*

need to follow, since the measure of damages in delict differs from that in contract.

The decision in *Kern Trust v Hurter* was confirmed by the Appellate Division in *Bayer v Frost*[163]. Here, the *Administrateur*-principle definitely is extended to the pre-contractual sphere with the argument that if justice requires a remedy for a negligent misstatement made by and to persons who are not in any contractual relationship, then justice equally requires that there be a remedy for a negligent misstatement which induces a contract[164]. 'The realities of modern commercial life' show that it could not reasonably be expected of the layman to safeguard himself against any possible loss by demanding a warranty. For that reason, Corbett CJ holds, the law should provide adequate protection (...) by granting compensation of loss suffered as a result of the misstatement[165].

In principle the delictual action for negligent misrepresentation inducing a contract is now recognised, given the essential requirements of delictual liability. In order to avert the danger of limitless liability the court has the duty to (a) decide whether, on the facts of the case, there rested upon the defendant a legal duty not to make a misstatement (the making of such a statement thus being a breach of duty, constituting unlawfulness) and whether the defendant exercised reasonable care in giving the statement;

(b) give proper attention to the nature of the misstatement and the question of causation[166].

III Conclusion

Finally, all obstacles in principle and legal policy are overcome. Now it remains necessary to develop categories of cases that allow more certainty in the new area of judicial discretion. The stage of development that has

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[162] As it is proposed in *Administrateur v Trust* at 833 B-C.
[163] S.A.L.R. 1991 (4) 559.
[164] *Bayer v Frost* at 559 F.
[165] *Bayer v Frost* at 569 G.
[166] *Bayer v Frost* at 560 A.

finally been reached with *Bayer v Frost* raises subsequent questions, for example those relating to the concurrence of delict and contract, the measure of damages for negligent misrepresentation and the tests for determining whether a representation has become a term, or warranty, of the contract.

PART B: GERMAN LAW

I Introduction to misrepresentation in the German Law of obligations

The German Civil Code[167] contains a number of provisions that govern the law of obligations: starting with the general formation of a legal obligation and the different grounds for an obligation, over distinct rights and rules resulting from the legal relationship, to consequences for breaches of obligations. In general, a legal obligation may originate in the forming of a contract (of whatever nature) between consenting parties, but in contrast to that it may also flow from an unlawful impairment of certain rights, causing delictual liability.

The notion of misrepresentation is of a broad scope and is considered under several legal sections of the German Civil Code. According to the various forms of misrepresentation there are different rules and remedies, sometimes in concurrence with each other.

1. Misrepresentation and contract

First of all, in the law of contract, misrepresentation may occur as mistake, causing error in the other party. If a mistake in the formation of a contract comes into play, either caused by misrepresentation or otherwise, the party which is in error may rescind the contract, par. 119, 120 BGB. Was the mistake caused by fraudulent misrepresentation, the right to rescind follows from par. 123 I BGB.

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[167] *Buergerliches Gesetzbuch* (BGB), in force since 1.1.1900.

In the field of simple mistake (without fraudulence) it does not matter at all how the error came about. All options of rescinding a contract involve the recovery of damages, albeit in varying range: the party which makes use of the right to rescind according to par. 119, 120 BGB is obliged to compensate the other who relied on the validity of the contract, par. 122 I BGB. The amount of the recoverable reliance loss is limited by the value of the interest which the other has in the validity of the agreement. Was the contract rescinded on the grounds of par. 123 BGB, obviously no reliance loss can incur, since the fraudulent party did not trust in the validity of the contract. Instead, both parties have to give up to each other what they had gained on the basis of the apparently valid contract, par. 812 I BGB.

Other contractual options in cases of misrepresentation leave the validity of the contract untouched:

Guaranteed liability for the quality of the purchased goods does not affect the underlying consensus between the parties, but refers to the performance of the contractual obligations. According to par. 459 I BGB the seller of a thing warrants the purchaser that it is free from defects which diminish or destroy its value. Likewise, the seller warrants that the thing has the promised qualities, par. 459 II BGB. For this liability is does not matter whether the seller had any negative, harmful intentions towards the buyer. However, the remedies that are available to the purchaser amount to a recovery for damages: either through the reduction of the purchase price according to the devaluation, or through annulment of the sale, par. 462 BGB. In the latter case, the mechanisms of par. 812 BGB come into operation.

Compensation for non-performance only comes into play as an alternative option to reduction or annulment if a quality of the thing was promised and is absent. The same applies when the seller has fraudulently concealed a defect, par. 463 BGB. Apart from this last option, no intention of the seller

whatsoever matters with regard to the rights of the purchaser. To be precise, the liability for defect of quality, left aside any promise of qualities, does not represent a case of misrepresentation, for the defect of quality may be caused by circumstances totally independent from any statement of the seller. However, the other cases that were mentioned above are cases of misrepresentation.

Misrepresentation may constitute a breach of a contractual duty as well. This is the case when the content of the contract is directed at giving certain information. It is then part of the performance that the given information is correct. German law is open to accept the existence of a contract with almost any content (limitations are provided by par. 134, 138 BGB), as long as the necessary declarations of intent and consent are given. A case example may show how such contractual duty can arise. The *Bundesgerichtshof* (BGH) held a bank liable on the basis of a contract to supply objectively correct information. In negligently failing to do so, liability arose according to par. 276 BGB[168]. The bank had distributed information that concerned a certain business project to a number of potential lenders. As the publication of information was initiated by the inquiry of the prospective investors, there exists a contractual or quasi-contractual relationship between the bank and this group of people. This is based on the fact that the information supplied by the bank is of manifest significance to the inquiring party and it is clear that the latter will be relying on it in making substantial capital allocations. The bank must realise that the persons likely to rely on the information must understand it in the sense of a legally binding declaration. In consequence, it is the principle of good faith that causes a contractual relation to arise.

[168] BGH NJW 1979, 1595; Markesinis Vol. II at 266, 270.

As it could be seen, liability out of contract differs in certain cases according to whether the misrepresentation was fraudulent or unintentional. This aspect is, of course, more relevant in the law of tort.

2. Misrepresentation and delict

The basic norm for delictual liability, par. 823 I BGB states that any wilful or negligent, unlawful injury to life, body, health, freedom, property or other right of another causes the obligation to compensate for any damage arising therefrom. As this obligation may come occur towards any person, irrespectively of contractual or likewise relationships, its scope is limited by the enumeration of protected goods. In general, every conduct (act, omission, statement) is suitable for causing injury and thus liability. Misrepresentation is therefore one possible cause for instituting an action in delict.

3. The limits and weaknesses of torious liability

Despite the apparently wide range of cases in which delictual liability may be imposed there are some flaws that leave certain constellations unattended. Two major defects or insufficiencies can be pointed out that also concern misrepresentation, albeit not necessarily in the first place.

a) Liability for employees

According to par. 831 I S.1 BGB a person who employs another to do any work is bound to compensate for any damage which the other unlawfully causes to a third party I the performance of his work.

Par. 831 I S.2 BGB provides for the possibility of exoneration: the duty to compensate does not arise if the employer has exercised necessary care in the selection of the employee. Obviously, the purpose of this provision is to limit liability, since in general, the law of delict imposes liability towards anybody.

However, the exoneration proof leads in many cases to a gap in the protection of rights, for example when no alternative or concurrent contractual remedies against the employer exist, or when a claim against the employee on the basis of par. 823 I BGB is *de facto* void because of his impecuniosity[169].

b) Recovery of pure economic loss

Par. 823 I BGB imposes on the wrongdoer the duty to compensate for any damage arising from the injury of rights. Therefore, of course, economic loss is recoverable when it originates in such injury. On the other hand, pure economic loss, *i.e.* loss that does not result from the impairment of life, body, health, freedom or property, is not recoverable under the German law of delict: the protection of wealth as such is not included in the list of enumerated interests of par. 823 I BGB.

Behind this reluctance to extend delictual liability stands firstly the fear of indeterminable of claims and liability[170]. Secondly, the rigid anti-compensation rule was clearly incorporated in the code in accordance with the demands of both the socio-economic environment of the nineteenth century and Roman legal tradition[171]. The socio-economic environment ranked physical property above pure economic interests. And in legal history, the hostility towards pure economic loss was an outflow of the *Lex Aquilia* and classical Roman law which formed part of the German Common law and which was devised for damage to physical objects[172].

Only par. 826 BGB is of such a broad scope that any interest may be protected, yet only against a very specific manner of conduct (intentionally and in violation of *boni mores*). A few other provisions grant remedies for financial loss, *cf* par. 824 and 839 in connection with 823 II BGB, but these cases cover only a minority of specific constellations.

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[169] *Cf.* RGZ 78, 239 (*Linoelumrollenfall)* and BGH NJW 62, 32 (*Bananenschalenfall).*

[170] *Cf.* Markesinis, Vol. II at 43, referring to R. Jhering, '*Culpa in contrahendo*', Jahrbuecher fuer die Dogmatik des heutigen roemischen und deutschen Privatrechts 4 (1861) 1, 12.

[171] Markesinis, Vol. II at 45.

[172] Markesinis, Vol. II at 46.

The position of refusing to compensate pure economic loss has not been softened and therefore inevitably led to the escape to contractual rules.

II Misrepresentation between delict and contract: the extension of contractual remedies

German statutory law of obligation has proven itself as insufficient for the solution and adequate treatment of certain cases of damages. The features of these cases show that the insufficiencies occur where negligent misstatements are made in a pre-contractual sphere, or by a third party, causing pure economic loss. However, the limits of the law of delict have not been removed by the adjustment of its scope to the concerned cases. Rather, by means of academic opinion and judge-made law, new institutions were established, which have in common that elements of the, in principle, broader delictual liability are moved into a contractual context and the advantages thereof.

One of these institutions is that of *culpa in contrahendo*.

1. The doctrine of *culpa in contrahendo* and its development

Culpa in contrahendo (c.i.c.) is a doctrine under which a party can be held liable for negligently causing damage to another during contractual negotiations.

The early beginnings of c.i.c. can be traced back to par. 284 I 5 of the *Allgemeine Preussische Landrecht* (ALR), the General Law of Prussia of 1794, but its development is generally ascribed to Rudolf Jhering[173]. His framework of the doctrine was not fully accepted by the creators of the Civil Code, its existence, though, is today undisputed and its content derived from certain provisions, such as par. 122, 179, 307, 309, 463 S. 2, 663 BGB. However, the doctrine of Jhering was essentially focused on cases in which no valid contact was ever concluded and fault remained in

the pre-contractual sphere. For that constellation,there is no general provision in the BGB as it was provided for in par. 284 of the ALR. In the early years after the coming into force of the Civil Code the *Reichsgericht* accepted liability for c.i.c. only in those explicitly regulated cases. As the general norm for liability,par. 276 BGB, demands an existing legal obligation between a debtor and creditor, the compensation of damages resulting from a pre-contractual fault was considered as impossible - apart from the above mentioned provisions and of course irrespectively of the law of delict. Especially the concept of delictual liability proved to be insufficient, though, as can be seen in cases of pure economic loss and liability for employers. A first step away from these inadequacies was achieved when the *Reichsgericht* treated pre-contractual negotiations as a single unit with the later concluded contract: the obligations of that agreement, if it was ever concluded, were extended to the relationship between the parties before the agreement.

It was with the famous *Linoleumrollenfall*[174] that the *Reichsgericht* leaped forward and extended quasi-contractual liability (instead of delictual liability) into the pre-contractual field, irrespectively of the later coming into existence of an agreement. According to the court, the parties that negotiate about the conclusion of a sales contract do not just perform acts of courtesy. Their conduct is directed at the entering into legal obligations. Therefore, a quasi-contractual relationship exists and creates the general duty not to harm body or property of the other.

In another case the *Reichsgericht* confirmed that a claim for c.i.c. was not dependant on the conclusion of a contract[175]: the parties thought they had concluded a contract, which was in fact invalid because of lack of consensus. The one party suffered economic loss and was granted compensation of his reliance interest. Legal writers attempted to explain in a dogmatic way such expansion of liability, proposing *e.g.* a 'legal

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[173] Jhering, '*Culpa in Contrahendo*', Jahrbuecher fuer die Dogmatik des heutigen roemischen und deutschen Privatrechts, 4 (1861), 1.

[174]RGZ 78, 239.

relationship of contract negotiations'[176]. This was supposed to be initiated by making a contractual offer. The *Reichsgericht* followed this idea and established the principle that the mere initiation of contract negotiations gives rise to a quasi-contractual fiduciary relation, imposing on the parties the duty to take care[177]. In continuity with this approach, the BGH called the fiduciary relation a 'legal obligation' (*Gesetzliches Schuldverhaeltnis*)[178], which is ever since the common term for the judge-law doctrine. The link between this legal relation and a claim to damages is the disappointed confidence of the party which enters into the sphere of proficiency or influence of the other. Where this special trust is justified, the principle of good faith (*Treu und Glauben*) requires legal protection[179]. Today, the pre-contractual relation is accordingly seen as independent ground for liability, neither contractual nor delictual[180]. In this form, the applicability of c.i.c. has constantly grown.

2. General preconditions

It is agreed that certain requirements must be fulfilled in order to constitute liability for c.i.c. The latin term *culpa in contrahendo* indicates that the parties must have entered into a relationship of negotiating or preparing a contractual agreement. Because of the prospect of a contract --even if it never comes into existence – the involved persons owe care towards the other's integrity in rights[181]. This duty of care can be violated by any conduct (act or omission) or the use of words with either intent or negligence.

The common feature which distinguishes the pre-contractual relation from a delictual matter is the fact that the parties voluntarily allow the overlapping of their legal spheres or interests. They do not face each other

[175]RGZ 104 (1922), 265.
[176]Stoll, LZ 1923 at 532.
[177]RGZ 120, 249, 251 (1928); RGZ 159, 33, 54.
[178]BGHZ 6, 330, 333 (1952).
[179]*Cf* Ballerstedt, AcP 151, 501 *et seq.*; BGHZ 60, 221, 222 (1973).
[180]Canaris, *Festschrift fuer* Larenz, 84.

as unconcerned third parties. This distinguishes it from an encounter of delictual nature, however, the relation is still a minus in comparison with a contractual link.

It can be disputed when the special relation begins in certain cases, but it is agreed that both parties have to manifest in some way their intention to negotiate a contractual agreement. A personal contact is not required, therefore it is already sufficient if a person enters a store with the intention to buy something, reacting to the manifest willingness of the owner of the store to sell his goods[182].

3. Legal consequences and scope of damages

In the early provision of the ALR, par. 285, the scope of recoverable damages, caused by c.i.c., was equated with that of damages resulting from the performance of contract. This provision was not adopted in the Civil Code, and the question expressively left open, whether liability for c.i.c. should follow a delictual or contractual standard. In **its** decision of the *Weinsteinsaeurefall*[183] the *Reichsgericht* tends towards the contractual measure for damages: the Civil Code allows recovery of reliance interest (negative interest) for certain cases when a valid contract was not concluded: *cf.* par. 122, 179, 307, 309 BGB. In the opinion of the court the extension of such provisions to cases of c.i.c. is favourable for cases in which no contract was concluded.

The compensation of the negative interest is however not limited by the positive interest of performance of contract, as it is the case in par. 122, 307, 179 BGB. The reason is that a c.i.c. claim may exist even if there is also a contractual relation[184]

4. Character of liability for c.i.c.

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[181] *Cf.* Palandt par. 276, mn. 66; Markesinis, Vol I at 64.

[182] Disputed are the cases when somebody enters a store seeking shelter from rain, or intending to steal something.

[183] RGZ 104, 265 (1922).

[184] Palandt, intro. to par. 249, mn. 16.

C.i.c. is described as a 'third lane' between contract and delict[185]. As it is not imposed towards the public in general, but with regard to a special circle of people who have entered into the 'special relationship', it cannot be considered as delictual. On the other hand, since the special duties arise regardless of whether or not a contract comes about, c.i.c. is not perceived to be based on contract either.

Over the years, the courts have developed a diversity of case groups that fall under the doctrine of c.i.c. This circumstance makes it more difficult to understand the nature of c.i.c. It has been said that today cases fall under the term that have nothing in common but the fact that they do not fall under the scope of any other statutory basis for liability[186]. In the following section the focus shall therefore be laid on the description of some cases of c.i.c. that have gained a certain consistency and especially relate to problems of negligent misrepresentation.

5. Categories of c.i.c.

Three major categories or functions of c.i.c. can be distinguished, according to the nature of duty of care. The first can be called tort-related[187] and comprises the duty to observe the necessary care for the health and property of the other party in displaying and inspecting goods (*Verkehrssicherungspflichten*).

The second category focuses on the duty to reveal to each other all circumstances that are of obvious importance to the other party or for the success of the contract (*Aufklaerungspflichten*).

The third category, finally, concerns the termination of contractual negotiations without reasonable ground at a stage where it seemed to be

[185] Markesinis, Vol I at 64.
[186] Muenchner Kommentar, intro. to par. 275, mn. 32.
[187] See Markesinis, Vol I at 65.

sure that a contract would be concluded (*Abbruch von Vertragsverhandlungen*)[188].

a) Tort-related situations/ *Verkehrssicherungspflichten*: two case examples

The first case that was treated according to the principles of c.i.c. could be called tort-related. In the famous *Linoleumrollenfall*[189] the *Reichsgericht* held the owner of a department store liable for the reason that his sales assistant negligently had caused two rolls of linoleum to fall over and knock down a customer and her child. The Court based the right of the plaintiff to recover the personal injury on a legal relationship that came into existence between the parties in preparation for a purchase. This legal relationship bore a character similar to a contract and produced legal obligations in so far as both seller and prospective buyer came under a duty t observe the necessary care for the health and property of the other party in displaying and inspecting the goods[190].

Obviously the action is embedded in a contractual set-up. Also, since a 'legal relationship' has come into existence, the contractual rules, governing liability, are applied to the situation (rules concerning the burden of proof, liability for wrongs of servants, limitation of actions. So, while the grounds and governing rules for the existence of the particular right to claim damages are contractual, the content, on the other hand, is delictual: the claim for damages resulting from physical injury is a typical example for *restitutio in integrum* (interest in the integrity of personal rights, *Integritaetsinteresse*), which is protected by the provisions of par. 823 *et seq.* BGB.

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[188] Markesinis refers to three functions of *c.i.c.*: to overcome certain flaws of the law of delict, to establish liability where one party has negligently led another party to incur expenses in the hope of a contract which eventually falls through or is void, and to establish liability for negligence during contractual negotiations in situations where a contract has been concluded, but where the usual remedies seem insufficient (the latter being a complementary function), see Markesinis, Vol. I at 65.

[189] RGZ 78, 239 (1911).

[190] See Markesinis, Vol II at 775 (Case 89, RGZ 78, 239).

A second famous case that conforms to decision of the *Reichsgericht* in the *Linoleumrollenfall* is the *Gemueseblattfall*[191]. The plaintiff, who at the time of the accident was fourteen years of age, went with her mother to a branch of the defendant's self-service store. Whilst her mother, after selecting her goods, stood at the till, the plaintiff went round to the packing counter to help her mother pack the goods. In doing so she fell to the floor and suffered an injury which necessitated lengthy treatment. Alleging that she had slipped on a vegetable leaf, she sued the defendant for breach of his duty to provide safe access. The *Bundesgerichtshof* (*BGH*) confirms the right of the plaintiff to sue for damages for c.i.c.

In his decision the BGH works out the advantages of applying contractual rules to c.i.c.

Liability for fault in concluding a contract allows increased liability for employees because of par. 278 BGB, whereas the general liability in delict for breach of the duty to provide save access would be excluded by the mechanism of par. 831 I S. 2 BGB (exculpatory proof). Further, c.i.c. falls under the limitation period of par. 195 BGB (30 years), while claims in delict are subject to a 3-year period of prescription, par. 852 BGB. Finally, the burden of proof is reversed and placed with the debtor, par. 282 BGB.

b) The reasoning behind this category

Other decisions[192] in the same line of reasoning confirm that this category of c.i.c. exists in concurrence to delictual claims, that the relevant duties of care are actually taken from the delictual principle to refrain from doing any harm to person or property, and that the basis for liability was simply

[191] BGHZ 66, 51 (1976).

[192] BGH NJW 62, 32 (*Bananenschale*); BGH BB 86, 1185 (*Fussbodenbelag*).

shifted to a 'contractual' environment[193]. The approach of the courts though remains a casuistic one, as the constitution of the 'special relationship' depends on the circumstances.

What is the justification or the reasoning behind this extension of contractual liability to the pre-contractual sphere?

The BGH puts it this way that liability is justified in the fact that the injured party entered the other party's sphere of influence for the purpose of negotiating for a contract and can therefore rely on an enhanced carefulness in the other party to the negotiation[194].

If the extension of contractual liability had not come about, the only remedy for cases like this would have been in the law of delict, based on par. 823 I and par. 831 BGB. But as it has been mentioned above, the proof of exoneration would probably lead to a dismissal of the action.

This deficiency of the law of tort can be best rectified – in the view of German courts – by applying the standards of par. 276, 278 BGB. With the words of the *Reichsgerichtshof* in the *Linoleumrollenfall* it would be contrary to the general feeling of justice if in cases where the person in charge of the business of displaying or laying out goods for exhibition or the like carelessly injures a prospective purchaser, the prospector wished to make a purchase – should be answerable only under par. 831 BGB and not unconditionally, so that the injured person should, if the proprietor succeeds in exonerating himself, be referred to the usually impecunious employee[195].

c) Recovery for loss caused by negligent misstatements/ *Aufklaerungspflichten*

Other categories of c.i.c. apart from the first, tort-related one, cover cases of giving false or incomplete information, or otherwise causing the prospective partner to the contract to put his trust in certain circumstances

[193] *Cf.* Muenchner Kommentar, intro. to par. 275, mn. 39; Markesinis, Vol. II at 688; Palandt, par. 276, mn. 71.

[194] BGHZ 66, 51 (1976); *cf.* Markesinis, Vol. II at 777.

that relate to the validity or performance of the intended contract. This field of c.i.c. is a very wide one and offers a variety of casuistic[196].

(1) Invalid contracts

A negligent misstatement, or rather, the omission of making a statement may lead to liability according o the principles of c.i.c. when certain obstacles to the validity of the intended contract existed. The party to the contract in whose sphere these obstacles fall is obliged to inform the other about it[197]. such a duty to reveal certain circumstances shows once again that the institution of c.i.c. is used to grant protection of reliance in very particular constellations where delict would not apply - for example because the damage caused is purely economic.

(2) Valid contracts to the disadvantage of one party

In this group of cases a misstatement (or the omission of giving information) has led to the conclusion of a contract that is disadvantageous for one party and does not meet the expectations. The damage lies in the existence of the valid contractual obligation and is usually of pure economic nature.

Academic writers and courts explain this type of c.i.c. with the principle of *bona fides*: this principle protects the freedom of making decisions (*Entscheidungsfreiheit*) and obliges the partners to a (future-)contract to reveal such circumstances that contradict the motives and justified interests of each other. Relevant are only such circumstances that are of essential importance for the considerations to conclude a particular contract, and that are outside of the available sources of information of one party[198]. In such cases the party which suffered loss is entitled to claim rescission of the agreement as a form of recovery of damages according to par. 249 BGB.

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[195] RGZ 78, 239 in Markesinis, Vol. II, 775, 776.

[196] See *e.g.* Palandt, par. 276, mn. 72-90; Muenchner Kommentar, intro. to par. 275, mn. 43-79; Markesinis, Vol. I, 66-71.

[197] Palandt par. 276, mn. 77.

[198] See Knoepfel-Kunz, 291.; RGZ 95, 58 *et seq.*; RGZ 103, 47.

Important is that the misstatement has actually led to the inducement of the contract by influencing the will of the party[199].

It is disputed whether the giving of incorrect advice can be considered as one separate category of c.i.c. If the advice is sought in connection with pre-contractual negotiations and the special relationship is already in existence, the parties are obliged to refrain from wrong statements with regard to the intended contract[200]. Where the element of the special pre-contractual relationship is missing, though, the mere seeking of advice does not impose duties on the one giving the information.

The special relationship is thus the decisive criteria. A decision of the BGH which has been cited above[201] shows how floating the border in such cases is between c.i.c. and contractual liability

In that particular case the court accepted the existence of a contract with the content of giving information (*Auskunftsvertrag*). The difference of founding liability on contract or merely on a quasi-contract (a special relationship in the terms of c.i.c.) is based on the importance of the statement for the party that relies on it, and the ability of the bank (in this case) to perceive that.

It is either a mere special relationship that obliges the parties to take care, or the principle of *bona fides* leads to the assumption that even a contract to give information (*Auskunftsvertrag*) has been concluded. The results, however, are the same, as c.i.c. follows contractual principles in its effects.

PART C: COMPARISON AND CONCLUSION

A comparative look at both the South African and German system shows that the distinction between the law of contract and the law of tort has been blurred. Not in principle, but by means of a third lane remedy for cases that cannot sufficiently be solved with the conventional contractual or delictual

[199]Palandt par. 276, mn. 78.
[200]*Cf.* Larenz, 123.
[201]BGH NJW 1979, 1595, in Markesinis Vol. II at 266, 270..

institutes. This third lane results from the expansion of delictual liability in South African law, and the development of c.i.c. n German law.

In common law, first of all, the old approach of *caveat emptor*, placing the risk of damages on the buyer, forbid that a duty of care should burden the seller. Additionally, the doctrines of consideration and of privicy of contract led to the inevitable conclusion that, within a contractual relationship, liability was not to be imposed for damages that arose apart from the specific agreement of obligations between the parties. Finally, the given nature of contractual liability as a guarantee liability for terms and warranties also stood in the face of an introduction of an extra, *culpa*-based liability for misrepresentation.

German law faced other obstacles in doctrine: the law of delict rendered the recovery of pure economic loss caused by negligent misstatement impossible, it likewise excluded liability in certain cases of third persons being involved. The understanding of contractual liability, however, allowed the necessary expansions, as concepts of good faith and *boni mores* built the foundation for liability for *culpa* in the quasi-contractual context.

However, the justified or legitimised confidence of the mistaken party in the correctness of a statement is protected in either system with comparable results.

Which approach has now the better tools to provide for sufficient and just remedies, and which are the weak points in each system?

As far as the group of entitled or obliged persons is concerned there is no difference: the South African law of delict offers legal remedies for anybody who is affected by the pre-contractual negligent misstatement; so does the German law.

The scope of recoverable damage in both systems is normally determined by the negative interest (reliance interest), especially in tort-related cases. However, it may equal or even exceed the interest of performance,

especially if a contract was agreed on but a misrepresentation has led to a disadvantageous content.

The difficulty that is similar to both systems is that of explaining precisely enough the foundation of liability and of putting limits to it. To base liability for c.i.c. on a special relationship of trust has been criticised as not specific enough to form a distinct third lane besides contract and delict[202]. Rather, it should be classed as delictual in nature and contractual in operation. Similar problems to determine the dogmatic context of liability for pre-contractual negligence exist in the Common law where the law of delict has been expanded to such an extend that legal writers say: 'Tort and contract are like cheese and biscuits: different, but complementary'[203].

In both legal systems the goal of granting comprehensive protection is achieved by the common element of the special relationship between the parties, giving rise to a duty of care. The criterion for such a relationship are comparatively equal, and in the end it is a matter of case to case consideration whether the circumstances fulfil these conditions. In that regard, South African law of delict and German c.i.c. have a strong tendency to a casuistic nature, leaving ample scope for new cases and categories and causing more insecurity.

Other preconditions of liability are required under the delictual approach: foreseeability of harm (reasonable man test) and remoteness of the damage, which offer possibilities to limit liability.

Liability which is based on the c.i.c.-special relationship is subjected to the general provision of par. 276 BGB. This provision comprises the standard for all *culpa*-based liability. Any possible limitations must therefore be derived from it. Problems arise when the standard of liability would be mitigated by certain provisions related to the intended contractual agreement. Thus, german legal practice differentiates: as far as the tort-related duty of care (*Verkehrssicherungspflicht*) is concerned, aiming at the integrity interest of the other, the rules of par. 276 BGB apply. It is

[202] *Cf.* Choi, at 312.

different though in those cases that involve the giving of information or the revelation of certain circumstances. If these pre-contractual duties (*Aufklaerungspflichten*) relate directly to the content of the envisaged agreement the rules of limitation of liability for that particular contract apply to the c.i.c.-relationship[204].

Compared to the common law approach, where all limitations of liability are derived from principles of the law of delict, German law applies two different standards according to the category of c.i.c. But as far as par. 276 BGB is applicable, a look at the provisions shows similar rules and limits for negligence as in delict in common law: foreseeability and preventability of harm, according to the standard of the reasonable man[205].

Thus, both systems have similar mechanisms to control the ambit of the extended liability and none is in itself more precise and hence not more preferable compared to the other.

[203]Holyoak, 99 L.Q.R. (1983) at 604.
[204]Muenchner Kommentar Vol. II, intro to par. 275, mn. 216.
[205]Muenchner Kommentar Vol. II, par. 276, mn. 100, 127.

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