Federal Court of Justice and Expert Liability Towards Third Parties: Public Safeguard and Private Interest

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[1] On June 26, 2001 the *Bundesgerichtshof* (Federal Court of Justice) handed down a new decision regarding the liability of experts towards third parties (Reg. No. X ZR 231/99). While the Court appeared to have taken a somewhat new direction, the latest judgement must be considered in the context of a steadily evolving jurisprudence related to the effect on third parties of contracts involving the transfer of expertise, especially in light of a third party's reliance on this expertise. Parties contracting for expert testimony or evaluation regularly do not, at least not explicitly, take a third party into consideration in their contractual dispositions. Problems arise, however, when in the performance of the contract a third party, often the buyer or a bank seeking an evaluation of a client's creditworthiness, substantially relies on this expert evaluation produced pursuant to the contract. Where the seller defaults, the bank (in this example) may attempt to directly sue the expert.

[2] In the case recently decided by the FCJ, the plaintiff was a majority shareholder of a banking corporation which applied to the responsible *Bundesaufsichtsamt für das Kreditwesen* (BAK -- Federal Securities Supervisory Authority) for the authorisation of a *Vollbankerlaubnis* (Right to Conduct Full Banking Activities). After the corporation had applied for this licence in 1992, the BAK stipulated that before granting the licence, a separate examination under Section 44 of the *Kreditwesengesetz* (German Banking Act) (1) would have to take place. For this purpose the BAK commissioned the defendant auditor. The defendant was engaged, among other things, to assess the plaintiff's investment policy plan. The report presented by the auditor contained substantial errors, which, upon plaintiff's objections, were partially corrected, but the full banking licence has not yet been granted.

[3] The plaintiff argued that, due to the defendant's serious mistakes (primarily the failure to present a valid report), the plaintiff had incurred major economic losses. The plaintiff's claim was denied by both the lower courts. The Federal Court of Justice, in its decision, affirmed the judgements of the lower courts.

[4] The Court rejected the plaintiff's claims, holding that the contract concluded between the commissioning banking authority and the expert did not extend to the plaintiff. As in the typical constellation of expertise contracts, the third party relying on the expert testimony is not directly a party to the contractual agreement concluded between the commissioner and the expert. Under a number of specific conditions, a third party can, however, benefit from these contractual terms. The Court held, however, that this was not the case here. The Court did not support the plaintiff's view that he was entitled to sue for damages based on the relationship established by the contract between the bank and the auditor because the agreement did not assume a protective character towards the plaintiff as a third party. Therefore, the plaintiff was not, in the Court's view, covered by the contract drawn up between the commissioning authority and the auditor.

[5] The Court has developed a long line of case law with regard to third-party effect of bilateral contracts. This tightly woven jurisprudence includes a line of case law concerning *expert liability*. While engaging in an interpretation of the parties' will as expressed both in the terms of contract and the context in which it was concluded, there is a strong trend in the Court's reasoning to consider the nature of the contractual transaction as such. By taking into account the outcome for which the parties aimed when entering into the contract, and in the light of the overall implications following from the agreement, the Court lends itself, in some respect, to an *objectivation* of the parties' will. The interpretation of the contract thus becomes a reconstruction of the subjective ideas the contracting parties had in mind, set against a whole number of standards which are *usually* applied to contracts of that sort. The standards of negligence and consequently the level of liability are established in light of the concrete market segment in which the transaction involving the expertise is embedded. In cases where expert consultation is involved, the question will regularly arise: who can rely on the expertise. In other words, to whom will the expert be held liable for his or her evaluation: (a) only to the (contractual) party by whom he or she was commissioned to render the evaluation, or (b) to third parties as well? The Court, in a number of cases, has held that the expert can be liable to a third party for his or her evaluation if this party holds a protected interest in the expert's consultation. Therefore, where the *expert quality* of a person or a corporation can be established in light of the services the person or firm renders, the first and decisive step is taken towards extending the negligence standards that govern the expertise contract between the expert and the contractor to a third party. (2) Classic cases establishing this third-party liability have dealt with, *e.g.* the (misguided or wrongful) expert evaluation of the quality of a building or property which led to a purchase of the property. (3)

[6] The development of the jurisprudence concerning a contract's protective effect towards more remote third parties

did not, from the beginning, suggest this possibility. The first cases regularly involved constellations where one contracting party had particular, especially personal ties, to the third party. For cases where relatives (*minors*) of contracting party (A) were harmed or else incurred damages by the other contracting party (B), the Court applied a "care" standard between A and his minor or another close person in order to extend the contractual obligations owed to A by B to the third person. (4) In even earlier cases, the *Reichsgericht* held that a tenant was protected by the contract concluded between the landlord and a craftsman if the tenant incurred any damages from this contract. (5) The basis for this jurisprudence was the existence of particular ties of a personalised nature between the contracting party and a third party, *e.g.* family, employment or landlord-tenant relations. To prevent, however, an unlimited extension of contractual rights to third parties, the Court regularly required that the third party be "in proximity" to the specific contract, meaning that it would be in the nature of the contract that a third party could in some way be affected by it. Later, the Court built on these considerations requiring that the protection of the third party could be identified as being in the interest of one of the contracting parties and that it was the parties' will to extend the contract's reach to the third party. (6)

[7] In its most recent decision, the Court seemed to indicate an alteration of this track. The Court's emphasis in the field of expert liability had so far been on the market expectations, always under somewhat objectified conditions. In the Court's view, when a person with specialized, state recognized expert knowledge is commissioned by another to draw up a report, an assessment or an evaluation and the expert knows or must expect that his or her evaluation will be communicated to a third party, there can be a direct claim for the third party against the expert. In most cases, parties that had incurred damages had been persons who, in trusting in the reports or assessments, had taken substantial financial decisions.

[8] The Court, in its decision of June 26, explicitly acknowledged the particularity of applying the doctrine of third party effect of a contract to the case before it. Here, the Court held, the plaintiff had not relied on the commissioned report for further financial decisions but, instead, the report was to serve as the basis for further action to be taken by the banking authority (BAK). In the Court's view the BAK is executing its supervisory function solely in the public interest, in accordance with Section 6 of the German Banking Act. It was in the context of this federal supervisory function that the BAK commissioned the auditor, pursuant to Section 8 of the German Banking Act. The Court concluded that the report must be seen as part of the duties laid upon the BAK, even if it is drawn up by a private auditor. It is against this background that the Court declared this case's concrete constellation to be falling into none of the categories developed earlier with regard to third-party effect of contracts dealing with expert testimony. The Court then, nevertheless, proceeded to go through the examination steps it generally applies in third-party effect cases and finds, not surprisingly at this point, that they do not apply. It is this particular public nature of the auditor's commissioning by the BAK that prohibits the application of the standards governing the third-party effect of contracts to the case at hand.

[9] The Court laid out the reasons why it did not choose to apply the third-party effect doctrine in this case. But are the reasons entirely convincing? The Court underlined that it had been a coincidence that the BAK commissioned an outside auditor instead of drawing up the report itself. If it had chosen to do so, plaintiff would not have been able to bring a claim in contract but, if at all, only in tort by a public agent pursuant to Section 839 of the *Bürgerliches Gesetzbuch* (German Civil Code) in connection with Article 34 of the *Grundgesetz* (German Basic Law). In the Court's view, the fact that the BAK commissioned a private auditor on a contractual basis did not give rise to the contractual claim asserted by the plaintiff pursuant to the third-party effect doctrine because plaintiff had not relied on the report in ways comparable to the constellations established by the Court's precedent. The Court emphasised at this point that plaintiff had no reason to "trust" in the auditor's work because his commissioning had not taken place in the interest of the plaintiff but solely in the general public interest as protected by the Banking authority itself. In this line of reasoning the Court also rejected a particular need for protection of the plaintiff. This seems almost circular as the Court stressed the fact that the BAK's commissioning was a coincidence and that, had the BAK drawn up the report itself, the plaintiff would be restricted to possible tort claims. This is, however, purely hypothetical because the report was, in fact, commissioned to an outside auditor and it is hard to understand why this should result in the detriment of the plaintiff. It is not convincing to deny a claim in contract, even in the particular case of third-party effect, with the argument that there would not be a claim if the outside commissioning had never taken place. The basis for this argument, then, can only be the public nature of the report in the first place. Nevertheless, to recognise that plaintiff was left without a claim should have led the Court to extend the protective reach of the contract to the plaintiff. What the Court did, in fact, was deny the plaintiff's need for protection with reference to the hypothetical case that the BAK could have drawn up the report itself. But it did not. The Court held that the plaintiff could not be protected only because the BAK had commissioned an outside auditor for a genuinely public task. This, however, privileges the defendant auditor. After all, whether by contracting-out the report or by, in the hypothetical case, doing it itself, the fault lies with the auditor and the damage with the plaintiff.

[10] The court did not enter into a thorough examination of eventual tort liability of the BAK holding that, in absence of a damage recognized by German tort law (Section 823 German Civil Code) there is no claim in tort, whatsoever. It

rejects the argument that the deficient report constituted an *Eingriff in den eingerichteten und ausgeübten Gewerbebetrieb* (infringement of plaintiff's rights with regard to his protected business interests). (7) The Court denies a direct effect upon the plaintiff's business resulted from the false report. The Court, in concluding, also denied other eventual claims in tort, holding that the auditor had not, in any recognisable manner, acted in bad faith with respect to the plaintiff's interests.

[11] Until this decision, the Federal Court of Justice has been assuming liability only when it could be established that the report or evaluation was actually presented to the third party and when the report had a clear effect on the third party when reaching a financial decision. The particularity of the June 26, 2001 decision might lie in the Court's express holding that a line must be drawn between those contracts between private parties for an explicit private purpose and those where the requirement of expertise is expected by law with regard to protection of the public's interest. While this might, at first sight, seem convincing, the difficulty here clearly lies in the alleged possibility to legitimately distinguish both. The Court seems to suggest that where the law, *i.e.* written law in the form of rules and regulations, requires the execution of an evaluation for the purposes of control and public scrutiny, the liability standard shall be a different one than that which the Court has been developing in a series of breathtaking decisions. (8) How such a separation can aptly be made, however, remains doubtful since the Court's jurisprudence in the field of expert liability towards third parties is motivated by the same set of rationales. The protection of the consumer or user of an expert evaluation, whether in direct contractual relationship or in indirect reliance, does not seem to be different than the interests at stake in the protection of the public interests secured by regulation. At least some doubt might be cast on the Court's allusion to a clear separation of private use and public safeguards and the paradoxical scepticism inherent in this jurisprudence with regard to the role of case law in relation to (other) written law. If it had been a private party commissioning the report the case surely would have been decided differently. The fact that the BAK contracted the auditor, however, leads to an overall privilege of the defendant.

For more information:

Decision of the Bundesgerichtshof (Federal Court of Justice - FCJ), 26 June 2001 - X ZR 231/99, not yet published.

Banking Act of the Federal Republic of Germany (Kreditwesengesetz) of 1961, revised in 1998: http://www.redmark.de/redmark/f/FKWG1.html (German edition) and http://www.iuscomp.org/gla/statutes/KWG.htm (English edition)

The German Basic Law on-line: http://www.uni-wuerzburg.de/law/gm00000_.html

The German Civil Code (excerpts) on-line: http://www.iuscomp.org/gla/

(1) Gesetz über das Kreditwesen: Banking Act of the Federal Republic of Germany (http://www.iuscomp.org/gla/statutes/KWG.htm)
(2) *See* the comprehensive treatise by Heribert Hirte, EXPERTENHAFTUNG, Munich 1996.
(3) *See Bundesgerichtshof* (Federal Court of Justice - FCJ), Decision of 2 April 1998, published in: 138 BGHZ (Official Collection of FCJ Cases), p. 257; *see also* FCJ, Decision of 10 November 1994 - III ZR 50/94, in: 127 BGHZ p. 378, at 381; FCJ, published in: NEUE JURISTISCHE WOCHENSCHRIFT (NJW) 2001, p. 514, at 516; FCJ, in: NJW 1998, 1948, at 1949; FCJ, in: NJW 1987, 1758, at 1759; FCJ, in: NJW 1984, 355, at 356; FCJ, in: NJW 1973, 321; FCJ, in: NJW 1970, p. 1737.
(4) *See* in particular *Bundesgerichtshof*, Decision of 28 January 1976 - VIII ZR 246/74, published in: 66 BGHZ p. 51.
(5) *See Reichsgericht*, published in: 91 RGZ p. 21, *at* 24.
(6) *See Bundesgerichtshof*, Decision of 2 April 1998 - III ZR 245/96, published in: 138 BGHZ p. 257.
(7)*See, hereto, Bundesgerichtshof*, published in 138 BGHZ p. 311; Bundesgerichtshof, Decision of 29 January 1985 - VI ZR 130/85, published in NEUE JURISTISCHE WOCHENSCHRIFT (NJW) 1985, p. 1620; *see also* the article by Rudolf Wiethölter, Zur politischen Funktion des Rechts am eingerichteten und ausgeübten Gewerbetrieb, in: KRITISCHE JUSTIZ (KJ) 1970, p. 121.
(8) *See*, most recently, *Bundesgerichtshof* (Federal Court of Justice), Decision of December 12, 1999 - IX ZR 415/98, published in: JURISTENZEITUNG 2000, p. 469; *cf.*Peer Zumbansen, *Drittschützende Wirkung eines Anwaltvertrages und verdeckte Sacheinlage*, *ibid.* at 442.