Negligently caused pure economic loss from a comparative perspective

by

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Abbreviations

AC	Appellate Division
All ER	All England Law Reports
BAG	Bundesarbeitsgericht
BGB	Bürgerliches Gesetzbuch
BGH	Bundesgerichtshof
BGHZ	Eintscheidung des Bundesgerichtshofs in Zvilsachen
CA	Court of Appeal
Ch	Law Reports; Chancery Division
Co	Company
DB	Der Bertieb
GG	Grundgesetz (Basic Law)
GmbH	Gesellschaft mit beschränkter Haftung
HL	House of Lords
JA	Juristische Arbeitsblätter
JuS	Juristische Schulung
JZ	Juristenzeitung
KB	King's Bench; Law Reports King's Bench Division
LQR	Law Quaterly Review
Ltd	Limited
MLR	Modern Law Review
NJW	Neue Juristische Wochenschrift
OLG	Oberlandesgericht
QB	Queen's Bench; Law Reports Queen's Bench Division
RGZ	Entscheidungen des Reichsgericht in Zivilsachen
STELL LR	Stellenbosch Law Review Regstydskrif
UWG	Gesetz gegen den unlauteren Wettbewerb
VersR	Zeitschrift für Versicherungsrecht
WLR	Weekly Law Reports
ZIP	Zeitschrift für Wirtschaftsrecht und Insolvenzrecht

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I. Introduction

The problem of pure economic loss, which refers to financial loss that is not the result of physical damage to the person or property of the plaintiff,[1] has a long history and is still controversial in many systems. In a number of legal systems, compensation for pure economic loss is not allowed,[2] however, the jurisprudence and courts of these systems have tried to develop mechanisms to cover such loss in certain instances.[3] This dissertation looks at the problem of negligently caused pure economic loss from a comparative perspective. A comparison is made between the legal system of English and Germany. The German and English law differ in so far as English law is a common law and the German is a code law. Both countries have developed different approaches to solve the problem of pure economic loss; in England, the law of tort was expanded and in Germany, the law of contract was expanded. This paper demonstrates, however, that both systems arrive at the same general result. This dissertation focuses only on the non-contractual liability for negligently caused pure economic loss. Liability for fatal accidents will not be included.

The first chapter presents the English approach in the field of negligently caused pure economic loss in accordance with landmark decisions. The second chapter deals with the German approach. The emphasis of this chapter lies on the expansion of the law of contract.

II. Negligently caused pure economic loss in England and Germany

1. Negligently caused pure economic loss in England

Originally the English tort of negligence with its three essential requirements of duty, negligence breach and damage,[4] did not provide an action to recover pure economic loss, because the courts were not prepared to impose a duty where pure economic loss was suffered negligently.[5] According to the tort of negligence, such loss was only recoverable where the plaintiff could bring forward evidence that he had suffered injury to his person or loss of or damage to his property.[6] Furthermore, a loss was also recoverable in such cases where the loss was a

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[1] B. Feldhusen *Economic Negligence* 2 ed. (1989) 1.

[2] For example, in the German, English and Austrian systems [K. Zweigert & H. Kötz *Einführung in die Rechtsvergleichung auf dem Gebiet des Privatrechts* Vol.2 2 ed. (1984) 331; R. Zimmermann *The Law of Obligations. Roman Foundations of the Civilian Tradition* (1993) 907.

[3] Compare W. Freiherr Raitz von Frentz *Pure Economic Loss from a Comparative Perspective* (1993).

[4] R. Zimmermann (n2) 911.

[5] K. Zweigert & H. Kötz *Introduction to Comparative Law* 2 ed. (1987) 308.

[6] J. Stapleton *Duty of Care and Economic Loss: A Wider Agenda* (1991) 107 LQR 260; B. Feldthusen (n1) 6.

consequence of a damage to the body or property.[7] Thus, for example, a person who was injured by another could not only claim compensation for his injuries, but he also could claim for his consequential loss of earnings.[8]

The principle that pure economic loss is irrecoverable in the tort of negligence has never been clearly enunciated.[9] However, there existed two foundation cases on which this general rule was based.[10] The first was the decision of *Cattle v Stockton Waterworks Co.*[11] In this case the plaintiff - Cattle-, was a builder who had contracted with K to construct a tunnel under a road which crossed K's land. Owing to the negligence of the defendants -Waterworks Co. - a water-pipe owned by them, sprang a leak. Water flowed into the tunnel and obstructed the works, with the result that the plaintiff incurred additional costs in executing his contract. He sued Waterworks Co. and claimed compensation for his economic loss. His claim was dismissed with the *floodgates argument*[12]. Blackburn J commented that, if such a claim for negligent interference with contractual relations were to be allowed, *we should establish an authority for saying that in such cases as that of Fletcher v Rylands*[13] *the defendant would be liable, not only to an action by the owner of the drowned mine, and by such of his workmen as had their tools or clothes destroyed, but to an action by every workman and person employed in the mine, who in consequence of its stoppage made less wages than he would otherwise have done. And many similar cases to which this would apply might be suggested.*[14]

The second case which was seen as the basis that pure economic loss is irrecoverable was the decision of House of Lords in *Simpson and Company v Thomson, Burrel et al*[15]. In that case the plaintiff was an insurer who was contractually bound to indemnify an insured whose property was damaged by a negligent third party. The insurer sued the third party for compensation that had been paid to the insured. The House of Lords decided that the insurer has no independent right to sue in his own name for the recovery of this economic loss. The insurer is restricted to the long-established right to be subrogated to whatever rights the insured might have against the third party, after satisfying the insurance claim against him.

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[7] P. S. Atiyah *Negligence and Economic Loss* (1967) 83 LQR 252; J. G. Fleming *The Law of Torts* 7 ed. (1987) 164.
[8] D. Hutchison *Murphy's Law: The Recovery of Pure Economic Loss in the Tort of Negligence* (1995) 6 STELL LR12.
[9] P. S. Atiyah (n7) 248 and 250.
[10] D. Hutchison (n8) 10.
[11] 1875 LR 10 QB 453.
[12] D. Hutchison (n8) 3.
[13] 1866 LR 1 265.
[14] 1875 LR 10 QB 453 (457).
[15] 1877 3 AC 279 (HL).

The first signs of a willingness to compensate pure economic loss occurred in the decision of the House of Lords in *Morrison Steamship C. Ltd. v Greystoke Castle Cargo Owners*[16] in 1947.[17] In this case, the ships A and B had collided as a result of negligence on the part of both captains. Ship A sank and ship B was put into the harbour for repair. The cargo on ship B was undamaged, but in terms of the rules of maritime law the cargo owners became liable, as a consequence of the accident, to pay a sum to the owners of B. Although it was pure economic loss, the House of Lords held that the cargo owners could recover a part of this loss in negligence from the owners of ship A which had been partly responsible for the accident. This decision, however, did not lay down a general principle that pure economic loss was recoverable, but it made it impossible to argue the rule that pure economic loss is of its nature irrecoverable.[18] Furthermore, this decision is quite often explained as a decision which is only applicable for the maritime law.[19]

The idea that pure economic loss was recoverable in the tort of negligence arose in the 60's, in the decision of the House of Lords in *Hedley Byrne & Co Ltd. v Heller & Partner Ltd*[20]. This landmark decision brought the previously, fairly rigid distinction between physical and financial loss to an end[21] by widening the tort of negligence insofar, as it brought pure economic loss into its scope.[22] After this decision in some circumstances pure economic loss was now recoverable in the tort of negligence.[23] There was a line of cases, starting with *Dutton v Bognor Regis UDC*[24] in 1972 and leading on through *Anns v Merton London Borough Council*[25] in 1977 to *Junior Books Ltd. v Veitchi Co. Ltd.*[26] in 1982, in which the courts expanded the liability for pure economic loss in the tort of negligence.[27] However, after the decision in *Junior Books v Veitchi Co. Ltd.*, the House of Lords suddenly stopped the previous development and tried to restore the position before the *Anns* case.[28] Finally, in the decision of *Murphy v Brentwood District Council*[29] in 1990, the House of Lords overruled the decision of

[16] 1947 AC 265 (HL).
[17] W. Freiherr Raitz von Frentz (n3) 3; D. Hutchison (n8) 13.
[18] Lord Devlin in *Hedley Byrne & Co Ltd. v Heller & Partner Ltd.* 1964 AC 465 (HL) at 518.
[19] Compare Lord Keith in *Murphy v Brentwood District Council* 1991 1 AC 398 (HL) at 468; W. Freiherr Raitz von Frentz (n3) 4; P. S. Atiyah (n7) 248 and 251-252. Other opinion D. Hutchison (n8) 13.
[20] 1964 AC 465; 1963 All ER 575 (HL).
[21] D. Hutchison (n8) 3.
[22] J. W. Sir Salmond & R. F. V. Heuston *The Law of Torts* 20 ed (1992) 211; J. G. Fleming (n7) 162.
[23] D. Hutchison (n8) 3.
[24] 1972 1 QB 373 (CA).
[25] 1978 AC 728 (HL).
[26] 1983 1 AC 520 (HL).
[27] The whole development is explained in D. Hutchison (n8).
[28] Compare, for example, *Governors of the Peabody Donation Fund v Sir Lindsay Parkinson & Co. Ltd.* 1985 2 AC 210 (HL) or *D & F Estates Ltd. v Church Commissioners for England* 1989 1 AC 177 (HL).
[29] 1991 1 AC 398 (HL).

Anns and, more or less, the decision of *Junior Books*.[30] The impact of the decision in *Murphy v Brentwood District Council* will be discussed later however, it can be determined at this stage that this decision did not totally abolish the recover of pure economic loss in the tort of negligence. The cases and circumstances under which recovery of pure economic loss in the tort negligence is possible will be discussed below. This discussion will fall under four headings - according to the categories of cases: Firstly the misstatements cases, followed by the building cases, the professional service cases and the cases of relational economic loss.

a. Misstatements cases

Originally in the tort of negligent one could only be liable for acts and not for statements.[31] A negligent misstatement could give rise to an action for damages only if there were a contract or a fiduciary relationship between the parties.[32] This approach changed dramatically after the decision of *Hedley Byrne*[33]. The facts of the case were as follows: Hedley Byrne Co. Ltd. an advertising agency received an advertising order from the company Easipower. According to the instructions, Hedley Byrne were personally liable for the cost of the order. For this reason they asked their Bank to enquire into the company's financial stability. Their bank asked Heller & Partners Ltd. - the defendant - about the financial stability of the company. Heller & Partners Ltd. informed them that the company was financially stable, but they gave the information *without responsibility*. Relying on this information, Hedley Byrne took the order. Easipower became insolvent and Hedley Byrne lost a large sum of money. They sued Heller & Partners Ltd. for negligent misinformation and claimed the loss they had suffered as a consequence.

The House of Lords decided to dismiss the claim, because the defendant gave the information *without responsibility*. However, the House of Lords overruled, in this decision, the earlier cases to the effect that a negligent misstatement could give rise to an action for damages only if there were a contract or a fiduciary relationship between the parties,[34] and established a totally new principle of liability in negligence. In terms of that principle, the law would imply a duty to use words with care whenever the parties were in a special relationship with each

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[30] D. Hutchison & B van Heerden *The Tort/Contract Divide seen from the South African Perspective* (1997) Acta Juridica 99.

[31] K. Zweigert & H. Kötz (n5) 308; J. W. Sir Salmond & R. F. V. Heuston (n22) 214.

[32] *Nocton v Ashburton* 1914 AC 932 (HL); *Candler v Crane, Christmas & Co.* 1951 2 KB 164.

[33] *Hedley Byrne & Co. Ltd. v Heller & Partner Ltd.* 1964 AC 465, 1963 2 All ER 575 (HL).

[34] *Nocton v Ashburton* 1914 AC 932 (HL); *Candler v Crane, Christmas & Co.* 1951 2 KB 164; D. Hutchison (n8) 14.

other. Such a *special relationship* generally exists in those cases where a party who has special knowledge, voluntary undertakes to supply information or advice to another, whom he knew or could know (foreseeable) would place reliance on his knowledge and judgement in giving information or advice.[35]

At one stroke, the tort of negligence was expanded by this decision on two significant points: Firstly it expanded the tort of negligent insofar, that it was no longer limited to negligent acts, as opposed to words.[36] Secondly it expanded the tort of negligence insofar as that it covers also liability for pure economic loss.[37]

As a result of this decision pure economic loss was now recoverable in the tort of negligence, and one could be liable for statements. However, the House of Lords had clearly recognised the need for a closer check on liability in the field of liability for negligent misstatements causing pure economic loss.[38] It insisted on a *special relationship* between the parties involving assumption of responsibility by the representor and reasonable reliance by the representee.[39] This was different to physical harm, where a duty to care was established in accordance with *Donoghue v Stevenson*[40] when the harm was foreseeable. The reason for this restriction was that the House of Lords feared too wide a potential for liability.[41] Lord Pearce stated in his speech:

Negligence in words creates problems different from those of negligence in act. Words are more volatile than deeds. They travel fast and far afield. They are used without being expended and take effect in combination with innumerable facts and other words. Yet they are dangerous and can cause vast financial damage. How far they are relied on unchecked must in many cases be a matter of doubt and difficulty. If mere hearing or reading of words were held to create proximity, there might be no limit to the persons to whom the speaker or writer could be liable. Damage by negligent acts to persons or property on the other hand is more

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[35] D. Hutchison (n8) 14.

[36] *Hedley Byrne & Co. Ltd. v Heller & Partner Ltd.* 1964 AC 465 at 486 (HL).

[37] The first enlargement was much more recognised by the court then the second. Only two of five judges mentioned it: Lord Devlin (at 517) and Lord Hodson (at 520) [Compare D. Hutchison (n8) 14; J. G. Fleming (n7) 162].

[38] Compare *Donoghue v Stevenson* 1932 AC 562 (HL) where this requirement was developed for liability for negligent acts causing physical injury to person or property.

[39] D. Hutchison (n8) 6.

[40] 1932 AC 562 (HL) where the requirement foreseeability was developed for the field of liability for negligent acts causing physical injury to person or property. According to *Donoghue v Stevenson* a duty to care existed when the damage was foreseeable. Compare also *Dorset Yacht Co. Ltd. v Home Office* 1970 AC 1004 (HL) at 1026.-1027.

[41] W. Freiherr Raitz von Frentz10; J. W. Sir Salmond & R. F. V. Heuston (n22) 215.

visible and obvious; its limits are more easily defined, and it is with this damage that the earlier cases were more concerned.[42]

However, there was such a restriction, in accordance with the decision of *Hedley Byrne*, for example, accountants, lawyers, valuers, insurance agents and others, whose negligent advice normally results only in purely economic loss, could now be liable to persons other than their clients.[43]

One of the first important cases after *Hedley Byrne* in the field of negligent misstatement cases, was the decision of the Privy Council in *Mutual Life and Citizens' Assurance Co. v Evatt*[44]. In this case the plaintiff brought an action against the defendant, claiming damages for the negligence of the defendant in giving advice on the financial stability of an associated company of the defendant with the knowledge that the plaintiff would act on that advice and invest in the company; and claiming that he had invested therein and that he had incurred a financial loss. The majority of Privy Council dismissed the claim. It held that the defendant did not owe a duty of care to the plaintiff, because the defendant's business did not include giving advice on investments and did not claim to have the necessary skill and competence to give such advice.[45] As a result of such a view, a duty of care only arises where advice is sought and given in a business or professional context. Two members of the House of Lords, Lord Reid and Lord Morris, dissented in this decision. In their opinion, this view is too narrow and there was no ground that a duty of care arise only in those cases where the defendant has a special skill.[46]

This decision is a step backwards from *Hedley Byrne*, because it tries to interpret the requirements which were laid down in *Hedley Byrne* in a very restrictive way.[47] By imposing a special skill or profession, the majority of the Privy Council tries to limit the cases of liability in the field of misstatements. The decision has been widely criticised for reversing the liberal development of the *Hedley Byrne* decision.[48] In the decision of *Howard Marine v Ogdan*[49],

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[42] Lord Pearce in *Hedley Byrne & Co. Ltd. v Heller & Partner Ltd.* 1964 AC 465 at 534.
[43] A. M. Dugdale & K. M. Stanton *Professional Negligence* (1982).
[44] 1971 AC 793.
[45] *Mutual Life and Citizens' Assurance Co. v Evatt* 1971 AC 793 at 809.
[46] Lord Reid and Lord Morris in *Mutual Life and Citizens' Assurance Co. v Evatt* 1971 AC 793 at 811.
[47] J. G. Fleming (n7) 609.
[48] Compare J. W. Sir Salmond & R. F. V. Heuston (n22) 217; J. G. Fleming (n7) 609.
[49] 1978 QB 574 at 591, 600.

the Court of Appeal has declined to accept it as a binding statement of English law. This narrow interpretation was never followed after this decision.[50]

Another important misstatement case was decided in 1976. In decision of the Court of Appeal in *Esso Petroleum Co. Ltd. v Mardon*[51]. The facts of the case are as follows: Esso wanted to build a filling station next to a busy main street. One of their employees who had extensive experience, calculated that the potential throughput, was likely to reach 200 000gallons by the third year of operation. When Esso decided to build the filling station, they were obliged by city planers not to build the pumps to front the main street. Thus, the company built the pumps at the back. Despite this fundamental alteration in siting, Esso told Mardon - the later lessee of the filling station - that the throughput will reach 200 000 gallons. Mardon trusted Esso and leased the filling station. The throughput turned out to be only 78 000 gallons, and Mardon incurred a financial loss. The court decided that Mardon could claim compensation for his loss, because of the negligent misrepresentation.[52] The significance of this decision is that it expanded the principle of *Hedley Byrne* to include pre-contractual relationships. According to this expansion, Lord Denning, after discussing whether or not the principle of *Hedley Byrne* was applicable, stated:

It seems to me that Hedley Byrne, properly understood, covers this particular proposition: If a man, who has or professes to have special knowledge or skill, makes a representation by virtue thereof to another - be advice, information or opinion - with the intention of inducting him to enter into a contract with him, he is under a duty to use reasonable care to see that the representation is correct, and that advice or information or opinion is reliable. If he negligently gives unsound advice or misleading information or expresses an erroneous opinion, and thereby induces the other side into a contract with him, he is liable in damages.[53]

Consequently, after this decision one could also be liable for misstatements in a pre-contractual relationship.

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[50] Compare J. W. Sir Salmond & R. F. V. Heuston (n22) 217.
[51] 1976 QB 801, 1976 2 All ER 5.
[52] 1976 2 All ER 5 at 16, 22 and 26.
[53] Lord Denning at 16.

In 1989 the House of Lords decided two cases in the field of negligence in misstatements. At this time, the courts in England had already started to limit the liability in the field of pure economic loss.[54]

The two cases *Smith v Eric S. Bush* and *Harris v Wyre Forest District Council*[55], were decided together, because they raised essentially the same issue. In both cases, the plaintiff bought a building on reliance of a report by a valuer. The reports contained significant mistakes with the results that the plaintiffs lost a large sums of money. In both cases, no contract existed, thus, the plaintiffs sued on the basis of the tort of negligence and the defendants, in both cases, disclaimed liability for their reports. The House of Lords allowed the claims of the plaintiffs, because it was of the opinion that a duty of care was owed and was breached by the defendant, and that the disclaiming of liability in such cases was ineffective by the Unfair Contract Terms Act of 1977.

One of the main issues here is whether the valuer in such cases owes a duty of care to the purchaser to exercise reasonable care and skill in carrying out his valuation. The House of Lords discussed the different requirements which are needed to impose a duty of care - particularly the requirement of 'voluntary assumption of responsibility', because the defendants disclaimed their liability. The three members of the House of Lords who delivered speeches[56] were prepared to accept that an assumption of responsibility was an element of liability for a negligent misstatement, but did not favour extending this to a voluntary assumption.[57] Thus, Lord Griffiths stated:

I do not think that voluntary assumption of responsibility is a helpful or realistic test for liability ... The phrase 'assumption of responsibility' can only have any real meaning if it is understood as referring to the circumstances in which the law deem the maker of the statement to have assumed responsibility to the person who acts upon the advice.[58]

In the opinion of the Lord Griffith, a *duty of care [is] owed ... only if it is foreseeable that if the advice is negligent the recipient is likely to suffer damage, that there is a sufficiently proximate relationship between the parties and that it is just and reasonable to impose liability.*[59] According to the cases he goes on: *In the case of a surveyor valuing a small house for a building society or local authority, the application of these three criteria leads to the con*

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[54] D. Hutchison (n8) 26.
[55] 1990 1 AC 831, 1989 2 All ER 514, 1989 2 WLR 790 (HL).
[56] The other two members agreed with the three of them.
[57] Lord Griffiths in *Smith v Eric S. Bush, Harris v Wyre Forest District Council* 1989 2 WLR 790 at 813, Lord Jauncey at 822, Lord Tempelman at 799.
[58] Lord Griffiths in *Smith v Eric S. Bush, Harris v Wyre Forest District Council* 1989 2 WLR 790 at 813.
[59] Ibid. at 816.

company. In other words, the audit was not provided for the plaintiff, and there existed no close relationship (proximity) between him and the defendant. Consequently, the defendant owed no duty of care to the plaintiff.[64]

The decision made in *Smith v Eric S. Bush* and *Harris v Wyre Forest District Council*[65] and *Caparo Industries Plc. v Dickman*[66], show that *Hedley Byrne* remained good law.[67] Of course, there are some changes, like the extra requirement of 'just and reasonable', but the main idea of *Hedley Byrne*, that pure economic loss is recoverable and that a person could be liable in some circumstances for his statements, does still exist.

At this stage it can be determined that one could be liable for misstatements causing pure economic loss, if the damage is foreseeable, if there is proximity between the defendant and the plaintiff, and if it is just and reasonable to impose liability.

b. Building cases

The second category are the building cases. In this category economic loss is caused by the acquisition of defective property.[68] This category played an important role in expanding the tort of negligence in the field of pure economic loss during the 70's and 80's.[69]

One of the first important building cases is the decision of the Court of Appeal in *Dutton v Bognor Regis Urban District Council.*[70] This case had the following facts: the defending local authority had negligently approved the inadequate foundations of a dwelling house subsequently bought by the plaintiff. When subsidence occurred and the walls and ceilings began to crack, the plaintiff sued the council for damages in respect of the cost of repairs and the diminution in value of the house. While there was no contract between the plaintiff and the defendant, the plaintiff sued on the basis of the tort of negligence, but this brought a lot of difficulties, because firstly the claim could be not based on the principles of *Hedley Byrne*, because the plaintiff did not rely on the report of the local authority and secondly it could not be based on the principles of *Donoghue v Stevenson*[71], because the loss was purely economic in nature;

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[64] Lord Bridge 1990 1 All ER 578.
[65] 1990 1 AC 831 (HL).
[66] 1990 2 AC 605 (HL).
[67] D. Allen *Hedley Byrne Revalued* 1989 105 LQR 511; D. Hutchison (n8) 28.
[68] D. Hutchison (n8) 32.
[69] J. W. Sir Salmond & R. F. V. Heuston (n22) 205; W. Freiherr Raitz von Frentz (n3) 11-15.
[70] 1972 1 QB 373 (CA).
[71] 1932 AC 562 (HL).

the defect merely reduced the value of the house without causing damage to any person or other property.[72] Despite these difficulties, the Court of Appeal decided to allow the claim. It overcame the first difficulty by drawing the following distinction: where negligent advice was given on financial or property matters, as in *Hedley Byrne*, reliance was required; but where the advice was given on the safety of buildings, machines or material, the duty was owed to all who might suffer injury if the advice was bad.[73] According to the second problem, Lord Denning had the opinion that it was a physical harm and not a purely economic one. However, he made it clear that he would also have allowed the claim if it were purely economic.[74] In the opinion of Sachs LJ, it is a 'fallacious approach' to enquire whether the harm was physical or financial. He thought that the nature of the harm no longer mattered.[75] Looking at the reasons of the court it can be determined that in effect, then, the court applied the neighbour principle which was established in the decision of *Donoghue v Stevenson*[76], and held that the council owed the plaintiff a duty of care because the harm was foreseeable and because policy considerations favoured the imposition of liability.[77]

The significance of this decision is, that it expanded the tort of negligence, not only for building but also for manufacturers cases, in a field where previously only the law of contract was thought to be applicable.[78] The decision of *Dutton v Bognor Regis Urban District Council*[79], expanded the tort of negligence insofar as it opened the possibility to hold manufacturers liable on a tortuous warranty of quality that was transmissible down the contractual claim.[80]

The next important building case is the decision of the House of Lords in *Anns v Merton Borough Council*[81]. This case is seen as an another important step forward into the area of economic loss.[82] This case is seen as an attempt to get rid of the orthodoxy that the negligence in word was governed by principles different from those governing negligence in deed, by making a formula capable of application in all cases of negligence.[83]

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[72] D. Hutchison (n8) 20.
[73] Lord Dennings speech is summarised in D. Hutchison (n8) 20.
[74] Lord Denning in *Dutton v Bognor Regis Urban District Council* 1972 1 QB 373 at 396 E.
[75] Sachs LJ in *Dutton v Bognor Regis Urban District Council* 1972 1 QB 373 at 404.
[76] 1932 AC 562 (HL).
[77] C. Craig *Negligent Misstatements, Negligent Acts and Economic Loss* (1976) 92 LQR 220; Hutchison (n8) 21.
[78] Compare D. Hutchison (n8) 21 about the old view.
[79] 1972 1 QB 373 (CA).
[80] D. Hutchison (n8) 21.
[81] *Anns v Merton Borough Council* 1978 AC 728 (HL).
[82] J. W. Sir Salmond & R. F. V. Heuston (n22) 205.
[83] D. Hutchison (n8) 6.

In the *Anns* case, the plaintiff was a leaseholder of flats. Eight years after these flats had been built, structural movements began to occur with the result that the walls and floors began to crack and tilt. The plaintiff issued a writ against the local authority, claiming damages for negligent failure to inspect the foundations or to detect, on inspection, that they were shallower than was required by bye-laws or was indicated on the approved plans. The claim of the plaintiff succeeded and the local authority had to pay the costs of repairing them.

The significance of this case is that it extended the tort of negligence insofar as pure economic loss caused by a negligent statement made by a local authority was recoverable. This meant a remarkable extension of the liability of public authorities.[84] Another significant point of this decision was the development of the two-stage test by Lord Wilberforce, which changed the tort of negligence as a whole for a few years. [85] This two-stage test was aimed at proving whether a duty of care existed. The two-stage test was a redefinition and updating of the neighbour principle of Lord Aktin, developed in the *Donoghue v Stevenson*[86] case.[87]

Lord Wiberforce stated:[88]

Through the trilogy of cases in this House - Donoghue v Stevenson[89]*, Hedley Byrne & Co Ltd. v Heller & Partners Ltd.*[90]*, and Home Office v Dorset Yacht Co. Ltd.*[91] *- the position has now been reached that in order to establish that a duty of care arises in a particular situation, it is not necessary to bring the facts of that situation within those of previous situations in which a duty of care has been held to exist. Rather the question has to be approached in* ***two stages****. First one has to ask whether, as between the alleged wrongdoer and the person who has suffered damage there is a sufficient relationship of proximity or neighbourhood such that, in reasonable contemplation of the former, carelessness on his part may by likely to cause damage to the latter - in which case a prima facie duty of care arises. Secondly, if the first question is answered affirmatively, it is necessary to consider whether there are any considerations which ought to negative, or to reduce or limit the scope of the duty or the class of person to whom it is owed or the damages to which a breach of it may give rise.*

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[84] W. Freiherr Raitz von Frentz (n3) 11; J. G. Fleming (n7) 142.
[85] D. Hutchison (n8) 6.
[86] *Donoghue v Stevenson* 1932 AC 562 (HL).
[87] D. Hutchison (n8) 6.
[88] *Anns v Merton Borough Council* 1978 AC 728 (HL) at 751-752.
[89] *Donoghue v Stevenson* 1932 AC 562 (HL).
[90] *Hedley Byrne & Co. Ltd. v Heller & Partner Ltd.* 1964 AC 465, 1963 2 All ER 575 (HL).
[91] *Home Office v Dorset Yacht Co. Ltd.* 1970 AC 1004 (HL).

According to the speech of Lord Wilberforce, the first requirement of the two-stage test, is foreseeability - which he describes as proximity or neighbourhood, and the second is policy. The first requirement in particular takes an important place, because it is the crucial criterion of whether or not a duty of care exists, as far as policy reasons not demanding a total immunity from suit.[92] Consequently, once proximity or neighbourhood is established, the defendant would have to bring evidence that such a duty of care did not exist.[93]

This two-stage test was seen as an abstract test to determine whether one person owed a duty to another.[94] Thus, it was applicable for the whole tort of negligence and not only for negligence in words.

The decision of the House of Lords in *Junior Books Ltd. v Veitchi Co. Ltd.*[95], was the highest point of the expansion of the tort of negligence.[96]

The facts of the case are as follows: Junior Books engaged a building company to build a factory for them. The floor of the factory was laid by Veitchi - the defendant - a company specialising in that work. There was no contractual link between Junior Books - the plaintiff - and the defenders, although the latter were subcontractors nominated under the contract between the plaintiff and the main contractors. After cracking had occurred in the surface layer of the floor, the plaintiff brought an action against the subcontractor on the basis of the law of tort and not against the main-contractor on the basis of contract. Although the plaintiff merely wanted to recover his economic loss for replacing the floor, and did not claim that there was any danger to property or person, the majority of the House of Lords allowed the case to go to trial.

Lord Roskill, however, rejected the argument that a claim for the value of a defective product lay in contract and not in tort. He stated: *I think the proper control lies not in asking whether the proper remedy should lie in contract or instead in delict or tort, not in somewhat capricious judicial determination whether a particular case falls on one side of the line or the other, not in somewhat artificial distinctions between physical and economic or financial loss when the two sometimes go together and sometimes do not ... but in the first instance in es*

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[92] J. G. Fleming (n7) 162.
[93] D. Hutchison (n8) 6; R. P. Balkin & J. L. R. Davis *The Law of Torts* (1991) 210; J. W. Sir Salmond & R. F. V. Heuston (n22) 205.
[94] M. H. McHugh 'Neighbourhood, Proximity and Reliance' in P. D. Finn (ed.) *Essays on Torts* (1989) 17; W. Freiherr Raitz von (n3) 12; J. W. Sir Salmond & R. F. V. Heuston (n22) 205.
[95] *Junior Books v Veitchi* 1983 AC 520, 1982 3 All ER 201 (HL).
[96] D. Hutchison (n8) 24.

tablishing the relevant principles and then in deciding whether the particular case falls within or without those principles.[97]

The duty of care was proved in accordance with the two-stage test of Lord Wiberforce from the *Anns* case.[98] Lord Roskill held that both requirements, proximity and the fact that there were no policy factors warranting a restriction of the duty of care arising from such proximity, were given.[99]

According to this decision the rigid distinction between tort and contract seemed to have come to an end. Although there was no contractual relationship, a claim which is usually based on contract can be based on tort. Against this development, Lord Branton stated in his dissenting opinion, that such an extension of the law of tort is wholly undesirable. In his opinion, there should be not the possibility for liability in tort where the parties were in a contractual relationship, because such an expansion of the tort of negligence would give rise to unlimited liability.[100]

It took only a short time for Lord Branton's doubts to be vindicated, as others began to express reservations. Thus, in the same year of the decision of *Junior Books*, the reactionary process began.[101] In 1985, in *Governors of Peabody Donation Fund v Sir Lindsay Parkinson & Co. Ltd.*[102], the retreat from *Anns* began in earnest. In this case, the plaintiff, who was a building developer, sued the local authority for his economic loss, because the building inspector of the defendant local authority had been aware that the contractors of the plaintiff installed a drainage system in a manner contrary to the approved plans. The wrongly constructed drainage system had to be reconstructed with the consequence that the plaintiff lost a lot of money, because of the delay in completion of the building project. The House of Lords decided not to allow the claim of the plaintiff, because in the opinion of the Lords, the local authority did not owe a duty to the building owner. It was the responsibility of the developer himself to ensure that his contractors executed the work in the approved manner. To impose a liability on the local authority would not be 'just and reasonable'.[103]

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[97] At 545.
[98] D. Hutchison (n8) 25.
[99] At 546.
[100] At 552.
[101] The first retreat was in the decision of the Privy Council in *Pirelli General Cable Works Ltd. v Oscar Faber & Partner* 1983 2 AC 1 [Compare D. Hutchison (n8) 26].
[102] 1985 2 AC 210, 1984 3 All ER 529 (HL).
[103] Lord Keith in *Governors of Peabody Donation Fund v Sir Lindsay Parkinson & Co. Ltd.* 1985 2 AC (HL) at 241-242.

In *Investors in Industry Commercial Properties Ltd. v South Bedfordshire District Council*[104] and *Jones v Strout District Council*[105] in which the plaintiff also sued a local authority because it did not check the plans in the correct way, the court of appeal adopted this restrictive approach. They decided that there was no duty of care on the local authority.
More and more frequently, the courts abandoned the two-stage principle of Lord Wilberforce,[106] and doubts on the correctness of the decision of *Anns* arose.

Of particular note is the decision of the House of Lords in *D & F Estate v Church Commissioners for England*[107], the House of Lords challenged the *Anns* judgement by casting doubts on the correctness of this decision. In this case, a land owner built on his land a house. He made a contract with a building company which in turn made a contract with a subcontractor who carried out the plastering work on the block. After 15 years some defects became evident and the plaster in the flats was loose. The lessees and occupiers of a flat in the house brought an action against the building company and against the subcontractor claiming the cost of the remedial work already done, and the estimated cost of future remedial work. The House of Lords dismissed the claim of the plaintiffs. It held that in the absence of physical damage to other property or personal injury, the builder of a structure or the manufacturer of a chattel could not ordinarily be held liable in tort to a remote buyer or lessee for the cost of repairing a defect in the structure or chattel. Such cost of repair was pure economic loss which could be recovered only in contract, or in terms of the *Hedley Byrne* principle, if there was a special relationship of proximity between the parties. With this decision the House of Lords complied with the statement of Lord Brandon in his dissenting opinion in *Junior Books*, that an extension of the law of tort is wholly undesirable where the parties were in a contractual relationship.

Finally and not suprisingly, in 1990 the House of Lords overruled the *Anns* case. It was the decision of the House of Lords in *Murphy v Brentwood District Council*[108], where the facts of the case were very similar to the *Anns* case.[109]

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[104] 1986 QB 1034 (CA).
[105] 1986 1 WLR 1141.
[106] For example, *Hill v Chief Constable of West Yorkshire* 1989 1 AC 53 (HL) 60 (Lord Keith). For a comprehensive presentation on the development, see D. Hutchison (n8) 7-9.
[107] 1989 1 AC 177 (HL).
[108] *Murphy v Brentwood District Council* 1991 1 AC 398 (HL) (hereinafter referred to as *Murphy*).
[109] J. W. Sir Salmond & R. F. V. Heuston (n22) 206; W. Freiherr Raitz von Frentz (n3) 5.

In the case of *Murphy* the plaintiff was the purchaser of one of a pair of semi-detached houses. He sued for compensation against the local authority because it passed the plans and calculation of the house of the plaintiff, even though the foundations were defective. The plaintiff lost a substantial sum in selling the house at less than its market value in sound condition subject to the defect. The House of Lords emphasised that this was pure economic loss and, as such, was not recoverable in an action of negligence against the local authority. The council owed no duty to protect building owners or occupiers against such loss when carrying out its statutory functions of building control.[110] To allow a recovery of economic loss would have grave implications for builders and manufactures and would amount to judicial legislation.[111]
According to the *Anns* case Lord Keith stated:
In my opinion there can be no doubt that Anns has for long been widely regarded as an unsatisfactory decision .... I would hold that Anns was wrongly decided as regards the scope of any private duty of care resting on local authorities in relation of their function of taking steps to secure compliance with building bye-laws or regulations and should be departed from.[112]
The majority of the House of Lords had the same view, that the decision of *Anns* was wrong.[113]

The decision of *Murphy* reduces the formely wide liability of public authorities towards third parties and stopped the tendency to extend liability in cases of pure economic loss such as which began with *Anns* - as far as they belong to the category of *Anns*. This means for the building cases that pure economic loss is not recoverable, in that there is no contract or the principles of *Hedley Byrne* are not met.

c. Professional services

The third category is that of professional services. These are cases where economic loss is caused to the plaintiff as a result of negligent rendering of professional services. In this field the first important decision was in 1979. It was the decision in *Midland Bank v Hett, Stubbs & Kemp*[114]. Here the plaintiff sued a firm of solicitors, because it neglected to register their

[110] Lord Keith 1991 1 AC 468; Lord Oliver at 485.
[111] Lord Bridge 1991 1 AC 480-481.
[112] Lord Keith at 471.
[113] For example Lord Brandon, Lord Ackner at 482; Lord Oliver at 491.
[114] 1979 1 Ch 384.

client's option to purchase a farm, with the result that the farm was sold and conveyed free of incumbrance to a third party. The court decided that a duty of care was imposed on the defendant firm of solicitors by reason of the relationship of solicitor and client existing between the parties.[115] In the opinion of the court the three requirements of *Hedley Byrne* which constitute a relationship were met - special skill, assumption of responsibility and reasonable reliance -, although the negligence took the form of omission rather than the giving of information or advice.

The significance of this case is, that it overruled the former rule that an action by a client against a solicitor for damages for breach of his professional duty of care is necessarily and exclusively one in contract.[116] Thus, professional people could incur concurrent liability in contract and tort on their client. Consequently, a claim in tort for professional negligence causing pure economic loss is now also allowed.

The next important case which dealt with a claim in tort for professional negligence causing pure economic loss, was the decision of *Ross v Caunters*[117]. This case also dealt with the liability of a solicitor in a non-contractual relationship and confirmed the rule which was established in the decision of *Midland Bank v Hett, Stubbs & Kemp*[118] - that a solicitor who was negligent in his work was liable not only to his client in contract, but he could also be liable in tort of negligence.[119] In this case, the defendant solicitors prepared a will for a testator but failed to warn him that it should not be witnessed by the spouse of a beneficiary, with the result that a handsome bequest to the plaintiff failed. The plaintiff sued the solicitor, claiming his economic loss. Although the *Hedley Byrne* requirements were not satisfied, because there was no decisive reliance on the part of the plaintiff, the court allowed the claim. In the opinion of Sir Robert Megarry V. C., who decided this case, the requirements for liability were met. In his opinion there was professional negligence, a foreseeable loss, proximity between the plaintiff and the defendant and a limited number of potential plaintiffs. The requirement of 'reliance' was not necessary to impose a duty of care, because Sir Robert Megarry V. C. preferred to base the duty of care which he found to exist purely on the *Donoghue v Stevenson* principles, rather than on *Hedley Byrne*.[120] Thus, it was only necessary that there was a close relationship between the solicitor and the plaintiff (neighbour principle). Such a relationship

[115] Ibid. at 417.
[116] J. W. Sir Salmond & R. F. V. Heuston (n22) 13.
[117] 1980 1 Ch 297.
[118] 1979 1 Ch 384.
[119] *Ross v Caunters* 1980 1 Ch 297, 314.

was seen by Sir Robert Megarry V. C. as existing between the plaintiff and the defendant. Following the approach adopted by Salmon J in the decision of *Ministry of Housing and Local Government v Sharp*[121], however, Sir Robert Megarry V. C. regarded *Hedley Byrne* as establishing *that there is no longer any general rule (if there ever was one) that purely financial loss is irrecoverable in negligence. Instead, such loss may be recovered in those classes of case in which there are no sufficient grounds for denying recovery, and in particular no danger of exposing the defendant to a degree of liability that is unreasonable in its extent.*[122]
Sir Robert Megarry V. C. saw the danger of indeterminate liability by applying the *Donoghue v Stevenson* principle in cases of economic loss, and he shared the opinion of other decisions[123] - that there is a need for limiting liability in such cases, but he did not decide how this should be done. He left the question open and came to the result that this case were covered by the authority of the decision in *Ministry of Housing and Local Government v Sharp*[124], where the Court of Appeal allowed a claim, although there was no decisive reliance on the part of the plaintiff.[125]
As a result of this decision, it can be determined that reliance is not a necessary requirement to impose a duty of care in the field of professional negligence. There merely has to be a close relationship between the plaintiff and the defendant (neighbour principle).

One of the most interesting cases in the field of professional negligence in recent times was the decision of the Court of Appeal in *White and another v Jones and others*[126]. This case was decided shortly after *Murphy* and the whole jurisprudence was ambivalent as to whether or not the claim was allowed. As stated previously, the impact of *Murphy* on the tort of negligence was not very clear. In the various speeches in the *Murphy* case, it was emphasised that economic loss is only recoverable if there is a special relationship of proximity.[127] One could understand this in that economic loss is only recoverable when the requirements of *Hedley Byrne* are satisfied.[128] The *White and another v Jones and others* case[129] is similar to the *Ross*

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[120] Ibid. at 318 and 320.
[121] 1970 2 QB 223 (CA). [See short presentation of the case *Ministry of Housing and Local Government v Sharp* by D. Hutchison (n8) 19-20].
[122] *Ross v Caunters* 1980 1 Ch 297 at 315.
[123] For example Hedly Byrne or *Caltex Oil (Australia) Pty. Ltd. v The Dredge* 1976 136 C.L.R. 529.
[124] 1970 2 QB 223 (CA).
[125] *Ross v Caunters* 1980 1 Ch 297 at 319-321.
[126] 1993 3 All ER 481 (CA).
[127] See speeches of Lord Bridge in *Murphy v Brentwood District Council* 1991 1 AC 398 (HL) at 475 and 480, Lord Oliver at 486 and Lord Jauncey at 492.
[128] J. G. Fleming *Requiem for Anns* 1990 106 LQR 526; compare D Hutchison (n8) 29.
[129] 1993 3 All ER 481 (CA).

v Caunters case[130]. In this case, the defendant solicitor had negligently delayed preparing a will for his client, with the result that the latter died before the new will could be executed, and the plaintiff lost the benefit she would have received under it. The plaintiff sued the defendant claiming her loss, which is undoubtedly an economic loss. As in the case of *Ross v Caunters*[131], there was no decisive reliance on the part of the plaintiff. This meant that the requirements of *Hedley Byrne* were not met. However, the court allowed the claim of the plaintiff. The court was of the opinion that the requirements for liability were met, because it was foreseeable that the disappointed beneficiary would suffer financial loss, there was a sufficient degree f proximity between the solicitor and the intended beneficiary and it was fair just and reasonable that liability should be imposed on the solicitor.[132] According to the fact that there was no reliance the court decided that reliance is undoubtedly an important requirement to impose a duty of care in the field of pure economic loss, but not an indispensable one.[133] This had already been said in the decision of *Ross v Caunters*[134] which was not overruled by *Murphy*, because it did not fall into that category. *Ross v Caunters* is an decision of its own category.[135]

In 1995 the *White and another v Jones and others* case was decided again. This time it was decided by the House of Lords. The House of Lords affirmed the decision of the Court of Appeal.[136]

Consequently, in the field of professional negligence pure economic loss is recoverable, if the requirements of foreseeability, proximity and fair, just and reasonableness are met. The requirement of reliance on the part of the plaintiff is not necessary.

d. Relational economic loss

The fourth category is relational economic loss. These are cases where economic loss is caused to the plaintiff as a result of physical injury to the person or property of a third party.[137] Here, the potential for indeterminate liability is at its greatest and the opposition to recovery,

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[130] 1980 1 Ch 297.
[131] Ibid.
[132] *White and another v Jones and others* 1993 3 All ER 481 at 495-497 and 499-502.
[133] Ibid. at 488.
[134] 1980 1 Ch 297.
[135] *White and another v Jones and others* 1993 3 All ER 481 at 492, 498 and 502 (CA).
[136] *White and another v Jones and others* 1995 2 AC 207, 1995 1 All ER 691 (HL).
[137] R. Bernstein *Economic Loss* (1993) 131.

accordingly most deeply ingrained.[138] However, it was a case of relational economic loss where the first time a claim for recovery of a pure economic loss was allowed. This was in the above mentioned decision of the House of Lords in *Morrison Steamship C. Ltd. v Greystoke Castle Cargo Owners*[139] in 1947.[140] This was, however, seen as a narrow exception to accommodate the very special case of compensation in the field of maritime law.[141]

Just after the decision of *Hedley Byrne*, several cases in the field of relational economic loss were decided.[142] One of these was the decision of *Weller &Co. and another v Foot and Mouth Disease Research Institute*[143]. In this case, the defendant was a research institute. This institute negligently allowed a virus to escape from their laboratories, infecting cattle in the area with foot and mouth disease. When the government exercised statutory powers to close the local cattle market, the plaintiffs, who were cattle auctioneers, were unable to carry on their business. The plaintiff sued the institute claiming the economic loss they had suffered as a consequence of the closed cattle market. The court denied the claim of the plaintiff, because the defendant owed no duty of care to the plaintiff. In the opinion of Widgery J. a duty of care *is owed only to those whose person or property may foreseeably be injured by a failure to take care. If the plaintiff can show that the duty was owed to him, he can recover both direct and consequential loss which is reasonably foreseeable. ... In the present case, the defendants' duty to take care to avoid the escape of the virus was due to the foreseeable fact that the virus might infect cattle in the neighbourhood and cause them to die. The duty of care is accordingly owed to the owners of cattle in the neighbourhood, but the plaintiffs are not owners of cattle and have no propriety interest in anything which might conceivably be damaged by the virus if it escaped.* According to this, the decision of *Hedley Byrne* had changed nothing.[144]

[138] J. G. Fleming *The Law of Torts* 8 ed. (1992) 145; B. Feldhusen (n1) 200.
[139] 1947 AC 265 (HL).
[140] W. Freiherr Raitz von Frentz (n3) 3; D. Hutchison (n8) 13.
[141] Lord Keith in *Murphy v Brentwood District Council* 1991 1 AC 398 (HL) at 468; W. Freiherr Raitz von Frentz (n3) 4.
[142] See D. Hutchison (n8) 16-19.
[143] 1966 1 QB 569.
[144] Ibid. at 587.

Several criticism were made over this judgement[145] and it was partly seen as an attempt at reaffirmation of the narrow exclusionary rule.[146] However, looking at this judgement in its entirety, it is notable that it was based on the unspoken consideration that liability for negligence has to be kept within reasonable limits.[147]

Another decision in the field of relational economic loss was the decision in *Margarine Union GmbH v Cambay Prince Steamship Co. Ltd.*[148]. In this case the defendants were ship-owners who had negligently allowed a cargo of copra to be damaged by cockroaches on board their ship. The plaintiffs who had bought the copra, but were not the owners of it at the time when the damage occurred sued the ship-owners and claimed the economic loss they had suffered as a result the damage. Following the *Weller* case, the court denied the claim. It was of the opinion that only those with a proprietary or possessory interest in the property at the time it was damaged were entitled to recover damages in negligence.[149]

This view was confirmed in several decisions in the 70's and 80's.[150] One of these was the decision of the House of Lords in *Leigh and Sillavan Ltd. v Aliakmon Shipping Co. Ltd.*[151] in 1986. This case was very similar to the *Margarine Union GmbH v Cambay Prince Steamship Co. Ltd.*[152]. There again goods, on board a ship were damaged in transit after the risk, but not the ownership, had passed to the buyer. The House of Lords denied the claim, with the argument that the defendant owed no duty of care to the plaintiff, because the plaintiffs had neither become the legal owners of the goods nor had they obtained the possessory title in terms of the bill of lading when the damage occurred.

In the so called cable cases - which also belong to relational economic loss category - the courts were also not prepared to allow a claim. The so called cable cases are cases, where pure economic loss is caused by interruptions of the supply of electricity or water.[153] As in the other cases of relational economic loss the courts denied claims of plaintiffs with the argu

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[145] P. S. Atiyah (n7) 259-261.
[146] D. Hutchison (n8) 16.
[147] *Weller &Co. and another v Foot and Mouth Disease Research Institute* 1966 1 QB 569 at 577. (hereinafter referred to as Weller).
[148] 1969 1 QB 219.
[149] Ibid. at 250.
[150] *Candlewood Navigation Corporation Ltd. v Mitsui O.S.K. Lines Ltd.* 1986 1 AC 1 (PC).
[151] 1986 1 AC 785 (HL).
[152] 1969 1 QB 219.
[153] D. Hutchison (n8) 18.

ment that only those with a proprietary or possessory interest in the property at the time it was damaged were entitled to recover damages in negligence; and this are only the owner of the electricity cables or water-pipes.[154]

Finally, it can be determined, that in the case category of relational economic loss the courts were not prepared to allow a claim. The fears for indeterminate liability were to big.

2. Negligently caused pure economic loss in Germany

As mentioned above negligently caused pure economic loss in a non-contractual relationship was and still is a problematic issue in Germany, too.[155] Many attempts have been made to resolve this issue in the last 150 years. However, this chapter only discusses the legal situation after the German Civil Code, the Bürgerliches Gesetzbuch (BGB), came into force in 1900. The means of resolving the problem in Germany were different to those in England.[156] As opposed to England one did not expand the law of tort, one expanded the law of contract in Germany. This chapter will show how the problem of economic loss was attempted to be solved in the law of contract in Germany. Before discussing this, I will briefly outline how far the German law of delict covers negligently caused pure economic loss.

a. Pure economic loss in the German law of delict

The German law of delict is stated in the twenty fifth title of the second book of the civil code. Unlike the French civil code, the German the law of delict does not have a general clause.[157] There are four provisions that deal with negligently caused damages: §§ 823 I, 823 II, 824 and 839 BGB.[158]

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[154] *SCM (United Kingdom) Ltd. v W.J. Whittal and Son Ltd.* 1971 1 QB 337 (CA); *Spartan Steel & Alloys Ltd. v Martin & Co. Ltd.* 1973 1 QB 27 (CA).

[155] G. Herrmann *Zum Nachteil des Vermögens* (1978) 1.

[156] Compare W. Freiherr Raitz von Frentz (n3) 92-172. B. S. Markesinis *An Expanding Tort Law-The Price of a Rigid Contract Law* (1987) 103 LQR 354.

[157] K. Zweigert & H. Kötz (n5) 293.

[158] There are also some other sections, but these deal with victims of fatal accidents, which will be not discussed in this paper. The other provisions are not independent, for example, in order to prove liability in accordance with §831, § 823 I BGB has to be proved as well.

aa. Pure economic loss in terms of § 823 I BGB

§ 823 I BGB is the basic provision of the German law of delict.[159] It provides:

> *A person who, wilfully or negligently, unlawfully injures the life, body, health, freedom, property or other right of another is bound to compensate him for any damage arising therefrom.*[160]

Looking at the wording of § 823 I BGB, it can be seen that for an action based on § 823 I BGB, the following requirements must be satisfied: there must be a violation of one of the enumerated rights or interests, namely life, body, health, freedom, property, or any other right, which was unlawful, and culpable (intentional or negligent), and there must be a casual link between the defendant's conduct (which can be an act or an omission) and the plaintiffs harm as defined by this paragraph.[161]

Another fact which can be seen from the wording of § 823 I BGB, is that wealth is not in the enumerate list of the paragraph. The question is whether or not wealth is included in the meaning of 'other rights'. From the enumeration in the paragraph the courts[162] and the dominant opinion in the literature[163] conclude that that § 823 I BGB, protects only absolute rights and not wealth. Consequently, people who suffer loss caused indirectly - for example, as a result of an infringement of another person's legally protected right - will usually not be entitled to compensation. Formulated differently, culpable behaviour which causes the victim only pure economic harm, unconnected to any personal injury or damage to property or the invasion of any 'other right', does not give rise to a claim under § 823 I BGB.[164] Thus, the shop owner, who loses income due to the killing of his customer, will not be entitled to compensation. On the other hand, however, there is no doubt that a person who suffers personal injury and damage to his car in a traffic accident, can claim compensation for all the economic loss which flows from personal injury or from damage to the car.[165]

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[159] B. S. Markesinis *The German Law of Torts* 3 ed. (1994) 35.
[160] Translated by I. S. Forrester S. L. Goren & H-M. Ilgen *The German Civil Code* (1975).
[161] B. S. Markesinis A Comparative Introduction of the German Law of Tort 2 ed (1986) 35; H. Thomas '§823' in P. Bassenge et al (ed.) Palandt Bürgerliches Gesetzbuch 54 ed. (1995) Rn.1.
[162] BGHZ 41, 127; BGHZ 86, 152; BGH NJW 77, 2264.
[163] H. Thomas '§823' (n161) Rn.31; N. Horn, H. Kötz & H. G. Leser *German Private and Commercial Law* (1982) 149.
[164] B. S. Markesinis 3 ed. (n159) 42; N. Horn, H. Kötz & H. G. Leser (n163) 149; W. Freiherr Raitz von Frentz (n3) 99.
[165] N. Horn, H. Kötz & H. G. Leser (n163) 149; W. Freiherr Raitz von Frentz (n3) 99.

In judicial decisions as well as literature, many attempts were made to include pure economic loss in the protective ambit of § 823 I BGB. For example, there was an attempt to extend the ambit of §823 I BGB, by making a wide interpretation of the term 'property' to include pure economic loss.[166]

Another measure to provide for cases that were originally treated as instances of irrecoverable pure economic loss, was the recognition of a new 'other right'. This is the right of an established and operating business. It was developed by the Reichsgericht[167] only four years after the BGB had come into force,[168] and enabled a business owner to claim compensation in cases of negligently caused loss.[169] The intention of recognising this right was to protect the business owner in the entire field of his commercial activities, against disturbance by others, for example, the clientele and the business connections of an enterprise would be protected.[170] This was necessary, because the protection of the business in the law of delict was unsatisfactory. § 826[171], for example, covers only intentional and not negligent activities which are contrary to 'public policy'; and § 824[172], for example covers only 'untrue' statements damaging the 'credit' of another person. However, to prevent an unlimited liability the courts developed three requirements to keep the matter within manageable bounds which have to be satisfied until one could base an action on this legal institution. These are:

- the plaintiff must not have another action, which entitles him to compensation (subsidiary)
- the business should actually be established and operating
- and the conduct should be business connected

The Federal Supreme Court often emphasised that the interpretation of these requirements had to be very restrictive, because otherwise the liability would be too wide.[173]

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[166] This attempt will be not discussed in this paper, because it is not generally recognised and it is not answered properly. Compare W. Freiherr Raitz von Frentz (n3) 100.

[167] Reichsgericht was the German Supreme Court from 1871 until 1945.

[168] RGZ 58, 24 (30).

[169] E. Deutsch *Die neuere Entwicklung der Rechtsprechung zum Haftungsrecht* JZ 1984, 308.

[170] W. Freiherr Raitz von Frentz (n3) 101; B. Drees '§823' in H.P. Westermann & K. Küchenhoff (ed.) *Erman BGB Handkommentar* Vol. 1 7 ed. (1981) Rn.38; B. S. Markesinis 3 ed. (n159) 61; K. Larenz Lehbuch des *Schuldrechts* Vol. 2 12ed. (1981) 632.

[171] §826 provides: *A person who wilfully causes damage to another in a manner contrary to public policy is bound to compensate the other for the damage.* [N. Horn, H. Kötz & H. G. Leser (n163) 156].

[172] §824 BGB will be discussed later.

[173] BGHZ 41, 123; BGH NJW 1969, 2047.

(1). Subsidiarity of the legal institution established and operative business

The legal institution an 'established and operative business' is subsidiary. This means, that the plaintiff must not have another action, which entitles him to compensation.[174] Thus, if the plaintiff could base an action on § 823 II, §824 BGB, or on any other provision even if it is not one of the BGB, for example, § 1 UWG[175], the legal institution 'established and operative business' would be not applicable. The Federal Supreme Court, for example, allowed an action on the basis of being an 'established and operative business' in a case where a newspaper negligently reported that a certain new product did not meet the correct safety standard. § 826 BGB was no applicable, because there was no intention, and § 824 BGB was also not applicable, because it was a value judgement and not a statement which is not covered by § 824 BGB.[176]

(2). The business should actually be established and operating

The second requirement is, that the business should actually be established and operating.[177] This is the case, when it is set up for a long run with the intention to make profit.[178] Thus, legal partnerships, trade unions or clubs, for example do not get protection by this legal institution.[179] However, this requirement is very vague and was much criticised in literature.[180] Despite the criticisms the Federal Supreme Court did not drop this requirement.

(3). The conduct should be business connected

Thirdly, the right of an established and operating business is only infringed, if the conduct of the defendant is in some way business connected. The Federal Supreme Court decided in a cable case[181] where a driver of an excavating vehicle negligently interrupted the supply of electricity, that such an action is business connected, when the action is *in some way directed against the business as such ... and does not simply affect rights and interests which are separable from the business as a functioning unit.*[182] In this cable case, the Federal Supreme Court denied such a business connection, because supplying of electricity is only a right which is

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[174] BGHZ 36, 252 (257); BGHZ 38, 200 (204); B. S. Markesinis 3 ed. (n159) 63.
[175] Act against unfair competition.
[176] BGHZ 3, 270 (279); H. J. Mertens '§823' in K. Rebmann & F. J. Säcker (ed.) *Münchner Kommentar zum Bürgerlichen Gesetzbuch* 2.ed. Vol. 3 (1986) Rn.502.
[177] B. Drees (n170) '§823' Rn.36.
[178] BGHZ 3, 270; BGH NJW 1969, 2047.
[179] W. Freiherr Raitz von Frentz (n3) 103.
[180] B. Drees (n170) '§823' Rn.40.
[181] BGHZ 29, 65.
[182] BGHZ 29, 65 = translated in N. Horn, H. Kötz & H.G. Leser (n163) 150.

separable from the business as a functioning unit. In another case, where picket holders blocked the entry to a business, while they were labouring under an error as to the legality of this blockade (and thereby negligently and wrongfully causing financial loss for the business owner), the Federal Supreme Court decided that the conduct was business connected, because the entrance of a business is not a separable unit.[183] Thus, the picket holders were held liable for compensation of the business owner's economic loss resulting from the blockade.

If these three requirements are met, an 'other right' of § 823 I BGB is infringed, if this infringement was unlawful, and culpable (intentional or negligent), and there is a casual link between the defendant's conduct (which can be an act or an omission) and the plaintiffs harm, the plaintiff would have a claim against the defendant.[184]

bb. Pure economic loss in terms of § 823 II BGB

The second provision that deals with negligently caused damages, is § 823 II BGB. It states:

> *The same obligation is placed upon a person who infringes a statute intended for the protection of others. If, according to the provisions of the statute, an infringement of this is possible even without fault, the duty to make compensation arises only in the event of fault.*[185]

According to this provision, liability arises when there is a culpable contravention of a statute to protect another. Protective statutes in this sense include all those rules of private, criminal and public law, whose main purpose is to protect an individual or a group of individuals rather than the public as a whole.[186] Several provisions exist[187] in German law which provide for such protection, for example, §§ 185 StGB[188] (defamation) or § 1 UWG[189]. An interesting fact of this provision, however, is that it can, under certain circumstances, cover pure economic loss.[190] Therefore the following requirements have to be met:

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[183] BAG NJW 1964, 1291; also BAG NJW 1973 1994.
[184] For a comprehensive presentation of the requirements unlawful, culpable and casual link see W. Freiherr Raitz von Frentz (n3) 104-113.
[185] S Forrester, S. L. Goren & H-M. Ilgen *The German Civil Code* (1975)
[186] N. Horn, H. Kötz & H.G. Leser (n163) 155.
[187] A comprehensive presentation of such provisions by H. Thomas '§823' (n161) Rn.145-152.
[188] The German penal code.
[189] Unfair Competition Act.
[190] H. Thomas '§823' (n161) Rn.159.

Firstly, the provision violated by the defendant must have the aim of protecting the individual against economic loss. For example, § 223 StGB (bodily harm), protects only the body of an individual and not his wealth. Consequently, if a defendant makes a culpable contravention of this statute, he is not obliged to pay compensation for pure economic loss. But if a director of a limited company culpably fails to start liquidation proceedings when the company becomes insolvent, and so commits an offence under § 64 GmbHG[191], he will be personally liable under § 823 II BGB, in connection with § 64 GmbHG, to the companies creditors - who thereby suffer mere economic loss. This is because the purpose of § 64 GmbHG is to protect creditors against harm of this.[192] §§ 42 and 53 BGB, in terms of which a club has a duty to declare itself bankrupt in the event of it having high debts, also have the purpose of protecting creditors from suffering economic loss.[193]

Secondly, this provision must have the purpose of enabling claims in such cases. § 64 GmbHG, for example, only enables creditors of the bankrupt company to a claim and no-one else. Thus, a creditor of a company which is not bankrupt cannot base a claim on 823 II BGB, in connection with § 64 GmbHG, and a person who is not a creditor of the bankrupt company also cannot base an action on these provisions. Other examples are the §§ 1, 38 and 25 GWB[194], which have the purpose of protecting the competitor who has been excluded from the market. Thus, only the excluded competitors are able to take advantage of the protective ambit of these statutes.[195]

There are not many provisions in German law, however, which constitute these requirements; even § 823 II BGB cannot cover pure economic loss in an adequate way.

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[191] The German Companies Act.
[192] BGHZ 29, 100 as discussed in: N. Horn, H. Kötz & H.G. Leser (n163) 156.
[193] B. Drees (n170) '§823' Rn.133.
[194] Law against restraints on competition.
[195] BGHZ 64, 232 (237-240); BGH NJW 1965, 2249.

cc. Pure economic loss in terms of § 824 BGB

The third provisions that deals with negligently caused damages is § 824 BGB. It states:

> *A person who declares or publishes, contrary to the truth, a statement which is likely to endanger the credit of another, or to injure his earnings or prosperity in any other manner, shall compensate the other for any damage arising therefrom, even if he does not know of its untruth, but should know of it.*
>
> *A person who makes a communication, the untruth of which is unknown to him, does not thereby render himself liable to make compensation, if he or the receiver of the communication has a lawful interest in it.* [196]

§ 824 BGB, offers protection against endangerment of credit or injury to earnings or earnings prospects. Liability in accordance with § 824 BGB may overlap with § 823 II BGB in connection with §§ 185-187 StGB. However, § 824 BGB is wider, because it covers statements which may endanger a person's credit or economic interests, even if they do not actually affect his reputation.[197]

Firstly, § 824 BGB requires the declaration or publishing of an untrue statement. As stated earlier, § 824 BGB, refers only to statement of facts and not expressions of opinion or other value-judgements.[198] To avoid exposing the wrongdoer to a multiplicity of delictual claims, the Federal Supreme Court requires that the statement must deal specifically with the sufferer or the given statement must at least relate in any form to the activities or his activities.[199] If, for example, someone maintains that electric organs are not suitable for the use in churches, a producer or dealer of such organs will not have an action based on § 824 BGB, although they might suffer loss.[200] Secondly, §824 BGB requires that the statement must be likely to endanger the credit of another, or to injure his earnings or prosperity in any other manner. Furthermore, the action of the wrongdoer must be wrongful. Wrongfulness would be lacking in a case where someone merely looks after his legitimate interests in making a particular statement (§824 II BGB). This privilege only applies, if the maker of the statement did not know that this statement was incorrect. The defence of 'justified interest', as this defence is called, will be upheld only where an *objective assessment of contents of the communication, its form*

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[196] Translated by I. S. Forrester, S. L. Goren & H-M. Ilgen *The German Civil Code* (1975).
[197] B. S. Markesinis 3 ed. (n159) 902.
[198] BGH NJW 1987, 2225.
[199] BGH Z 90, 119 (120-122); BGH NJW 92, 1312. H. J. Mertens '§824' in K. Rebmann & F. J. Säcker (ed.) *Münchner Kommentar zum Bürgerlichen Gesetzbuch* 2.ed. Vol. 3 (1986) Rn.37.

and all the surroundings circumstances suggest that it is the appropriate and necessary means for achieving a legally acceptable objective.[201] Finally, § 824 BGB requires that the acting person culpably did not recognise that the statement is contrary to the truth. Negligent ignorance is sufficient.[202]

dd. Pure economic loss in terms of § 839 BGB

The last provision that deals with negligently caused damages is § 839 BGB. This provision deals with liability for breach of official duty and is a specific enactment, and as such, overrides the provisions of the other, more general, clauses of the code, such as § 823 I, II BGB and 824 BGB.[203] § 839 BGB states:

> *If an official wilfully or negligently commits a breach of official duty incumbent upon him as against a third party, he shall compensate the third party for any damage arising therefrom. If only negligence is imputable to the official, he may be held liable only if the injured party is unable to obtain compensation elsewhere.*
>
> *If an official commits a breach of his official duty in giving judgement in an action, he is not responsible for any damage arising therefrom, unless the breach of duty is punished with a public penalty to be enforced by criminal proceedings. This provisions does not apply to a breach of duty consisting of refusal or delay in the exercise of the office.*
>
> *The duty to make compensation does not arise if the injured party has wilfully of negligently omitted to avert the injury by making use of a legal remedy.*[204]

Here it can be seen, that in accordance with § 839 BGB a person could be held liable for a breach of official duty only under certain circumstances. These circumstances are narrower than the circumstances of § 823 I BGB, because according to § 839 I 2 BGB, for example, a civil servant who merely acted negligently can be held liable only if the victim cannot achieve compensation in a different way. Thus, § 839 BGB represents a narrowing of liability.[205] On the other hand, the provision is also wider than some of the general clauses, for example § 823 I BGB, in so far as it imposes liability for *any damage* arising from unlawful conduct of the

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[200] *Electric organs case* BGH JZ 64, 509.
[201] BGHZ 3, 281 translated in B. S. Markesinis 3 ed. (n159) 902.
[202] B. Dress '§824' Rn.10.
[203] BGHZ 3, 94 (102); BGH NJW 1971, 43 (44); B. S. Markesinis 3ed. 903.
[204] Translated by I. S. Forrester S. L. Goren & H-M. Ilgen *The German Civil Code* (1975).

official, which means that under this heading, even claim for negligently inflicted purely economic loss may succeed.[206]

Since the German Basic Law came into power, § 839 BGB has to be seen in connection with Article 34 of the Basic Law.[207] According to this article, the liability of the civil servant for his conduct will be a liability of the state, because Article 34 of the Basic Law provides:

> *Should anybody, in exercising a public office, neglect their duty towards a third party liability shall rest in principle with the state or the public body employing them, in event of wilful intent or gross negligence remedy may be sought against the person concerned. In respect of claims for compensation or remedy recourse to the ordinary courts shall not be precluded.*[208]

Thus, the constitution in effect, shifts the responsibility of the official under § 839 BGB, onto the state or the public body employing the official.[209] Such a shifting of liability, however, is only in those cases, where the civil servant takes action in a 'sovereign' sphere, whereas when he acts for 'non-sovereign' purpose Article 34 of the Basic law is not applicable, and then the civil servant and not the state will be liable.[210]

(1). Liability in cases of sovereign acting

In order for liability of the state for civil servants to be given, the following requirements have to be satisfied:

Firstly, in accordance with Article 34 of the Basic law, somebody must have acted while holding an office. This is the case, when the act of the person is typically sovereign or is based on public law, for example, a policeman, a judge or a soldier.[211] It also includes people who are working in the so-called performance administrative, such as public teachers or medical

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[205] B. S. Markesinis 3 ed. (n159) 903.
[206] Ibid.
[207] W. Meyer 'Artikel 34' in I. von Münch (ed.) Grundgesetz Kommentar 2 ed. (1983) Vol. 2 Rn.2; H. J. Papier '§839' in K. Rebmann & F. J. Säcker (ed.) *Münchner Kommentar zum Bürgerlichen Gesetzbuch* 2 ed. Vol. 3 (1986) Rn.2.
[208] Official translation of the German Basic Law published by the Press and Information Office of the Federal Republic of Germany 1994.
[209] B. S. Markesinis 3 ed. (n159) 903; W. Meyer (n207) 'Artikel 34' Rn.4
[210] B Drees '§839' in H P Westermann & K. Küchenhoff (ed.) Erman BGB Handkommentar Vol. 1 7 ed. (1981) Rn.12.
[211] BGHZ 110, 253 (255); BGH NJW 1971, 2220; H. D. Jarass 'Artikel 34' in H. D. Jarass & B. Pieroth *Grundgesetz* 3 ed. (1995) Rn.6.

practitioners of the public health department.[212] However, people who worked in such sectors as the former public railway did not exercise a public office, because it was neither a typically public task nor was it based on public law.[213]
According to Article 34 of the Basic law in connection with § 839 BGB, it is not necessary for the acting person to be a civil servant.[214] They could be also a state employee or anybody else. It is only necessary that the wrongdoer carried out a sovereign task, which makes the person a civil servant in the sense of liability.[215]

Secondly, the wrongdoer must have acted in the exercise of a public office. This requirement is not met if the wrongdoer performed the damaging act just by chance (bei Gelegenheit), in exercise of the public office. For example, if a bailiff, during a seizure, steals a bike of the debtor, he is acting outside his sphere of official public duties.[216]

Thirdly, the civil servant must have committed a breach of an official duty. Such duties arise out of statutes, common law and service instructions.[217] Thus, the civil servant has, for example, the common law duty to make decisions in an objective way. If the civil servant takes subjective elements into his decision, he would violate an official duty. A breach of an official duty is also committed when the civil servant acts beyond his competence or violates criminal law statutes. The official duty catalogue is not a closed book; in this field the courts have a great power of decision.[218]

Fourthly, this official duty must be owed to a third party. Cases in which duty is owed to a third party, must be decided according to the purpose of the official duty.[219] If the official duty exists solely in the interest of the public, it would not be owed to a third party. For example, the duty of the Public Prosecutor's Office to prosecute certain crimes is one that is owed to the public and not to an individual who cannot complain if it is not exercised.[220] State supervision, on the other hand, over certain banking activities is not instituted solely in the interest

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[212] B. Drees '§839' (n210) Rn.14.
[213] B. S. Markesinis 3 ed. (n159) 903.
[214] H. Thomas '§839' in P. Bassenge et al. (ed.) Palandt Bürgerliches Gesetzbuch 54 ed. (1995) Rn.38. In Germany people who are working for the state are either civil servants or state employees. Civil servants are officially appointed and have special duties and rights.
[215] BGH NJW 1972, 2088.
[216] W. Meyer 'Artikel 34' (n207) Rn.38.
[217] H. Thomas '§839' (n214) Rn.32.
[218] W. Meyer 'Artikel 34' (n207) Rn.48.
[219] BGHZ 68, 142 (145).

of the public, it is also in the interest of creditors of these institutions who may suffer loss as a result of an unlawful activity on their part. A planning and building permission procedure, for example, is also a duty which is owed to a third party, it is owed to the person who applied for the permission. However, this duty is owed to the third party only in so far, as that it covers damages which arose direct from the planing and building permission. Mistakes of the building company or the architect, are not included, because it is not the purpose of the planning and building procedure, to remove the responsibility from the builder to the administrative.[221]

The fifth and sixth requirements are, as in all delictual acts, that the act must have been wrongful and culpable. The fault must relate only to the breach of the official duty and not to the damage itself.[222]

The seventh requirement is, that there is no exclusion of liability. There exist three exclusions of liability that are provided in § 839 BGB.

The first exclusion can be found in § 839 I, 2 BGB. Its effect is to render the official liable only when the victim cannot obtain redress from another source, which includes, for example, private insurance and social security. This rule is nowadays considered to be antiquated, because it was introduced before the constitution shifted the responsibility of the official onto the state, and was meant to shield public officials from excessive liability which might lead them into complete inactivity out of fear of being responsible for their conduct.[223] Since the responsibility is shifted onto the state, this exclusion rule is interpreted narrowly. According to the judicial decisions of the Federal Supreme Court[224], this rule is only applicable in cases where the civil servant is expressly not exercising the same right as others, for example driving on the road with blue light.[225]

The second exclusion can be found in § 839 II 1 BGB. According to this exclusion, liability arose only where a judge, by making a decision constituted a crime. In this regard it is necessary to consider 'Misconstruction of the law' (§ 336 StGB) and 'Serious Passive Bribery of a

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[220] RGZ 108, 249, (251); 154, 266 (268); B. Drees '§839' (n210) Rn.125.
[221] BGHZ 39, 358; B. S. Markesinis & S. Deakin *The Random Element of their Lordships' Infallible Judgement* (1992) 55 MLR 634.
[222] H. Thomas '§839' (n214) Rn.53.
[223] B. S. Markesinis 3 ed. (n159) 904.
[224] BGHZ 85, 225; BGH NJW 1991, 1171.
[225] Example from W. Freiherr Raitz von Frentz (n3) 128.

judge' (§332 II StGB);[226] both require intention on the side of the judge and are consequently of no interest to this dissertation.

The third exclusion can be found in § 839 III BGB. According to this provision, the right to claim compensation is lost if the victim has either intentionally or negligently omitted to mitigate his loss by making use of any other legal remedy available against the official in question. Examples of such legal remedies are: appeal on questions of fact and law (Berufung) or appeal on a question of law only (Revision).

These are not the only exclusion rules. There are others which are not found in § 839 BGB. There are several provisions that also exclude liability, for example, § 57 of the Hessian Building Act[227], that provides that the state is not liable for the checking of building plans.

In summary there are seven requirements that have to be met before the state is considered liable for its servants. If they are met, the state or the public body employing the civil servant has to pay compensation - which includes pure economic loss.

(2). Liability in cases of non-sovereign acting

As stated above cases exist where there is no shifting of liability from the civil servant onto the state. In those cases, the civil servant is liable and not the state. The requirements of this liability do not differ very much from the liability of civil servants in cases of sovereign acts. Where they do differ is that in these cases of non-sovereign acts, the wrongdoer must be a civil servant.[228] Wrongdoers who are not civil servants, but are working for the state are liable in accordance with §§ 823-831 BGB.[229] They are also different in that the wrongdoer must have carried out tasks that are solely connected to the 'non-sovereign' interest of the public body.[230] In other words, the person must not have carried out any sovereign tasks, for example, buying pencils for the police office.

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[226] W. Freiherr Raitz von Frentz (n3) 128.
[227] As cited in: E. Fuhr & E. Pfeil Hessisches Verfassungs- und Verwaltungs- Gesetze 53ed (1994) No.168.
[228] W. Freiherr Raitz von Frentz (n3) 131.
[229] B. S. Markesinis 3 ed. (n159) 903.
[230] W. Freiherr Raitz von Frentz (n3) 131.

b. Pure economic loss in the German law of contract

The law of contract is contained in the second book of the civil code from the first to the tenth titles. Liability in the law of contract is only possible, if there is an obligation. Where there is no obligation between the tortfeasor and the injured party, the latter can base his claim only on the law of delict.[231] However, the law of delict has a number of disadvantages and often leads to unsatisfactory results. It not only provides inadequate protection in cases of pure economic loss, it also has the disadvantage in that in the field of vicarious liability, it offers the possibility of exculpation. According to §831 BGB, which provides for vicarious liability, an employer is only liable for the unlawful acts of his employee to the extent that he cannot show that he, the employer, exercised ordinary care in selecting (culpa in eligendo) or supervising (culpa in custodian) the employee. Another disadvantage of the delict law is that an action based on delict prescribes after 3 years, according to § 852 BGB. The number of disadvantages of the law of delict, led the German courts and jurisprudence to an extension of the law of contract with the consequence that in several circumstances, the law of contract is applicable where usually only the law of delict is applicable. The main advantage of the law of contract is, that § 278 BGB and not § 831 BGB, is applicable. § 278 BGB provides for the general responsibility of the debtor for persons employed in performing an obligation without the possibility of exculpation. Furthermore, the law of contract covers pure economic loss, and a claim prescribes in general according to § 195 BGB after 30 years.[232]

aa. culpa in contrahendo

One of the oldest extensions of contractual liability is the culpa in contrahendo (liability for pre-contractual contact). It was developed by von Jhering in 1861, but was not directly laid down in the BGB. However, in due course it became generally accepted that liability could be based on culpa in contrahendo (cic).[233] Today it is recognised[234] in Germany as customary law.[235]

The cic is a quasi-contractual reliance liability. This means that the basis for the liability is not an act of legal significance (Rechtsgeschäft), but the fact that a person creates a situation of

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[231] P. Gottwald '§328' in K. Rebmann & F. J. Säcker (ed.) *Münchner Kommentar zum Bürgerlichen Gesetzbuch* 2.ed. Vol. 2 (1985) Rn.60.

[232] H. Heinrichs '§328' in P. Bassenge et al (ed.) Palandt Bürgerliches Gesetzbuch 54 ed. (1995) Rn.13.

[233] The Linoleum case RGZ 78, 239 is the starting point that the cic is accepted by the German courts.

[234] BGH NJW 1979, 1983; N. Horn, H. Kötz & H. G. Leser (n163) 109.

[235] Generally the German legal system is based on a code and the main part is provided in the BGB. However, when there is a legal defect in the law, the courts are allowed to cover such defects with a legal analogy. If this analogy is used in several decisions over a long period, it will become customary law. [K. Larenz *Allgemeiner Teil des Deutschen Bürgerlichen Rechts* 5 ed. (1980) 10].

reliance (Vertrauenstatbestand) on that the other party is actually relied on. Why this legal institution is necessary can be explained with the following example: B wants to buy a car from S and takes it for a test drive. Due to the fault of S, the car has a break-down in a deserted area; B's only option is to order a taxi to take him back to S's garage. B has no contractual claim against S as no contract has been concluded at that stage. B also does not have a delictual claim, as the cost of the taxi - an instance of pure economic loss - does not fall within the protective ambit of § 823 I BGB, neither has a statute with a protective purpose been violated (§ 823 II BGB) and S did not cause B's loss intentionally in a manner that is in conflict with the *boni mores* (§ 826 BGB).[236]

As it is not any social contact that leads to a contractual liability, the German courts allow a claim on the basis of cic only under specific circumstances.

Firstly, a relationship based on reliance has to exist . Such a relationship exists if parties are actually involved in negotiations,[237] - for example, as in the earlier example where B and S are negotiating the sale of a car. However, a relationship based on reliance does not only exist when the parties are actually in negotiations. It could, for instance, exist at an earlier stage, such as when a person enters a store, since the business contact is taken to begin at that stage.[238] However, mere social contact and geographical proximity are not sufficient to imply the existence of a relationship based on reliance. Thus, in a case where a person who enters a shop to warm himself and then suffers damage, no relationship based on reliance is believed to exist.[239] A relationship based on reliance also in cases where parties have concluded a contract that was invalid or where parties are involved in a permanent business contact.[240]

Secondly, the perpetrator must violate a duty of care arising from the relationship based on reliance. A number of duties of cares exist which can arise from relationships based on reliance. There exists, for example, the duty of care that during contract negotiations no party should suffer damage to his property, body or wealth. In the earlier example of the car sale, for instance, the seller violated this duty of care, because the car broke down due to a fault of the seller, with the consequence that B suffered loss to his wealth by taking a taxi at his own costs to S's garage. An other duty of care is duty to provide clarification (Aufklärungspflicht). This duty of care was violated in a case where the seller of some land negligently neglected to tell the purchaser, who was a foreigner and was not well acquainted with the German law system,

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[236] Example from H. Brox *Allgemeiner Schuldrecht* 21 ed. (1993) Rn.55, translated by W. Freiherr Raitz von Frentz (n3) 138.
[237] BGHZ 6, 333.
[238] BGHZ 66, 54.
[239] BGH NJW 1974, 1503.

that the contract needed notarial recording. This resulted in the contract being invalidated and the purchaser being unable to begin building - with the result that he lost a large sum of money, because he was unable to finish the building in time.[241] There also exists the duty not to end contract negotiations without reason, after one party has given the other party reason to be confident that the contract will be concluded.[242] This duty was violated in a case where an employer denied an applicant a job, although he seriously offered the applicant the advertised job, with the result that the applicant discontinued his old employment, relying on the fact that he had found new employment.[243] A further duty of care is the legal duty to maintain safety. This duty of cares includes, for example, the duty of a shop-owner for his shop to be in such a condition that nobody suffers damage in it.[244]

There are a number of other duties of care. However, these four are the most important ones.

The third requirement of the cic is that the perpetrator must have violated the duty of care, at least negligently. Without fault there would be no liability in accordance with the cic.

Finally, the application of the doctrine cic requires that there is a loophole in the BGB, because it is only customary law. A loophole does not exist, for example, in cases where the violation of the pre-contractual duty consists in a delay of performance (§ 286, 326 BGB) or due to a supervening impossibility (§§ 323-325 BGB) or when the provisions of male performance are applicable (§§ 459-481 BGB).

bb. The contract with protective ambit towards a third party

Another legal institution which is an extension of the contractual liability in the field of the law of delict is the contract with protective ambit towards a third party. This legal institution extend the protective ambit of a contract which is concluded between other parties. The expansion of the contract does not cover the right to performance. According to the contract with protective ambit towards a third party the creditor is the only one who has a right to performance, but the third party comes under the protective umbrella of the contract concluded between the debtor and the creditor.[245] When a contractual duty has been violated the third party gets, besides the delictual claim, a contractual claim.[246] The advantage of the contract with protective ambit towards a third party is that it is a contractual claim with the advantage, that §

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[240] BGH NJW 1974, 456; P. C. Müller-Graf *Die Geschäftsverbindung als Schutzpflichtverhältnis* JZ 1976, 153.
[241] BGHZ 99, 106.
[242] BGHZ 71, 395; BGH ZIP 1988, 88 (90).
[243] BAG DB 1974, 2060.
[244] *Linoleum case* RGZ 78, 239; BGH NJW 1962, 31.
[245] B. S. Markesinis 2 ed. (n161) 55; B. S. Markesinis 2 ed. (n161) 358.
[246] H. Heinrichs (n232) Rn.13

278 and195 BGB and not § 831 BGB and § 852 BGB are applicable and as stated earlier the law of contract covers pure economic loss. The following case -the *gas meter case*[247] - which was one of the first cases where the legal institution was applied will show why this legal institution is necessary in the German law: The plaintiff K acted as daily help to the widow M. M employed the defendant firm B. & R. to move the gas meter in the bathroom of her new dwelling. The firm instructed B to do this job for M. After the work was done, K noticed a smell of gas in the dwelling. She went to the gas burner and wanted to light it with a match. The leaking gas was set alight and K was badly injured. The escape of gas resulted from a loose overflow screw on the meter. The screw had been installed by S. K sued against B. & R. and against S. There was no contract between K and S or B. & R. Thus, K had to base her claim on the law of delict. A claim against S on the basis of § 823 BGB was not successful, because S did not have enough money to pay K compensation and the claim against B. & R. on the basis of the law of delict was dismissed, because the firm was able to exculpate themselves in accordance with §831 BGB (vicarious liability). Thus K would not get any compensation. However, the Reichsgericht decided that K was included in the protective ambit of the contract with the consequence that she could base a claim against B. & R. on the law of contract and so B. & R. had to pay compensation.

Originally the legal basis of the contract with protective ambit towards a third party was §328 BGB, the contract in favour of a third party.[248] This contract allows the third party to require performance of the contract concluded between the creditor and the debtor.[249] In general in cases of the contract with protective ambit towards a third party, the third party does not have a right of performance. However, this is one of the main requirements of the contract in favour of the third party.[250] This was the reason that the dominant opinion[251] followed the idea of Larenz[252] that the contract with protective ambit towards a third party is an Institution sui generis. The legal basis of the contract with protective ambit toward a third party in the BGB is controversial, today. Some authors are of the opinion that § 242 BGB (performance according to good faith)[253] is the basis of this institution while the courts[254] and other authors[255]

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[247] RGZ 127, 218, translated in B. S. Markesinis *A Comparative Introduction to the German Law of Tort* (1986) 444 - 448.
[248] W. Freiherr Raitz von Frentz (n3) 160.
[249] B. S. Markesinis 2 ed. (n161) 55.
[250] H. Heinrichs (n232) Rn.2; P. Gottwald (n231) Rn.61.
[251] BGHZ 49, 353; BGH NJW 1959, 1676; W. Lorenz *Die Einbeziehung Dritter in vertragliche Schuldverhältnisse* JZ 1960, 108; P. Gottwald (n231) Rn.61.
[252] K. Larenz *Anmerkung* NJW 1956, 1193.
[253] P. Gottwald (n231) Rn.62; H. Dahm *Vorvertraglicher Drittschutz* JZ 1992 1168; K. Larenz *Lehrbuch des Schuldrechts Vol. I Allgemeiner Teil* 12 ed (1979) 190.

are of the opinion that § 157 BGB (interpretation of contract) is. Those who hold the view that §242 BGB forms the legal basis argue, in my opinion correctly, that if §157 BGB is the legal basis, the legal institution would be applicable only in a contractual relationship. The Federal Supreme Court itself decided in the lettuce-leaf case[256] that the contract with protective ambit towards a third party is applicable in a pre-contractual relationship, too. However, this controversy is not very important, because both opinions have the same requirements and, in general, come to the same results.[257]

A protective ambit of a contract can flow out from any kind of contract.[258] Since the *testament case*[259] it covers not only damage to property or body, it also covers economic loss. Furthermore, the protective ambit of a contract is no longer restricted to loss that results from inadequate performance, for example, the breach of a secondary obligation like duties of care or duties of correct information; it also covers damage resulting from failure to perform, for example the breach of a primary obligation.[260] In the *testament case* a man wanted to make a will in favour of his daughter. He instructed his lawyer to draw up a will. The lawyer undertook to draw up the will and to bring a notary. The client and his daughter phoned the lawyer four times without success. The client died and the daughter D had to share the inheritance with her niece. D sued against the lawyer for compensation for her lost inheritance. The court decided that the daughter D should be compensated by the lawyer because of his culpable omission. The Federal Supreme Court based this judgement on the contract concluded between the testator and the lawyer, which was held to have protective ambit towards the disappointed heir, the daughter D. The reason for the court to include D in the protective ambit was that it was foreseeable for the lawyer that a third person, D, would benefit under the contract concluded between him and the creditor. The court stated expressly that the contract with protective ambit toward a third party covers failure of performance only in those cases where it is clear from the beginning of the contract concluded between the debtor and creditor, that a third party will benefit without a claim of performance (drittbezogenheit des Vertrages). In the *divorce case*[261] the court strengthened this judgement by highlighting this point. In this case a father F went to an attorney to make a divorce settlement with his wife M. The divorce settle

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[254] BGH NJW 1977, 2073 (2074); BGH NJW 1984, 355 (356);
[255] H. Heinrichs (n232) Rn.14.
[256] BGH NJW 1976, 712 translated in B. S. Markesinis 2 ed. (n161) 434. This decision is generally accepted in the jurisprudence [H. Dahm (n253) 1170; H. Heinrichs (n232) Rn.15]
[257] H. Heinrichs (n232) Rn.14.
[258] H. Heinrichs (n232) Rn.15.
[259] BGH NJW 1965, 1955.
[260] BGH NJW 88, 200; W. Freiherr Raitz von Frentz (n3) 161-162.
[261] BGH NJW 1977, 2073.

ment stated that the children of M and F would get the house without any claim of their parents. Because of a mistake by the attorney the mother did not lose her claim and the children were not the only owner of the house. The Federal Supreme Court accepted that the plaintiff, one of the children, was included in the protective ambit of the contract between the father and the attorney. However, the court determined that this case is not a typical case of the contract with the protective ambit towards a third party, because it is not a breach of a secondary obligation it was a breach of a primary obligation and is generally not covered by this legal institution. *Thus the fact that third parties have an interest in what an attorney does will not normally lead to any extension of his liability, even if those persons are named or known to him. However, an exception must be made where a contract drafted by the attorney is to vest rights in third parties specified therein, especially third parties who, as in the present case, are represented by the client.*[262] These were the reason for including the children in the contract concluded between the father and the attorney.

However, as stated earlier, the contract with protective ambit towards a third party is not only applicable in contractual relationships. Since the lettuce-leaf case[263], where a mother went shopping with her daughter and the daughter slipped on a lettuce leaf and was badly injured, it has been established, that this legal institution is also applicable in a pre-contractual relationship[264], where a close relationship exists.[265]

As stated earlier the contract with protective ambit toward a third party is an expansion of contractual liability. In German law the principle of contractual privity is as firmly established as it is in the Common Law.[266] It is for this reason that the expansion of the contractual liability must be kept under control lest it completely undermine the relativity of the contractual bond. Therefore the number of persons who come under the protective umbrella of a contract

[262] BGH NJW 1977, 2073 translated by Tony Weir as cited in B. S. Markesinis 103 LQR (n156) 363.
[263] BGH NJW 1976, 712 translated in B. S. Markesinis 2 ed. (n161) 434.
[264] Pre-contractual compensation has to be paid according to culpa in contrahendo [A brief presentation is found in N. Horn, H. Kötz & H. G. Leser (n163) 107-109].
[265] H. Dahm (n253) 1170; H. Heinrichs (n232) Rn.15.
[266] B. S. Markesinis 2 ed. (n161) 55; K. Larenz (n235) 200.

has to be limited.[267] The jurisdiction and the courts developed four requirements to limit the number of persons who come under the protective umbrella of a contract concluded between a creditor and a debtor.[268] They are:

- proximity of performance (Leistungsnähe)
- that the creditor must have a legitimate interest in the protection of the third party (Gläubigerinteresse)
- that the proximity of performance of the third party and the interest of the creditor must be foreseeable to the debtor at the time of contractual conclusion (Vorhersehbarkeit)
- and at least the third party must be in need of protection

According to § 305 (the freedom of contract), a third party can be included in a contract by agreement. In such cases the four requirements do not apply, because in those cases a limitation of people who are included into the contract is not necessary.[269]

(1). proximity of performance

Firstly there has to exist a proximity of performance to the third party.[270] This means that the third party typically comes into contact with the performance of the debtor.[271] An accidental contact with the performance is not enough.[272] For example, a person who visits a patient in hospital is not included in the contract concluded between the hospital and the patient, because the visitor does not typically come into contact with the performance of the hospital.[273] Persons who typically stand in contact with the performance of a debtor are, for example, in a contract of tenancy, members of the family of the lessee;[274] or a child going shopping with her mother in the sales contract concluded between the mother and the shop[275]. Moreover, a third person can be included in a lawyer[276] or valuer[277] contract, when the third person is a subject

[267] B. S. Markesinis 103 LQR (n156) 359
[268] BGH NJW 1965, 1955; BGH NJW 1978, 883; P Gottwald (n231)Rn.67-71a.
[269] W. Freiherr Raitz von Frentz (n3) 163.
[270] D. Medicus Schuldrecht I Allgemeiner Teil (1981) 319.
[271] BGH NJW 1968, 885 (887).
[272] P Gottwald (n231)Rn.68.
[273] BGH NJW 1951, 596 translated in . B. S. Markesinis 2 ed. (n161) 438.
[274] BGH NJW 1968, 885 (887).
[275] BGH NJW 1976, 712.
[276] BGH NJW 1965, 1955; BGH NJW 1977, 2073 (2074).
[277] BGH NJW 1984, 355.

of the contract. In the above mentioned divorce case[278] for example, the court found that the children were a party that was typically exposed to the danger of a malperformance, because the maintenance of the children was the subject of the contract.

(2). The creditor must have a legitimate interest in the protection of the third party

The second requirement is that the creditor must have a legitimate interest in the protection of the third party.[279] Originally the jurisdiction only accepted a legitimate interest of the creditor in the protection of the third party, when there existed a close relationship between himself and the third party (personenrechtlicher Einschlag). Such close relationship existed only when the creditor was responsible *for better or for worse* (Wohl und Wehe) for the third party.[280] In other words he was responsible for the welfare of the third party.[281] Particularly this was the case, when the creditor was himself under a duty of care towards a third party. Thus, parents are responsible for the well-being of their children (§1626 BGB) and employers for the safety of employees (§618 BGB).[282] The responsibility of the employer for the safety of his employee was, for example, the close relationship between the old lady and her maid in the gas meter case[283] and in the divorce case the responsibility of the father for the well-being of his children[284].

The narrowly drawn circle of persons who are entitled to enjoy the protective effects of a contract has been abandoned by the Federal Supreme Court. Today the Federal Supreme Court has recognised that such a personal relationship is not necessary for the extension of contractual liability. In the *Valuer case*[285] the court stated ...*It is true that in several instances the Federal Supreme Court, in deciding whether a certain person is owed a duty of care by virtue of a contract, has examined whether the other contracting party, to whom the duty of care was owed, was in charge of that person 'for better or for worse'. These decisions must not, however, be interpreted in the sense that the Federal Supreme Court affirmed the legality of this*

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[278] BGH NJW 1977, 2073 (2074).
[279] D. Medicus (n270) 319; P. Gottewald Rn.69.
[280] RGZ 127, 218 as mentioned above (n2); BGH NJW 1969, 269; BGH NJW 1971, 1931; BGH NJW 1976, 712.
[281] H. P. Westermann '§328' in W. Erman (ed.) *Handkommentar zum Bürgerlichen Gesetzbuch* 7 ed. (1981) Vol. 1 Rn.12; H. Heinrichs (n232) Rn.17.
[282] H. Dahm (n253) 1168; P Gottwald (n231)Rn.69.
[283] RGZ 127, 218 see footnote 2.
[284] BGH NJW 1977, 2073 (2074).
[285] BGH NJW 1984, 355.

type of contract only in these circumstances. Instead they only concern the question in what circumstances the objective interest involved permit the conclusion that the parties have implicitly stipulated a duty of care towards third parties...[286].

According to this decision, it can be recognised that if the creditor is responsible for the welfare of the third party, the objective interest indicates the inclusion of the third party into the contract. However, if the creditor is not responsible for the welfare of the third party, other indicators may exist which show that the third party is included into the contract.

The move, by the Federal Supreme Court, away from the narrowly drawn circle of persons who are entitled to enjoy the protective effects of a contract started in the end of the 60's in the tenant cases.[287] In these cases the third party stored furniture in a building which the creditor rented from the debtor, subject to the condition that the creditor to take care for the furniture. Because of a defect in the building the furniture was destroyed. The Federal Supreme Court decided in these cases that a personal duty of care was not necessary to justify a legitimate interest between the creditor and the third person. Such interest was justified by the duty of the creditor to exercise proper care of the furniture of the third person in accordance with the condition.

The greatest move away from the requirement of a personal relationship was made in the *Lastschriftent case*[288] (debit advice case).[289]

The facts of the case were as follows: The plaintiff K sold limestone to F who agreed that his bank V (the defendant) would pay submitted invoices by directly debiting the account of F. K presented, through his bank X, at five different dates, invoices for goods delivered to F. None of these invoices were paid since the account of F was overdrawn. Soon after F received the last goods he was declared bankrupt. When F was declared bankrupt, K realised that F had not paid his invoices. K sued against V on the grounds that if V had returned the unpaid invoices promptly he would have made no further deliveries to F. In the view of the court the debiting agreement did not create a direct contractual relationship between V and K. However, there was a separate agreement between K's bank and V *to notify each other promptly of any non-payment of presented invoices that exceeded a certain amount.*[290] Under this agreement K got a contractual claim against V, because in the view of the court he was included in the protective ambit of the agreement.

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[286] BGH NJW 1984, 355 translated by K. Lipstein as cited in B. S. Markesinis 103 LQR (n156) 365.
[287] BGH NJW 1968, 885; BGH NJW 1970, 419.
[288] BGHZ 69, 82.
[289] B. S. Markesinis 103 LQR (n156) 366.
[290] BGHZ 69, 82 translated by K. Lipstein as cited in B. S. Markesinis 103 LQR (n156) 367.

The court stated that generally according to the requirement of a personal relationship this requirement should be interpreted narrowly. However, a narrow interpretation is unnecessary *where - as in the present case- bulk transactions of a certain type are in issue which follow a uniformly practised procedure provided on a general scale for legal transactions based upon the confidence that they will be settled properly and with due regard for the interest involved. In these circumstances the inclusion of third parties in the protective sphere of the contractual relations in issue may be possible and indicated according to good faith, if the mechanism entails for the third party who employs it certain risks inherent in it and if the participants charged with handling the mechanism can be called upon without further discussion to keep the risk down. Such is the case in so far as in direct debit proceedings the debtor bank must return invoices because the payments cannot be made in the absence of funds.*[291] The Banks X and V had an agreement to return invoices if a payment was not possible due to a lack of funds. The Federal Supreme Court held that this agreement had been adopted primarily in the interest of the bank X. However, the interest of X in the protection of K is justified in the contractual relationship and in the interest of having a liquid customer.

On the basis of this decision it can be argued that the Federal Supreme Court no longer insists on a 'personal relationship' between the creditor and the third party. This was the main criticism of academic writers against this decision. In their opinion it was an *ex aequo et bono* decision, which makes the jurisdiction unpredictable.[292] Despite the criticism the Federal Supreme Court has not changed its decision in the cases of bulk transaction[293] and has extended the scope to adviser cases, too.[294] Generally there is a tendency to enlarge the group of protected persons[295] and to abandon the principle *for better or worse*.[296] Today, except in the cases of bulk transaction the requirement that the creditor must have a legitimate interest in the protection of the third party can be defined as follows: A creditor has a legitimate interest if he is responsible for the welfare of the third person or if the performance has a tendency to be in favour of the third party.[297]

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[291] BGHZ 69, 82 = NJW 1977, 1916 translated by K. Lipstein as cited in B. S. Markesinis 103 LQR (n156) 367.
[292] H. Berg *Zur Abgrenzung von vertraglicher Drittschutzwirkung und Drittschadensliquidation* NJW 1978, 2018; D. Medicus *Bürgerliches Recht* 16 ed. (1995)Rn.842; J. Sonnenschein *Der Vertrag mit Schutzwirkung für Dritte - immer neue Fragen* JA1979, 230.
[293] BGH NJW 1979, 542; BGHZ 96, 17.
[294] BGH NJW 1984, 355; BGH NJW 1987, 1758; H. Dahm (n253) 1168.
[295] B. S. Markesinis 103 LQR (n156) 363.
[296] BGH NJW 1982, 2431; BGH NJW 1983, 1053.
[297] H. Heinrichs (n232) Rn.17.

(3). The proximity of performance of the third party and the interest of the creditor must be foreseeable to the debtor at the time of the contract conclusion

The third requirement is that the proximity of performance of the third party and the interest of the creditor must be foreseeable to the debtor at the time of the conclusion of the contract.[298] The reason for this requirement is that the debtor must have been in a position to know what kind of risk he was exposing himself to.[299] However, foreseeability does not mean that the debtor has to know the name of the third party. Duties of care can, according to the contract with protective ambit towards a third party, be created in favour of those persons who are not mentioned by name.[300] It is also not necessary that the debtor knows the exact number of persons to whom a duty of care is owed. It suffices if he knows an approximate number.[301] Furthermore it is not necessary to mention that a third party is included in the protective ambit. It is sufficient that the debtor is aware of the possibility that a third person may be included in the contract.[302]

According to this requirement, especially the cases of negligent interruptions of supply of water or electricity fall out of the contract with protective ambit towards a third person, because in such cases the debtor cannot foresee how many third persons are included.[303] This applies to product liability, too.[304] However, it is not only in these cases that a protective ambit does not exist due to unforeseeability. In the above mentioned *Valuer case*[305] the Federal Supreme Court decided that the debtor could not have foreseen that a third person was included in the contract. Before taking a look at the arguments of the Federal Supreme Court we have to take a look at the facts of the case.

The facts of the case were as follows: the defendant B, a professional valuer of land, was asked by the businessman S to advise him on the value and rental income of a particular building. S gave his instructions at a meeting attended by the banker L and the plaintiff K, who subsequently bought the building. It was not clear if B knew that S and K were intending to purchase the building jointly. A letter that B wrote to another businessman stated that B believed that S had probably made the inquiry on behalf of a consortium interested in purchasing the building. However, there was a consortium behind S, K was not a part of it. K

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[298] BGH NJW 1984, 355; BGH NJW 1985, 2411; H. P. Westermann (n281) Rn.12
[299] P. Gottwald (n231) Rn.71.
[300] BGH NJW 1984, 355 translated by K. Lipstein as cited in B. S. Markesinis 103 LQR (n156) 364.
[301] P. Gottwald (n231) Rn.71.
[302] BGH NJW 1984, 355
[303] P. Gottwald (n231) Rn.71.
[304] Ibid.
[305] BGH NJW 1984, 355.

signed a contract of sale. S and his consortium decided not take part in it. After the contract had been signed it was discovered that the valuation of B concerning the building did not take into account that some of the flats in the building were subject to rent control restriction. On this basis K decided to withdraw. As a result he lost a lot of money. K sued against B, for his economic loss. The Federal Supreme Court decided, as stated earlier that the requirement of proximity of performance and the legitimate interest of the creditor were given, but both requirements were not foreseeable for the debtor B. The court held that it is not necessary that the debtor *should know the exact number of persons whom the duty of care is owed,*[306] but the debtor must know to whom he owes a duty of care. In this case B exercised his expertise for S and his consortium. It was not foreseeable to him that persons who were not a part of the consortium would also base their knowledge on the expertise.

According to this decision it can be concluded that the Federal Supreme Court in general interprets the requirement of foreseeability generously. However, the Federal Supreme Court presuppose that the debtor knows roughly the parties to whom he owes a duty. In the *Valuer case* he knew about S and his consortium, but not that K also would base his conduct on the expertise.

(4). The third party must be in need of protection

The last requirement is that the third party must be in need of protection.[307] The third party is not in need of a protection if he has an own contractual claim against the creditor.[308] However, the contractual claim against the creditor must be similar to the claim against the debtor.[309] If the third party, for example, has a claim against the creditor for defect of quality, he cannot have the same claim in accordance with the contract of protective ambit toward a third party too, because he is not in need of protection. He has an own and similar claim against the creditor.

The facts of the case where this requirement was developed were as follows: The company K rented two warehouses from B. C rented one of the warehouses from K and stored. After heavy rain, the warehouse was flooded and the furniture was destroyed. C sued against B for compensation on the basis of the contract with protective ambit toward a third party. The Federal Supreme Court denied the claim.[310] The court doubted whether C was included into

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[306] BGH NJW 1984, 355 translated by K. Lipstein as cited in B. S. Markesinis 103 LQR (n156) 364.
[307] BGH NJW 1978, 883; H. Heinrichs (n232) Rn.18; W. Freiherr Raitz von Frentz (n3) 166.
[308] P. Gottewald (n231) Rn.71a.
[309] J. Sonnenschein (n292) 229.
[310] BGH NJW 1978, 883.

the contract between B and K, but left the question open. The court stated that the contract with protective ambit towards a third party has its roots in the principle of good faith and its basic idea is to give a person who is in need of protection an own contractual claim. A person is only in need of protection, if he comes typically and in the same way as the creditor into contact with the performance of the debtor, but has no contractual claim of compensation. The aim is to prevent for inequitable results which exist because of loopholes. However, in this case the third party had an own contractual and a similar claim against his creditor K.
Despite the criticism in the literature[311] the Federal Supreme Court did not drop this requirement.[312]

cc. Liquidation of a third party's damage

In general, compensation for damages is granted in the law of contract only to those people who are parties of the contract or who are included in the protective ambit of the contract; and according to the law of delict, only those people are entitled to recover damages if their rights or legal interests are violated. In cases where a third person suffers damage as a result of the infringement of the rights of another person, generally the third person has no claim against the wrongdoer, because it is only an indirect loss. For example, when a concert cannot take place because the main singer has been injured, the promoting agency would have no claim for compensation of its pure economic loss against any person who may have injured the singer accidentally.
The principle that no compensation will be paid in cases of indirect economic loss, sometimes leads to inequitable results, as the following example illustrates[313]: A bought some goods from B. On the way to A, the goods were negligently destroyed by the transport company. In this case, neither A nor B could claim compensation. The reason for this is that according to the law of delict, A has no right to compensation because, as stated earlier, § 823 I BGB protects only absolute rights such as property, life or health and not relative rights such as contractual obligations. During transportation the purchased goods were, however, still the property of B, because ownership would only be transferred at the moment of delivery to the purchaser (§ 929 BGB). A also had no claim on the basis of the law of contract against the transport company, because there was no contractual relationship. B, who was still the owner of the goods could also not base a claim according to § 823 I BGB, because he had suffered no loss. The

[311] H. Berg (n292) 2019; D. Medicus (n292) Rn.842.
[312] BGH NJW 1993, 655.
[313] Example from RGZ 62, 331 (*Dispatch-sale case*).

reason for this was that A had to pay B the goods, because according to the law on sales, the risk of payment passes to the purchaser as soon as the seller - in this case B - has delivered the object to the forwarder, freighter, or other person or institution designated to carry out the transmission. This is also the reason why B had no contractual claim against the transport company. Consequently, the defaulting party may never face the consequence of his negligent conduct. In order to circumvent such inequitable results, the German courts[314] and the majority of the German jurisprudence[315] accepted that in certain circumstances someone can claim to have loss compensated which was not actually suffered personally, but which was suffered by a third person. This legal construct is referred to as liquidation of a third person's loss or doctrine of transferred loss (Drittschadensliquidation).[316] The liquidation of a third person's loss is not only an expansion of contractual liability, it is also an expansion of the delictual liability, because this legal institution is applicable in the law of contract and delict. Although it is applicable in both, it is regarded as a quasi-contractual liability, because a contractual relationship between the person who suffered indirect loss and the third person has to exist.[317] The proceeding of this legal institution is the reverse of the proceeding of the contract with protective ambit towards a third party, where the right to an action gets transferred to the damage; here the damage gets transferred to the right to an action.[318] In the above mentioned case, this would mean that the loss of A would be transferred to B's claim which he had either in delict or in contract. Thus, B would be allowed to liquidate the loss of A.[319] The doctrine of transferred loss should neither enlarge the number of plaintiffs against the tortfeasor, nor should it enlarge the number of damages which would have to be compensated, because this would lead to an unacceptable expansion of liability. In order to keep the liability within limits, the doctrine of transferred loss provides that damages of a third party have to be compensated, if they would have typically emerged in the person who has the right to an action - a title - but are, in the wake of certain circumstances, occurred only by the third person.[320] The courts have developed different categories of cases in which this would happen:

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[314] RGZ 62, 331; BGHZ 40, 100; BGH NJW 1970, 38; BGH VersR 1979, 906.
[315] Ries *Grundprobleme der Drittschadensliquidation und des Vertrages mit Schutzwirkung zugunsten Dritter* JA 1982, 453; H. Brox (n236) Rn. 324; H. U. von Schröter *Die Haftung für Drittschäden* Jura 1997, 343.
[316] W Lorenz & B. S. Markesinis *Solicitors Liability Towards Third Parties* (1993) 56 MLR 562; B. S. Markesinis 103 LQR (n156) 369.
[317] B. S. Markesinis 3.ed 55; W. Freiherr Raitz von Frentz (n3) 167.
[318] H. U. von Schröter (n315) 344.
[319] In praxis B would not directly sue against the tortfeasor. B would assign his claim to A and A would then sue against the tortfeasor. This assignment would will be ordered by law. Compare § 281 BGB. [H. Brox (n236) Rn.324.].
[320] B. S. Markesinis 103 LQR (n156) 369; H. U. von Schröter (n315) 345.

(1). Shift of a loss as a consequence of a statutory rule concerning the burden of risk

The first category is made up of those cases where the loss shifts to a third party as a result of a statutory rule concerning the burden of risk. A typical situation in this category is the above mentioned case of the dispatch-sale. In this case, the Reichsgericht decided that a claim could be based on the doctrine of transferred loss, because in the opinion of the Reichsgericht it is unacceptable that the defaulting party benefits from the fact that the loss has been shifted from the creditor to the third party.[321]

Another case where the loss shifts to a third party as a result of a statutory rule concerning the burden of risk, is the following case, decided by the Federal Supreme Court[322]: U, a firm of specialist flooring contractors, had laid a floor in a survey room for B. After the work was finished, but before B accepted it, S who was a worker for another company carrying out workt at the survey room negligently set fire to the building, with the consequence that U's work was destroyed. In this case, neither U nor B could claim compensation without the doctrine of transferred loss. The reason for this is that according to § 644 I BGB the contractor bears the risk of destruction until acceptance of the work. Thus B was not thought to suffer any damage because U was still obliged to lay a floor and U, due to this fact, suffered economic loss. However, B was already the owner of the laid floor, according to § 946 BGB[323], thus U did not have a delictual claim (823 I BGB) against S and there was no contractual link which could provide duty of compensation upon S to U. B did not suffer the damage concerning the floor but had a delictual (823 BGB) and probably a contractual claim against S. In this case, the Federal Supreme Court also decide, however, that the doctrine of transferred loss was applicable. The reason was the same as in the *dispatch-sale* case.

(2). Care-keeping cases

A further important category is that of the care-keeping cases. Here, the legitimate possessor of an object can claim compensation for the owner of the object against the tortfeasor. A typical situation is the following example:[324] A borrowed a picture from B. During the restoration of A's house, the picture was destroyed by the insolvent S who worked 10 years without faults by C. A had no claim against C or S, for the reason that he had no loss. Firstly because the

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[321] RGZ 62, 331 (335); BGHZ 40, 91 (100) with similar facts.

[322] BGH NJW 1970, 38.

[323] §946 [Connection with a piece of land].
If a movable thing is so joined to a piece of land that it becomes an essential component part of the piece of land, the ownership of the land extends to that thing. [Translated by I. S. Forrester S. L. Goren & H-M. Ilgen *The German Civil Code* (1975)].

[324] Example from H. Brox (n236) Rn.326.

loss of the use of the picture was not a recoverable loss and secondly he was, according to § 275 I BGB[325], not obliged to give the picture back and so he was not obliged to pay compensation by B for the picture. According to a delictual claim of B against C (§ 823 BGB), C was able to give evidence that he had exercised necessary care in the selection of the employee and has exercised ordinary care regarding the supply and supervision in accordance with §831 I BGB. Thus, C could not be held liable in terms of the law of delict. B would have had to claim in delict against the employee, however, he was insolvent. In order to prevent such a result, the major opinion allowed a claim against C on the basis of the doctrine of transferred loss.[326]

(3). Indirect representation

The third and last category is that of indirect representation. In a case of indirect representation the representative does not act not in the name of another. He acts in his own name, but on account of another. Consequently, the representative is involved in the contract and not the represented person. This can have the consequence that the represented person suffers a loss, without having a claim, as the following case, which was decided by the Reichsgericht illustrates:[327] B, in his own name, bought vegetables from S on the instruction and account of T. Here, there was no direct legal relationship between S and T. S came into delivery-default, with the consequence that T suffered a loss. T could neither claim compensation on the basis of contract, because there is no contract between him and S, nor could he base his claim on the law of delict, because no right of § 823 I BGB had been infringed. B also had no claim against S, because he has no loss. As a result of this, S would not face the consequence of his negligent conduct. The Reichsgericht decided in this case to apply the doctrine of transferred loss with the following arguments: if B had been a direct representative of T, T would be party of the contract and thus had the potential to claim compensation against S. In a case of indirect representation the possibility for the creditor to claim compensation also has to exist, because

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[325] § 275. [Impossibility for which one is not responsible]
'(1) The debtor is relieved from his obligation to perform if the performance becomes impossible because of a circumstance, for which he is not responsible, occurring after the creation of the obligation.' [Translated by I. S. Forrester S. L. Goren & H-M. Ilgen *The German Civil Code* (1975)].

[326] H. Heinrichs 'Vorbem. §249' in P. Bassenge et al (ed.) Palandt Bürgerliches Gesetzbuch 54 ed. (1995) Rn.116; K. Larenz Lehrbuch des Schuldrechts (n253) Vol. 1 381; W. Grunsky 'Vorbem. 249' in K. Rebmann & F. J. Säcker (ed.) *Münchner Kommentar zum Bürgerlichen Gesetzbuch* 2.ed. Vol. 3 (1986) Rn.121.

[327] Example from RGZ 90, 246.

it does not seem to be justified that the person responsible for the loss would not be held liable to make good of the loss, merely due to the particular fact of this case, that the person who actually suffered the loss did not have a title to sue.[328]

In the 140 year history of the doctrine of transferred loss, the courts refused to expand the case category. The fears of unlimited liability were too big. However, the attempts in the literature to eliminate the doctrine of transferred loss were not successful, but also the attempt to codify the doctrine was also not successful. This shows how important the doctrine of transferred loss is, but on the other hand how big the fears of an unlimited liability are.

II. Conclusion

The first chapter of this dissertation presented the field of negligently caused pure economic loss in English law. In England, the problem was tackled by extending the law of torts. The decision of the House of Lords in *Hedley Byrne* opened the door to recovery of economic loss in the tort of negligence. With this decision, a new era in the tort of negligence began. However, not all categories in the tort of negligence changed after the decision of *Hedley Byrne*: within the category of relational economic loss, for example, the courts were not prepared to allow a claim. This was different in the building cases where the courts allowed claims in the field of economic loss for a short time - which started with *Anns*, had its highest point with *Junior Books* and had an end with *Murphy*. Today, a claim in the category of building cases claiming pure economic loss would no longer be successful. This is different in the categories of professional cases and misstatement cases - where an action claiming pure economic loss is successful only if the requirements of foreseeability, proximity (special relationship) and fair, just and reasonablness are met.

The second chapter demonstrated the manner in which the German legal system deals with negligently caused pure economic loss. Firstly, the law of delict was presented. This law covers pure economic loss insufficiently. For this reason the law of delict was also expanded in Germany - by developing a new 'other right': the established and operative business. However, this legal institution is subsidiary and covers only a few cases of pure economic loss. The largest number of cases of pure economic loss are covered by the extension of the law of contract with the three legal institutions - cic, contract with protective ambit towards a third

[328] RGZ 90, 246 (248), affirmed by RGZ 115, 425; BGHZ 15, 227; BGHZ 49, 356.

party and the doctrine of transferred loss. These three legal institutions gave wealth a more comprehensive protection than the law of delict. However, also in Germany not every case of pure economic loss is covered, for example, pure economic loss is not recoverable in so-called cable cases. The reason for this is the fear of the German courts and jurisprudence, of unlimited liability. On one hand there is a tendency to open the door to cover more cases of pure economic loss, for example, in the contract with protective ambit towards a third party, where there is the tendency to enlarge the group of protected persons by no longer insisting on the requirement of 'personal relationship'. On the other hand, in the field of the doctrine of transferred loss, however, such a tendency is not noticeable in the last 60 years, the requirements have not changed and attempts to enlarge the case category were unsuccessful.

Chapter One and Two showed that a comprehensive protection of negligently caused pure economic loss does not exist in either England or Germany. Both countries, however, have developed different systems in order to give such a loss more protection. In England this has been achieved by extension of the law of torts and in Germany by extension of the law of contract. Despite the different approaches in these two countries, there are only a few differences in the outcomes of such cases. The decisions reached by the German courts are often identical to those accepted by the English courts. In order to demonstrate that the English and German legal systems render similar outcomes , brief and hypothetical examples are presented showing how some cases in the English categories would be dealt with in the German courts.

Firstly, the misstatement category is studied. In this category the English courts generally allow a claim in the field of negligently caused pure economic loss, as far as the requirements are met. A claim in this field is also allowed in Germany, as seen in the *Lastschriftent*[329] and V*aluer*[330] cases which are very similar to the cases that were decided in England in the misstatement category. However, the two systems have different requirements; in England, the requirements of foreseeablility, proximity and fair, just and reasonableness have to be met before a party can be held liable. In Germany, the misstatement cases are cases which fall in the field of the contract with protective ambit towards a third party. A liability would only arise if the four requirements proximity of performance, legitimate interest, foreseeability and need of protection are met. Although the requirements for liability are different in Germany and England, the results are in the misstatements cases are identical,[331] as the following ex

[329] BGHZ 69, 82.
[330] BGH NJW 1984, 355.
[331] Compare B. S. Markesinis 3 ed. (n159) 49.

amples will show: In the *Caparo Industries Plc. v Dickman*[332] decision, the claim was denied because there was no proximity between the defendant and the plaintiff.[333] In Germany, the claim would have been denied as well, because the audit was a general statement and so the debtor did not really know whom he owed the duty to - thus, it was not foreseeable for the debtor. In the decisions would of the House of Lords in *Smith v Eric S. Bush, Harris v Wyre Forest District Council*[334], where the plaintiffs lost a large sum of money, because of a wrong, the House of Lords allowed the claim for recovery of pure economic loss.[335] In this case, the value was not made for a general statement, thus it was foreseeable for the valuers and so they were liable. The two systems are also similar in their outcomes in the field of professional negligence, for example, the German *Testaments case*[336] is factually similar to the *White and another v Jones and others* case[337] and the *Ross v Caunters* case[338]. In these three cases, the defendant solicitor had negligently delayed in preparing a will for his client, with the result that the latter died before the new will could be executed and the plaintiff lost the benefit she would have received under it. Both the English and German courts allowed the plaintiff's claim. In the field of the building cases there are also no differences in the outcomes. The *Murphy* case, for example, would be decided on the basis of state liability, Article 34 GG in connection with § 839 BGB, in Germany, because the checking of building plans is a public task.[339]. State liability does covers pure economic loss, but not in a case like *Murphy*, because liability is excluded by law - for example, in Hessia by § 57 of the Hessian Building Act[340] that provides that the state is not liable for the checking of building plans.[341] *Junior Books* would be decided in accordance with the private law. The House of Lords allowed the claim of the defendant in this case, but this decision was taken before *Murphy*. Whether or not the House of Lords would allow the claim today is doubtful;[342] it is likely that they would deny the claim, because the whole decision is based on *Anns*, which was overruled by *Murphy*. In Germany, a claim would be denied in a case like *Junior Books*. Neither is it a case of transferred loss, because it does not fall into one of the categories, nor is it a case of cic, because it is a three person relationship, furthermore, nor is it a case of the contract with protective ambit

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[332] 1990 2 AC 605 (HL).
[333] See discussion of the case page 9; compare B. S. Markesinis 3 ed. (n159) 49.
[334] 1990 1 AC 831 (HL).
[335] See discussion of the case page 10.
[336] BGH NJW 1965, 1955.
[337] 1993 3 All ER 481 (CA).
[338] 1980 1 Ch 297.
[339] Compare Hessisches Bauordnung § 60 as cited in E. Fuhr & E. Pfeil (n227) No.168.
[340] As cited in: E. Fuhr & E. Pfeil (n227)No.168.
[341] Other Bundesländer have a similar provision.

towards a third party, because there is no need of protection. The plaintiff was not in a need of protection, because he had the potential to sue against his contract partner, the building company. Even if the building company had folded, *Junior Books* would not have been in need of protection, because they had a claim. That the claim was not enforceable is immaterial - this is the business risk of a company.[343]

Relational economic loss is the last category to be discussed. In this category, the English courts denied a claims for negligently caused pure economic loss in general, except in the decision in *Morrison Steamship C. Ltd. v Greystoke Castle Cargo Owners*[344] in 1947 - which remained an exception. In Germany, there are some areas in the field of relational economic loss where a claim will be allowed, but there are also some areas in this category where a claim will be not allowed. For example, in the so-called cable cases, the German courts denied a claim for compensation. The German courts would also deny the claim in a case like the *Weller &Co. and another v Foot and Mouth Disease Research Institute*[345] the German courts would deny the claim. This cases is neither a case of the doctrine of transferred loss, because it does not fall into one of the categories, nor is it a case of a contract with protective ambit towards a third party, because no contract existed. In such cases as *Margarine Union GmbH v Cambay Prince Steamship Co. Ltd.*[346], or the *Leigh and Sillavan Ltd. v Aliakmon Shipping Co. Ltd.*.[347], however, the German courts would allow a claim. These cases - where the goods were destroyed in a transit after the risk, but before the ownership had passed to the buyer - are classical cases of the doctrine of transferred loss. Both cases fall into the first category where the loss shifts to a third party as a result of a statutory rule concerning the burden of risk.[348] The question that arises at this stage, is whether or not such a result is desirable. In my opinion, the result of the German courts in this field is desirable. The main argument against the recovery of pure economic loss is the danger of unlimited liability. However, this danger does not exist in such cases, because the doctrine of transferred loss neither enlarges the number of plaintiffs against the tortfeasor, nor does it enlarge the number of damages which have to be compensated. The doctrine of transferred loss only avoids the undesirable result that a person does not face the consequence of his negligent conduct. The rule that the risk passes to the creditor during the transport, is basically to protect the debtor, and thus, a person

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[342] Compare D. Hutchison (n8) 29.
[343] J. Sonnenschein (n292) 230.
[344] 1947 AC 265 (HL).
[345] 1966 1 QB 569.
[346] 1969 1 QB 219.
[347] 1986 1 AC 785 (HL).
[348] Compare B. S. Markesinis 3 ed. (n159) 54.