

Liability of Experts and the Boundary between Tort and Contract

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This paper offers an economic analysis of one aspect of the possible liability for incorrect information traded on information markets: expert liability for incorrect asset valuation. The article does not address the questions of whether and under what circumstances an expert should bear contractual liability for an incorrect valuation. Rather, it assumes such contractual liability towards the person who has solicited the opinion and focuses instead on analyzing the circumstances under which the expert's liability should be extended to third parties as well.

INTRODUCTION

The importance of the production, processing, and marketing of information in modern economies carries an accompanying need for legal arrangements that provide for liability for incorrect information traded on information markets. This paper offers an economic analysis of one aspect of the possible liability for incorrect information: expert liability for incorrect

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asset valuation. Special emphasis is placed on third-party liability in this context. This article focuses, therefore, not on the conditions and scope of an expert's liability towards the party that solicits the valuation, but, rather, towards a third party. Throughout the article, it is assumed that the soliciting party would be liable in damages. The questions whether the contracting party should bear liability and whether such liability rules should be mandatory or default rules are not given special attention in this article.

There are two dimensions to the matter of which liability rules lead to efficient regulation of information markets. First, under what circumstances do liability rules provide incentives to exercise necessary care in the production of information? Second, under what circumstances can liability rules avoid a "liability maze" that leads to excessive care or even negatively affects information markets? This paper analyzes specific liability regimes to determine whether they provide the right degree of incentive for experts to act diligently and carefully in rendering opinions in accordance with the standards of their professions. In addition, I investigate each liability regime to determine whether and, if so, how the economic findings can be integrated into existing doctrinal solutions.

This article does not address the questions of whether and under what circumstances an expert should bear contractual liability for an incorrect valuation. Rather, I assume such contractual liability towards the person who has solicited the opinion and focus instead on analyzing the circumstances under which the expert's liability should be extended to third parties as well.

The article analyzes from an economic perspective a number of cases involving four different types of expert opinions: those of a property assessor; of an art expert; of an investment broker; and of an accountant. These paradigms are drawn mainly from the doctrinal literature and from leading German case law.¹

A property owner turns to a land assessor to assess the value of her property and passes on the assessment to a potential buyer in order to interest the latter in the property. The expert negligently over-assesses the property, thereby causing a loss to the buyer, who has relied on this information in purchasing the property. The question that arises is should the expert be liable to the buyer? Or suppose the expert's assessment was solicited by the potential buyer, who then buys the property at an inflated

1 Claus-Wilhelm Canaris, *Die Reichweite der Expertenhaftung gegenüber Dritten*, 163 *Zeitschrift für Handelsrecht [ZHR]* 206 (1999); Reinhard Damm, *Entwicklungstendenzen der Expertenhaftung*, 1991 *Juristenzeitung [JZ]* 373; B. Grunewald, *Die Haftung des Experten für seine Expertise gegenüber Dritten*, 187 *Archiv für die civilistische Praxis [AcP]* 285 (1987).

price. A bank extends credit to the buyer based on the expert assessment. Thus, not only the buyer but also the bank experiences a loss. In such an event, should the bank be able to claim damages from the expert? Should the assessor be liable to third parties that buy the property *jointly* with the party who solicited the opinion? Should such liability exist towards third parties who buy the property in question *instead* of the party that solicited the opinion and thus suffer the loss?

An art expert appraises an imitation painting at the value of the original. The person who has solicited the appraisal buys the imitation at an inflated price. This mistake is revealed only after the buyer sells the imitation also at an inflated price to a third person. Can the latter claim compensation for her loss from the art expert for his incorrect appraisal?

An investment broker negligently gives an incorrect investment recommendation. Both the person who consulted with the broker and her friend to whom she passed on the incorrect recommendation suffer a loss. Can the friend claim damages from the broker? Or suppose a broker negligently gives an incorrect investment recommendation that is made available to the public and thus relied upon by many people, who consequently incur losses. Should these people be able to claim damages from the broker?

An accountant gives a negligent audit of the financial state of a company, failing to note that the company is insolvent, and the company's stocks are overvalued on the market. The buyers of the overvalued stock suffer a loss when information of the overvaluation reaches the stock market. Should the accountant be liable towards these buyers?²

The above examples all concern third-party liability, that is, liability towards people other than the party that solicited the expert's services. In addition, all the cases relate to pure economic loss; and the economic analysis of this kind of loss differs from the economic consideration of liability for property damage and bodily harm. Granting third parties the right to compensation in these types of cases is not easily justified within the doctrinal framework of the German legal system. For example, although German contract law can provide protection to assets (*Vermögensschutz*), it is extremely difficult to extend such protection to third parties. Tort law, in contrast, allows for the protection of anyone's property, even that of

2 A classic article on the liability of accountants is Victor P. Goldberg, *Accountable Accountants: Is Third Party Liability Necessary?*, 17 J. Legal Stud. 295 (1988). Goldberg argues that information markets are often efficient enough to avoid inefficient information-producing. In such a case, liability rules would not enhance economic efficiency.

third parties, but does not allow for compensation for pure economic loss.³ Liability for the latter type of loss arises only in very special circumstances.⁴

Part I begins this article with a discussion of the two specific characteristics of the production of information. Part II follows with an economic analysis of an expert's liability for pure economic loss suffered by the soliciting party due to the expert's negligently incorrect opinion. Parts III and IV analyze an expert's liability for third-party damage from an economic perspective. In Part III, I consider under what conditions third-party liability should be treated similarly to liability towards the soliciting party, and Part IV discusses whether and under which conditions experts should bear liability for third-party damage in other cases.

I. THE SPECIFIC CHARACTERISTICS OF THE MISUSE OF INFORMATION FROM AN ECONOMIC PERSPECTIVE

From an economic perspective, the issue of expert liability revolves around how tort law should operate to create proper incentives for the careful production and trading of information; that is to say, how should tort law regulate markets for information without impairing the workability of those markets? As in any other area of liability law, the economic analysis of expert liability concerns setting incentives for damage prevention. However, there are unique characteristics to the economic analysis of expert liability, which form the basis of the discussion in this article.

The first feature is that information is a public good. The second feature is that the use or misuse of information not only leads to economic gain or loss, but also to redistribution; that is, some people suffer damage, while at the same time, others profit. These two economic characteristics of information imply an economic perspective to damage incurred from the (mis-)use of information, which differs from damage caused by accidents (such as traffic accidents or defective product accidents).

A. Information as a Public Good

A public good is characterized in particular by the fact that its use by one person does not decrease its value for others. For instance, an expert opinion on a given country's competitive advantages and disadvantages can be used

3 § 823I BGB.

4 §§ 823II, 826 BGB.

by all potential investors. A sailing club can display a map showing the shallows for the use of all the club's members. An expert appraisal of the economic value of a resource can be used also by parties that do not pay for the use. The latter profit as free riders, while all users could suffer loss if the assessment turns out to be incorrect.

If liability is borne by the expert towards anyone who relies on his opinion, the cost of that opinion rises. In such an event, the party that solicits the expertise will have to pay the expected costs of liability, and third parties that could profit from the expertise do not share in these costs. The question then arises under what conditions does the cost of third-party liability borne by the soliciting party improve the productivity of the information markets?

B. The Use of Correct and Incorrect Information, Damage to Economic Resources, and Damage from Redistribution

Incorrect information leads to individual damage that usually exceeds the social damage (resource damage). Sections 1 and 2 below elaborate on this point.

1. Damage to Economic Resources

Damage to an economic resource means either the destruction of or a decrease in the physical productivity of a valuable economic resource, a consumer good, or a producer good. Such is the case when a house burns down or when a factory cannot be used partially or temporarily due to an accident: the productivity and utility-creating capacity of the resource cannot at all or can only partially be used. In the event of damage to an economic resource, the injured party's damage, which she would claim in a lawsuit, equals the social damage. If a house worth \$1 million burns down, society's capital stock decreases in value by the decrease in the value of the destroyed house.⁵ Therefore, the damage to the victim equals the damage to society. Thus, as far as economic and legal policymaking are concerned, the question of how much effort should be invested in preventing damage to economic resources is equally relevant from the perspectives of both the individual and society. If an economic actor anticipates paying damages in the amount of \$1 million in the event of damage occurring, she should invest in preventing the damage in accordance with the amount of social damage that

5 See Roger van den Bergh & Hans-Bernd Schäfer, *Member States Liability for Infringement of the Free Movement of Goods in the EC: An Economic Analysis*, 156 *J. Institutional & Theoretical Econ.* 382 (2000).

will be caused. This is the optimal solution from the perspective of policy. In such a case, the individual's interest in damage compensation and society's interest in damage prevention coincide. However, this will no longer be the case when the factor causing the damage ceases to interfere with the physical characteristics of the economic resource.

2. *Pure Redistribution*

In the case of pure redistribution, damage to one party implies a corresponding gain in the same amount for another party.⁶ Accordingly, the net social damage, which is the sum of all change in wealth, is 0. For example, when an incorrect valuation of a piece of property causes damage to its buyer, since he pays an inflated price for it, the productivity of the property is not necessarily affected, and therein lies the difference between this situation and the case of the burnt house. In this situation, there is only a shift in wealth that would not have occurred had the assessment been correct. The same is true with regard to an investor who buys shares at an inflated price due to misinformation about the company's financial state or due to an incorrect ad-hoc report, without any change in resource allocation occurring.

The total amount of damage caused by an expert's incorrect assessment usually is comprised of two parts: pure redistribution and damage to economic resources. For instance, if a buyer purchases property, which, on the basis of misinformation, he assumes to be land for construction, at the price of 100, when the true value is only 20, this leads to pure redistribution. Furthermore, this may also result in damage to an economic resource if the buyer, in reliance on the assessor's expertise, takes further action, such as hiring an architect.

Similar situations can arise in the context of the stock market. If a company's shares are temporarily overvalued due to an incorrect assessment by an accountant, those who buy shares at that time and do not sell before the market corrects the overvaluation suffer a loss. However, sellers of the overvalued shares before the market has corrected the overvaluation of the stock would make a profit. The net social damage from the redistribution of gains and losses is, therefore, 0. But in general, damage to economic resources also is caused if investments made in the

6 William Bishop, *Economic Loss in Tort*, 2 Oxford J. Legal Stud. 1 (1982); Victor Goldberg, *Recovery for Pure Economic Loss in Tort: Another Look at Robins Dry Dock v. Flint*, 20 J. Legal Stud. 249 (1991); Israel Gilead, *Tort Law and Internalization: The Gap between Private Loss and Social Cost*, 17 Int'l Rev. L. & Econ. 589 (1997); Hans-Bernd Schäfer & Claus Ott, *Lehrbuch der ökonomischen Analyse des Zivilrechts*, 3 Auflage 271 (2000).

overvalued company could have, in the meantime, been made more profitably elsewhere. Furthermore, a social loss results from the stock market not being information-efficient, since the drop in confidence in the market's information-efficiency increases the incentive for shareholders to invest in the private production of information, which is an avoidable cost. Thus, the total damage to the injured party is comprised of both redistributive damage and damage to economic resources, which includes the loss in efficiency.

In principle, the damage to an economic resource is equal to the difference between the resource's revenue under correct information and its revenue under incorrect information. This loss is definitely a waste and, from the economic perspective, is demonstrated by the case of the burnt house.

Part II below discusses the legal policy ramifications and tort law implications of these hypotheses.⁷

II. LIABILITY TOWARD THE PARTY SOLICITING THE EXPERT OPINION

A party that solicits an expert opinion does not consider whether the damage to her may be accompanied by a corresponding gain to third parties. She consults with the expert and pays for his expertise in order to obtain precise information. In general, her willingness to pay for this expertise is the expert's costs of care, according to the professional standards. She also generally should have an interest in the expert maintaining this professional level of care and being liable to her if he does not meet these standards or is disloyal. The question that arises is whether this is economically efficient.

Much has been written on the issue of under what circumstances actions to acquire information increase or decrease the efficiency of the use of economic resources.⁸ In brief, a project to acquire or produce information that only redistributes, and does not improve, the use of economic resources should not be undertaken from the perspective of policy and should, therefore, not be protected under the law. In general, this applies to any endeavor (and,

7 For an economic analysis of the liability of auditors for pure economic loss, see Elisabeth Herrmann, *Ökonomische Analyse der Haftung des Wirtschaftsprüfers* (1997) (although the difference between damage to resources and redistribution is not addressed).

8 A basic text is Jack Hirshleifer, *The Private and Social Value of Information and the Reward to Inventive Activity*, 61 *Am. Econ. Rev.* 561 (1971); Jack Hirshleifer, *Where Are We in the Theory of Information?*, 63 *Am. Econ. Rev.* 31 (1973); Kim Lane Scheppele, *Legal Secrets, Equality and Efficiency in the Common Law* (1988); Schäfer & Ott, *supra* note 6, at 462.

particularly, insider trading) to acquire or produce information that enables a market participant to gain only a short-term advantage in information due to the incorrect market valuation of the resource in question. In such a case, correction of the faulty valuation by the market can be expected to occur quickly, even without the production and use of this advance information. The expense entailed in acquiring this information is a waste of resources. Incentives to avoid such expense can be created by any number of legal arrangements, such as setting a pre-contractual obligation to disclose information. For instance, if a duty exists for a buyer to reveal inside information (which he gathered at a possibly high cost) for the contract to purchase the company to be binding, he thereby is prevented from profiting from the inside information: the incorrect valuation of the resource is corrected before the purchase is completed, due to the buyer's obligation to disclose his information. Thus, the buyer has no incentive to acquire unproductive information.⁹ In general, information is productive only if it leads to a better use of resources. Expertise in asset valuation is usually traded on markets that are not information efficient, i.e., where the offering price does not contain all the information about the productivity of the given resource, which would enable its purchase without any additional information. Moreover, because the seller has an incentive to exaggerate the value of her resource, expertise in asset valuation is generally productive. Thus, not only does the party that solicits the expert opinion benefit from protection due to the expert's liability towards her, but this liability also discourages incautious behavior on the part of the expert and thus leads to better regulation of information markets.

III. (QUASI-)CONTRACTUAL THIRD-PARTY LIABILITY

This Part discusses cases in which the party that incurs the damage did not enter into an explicit contract with the expert, and therefore, the question that arises is whether (quasi-)contractual liability for (simple) negligence applies. Can economic and policy considerations support imposing (quasi-)contractual liability on experts towards third parties, which would lead to the adequate regulation of information markets by liability rules? Can such considerations be integrated into (quasi-)contractual doctrinal solutions? Below, I show that there are cases in which economic analysis recommends imposing liability on experts towards third parties, similar to the liability borne by the expert towards the party that solicits and pays for the expert

⁹ Schäfer & Ott, *supra* note 6, at 487.

opinion. Determining the scope of contractual liability, or the borderline between contract and torts, is of great practical and conceptual importance because tort law in most legal systems restricts or even excludes liability for pure economic damage, whereas similar restrictions do not generally exist under contract law.

A. Doctrinal Background

Under German contract law, liability for (simple) negligence can be derived from three sources: an expert's liability deriving from a contract to disclose information (*Auskunftsvertrag*) towards a third party who suffers a loss; liability deriving from a contract that has protective effect for third parties (*Vertrag mit Schutzwirkung für Dritte*); and liability deriving from an independent (quasi-)contractual claim of breach of duty prior to consummation of the contract (*Culpa in Contrahendo*).

B. Economic Analysis

The economic considerations discussed below regarding efficient liability rules depend not on the expert's willingness to bear liability, or on the third party's relationship with the soliciting party or the expert, or on whether the expert's duties have been set in the contract with the customer. Rather, from an economic perspective, the criterion is:

Does the protected person or the customer bear the costs of liability directly or indirectly, and does one of them (or both) have an interest in liability protection in spite of the costs?

If this question can be answered either directly or indirectly in the affirmative, (quasi-)contractual liability is merely a deal, to the benefit of both parties, between the expert and the group of protected people that is implemented by the legal system. The group of protected people must pay an adequate price for their protection via liability; otherwise, such liability would have to be rejected.

These conditions are met and therefore (quasi-)contractual third-party liability is triggered in one of the following situations:

1. The damage to the third party manifests a risk that would have been borne by the party that solicited the expert opinion had a third party not been involved. Consequently, extending liability to third parties does not increase the expert's risk. In this context, it is irrelevant whether or not the soliciting party and the third party have coinciding or diverging interests.

2. The expert opinion creates a risk for a third party in addition to the risk created to the soliciting party. However, in consulting with the expert, the soliciting party acted not only in his own interest, but also in the third party's interest. The third party's interests diverge from the risk to the soliciting party.

1. No Increase in the Liability Risk due to Possible (Quasi-)Contractual Third-Party Claims

a) Risk-sharing.

A third-party (quasi-)contractual claim based on a negligently incorrect expert opinion is justified if the *ex post* expansion of the group of potentially injured parties (beyond the soliciting party) does not increase the expected damage and, thus, the total in damages for which the expert can be liable.¹⁰

In the absence of any third-party involvement, the damage to the soliciting party is the difference in wealth between a correct expert assessment and an incorrect one. Due to liability, the price of expertise on a competitive market increases by the amount of damage multiplied by the probability of damage (expected damage) and the costs of care or precaution generated by the threat of liability. The expansion of the group of potential beneficiaries from the expert's liability is not problematic so long as it does not increase *ex post* either the probability of damage or the amount of damage as compared to a situation where only the soliciting party incurs damage. If this is the case, the expected total compensation to be paid by the expert for any loss incurred due to his negligent assessment, which, in turn, determines the cost of care or precaution, remains unchanged as well. The expert's price calculation and his extent of cautious behavior do not depend merely on the number of beneficiaries of his liability. In particular, this criterion is met when other parties bear with the soliciting party the risk of the transaction to which the expert's opinion refers because the resource is either bought or funded jointly by several people.

b) Risk-shifting.

In a second group of cases, a third party, and not the party that ordered the expert opinion, executes the transaction because the soliciting party has made the expert's valuation available to the third party, either for payment or due to the relationship between them. Again, the expert's risk of liability

¹⁰ The expected damage is the damage in the event of the occurrence of the damage multiplied by the probability of loss.

remains unchanged, despite the (quasi-)contractual protection extended to the third party.

From an economic point of view, the expert should be liable ((quasi-)contractual liability) to the third party for any injury to the latter due to a negligently incorrect valuation.

c) Liability limited to predictable damage.

The solution presented above implies that it is necessary to limit an expert's liability if the involvement of a third party increases the potential damage (as compared to when only the soliciting party is involved). For example, if an investor acts as the soliciting party, then the expert should bear liability towards injured third parties. However, if the damage to the new investor (for example, due to higher reliance investments) is considerably higher than to the soliciting party, liability should be limited because the expert calculated his liability risk and the corresponding extra charge according to the potential damage to the soliciting party. Otherwise, the expert would have to bear *ex post* costs that he did not allow for in his calculation. The Common Law foreseeability rule from *Hadley v. Baxendale*¹¹ leads to this result. The power of the solution presented here depends on whether from a doctrinal point of view, the expert's total liability can be limited to the amount of damage that the soliciting party would have suffered. The scope of the soliciting party's potential risk remains the basis for determining the scope of the expert's liability, even if the group of potential beneficiaries is expanded beyond the soliciting party. If a third party has a higher risk potential than the buyer, the expert should bear no liability for the additional damage. Under German law, a solution like that under the foreseeability rule (i.e., limitation of liability) usually is reached by assuming a pre-contractual obligation to disclose information about one's high risk potential. If a potential contracting party does not reveal information about his special, above-average damage potential, the court can apply the contributory fault clause in section 254 of the German Civil Code to limit liability to foreseeable damage, based on the pre-contractual obligation to disclose information. This solution, however, is not applicable in the cases discussed here, since at the time of contract formation, the third party generally cannot inform the expert of his special risk potential and therefore the expert cannot include this elevated risk potential in his cost calculations. Typically, the third party can inform the expert of her risk potential only at a point in time when the contract has already been concluded and the price for the expertise has

11 156 Eng. Rep. 145 (1854).

been set. The rule of contributory fault, which is functionally equivalent to the general limitation of contractual damage compensation to foreseeable damage, usually does not apply in such cases.¹² Thus, other ways to limit the scope of liability to the damage known at the time of contract formation must be found. Köndgen's¹³ proposal for cases of this type is to assume the expert's liability on the basis of the rule of liquidation of third-party damage (*Drittschadensliquidation*) and thereby limit the scope of his liability to the potential damage of the soliciting party.

d) Criticizing the economic solution?

The solution presented above can be criticized for extending the circle of potential beneficiaries to an extent that is no longer workable. Not only those parties who have a special relationship with the soliciting party would be protected by the expert's liability, but also *any* party that suffers damage due to the expert's opinion could claim such protection. Under this proposition, the soliciting party could buy the resource at an inflated price, then sell it to a third party, again, at the inflated price, and upon discovering the overvaluation, the third party could claim damages from the expert. This line would continue until the *n*th buyer who would be the first to notice the overvaluation. Thus, the circle of beneficiaries would be extended to an unmanageable extent.

On the other hand, the following counterargument can also be made. The excessive expansion of the circle of potential beneficiaries does not lead to an unmanageable risk of liability. Rather, it provides the expert with incentive to exercise as much care when giving an assessment, as though his opinion will be the basis for the relevant transaction, regardless of who actually executes the transaction. From an economic perspective, the situation can be described as follows: In addition to the expert's opinion, the soliciting party also receives a certificate of warranty (*Inhaberhaftungsbrief*) stating, "In the event that he provides a negligently incorrect asset valuation, the expert is liable for damages to the extent of the difference between the purchase price and the actual value of the resource to which the assessment refers." The soliciting party pays for the certificate of warranty (*Haftungsbrief*) and can make use of it himself, or transfer it to a third party, or split the rights deriving from the certificate of warranty. This does not alter the overall value of the certificate of warranty, similar to a claim that is transferred to

12 I would like to thank Klaus J. Hopt for bringing this point to my attention.

13 Johannes Köndgen, *Die Einbeziehung Dritter in den Vertrag*, in *Karlsruher Forum* 39, 44 (1998-1999).

one or several parties. But the liability to a third party cannot exceed the liability borne towards the soliciting party; thus, any future developments on the market that add to the amount of damage caused cannot be considered.

Another argument against the expansion of the expert's liability to an unlimited line of third parties is that it could destroy the personal relationship existing between the soliciting party and the expert. Thus, it may become impossible to solve problems bilaterally between the two, that is, within the framework of a long-term business relationship. Rather than the person who solicited the expert and is therefore in a cooperative relationship with the expert or a third party who has such a relationship with the soliciting party, an anonymous party would appear.

However, it should be emphasized that in the rapidly growing information markets, there is an increasing need for formal regulation by the legal system, which does not take personal relationships into account. Experience has taught us that the larger and more anonymous a market becomes, the more abstract and formal the regulation of that markets has to be. In contrast, in smaller-scale markets, personal relationships are often more effective than formal rules are.

e) The boundaries of tort liability.

This draws the borderline between tort liability and (quasi-)contractual liability for (simple) negligence. If this line were drawn in a different way, liability for the full damage of the injured parties would no longer depend on the purpose of the expert's assessment, but, rather, on a coincidence of financing or of the identity of the user of the assessment.

In contrast to this conclusion, it can be argued that (quasi-)contractual liability for (simple) negligence does not come into play as long as the expansion of the circle of beneficiaries increases the expert's liability risk beyond the amount of damage the soliciting party would suffer. Hence, an investment consultant, when giving an investment recommendation to a particular customer, should not bear (quasi-)contractual liability for mistakes in his recommendation towards third parties who have access to his recommendation and invest in the same manner as the customer and thus experience a loss. If this were the case, the risk of liability would increase proportionately with each additional third party. An expert who gives a recommendation to buy a condominium should not be liable for damage that occurs to someone who buys an adjacent condominium of the same value because of the expert's opinion, even when it is the party who consulted with the expert who buys the adjacent condominium. Under this concept, all contracts that deviate from the scope of the transaction for which the expert's opinion was sought would not be covered by the expert's

(quasi-)contractual liability for negligently incorrect advice. Otherwise, the expert's risks and, accordingly, cost would be extended so as to exceed the extent of the soliciting party's willingness to pay. The portion of the cost of the expertise that corresponds with the cost of liability would be inflated, and third parties would free-ride on the back of the soliciting party. The expertise would be excessively costly, and thus the demand for it would be lower than the soliciting parties' actual needs and the extent of his willingness to pay. Under the solution presented here, however, the costs of care and liability, which are included in the price of the expertise, do not exceed what the soliciting party is willing to pay if he has to bear fully the risk of a wrong decision due to an incorrect opinion.

2. The Soliciting Party Acts as the Third Party's Agent, Thereby Increasing the Liability Risk

We now turn to those cases in which extending liability to third parties *increases* the risk of liability. Often, expertise on asset valuation for an object for sale is not solicited by the potential buyer, but by the owner who wishes to sell the object and seeks information for both himself as well as the potential buyer, in order to increase the likelihood of the sale taking place. In such cases, the criterion of no increase in the expert's risk of liability as a precondition for third-party liability is not met. The risk borne by the expert vis-à-vis the soliciting party is different in extent from the risk that would be borne towards the third party, and the appearance of the third party increases the risk of liability right from the beginning.

For instance, if someone solicits a valuation of the stamp collection he has inherited in order to gain information for himself and for the potential buyer, the damage potential is twofold: the stamp collection could be undervalued by the expert, which would cause damage to the owner if he sells it for too low a price, or it could be overvalued, which would cause damage to the buyer. Preventing over-deterrence is in the interest only of the — perhaps still unknown — third party, and of the seller, who is interested in a high price.

We can assume that the owner has a positive willingness to bear the cost of his own compensation for potential damage due to undervaluation. However, is there any party with a positive willingness to bear the cost of compensation in the event of an overvaluation? This cannot be easily assumed, and accordingly, we cannot assume an implicit contract between the soliciting party and the expert to shift this risk. The owner has no interest in paying the expert to assume the risk of liability toward a potentially injured third party. Hence, the expert does not have any incentive to assess the

resource for sale at a high price (which would be in the soliciting party's interest).¹⁴

In this context, it is rather important from an economic perspective that the owner, when revealing the expert's economic valuation of the resource to a potential buyer, should also act in the buyer's interest, even though this is contrary to the owner's interest. Under principal-agent theory, the owner acts as the potential buyer's agent and helps the buyer to become involved in a transaction that is beneficial to him. However, in such a case, where a transaction is initiated with the help of an expert opinion, the buyer should be able to rely on the valuation. The law should provide him with incentives to do so. Otherwise, the conflict between the owner's interest in the highest possible price and the buyer's interest in the lowest possible price leads to a distortion in the liability system. If the expert is liable only for the undervaluation and not overvaluation of a resource, he will have an incentive to give not an accurate assessment of the resource's value but a biased one in favor of the party who pays for the opinion. This will therefore create a tendency to expert overvaluation. Such a tendency toward disloyal or even opportunistic behavior on the part of the expert could be counteracted by extending the expert's liability to the buyer.¹⁵

Furthermore, it is of crucial importance that this rule not be rejected only because it contradicts the soliciting party's conjectural will — and perhaps also that of the expert, for the exclusion of liability could destroy the protection of third parties, which is desirable from an economic perspective. The release from liability should not apply where the exclusion of liability to third parties enables a counterproductive interaction between the expert and soliciting party. For there would not only be an incentive for dishonest behavior, but, also, in the long run, the expert's assessment commissioned by the resource's owner would appear invalid to potential buyers. As a result, the market for information would be non-transparent and poorly regulated. It would erode or even fail to develop to an efficient level. Even though the production of an expert's economic valuation of a resource is a good means of increasing the transparency of the information market and consequently the volume of efficient transactions, which are utility-enhancing both for buyer and seller, the market still would remain underdeveloped in terms of efficiency.

14 In this context, it could be argued that the seller will lose his good reputation if he has an interest in overvaluation. However, while this is true, protective legal rules are intended to regulate anonymous markets in particular, where reputation is of little importance.

15 Köndgen, *supra* note 13, at 47.

Therefore, for cases such as these, the legal system should impose (quasi-)contractual liability on experts for (simple) negligent overvaluation. This would increase the price of the expertise in accordance with the expected value of the resulting additional costs of care and liability. The seller, who has solicited the expert's expertise and also acts in the buyer's interest, should bear these costs, since the buyer (who is the third party) has an interest in liability and not in a worthless biased valuation. If an expert opinion solicited by the owner/seller of a given resource can generally be relied upon, due to its public good characteristics, it needs to be produced only once for it to be useful to any potential buyer of the given resource. If, however, expert economic valuations are notoriously unreliable, every single potential buyer would commission his own valuation — which would inflate costs in a way that could easily be avoided. In markets where expert assessments are common, costs are incorporated into the price of the resource and, thus, paid by the buyer, whose protection is guaranteed by the (quasi-)contractual third-party liability borne by the expert.

Accepting imposing (quasi-)contractual third-party liability even in those cases where it increases the expert's overall risk of compensation payment is based on the premise that the expert knows for what purpose his valuation is intended. Otherwise, he cannot accurately calculate his liability risk and, therefore, the price of the valuation.

This draws a second boundary between torts and (quasi-)contractual third-party liability. (Quasi-)contractual third-party liability for a negligently incorrect expert assessment also should apply in cases where the soliciting party acts not only on his own behalf, but obviously also on behalf of a third party whose risk potential adds to that of the soliciting party.

IV. TORT LIABILITY

If the criteria presented above for (quasi-)contractual third-party liability are not met, we can still consider expert tort liability towards anyone. I discuss first to what extent the preconditions for and scope of tort liability for incorrect information differ from contractual protection of the soliciting party and (quasi-)contractual protection of injured third parties. Paradigmatic for such cases is incorrect information on the financial standing of a businessman, which is given to third parties or an investment recommendation used by third parties, in addition to the soliciting party.

This is followed by an attempt to bring economic requirements on expert tort liability in line with the legal preconditions for such liability rules. Thus, we must take into account, for instance, that German tort law allows

for protection for pure economic loss only under specific circumstances (violation of a protective norm under section 823(II) of the Civil Code ("BGB") or willful damage *contra bonos mores* (*vorsätzliche sittenwidrige Schädigung*) under BGB section 826).

A. The Bearer of Liability Costs under Contractual Liability Rules versus Tort Liability Rules

The expert will always shift the expected additional costs from pure tort liability to the price.¹⁶ Thus, the soliciting party bears these additional costs. The question we must ask is whether in the case of pure tort liability for an expert opinion, the same standards should apply as, for example, in the case of product liability, liability for incorrect information on instruction leaflets for medicines, or medical handbooks and where possible differences could arise.

From the economic perspective, (quasi-)contractual liability concerns whether the protected parties enjoy liability protection ultimately at their own cost. (Quasi-)contractual liability applies to situations where this correlation of protection by liability rules and payment for this protection is a given. Where this correlation is not present, other considerations about the protection of third parties have to be made.

Third-party protection by means of tort liability means the compensation of damage to third parties without them either directly or indirectly contributing to the costs of the liability. The ordinary level of care thus has to depend on the total expected loss to these third parties. Can this situation be analyzed in the same manner as that of contractual duties? The answer to this question is partially in the negative, since the tortious damage to the resource that is borne by its owner is not equal to the damage that the damaged party would claim in court. The damage can differ significantly, usually lower for two reasons:

1. The third parties use the information in the expert's asset valuation for free, thus securing an advantage for which they have not paid, which must be taken into consideration and balanced against the damage they could suffer.
2. The transactions lead to damages for some persons and to gains for other persons (redistribution).

16 In a competitive market, the long-run equilibrium price equals the long-run marginal costs. If long-run marginal costs increase for every firm on the market, for example, due to allocation of costs by the legal system, the equilibrium price must fully include this increase in cost. Just how much the price actually increases depends on the elasticity of the demand and supply on the market.

B. Third-Party Benefits and Damages

People who use an expert's assessment for free do not pay for this public good, while enjoying its benefits. With these benefits on the one hand, damage is created on the other hand. Benefits and damage must be balanced when determining ordinary standard of care for anyone, irrespective of whether the damage in question is to resources or to pure redistribution. If anyone is to be held liable (*Jedermannhaftung*), the overall impact, negative and positive, of the information for society has to be taken into consideration, both free benefits as well as damage caused. For example, an incorrect expert assessment may be beneficial to some parties, but cause damage to others. The ordinary standard of care should be based on the net damage caused by an incorrect expert opinion, on the overall impact for third parties. The standard will thus be lower than if it were based only on the damage incurred to the injured party.

C. Damage from Redistribution and Damage to Economic Resources in Cases of Primary Economic Loss: The Need for Balancing and Possible Solutions

In considering how to compensate for tortious damage, let us assume that the injured party does not bear the cost of the liability towards him or her. When determining the total loss, upon which the standard of ordinary care depends, we must subtract damage that is purely redistributive, i.e., damage that implies a gain to one party and a corresponding loss to another. Strictly speaking, those who gain should report this to the expert and allow him to share in the benefits of his incorrect assessments. In actuality, however, only the injured parties can be expected to inform the expert. Therefore the task of determining the net social damage, and thus creating the right incentives, has to be performed by the legal system.

In the law & economics' literature, Bishop's important article gives a detailed explanation of this necessity to balance costs.¹⁷ In the case of pure financial loss, a liability rule of ordinary negligence, as is usual in (quasi-)contractual law, would lead to overdeterrence. This is the case if the standard of due care is based on the expected damage to the injured party, and not on the net social loss. There are a number of ways in which a legal system

17 Bishop, *supra* note 6; see also Goldberg, *supra* note 6, at 249; Gilead, *supra* note 6, at 589; Schäfer & Ott, *supra* note 6, at 271.

can contend with the problem of how to reduce incentives to exert excessive care.

1. No Compensation for Pure Economic Loss

The legislator could exclude entirely any liability for pure economic loss. Bishop¹⁸ made this proposition, following along the lines of the Common Law. This is an appropriate solution for cases where the damage to the resource is of a trivial amount compared to the purely redistributive damage. Furthermore, this proposition has the advantage of being easy to apply, since the distinction it draws between damage that should be compensated for and damage that should not can be easily recognized by the courts. However, it does not provide a reasonable rule for liability for damage that is caused by negligence on the part of experts in their assessments.

2. Partial Damage Compensation

A second possible way to respond to the difference between pure redistribution and damage to resources would be to allow partial compensation to the injured third party. From an economic perspective, it would be reasonable to limit liability so that the injured party is compensated for only a portion of the damage, that comprising damage to resources, whereas pure redistributive loss is not compensated. Israel Gilead has proposed just this solution,¹⁹ according to which, the courts would have to make ad hoc estimates of the proportions of the two different types of damage. However, it is doubtful whether the necessary information can be produced and processed in court, and in any event, this solution may be too complicated.

3. Lowering the Standard of Ordinary Care

A third possibility to prevent excessive care would be to impose liability for the total amount of damage, but set a low standard of care that is based only on social (net) damage, and not on the higher individual damage incurred by the injured party. Thus, the standard of care would be significantly lower than in the case of (simple) negligence. If this standard of care could be precisely defined so that the tortfeasor knows (or at least is able to know) *ex ante* the precise level of care necessary to avoid liability, overdeterrence would be prevented, even though there would still be excessive liability. In

18 Bishop, *supra* note 6.

19 *Id.* at 606.

this case the potential tortfeasor would apply the level of care that would release him from tort liability and, therefore, from bearing excessive liability.

Under these conditions, excessive liability would not create incentives to exercise too much care, but, rather, would create only additional incentives to comply diligently with the standard of due care.

4. Partial Damage Compensation versus Lowering the Standard of Ordinary Care

Which is the best solution, partial compensation or lowering the standard of care? The disadvantage to lowering the required standard of care is that this solution leads to efficient outcomes only when the level of due care is not precisely defined *ex ante*. In comparison, partial damage compensation is a valid solution also for more general cases and, therefore, produces an efficient outcome even if the standard of care is precisely known *ex ante*. However, in most civil law countries, there are no legal norms that authorize the courts to apply such a limitation of liability. For example, Article 20, Section 3 of the German Constitution requires judges to conform strictly to the provisions of law. Thus, it would be unconstitutional for German courts to deviate from the rule of full damage compensation under section 249 of the Civil Code. Under German law, therefore, as in most civil law countries, partial damage compensation could only be adopted in legislation, and not by the judiciary. In common law systems, however, a rule of partial damage compensation could, at least theoretically, be applied by the courts, without any statutory provision to that effect.

As opposed to the solution of partial damage compensation, lowering the required level of care has to its advantage the fact that it can be implemented within the given legal system in most civil law countries without enabling legislation necessary. In Germany, for example, the courts could apply such a rule through interpretation of existing provisions. In fact, the German case law appears to be moving toward this solution: grossly negligent violations of professional standards have been interpreted by the courts to be *contra bonos mores* and willful, thus leading to liability for damage under section 826 of the Civil Code.

CONCLUSION

Liability for a negligently incorrect expert asset valuation should be based on (simple) negligence as long as the soliciting party either voluntarily pays the costs of liability or else has a legal duty (perhaps the product of policy considerations) to do so. This condition is fulfilled if the expert is liable

to the soliciting party. The same applies if the expansion of the number of people protected against the expert's negligence does not increase the expert's costs of liability or if the soliciting party acts in the interests of a third party who is willing to pay for the protection from negligence on the expert's part, which is reflected in a higher price for the product. If an infinite number of third parties is to be protected, considerations have to be based on the total damage to the economic resources in question. The total loss is lower than the damage to the party that suffered damage. Under the tort liability rules, this should lead to a lower level of care, a fact that could easily be known by the expert. As long as the expert complies with this level of care, he meets his burden under the law and cannot be held liable for his conduct. Thus, the level of liability is not so excessive as to lead to overdeterrence.

