

## **THE HARMONISATION OF CONTRACT LAW IN EUROPE BY MEANS OF THE HORIZONTAL EFFECT OF FUNDAMENTAL RIGHTS?**

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### **Abstract**

In recent literature a plea has been made for the non-legislative harmonisation of contract law in Europe through the horizontal effect of European fundamental rights. The idea behind such harmonisation is that the European Court of Human Rights and the European Court of Justice need to strike a balance between competing fundamental rights, in order to assess the appropriate level of the protection of the weaker party. This idea has in particular been advocated with a view to achieving harmonisation in the protection of sureties in the EU. The general aim of this paper is to critically assess the possibilities for the non-legislative harmonisation of contract law in Europe. Based in particular on the analysis of German constitutional law and the Nice Charter of Fundamental Rights of the EU 2000, it is argued that constitutional principles can hardly be understood in such a way as to prescribe a particular way of protecting the surety or other weaker party, and EU member states cannot be held to be thereby precluded from experimenting with different levels of protection within contract law. The European Court of Justice accordingly clearly lacks democratic legitimacy to promote a top-down non-legislative harmonisation of contract law through EU fundamental rights. It is submitted therefore that if the harmonisation of the protection of sureties and other weaker parties in Europe is to be attained, this can only be done by the European legislator and not through the interpretation of EU fundamental rights.

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## 1 Introduction

In recent literature a plea has been made for a top-down non-legislative harmonisation of contract law in Europe by means of the horizontal effect of European fundamental rights. The idea behind such harmonisation is that the European Court of Human Rights (ECHR) and the European Court of Justice (ECJ) need to assess the appropriate level of the protection of the weaker party on the basis of fundamental rights. This idea has in particular been advocated with a view to achieving the harmonisation of both the surety's and the lender's protection, which currently differs significantly in scope among the member states.<sup>1</sup> The general aim of this article is to critically assess the possibilities for the non-legislative harmonisation of contract law in Europe by means of fundamental rights.

In the light of the above, this essay will first address the issue of the horizontal effect of fundamental rights in contract law. It will be argued that today we are witnessing the growing impact of fundamental rights on contract law. Special attention in this context will be given to the possibilities for the effect of EU fundamental rights in European contract law. Subsequently, the idea of the non-legislative harmonisation of contract law by means of fundamental rights will be subjected to closer scrutiny. Firstly, the practical implications of the adoption of such an idea by the ECJ for the national courts of the EU member states will be considered. Secondly, the perplexities concerning the non-legislative harmonisation of contract law by means of fundamental rights will be discussed. It will be argued that pursuing the harmonisation of contract law in such a way is highly questionable, as fundamental rights themselves are hardly suitable for directly regulating the relationships between private parties and, in particular, for protecting the weaker party. Based on this analysis, a plea will be made against the non-legislative harmonisation of contract law through the horizontal effect of EU fundamental rights.

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<sup>1</sup> A. Colombi Ciacchi, 'Non-Legislative Harmonisation of Private Law under the European Constitution: The Case of Unfair Suretyships' (2005) 13 *European Review of Private Law* 285 at 306 ff.; A. Colombi Ciacchi, 'The Constitutionalization of European Contract Law' (2006) 2 *European Review of Contract Law* 167. See also the contribution by Chantal Mak in the current issue of the *Erasmus Law Review*.

## 2 The horizontal effect of fundamental rights in contract law

Originally, fundamental rights and contract law were considered to be wide apart due to the sharp distinction between public and private law. For a long time, therefore, contract law was considered to be immune from the effect of fundamental rights, the function of which was limited to being an individual defence against the vigilant eye of the state. Recently however, in many European legal systems, and in German law in particular, fundamental rights and contract law have started to move towards each other with ever-increasing speed. The growing influence of fundamental rights on the relationships between private parties under contract law (i.e. horizontal effect of fundamental rights in contract law, which can now be traced in many European legal systems), makes it possible to speak about the tendency towards the constitutionalisation of contract law<sup>2</sup> and clearly shows that the world of fundamental rights and the world of contract law no longer exist in isolation from each other.<sup>3</sup> Therefore, the major issue at

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<sup>2</sup> The term 'constitutionalisation' has been widely used by Dutch scholars in particular. See, for example, F.W. Grosheide, 'Constitutionalising van het burgerlijk recht?' (2001) 3 *Contracteren* 48; J.M. Smits, 'Constitutionalising van het vermogensrecht', *Preadviezen uitgebracht voor de Nederlandse Vereniging voor Rechtsvergelijking* (Deventer: Kluwer, 2003); O.O. Cherednychenko, 'The Constitutionalization of Contract Law: Something New under the Sun?' (2004) 8.1 *Electronic Journal of Comparative Law*, <http://www.ejcl.org/81/art81-3.html>; S. Lindenbergh, 'The Constitutionalisation of Private Law in the Netherlands', in T. Barkhuysen and S. Lindenbergh (eds.), *Constitutionalisation of Private Law* (Leiden/Boston: Martinus Nijhoff Publishers, 2006) 97. In other legal systems, however, many authors have also signalled the growing impact of fundamental rights in private law in general and contract law in particular, occasionally also using the term 'constitutionalisation'. For Germany, see, for example, C. Starck, 'Human Rights and Private Law in German Constitutional Development and in the Jurisdiction of the Federal Constitutional Court' and A. Heldrich and G.M. Rehm, 'Importing Constitutional Values through Blanket Clauses', in D. Friedmann and D. Barak-Erez (eds.), *Human Rights in Private Law* (Oxford/Portland Oregon: Hart Publishing 2001) 97 and 113; G. Brüggemeier, 'Constitutionalisation of Private Law – The German Perspective', in Barkhuysen and Lindenbergh (eds.) 59. For the UK, see, for example, H. Beale and N. Pittam, 'The Impact of the Human Rights Act 1998 on English Tort and Contract Law', in Friedmann and Barak-Erez (eds.) 131; L.M. MacQueen, 'Delict, Contract, and the Bill of Rights: a Perspective from the United Kingdom' (2004) 121 *Edinburgh Law Review* 359; S. Banakas, 'The Constitutionalisation of Private Law in the UK: is there an Emperor inside the new Clothes?', in Barkhuysen and Lindenbergh (eds.), 83.

<sup>3</sup> Although until recently the tendency towards the constitutionalisation of private law has primarily manifested itself within domestic legal systems, private law, in particular contract law, may potentially also be considerably affected by fundamental rights as a result of the case law of the ECHR and the ECJ. On this, see

present is no longer *whether* fundamental rights may have an impact on the relationships between private parties in different phases of the life of a contract but *to what extent* this will occur.<sup>4</sup>

It would not be an exaggeration to say that the constitutionalisation of contract law in Europe has currently reached its most advanced stage in Germany, where the case law of the Federal Constitutional Court contains the most telling examples of the far-reaching effect of constitutional rights on the relationships between private parties under contract law. It all started with the judgment of the Constitutional Court in the *Handelsvertreter* case<sup>5</sup> in 1990 where, in essence, the court invalidated a non-competition clause in the contract between a commercial agent and his principal on the grounds that it was contrary to the agent's constitutional right to freedom to exercise a profession guaranteed by article 12 (1) of the Basic Law. According to this clause, the agent was barred from working in any capacity for any competitor of the principal for two years after the termination of the contractual relationship, and in the event that the termination was brought about by culpable behaviour on his part he would not be entitled to any compensation. This clause was compatible with the mandatory provisions of the German Commercial Code introduced by the German legislator with a view to regulating the conflict of interests between the principal and the agent and, in particular, protecting the agent who often had only little negotiating power. However, the Constitutional Court overturned the decision of the Supreme Court in private law matters in which the clause in

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O.O. Cherednychenko, 'Towards the Control of Private Acts by the European Court of Human Rights?' (2006) 13 *Maastricht Journal of European and Comparative Law* 195 and O.O. Cherednychenko, 'EU Fundamental Rights, EC Freedoms and Private Law' (2006) 14 *European Review of Private Law* 23, with further references. European contract law is also unlikely to escape from the influence of EU fundamental rights. For an analysis of the potential for the constitutionalisation of European contract law, see, for example, M.W. Hesselink, 'The Horizontal Effect of Social Rights in European Contract Law', in M.W. Hesselink *et al* (eds.), *Privaatrecht tussen autonomie en solidariteit* (Private law between autonomy and solidarity) (Den Haag: Boom Juridische Uitgevers 2003) 119; A. Colombi Ciacchi, 'The Constitutionalization of European Contract Law: Judicial Convergence and Social Justice' (2006) 2 *European Review of Contract Law* 167; O. Cherednychenko, 'Fundamental Rights and Contract Law' (2006) 2 *European Review of Contract Law* 489.

<sup>4</sup> For a comprehensive study of the phenomenon of the constitutionalisation of contract law, see O.O. Cherednychenko, *Fundamental Rights, Contract Law and the Protection of the Weaker Party: A Comparative Analysis of the Constitutionalisation of Contract Law, with Emphasis on Risky Financial Transactions* (Munich: Sellier. European Law Publishers 2007).

<sup>5</sup> BVerfG 7 February 1990, BVerfGE 81, 242 (*Handelsvertreter*).

question was upheld and it declared the respective provisions of the Commercial Code to be unconstitutional. In the view of the Constitutional Court, in those cases where the legislator omits adopting mandatory contract law for particular areas of life or types of contract, it is the private law courts that are obliged to *protect* constitutional rights in situations of disturbed contractual parity using the means available within private law.

In 1993 the Constitutional Court delivered another revolutionary judgement in the famous *Bürgschaft* case.<sup>6</sup> In this case, the daughter, who was 21 years of age, did not have a high level of education, owned no property and worked as an unskilled employee at a fish factory for a modest salary, had acted as a surety for her father's debts to the amount of DM 100,000 (50,000 Euros). Essentially, the court invalidated the suretyship contract concluded by the daughter on the basis of her constitutional right to private autonomy, which follows from the constitutional right to the free development of one's personality, in conjunction with the principle of the social state (articles 2(1) and 28(1) of the Basic Law). According to the court, in cases where a 'structural inequality in bargaining power' has led to a contract that is exceptionally onerous for the weaker party, the private law courts are obliged to protect the constitutional right to private autonomy of this party by intervening within the framework of the general clauses (§ 138(1) and § 242 of the German Civil Code concerning good morals and good faith, respectively).

In addition to commercial agents and sureties, some six months later extensive protection on the constitutional level was also given to tenants as a result of the Constitutional Court's decision in the *Parabolantenne* case.<sup>7</sup> In this case the Constitutional Court obliged a landlord to allow the tenant of Turkish origin to install an additional satellite dish in order to be able to receive Turkish TV programmes. The decision of the private law courts that upheld the refusal of the landlord to permit such an installation on the basis of the contract concluded between the parties was considered by the Constitutional Court to be unconstitutional. According to the court, by interpreting in a highly restricted manner § 242 of the Civil Code on good faith, which was applicable in this case, the private law courts had violated the tenant's constitutional right to freedom of information guaranteed by article 5(1) of the Basic Law.

Despite fierce criticism of this approach in the German literature not only from lawyers with a private law background but also from those with a public law background,<sup>8</sup> the more recent case law of the Constitutional

<sup>6</sup> BVerfG 19 October 1993, BVerfGE 89, 214 (*Bürgschaft*).

<sup>7</sup> BVerfG 9 February 1994, BVerfG 90, 27 (*Parabolantenne*).

<sup>8</sup> See, for example, U. Diederichsen, 'Das Bundesverfassungsgericht als oberstes Zivilgericht – ein Lehrstück der juristischen Methodenlehre' (1998) 198 *Archiv für die civilistische Praxis* 171, at 210 ff.; A. Röthel, 'Verfassungsprivatrecht aus

Court shows no signs of the court retreating from this stance. On the contrary, by way of two spectacular judgments of 26 July 2005<sup>9</sup>, in which the court declared clauses in life insurance contracts to be unconstitutional, it has demonstrated its readiness to interfere further with contract law and to subject contractual agreements between private parties to control as to their compatibility with constitutional rights. In the judgements in question, the court held *inter alia* that the state's duties to protect the insured person's constitutional right to the free development of one's personality (article 2(1) of the Basic Law) and the constitutional right to property (article 14(1) of the Basic Law) ensure that in the case of the assignment of claims out of life insurance contracts, the assets created with the insurance company through the payment of the fees by the insured will remain to be kept as sources of a surplus and will be of benefit for the insured to the same extent as if the assignment of claims had not taken place.

The tendency towards the constitutionalisation of contract law is not only true for some national legal systems. A significant potential for imposing its own standards with regard to the way in which contract law and fundamental rights are to relate to each other in national legal systems on the basis of the European Convention on Human Rights (ECvHR) has recently been demonstrated in the decision of the ECHR in the *Pla* case.<sup>10</sup> Although it was mainly the law of succession that was at stake here, the reasoning of the court opens up the possibility for fundamental rights enshrined in the ECvHR to deeply affect the national law of contracts of the contracting states. According to the ECHR:

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Richterhand? Verfassungsbindung und Gesetzesbindung der Zivilgerichtsbarkeit' (2001) 41 *Juristische Schulung* 424; D. Medicus, 'Der Grundsatz der Verhältnismäßigkeit im Privatrecht', (1992) 192 *Archiv für die civilistische Praxis* 35, at 54 ff.; G. Spieß, 'Inhaltskontrolle von Verträgen – das Ende privatautonomer Vertragsgestaltung?' (1994) 109 *Deutsches Verwaltungsblatt* 1222 ff., in particular, 1229; C. Hillgruber, 'Abschied von der Privatautonomie?' (1995) 28 *Zeitschrift für Rechtspolitik* 6 at 9; S. Oeter, 'Fundamental Rights and Their Impact on Private Law – Doctrine and Practice under the German Constitution' (1994) 12 *Tel Aviv University Studies in Law* 7, at 15 ff.; K. Hesse, *Verfassungsrecht und Privatrecht*, (Heidelberg, 1988) 24; K. Stern, *Das Staatsrecht der Bundesrepublik Deutschland*, III/1 (Munich, 1988), § 76 IV, 1583.

<sup>9</sup> BVerfG *NJW* 2005, 2376.

<sup>10</sup> *Pla and Puncernau v Andorra*, ECHR (2004), No. 69498/01 (Sect. 4). For a detailed analysis of this case, see R.S. Kay, 'The European Convention on Human Rights and the Control of Private Law' (2005) 10 *European Human Rights Law Review* 466; Cherednychenko (2006, Towards the Control of Private Acts), above n. 3.

[T]he Court is not in theory required to settle disputes of a purely private nature. That being said, in exercising the European supervision incumbent on it, it cannot remain passive where a *national court's interpretation of a legal act, be it a testamentary disposition, a private contract, a public document, a statutory provision or an administrative practice* appears unreasonable, arbitrary or, as in the present case, blatantly inconsistent with the prohibition of discrimination established by Article 14, and more broadly with the principles underlying the Convention (emphasis added).<sup>11</sup>

It follows from this passage that the ECHR is prepared to check the national courts' interpretation of contractual agreements as to their compatibility with the ECvHR. Moreover, the *Pla* case also shows how subtle the distinction between testing the *interpretation* of private arrangements and testing these *arrangements* themselves can be in practice when the compatibility of their interpretation is decided in Strasbourg. It is notable that, whereas the Constitutional Court of Andorra, which considered the case before it went to Strasbourg, and one of the judges of the ECHR found that it was a discriminatory *testamentary disposition* that was involved in this case, the majority of the Strasbourg Court held that it was a discriminatory *interpretation* of the testamentary disposition that was at stake. What may therefore occur is that under the cover of testing the interpretation of contractual agreements, the ECHR may in reality start exercising control over these agreements and thus extend the horizontal effect of fundamental rights to the very heart of contract law.<sup>12</sup>

### 3 Possibilities for the effect of EU fundamental rights in European contract law

The possible effect of EU fundamental rights in European contract law<sup>13</sup> deserve our special attention in the present context, as it is primarily these rights that may become a vehicle for the non-legislative harmonisation of contract law in Europe. As will be demonstrated below, such possibilities are clearly present in EU law.

When the three EC Treaties were originally signed in the 1950s, they contained no express provisions concerning the protection of fundamental rights in the conduct of Community affairs. However, governed by the common constitutional traditions of the member states and by the fundamental rights recognised in the international human rights treaties, first

<sup>11</sup> *Pla and Puncernau v Andorra*, above n. 10, para. 59.

<sup>12</sup> On this in more detail, see Cherednychenko (2006 Towards the Control of Private Acts), above n. 3 at 203 ff.

<sup>13</sup> On this in more detail, see Cherednychenko (2006 Fundamental Rights and Contract Law), above n. 3 at 500.

and foremost, in the ECvHR, over the years the ECJ has developed in its case law what effectively amounts to an unwritten charter of rights for the Community. This development has gradually been given formal recognition within the amended EU and EC Treaties.<sup>14</sup> Article 6(1) and (2) of the EU Treaty currently in force explicitly states that the Union shall respect fundamental rights as general principles of Community law. The adoption of the Nice Charter of Fundamental Rights of the European Union containing, apart from individual civil liberties, also a rich set of social and economic rights can certainly be considered to be the culmination point in this development. According to article II-51 of the Constitution for Europe of which the Nice Charter now forms a part, fundamental rights of the charter are addressed to the institutions, bodies and agencies of the European Union and to the member states when they are implementing Union law.

Although recognition of the importance of fundamental rights has not yet led to a series of spectacular ECJ decisions dealing with European contract law, the possibilities for fundamental rights affecting this field of law has certainly been opened up.<sup>15</sup> The current case law of the ECJ contains examples of the fundamental rights review of EC law<sup>16</sup> and the member states' measures implementing EC law<sup>17</sup> or derogating therefrom.<sup>18</sup> Furthermore, in a number of cases the court has interpreted the EC legislation in the light of fundamental rights. Thus, for example, in the *Johnston* case,<sup>19</sup> the court treated article 6 of the Equal Treatment Directive 76/207 establishing the requirement of judicial control as a specific manifestation of the general principle of law. The Community provision was therefore to be read in the light of the corresponding principle in the ECvHR dealing with access to court and an effective judicial remedy. The use of the

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<sup>14</sup> On this development see, for example, P. Craig and G. de Búrca, *EU Law: Text, Cases, and Materials* (Oxford: University Press, 1998) 331-337.

<sup>15</sup> For a detailed discussion of these possibilities in relation to private law in general, see Cherednychenko (2006 EU Fundamental Rights), above n. 3, at 45 ff.

<sup>16</sup> Case 11/70, *Internationale Handelsgesellschaft v. Einfuhr- und Vorratstelle für Getreide und Futtermittel* [1970] ECR 1125; Case 44/79, *Hauer v. Land Rheinland-Pfalz* [1979] ECR 3727.

<sup>17</sup> Case 63/83, *R. v. Kent Kirk* [1984] ECR 2689; Case 249/86, *Commission v. Germany* [1989] ECR 1263; Cases 201 and 202/85, *Klensch v. Secrétaire d'Etat et à l'Agriculture et à la Viticulture* [1986] ECR 3497; Case 5/88, *Wachauf v. Germany* [1989] ECR 2609.

<sup>18</sup> Case C-260/89, *Elliniki Radiophonia Tileorassi AE v. Dimotiki Etairia Pliroforissis and Sotirios Kouvelas* [1991] ECR I-3925; Case C-368/95, *Vereinigte Familiapress Zeitungsverlags- und Vertriebs-GmbH v. Heinrich Bauer Verlag* [1997] 3 CMLR 1329.

<sup>19</sup> Case 36/75, *Rutili v. Minister for the Interior* [1975] ECR 1219; Case 222/84, *Johnston v. Chief Constable of the Royal Ulster Constabulary* [1986] ECR 1651.



fundamental rights laid down in the ECvHR here was indirect, it being used as an interpretative aid to the written provisions of Community law against which a member state's derogation was to be tested.

It is also notable in the present context that in its recent case law the ECJ has recognised that fundamental rights may serve as a justification for the member states' restriction of EC freedoms resulting from the prohibition of a certain commercial activity with a cross-border element in a member state. Thus, for example, in the *Omega* case,<sup>20</sup> which involved the German authorities banning the computer game 'Laserdrome' because it involved simulated killings, the court held that the objective of protecting human dignity could justify the restriction of the freedom to provide services.<sup>21</sup>

Thus, under the existing EC law, firstly, the content of fundamental rights must be respected when adopting and implementing EC law or derogating therefrom<sup>22</sup> and, secondly, EC law and the national law of the member states must be interpreted and applied in a way that is compatible with them. Therefore, European contract law as part of EC law in theory also cannot escape from the influence of EU fundamental rights. Potentially, such rights of the worker as, for example, the right to working conditions which respect his or her health, safety and dignity or the right to a limitation of maximum working hours may be used to influence the interpretation of more specific legislation and even form the basis for repealing the incompatible legislation.<sup>23</sup> Moreover, the contractual relationships between private parties may also be indirectly affected by EU fundamental rights through the fundamental rights review of the EC legislation in the field of contract law and the national laws adopted in the course of its implementation. Fundamental rights may therefore in practice form the basis for challenges to the validity of certain contract terms. This may in particular be the case if the ECJ follows the German Constitutional Court and, with a view to strengthening the position of the weaker contractual parties, imposes on the

<sup>20</sup> Case C-36/02, *Omega Spielhallen- und Automatenaufstellungs-GmbH v. Oberbürgermeisterin der Bundesstadt Bonn* [2004] ECR, I-09609. See also Case C-112/00, *Eugen Schmidberger, Internationale Transporte und Planzüge v. Republik Österreich* [2003] ECR, I-05659.

<sup>21</sup> On the relationship between EU fundamental rights, EC freedoms and private law, see Cherednychenko (2006 EU Fundamental Rights), above n. 3 above, with further references.

<sup>22</sup> It is not entirely clear, however, whether the expansion of the ECJ's review to those situations when member states are derogating from Community law is compatible with the limitation contained in article II-51 of the Constitution for Europe under which member states are only bound by fundamental rights when they are *implementing* EU law. Therefore, how the scope of the court's review will develop still remains to be seen.

<sup>23</sup> Compare H. Collins, 'European Social Policy and Contract Law' (2005) 1 *European Review of Contract Law* 115, at 117.

EC legislator and the national courts of the member states the duty to protect EU fundamental rights in the relationships between private parties under contract law.

In view of the foregoing, it is clear that EU law contains possibilities for the impact of fundamental rights on European contract law. Much will depend, however, on how the ECJ will regard its role with respect to the alignment between EU fundamental rights and European contract law.<sup>24</sup>

#### **4 The non-legislative harmonisation of the protection of weaker parties by means of fundamental rights: What is this all about?**

If the ECJ takes an activist stance concerning the alignment between fundamental rights and European contract law and sees therein the opportunity to eliminate the differences existing between the national contract law rules concerning certain sensitive issues, such as the scope of the surety's and the lender's protection, it may embark upon the non-legislative harmonisation of contract law in Europe by means of the horizontal effect of EU fundamental rights. In general terms, the idea behind such harmonisation is that the ECHR and the ECJ need to determine an appropriate level of protection to be granted to a particular weaker party on the basis of fundamental rights enshrined in the ECvHR or the Constitution for Europe. I will try to illustrate the practical implications of this idea by using the example of suretyship contracts concluded by the family members of the principal debtor under German, Dutch and English law.

At present, the need to protect family sureties who often enter into highly risky and potentially ruinous obligations is equally shared in all three legal systems. Nevertheless, considerable differences exist between them concerning the extent and the particular features of such protection in national laws. The analysis of the scope of the protection currently enjoyed by family sureties in these legal systems reveals a tension between a more interventionist approach aimed at prohibiting ruinous sureties as such, and thus protecting sureties against themselves, and a more freedom-oriented approach, under which suretyship contracts, including those that impose potentially highly burdensome obligations on the surety, are basically valid when the surety has freely entered into them.<sup>25</sup> Whereas the former approach

<sup>24</sup> The need for an 'alignment' of private law, in particular the 'principles of social justice in European contract law' with the 'constitutional principles already recognized in Europe', has been advocated by the Study Group on Social Justice in European Private Law. See 'Social Justice in European Contract Law: a Manifesto' (2004) 10 *European Law Journal* 653, at 667.

<sup>25</sup> On this issue in more detail, see Cherednychenko, above n. 4, Chapter 6.

is based on the idea of the substantive fairness of suretyship contracts, the latter starts out from the notion of procedural fairness. German law tends to follow a more paternalistic approach and to hold suretyship contracts contrary to good morals in those cases where the amount of the potential liability was grossly disproportional to the surety's financial means at the time of concluding the contract. By contrast, a more limited form of intervention in similar cases is currently practised in Dutch and English law, where distinctions on the basis of the financial situation of the surety are not made. These legal systems focus on the bargaining process that led to the conclusion of the suretyship contract and not on the content of the transaction. They tend to take the content of the suretyship contract into account only as an indicator that the procedure for concluding the contract must be examined more thoroughly. A further tension between the legal systems in question exists with regard to the scope of procedural protection to be afforded to the surety. What is at issue here is whether the creditor owes a duty to inform or advise the surety and, if so, what is the scope of such a duty. The German approach to the validity of family sureties in those cases where there is no gross disproportionality between the obligation incurred and the financial potential of the surety is based on a formal conception of private autonomy and is characterized by a highly restrictive approach to the creditor's duties to inform and to advise the surety about the nature of the suretyship contract and the risks involved therein. By contrast, Dutch and especially English law tend to attach primary importance to such duties and to regard them as the basic instrument for the protection of family sureties.

In practical terms, the harmonisation of contract law by means of fundamental rights leads to the ECJ determining the extent of the necessary protection of the weaker parties on the basis of EU fundamental rights. Such an approach may result, for example, in a finding that, by denying substantive protection to family members against potentially ruinous obligations under the suretyship contract, the national courts of a particular member state have acted contrary to article 8 of the ECvHR, which constitutes a fundamental right recognised in the EU<sup>26</sup> and protects the surety's right to the free development of his or her personality.<sup>27</sup> In such a case, the Dutch and English courts, which at present protect family sureties purely by procedural means, would have to radically change their approach in order to comply with EU fundamental rights. For instance, they would need to hold that in those cases where an obligation incurred under the suretyship contract is grossly disproportional to the income of the family

<sup>26</sup> See text at and following n. 14 above.

<sup>27</sup> That article 8 of the ECvHR protects not only private life in a strict sense but also personal autonomy in general has, in particular, been argued by Colombi Ciacchi, above n. 1, with further references.

member of the principal debtor, the fact that the bank has informed the family member about the high risks involved in acting as a surety is in such circumstances irrelevant and that the contract is void as such. Similarly, recourse to fundamental rights may lead the ECJ to conclude that the German approach to the validity of suretyship contracts in those cases where there is no gross disproportionality between the obligation incurred and the financial potential of the family surety constitutes a violation of article 16 of the Constitution for Europe that guarantees the freedom to conduct a business, which also includes freedom of contract,<sup>28</sup> because German law does not impose on the creditor the duty to inform the surety about the nature of the suretyship contract and the risks involved therein. In such a case, the German courts would have to abandon their more formalistic approach and, following the approach adopted by the Dutch and English courts on this matter, to impose on the creditor the extensive duties related to bringing the transaction home to the surety.

Can such outcomes, however, be derived from fundamental rights? In other words, do fundamental rights really tell us to what extent potential family sureties and other weaker parties can really be protected? As I will try to illustrate in the following section, it is highly doubtful whether this, in fact, is the case.

## **5 Perplexities concerning the non-legislative harmonisation of contract law by means of fundamental rights**

It is submitted that pursuing the non-legislative harmonisation of contract law through the horizontal effect of fundamental rights is highly questionable because, as will be demonstrated below by using the example of the decision of the German Federal Constitutional Court in the *Bürgschaft* case mentioned above, fundamental rights themselves are hardly suitable for directly regulating the relationships between private parties in different phases of the contract's life and, in particular, for protecting the weaker party against risky financial transactions by the private law courts. The following two reasons must be mentioned in support of this claim.

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<sup>28</sup> According to the commentary to article 16 of the Nice Charter, this article is based on the case law of the ECJ, in which the freedom to pursue economic and commercial activities as well as the freedom of contract are recognized. In particular, see Cases C-90/90 and C-91/90, *Neu and Others* [1991] ECR I-3617, para. 13 (free choice of contractual partners). See also P. Oliver and W.H. Roth, 'The Internal Market and the Four Freedoms' (2004) 41 *Common Market Law Review* 407, at 427.

Firstly, the interests of the weaker party in a particular case can be protected not only by one fundamental right but by several. In this case, the competition between fundamental rights (*'Grundrechtskonkurrenz'*) arises, and the difficulty faced by the courts is to determine which of several fundamental rights that are potentially relevant in the circumstances of a particular case is ultimately applicable. Thus, for example, whereas the Constitutional Court in the *Bürgschaft* case has provided relief for the surety on the basis of her constitutional right to private autonomy, which follows from the constitutional right to the free development of one's personality, in conjunction with the principle of the social state, it is equally possible to argue that the case could have been decided on the basis of the surety's right to family life as guaranteed by article 6(1) of the Basic Law. In such a case, the argument could have been that a potentially ruinous contract of suretyship by a family member is problematic from the constitutional point of view, not because such a contract was concluded as a result of the inequality in bargaining power between the parties but because family solidarity has been exploited for economic purposes.<sup>29</sup> If one follows such a line of reasoning, it could be concluded that the issue of whether the bank has informed the surety about the risks involved in a suretyship contract is no longer relevant because ruinous suretyships by family members must be prohibited as such, as they severely interfere with the surety's constitutional right to family life.<sup>30</sup> It is submitted that the rules developed in German constitutional law for the purpose of resolving the problem of the competition between two or more constitutional rights do not provide a satisfactory solution for the competition between the constitutional right to private autonomy in conjunction with the principle of the social state and the constitutional right to family life.<sup>31</sup> As a result, from the point of view of their validity such contracts can be approached from two entirely different perspectives, both of which are equally possible under the Constitution. On the one hand, it can be argued that a potentially ruinous suretyship contract that may entail extremely burdensome financial consequences for a family

<sup>29</sup> This argument was defended in German literature by Teubner in G. Teubner, 'Ein Fall von struktureller Korruption? Die Familienbürgschaft in der Kollision unverträglicher Handlungslogiken (BVerfGE 89, 214 ff.)' (2000) 83 *Kritische Vierteljahrsschrift für Gesetzgebung und Rechtswissenschaft* 388, at 389 ff.

<sup>30</sup> Compare Teubner *id.*

<sup>31</sup> In German constitutional theory one can distinguish three rules for resolving the problem of *'Grundrechtskonkurrenz'*: *'Allgemeine Spezialität'* (the more specific fundamental right prevails over the more general one), *'Einzelfallsspezialität'* (the right that in a concrete case has a closer connection with the facts of the case will prevail) and, in case none of these two rules offer a solution, *'Anwendungskonkurrenz'* (in case two or more fundamental rights are equally relevant, the least susceptible to limitations will prevail). See H.-G. Pieper (ed.), *Grundrechte* (Münster: Alpmann und Schmidt Juristische Lehrgänge, 1997) 72 -73.

member of the principal debtor is in principle *illegal as such even if the bank has informed the surety about the risks involved therein*. Such a solution could be reached on the basis of the constitutional right to family life as well as the principle of human dignity enshrined in article 1(1) of the German Constitution; the whole issue of the inequality in bargaining power would then be completely irrelevant. On the other hand, however, it can also be argued that a potentially ruinous suretyship contract by a family member of the principal debtor is valid as long as the bank has fulfilled its duties with regard to bringing the transaction home to the surety, and the latter can therefore be presumed to have given not only free but also informed consent for such a contract. The surety's constitutional right to private autonomy in conjunction with the principle of the social state would then be the most relevant here. In the absence of clear and workable criteria for dealing with competition between constitutional rights in contract law disputes, which of the two perspectives of dealing with potentially ruinous suretyships is ultimately chosen depends solely on the subjective view of the judges. As a consequence, there is a danger of arbitrary choices between constitutional rights being made by judges guided primarily by their own views on the extent of the protection of family sureties, which can be both in favour of and against a far-reaching protection of sureties against themselves.

Secondly, even when the problem of the competition between fundamental rights is resolved, the courts are confronted with another difficult issue. Whereas the main purpose of resorting to fundamental rights in contract law is the protection of the interests of the weaker contractual parties, fundamental rights constitute a double-edged sword in the hands of both powerful creditors and weak debtors, as in practice *both* the interests of the stronger and those of the weaker parties can be protected on their basis. Moreover, in certain cases *one and the same* fundamental right can be used in support of the diametrically opposite claims of the two parties. As a consequence, the courts must resolve the conflict that arises between the two fundamental rights. In the absence of a hierarchy between fundamental rights, essentially the only way of doing this is through balancing the two competing rights against each other. Thus, for example, in the *Bürgschaft* case, the conflict arose between the surety's constitutional right to private autonomy in conjunction with the principle of the social state and the bank's constitutional right to private autonomy. The balance therefore had to be struck on the constitutional law level between the protection of the private autonomy of the weaker party and the interference with the private autonomy of the stronger party. That this task is not an easy one can already be concluded based on the broad formulation of the constitutional right involved and from the very fact that the same right basically protects the interests of both parties. The perplexities relating to striking a balance between the colliding interests of the two parties on the constitutional level,

however, mostly manifest themselves in the outcome of the balancing carried out by the German Constitutional Court, which boils down to a directive for the private law courts. According to this directive, in cases where a 'structural inequality in bargaining power' has led to a contract that is 'exceptionally onerous' for the weaker party, the private law courts are obliged to intervene in contractual relationships between the parties in order to protect the weaker party. While the directive clearly implies that weaker parties must be protected by the private law courts, it does not make it clear how far this protection should extend in order to be in conformity with the German Constitution. In particular, should ruinous suretyship contracts by family members of the principal debtor be held contrary to good morals as such or should they be considered valid provided that the surety has been informed about the risks involved therein? As in the case of competition between constitutional rights, here again constitutional law does not provide an answer as to which of the two alternatives should be followed and why. In essence, therefore, resorting to fundamental rights in the surety cases leads to the interpretation of the well-established general clauses of a private law character on the basis of the newly created general clauses of a public law character, and the latter are even much more difficult to grasp than the former. The major problem, however, is that it is not at all obvious that a certain outcome even follows from the constitutional right to private autonomy as such and from the constitutional right to private autonomy in conjunction with the principle of the social state. What these rights require is respect for the private autonomy of both parties, but they give no clue as to how this should be done and in fact leave this issue for private law to resolve. Therefore one can argue that it would have been equally consistent with the German Constitutional Court's approach with regard to the effect of fundamental rights in private law to uphold the decision of the German Supreme Court in private law matters in *Bürgschaft*, reasoning that the surety's constitutional right to private autonomy had in fact been respected, since the surety, like every person who has reached the age of majority, could not have been unaware of the risks involved in acting as a surety. Especially in the context of risky financial transactions with burdensome consequences for the weaker party, balancing between fundamental rights accordingly allows the courts to concentrate on a politically desirable outcome of the case and to conceal the real issues concerning the scope of the protection of the weaker party under the cover of interpreting fundamental rights.

In this light, it appears to be a major fallacy to believe that fundamental rights can bring private lawyers closer to the solution of the old problem of contract law: under which conditions can a contract between two private parties be considered to be valid? In essence, therefore, fundamental rights may be used both to promote the protection of the weaker party in contract law and to defend individual freedom and the binding force of

contracts. In giving expression to both of these values, however, fundamental rights do not provide a concrete answer to the question of where individual freedom must stop and protection must begin. In particular, they shed no light as to whether a risky contract that may potentially result in extremely burdensome financial consequences for one of the parties must be considered to be contrary to good morals or public policy as such and therefore be prohibited, or whether it should be allowed subject to the condition that the stronger contractual party has taken the necessary steps to obtain the *informed* consent of the weaker party. Furthermore, if it is informed consent that is at stake, fundamental rights say nothing about the circumstances under which the courts may hold that the stronger party has fulfilled its duties with regard to bringing the transaction home to the weaker party.

The difficulties connected with the unavoidable competition between fundamental rights and the need to balance them against each other relate to the substance of the fundamental rights law and do not depend on which court applies them: a national private law court, a national constitutional court or a supranational court entrusted with a power of reviewing national court decisions as to their conformity with fundamental rights. These perplexities are certainly not a peculiarity of German constitutional law, but are equally true for EU constitutional law. As a consequence, the harmonisation of contract law through the horizontal effect of EU fundamental rights would lead to a top-down approach to the protection of the weaker party when justice in a concrete case is imposed from above on the basis of the vague norms of a higher order. Such an approach entails the risk of fundamental rights becoming a basis for a political struggle between the proponents of paternalism and freedom, while those rights do not contain the answers to many issues raised in the course of this struggle. Furthermore, protecting the weaker party through fundamental rights shifts the discussion as to what is socially and economically suitable for a specific community to the meta-level of broadly formulated constitutional values, thereby significantly restricting the competence of the European legislature to decide upon this issue and severely impairing the legal certainty and predictability of judicial decisions.

## **6 The plea against non-legislative harmonisation of contract law by means of fundamental rights**

In the light of the foregoing, I would also like to express my concern with regard to the notion of the non-legislative harmonisation of contract law in Europe through the horizontal effect of EU fundamental rights. Such a scenario appears frightening to me, since broadly formulated EU



fundamental rights in themselves say nothing about the character and extent of the protection of family sureties in contract law, and therefore a specific choice in favour of a particular solution can hardly be derived therefrom. Constitutional principles can hardly be understood in such a manner as to prescribe a particular way of protecting the surety or other weaker party, and EU member states cannot be held to be thereby precluded from experimenting with different levels of protection within contract law, taking into account the shortage or availability of credit in particular markets. Moreover, the fact that the 2000 Nice Charter of the Fundamental Rights of the EU contains a broad catalogue of fundamental rights and values says nothing about the mutual relationship between them in contract law and, in particular, their implications for the relationships between private parties. The ECJ accordingly clearly lacks democratic legitimacy to promote a top-down non-legislative harmonisation of contract law through EU fundamental rights. Therefore, if the harmonisation of the protection of sureties and other weaker parties in Europe is to be attained, this can only be done by the European legislator and not through the interpretation of EU fundamental rights.

A good example of the legislative harmonisation of the protection of weaker parties, which also provides evidence that such harmonisation is the only possibility in the context of risky financial transactions, is the conduct of business rules contained in the new Markets in Financial Instruments Directive of 2004 (MiFID). These rules aim, in particular, at the protection of non-professional investors against highly risky investment transactions and, in many respects, constitute a choice from the different approaches followed by the EU member states or a compromise between them.<sup>32</sup> In particular, tensions between the legal systems in question were found to exist with regard to the character of investor protection and its scope in the case of the execution-only relationship between an investor and an investment firm. In such a relationship, the investment firm is simply used by the investor for the execution and/or transmission of his or her orders, via a telephone order line or the internet, for example; the decision as to whether to proceed with a certain investment transaction is in principle taken by the investor alone on the basis of his or her own knowledge. As to the character of the protection in the execution-only relationship, the European legislator has followed a purely informational model based on procedural fairness, which was in particular adopted in German law and, in all cases, including those where the intended investment transaction (potentially) exceeds the customer's ability to pay, has left it to the customer to make an investment decision him or

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<sup>32</sup> On the differences in the approach to investor protection in the execution-only and advisory relationship prior to the adoption of the Markets in Financial Instruments Directive of 2004 (ISD II or MiFID), see Cherednychenko, above n. 4, Chapters 7 and 8.

herself, however irrational it may be. In this way, the European legislator has rejected the application of a more interventionist model based on the idea of substantive fairness as adopted, for example, in Dutch law in relation to the most extreme cases where the prospective investor does not possess sufficient financial means to be able to meet his or her potential obligations under the intended investment transaction. As to the scope of procedural protection in the execution-only relationship, a compromise had in particular to be reached between the most restrictive position taken by English law, which altogether relieved the providers of execution-only services of the duty to know their customers and the most protectionist approach adopted by Dutch law, which even in the execution-only relationship imposed on the providers an extensive duty to know their customers. The European legislator chose neither of the two extreme positions and instead opted for the compromise solution, which comes close to the approach adopted under German law: it did impose on the providers of execution-only services the duty to know one's customers, but at the same time considerably restricted its scope.<sup>33</sup> It is submitted that achieving harmonisation in such matters on the basis of fundamental rights is virtually impossible if one acknowledges that fundamental rights should not become a volleyball between the opponents and proponents of far-reaching protection for weaker parties in European contract law.

Additionally, a considerable differentiation in the scope of investor protection has also been introduced in the Investment Services Directive (ISD) II, depending on the type of investment services. A closer relationship between the investment adviser and the customer has led all the legal systems in question as well as EC law to acknowledge the need for a higher level of investor protection in the advisory relationship compared to that in the execution-only relationship. The broader scope of investor protection in this case is justified by the very nature of the advisory relationship, in which the customer relies on the assistance of a professional because he or she does not possess sufficient knowledge about the investment field and intends to rely on the recommendation provided by the professional. By contrast, the narrower scope of investor protection in the execution-only relationship has been explained by the limited nature of 'execution-only' investment services, which consist only of the execution and/or reception and transmission of client orders by a firm upon the specific instructions of a client, and do not include the provision of recommendations concerning investments relating to the merits of transactions. This implies that those investors who consider themselves to have enough expertise in the investment field can choose to pay lower transaction costs than complete laymen who need more information or even investment advice in order to be

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<sup>33</sup> See articles 19(5) and 19(6) of the MiFID.

able to make a decision as to whether to enter into a particular investment transaction and, for this very reason, are prepared to spend more money on the transaction fees. It follows that, in the exercise of their freedom of contract, private investors may be interested in a minimum involvement of an investment firm in their investment transactions with a view to saving costs, and, by choosing the type of investment services that allows that, they can be considered to have implicitly rejected certain duties of care that are inherent in more expensive types of investment services, such as investment advice. If, however, the harmonisation of investor protection were to be imposed from above on the basis of broadly formulated norms, there is a danger that the nature of the relationship between the parties as well as many other important peculiarities of a particular kind of investment service could simply be neglected while balancing between the competing fundamental rights involved in such a case.

Because of the highly complex nature of investment services and the constant changes in the financial sector in general it is therefore only to be welcomed that the European legislator has chosen to harmonise the area of investment services on the basis of the new legislative structure proposed by the Lamfalussy Committee: the Lamfalussy architecture.<sup>34</sup> The idea of this structure is that only core principles are to be set at level 1, at which the agreement is to be reached by the Council and the European Parliament through the co-decision procedure, whereas at level 2 these core principles are to be developed and elaborated with detailed technical implementing measures. These technical measures are adopted by the Commission through the ‘comitology’ procedure established by decision 1999/468/EC, after consultation with the European Securities Committee (ESC), which is the competent regulatory committee in the field of securities, and taking into account the views of the European Parliament. The next levels, level 3 and level 4 of the Lamfalussy structure, mainly concern the implementation and enforcement of the EC legislation adopted at level 1 and level 2 in the national legal orders of the EU member states. An important role designated in this structure for experts in the field of financial services (i.e. ESC, in particular when it comes to the implementation of the principles adopted by

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<sup>34</sup> The Lamfalussy Committee was established by the Economic and Financial Affairs Council (ECOFIN) on 17 July 2000 with a mandate to assess the current conditions for the implementation of securities market regulation in the European Union. As a result, a new structure was set up to improve the responsiveness of the European regulatory framework to developments rapidly occurring in the financial sector, by increasing the system’s flexibility and the quality of regulation. On the Lamfalussy structure, see, in particular, G. Ferrarini, ‘Contract Standards and the Markets in Financial Instruments Directive (MiFID): an Assessment of the Lamfalussy Regulatory Architecture’ (2005) 1 *European Review of Contract Law* 19, at 23.

the Council and European Parliament) allows one to take into account the peculiarities of investment services and the developments within the financial sector on a EU-wide basis when developing technical implementation measures, thereby increasing the flexibility and quality of the European regulatory framework.

In view of the fact that fundamental rights can hardly descend into the realm of such details and the acknowledgement at the EU level of the need for closer co-operation between the legislator and experts in particular fields, it would be all the more surprising if the ECJ started to promote the idea of a top-down harmonisation of the protection of the weaker party in a particular field on the basis of fundamental rights. To do so would risk it becoming involved not only in highly sensitive political issues pertaining to the scope of investor protection in a particular case but also in highly technical matters that require a profound knowledge of a particular industry. Assuming such a role, however, would seriously undermine the authority of the ECJ and the fundamental character of the rights embodied in the ECvHR and the Charter of Fundamental Rights of the EU.

In fact, neither the ECHR nor the ECJ must become involved in striking a balance between competing interests in such disputes on the basis of fundamental rights and subsequently in imposing the outcome of such balancing on the national private law courts of the member states. A deferential attitude of the European courts to the decisions of the national private law courts in disputes involving the extent of the protection for the weaker party, in particular against risky financial transactions, implies that the private law courts can presume to be acting in conformity with fundamental rights when they apply those well-established private law rules, which already constitute an embodiment of private autonomy and strike a balance between the competing interests of the stronger and the weaker party. In such cases in particular, a private law court should not fear that its decision may be overturned on the ground that it violates fundamental rights. Instead, a private law court should be certain that it avails itself of sufficient room within which it can decide a dispute in an individual case and can develop contract law, taking into account that fundamental rights protect the private autonomy of both parties. The fact that at a particular point the balance has tipped from the interests of the stronger to the weaker party or *vice versa* should not lead the bodies entrusted with reviewing the judgments of the private law courts as to their conformity with fundamental rights to overturn these judgments.

## 7 Final remarks

The growing impact of fundamental rights on contract law in the last decade makes it clear that the contract law is no longer immune from the effect of fundamental rights. The tendency towards the constitutionalisation of contract law is true for many European legal systems, and it is obvious that in the years to come European contract law will also not escape from it. Considerable potential for the alignment of EU fundamental rights and European contract law is present in the existing EU law, and it can only be strengthened in view of the recent case law of the ECHR and, in particular, once the Nice Charter of Fundamental Rights of the EU becomes binding. However, the alignment between fundamental rights and European contract law should not lead to attributing to fundamental rights a meaning that can hardly be derived therefrom with a view to promoting one's own views on the desirable extent of the protection of the weaker parties in European contract law. The danger of such a misuse of fundamental rights, which may seriously impair their paramount importance in a society as the individual's bulwark against the state, is imminent if one uses them for the purpose of the non-legislative harmonisation of contract law in Europe. In contrast to fundamental rights, contract law is much better equipped to be able to address the issue of the imbalance in power in contractual relationships and to provide a basis for an open debate concerning the desirable extent of the protection of the weaker party on the European level. To conclude, fundamental rights should not become a new religion that encourages one to believe rather than to think analytically.

