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Unfair Contracts of Suretyship — a Question about the Horizontal Effect of Fundamental Rights or about the Application of Contract Law Principles?

The question about the horizontal effect of fundamental rights and freedoms and constitutional principles on private relationships has again become topical in connection with discussions over the objectives and methods of the harmonisation process of European contract law. Namely, consideration for the horizontal effect of constitutional rights and freedoms and principles is seen as a possible method of harmonisation of European private law and hence also contract law. Article 6 of the consolidated version of the Maastricht Treaty¹ sets out the underlying principles of the EU such as the principles of liberty, democracy, respect for human rights and fundamental freedoms, and the rule of law, i.e., the principles derived from the constitutional traditions of the Member States. Citizens of the EU Member States thus have a right to the protection of not only economic interests, but also their personal interests and fundamental rights. The activities of the EU Commission in harmonising European private law have been influenced by the need to ensure the efficient functioning of the common internal market, underpinned by harmonised private law², the idea of harmonising private law based on legal principles recognised by all the Member States³, and the plan to draft a European Civil Code as an opt-in instrument.⁴ The idea of finding common legal principles has by now been replaced with a search for

¹ European Union — Consolidated Versions of the Treaty on European Union and of the Treaty Establishing the European Community (consolidated text). — OJ C 321E, 29.12.2006.

Article 6: “1. The Union is founded on the principles of liberty, democracy, respect for human rights and fundamental freedoms, and the rule of law, principles which are common to the Member States.”

2. The Union shall respect fundamental rights, as guaranteed by the European Convention for the Protection of Human Rights and Fundamental Freedoms signed in Rome on 4 November 1950 and as they result from the constitutional traditions common to the Member States, as general principles of Community law.”

Available at <http://eur-lex.europa.eu/LexUriServ/site/en/oj/2006/ce321/ce32120061229en00010331.pdf> (25.07.2007).

² Communication from the Commission to the Council and the European Parliament on European Contract Law, COM (2001) 398 final (11 July 2001).

³ Communication of the Commission to the European Parliament and European Council: A more coherent European Contract Law. An Action Plan, COM (2003) 68 final (15 March 2003).

⁴ In recent years discussion over the necessity, methods of preparation, and instruments of the European Civil Code have mainly focused on seeking alternatives. Various solutions have been offered from harmonisation of private law to the specific solution of preparing only a Consumer Code. See, e.g., J. Smits. The Need for a European Contract Law. Empirical and Legal Perspectives. J. Smits (ed.). Groningen: Europa Law Publishing 2005; N. Reich. A European Contract Law, or an EU Contract Law Regulation for Consumers? — *Journal of Consumer Policy*, 28, 2005, pp. 383–407; S. Grundmann. European Law(s) of What Colour? — *ERCL* 2005/2, pp. 184–210. See also C. U. Schmid. The Instrumentalist Conception of the *Acquis Communautaire* in Consumer Law and Its Implications on a European Contract Law Code. — *ERCL* 2005/2, pp. 226–227.

“best solutions” from among the models of national legal systems.^{*5} The fact that issues of constitutionalisation of European private law have become topical refers to certain paradigm changes, which arise from reaching the stage of harmonisation where the harmonisation of private law, which is more than harmonisation of the rules but also the harmonised practice of application of the main principles of EU law, has given rise to the question of the horizontal effect on private law of fundamental rights and constitutional values.^{*6} This paper attempts to answer the questions of whether courts should use only private law instruments to protect private autonomy and freedom of contract in private law disputes or whether they should directly apply constitutional values and principles to protect these freedoms; which private law instruments in Estonian law allow for the protection of fundamental rights, whether they are sufficient, and whether Estonian private law could offer a “best solution” for harmonised European private law.

1. Constitutionalisation of private law

Although the Constitution was found for a long time not to have a direct effect on private law relationships, law literature has in recent years started to speak about the constitutionalisation of contract law.^{*7} In most EU Member States, the vertical effect of fundamental rights and freedoms on relations between individuals is recognised in addition to their horizontal effect on relations between the state and individuals.^{*8} On the domestic level the issue of constitutionalisation of private law largely reduces to how disputes in private law relationships should take account of fundamental rights and the needs to protect them, i.e., what role the constitutional system of values should have in the application of private law principles and instruments to the settlement of specific disputes.

Constitutional principles serve for the applier of law as a source material in the interpretation of provisions; they help provide content to the meaning of a provision and provide direction for interpretation purposes, which also delimits the space of interpretation.^{*9} However, fundamental rights do not settle a specific legal dispute, but open themselves via the legal provisions regulating the relevant area of law.^{*10} The direct horizontal impact of fundamental rights and constitutional principles implies the possibility to rely on them in private law claims. According to the theory of the indirect horizontal effect, a claim itself has to be based on a private law provision, which is interpreted and applied in the light of fundamental rights and freedoms and constitutional principles.^{*11} Both theories are actually applied in judicial practice, and as the judicial practice of applying fundamental rights and freedoms in private law relationships varies significantly by country, there is reason to be sceptical about arguments claiming that uniform practice in this area is a prerequisite for harmonising European private law.^{*12}

The process of harmonisation of European private law has been associated with the European Constitutional Treaty and the protection of fundamental rights and freedoms since the publication of the manifesto^{*13} which formulated the idea of social justice in European contract law. One of the areas of application of the idea of social justice is contracts of suretyship, in which the connection between the general principles and rules of contract law, on the one hand, and the need to protect fundamental rights, on the other, is especially vividly expressed.

⁵ Communication from the Commission to the European Parliament and the Council – European Contract Law and the Revision of the Acquis: the Way Forward, COM (2004) 651 final (11 November 2004).

⁶ A. Colombi Ciacchi. Non-legislative Harmonisation of Private Law under the European Constitution: The Case of Unfair Suretyships. – ERPL 2005/3, p. 291.

⁷ O. Cherednychenko. The Constitutionalization of Contract Law; Something New under the Sun? – EJCL (Electronic Journal of Comparative Law) 2004/8. Available at <http://www.ejcl.org/81/art81-3.html> (25.07.2007).

⁸ About the horizontal effect of fundamental rights and freedoms in the harmonisation of EU private law see U. Magnus. Towards European Civil Liability. – Towards a European Ius Commune in Legal Education and Research. M. Faure, J. Smits, H. Schneider (ed.). Groningen: Intersentia 2002, pp. 209–212; B. Lurger. Political Issues in Property Law and European Unification Projects. – The Politics of a European Civil Code. M. W. Hesselink (ed.). Kluwer Law International 2006, pp. 39–40; T. Wilhelmsson. The Ethical Pluralism of Late Modern Europe and Codification of European Contract Law. – The Need for a European Contract Law. J. Smits (ed.). Groningen: Europa Law Publishing 2005, pp. 142–146.

⁹ Eesti Vabariigi Põhiseadus. Kommenteeritud väljaanne (Constitution of the Republic of Estonia. Commented Edition). Tallinn: Juura, Õigusteabe AS 2002, p. 46 (in Estonian).

¹⁰ D. W. Belling. Põhiõiguste tähendus eraõigusele (The Implications of Fundamental Rights for Private Law). – Juridica 2004/1, p. 6 (in Estonian).

¹¹ A. Colombi Ciacchi (Note 6), p. 293.

¹² *Ibid.*, pp. 306–308.

¹³ Study Group on Social Justice in European Private Law (Social Justice Group). Social Justice in European Contract Law. A Manifesto. – European Law Journal 2004/10, p. 653.

2. Unfair contracts of suretyship and fundamental rights

The constitutional courts of European countries' interference with private relationships is most frequent in the case-law concerning unfair contracts of suretyship. A typical case of an unfair contract of suretyship involves surety by a family member, which is excessively burdensome in view of the surety's ability to perform the obligor's obligation, the obvious disproportionality of the surety obligation, and the provision of surety under pressure from family members or other close persons. The German Constitutional Court has repeatedly found that courts have the duty to protect private autonomy as a fundamental right by interfering with private relationships on the basis of § 138 (1) and § 242 of the German Civil Code.^{*14} Recourse has been had to the argument of the inequality of the parties' structural bargaining ability, violation of the information duty in conditions of the unequal bargaining ability of the parties, as well as taking advantage of the inexperience of the other party and the disproportionality of the surety obligation compared to the surety's income or actual possibilities to cover the owed amount.^{*15} By weighing fundamental rights the Constitutional Court ascertained the desired end result or the objective which the court needs to protect by private law means. In the event of surety, the competing aspects have been both parties' right to private autonomy as a fundamental right, and the private law instrument of good morals. The latter has been used, as a rule, without reference to an established system, logic, or prerequisites of application of this instrument. If we compare, e.g., the application logic of the constitutional principles and the private law arguments published in the commentaries to the Estonian Constitution, the same results can be achieved.^{*16} It is questionable whether in private law a claim can be dismissed for the sake of protecting the legitimate interests of the parties with a reference to a constitutional principle or whether appropriate private law principles need to be found that serve the same goal.^{*17}

In the most frequently cited case of Lüth^{*18}, the German Constitutional Court finds that constitutional principles have only an indirect effect on private law via the interpretation of private law provisions; this was the foundation for H. C. Nipperdey's theory of indirect effect. According to the theory, disputes over the rights and obligations of parties to private law relationships must remain private law disputes in terms of their substance and procedurally, and must be settled according to private law principles. The later decisions of the German Constitutional Court have weighed, e.g., a party's constitutional right to private autonomy and the idea of a social state and the other party's right to private autonomy, and applied the good morals clause only formally. It has been concluded from German case-law that one can no longer speak about private law influenced by fundamental rights and the needs to protect them, but it is the Constitution that determines the results of a dispute between contracting parties, and the role of contract law has been restricted to providing the formal result and the appropriate instrument.^{*19}

Unfair suretyship cases are settled in various European legal orders also using civil law and contract law instruments, which is why it is questionable whether changing the role of the Constitution in settling private law disputes in German law is anything more than simply the transformation of contract law issues to fundamental rights issues. The case-law of the European Court of Justice refers to control exercised via limited constitutional principles, in which fundamental rights have rather the role of additional issues.^{*20}

Estonia's prospects of settling unfair suretyship disputes depend on whether interference with surety relations is deemed necessary on the level of fundamental rights, on the general attitude to the freedom of contract and unfairness in contractual relationships, and how effectively the existing contract law instruments can be used in removing unfairness from contractual relationships.

¹⁴ BGB § 138 (1) provides for the voidness of contracts made against good morals and § 242 sets out the obligation to act mutually in good faith (*Treu und Glaube*). See, e.g., BVerfGE 89, 214, NJW 1994, 36.

¹⁵ Well-known are also disputes over agency contracts, where the excessive burden imposed by competition restrictions has been judged to be contrary to good morals, and the so-called satellite dish case in which a tenant of Turkish roots was prohibited to install a dish aerial on the house in order to watch Turkish TV channels. The fundamental right whose violation the court established in the latter case was the freedom of information, which is guaranteed by the Constitution. See O. Cherednychenko (Note 7), p. 493.

¹⁶ Põhiseadus. Kommenteeritud väljaanne (Constitution. Commented Edition) (Note 9). Section 31, commentary 18, p. 273 (in Estonian).

¹⁷ According to this principle, e.g., an agent cannot be subjected to a competition restriction covering the entire territory of Estonia if under the agency contract the agent was obliged to enter into or intermediate contracts on behalf and for the account of the mandator only in Tallinn. The Estonian Supreme Court has found that a competition restriction touches on the agent's fundamental right arising from § 29 (1) of the Constitution and the restriction should be compensated as fairly as possible. See CCSCd 3-2-1-121-06.

¹⁸ See O. Cherednychenko (Note 7), p. 494.

¹⁹ *Ibid.*, p. 495.

²⁰ N. Reich. *Understanding EU Law. Objectives, Principles and Methods of Community Law*. Antwerpen, Oxford: Intersentia 2005, p. 214.

3. Civil law protection of the surety

3.1. Surety as a personal guarantee

A study of the lending conditions of seven Estonian banks^{*21} shows that loans guaranteed by surety form only a marginal share of the total number of loans.^{*22} Savings and loan associations may also give loans^{*23}, but surety is not the most frequently used guarantee to their loans either. As a rule, surety is accepted as an additional security to long-term loan agreements and business loans, but there are lenders who are willing to lend against surety only.^{*24} As a rule, sureties are required to have a regular income.^{*25} Surety is also used as an additional security to housing loans^{*26} and as a security to study loans.^{*27} Estonia's experience thus shows that surety as a personal security is not massively used in conditions of a developing real estate market, low risk levels and legal freedom, which is why there is little case-law concerning unfair suretyship. When economic growth slows down, surety in Estonia may change from an instrument serving solely private interests into a means of strengthening the direct effect of constitutional principles in private law relationships.

Suretyship is a contract in which the surety undertakes to meet a third party's (obligor's) obligation to an obligee. Suretyship is accessory to the principal obligation and independent of the obligation relationship between the obligor and the surety.^{*28} According to the Law of Obligations Act^{*29} (LOA) a surety and an obligor are solidary obligors unless the contract provides otherwise.^{*30} A surety is subject to the privilege that Estonian law gives the weaker party: any agreements deviating from the provisions of law to the detriment of the surety are void unless otherwise provided by law. In addition to surety, the Estonian law is also familiar with the first claim guarantee (LOA § 155), which may be given only in economic or professional activities. As opposed to surety, a guarantee is abstract with respect to the underlying obligation and an obligation is created by the obligee's submission of a claim. The requirements for a surety do not apply to a guarantee.^{*31} A surety may be provided within or outside economic or professional activities, which is why problems may arise with determining the actual type of contract and the protective provisions that should be applied. A third party may join a contractual obligation for securing purposes, in which case the provisions regulating surety apply to the contract.^{*32}

In contracts of consumer surety, the surety is a consumer, defined in LOA § 34 as a natural person who performs a transaction not related to an independent economic or professional activity. The concept of a consumer is specified in § 2 (1) of the Consumer Protection Act.^{*33} The Supreme Court has found that a natural person, who, motivated by his or her own interest, gives a surety to the economic activities of a company which is an

²¹ AS Eesti Krediidipank, AS SEB Eesti Ühispank, AS Hansapank, AS SBM Pank, AS Sampo Pank, Tallinna Äripanga AS and Balti Investeeringute Grupi Pank AS.

²² About the share and total volume of loans against surety see the Bank of Estonia website http://www.eestipank.info/pub/en/dokumendid/publikatsioonid/seeriad/finantsvahendus/_2006_1/_2.pdf (25.07.2007), p. 42; http://w.hansa.ee/eng/arikliendile_kaibekapitalijuhtimine_tagatised.html (25.07.2007) (in Estonian).

²³ Hoiu- ja laenuühistute seadus (Savings and Loan Associations Act), entered into force on 1.07.1999. – RT I 1999, 24, 357; last amendments 5.06.2002. – RT I 2002, 53, 336 (in Estonian). English translation available at <http://www.legaltext.ee/et/andmebaas/ava.asp?m=022>. See also the 2006 report of SEB: Nordic Outlook. Global economy continuing to resist American deceleration Sweden: ketchup effect for jobs means higher key interest rate, November 2006, p. 20. Available at <https://www.seb.ee/cgi-bin/unet3.sh/un3.w?act=SENDFILE&fname=NOFeb2006eng.pdf> (25.07.2007).

²⁴ AS BIG is one of those who lends against surety only, see <http://www.big.ee/?nodeid=66&lang=en> (25.07.2007) (in Estonian).

²⁵ In different banks from EEK 5000 (€ 321) to EEK 10,000 (€ 641) a month over the past six months.

²⁶ See the SEB Bank website <http://www.seb.ee/index/1301> (25.07.2007) (in Estonian).

²⁷ Õppetootuste ja õppelaenu seadus (Study Allowances and Study Loans Act), entered into force on 1.09.2003. – RT I 2003, 58, 387 (in Estonian).

²⁸ See also S. van Erp. Surety Agreements and the Principle of Accessory – Personal Security in the Light of a European Property Law Principle. – *European Review of Private Law* 2005/3, p. 311.

²⁹ Völaõigusseadus. Entered into force on 1.07.2002. – RT I 2001, 81, 487; 2005, 61, 473 (in Estonian). English translation available at <http://www.legaltext.ee/et/andmebaas/ava.asp?m=022>.

³⁰ LOA § 145 (1): In the case of non-performance, the principal obligor and the surety shall be solidarily liable to the creditor unless the contract of suretyship provides that the surety is liable only if the claim of the creditor against the principal obligor cannot be satisfied.

³¹ Guarantee in Estonian law constitutes legal concept which is regulated under the model of ICC's Uniform Rules for Demand Guarantees. – ICC Publication No. 458, Paris: ICC Publishing S.A. 1992, p. 20. As a model also United Nations Convention on Independent Guarantees and Stand-by Letters of Credit was used. See UN General Assembly Resolution 50/48, 11.12.1995.

³² If a person joins an obligation, i.e., enters an obligation relationship in addition to the obligor to provide a security, LOA §§ 145, 149 and 152 apply.

³³ According to the Consumer Protection Act, "consumer" means a natural person to whom goods or services are offered or who acquires or uses goods or services for purposes not related to his or her business or professional activities. See *Tarbijakaitse seadus* (Consumer Protection Act). Entered into force on 15.04.2004. – RT I 2004, 13, 86 (in Estonian). English translation available at <http://www.legaltext.ee/et/andmebaas/ava.asp?m=022> (25.07.2007).

obligor, cannot be treated as a consumer.^{*34} Therefore, we can speak about consumer surety only if the surety is not related to independent economic or professional activities, i.e., if there is a lack of any economic interest or other interest related to economic or professional activities. The fact that the surety is given by a consumer or a professional contracting party does not imply major differences in the scope of protective provisions, as the general clause limiting party autonomy (LOA § 142 (6)) applies to all contracts of suretyship. As a rule, the protective provisions themselves are wide enough to be furnished with a catalogue of interests and values that should be taken into account when assessing the validity of an obligation of a surety that has been agreed on, deviating from the law. In the event of consumer surety, the protective provision lies in the duty to inform the surety of the maximum amount covered by the liability (LOA § 143 (2)), the requirement to put the relevant undertaking in writing (LOA § 144 (2)), the breach of which is rectified by meeting the obligation to the obligor. A surety who is a consumer has the right to withdraw from a contract of suretyship concluded for the performance of future obligations for an indefinite period; in the event of a fixed-term contract the right of withdrawal is limited to five years from the conclusion of the contract. All other protective provisions extend equally to consumer surety and ordinary contracts of suretyship.

3.2. The argument of fairness in Estonian law

The unfairness of suretyship is practically an unknown issue in Estonian law today. Only one judgment of a court of first instance is known^{*35} in which the court declared a contract of suretyship to be unfair and contrary to good morals (GPCCA^{*36} § 97), because the contract was made on extremely unfair conditions, the loan that was secured was obviously disproportionate to the surety's income, the surety had no personal interest in the loan being secured, and the surety was an older family member who apparently did not understand the nature of the obligations or the consequences arising from the contract. The Estonian Constitution^{*37} has been described as an overwhelmingly individualistic and liberal law.^{*38} Supreme Court decisions are also dominated by the approach, according to which the individual economic interests of the parties deserve to be protected in the first order. For example, the Supreme Court has taken the view that a loan contract cannot be unfair and contrary to good morals just because the parties agreed on an extremely high interest rate and that a party was not aware of the financial risks assumed. A loan contract may be contrary to good morals because it has a high interest rate only if the contract was made under duress (GPCCA § 96) or under extremely unfavourable conditions (GPCCA § 97).^{*39} It should be mentioned that these grounds allow for extrajudicial cancellation of a contract, but only during a limited time frame. Therefore, certain contracts which are contrary to good morals may still be binding on the parties if a party does not cancel the contract. Case-law seems to refer to the state's unwillingness to interfere with the aforementioned contractual relations.

Unfairness in contractual relationships is not easy to define or determine. Many provisions of the LOA help answer the question of what is considered unfair in Estonian civil law. For example, LOA § 140 (1) provides that something which is not reasonably acceptable can be considered grossly unfair. The grounds for applying the principle of reasonableness are provided in LOA § 7. According to this provision, with regard to an obligation, reasonableness is to be judged by what persons acting in good faith would ordinarily consider to be reasonable in the same situation, taking into account the nature of the obligation, the purpose of the transaction, the usages and practices in the fields of activity or professions involved and other circumstances. The principle of reasonableness thus involves the principle of good faith, which allows for fair suretyship to be defined as a contract which is made in good faith, reasonable, and generally acceptable.

Fairness as a principle involves both substantive and procedural elements. Procedural fairness means that a contract of suretyship must be in line with the principle of good faith not only for its substance, but the principle has to be taken into account also when entering into the contract. The principle of good faith or the substantive element in the concept of fairness means that the parties' obligations must not result in a consequence which is contrary to the principle of good faith. Like the principle of good faith, the principle of reasonableness may also be analysed from the aspect of the procedural and substantive elements of fairness. However, if we introduce

³⁴ The court took the view that a management board member who entered into a sales contract in his capacity of a member of the company and secured the performance of an obligation arising from the same sales contract in his capacity as a natural person had an interest in the business of the company as a board member and therefore the surety was given in connection with economic or professional activities. CCSCd 23.03.2006, 3-2-1-8-06.

³⁵ Judgment of the Tallinn City Court 13.12.2004, 2/270-10222/03.

³⁶ Tsiviilseadustiku üldosa seadus (General Part of the Civil Code Act). Entered into force on 1.07.2002. – RT I 2002, 35, 216; 2007, 24, 128 (in Estonian). English translation available at <http://www.legaltext.ee/et/andmebaas/ava.asp?m=022>.

³⁷ Eesti Vabariigi Põhiseadus (The Constitution of the Republic of Estonia). Available at <http://www.legaltext.ee/et/andmebaas/ava.asp?m=022>. See also I. Kull, Principle of Good Faith and Constitutional Values in Contract Law. – *Juridica International* 2002, p. 142. Available at http://www.juridica.ee/get_doc.php?id=434 (25.07.2007).

³⁸ K. Saaremäel-Stoilov, Liberal Communitarian Interpretation of Social and Equality Rights: A Balanced Approach? – *Juridica International* 2006, p. 90. Available at http://www.juridica.ee/international_en.php?document=en/international/2006/1/113249.SUM.php (25.07.2007).

³⁹ Ruling of the Supreme Court from 16.10.2002, 3-2-1-80-02.

the attribute of general acceptance of a contractual agreement, this refers to good morals which must be taken into account when assessing the fairness or unfairness of a surety. As there is currently no case-law of the Supreme Court concerning assessment of the unfairness of surety and only a few judgments of lower courts are available, we can only guess what arguments courts could have when making such an assessment.

This leads us to the problem referred to at the beginning of this paper. Namely, fairness does not only lie in the texts of laws, but also their interpretation and practical implementation. An analysis of the elements of the legal system must have regard to its dynamics. Law goes through various stages — the chronological sequence of the preparation of a law, its adoption, interpretation and implementation.^{*40} Although there is a law regulating suretyship and the protection of the parties' interests, its interpretation and application in, e.g., Estonia is still insufficient for making solid conclusions or generalisations about the application of the provisions. The decisions of the Supreme Court made so far certainly do not lead to the conclusion that Estonian courts would not admit the unfairness of consumer surety as an argument.

3.3. Unfairness of surety provided by family members

If we analyse the individual elements of unfairness of contracts of suretyship in Estonian law, we will see that the question lies not only in admission of the argument of unfairness, but also in the context in which we handle a legal phenomenon. For example, in the case-law of European countries sureties given by children to secure their parents' obligations have been considered unfair. Estonian case-law is not yet familiar with these problems, which are known in many countries. The reason is very simple — Estonian lenders accept sureties only from adults.^{*41} Even if a lender is willing to lend against surety by a minor, this is prevented by the Family Law Act^{*42} and the GPCCA.^{*43}

Spouses may also be the family members whose sureties have been considered unfair in the case-law of European countries. The bases on which sureties given by spouses may be held void differ greatly from country to country. In the German Federal Republic, surety given by family members is held to be void if it is obviously disproportionate compared to the income and property of the family member; in the UK and the Netherlands sureties by family members are held to be void only if the surety was not adequately informed of the risks arising from the contract at the time of conclusion. In Italy there are no rules about the voidness of surety given by non-professionals.^{*44} The differences between legal orders are thus considered to be not formal, but substantive. The indirect rules and models which are considered to be encrypted models in comparative law and influence the solutions of specific situations in a specific legal order are not expressly stated by law. They are concealed by certain provisions of law and doctrines, which are applied to solve certain specific problems.^{*45} An assessment of the indirect rules and models developed by the Estonian case-law shows that transactions are held to be contrary to good morals if they ignore significantly other moral norms than those described in GCPPA §§ 92, 94, 96 and 97.^{*46} Therefore, according to the Estonian encrypted legal rule, it would not be possible to declare void due to conflict with good morals an unfair surety, the unfairness of which arises from gross disparity, duress or fraud, other circumstances reducing a party's bargaining ability or the ability to understand the consequences of the contract.^{*47} For example, to declare a loan contract to be usurious and hence voidable, it is not enough that the contract was made under great disparity, but it is important to establish a party's difficult circumstances at the time of entry into the contract, and the usurious conduct of the other party.^{*48} The same model may be presumed to apply to an unfair contract of surety.

⁴⁰ R. Narits. General Objectives of Legal Theory and Significance of Values in the Context of Globalisation. – *Juridica International* 2006, p. 12. Available at http://www.juridica.ee/get_doc.php?id=1005 (25.07.2007).

⁴¹ See P. Varul, A. Avi, T. Kivisild. Restrictions on Active Legal Capacity. – *Juridica International* 2004, p. 100. Available at http://www.juridica.ee/get_doc.php?id=735 (25.07.2007).

⁴² Perekonnaseadus. Entered into force on 1.01.1995. – RT I 1994, 75, 1326; 2006, 14, 111 (in Estonian). English translation available at <http://www.legaltext.ee/et/andmebaas/ava.asp?m=022>.

⁴³ Minors under the age of 7 may enter into transactions only with the consent of their parents or other legal representatives (GPCCA § 12 (2)). A minor who is 15 years old may acquire the right to enter into contracts, including contracts of suretyship, by a court decision. As a court decides on the active legal capacity of a minor who is 15 years old, it is highly doubtful that contracts of suretyship would be included in the allowed transactions (GCPPA § 9). However, the Family Law Act does not prohibit a representative to enter into transactions, including contracts of suretyship, on behalf of the minor without the consent of a guardianship authority (FLA § 99). It may thus happen that a minor's parents enter into a contract of suretyship on behalf of the minor and the guardianship authority cannot check the transaction. Therefore the substantive and procedural fairness of these contracts needs to be checked by a court.

⁴⁴ A. Colombi Ciacchi (Note 6), p. 305.

⁴⁵ See R. Sacco. Legal Formants: A Dynamic Approach to Comparative Law. – *American J. Comp. L.*, 1991 (39), p. 384.

⁴⁶ The sections of the GPCCA concern, respectively, transactions entered into under the influence of a relevant mistake, fraud, threat, violence or gross disparity.

⁴⁷ See CCSCd 3-2-1-158-05.

⁴⁸ See CCSCd 3-2-1-108-02.

Sureties given by family members have also been held to be contrary to good morals on grounds that the obligations of the parties are disproportionate.⁴⁹ When considering the assessments of the substances and scope of the parties' obligations in various legal orders, the rules under which a contract has been concluded should also be taken into account. The above position of the German Constitutional Court was adopted in a situation where banks were under the obligation to secure loans by surety, which is why the bank clerk who signed the contract referred to the surety as a necessary formality that cannot have any detrimental consequences. However, if a bank is free to decide what type of surety it requires for a loan, the bank is obviously not interested in a formal security but a security that can be later used to cover the loan, if necessary.

If the borrower and surety are closely related persons, it is not easy to assess the unfairness of the suretyship. Close relations imply that assuming the obligor's obligation is the goal desired by the surety. Where the surety has personal economic interests, the person is presumed to exercise his or her private autonomy by assuming risks with the burdening surety obligation, hoping at the same time to have a gain.⁵⁰ However, if a contract is made because of personal relationships and the surety has no economic interests in the contract and the contract substantially damages the surety's economic interests or jeopardises his or her financial future⁵¹, a contract of suretyship must be held void because it is contrary to good morals. When justifying the disproportionality of obligations, the Supreme Court has referred to § 32 (2) of the Constitution, which provides for freedom of ownership, i.e., everyone's right to freely possess, use, and dispose of his or her property. Without references to principles of private law or legal provisions restricting the parties' lawful freedom of contract, the court has motivated a borrower's right to determine the rate of interest. The Supreme Court has taken the view that the court cannot interfere with the free economic activities of persons or check the amount of a price unless there the law provides a basis for this.⁵² However, the Supreme Court's general approach to the contracts violating good morals allows for holding contracts of suretyship between family members to be unfair if such a contract materially restricts a party's personal or economic freedom or if one party has unfairly used his or her position when entering into the contract. Also, a transaction that places a party in a situation where the party cannot assess the scope of his or her future obligations can also be contrary to good morals.⁵³ Owing to an effective system of credit information databases, increased duties can be posed on professional lenders and thus they can be presumed to have the duty to inform the surety of the obligor's solvency and other obligations that may jeopardise the possibility of recourse. It is common practice to check the background of both debtors and sureties through public databases⁵⁴, which are accessible to everyone, but professional lenders are more experienced and better equipped to use these databases. However, when dividing the risk between the parties, it could be presumed that a surety takes reasonable measures to study the financial situation of the obligor and his or her related companies.

3.4. Unfairness of suretyship arising from breach of the information duties

The Estonian law does not directly provide for the duty to give information about the potential risks of entering into a contract of suretyship. LOA § 14 (1) provides for the general obligation to protect persons participating in pre-contractual negotiations or other preparations for entering into a contract. Namely, negotiating parties must take reasonable account of each other's interests and rights. In addition to other things, the general protection obligation implies the duty to present accurate information upon entry into a contract (LOA § 14 (1) second sentence) and inform the other party of all circumstances with regard to which the other party has, based on the purpose of the contract, an identifiable essential interest (LOA § 14 (2) first sentence). However, there is no duty to inform the other party of such circumstances of which the other party could not reasonably

⁴⁹ See e.g., the decision of the German Constitutional Court BverfG 19 October 1993 (NJW 1994, p. 36); its description can be found in: O. Cherednychenko (Note 7).

⁵⁰ Structural un-equality is a very delicate question and any generalisation made by courts will be criticised. Personal interest of the surety in guaranteeing loan taken by close family member is in most cases a good evidence of fairness in contractual relations. See D. Schnabl. *Neue Entwicklungen der Rechtsprechung zu sittenwidrigen Bürgschaften* (Seminararbeit). Available at <http://www2.uni-leipzig.de/bankinstitut/dokumente/2002-12-07-06.pdf> (27.07.2007).

⁵¹ The Estonian Supreme Court has taken the view that if a contract creates obligations for one party only, then only one party's immoral conduct upon entry into the contract is sufficient to declare the contract to be contrary to good morals. However, like in the event of a loan contract, surety cannot be held to be unfair and contrary to good morals merely by reason of the substantive burdensomeness of the contract and the disadvantage it brings to the surety, but the party's a difficult situation upon entry into the contract and the other party's usurious conduct also need to be ascertained. See CCSCd 3-2-1-108-02.

⁵² See CCSCd 3-2-1-158-05.

⁵³ *Ibid.* The Estonian Supreme Court has repeatedly assured that a high interest rate alone is not sufficient for declaring a contract void on grounds of being contrary to good morals; see decisions 3-2-1-21-06, 3-2-1-29-04 and 3-2-1-41-04.

⁵⁴ The Estonian Credit Register was established by Estonian banks in 2001 and it is administered by Krediidinfo. See http://www.krediidinfo.ee/index.php?ss_max=10&ss=&m=&otsi=1&lang=I (27.07.2007) (in Estonian).

expect to be informed (LOA § 14 (2) second sentence). In addition to the general duty to inform, the law thus also contains more specific obligations of presenting information that the other party may have expected under the circumstances because the party had to be interested in obtaining such information. In the event of a surety, the amount of the duty being secured is certainly such an interest, as it determines the scope of the surety's obligations and the risks that he or she takes. Whether a surety's interest in information about the obligor's financial situation or solvency is recognisable should be considered based on the meaning and purpose of law. The private autonomy of contracting parties as a protected fundamental right apparently does not allow answering this question. A surety may set up only those defences which could have been set up by the principal obligor (LOA § 149 (1)). This means that a surety cannot set up defences relying on an error concerning the obligor's solvency or the violated obligation to use the money only for its intended purpose. It must be presumed that when entering into a contract of suretyship, the surety should be informed of any circumstances increasing the risk that the obligation undertaken by the surety will have to be met in a situation where the possibilities of recourse have significantly worsened by the fact that the obligor has no means of fulfilling the claim. Therefore, when relying on the provisions of the LOA, a surety can be protected against unfair suretyship by considering the debtor to have violated his or her information duty and to submit a claim for compensation of damage in addition to relying on fraud or error. As the second sentence of LOA § 14 (2) limits the information duty to such circumstances of which the other party could reasonably expect to be informed, a bank, for example, cannot be blamed for failing to submit information, the interest in which the bank did not recognise and providing which would not have been reasonable under the circumstances.⁵⁵ The requirements for credit institutions' recognising an interest relevant to the objective of a contract are certainly higher than the requirements for a non-professional lender. Based on these premises, it is possible to deliberate whether the obligee recognised the other party's interest, e.g., in the surety's financial situation or other things that later became decisive in the surety's obligation. Therefore, the argument of protection of fundamental rights should remain the source from which a contracting party's protection need is derived, but the principle of the weaker party's protective or private autonomy should be furnished within the limits of private law's own principles and regulations. The state's interference with contractual relationships must be justified and such interference via direct application of constitutional values should be extremely exceptional, i.e., justified only if private law does not contain a relevant principle or if the existing institutional structure does not allow for the desired result.

If the obligee does not give information about the obligor's difficult financial situation or excessive loan burden or gives incorrect information, this constitutes a breach of the information duty. The obligation to procure the necessary information should lie with the transmitter of information, particularly a professional lender, since a professional lender has access to information about the borrower's financial situation. However, there are arguments that vest the risk of incorrect information or lack of information in the surety, who himself or herself should show interest in receiving the information about the obligor's financial situation. Rights protected by the Constitution, which ensure private autonomy and freedom to dispose of one's property, should be weighed against the principle of protecting the weaker party. The latter principle is contained in the very LOA and in the provisions governing suretyship it recognises the surety as the weaker party (LOA § 142 (6)).

4. Main principles of contract law in the protection of fundamental rights

The developments in Europe relating to the effect of fundamental rights on private law have been called a transfer from the commercialisation stage to the consumerisation stage, i.e., the principle that a contracting party is not only liable for himself or herself, but must take into account also the legitimate interests of the other party, thus having liability for the other party.⁵⁶ The information duty, which arises from the principle of good faith, and protection of the weaker party are those instruments of private law that motivate interference with contractual relationships; one of the forms of such interference is assessing the conformity of a contract with good morals. If there is an inequality of the structural ability to bargain, which renders a contract extraordinarily burdensome for one party, a court may interfere with the freedom of contract and, to protect the weaker party, dismiss a claim if fulfilment of the claim would have an unfair result.

At the same time, forced protection of constitutional rights in private relationships leads to a situation where a judge may easily be guided in his or her judgment by his or her subjective feelings and not take into account the solutions and principles provided by specific laws. Provisions of private law contain the values inherent of the entire legal order, which are guaranteed by protection of fundamental rights, but as opposed to the Consti-

⁵⁵ About the information duty of banks upon entry into a contract of suretyship see R. Parry, *The Position of Family Sureties within the Framework of Protection for Consumer Obligors in European Union Member States*. – *European Review of Private Law* 2005/3, p. 363.

⁵⁶ O. Cherednychenko (Note 7).

tution, they focus on the horizontal relationships between private law parties and not vertical relationships to which the state is a party. Fundamental rights do not give an answer that would clarify the behaviour expected of the parties. If a court assesses a situation to be contrary to good morals and blames the other party of violating the information duty, the next question that arises concerns the content of the information duty. Is a bank required to give information about the other party's financial situation, his or her ability to use money for the intended purpose, or to provide enough money to meet his or her obligations himself or herself? The principle of freedom of contract ensures the parties' freedom to enter into high-risk contracts and assume liability that may result in a significant deterioration of their financial status or bankruptcy, and in which the entire contract is based on the hope that the party will be able to meet his or her obligations if his or her circumstances are good. The abstract nature of fundamental rights and the different interpretations make it extremely difficult to find the balance when protecting various interests. For example, trying to reach socially just results may have the consequence of causing legal uncertainty and increasing the risk that the judgment will be motivated by the judge's "gut feeling" and not the principles of private law.

To sum up, the question of fairness or unfairness of suretyship can be reduced to the limits of application of the freedom of contract. To what extent should modern contract law, in which the principle of social justice as a principle having an impact on contract law in its entirety has risen next to the freedom of contract, take into account the need to protect the parties' right to enter into contracts whose content the parties themselves determine? Latest developments in EU law and in the harmonisation of European private law show that ordoliberalism, which is mainly the contract theory of the 20th century, is closely related to the market functionalism characteristic of EU law.⁵⁷

Estonian private law, which was largely adopted from German private law that rests on the ideas of social state and protection of the weaker party, must be effective in a society based on liberal market economy, where the ideas of social state are still too distant in many cases. Court decisions also demonstrate the effect of private autonomy and freedom of contract rather than social justice arguments (justice does, however, appear as an argument in many Supreme Court decisions⁵⁸). Neither have such general principles of contract law as fairness, consideration for the other party's interests or the principle of social justice been expressed very frequently in the court decisions of many European countries.⁵⁹ However, the suretyship rules provided by law do, rather, follow the ideas of social justice and the protection of the weaker party and not only in the case of consumer surety.⁶⁰ Estonian law has all the necessary instruments in the form of general provisions and special regulations for assessing the unfairness of contracts of suretyship. All the more so because it protects all non-professional sureties, not only consumers. The catalogue of fundamental rights that follows not only the principle of the freedom of contract, but also the principle of protecting the weaker party, binds the implementer of law and they are exercised via the indirect horizontal effect of fundamental rights with the help of private law principles (good faith, good morals, reasonableness, etc.). These principles guide judges in the interpretation of contract law provisions and in the elaboration of rules. Whether to be more inclined to follow the individualistic model of liberal contract law or the altruistic principle of social care and justice⁶¹ is a question to be answered by case-law, while legal science also has a considerable role here.⁶²

When studying the possibilities of applying the principle of social justice in judging the fairness of a contract of suretyship in the Estonian legal order, it may be said that a surety has, on grounds of the unfairness of suretyship, good enough defences against an obligee's claim. The pre-contractual information duty, the defences allowed to a surety, and other civil law instruments that apply together with the principle of freedom of contract give a surety a fairly good position to eliminate unfairness. Although fundamental rights are the first things to

⁵⁷ B. Lurger. *Grundfragen der Vereinheitlichung des Vertragsrechts in der Europäischen Union*. Vienna, New York 2002, p. 396.

⁵⁸ See, e.g., CCSCd 11.12.2006, 3-2-1-128-06, paragraphs 24, 28; 13.12.2005, 3-2-1-133-05, paragraph 12; 22.12.2005, 3-2-1-73-04, paragraph 32.

⁵⁹ B. Lurger. *The 'Social Side' of Contract Law and the New Principle of Regard and Fairness*. – A. Hartkamp, M. Hesselink et al (eds.). *Towards a European Civil Code*. 3rd ed. Nijmegen 2004, pp. 273, 286.

⁶⁰ I recall LOA § 142 (6), according to which agreements derogating from the provisions of law to the detriment of a surety shall be void.

⁶¹ R. Sefton-Green. *Social Justice and European Identity in European Contract Law*. – ERCL 2006/2, p. 275. See also B. Lurger. *The Future of European Contract Law between Freedom of Contract, Social Justice and Market Rationality*. – ERCL 2005/1, p. 442, 453 ff.

⁶² See I. Kull. *Hea usu põhimõte lepinguõiguses (Principle of good faith in contract law)*. – Eetika. Interdistsiplinaarsed lähenemised (Ethics. Interdisciplinary Approaches). M. Sutrop, K. Simm (eds.). Tallinn: Tartu Ülikooli eetikakeskus 2006, p. 186–207 (in Estonian); I. Kull. *Riigikohtu praktikat lepingulistes vaidlustes. Lepinguvabaduse piirangud ja nõrgema poole kaitse (Case-law of the Supreme Court in Contractual Disputes. Limits of Principle of Freedom of Contract and Protection of Weaker Party)*. – Riigikohus 2005. Lahendid ja Kommentaarid. Tallinn 2005, pp. 1310–1321 (in Estonian). In English: I. Kull. *Principle of Good Faith and Constitutional Values in Contract Law*. – *Juridica International*. Law Review University of Tartu 2002, pp. 42–149; I. Kull. *European and Estonian Law of Obligations – Transposition of Law or Mutual Influence?* – *Juridica International* 2004, pp. 32–44; I. Kull. *The Principle of Private Autonomy and Harmonization of Estonian Contract Law*. – F. J. Feldbrugge (ed.). *Law in Transition*. Netherland, Kluwer Law International 2002, pp. 55–80; I. Kull. *Legal Integration and Reform- Innovations and Traditions in the Estonian Law of Obligations*. – *Rechtstheorie* 2000/31, pp. 371–381. About general principles in Estonian commercial contract law see I. Kull. *Estonian Contract Law in Support of Foreign Investments*. – M. Boguslawskij, A. Trunk (Hrsg.). *Rechtstlage von Auslandsinvestitionen in Transformationsstaaten/Legal Issues of Foreign Investment in Transition Countries*. Berlin: Berliner Wissenschafts-Verlag GmbH, Neuer Wissenschaftlicher Verlag GmbH 2006, pp. 427–443.

be taken into account when applying civil law principles, the very principles of civil law allow furnishing the fundamental rights with specific standards of conduct. Finally, the general principle applied in civil law is the principle of good faith^{*63}, which allows removing the gaps in the applicable law and blocking the exercise of rights if this would be contrary to the principle of good faith (*contra factum proprium*).^{*64}

In an ideal society, the dimensions of law are homogenous both in the quantitative and qualitative senses. Quantitative homogeneity means that people's ideas of justice coincide with the substance of law and that solutions to disputes are in line with the substance of law. Qualitative homogeneity means that the addressees of texts have a clear understanding of the substance of laws and this creates order and ensures certainty.^{*65} In Estonia, we cannot yet speak about excessive protection or lack of protection when it comes to sureties provided by non-professionals.^{*66} In private law, a court has to take into account the rules of private law, the intrinsic logic and purpose of the provisions and the underlying system of values, and on this basis weigh the need to protect the various interests under the specific circumstances of the case. Therefore, fundamental rights should not be directly applicable in private law, especially contract law, where private law itself contains the principles corresponding to the purposes and substance of these rights.

⁶³ Although the Estonian general provision setting out the mandatory nature of the principle of good faith is similar to German BGB § 242, the second part of the clause, or LOA § 6 (2), is based on the example provided by article 6:248 of the Civil Code of the Netherlands.

⁶⁴ The general clause derived from the principle of good faith, namely *exceptio doli*, i.e., the defence of the claimant's unclean hands, enacted in GPCCA § 138 (1). GPCCA § 138 (2) provides that a right shall not be exercised in an unlawful manner or with the objective to cause damage to another person. See also: M. Schmidt-Kessel. Rechtsmißbrauch im Gemeinschaftsprivatrecht – Folgerungen aus den Rechtssachen *Kefalas* und *Diamantis*. – Jahrbuch Junger Zivilrechtswissenschaftler 2000, pp. 61–83.

⁶⁵ R. Narits. General Objectives of Legal Theory and Significance of Values in the Context of Globalisation. – *Juridica International* 2006, p. 12. Available at http://www.juridica.ee/get_doc.php?id=1005 (25.07.2007).

⁶⁶ L. Kähler takes the view that in an overprotection situation preference is given to a broad interpretation of unfairness, as a result of which courts begin to claim sureties void in a greater number of cases. On the other hand, in an underprotection situation, declaring a surety void on grounds of being unfair is an exceptional phenomenon. In such case, the principle of freedom of contract may be a so-called covering principle of unfair contracts of suretyship, or a principle outside this. L. Kähler. Decision-making about Suretyships under Empirical Uncertainty – How Consequences of Decisions about Suretyships Might Influence the Law. – *European Review of Private Law* 2005/3, p. 348.