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THE EUROPEAN UNION PROJECT ON UNFAIR SURETYSHIPS: WHAT FOLLOWS FOR ALBANIA?

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Abstract

The thesis analyzes the problem of unfair suretyship agreements, as treated in the framework of the ongoing European Union Project on Unfair Suretyships, and its possible impact to Albania as a potential candidate country. The main debate concentrates on how to achieve an increased harmonized level of sureties` protection in Member States, and how to reform the Albanian legal position in this respect.

The comparative analysis of legal provisions and case law in France, United Kingdom and Germany, demonstrates the existence of divergent approaches for the protection of sureties. In the European Union level, the final proposal for a Directive on Credit Agreements for Consumers, not only leaves suretyships out of its scope, but has almost entirely lost its consumer protection dimension. It is shown that, in order to increase and approximate the level of protection of vulnerable sureties in Member States, a combination of judicial harmonization, sector-specific legislative measures and self-regulatory provisions of credit institutions, is recommendable.

In addition, it is demonstrated that Albania, in the absence of specific regulation, follows a traditional civil law approach with regards to suretyships. Amendments in its Civil Code, as well as the enactment of a new Law on Consumer Credit Agreements, are necessary and crucial to its European integration.

Introduction

The recent decades have not only witnessed the triumph of secured transactions in the business arena, but, seen in light of the well-founded principles of justice and fairness, have also opened a Pandora box to many countries. In striking to establish and maintain a balance, between the present commercial rapidness and the respective legislative norms, many states face a furious need for reform in order to protect not only creditors and debtors, but also other parties involved or related to the transaction.

In this line, one of the issues which needs special attention and analysis, is the problem of unfair suretyships[1] and protection of sureties, which are burdened by an enormous amount of debt. This thesis addresses exactly the problem of unfair suretyships in European countries like United Kingdom (hereinafter UK), Germany and France, with the main focus on the continuing European Union Project on Unfair Suretyships[2], (hereinafter the EU Project), and the situation of Albania, as a potential candidate country[3], in this respect. The rationale for choosing UK, France and Germany rests mainly on the idea of achieving an overview of the solutions given by a common law country and two distinguishable civil law countries. While Albania on the other

[1] Suretyship is considered as the legal relation that arises when one party assumes liability for a debt, default or other failing of a second party. *Black`s Law Dictionary* (West, abridged 8th ed. St. Paul, Minn.2004). In a suretyship agreement, a person other than the debtor, (the surety), undertakes vis-à-vis the creditor to answer for the debts of the debtor upon default. Unfair suretyships refer to suretyship agreements when the surety is usually related to the principal debtor, has undertaken responsibility under some form of a vitiated will and often, there is a disproportion between the obligation and the surety's financial means. Mel Kenny, *Standing Surety in Europe: Common Core or Tower of Babel?,* 70(2) MLR [175-196] at 181 (2007)

[2] Protection from Unfair Suretyships in the European Union, a project supported by the European Community in its sixth Research Framework Program, duration April 2004 – 31st of March 2007, *available at* http://www.zerp.uni-bremen.de/english/projekte/assoziierte/protection.html, (last visited March 03, 2007)

[3] Albania has signed the Stabilization and Association Agreement on 12 June 2006. European Commission Country Profile, a*vailable at* : http://ec.europa.eu/enlargement/albania/political_profile_en.htm (last visited March 3rd , 2007)

side, has been chosen in order to "generalize" possible recommendations that might derive from this analysis to potential candidate countries in the EU.

Banks often are willing to give loans, only on the condition that close family members of the principal debtor, enter a suretyship agreement in order to secure the debtor's loan[4]. Thus, if the amount of the suretyship is not proportionate to the financial means of the surety, it might as well cause his financial destruction.

Despite the issue of whether the surety possesses a free or a vitiated will in entering such agreements, the ultimate result of these type of suretyships may result unfair for several reasons, such as, not being aware of the risk undertaken, being under pressure or influence by family members or, lacking an economic interest in the transaction.[5]

In light of the above, Member States[6] have searched for remedies and started to develop legal solutions in order to adequately protect sureties. In most of them special statutory provisions were enacted but yet, it is dubious whether the standard of protection in this respect, is unified.

At the same time, the Albanian legal framework dedicated to suretyships in general does not go beyond what is offered by the provisions of the Civil Code[7]. Unfair suretyships specifically, have not been dealt with in any provision of the Civil Code and the main grounds for protecting sureties when the agreement results detrimental, remain the general grounds for avoiding contracts, such as fraud, duress, mistake and extreme necessity[8]. The ambiguity and anachronism of regulation, not only results in detrimental treatment of non-professional sureties,

[4] Aurelia Colombi Ciacchi, *Non-Legislative Harmonization of Private Law under the European Constitution: The Case of Unfair Suretyships*, (13) 3 ERPL [285-308] ERPL at 297 (2005).
[5] *id.*
[6] Mel Kenny, *Standing Surety in Europe: Common Core or Tower of Babel?*, 70(2) MLR [175-196] at 184-189 (2007)
[7] Law No.7850, *Kodi Civil i Republikes se Shqiperise* [Civil Code of the Republic of Albania], 11 Official Gazette 491, art. 585-600, (1994)

but also leaves Albania behind the standards of protection achieved in EU Member States. Therefore, it is clear that the above-mentioned situation requires analysis and conclusions on the necessary steps to be undertaken in order to find proper remedies.

The question of how and to what extent sureties need legal protection from the abuse of contractual power of credit institutions, is a recently emerged issue, which has not yet been sufficiently studied in a comparative analysis from supranational to national level.

The thesis will answer several questions, such as: What are the legal devices that Germany, UK and France have developed, in order to protect natural persons who stand surety for the debts of their spouses, relatives or other persons to whom they have a relation or are emotionally dependent from? When and under what circumstances a suretyship contract can be detrimental to EU fundamental rights and constitutional principles? What does the EU Project suggest for establishing an increased harmonized level of protection in Member States? What is the legal background focusing on unfair suretyships in Albania, and what might be recommendable from the Member States solutions and the EU Project? What changes are needed for such an undertaking?

It will be shown that the underlying reason for the actual Albanian situation of unfair suretyships lies in the lack of proper legislation and remedies, as well as in the absence of reforms in the field.

The first chapter of the thesis will deal with the nature and extension of unfair suretyships in France, Germany and UK. In order to find the legal solutions implemented in such situations, the focus will be on leading cases and legal doctrines, as well as respective legal provisions.

[8] *id.* art. 94 - 99

The second chapter will continue with the ongoing EU Project, the conflicting character of unfair suretyships with fundamental human rights and common European constitutional principles and also the EU proposal for a new Directive on Credit Agreements for Consumers[9].

The third chapter will focus on the presentation of the legal situation with regard to unfair suretyships in Albania. This will be presented through the interpretations of actual legal provisions on suretyships and general grounds for avoiding contracts. Furthermore, the chapter will address what proposals might derive for Albania from the provisions and measures used in different Member States, what does the EU Project direct to Albania, and what are the exact legislative changes that need to be developed.

From the methodological point of view, this thesis will encompass various forms of research and analysis, such as analysis of legal provisions, case evaluation and theoretical approaches towards unfair suretyships.

Since the topic has not been addressed before, from such a comparative perspective which includes Albania as a potential candidate country in EU, this thesis might contribute in recommending possible standards of sureties` protection in this state, certain changes and amendments in the Albanian Civil Code, as well as a proposal for the enactment of new laws in the field of consumer protection.

[9] Amended Proposal for a Directive of the European Parliament and of the Council on Credit Agreements for Consumers amending Council Directive 93/13 EC, COM(2005) 483 final, *available* at : <http://ec.europa.eu/consumers/cons_int/fina_serv/cons_directive/2ndproposal_en.pdf> (last visited March 25th, 2007).

CHAPTER 1

Unfair suretyships in UK, Germany and France

1.1 Introduction

This chapter will analyze unfair suretyship regulations in UK, Germany and France. Nevertheless, a clarification of the definition of suretyship agreements and a special comparison to the guarantee contract will precede the respective countries` analysis. Legal provisions, doctrines and leading cases concerning unfair suretyships, will be reflected in the following subchapter. Also, since case law is the backbone of the common law systems, illustration through case law will be the main analysis method for UK, in contrast with the civil law systems of Germany and France. The latter will also encompass case evaluation, but statutory provisions will be of a primary focus.

1.2 Definition of suretyship: Suretyship versus Guarantee?

If one has a look at the historical development, it is interesting to note the fact that, problems with unfair suretyships have been encountered centuries, or even millenniums ago and the main problems they posed were the same, which we face today. The concept of suretyships was known since Roman times and it encompassed cases where one person undertook to assume liability for a debt of another person (the principal debtor). [10] The nowadays concept of suretyships does not differ from the one Romans defined time ago. Thus, suretyship is considered as "the legal relation that arises when one party assumes liability for a debt, default or other failing of a second party".[11]

[10] Kenneth Pennington, *The Ius commune, Suretyship, and Magna Carta*, 11 Rivista Internazionale di diritto comune [International Journal of *ius commune*], at 255-274 (2000).
[11] *Black`s Law Dictionary*, (West, abridged 8th ed. St. Paul, Minn.2004).

In the majority of legal systems, suretyship is often confused or used interchangeably with the concept of guarantees[12]. Therefore, there is a need to clarify whether and when these systems distinguish between the two concepts.

The terminological definitions do not help much in this respect. Compared to the above definition of suretyship, guarantee on the other side means "to assume a suretyship obligation; to agree to answer for a debt or default"[13] and also "something given or existing as security, such as to fulfill a future engagement or a condition subsequent."[14] In addition, subrogation is also a corollary of both contracts.[15] It remains still unclear whether there are differences between the two personal security devices, especially since the definition of guarantee seems to include suretyship rather than distinguish itself from it.

A suretyship is considered an agreement of an accessory character[16]. In addition to this, in a suretyship agreement, " …although the surety's liability co-exists with the liability of the principal debtor, there is usually no liability on the part of the surety if the underlying obligation is void or unenforceable, or if the obligation ceases to exist".[17] Another important feature of the suretyship is that the surety is liable to the same extent that the debtor is liable to the creditor.[18]

Despite the above characteristics, a suretyship agreement is yet, not totally differently identifiable from a guarantee, and an overview on how different legal systems have conceptualized it, is necessary.

[12] Tibor Tajti, *Comparative Secured Transactions*, at 84, n. 225 (Akadémiai Kiadó, Budapest 2002).
[13] *supra* note 10
[14] *id.*
[15] *supra* note 12 at 85
[16] Mel Kenny, *Standing Surety in Europe: Common Core or Tower of Babel?*, 70(2) MLR [175-196] at 181 (2007)
[17] *supra* note 11, at 84-85
[18] *id.* at 85

In England there is a terminology problem when it comes to distinguishing between the guarantee and the suretyship[19]. One approach has been to consider suretyship as covering both guarantees and indemnities. Nevertheless, the recent use of the term "suretyship guarantee" identifies a guarantee, which becomes "active" when the principal debtor defaults. This is opposed to the character of the "demand guarantee" which identifies an independent undertaking[20].

Suretyship differs also from a contract of indemnity, since the latter is again a primary contract and not accessory[21]. Finally when distinguishing between contracts of indemnity and demand guarantees, one must bear in mind that the former is primarily entered to cover the creditor's loss rather than to pay a certain amount. In this respect, the liability on a demand guarantee is liquidated, while on an indemnity is unliquidated.[22]

Germany also has developed an overall concept of guarantee, (*"garantievertrag")*[23], or "autonomous guarantee", which is distinguished from the accessory suretyship contract, on the basis of its independent nature. These contracts are two-party relationships and have been applied especially when the beneficiary of the guarantee is not also a creditor in the underlying relationship, where the underlying relationship is lacking, or where the guarantor acts on his own account[24]. However, there is a general confusion when it comes to distinguishing first demand guarantees from suretyships, which although labeled as such, are payable on the first demand of

[19]Roy Goode, *Legal problems of Credit and Security*, at 297, (Sweet a& Maxwell, 3rd ed. 2003)
[20] *id.*
[21] *id.*
[22] *id.*
[23] Roeland Bertrams, *Bank Guarantees in International Trade*, at 36, (Kluwer Law International, 2nd revised ed. Deventer 1992)
[24] *id*

the beneficiary. Such a recognition as a distinct concept of a first demand suretyship is particular to German law[25].

In view of the German law, in cases of first demand suretyship, the surety can recover the amount if it later appears that the beneficiary was not entitled to it, while it seems that this is not the case with independent guarantors[26]. So the accessory nature of the suretyship is not eliminated, but only suspended until payment. Another difference that German law designs between the two concepts is the shifting of the burden of proof.[27] In cases of first demand suretyships, the beneficiary needs to demonstrate that he was entitled to the payment, while in cases of first demand guarantees, the account party bears the burden of proof.

The concept of an autonomous guarantee is recognized in France as well, despite the fact that legal writings in this respect are missing.[28] Nevertheless, when it comes to distinguishing between the suretyship, also known as "*cautionnement*", and the autonomous guarantee ("*la garantie autonome"*), the latter is distinguished again by its independent character to the principal contract ("*contrat de base*").[29]

The conclusion that can be derived from the ambiguity of the terminology used is that, despite their similarities, a contract of suretyship is distinguished by a contract of guarantee, when the latter has an autonomous character, independent of the principal obligation.

[25] *id.* at 51
[26] *id.* at 52
[27] *id.*
[28] *id.* at 37
[29] Marie-Noëlle Jobard-Bachellier, *Droit Civil. Sûretés, publicité foncière*, [Civil Law. Securities, publication of immovables], at 37, (Mémentos Dallos, 13th ed. 2000)

1.3 Unfair suretyships in UK

1.3.1 Main legal grounds for avoiding sureties` liability

The England and Wales Statute of Frauds defines a suretyship agreement as " any special promise to answer for the debt, default or miscarriage of another person"[30]. Goode[31] states that the law is highly protective to sureties, considering the fact that their liability exists to the same extent of the debtor, and in cases when the main contract debtor-creditor, will be found void, voidable, breached by the creditor, or unenforceable, the surety will not be liable. However, such a stipulation does not cover cases of unfair suretyships, but remains as a general statement, strengthening even more the accessory nature of the suretyship contract.

The main grounds used by English sureties to avoid liability in cases of unfair suretyships are misrepresentation and undue influence[32]. Other grounds, which are rarely relied upon by English courts are mistake, forgery, fraud, inequality of bargaining power, duress, *non es factum*[33] and only as a last resort, unconsciousness[34]. English law affords protection to sureties through procedural means and does not consider the substantive unfairness of the contract, except for the cases when unconsciousness is claimed.[35]

For the purpose of this analysis, main grounds for avoiding liability under suretyship contracts will be considered.

[30] England and Wales Statute of Frauds, s. 4, 1677
[31] Roy Goode, *Legal problems of Credit and Security*, at 308, (Sweet & Maxwell, 3rd ed. 2003)
[32] Belinda Fehlberg, *Sexually Transmitted debt. Surety Experience and English Law,* at 22, (Clarendon Press, Oxford 1997)
[33] *id.* meaning :"It is not my deed".
[34] *supra* note 27
[35] Mel Kenny, *Standing Surety in Europe: Common Core or Tower of Babel?*, 70(2) MLR [175-196] at 184-185 (2007)

1.3.1.1 Misrepresentation

Misrepresentation consists of an act of making a false or misleading statement about something, usually with the intent to deceive"[36]. For a misrepresentation to give rise to a right to avoid the contract in cases of suretyships, it must be material and relied upon in entering the contract[37]. Therefore, it must be an element *sine qua non*, the contract would not have been concluded. It might have been accomplished either by the creditor, or by the debtor and in the first case, the transaction will not be enforceable. In addition, damages for negligent misstatement may also be available.

In cases where misrepresentation is made by the debtor, or although made by the latter, is imputable to the creditor, a surety may find it more difficult to establish that a material misrepresentation of fact has occurred[38].

1.3.1.2 Undue influence

Undue influence[39] involves the exploitation of the position or relation, that one person has over the other, in a way that the actions of the latter are not free and voluntary. In cases of undue influence, there has been a clear division between presumed undue influence and actual undue influence. In the first case, the "donee is in a position to dominate the donor"[40], while in the second case, "the will of the weaker party has been overborne, as a result of the unconscientious use by the stronger party, of his or her ascendant position…"[41].

[36] *Black`s Law Dictionary*, (West, abridged 7th ed, St. Paul, Minn.1999).
[37] *supra* note 28, at 23
[38] *id.* at 24
[39] *id.*
[40] *id* at 25
[41] *id*, definition derived from *Johnson v. Buttress* (1936) 56 CLR 113 (HC of Aust)

It is surprising why, prior to *Barclays Bank plc. v. O`Brien*[42] (hereinafter *O`Brien)*, courts not only did not expand the automatic presumption of undue influence to wife-husband relationship, but they even treated cases involving wives as sureties, as cases of actual undue influence. [43] What *O`Brien* generally brought to the English judicial thought, is that it opened a way for surety wives, to argue a less burdened presumption of undue influence, rather than an actual undue influence.

1.3.2 Barclays Bank plc. v. O`Brien[44]

In *O'Brien* case, *Barclay`s* Bank (hereinafter the Bank), agreed to allow a manufacturing company in which Mr. O`Brien was interested, an increased overdraft, if the latter would guarantee all of the company's liabilities to the Bank, and his guarantee was secured by a legal charge over the family home, of which Mr. and Mrs. O`Brien were jointly owners. The Bank send the documents, with a special reference to ensure that customers were aware of the nature and content of the documents to be signed, and in case of doubts to contact their solicitors. The instructions send to the branch clerk, were unfortunately not observed by him when Mrs. O`Brien signed the documents. She signed without reading them and moreover, her husband told her that the charge was limited in amount and duration, when in fact it was unlimited in both respects. When the Bank sought enforcement, Mrs. O`Brien claimed that the decision could not be enforced against her, on the basis that she had procured her consent under misrepresentation and undue influence.

[42] *Barclays Bank plc. v. O`Brien* [1994] 1 AC 180 (HL) for comments on the case *see* : Noel McGrath, *A Tale of Two Judgments: Third-Party Undue Influence and the Path to Reform in Ireland,* X COLR (2006), available at : http://colr.ucc.ie/index.php?option=com_content&task=view&id=90&Itemid=40 (last visited March, 23rd, 2007)
[43] *BBCI v. Aboody* [1990] 1 QB 923; *CIBC v. Pitt* [1994] 1 AC 200
[44] *supra* note 38

The trial judge[45] held that Mrs. O`Brien was bound by the security, because although Mr. O`Brien `s conduct amounted to misrepresentation, he was not acting as the Bank's agent. As for the undue influence issue, the trial court found that it had not occurred.

However, when the case reached the Court of Appeal[46], Mrs. O`Brien won her case. The Court applied the "special equity theory" which became well known since *Yerkey v. Jones* case.[47] According to this theory, a surety has a prima facie right to have the security set aside, if the security was provided by the principal debtor to whom the surety has a relationship, accepted by the creditor without any contact with the surety, and the surety failed to understand the document in "essential respects".[48] This theory seems more surety- friendly as compared to the agency theory[49], which was applied by the Trial Court at *O`Brien* and also in previous cases in UK.[50] According to the agency theory, if the debtor acted as the creditor's agent in procuring the surety's consent, then the wrongdoing was imputed to the creditor. Applying the latter would often result in a more creditor-friendly conclusion, since cases in which a debtor will be strictly regarded as an agent for the creditor, are very rare.[51]

When the case reached the House of Lords[52], the latter dismissed the appeal, but also held that a surety's lack of understanding is not sufficient to avoid liability[53]. A surety, who was induced to provide security through undue influence, misrepresentation or other actionable wrong, had a claim in equity towards the debtor, to set aside that transaction. This right however,

[45] [1993] QB 109 at 115
[46] [1993] QB 109
[47] *Yerkey v. Jones* [1939] 63 CLR 649, 683
[48] *id.*
[49] Belinda Fehlberg, *Sexually Transmitted debt. Surety Experience and English Law,* at 34-35, (Clarendon Press, Oxford 1997)
[50] *Midland bank plc. V. Perry*, [1988] 56 P&CR 202 (CA*); Kings North Trust ltd. v. Bell* [1986] 1 WLR 119 (CA)
[51] *supra* note 45
[52] [1994] 1 AC 180 (HL)
[53] *id.* at 195

would be enforceable against third parties, if the debtor was acting as an agent for the third party, or the third party (i.e. creditors) had notice of the facts giving rise to this claim[54].

Thus, the "agency theory" was maintained and also another dimension in the House of Lords analysis was added: the doctrine of notice[55]. According to this approach, the creditor is responsible when he was aware, or ought to have been aware that there was a substantial risk of a legal wrong committed by the debtor, in achieving the surety's consent.[56]

In addition, *O`Brien* produced a really useful guideline for creditors in order to avoid liability in suretyship cases, namely "the reasonable steps"[57]. They consist mainly on informing the surety about the meaning and the consequences of the risk to be undertaken, advising him/ her, and only in special circumstances, insisting that he / she takes further independent legal advice.

1.3.2.1 Reflecting on O`Brien

It remains still doubtful whether *O`Brien* brought more protection to sureties, except for affording them an opportunity to claim presumed undue influence. Although it might seem that there is a *prima facie* attempt to balance the fairness in the relationship surety-creditor, if one analyzes the ultimate result of the above ruling, it clearly follows that it offers help to creditors in providing them with the adequate steps to take, in order to be "legally right" in their future claims. A signal for putting the creditors in inquiry to take the reasonable steps, would be the case when the relationship debtor-surety is one that might produce "pressures" and the transaction is "on its face" not to the surety's financial advantage[58].

[54] *id.* at 197
[55] *supra* note 45, at 39
[56] *id.* at 40
[57] *supra* note 48, at 196-197
[58] [1994] 1 AC 180 (HL), at 196

However, it is more than acceptable that "there is uncertainty as to what the "face" of a transaction is"[59]. It is not reasonable to put a firm and defined rule for cases in which creditors are deemed or not in inquiry, since this may result detrimental to many sureties[60]. The situation may seem at the advantage of the surety, if one presupposes that the relationship debtor-surety is one, which might produce benefits for the surety, but he might as well be mistaken. What the "face" of a transaction shows is not necessarily what lies under it.

In this line of argument, there is also a problem in conceptualizing the benefit expansion in cases of joint action by debtor and surety[61]. They might appear at the advantage of the surety, but indeed, they may as well be a consequence of the undue influence exercised by the debtor to the former.

In conclusion, insisting on duties to inform and recommend independent advice to sureties, appears to avoid dealing with substantive unfairness and sympathize a "secondary" means of protection, namely the procedural protection.

1.3.3 Royal Bank of Scotland v. Etridge[62]

In *Royal Bank of Scotland v. Etridge* (hereinafter *Etridge*), the House of Lords attempted to review *O'Brien*, clarify and amend its outcomes, issue further guidance on issues of undue influence, putting the creditors on notice and whether O`Brien could be extended to other classes of sureties. The eight appeals had in common the fact that surety wives had undertaken to secure their husband's debts, through charging their interest in their homes, in favor of the bank. Seven

[59] Belinda Fehlberg, *The Husband, the Bank, the Wife and her Signature*, 57 MLR 467 at 473 (1994)
[60] Noel McGrath, *A Tale of Two Judgments: Third-Party Undue Influence and the Path to Reform in Ireland*, X COLR (2006), available at : <http://colr.ucc.ie/index.php?option=com_content&task=view&id=90&Itemid=40> (last visited March 23rd, 2007)
[61] *id.*
[62] *Royal Bank of Scotland v Etridge*, [2001] UKHL 44, *available at:* <http://www.publications.parliament.uk/pa/ld200102/ldjudgmt/jd011011/etridg-1.htm> (last visited march 23rd , 2007).

of them claimed undue influence of their husbands, while the eighth claimed negligence of a solicitor, who had given her advice[63].

Thus, the Court was before a necessity to issue further guidance on issues of undue influence, putting the creditors on notice and the independent advice problem. First, the House of Lords clarified when "presumed" undue influence would be adequately established. The latter would arise only on proof of the existence of a relationship between the debtor and the surety, or in cases when the transaction itself requires explanation[64]. In order to specify whether the transaction has been affected by undue influence, the surety needs to show that "…the transaction is sufficiently unusual that it would not be ordinarily entered into".[65]

Another new dimension that this case brought to UK, was the clarification of the fact when creditors are put on notice[66]. Despite a first confusion that might derive when analyzing the decision, as an ultimate result, a creditor will be put on notice by a consideration of the nature of the transaction and the relationship between the parties. In cases of a married couple, such a presumption will always exist, due to the absence of the surety's advantage.

As per the independent advice issue, it is worth noting that when a solicitor fails to provide adequate advice, he would be liable to the surety for such negligence. According to the court reasoning, the solicitor duty is "…to bring home to a complainant a proper understanding of what he or she is about to do"[67]. Although the court realized that undue influence might not be entirely erased, a solicitor may contribute in making its appearance more costly.

[63] The appeal was dismissed for some of the appellants and allowed for others, based on the specific circumstances of each of the cases. However, what is important is the outcome of the case with respect to the issues concerning undue influence, notice and independent advice. Specifically the appeal was allowed for Mrs. Wallace, Mrs. Bennett, Desmond Banks & Co, Mrs. Harris, Mrs. Moore and dismissed for Mrs. Etridge, Mrs. Gill, and Mrs. Coleman. *See id.* at ¶ 4.
[64] *supra* note 58 at¶ 21.
[65] *supra* note 56.
[66] [2001] UKHL 44, at ¶ 44-49.
[67] *id* at ¶ 20.

Perhaps the most important outcome of *Etridge* case is the extension of the sureties classes encompassed in cases of unfair suretyships. According to *Nicholls LJ* "…there is no rational cut-off point, with certain types of relationship being susceptible to the *O'Brien* principle and others not. Further…the only practical way forward is to regard banks as "put on inquiry" in every case where the relationship between the surety and the debtor is non-commercial."[68]

The latter represents probably the most beneficial aspect derived from the case, since it predicts that the same level of protection might be offered to other categories of sureties, who are not close family members of the debtor..

At the end of this analysis, one might still have a dubious look on the progress that this case might have brought with regards to substantive protection of sureties. However, the increase of the situations when presumed undue influence will be established, the special emphasis on the legal advice, as well as the extension of the protection to other classes of sureties, remain progressive outcomes derived from *Etridge*.

1.3.4 Other regulatory grounds for unfair suretyships

Indeed, it is surprising that the first edition of the self-regulatory measures adopted by the banking sector in UK[69], in order to minimize the possibility of being found in legal disputes, preceded the above-discussed cases. Other editions, the last of which is the 2005 version[70], followed such a practice. It is important to note that the code is not binding on banks, which have adopted it, but it merely represents what is considered a "good practice". The 2005 edition[71], stipulates that sureties will be encouraged to take independent advice, they will be informed

[68] *id.* at¶ 87
[69] The Business Banking Code, March 2002, *available at*: http://www.bankingcode.org.uk/pdfdocs/2002codelit/Business%20Code%20Booklet%20MARCH%202002.pdf (last visited March 23rd, 2007).
[70] The Banking Code, March 2005, *available at* : http://www.bankingcode.org.uk/pdfdocs/BANKING%20CODE.pdf (last visited March 23rd, 2007).
[71] *id.* art. 13.4

about the liability and its limit. Contrary to the first version of the Code[72], the most recent edition provides that banks will not take an unlimited guarantee. Nevertheless, the non-binding character of the Code as well as the "soft" language it uses, make its impact non-decisive.

In addition, other devices like Unfair Contract Terms, which provide for exemption clauses, distinguishing between consumers and those who act in the course of their business, work in a reverse direction, specifically preserving the surety's liability[73].

Finally Scotland, although reluctant in accepting the outcomes of the above cases in its judicial perception, and despite its reliance more on the principle of good faith than on the doctrine of notice, has practically adopted the *Etridge* guidelines[74].

1.4 Unfair suretyships in Germany

1.4.1 German law on suretyships

According to the German Civil Code[75], (hereinafter BGB): " through a surety agreement, the surety undertakes vis-à-vis the creditor of a third party to accept responsibilities for the fulfillment of the third party's obligations". Despite the suretyships, German law knows another distinct personal security device, namely the joint and several liability[76]. The latter consists of cases when another debtor joins the principal debtor with equal liabilities and the creditor, as in typical cases of this kind of liability, can freely choose each or both of them to answer for the debts.

[72] *supra* note 64, at ¶ 14.1
[73] Mel Kenny, *Standing Surety in Europe: Common Core or Tower of Babel?*, 70(2) MLR at 185 (2007)
[74] *id.* at 186
[75] *Bürgerliches Gesetzbuch* (BGB), [German Civil Code] Book II Law of Obligations, Title 18 : Guarantees, s. 765, translation *available at* http://faculty.pccu.edu.tw/~borshan/German%20Civil%20Code
[76] York Strothman, Chapter on Germany *in* Winnibald E. Moojen & Matthieu Ph. Van Sint Truiden (Eds.)(hereinafter Moojen & Truiden), *Bank Security and other Credit Enhancement Methods. A practical Guide on Security Devices available to Banks in Thirty Countries throughout the World*, at 164 (Kluwer Law International-The Hague-London-Boston, 1995).

The surety agreement is concluded between the creditor, and the surety and the principal debtor need not be aware of such an undertaking.[77] However, it is possible that such an agreement might be concluded between the principal debtor and the surety, in favor of the creditor[78]. There is a need for a written form, which does not necessarily apply in cases where the surety is considered a fully qualified merchant, as stipulated by s. 350 of the German Commercial Code [79]. There is also a need to sufficiently specify the receivables, which have been secured by the suretyship agreement. German law states that "a suretyship contract is collateral, *i.e.* it is dependent on the existence and fate of the principal debt"[80]. So, in cases where the creditor has not attempted to foreclose on the principal debtor, the surety can refuse to make payment[81]. However, in cases where the surety is a fully qualified merchant or "when he has waived his right to do so, (so called *Directly Liable Suretyship*…)",[82] he can not exercise such a right.

As regards the choice of the applicable law, the parties can freely choose which law applies to the suretyship in the contract. In cases where parties are silent on this point, then the law that will apply is that of the residence of the surety or his place of business[83]. As expected, when the surety fulfills the obligations towards the creditor, he has a claim against the debtor.[84].

In cases where a bank drafted the suretyship agreement and a private person provides surety, there are further restrictions for establishing the protection of the surety.[85] If there is a high disproportion between the amount offered as security and the ability of the surety to pay it,

[77] *id.* at 163
[78] *id.*
[79] *id.*, referring to s. 350 of the German Commercial Code.
[80] York Strothman, Chapter on Germany *in* Moojen & Truiden, *supra* note 76, at 163
[81] *id.*
[82] *id.*
[83] *id.* at 164, referring to *Einführungsgesetz zum Bürgerlichen Gesetzbuch* [Introductory Law to the German Civil Code, BGB], Art. 28, ¶ 2.
[84] *id.* at 163.

if the surety is inexperienced and does not have a personal interest in the agreement, the suretyship will be often found void. As a general rule, in cases where surety is granted by a spouse, the approval given by the latter does not suffice in itself.

It is obvious that German law, in contrast with the UK legal solutions, relies more on substantive rather than procedural control of suretyships. This has been laid down by the German Federal Constitutional Court (hereinafter *BverfG],* in a case involving a daughter standing surety for the debts of her father. [86] In order to achieve such a level of constitutional protection German Civil courts apply the doctrines of good faith and immorality.

As per the doctrine of immorality, according to §138 BGB an agreement will be rendered void "if it is contrary to good morals".[87]At the same time, the good faith principle is stipulated in § 242 BGB. The standard of good faith is a principle to which contractual obligations are subjected. This article "has thus, by way of interpretation, been transformed into one of the famous "general clauses" by means of which Germany's "case law revolution" was effected".[88]

It is important to note however, how German Courts have dealt with cases of unfair suretyships and whether the implemented legal solutions offer adequate protection to sureties.

1.4.2 The "Bürgschaft" (suretyship) case[89]

In the *Bürgschaft* case, a bank had offered a loan of DM 100.000 to a businessman on the condition that his daughter would stand surety. Prior to the signing of the contract, the bank

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[85] *id.* at 164
[86] [19 Oct. 1993], *Bundesverfassungsgericht*, (BverfG*),* [German Federal Constitutional Court], 89, 214 (*Bürgschaft).*
[87] N. Horn & H. Kötz *German Private and Commercial Law* (Clarendon, Oxford 1982) at 86.
[88] Alberto M. Musy, *The good faith principle in contract law and the precontractual duty to disclose: comparative analysis of new differences in legal cultures*, 1 Global Jurist Advances, (2001*), available* at : http://www.bepress.com/gj/advances/vol1/iss1/art1 (last visited March 23rd , 2007)
[89] *supra* note 84

officer told the daughter to sign the document and that such a signing would not make her enter into any important obligation. Almost four years later, when the principal debtor faced financial difficulties, the bank claimed the amount provided as a loan, together with the interest, which in total consisted of DM 160,000 from the daughter under the original contract[90].

The District Court, (*Landesgericht*) held that the contract was valid and ordered the payment of the obligation, while the Appellate Court (*Oberlandesgericht*) stated that the bank officer had violated his duty to inform the daughter[91]. However, the Supreme Court (*Bundesgerichtshof*) overturned the decision, denied the duty of the bank officer to inform the daughter and reasoned "that any person of age knows that signing a suretyship entails a risk"[92]. Since the father was solvent at the time of the singing of the contract, therefore the information provided by the bank was found as correct[93].

The surety further appealed this decision at the German Federal Constitutional Court, which decided in her favor[94]. The claim was brought for a violation of the right of the surety to dignity[95], violation of party autonomy[96] together with the social state principle[97]. The Court reasoned that if one of the contractual parties is in a powerful position to decide as he wishes the content of the contract, "…this means heteronomy for the other party and in this case the fundamental right of private autonomy of the weaker party is affected"[98].

[90] *id.*
[91] *id.*
[92] Olha Cherednychenko, *The constitutionalization of contract law: Something New under the Sun*, 8.1 Electronic Journal of Comparative Law, at 3 (March 2004), *available* at <http://www.ejcl.org/> (last visited March 23rd, 2007)
[93] *id.*
[94] *supra* note 84
[95] art. 1(1) of the German Basic Law for the Federal Republic of Germany (*Grundgesetz*, GG)
[96] *id.* art. 2(1) of the GG
[97] *id.* art. 20(1) and 28(1)
[98] Aurelia Colombi Ciacchi, *Non-Legislative Harmonization of Private Law under the European Constitution: The Case of Unfair Suretyships*, (13) 3 ERPL [285-308] at 302 (2005).

In sum, the Federal Constitutional Court decided that, "…in cases where a structural imbalance of bargaining power has led to a contract which is exceptionally onerous for the weaker party, the civil courts are obliged to intervene on the basis of the general clauses § 138(1) and 242 of the … (BGB) concerning, respectively, good morals and good faith"[99]. Such a duty is necessary to protect the right to party autonomy together with the principle of the social state. In the present case it was considered that "a contractual imbalance existed because the bank had failed to sufficiently inform the daughter about the risk relating to the surety, although the risk was relatively high compared to her income"[100].

The above-mentioned case is considered as an example of the effect of constitutional rights on private law and "…is widely believed to have far-reaching consequences as far as the law of contracts is concerned"[101].

1.4.3 The level of protection in the German system

As illustrated above, German courts tend to dedicate analysis to substantive control of suretyships and "formal control is seen as inadequate"[102]. In view of the freedom of contract principle, German courts consider that unequal bargaining power can not be in compliance with such a principle.[103]

Nevertheless "the reality of surety protection in Germany is that Supreme Court …decisions have simply caught extreme cases, and, as all real property assets must be liquidated before an excessive burden can be found, the guarantor can lose his home without this being seen as excessive"[104].

[99] *supra* note 92.
[100] *id.*
[101] *id.*
[102] Mel Kenny, *Standing Surety in Europe: Common Core or Tower of Babel?,* 70(2) MLR [175-196] at 187 (2007).
[103] *id.*
[104] *id.*

Furthermore, there is a way to avoid a finding that an agreement is immoral by means of procedural instruments, specifically obtaining judgment through an order for payment procedures. [105] Only if the surety can establish that the bank chose the order, for the sole purpose of avoiding a finding of immorality, the latter will be void[106]. Since this represents a very difficult assessment to be established, the surety has few chances of bringing a successful claim.

Despite from the above, when it comes to drawing conclusions about the general level of protection that German law and practice offers in cases of unfair suretyships, one can easily position the German system as an "effectively protective" one. Its essential basis for offering protection is when a contract is found immoral on the basis of §138 BGB. So, if the surety is a close family member of the debtor, who lacks an economic interest in the transaction and there is a gross disproportion between his financial means and the amount of the obligation, it is presumed that the bank (the creditor), has taken advantage from the surety's lack of knowledge or his relation to the debtor[107]. Such a transaction will be found immoral and as a consequence void.

If all the above-mentioned conditions are met, but the imbalance is not gross, the contract will be found immoral if there is evidence of the creditor's exploitation of the surety's lack of knowledge and experience, or if there is undue influence exercised by the debtor.[108]

In cases where there is a connection between the debtor and the surety, but the latter is not a family member of the former, let's say in cases of an employer-employee relationship

[105] ¶ 688 German Code of Civil Procedure. (¶ hereinafter referring to paragraph).
[106] *supra* note 102, at 187-188
[107] [26 April 2001], German Supreme Court [hereinafter BGH] ZIP 1190
[108] [16 January 1997], BGH ZIP 446

between the two, it is necessary to have clear evidence that the surety was prevented to enter the contract on his free will.[109]

Case law turns into a matter of fact, the reluctance of German courts in making a direct connection between the immorality of a suretyship contract, and the gross imbalance between the surety's assets and the obligation undertaken.[110] However, the recent trend that courts seem to gradually embrace, is to see these two elements more and more tight to each other.[111]

As a conclusion, it can be derived that, despite such hesitation, the level of protection guaranteed by German law remains generally high compared to that offered by UK law. German law deals more with the substantial "unfairness" rather than the procedural one and at the same time reserves more protective attention to non-professional sureties rather than those acting in business capacity.

1.5 Unfair suretyships in France

1.5.1 French Civil Law on Suretyships

Suretyship in France is considered as the classic personal security device, namely "cautionnement"[112] and it is regulated by the French Civil Code[113] from article 2288 to article 2320. Article 2288 (ex article 2011) stipulates that: "A person who makes himself surety for an obligation binds himself towards the creditor to perform that obligation, if the debtor does not perform it himself". Similarly with the German law, a surety may offer security even without the

[109] [14 October 2003], BGH, XI ZR 121/02
[110] Aurelia Colombi Ciacchi, *Non-Legislative Harmonization of Private Law under the European Constitution: The Case of Unfair Suretyships*, (13) 3 ERPL [285-308] at 304 (2005).
[111] *id.*
[112] Marie-Noëlle Jobard-Bachellier, *Droit Civil. Sûretés, publicité foncière*, [Civil Law. Securities, publication of immovables], at 9, (Mémentos Dallos, 13th ed. 2000).
[113] French Civil Code, *transalated by* Georges Rouhette, *available* at <http://195.83.177.9/upl/pdf/code_22.pdf> (last visited March 24th, 2007).

knowledge of the debtor[114], for a part or the total amount of the debt and may not exceed the debtor's obligation or be given under more onerous conditions Article 2292 states that a suretyship needs to be expressed, meaning that it can not be presumed, while the subsequent article does not prohibit the existence of indefinite suretyships In the latter case, however, when a natural person stands surety, he shall be informed by the creditor of the evolution of the amount of the debt secured, at least once a year at the date agreed between the parties. According to Article 2298, a surety is bound towards the creditor upon the debtor's failure.

An interesting stipulation made by the French Civil Code, which also demonstrates the trend of the French approach to suretyships, is the exception in Article 2301. When a natural person has offered security in form of a suretyship, the amount he has undertaken for payment of the debt, may not deprive him of the minimum income fixed by Article L331-2 of the French Consumer Code.[115]

French law also recognizes the existence of statutory and judicial suretyships[116], in which cases the principal debtor is required to have someone stand surety on his behalf, either by law or by a judicial order.

1.5.1.1 First demand "suretyships" in French law?

As it was established before, France recognizes, although confusingly, a distinction between suretyship and autonomous guarantee.[117] Due to this confusion, it is necessary to outline separately the main differences between the suretyship and an even more specific type of personal security devices, namely first demand guarantees, which are often labeled as first

[114] *id.* art. 2291
[115] French Consumer Code art. L.331-2
[116] *supra* note 113, art. 2317 - 2320
[117] *supra* note 112, at 37

demand suretyships[118]. The French Civil Code distinguishes suretyships from independent guarantees in article 2321, according to which "an independent guarantee is an undertaking by which the guarantor binds himself, in consideration of a debt subscribed by a third party, to pay a sum either on first demand or subject to terms agreed upon."[119]. In a case when an independent guarantee is offered, the latter, unless otherwise agreed, does not follow the guaranteed obligation.[120] In this respect, the confusion in the French system stays mostly on whether there is a distinguished type of suretyships, namely suretyships payable on first demand, or whether they are independent guarantees payable on first demand.[121]French law has recognized the validity of this special type of suretyships, although their legal effects were considered the same as those of independent demand guarantees. However, one should not confuse the recognition of the validity of such agreements with their recognition as a distinct concept: the latter is not answered in the affirmative neither in practice, nor in law.[122] It is suggested that the confusion in the use of the term "suretyship" should be attributed to the familiarity of the Government departments with the latter.[123]

1.5.2 The consumer approach

French Law relates the protection of sureties with consumer protection[124]. Consumer law prevails in protecting professional and non-professional sureties, while the remedies offered by contract or surety law remain residual.[125] A specific rule, which declares invalid "grossly disproportionate suretyships for consumer credit", was included in the French Consumer Code

[118] Roeland Bertrams, *Bank Guarantees in International Trade*, at 50, (Kluwer Law International, 2nd revised ed. Deventer 1992)
[119] French Civil Code art. 2321
[120] *id.*
[121] *supra* note 118.
[122] *id.*
[123] *id.*
[124] Mel Kenny, *Standing Surety in Europe: Common Core or Tower of Babel?* 70(2) MLR [175-196] at 189 (2007).
[125] *id.*

since its enactment in 1993.[126] According to the rule embodied in article L341-1 of the new French Consumer Code, if at the time of the conclusion of the contract, there is a manifest disproportion between the amount offered as security, and the capital and income of the surety, the creditor can not rely on the agreement of suretyship, unless the surety can afford payment when he is called upon[127].

After the reform in 2003, this article was included in the part devoted to the protection of non-professional guarantors[128]. In the same year, in addition to non-professional suretyships, protection was also extended to professional guarantors[129]. Nevertheless, in view of the aim of consumer legislation, which is to protect consumers distinguishing them from those who act in a business capacity, one might as well question the extension offered by the French legislation.

1.5.3 The widow and the Bank[130]

Long before the enactment of the above-discussed legislative measures on consumer protection, French Courts were faced with cases involving unfair suretyships. In 1977, in a case[131] that involved a widow who had offered surety, the Paris Court of Appeal annulled the suretyship. The legal rule on which the Court based its decision was essential mistake on the basis of article 1110 of the French Civil Code. The Court of Appeal reasoned that " …when there is a fragrant disproportion between the poor sources of the surety, accompanied by her age and ignorance, and the enormity of the obligation undertaken by the latter, the mistake committed by

[126] *Loi* (Law) 93-949 (1993) *in* Aurelia Colombi Ciacchi, *Non-Legislative Harmonization of Private Law under the European Constitution: The Case of Unfair Suretyships*, 3 ERPL [285-308] note 57, at 299 (2005).
[127] *id.* referring to the *Loi Dutreil* (new French Consumer Code) (2003).
[128] art. L341-1 to 341-6 of the new French Consumer Code, *translation available* at: < http://legifrance.gouv.fr>(last visited March 24th, 2007).
[129] *supra* note 124 at 189
[130] [18.01.1977] *Cour d'Appel* (Court of Appeal) Paris, JPC G, II, 19318; [4 .07.1979] *La Semaine Juridique, édition générale(* Judicial Weekly Periodical, general edition) 1977, II, 19138; *Cour de Cassation* [Supreme Court] , D. 1979, at 538, *commented* by P. Simler, *in :* Aurelia Colombi Ciacchi, *Non-Legislative Harmonization of Private Law under the European Constitution: The Case of Unfair Suretyships*, (13) 3 ERPL [285-308] note 63 at 300, note 82 at 303 (2005).
[131] *id.* [18.01.1977] *Cour d'Appel* (Appellate Court) Paris, JPC G, II, 19318

her at the moment of the conclusion of the contract, lies not only on the purpose and consequences of the contract, but also on the very object and cause of the act undertaken, in other words on the very substance of the undertaking. This mistake causes the nullity of the suretyship."[132]

As it results from the reasoning of the Court of Appeal, the basis for the mistake done by the widow in the present case, was deducted from taking into consideration the age of the widow, her level of education as well as the manifest disproportion between her financial means and the amount of the obligation. Two years later the Supreme Court affirmed the decision given in favor of the widow.[133]

The element of the manifest disproportion, which at the time was considered as the essential basis for the application of the mistake provision, today is an explicit rule and is included in the new French Consumer Code in article L341-1.[134]

What derives from the above analysis of the French law treatment of unfair suretyships, is an obvious trend towards "consumerization". What might have been found void in the late `70s on the basis of mistake is still found void nowadays but on a different basis: that of consumer protection. Nevertheless, one can not deny that French Law in its totality, offers a high standard of protection, especially when it comes to extending the latter to professional suretyships.

In view of the above, French law may as well deserve the highest level of protection offered to sureties, when compared to the two other systems discussed in this chapter.

[132] *id.* note 83 at 303 *(*translation of the author*)*
[133] *supra* note 130
[134] art. L341-1 of the French Consumer Code 2003, *translation available* at : <http://legifrance.gouv.fr>(last visited March 24rth, 2007).

1.6 Conclusions

As it can be concluded from the above analyses, courts of different Member states have been familiar with cases of unfair suretyships. First there has been a need to find and "define" the element of "unfairness" and this has been accomplished through different existing legal doctrines or through enacting new legislative measures.

In England, the protection of sureties is of a procedural character, with an emphasis on duties to inform and advise independently the surety before signing the contract. Courts have mainly relied on the doctrine of undue influence, misrepresentation, special equity theory or agency theory and case law has deducted reasonable steps to be taken by the creditors when they are deemed put in inquiry. In the latter case they need to inform the surety and require independent advice to be given to him. In addition, the banking sector has issued self-regulatory measures which, despite their non-binding character, aim at enhancing the availability and transparency of the information given to sureties. Consumer protection measures do not extend to cases of unfair suretyships, neither does the unfair contracts terms approach.

In Germany, there is a substantive protection approach relying on the doctrine of good faith and good morals. The gross disproportion between the surety's obligation and his capital and income, in addition to his relation with the principal debtor and his lack of economic interest in the transaction, will be considered as grounds for finding the contract as immoral. The German approach is also constitutionalised in the meaning that, if the good faith or good morals are violated, unfair suretyship agreements will be declared contrary to the principles of personal autonomy and social state.

France on the other side follows a consumer protection approach and extends it also to non-professional sureties. It employs the concept of mistake together with the manifest

disproportion between the surety's obligation and his financial means, in order to declare a suretyship contract void. Its approach is as well substantive rather than procedural.

If one would draw a linear graphic and would place the three legal systems` effectiveness in regards of sureties' protection, the two ends of the spectrum might be easily identified: UK and France. The German approach is captured in between the two ends of the spectrum: UK and its procedural approach on one side, and France with a substantial, consumerized protection on the other side.

CHAPTER II

The European Union Project on Unfair Suretyships

2.1 Introduction

It might have started as a far more simple idea the concept of a common economic framework and a free market between European states. What it turned out to be is a far more complex and often over-detailed regulation of political, economic and social aspects of the EU Member States. The highly debated trend of integration might easily be translated, for some, into unification. Perhaps that is what stands behind the overall aim of creating and strengthening a single market in financial services throughout European Union and promoting coherence in European Private Law.

Despite the tendency of creating "common European cores", when it comes private law issues, the "architects" of this approach are faced with strikingly hard burdens offered by different national backgrounds. One of these "hard cases" is certainly the case of unfair suretyships. Given the previously discussed divergences between Member States solutions, one can easily doubt whether there might be a "unified approach" recommendable to all of them.

As it has been outlined in the previous chapter, suretyship cases throughout Member States often involve situations, when a close family member, usually a spouse, a relative, or someone related or 'dependent" on the debtor, stands surety for his debts. The element of "unfairness" is most of the time clear: persons standing surety might have a "frustrated" will to enter into such obligations due to the emotional ties or dependence from the debtor, they might not be aware of the amount of risk undertaken, or even if they were aware, they will stand surety because of their relation to the debtor. So, on one side we have the need to protect vulnerable

sureties and on the other side we have the claim of contractual integrity[135] and the freedom to enter into unwise agreements[136], or as Kenny puts it " we are caught between the claims of love and money"[137].

This controversial character of unfair suretyships has captured and deserved attention at the EU level. There is an ongoing project, which focuses on cases of unfair suretyships throughout Europe, namely "*Protection from unfair suretyships in the European Union*" [138] (hereinafter the Project). It has been running since April 2004 and is supported by the European Community in its Sixth Research Framework Program. Its aim is to discover, analyze and compare material divergences and convergences in the Member States national treatment of suretyship cases.

The project certainly represents a key development in the framework of the European Commission initiatives[139] aimed at creating a single market in financial services, as well as to the vibrant debate on the future (or even the existence) of the European Private Law.

In view of the above, the project involves issues of interest which extend to consumer protection and specifically to the modified proposal for a *Directive on Credit Agreements for Consumers*[140].

[135] Mel Kenny, *Standing Surety in Europe: Common Core or Tower of Babel?* 70(2) MLR [175-196] at 176 (2007).
[136] *id.* at note 6, The author refers to a case decided by the European Court of Justice, *Ulster Bank v Fitzgerald* [2001] IEHC 159, at [10] where it was stated: "*The courts are not required to intervene to protect a contracting party from ill-advised action . . . the court is not entitled to relieve her [Ms Williams] of her obligations . . . merely because amore prudent person might not have signed them*."
[137] *id.*
[138] *Protection from Unfair Suretyships in the European Union*, a project supported by the European Community in its Sixth Research Framework Program, duration April 2004 – 31st of March 2007. It is run by the Center for European Law and Politics at the University of Bremen (ZERP) in cooperation with the University of Oxford. a*vailable* at <http://www.zerp.uni-bremen.de/english/projekte/assoziierte/protection.html>(last visited March 26th, 2007).
[139] such as the creation of Academic Groups and Intitiatives like Study Group on a European Civil Code, European Private Law Networks, *Acquis* Group, etc. *available* at <http://ec.europa.eu/internal_market/contractlaw/links_en.htm >(last visited March 26th, 2007).
[140] Amended Proposal for a Directive of the European Parliament and of the Council on Credit

The aim of this chapter is to analyze first, in view of the above project, the EU dimension of rights violated in cases of unfair suretyships, the relation of the latter to the imperatives deriving from the idea of a common market and a maximum exploitation of debt within EU. It will also analyze the "common" or 'uncommon" background that unfair suretyships can offer to the European Private Law, by comparing the national approaches to such cases. Attention will also be paid to the consumer protection dimension involved in cases of unfair suretyships, in light of the amended proposal for a new Directive on Consumer Credit Agreements. The conclusions will focus specifically on what would be the best solutions in order to promote equal level of protection to vulnerable sureties throughout Member States. In this respect the recommendations posed in the actual publications of the Project[141], as well as the proposals made on this issue by the Study Group on a European Civil Code[142], will be evaluated.

2.2 The EU dimension of unfair suretyships

2.2.1 Unfair suretyships and the European fundamental rights

The lively debate inside the Project on unfair suretyships justifies the important rationale behind it: the protection of personal autonomy, self-determination and freedom of contract is at stake in such cases. All of them seem to be at risk, when unfair suretyships proclaim the "ill-founded" grounds on the basis of which they are often treated. It is true that freedom of contract

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Agreements for Consumers amending Council Directive 93/13 EC *available* at : <http://ec.europa.eu/consumers/cons_int/fina_serv/cons_directive/2ndproposal_en.pdf >(last visited Match 24th, 2007).

[141] Some crucial publications in the Project framework until now are: Rebecca Parry, *The position of Family Sureties within the Framework of Protection for Consumer Debtors in European Union Member States*, (13) 3 ERPL [357-381] (2005); Lorenz Kähler, *Decision-Making about Suretyships under Empirical Uncertainty – How Consequences of Decisions about Suretyships Might Influence the Law,* (13) 3 ERPL [333-355] (2005);
Peter Rott, *Consumer Guarantees in the Future Consumer Credit Directive : Mandatory ban on Consumer Protection?* (13) 3 ERPL [383-404](2005); Aurelia Colombi Ciacchi, *Non-Legislative Harmonization of Private Law under the European Constitution: The Case of Unfair Suretyships,* (13) 3 ERPL [285-308](2005); Sjef Van Erp, *Surtey Agreements and the Principle of Accessority- Personal Security in the Light of a European Property Law Principle*, (13) 3 ERPL [309-331] (2005).

[142] Working Team on Credit Securities, Study Group on a European Civil Code, *available* at : <http://www.mpipriv-hh.mpg.de/deutsch/Forschung/Kreditsicherheiten.html> (last visited March 24th, 2007).

and private autonomy are considered to be a crucial element of the fundamental right to self-determination and personal autonomy[143]. Their importance is strongly reflected in the fact that they represent common European fundamental rights.

When a surety is asked by a member of his family or someone, with whom he has emotional or dependence ties, his self-determination might be strongly affected and not autonomous. Since he is not free to enter into the agreement, or to decide the content of it, his freedom of contract is violated, in other words, his right to free determination and personal autonomy, enshrined in article 8 of European Convention on Human Rights[144] (hereinafter ECHR), is restricted. Also, according to the jurisprudence of the European Court of Human Rights, this article is extended to protection of the personal autonomy in general.[145]

It is also important noting that Article 6 of the EU Treaty makes the ECHR fundamental rights, general principles of Community Law[146]. In addition the principle of uniform interpretation of Community law applies to the common European constitutional rights as well.[147] Thus, the above interpretation, as well as the objective of the Union citizenship, which is "to strengthen the protection of the rights and interests of the nationals of its Member States"[148],

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[143] Aurelia Colombi Ciacchi, *Non-Legislative Harmonization of Private Law under the European Constitution: The Case of Unfair Suretyships*, (13) 3 ERPL [285-308] at 306-307 (2005)

[144]art. 8 (1) of the Convention reads: "Everyone has the right to respect for his private and family life, his home and his correspondence." European Convention on Human Rights, (Rome 4 November 1950), *available* at : <http://www.hri.org/docs/ECHR50.html#C.Art8> (last visited March 24th , 2007).

[145] *Goodwin v. United Kingdom*, [2002] European Court of Human Rights, 28957/95, *available* at <http://www.echr.coe.int/Eng/Press/2002/july/GoodwinjudGrand%20Chamber.htm> (last visited March 24th, 2007). ; *Pretty v. United Kingdom*,[2002] European Court of Human Rights, 2346/02, *available* at : <http://www.echr.coe.int/eng/Press/2002/apr/Prettyjudepress.htm> (last visited march 24th, 2007).

[146]EU Treaty, (Maastricht, 7 February 1992). According to art. 6 of the EU Treaty "(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://europa.eu.int/en/record/mt/top.html> (last visited March 24th, 2007).

[147] Hugh Collins**,** *The Voice of the Community*, (3) 4 EL.J. [407-421] at 407 (1998).

[148] Such an objective derives from art. 2(1) of the EU Treaty

can only be reached if such rights and freedoms are accompanied with a common background of protection which is able to overcome the differences between Member States. What is important is not to eliminate all the divergences between Member States treatments, since this might be impossible even if a single European Civil Code would be enacted, due to the differences in legal cultures, but to provide an equal level of protection for vulnerable sureties. It is exactly for the "sublime" character of the fundamental rights and freedoms involved in cases of unfair suretyships, and on the other side guaranteed on a supreme EU level, that suretyship cases need to involve an equal level of protection for individuals within Member States.

2.2.2 Unfair suretyships and the single financial market

The EU dimension of unfair suretyship cases does not include only the superior character of the rights which are at stake, but also their impact on the coherence of the European Private law and the achievement of a single market in financial service. To promote a single financial market means to intensively promote the exploitation of debt and in order to achieve the latter, there need to be a proper level of protection for persons offering securities for debts, *i.e.* sureties. On the other side, there need to be a balance between promoting sureties` protection and promoting credit lending by the banks or financial institutions, in order to induce the latter in such undertakings. In view of this analysis, one might say that well-regulated suretyships can afford its own contribution to the development of the internal financial market.

The central dilemma thus concentrates on which ways would be most effective to achieve this objective. Would it be better to leave such a regulation to non-legislative, spontaneous harmonization through results of Member States courts or to walk towards a "yet unknown

"process of total codification of European Private Law? There might also be a third alternative in between the two: "piecemeal measures of sector-specific harmonization".[149]

In order to derive a conclusion on which would be the most effective choice, one should also analyze what do the institutions and legislative acts of the EU say on the issue so far.

2.3 Harmonizing protection in cases of unfair suretyships

2.3.1 No need for legislative harmonization?

The first alternative to achieve a unified degree of sureties` protection in Member States, as presented by one of the publications of the Project[150], would be to leave harmonization to case law convergence through the horizontal effect of European Fundamental Rights, but certainly not to spontaneous convergence.

From the analysis of Member States case law, doctrines and statutory provisions[151], it is clear that there is not only a procedural, but also a substantial disparity in the treatment of similar suretyship cases. Thus, it can be said that the highest level of protection is offered by French and German law, compared to UK. The first states, although differentiating in between themselves as well, consider suretyship agreements of non-professional guarantors, invalid when they are in a gross disproportion to their assets.

British Courts as well as Dutch courts emphasize the duty of creditors to ensure that sureties have been properly informed before the conclusion of the contract,[152], thus paying more attention to the procedural element of information rather than to the substantial unfairness of the agreement. However they also consider the above duty importantly relevant to a finding of fraud, misrepresentation, or mistake.

[149] Mel Kenny, *Standing Surety in Europe: Common Core or Tower of Babel?* 70(2) MLR [175-196] at 178 (2007).
[150] Aurelia Colombi Ciacchi, *Non-Legislative Harmonization of Private Law under the European Constitution: The Case of Unfair Suretyships,* (13) 3 ERPL [285-308] at 306-308 (2005)
[151] Analysis of UK, Germany and France presented in the first chapter. *See supra* section 1.6

Surprisingly, there are also states like Italy, which in the absence of any specific rules, offer the lowest standard of protection to sureties burdened with disproportionate obligations[153].

It is obvious that letting case law freely "harmonize' itself is not an "apparently" successful attempt, due to the divergences between Member States solutions. One of the proposals of the Project in this respect, is to start using the already existing mechanisms of harmonization of case law in the EU, like the horizontal effect of European Fundamental Rights[154]. The latter embraces a settled principle in EU law and contends that fundamental rights and freedoms have effect not only in the "vertical" relationship between individuals and public institutions, but also in the relationship of private persons with each-other. As it was discussed above, article 6 of the EU Treaty, as well as Article 8 of the ECHR confer rights to sureties which are part of the Community law and stay at the level of European Constitutional norms. Therefore they need to be interpreted uniformly in all Member States and national laws need to be in compliance with them[155].

Those who argue that horizontal effect might bring harmonization, emphasize their practicability especially when it comes to the "non-necessity" of enacting secondary legislation[156]. They state that what is most important, is to achieve the same results in different Member States, despite of the doctrines or legal basis used. What seems to further support their argument is the acknowledgment that, states in Western Continental Europe have exercised the

[152] Rebecca Parry, *The position of Family Sureties within the Framework of Protection for Consumer Debtors in European Union Member States,* (13) 3 ERPL [357-381] at 361-365 (2005)
[153] *supra* note 156, at 305
[154] *id.* at 294-296. The doctrine of horizontal effect of fundamental human rights dates back to the case *Defrenne v. Sabena,* [1976] ECJ 43/75, *available* at< http://europa.eu.int/eur-lex/lex/LexUriServ/LexUriServ.do?uri=CELEX:61975J0043:EN:HTML> (last visited March 24th, 2007).
[155] *supra* note 156, at 307
[156] *id.* at 296-297

horizontal effect and have been able to "move away from established principles of private law no longer respondent to the spirit of time"[157].

When opposed to statutory harmonization, judicial approximation seems to be more "constitutionally legitimate" in two ways: it can produce effectiveness even in a context of diversity, without the need to enact secondary legislation and it has an already established assumption of "common core of rights" on a constitutional base.[158]

Despite of the advantages that the horizontal effect might include, there are also some doubts on their effectiveness. First, although generally accepted, there is still debate in UK whether or not human rights can have horizontal effect.[159] Second, it has only recently and sporadically been at the attention of scholars, the connection between private law approximation and horizontal effect of fundamental human rights.[160]

Nevertheless, when assessing the advantages and disadvantages of the judicial convergence approach, the ultimate conclusion should focus on whether pros can outweigh the cons and there need not be an automatic denial of other suitable alternatives. A combination of judicial convergence approach and legislative measures might as well result productive in assuring same degree of protection to non-professional sureties.

[157] *id.*. at 294
[158] Aurelia Colombi Ciacchi, *Non-Legislative Harmonization of Private Law under the European Constitution: The Case of Unfair Suretyships*, (13) 3 ERPL [285-308] at 296-297 (2005)

2.3.2 The consumer protection approach

2.3.2.1 European Court of Justice case law on consumer protection of sureties

The necessity for an extensive coherence in the treatment of suretyships has been at the attention of the European Court of Justice (hereinafter ECJ)[161]. European case law has dictated an imperative for further increase in the level of protection of sureties. The following cases absolutely evidence such concern.

2.3.2.1.1 The Dietzinger case[162]

An extension of protection to sureties was recognized by the ECJ in 1998 in *Bayerische Hypotheken-und Wechselbank AG v. Edgar Dietzinger* case.

In this case[163], Mr. Dietzinger gave a direct recourse written guarantee, for a sum not to exceed DM 100 000, covering his parents' obligations to the Bank. The guarantee contract was concluded at the house of Mr. Dietzinger parents and he was not informed on his right of cancellation. When he was sued by the bank for the payment of the amount under the guarantee, he claimed that his right of information was violated under the law[164] that transposed The Doorstep Selling Directive 85/577[165].

After its way through German Courts, the case reached the ECJ for a preliminary ruling. The question was whether a contract of guarantee or suretyship, concluded between a natural

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[159] *see* P. Craig, *Administrative Law*, at 599 (Sweet & Maxwell, 5th ed. 2003) ; R. Buxton, *The Human Rights Act and Private Law* 116 L.Q.R. 48 (2000)
[160] *see* O. Gerstenberg, *Private Law and the New European Constitutional Settlement*, 10 ELJ 776 (2004).
[161] *infra* at 162
[162] *Bayerische Hypotheken-und Wechselbank AG .v Edgar Dietzinger* C-45/96, [1998] ECR 1-1199 *available* at : < http://curia.europa.eu/jurisp/cgi-bin/> (last visited March 24th, 2007).
[163] *see* Peter Rott, *Consumer Guarantees in the Future Consumer Credit Directive : Mandatory ban on Consumer Protection?* (13) 3 ERPL [383-404] at 384 (2005).
[164] Law on the Cancellation of Doorstep Transactions and Analogous Transactions, BGBl. I, (Official Journal of the Federal Republic of Germany) at 122 (16 January 1986).
[165] Council Directive 85/577/EEC of 20 December 1985, OJ 1985 L 372, at 31

person, not acting in a business capacity, and a financial institution, could fall in the category of ”contracts, under which a trader supplies goods or services to a consumer”[166], in order to be protected as negotiated away from the business premises.[167]

The ECJ concluded that the Directive in question covered contracts of guarantee or suretyship, where the principal contract concerned the supply of goods or services to a consumer, the surety was acting outside his trade or profession and the ancillary contract (the suretyship or guarantee) was entered into outside the trader's premises[168].

Furthermore, the Court rejected the French, British, Finish and Belgian Governments opinion that the undertaking by the person providing security has nothing to do with the supply of goods or services by the trader[169]. Contrary to these states assertions, the Court observed that:" The grant of a credit facility is indeed the provision of a service, the contract of guarantee[170] being merely ancillary to the principal contract, of which in practice it is usually a precondition".[171]

In sum, whenever a non-professional surety grants security under a contract concluded outside the trader's premises, when the principal contract is for the supply of goods or services to a consumer, he may avail himself to the protection offered by the withdrawal rights under the "cooling-off" period in the legislation implementing the Doorstep Selling Directive. In view of the above, it is clear that the limitations of protection remained certainly excessive: first the character of the principal contract, then the place of the conclusion of the ancillary contract and third, the non-professional character of the surety's act.

[166] *id.* art. 1
[167] *supra* note 162 at ¶ 10
[168] *id.* at ¶ 23
[169] *id. at* ¶ 14-19
[170] It is worth noting the use of the term "guarantee" to cover the contracts of guarantee and suretyship, and also the fact that the question directed to the court asked for either of them. Thus, it is reasonable to assume that the Court uses the words interchangeably.

2.3.2.1.2 Proclaiming gaps in consumer protection: the Berliner Kindl case[172]

Another ECJ case, which proclaimed a gap in the consumer protection, offered by the 1987 Consumer Credit Directive[173], was *Berliner Kindl Brauerei AG v. Andreas Siepert*. In this case, Mr. Siepert gave a guarantee to the Brewery for the purpose of repaying the loans granted by the Brewery to a third party. Mr. Siepert was not acting in the course of a trade or profession and as in the previous case, he was not informed on his right of cancellation. The National Court in first instance found in favor of the Brewery, and on the motion of Mr. Siepert to have the judgment set aside, it asked ECJ for a preliminary ruling. The question was whether the Consumer Credit Directive of 1987 could be extended to cover a contract of guarantee for repayment of credit, where neither the guarantor nor the borrower was acting in a business capacity[174].

The Court ruled that the aim and the construction of the provisions in the Directive could not be interpreted as including contracts of guarantee or other forms of surety. The Court specifically stated: "Thus, the fact that the Directive both refers to guarantees when listing the terms regarded as essential to a credit agreement from the point of view of the borrower and is silent as to the legal implications of guarantees or other forms of surety shows that, …the Directive intentionally excluded agreements to act as guarantor from its scope"[175].

The Court recognized a distinction between the Doorstep Selling Directive and the latter when comparing the present case with Dietzinger.[176]On the basis of the very aim of the first Directive, which was to protect consumers when they might have not been able to appreciate the

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[171] *supra* note 162 at ¶ 18
[172] *Berliner Kindl Brauerei AG v. Andreas Siepert* C-208/98, [2000] ECR 1-1741 *available* at: < http://curia.europa.eu/jurisp/cgi-bin/> (last visited March 24th, 2007).
[173] Council Directive 87/102/EEC for the approximation of the laws, regulations and administrative provisions of the Member States concerning consumer credit, OJ 1987 L372/31
[174] *supra* note 172, at ¶ 11
[175] *id.* at ¶ 22

terms of the contract, a guarantee contract could not have been left *a priori* outside its scope. In the present case, considering the objective of the Consumer Credit Directive, which concerns primarily the information to be given to the debtor and is almost devoid of the guarantor's protection, since the latter is primarily concerned about the solvency of the debtor, the Directive might be regarded as not being designed to protect guarantors.[177]

In sum, what this case brought to the legal thought in the field, is that the Consumer Credit Directive of 1987, did not cover cases of suretyships, intended for the repayment of credit, where the surety and the debtor, were both not acting in the course of their business.

2.3.2.2 Legislative Consumer Protection of sureties in the European Union

The above case illustrated the gap in the Consumer Credit Directive of 1987 with regards to guarantors. In order to fill this statutory gap, on September 2002, the Commission submitted to the Parliament and the Council a proposal for a revised Directive for the regulation of consumer credit as a First Draft Directive on Consumer Credit[178] intended to include into its scope the protection of consumer suretyships. The proposal was supposed to include in its Article 23 the protection of consumer suretyships, but it still left out non-professional suretyships of a business loan.[179]

After the refusal of the European Parliament on 11 September 2003[180], there have been subsequent changes[181] till the recent new Draft Directive of 7 October 2005[182]. The new proposal

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[176] *supra* note 162. For the Doorstep Selling Directive *see supra* note 165.
[177] *supra* note 172, at ¶ 24, 25
[178] Proposal for a European Parliament and Council directive on the harmonization of the laws, regulations and administrative provisions of the Member States concerning Credit for Consumers (COM(2002) 443), OJ C 331E, 31.12.2002, at 200 *available* at :< http://eur-lex.europa.eu/Result.do?direct=yes&lang=en&where=EUROVOC:000278&whereihm=EUROVOC:cost%20of%20borrowing > (last visited March 24th, 2007).
[179] i*d*

(thereafter in this section, the *Proposal)*, not only leaves surety agreements out of its regulation, but it has almost lost its consumer protection dimension and has been followed by enormous critical reactions.[183] Most importantly, the *Proposal* (article 5.3.2) considers surety agreements excluded from its scope, since the main issue involving sureties was related to mortgage credit. It specifically states that: "Surety agreements are now excluded from the scope, as the main issue in relation to sureties was linked to the question of mortgage credit. Guarantors are excluded from the scope as well… it is more opportune not to deal with specific aspects of contract law…".[184] Thus, relatives standing surety will not need, in view of the European Parliament's opinion, any warning to the obligation they are undertaking.

The *Proposal* in (article 5.3.1) also excluded credit agreements for the granting of credit secured by real estate, since this type of credit was considered of a very particular nature. It is strikingly surprising to arrive to the conclusion that, when it comes to mortgage credit, the European Parliament is of the view that no internal market is needed, and also that home-owners need no protection. The proposal goes even further by stating that: "The first modified proposal covered equity releases, while excluding credit agreements concluded for housing purposes. …

[180] *see* <http://www.europarl.europa.eu/sides/getDoc.do?language=EN&pubRef=-//EP//NONSGML+REPORT+A5-2003-0310+0+DOC+PDF+V0//EN>(last visited March 24th, 2007).
[181] For an overview of one of the amended proposals, COM (2002) 747 final, *see* Peter Rott, *Consumer Guarantees in the Future Consumer Credit Directive : Mandatory ban on Consumer Protection?* (13) 3 ERPL [383-404] (2005). It should be noted however that this publication of the Project was issued before the final Amended Proposal and thus, it does not consider the subsequent changes brought by the latter.
[182] Amended Proposal for a Directive of the European Parliament and of the Council on Credit Agreements for Consumers amending Council Directive 93/13 EC, COM(2005) 483 final, *available* at : <http://ec.europa.eu/consumers/cons_int/fina_serv/cons_directive/2ndproposal_en.pdf> (last visited March 25th, 2007).
[183] *see* Critical Introduction and Selected Reading from the Modified proposal for a Directive of the European Parliament and of the Council on Credit Agreements for Consumers amending Council Directive 93/13/EC, Brussels, 7.10.2005, *available* at <http://www.responsible-credit.net/media.php?id=1812> (last visited March 25th, 2007).
[184] *supra* 182, art. 5.3.2 of the Proposal

Therefore, the Commission has excluded equity release from the scope".[185] What this means is that in cases of second mortgage consumer credit, misuse of homes will be privileged[186].

The Proposal leaves out of focus many outstanding problems when it comes to vulnerable sureties. Not only is over-indebtedness out of its regulation, but this final draft, in its article 5.11, intends maximum harmonization as its implementing measure. This can be clearly translated into a prohibition of Member States to introduce, or maintain different provisions from those stipulated in the "future" Directive.

The final absurd result of the *Proposal* seems to be that, according to it, the concept of responsible lending is modified into a right of the creditor to investigate the consumer creditworthiness[187] and to bring the ultimate controversial conclusion to social justice: no credit for poor people!

With the exclusion of protection extended to sureties and guarantors, with its questionable "maximum" harmonization measure, it is obvious that enhancing consumer protection, which is one of the very aims of this *Proposal*, is left out of consideration. It is difficult to predict how the latter might induce exploitation of debt, as a crucial factor in developing the internal market. In an ultimate result, it seems that the *Proposal* is much more attentive in offering protection to financial institutions rather than consumers or vulnerable sureties. At this stage, the inclusion of provisions, which regulate a "fair" treatment of consumers and sureties, is more than acute.

[185] *id.* art. 5.3.1
[186] *supra* note 183
[187] *id.*

2.4 Overprotection of sureties?

In addition to their complex character, suretyship agreements involve a plurality of parties and competing interests[188]. Many controversial interests are at stake in this type of agreements, such as interests of the parties in bankruptcy, interests between family members, and above all, between the creditor and the surety.

In this respect, on one side there are sureties who, despite their subsidiary liability, are often found in a weak position as regards the creditor and the principal debtor. On the other side, the creditor interests should not be entirely left out of the focus of protection. It is true that sureties need to be protected from excessive and "unfair" over-indebtedness, but at the same time, it can't be said that creditors are immunized against fraud that can occur in case of the transfer of assets between family members[189]. An excessive protection of sureties, despite its emphasis on social justice, can result counter-productive when it comes to induce financial institutions in offering credit. As Kenny puts it " …the poverty law paradox, is that, whilst over-indebtedness is a growing problem, the effect of securing higher standards of surety protection might be to isolate the poorest in society even more comprehensively from any access to credit"[190]. There is also a risk, if the creditor, reacting to the sureties` over-protective measures, withdraws from the market, since he can be charged with "socially divisive behavior"[191].

In this line of argument, there are approaches, which consider that the under-protection of sureties would result more productive and manageable than a contrary situation.[192] According to this approach, since overprotective rules can limit the capacity to enter into valid suretyships, and since courts can overrule under-protective precedents easier than the overprotective ones, the

[188] Mel Kenny, *Standing Surety in Europe: Common Core or Tower of Babel?* 70(2) MLR [175-196] at 181 (2007).
[189] *id.*, at 182
[190] *id.*.
[191] *id.*.

"less protection" represents a more effective method of dealing with suretyships.[193] In addition, it is believed that creditors` due diligence and informative measures will compensate the under-protective rules.

However, the above analysis, although partially acceptable, misses a fundamental point. Under-protective rules mean more valid suretyship agreements, and thus in a general overview, more over-indebtedness of sureties. The latter will certainly inform future possible sureties about the risk of being found in the same situation, and as a consequence, there will be more reasons not to avail themselves to such obligations when possible. Therefore, even the reverse scenario, the one of over-protection of creditors can be counter-productive[194]. Thus, from the productiveness point of view, what the regulation of suretyships should follow, is neither overprotection, nor the opposite approach. A balance between the competing interests of creditors and sureties is more than necessary in order to promote the availability of credit in the market.

2.5 Complexity and multifaceted regulation of suretyships

Suretyship agreements not only involve competing interests of different parties, but need also the intervention of an overlapping area of law. Suretyship is considered as situated in the borderline of contract and property law[195]. It is certainly a contract, but at the same time a personal security device, in such a way that the surety's liability is of a contractual nature, but agreed upon for securing payment of a debt. The latter aspect is what relates suretyship to property law[196].

[192] *see* Lorenz Kähler, *Decision-Making about Suretyships under Empirical Uncertainty – How Consequences of Decisions about Suretyships Might Influence the Law,* (13) 3 ERPL [333-355] (2005).
[193] *id.* at 355
[194] *supra* note 188, at 182
[195] Sjef Van Erp, *Surety Agreements and the Principle of Accessority- Personal Security in the Light of a European Property Law Principle*. (13) 3 ERPL [309-331] at 310 (2005).
[196] *id.*

However, from the analysis in different Member States` situations in the first chapter, the rules regulating suretyships, can be found in contract law, consumer law, unfair contracts terms, constitutional law, general doctrines of undue influence, good faith, unconscionability, in procedural protections or even in banking self-regulatory measures. A state's emphasis on one of the above law areas or a combination of them, might be reflected in the degree of protection afforded to sureties, as well as to the prevalence of such agreements[197].

Referring to the previous country analyses in the first chapter, the ultimate conclusion is that different Member States employ different regulatory measures in unfair suretyship cases. Apart from the conclusions already derived for UK, France and Germany, other EU countries present different backgrounds in this respect.

Thus, in comparison to England, Ireland relies more on an equitable approach, and considers important the protection of family interests[198]. However there is a divergence with England on undue influence and constructive notice. According to the Irish position, the existence of a family relationship can not itself presume undue influence, but at the same time, there is a general controversial presumption that in family relationships there is a high risk of such an influence.

Austria[199], on the other side, when compared to Germany follows a more traditional private law approach. It requires an "unfair" rather than a "gross disproportion" between the undertaken obligation and the surety's assets. Nevertheless it also embraces the constitutional approach of German law. In addition, Netherlands[200] also establishes protection through provisions of Civil Code and its case law emphasizes mostly on private autonomy.

[197] Mel Kenny, *Standing Surety in Europe: Common Core or Tower of Babel?* 70(2) MLR [175-196] at 183 (2007).
[198] *id.* at 186-187.
[199] *id.* at 188, 191.
[200] *id.* at 189.

In comparison to the French approach, Belgium[201] relies on family law, when declaring void the agreements that put family interests at risk and it also relies especially on proportionality-based insolvency law. According to the latter, the court may discharge the surety in cases when the obligation is not proportionate to his financial means.

The above divergences between national law approaches raise a number of doubts. Is it better to adopt a substantive law protection or a procedural one? Should we follow a consumer protection path or turn to consitutionalising private law? Can harmonization be achieved in such a diverging framework?

2.6 Towards a higher protection of sureties

In a legal background lightened by so many different tonalities, it is hard to find a way towards harmonization. Even more striking is the question whether harmonization is possible and necessary. Certainly, when it comes to the latter, harmonization might be seen not only as a move towards greater flexibility in the EU financial market, but also as a means towards a better and almost "homogeneous" protection of European sureties. Nevertheless, adopting a maximum harmonization approach, meaning an almost "codification" in this field, seems far from effective and the latter is moreover affirmed by the European Commission[202].

In addition, imposing legislative imperatives to different legal systems might confront not only resistance, but also confusion when it comes to overruling traditional solutions. Most importantly, what would be the system, which supposedly could represent the EU "Eureka" in the unfair suretyship case? Would it be a civil law (statutory) or a common law (case law) approach, and even if it was one of them, would it be possible to impose on the

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[201] *id.* at 188-189

[202] Sjef Van Erp, *Surety Agreements and the Principle of Accessority - Personal Security in the Light of a European Property Law Principle* (13) 3 ERPL [309-331] at 329 (2005).

"constitutionalised" Germany, a typical English " duty to inform ", or "doctrine of undue influence"? If this was the case, it would most likely be another "artificial EU product", rather than a proper solution, responding to the particularities of a certain social environment and legal culture. Divergence seems too intense to allow a maximum unified capture under the same EU "ceiling" or an "all-in-one" European codification of private law.

Nevertheless, when it comes to codification, an interesting two-fold approach for cases of suretyships comes by the Study Group on a European Civil Code[203]. The first aspect of the approach relies on general law of contract as provided in the Principles of European Contract Law[204], by employing a traditional private law protection. According to these principles, suretyship agreements can be protected through provisions of fair dealing, good faith, rules of excessive benefit and unfair disadvantage and also, through provisions of unfair contract terms not individually negotiated. The other aspect of the approach is the specific regulatory framework for personal sureties, which mostly emphasizes the pre-contractual duty to inform, and the subsequent annual information on the surety's liability[205].

Despite the fact that for reasons already mentioned, codification and maximum harmonization might not be easily achieved or even successful, harmonization itself is such a broad term that can embrace sector-specific harmonization in those areas, where similarities can outweigh divergences. Some of them are certainly consumer protection, responsible lending and a higher access to credit. The deficiencies observed above in the *Proposal*[206] concerning

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[203] Study Group on a European Civil Code, Working Team on Credit Securities , documentation of a summary of group work *available* at : <www.sgecc.net/pages/downloads/stellungnahme_kommission_5_final1.pdf> (last visited March 25th, 2007).
[204] The Principles Of European Contract Law, by the Commission on European Contract Law, *available* at: <http://www.jus.uio.no/lm/eu.contract.principles.parts.1.to.3.2002> (last visited March 25th, 2007).
[205] Mel Kenny, *Standing Surety in Europe: Common Core or Tower of Babel?* 70(2) MLR [175-196] at 189-190 (2007).
[206] *supra* note 182.

consumer credit agreements, if modified and adapted as some of the critics[207] have required, might be "uniformly" protective to sureties, and at the same time serve its very aim: consumer protection and strengthening of the free market.

Additionally, the previously discussed non-legislative harmonization through judicial convergence seems effective, responsive to many different legal systems and constitutionally legitimate in "naturally harmonizing" private law. As an ultimate result, courts of different Member States have come to similar conclusions by applying different legal solutions. What has varied and what makes the very essence of such an analysis, is the differentiation of the degree of protection offered to sureties. By having a European constitutional basis of the rights violated in unfair suretyship cases, the process seems far easier to be successful, by means of the horizontal effect doctrine of fundamental rights[208]. The latter will enable courts of different Member States to afford equal protective treatment to similar cases of unfair suretyships. Thus, a case-law approach seems to be adequate.[209]

Another method, which might contribute to increase the protection of both, sureties and creditors, is a self-regulatory environment of financial institutions. Adopting measures that constitute good practice and put the emphasis on the availability and transparency of information, despite their non-binding character, sounds as an additional positive aspect to be added to the spectrum of suretyship protection.

[207] Critical Introduction and Selected Reading from the Modified proposal for a Directive of the European Parliament and of the Council on Credit Agreements for Consumers amending Council Directive 93/13/EC, Brussels, 7.10.2005, *available* at <http://www.responsible-credit.net/media.php?id=1812> (last visited March 25th, 2007).

[208] Aurelia Colombi Ciacchi, *Non-Legislative Harmonization of Private Law under the European Constitution: The Case of Unfair Suretyships,* (13) 3 ERPL [285-308] at 296-297 (2005)

2.7 Conclusions

This chapter has first dealt with the EU dimension of unfair suretyships, focusing specifically on the fundamental rights involved in such cases and their impact on the internal market in financial services. As viewed so far, unfair suretyships represent cases in which the European fundamental right of private life, which includes self-determination and personal autonomy, is at stake. Thus, in view of article 8 ECHR and article 6 of the EU Treaty, since these rights constitute Community law, Member States have to comply with them and afford equal degree of protection to sureties. The problem of adequate harmonized protection of vulnerable sureties throughout Member States, can be achieved on the basis of an already existing mechanism: horizontal effect of fundamental human rights, which means that individuals enjoy, and can protect these rights not only against public institutions, but also vis-a-vis each-other. In conclusion, it remains the duty of Member States` courts to ensure uniformity in such a protection.

Another aspect of the EU dimension of unfair suretyships is its impact and connection to the internal market in financial services. While credit, which is otherwise translated as debt, is considered as the engine of a free developed market, access to it becomes more than important. Creditors are certainly more willing to offer credit, only when there is security, thus promoting the availability of the latter and protecting those who offer it, is a necessity dictated by the development of the market. In this regard, it is concluded that, not only the protection of sureties, but also the observance of creditor's interest, is of crucial importance. There is a challenging balance to be kept between the two competing interests, derived from the assessment that the over-protection of one class, at the expense of the other, may result counter-productive.

In the light of the consumer protection of sureties, statutory measures aimed at enhancing it, remain far from affording any special relief to sureties. The final EU legislative product on consumer protection is the "creditor-biased" *Proposal* regarding consumer credit agreements, which has entirely "erased" suretyships from its focus. In an ultimate result, the very aim of this proposal, contravenes the exclusion of suretyships.

Furthermore, when analyzing the possible paths towards increasing the level of sureties` protection, some of the options remain ineffective. Thus, maximum harmonization or codification seems far from being applied, due to the enormous divergences between Member States approaches in unfair suretyship cases.

Nevertheless, the above approach of case law convergence through the horizontal effect of fundamental human rights, does not exclude the recommendation of enacting sector-specific legislative acts, in those areas where similarities outweigh divergences. In addition, self-regulatory measures, which increase the availability and transparency of information, like Banking Codes of Good Practice, might be effective.

In conclusion, considering the complexity and importance of suretyship contracts in the nowadays-financial services market, a combination of judicial harmonization through case law convergence, statutory acts in specific sectors and self-regulatory measures, remains self-recommendable.

CHAPTER 3

UNFAIR SURETYSHIPS IN ALBANIA

3.1 Introduction

The new EU integration era has extended its attention to Western Balkans countries, including Albania[210]. In the present days, Albania stays as a potential candidate country and has signed the Stabilization and Association Agreement on June 12, 2006[211]. In this aspect, one of the main standards, in which the actual and future efforts need to concentrate, is the legislative reform and its adaptation with *acquis communitaire*. In addition, introducing reforms, which aim at creating a free developed market, is another key prospectus that Albania needs to promote[212].

In light of the above, this chapter will focus on the analysis of the legal background concerning unfair suretyships in Albania. Suretyships as personal security devices, are of crucial importance when it comes to enhancing credit access in the market and, thus, contribute in adapting a country's profile to more developed *Europeanized* standards. Therefore, it is of crucial interest analyzing what the Albanian system has to offer and improve in this respect.

The chapter will first deal with the traditional civil law approach to cases of unfair suretyships and also whether other fields of law, like consumer law and family law can offer protection. Furthermore, the chapter will analyze whether there are self-regulatory measures implemented by the banking sector on this issue. At the end there will be an analysis on what would follow for Albania, from the EU developments discussed in the second chapter.

[210] http://www.euractiv.com/en/enlargement/eu-western-balkans-relations/article-129607 (last visited 25th March, 2007).
[211] European Commission Country Profile, available at http://ec.europa.eu/enlargement/albania/political_profile_en.htm

3.2 Traditional Civil Law approach

3.2.1 Civil Code on Suretyships

The Albanian Civil Code of 1994 (hereinafter ACC)[213] in its Book Four on Obligations dedicates several articles to suretyships. According to Article 585 of the Civil Code, a suretyship is considered as the agreement on the basis of which, a person (the surety), undertakes vis-à-vis the creditor of a third party to accept responsibilities for the fulfillment of the third party's obligations.

The suretyship is not distinguished from the guarantee, indeed they are used interchangeably[214]. Just like the French Civil Code, the Albanian legislation acknowledges also the existence of legal suretyships, meaning that a suretyship is imposed by law in special cases.[215]

One of the main characteristics of the suretyship is that it is considered a personal security device, with a central aim of securing the creditor about the performance of the obligation, and also offering to the debtor a higher opportunity to access credit[216]. The parties in the suretyship contract are the surety and the creditor. It follows that the debtor, not being a party in the contract, needs not give his consent, or even know about such an undertaking[217].

Furthermore, suretyship is an accessory or complementary contract[218], meaning that the suretyship obligation exists only in so far, and to the same extent that the principal obligation

[212] *supra* note 210.
[213] Law 7850, *Kodi Civil i Republikes se Shqiperise* [Civil Code of the Republic of Albania] (1994), 11 Official Gazette 491, art. 585-600, (1994).
[214] Marjana Semini (Tutulani), *E Drejta e Detyrimeve dhe Kontratave. Pjesa e* Pergjithshme *(Law of Obligations and Contracts. General Part),* at 200 (Tirane 2002).
[215] *id.*
[216] *id.* at 200-202.
[217] *id.*
[218] *id.* at 201

involves. Thus, as Article 588 of the ACC provides, it follows that if the principal obligation is not valid, the suretyship will be not be valid as well.

In addition, a suretyship agreement can be entered into either for an actual obligation, or for a future or conditioned obligation[219]. In the latter case, the agreement will be valid, if it is entered into before the principal obligation arises. The essentiality of a suretyship contract, as in other types of contract, is the will of the parties. In this particular contract, there need to be an express will or consent, on behalf of the surety, for the undertaking of the debtor's obligations[220]. Therefore, it is important distinguishing the suretyship from both, the simple recommendation or declaration that the debtor is able to, and will fulfill the obligation, and the undertaking that instead of the debtor, a third person will respond for the principal obligation[221]. The first type is considered as a soft kind of *letter of comfort* given by a natural person and does not produce legal consequences, since it is considered as a stipulation *made in honor*[222]. The second type should also be distinguished from suretyship, since the person undertaking the obligation is not a surety, but rests on the debtor's shoes. Also, such an agreement needs to be entered into between the old and the new debtor, with the consent of the creditor[223]. Finally, article 587 of the ACC requires *ad probationem,* a written form of the suretyship contract.

Furthermore, according to Article 589 of the ACC[224], a suretyship agreement can be entered into to secure the whole or a part of the principal obligation. In principle, the surety will be responsible to the same extent as the principal debtor and this includes also the delay

[219] *supra* note 214 at 201.
[220] *id.*
[221] id.
[222] Marjana Semini (Tutulani), *E Drejta e Detyrimeve dhe Kontratave. Pjesa e* Pergjithshme *(Law of Obligations and Contracts. General Part),* at 201-202 (Tirana 2002).
[223] *id.*
[224] supra note 213, art. 588

penalties. Nevertheless, parties can vary the extent of their liability through the contractual provisions.

An interesting provision is made in the consecutive article[225], according to which, in order to favor the creditor's interest, the surety may be jointly and severally liable with the principal debtor. Nevertheless, such a provision is not of a mandatory character and parties are again allowed to change it through their agreement.

What derives from this stipulation is that the default rule remains that, in cases of suretyships, parties are jointly and severally liable, except when otherwise provided in the contract. Thus, at a first glance, it seems that there is a "creditor-biased" character of this particular provision. However, "the joint and several liability" rule in this default rule, differs from the general rule, specifically with regards to the claims that the surety and debtor might have against each other after payment[226]. In suretyship cases, if the debtor has fulfilled his obligation, he does not have a claim back towards the surety, but in a vice-versa situation, the surety has a claim towards the debtor. Indeed the surety has always a claim back towards the debtor, after paying for the obligation. In the general "joint and several liability situation", the one who has paid has always a claim back towards the other debtors. Thus the terminology used in this provision does not adequately describe the liability regime.

In addition, another stipulation in the ACC[227], provides for the "right" of the parties to include in their contract that the surety will not be obliged to pay, if the creditor has not tried to collect the debt from the principal debtor first. This means that the default rule is again favoring the creditor's position and requires a great degree of care, on the part of the surety to provide otherwise in the contract. However, only if the surety has thus provided in the contract, he has a

[225] *id.* art. 590
[226] supra note 223, at 203

right to value the creditworthiness of the debtor before paying.[228] This can easily be translated into an absurd result derived from even the simplest situation involving suretyships.

Thus, if we suppose a case in which, the surety has not provided in the contract about a requirement of the creditor to first foreclose on the principal debtor, and therefore the default rules of the ACC will apply, the creditor is not under a duty to foreclose on the principal debtor and can chose the surety as the target of the payment. Nevertheless, the surety may ask for a valuation of the debtor's assets also during judicial proceedings, initiated in order to challenge the creditor's action towards the surety[229]. But as it derives from the provision analysis, if not provided specifically in the suretyship contract, the surety is not specifically granted a right *ab initio* to require the creditor to first try on the principal debtor.

One may wonder why the creditor has an interest in requiring the surety to pay if the debtor has enough assets. There may be however several situations in which the creditor might make such a choice, such as exploiting the surety's position if the creditor knows that the debtor is more unwilling to pay and it may require more time to fulfill the obligation, it might be a creditor's subjective choice of the surety or even a hidden agreement between the principal debtor and the creditor. It is true that the latter might be extreme cases and whenever found that there was a hidden agreement to take advantage from the surety in bad faith, other legal measures will be employed, but the above-discussed provision leaves space for these cases to occur.

[227] art. 590, ¶ 2 of ACC
[228] Marjana Semini (Tutulani), *E Drejta e Detyrimeve dhe Kontratave. Pjesa e* Pergjithshme *(Law of Obligations and Contracts. General Part),* at 203 (Tirana 2002).
[229] *supra* note 227.

Despite the above, the surety has a means to recover what he has paid to the creditor, specifically he has a claim back to the debtor[230]. This means that at the end, the surety will get back from the debtor the amount paid to fulfill the obligation, but no one can assure that the debtor economic situation might have not collapsed during this time. It may happen that the debtor had more assets before, when the creditor had a choice to select him but did not and the surety did not raise such an issue either in the contract, or in the judicial proceedings. The surety is thus left with a claim risked by the bankruptcy of the debtor, not to say with anything left at all.

Another important stipulation of the ACC[231], requires the surety to direct to the creditor all the counterclaims and discharges, that the debtor would have made to him. If the surety does not act so, he can not claim from the debtor, what he might have already discharged from the creditor.[232]. Also, if the surety does not inform in time the debtor, about the payment of the obligation, he can't recover what the debtor subsequently may raise as "debts that were capable of being discharged from the creditor". The rationale behind is that the debtor was not given a right to make known to the surety what he could have reduced from the principal obligation.[233]

It derives from the above analysis that the surety not only is inadequately protected, but he needs to exercise due diligence when drafting the contract, when being in court proceedings and especially when it comes to exchanging information with the debtor. Rather than protected, the sureties are burdened with duties of information and due diligence.

[230] art. 593 of ACC
[231] art. 592 of ACC.
[232] art. 595 of ACC.
[233] *supra* note 228 at 205.

Finally, the suretyship obligation generally comes to an end when the principal obligation is fulfilled or is terminated in some other way[234]. Deviations from the general rule can happen in situations where the suretyship contract provides for a term in which the obligation can be enforced. In such a case, the suretyship agreement ends, if the creditor doesn't raise his claim towards the surety within six months from the day the above term has ended.[235] If the suretyship contract does not provide for such a term, it will terminate, if the creditor has not claimed the fulfillment of the obligation from the surety within a year from the date of the conclusion of the contract[236].

In conclusion, it is evident that the ACC does not provide any special provisions, dedicated to cases when the debtor and the surety have a relation between them and such a relation has induced the surety to the undertaking of the suretyship. Neither does it deal with the manifest disproportion of the surety's assets and obligation. Thus, what is left to scrutinize is whether the general grounds for invalidating a contract, such as mistake, fraud, unconscionability duress and extreme necessity[237] can be applied in cases of unfair suretyships.

3.2.1.1 General grounds for avoiding liability in unfair suretyships

Since there are no special provisions dedicated to unfair suretyship cases in Albania, there is a need to establish whether the gap created can be fulfilled through general grounds for declaring contracts as "absolutely invalid" or for "annulling" them[238].

According to the ACC[239], a legal transaction may be annulled in cases where at the moment of performance of the legal transaction, the party was not conscious of the importance of

[234] art. 597 of ACC
[235] art. 600 ¶ 1 of ACC.
[236] *id.*, ¶ 2.
[237] art. 92-99 of ACC
[238] According to art. 92 and 93 of ACC, invalid legal transactions are absolutely considered as such and do not produce any legal consequences. While declaring a transaction as invalid, or *void* means that the interested party has to initiate a proceeding for annulment.

his act. Thus, the doctrine of unconscionability comes into play, when the surety was not able to determine the importance of the obligation he was undertaking, at the time of the conclusion of the suretyship agreement[240].

Another ground on which contracts may be declared void is mistake[241]. According to ACC[242], only in cases where the mistake is essential, in the meaning that without it the party would not have entered into the legal transaction, can he require its annulment. It follows that the mistake has to be a crucial element of the contract, such as its object, the quality of the thing transacted for, the identity of the other person, or circumstances without which the transaction would not have been concluded. Thus, in cases of unfair suretyships, there is a need to establish that the surety was mistaken on one of the essential elements of the agreement, in order to avoid liability. However, the typical situation in suretyships requires a different type of relief, specifically relief on the basis of undue influence caused by the debtor, and on the meaningful disproportion between the surety's financial means and his obligation.

In Albania, there is no genuine doctrine of undue influence[243]. The ACC provides protection only in extreme cases where influence can amount to duress[244]. Duress can be exercised not only by one party of the transaction to the other, but also by a third person, such as the debtor in suretyship cases[245]. Duress may cause invalidation of the transaction, when it consists on "…a grave and unjust threat for physical and material harm and damage to one of the parties, their spouse, forerunners or successors…"[246]. It is obvious that the degree of influence in case of duress is so high, that situations when the relation between the debtor and the surety can

[239] art. 94 of ACC.
[240] Ardian Nuni, *Veprimet Juridike*, (*Legal Transactions)*, at 22 (Tirana 2001).
[241] *Id.*
[242] art. 97 of ACC.
[243] *supra* note 240 at 30.
[244] *id.*
[245] art. 96 of ACC.

be considered as vitiating the will *per se*, without the need to establish unjust threat for harm and damage, are far from being recognized in the Albanian courts.

Another ground for annulling a legal transaction is fraud[247], which needs to be essential in a sense that without it, the transaction would not have been concluded. In cases where fraud is caused by a third person, the party acting under it, may require the annulment of the transaction, only if the other party in the transaction was aware or could not have been unaware of the fraud[248]. Thus, in cases when the surety acts under fraud caused by the debtor, he has to prove that the creditor was or could not have been unaware of it, in order to avoid liability. Another similar scenario would fall under such provision, specifically, the case in which the creditor, has "deceived" the surety. However, as the cases illustrated in the previous chapters have demonstrated, what happens is usually misrepresentation committed by the debtor, or incomplete information given by the creditor. Only if the latter situations would be "heightened" in the level of fraud and would be essential to the transaction, the surety has a chance to escape liability.

Finally, the ACC deals with cases in which one party acts under extreme necessity[249]. This would be a ground to annul the suretyship agreement, if the surety can prove that it was exactly because of such extreme necessity, that he entered into the agreement.

As it results from the above, the grounds for avoiding liability in cases of unfair suretyships are covered by general provisions of the ACC, which are not properly suitable to the typical cases in which a surety is found "unfairly" over-indebted.

Nevertheless, it is worth noting that the Albanian Code of Civil Procedure, as amended[250], stipulates that acts concluded before the public notary, such as '… acts *necessary*

[246] Ardian Nuni, *Veprime Juridike* (*Legal Transactions),* at 32 (Tirana 2001).
[247] art. 95 of ACC.
[248] Ardian Nuni, *Leksione te se Drejtes Civile (Lectures on Civil Law),* at 55, (Tirana 2004).
[249] art. 99 of ACC.

for bank credit loans, …constitute writs of executions"[251]. Contracts of suretyship can easily fall under the category of "acts necessary for bank credit loans" concluded at the public notary, since the bank, in the position of a creditor may require contracts to have a notarial form. Therefore, if the contract of suretyship is concluded before a public notary, all the creditor needs to do, is require the issuance of a writ of execution from the court. Certainly, this will not happen if the surety successfully challenges the contract as concluded under one of the previously discussed forms of a vitiated will, but this amendment reduces the possibilities that the surety might have for finding relief. In addition, the conclusion of the suretyship agreement before the public notary, makes the challenge of the validity of a contract even harder. The very function of the notary service is to make sure that the element of form, (when required specifically in a notarial act), and the element of consent, are observed.

The ultimate conclusion that can be derived from the above stipulation is a warning for sureties not to conclude suretyships in a notarial form, but to suffice themselves with a written agreement. However, the question whether creditors would agree on this issue, is far from being answered in the affirmative.

3.3 Other devices for protecting sureties?

In 2003, a new Law on Consumer Protection was passed in the Albanian Parliament.[252] The law focuses on consumer protection, by defining its scope of application to the relations

[250] Law 8812, *Per Disa Shtesa dhe Ndryshime ne Ligjin 8816, date 29.03.1996 Kodi i Procedures Civile te Republikes se Shqiperise* [For Some Changes and Amendments in Law 8816, of 29.03.1996 Code of Civil Procedure of the Republic of Albania](17.05.2001) (Luarasi ,Tirana 2001). The above law represents the actual Code of Civil Procedure.
[251] Id. at art. 510/d
[252] Law 9135, *Per Mbrojtjen e Konsumatoreve* [On Consumer Protection] (11.09.2003), 84 Official Gazette 3681, (2003).

between the consumer and the supplier of goods and services[253]. Suretyship agreements for consumer credit are left outside the focus of this regulation.

In addition there is not yet any law on Consumer Credit which might have afforded specific protection to sureties. The lack of the legislation in this respect shows once again that the aim of developing the financial services market is not being properly addressed in the Albanian legal context.

The Albanian Family Code[254] on the other side does not offer any protection to sureties who are family members of the principal debtor. Also, there is not any practice similar to the English one concerning Banking Codes on Good Practices. In addition, the main laws leading the banking sector in Albania, respectively the Law on Banks in the Republic of Albania[255] and the Law on the Bank of Albania (Central Bank of Albania)[256], do not include any provision which might be relevant to suretyship cases.

Case law is also lacking in this respect.[257] The absence of challenging the unfairness in certain suretyship agreements, evidences the low level of trust in justice and judicial resolution.

[253] *id.*. art. 1 and 2
[254] Law 9062, *Kodi i Familjes* [Family Code] (08.05.2003), 49 Official Gazette 1907, (2003).
[255] Law 9662, *Per Bankat ne Republiken e Shqiperise,* [On Banks in the Republic of Albania] (18.12.2006) 149 Official Gazette 6013 (2006).
[256] Law 8269, *Per Banken e Shqiperise,*[On the Bank of Albania], (23. 12. 1997) 20 Official Journal 479 (1997).
[257] Research was done in the Statistics of the Ministry of Justice, *see also* <http://www.justice.gov.al/sistemi%20gjyqesor.asp?sgjy=Statistika>(last visited March 25th, 2007); Center for Official Publications, *see also* <http://www.qpz.gov.al/ >(last visited March 25th, 2007); Supreme Court Reports, *see also* cases information on an annual basis *available* at <http://www.gjykataelarte.gov.al/Vendime_gjyq.htm> (last visited March 25th, 2007); Constitutional Court Case Reports, *see also* cases information on an annual basis *available* at <http://www.gjk.gov.al/vendime.html>(last visited March 25th, 2007) .
Research was conducted also specifically in the District Court of Tirana, *see also* information *available* at <http://www.gjykatatirana.gov.al>(last visited March 25th, 2007); District Court of Fier, *see also* information *available* at<http://www.fier.gjykata.info/ >(last visited March 25th, 2007); District Court of Shkoder *see* information *available* at : <http://www.shkoder.gjykata.info > (last visited March 25th, 2007), District Court of Kavaje, *see* information *available* at <http://kavaje.gjykata.info >(last visited March 25th, 2007); District Court of Vlore, *see* information *available* at< http://vlore.gjykata.info>(last visited March 25th, 2007).

In conclusion, it remains clear that, in the absence of good banking practices and specific statutory provisions, the main and the only grounds for avoiding liability under an unfair suretyship agreement, are the above-discussed means, provided in the ACC.

3.4 Conclusions and recommendations: What follows for Albania?

In a background where surety's protection is almost lacking, it might sound ironic to ask the question what would follow for Albania, since one would not be necessarily wrong in answering that, perhaps, Albania needs to "entirely import" European solutions. However, when proposing measures to the legislation of a country, one has to take into consideration their adaptability to the existing legal system. Thus, it would be surprising for Albanian law professionals to have to deal with cases of undue influence through a procedural perspective like the English one. What the Albanian civil law approach demonstrates is a reliance on substantive protection through establishing a wrong or a vitiated will in the form of fraud, duress, mistake or cases of extreme necessity, and not an emphasis of procedural aspects like duties to inform or advise the surety independently.

Nevertheless, it does not mean that the common law approach should be entirely disregarded *per se.* If it has something to offer to the civil law approach, rejecting it, would mean depriving the civil law system of an opportunity to reform itself, for the sake of a traditional, confusing, and perhaps out-of-date division line between the two. In order to conclude what would be recommendable to the Albanian system for a higher degree of surety's protection, the latter should be first defined.

From the analysis in the above sub-chapter, it derives that the ultimate result of the Albanian approach is almost no protection to the typical cases of unfair suretyships when one of

the general ACC grounds for annulling contracts, can not be established. Thus, it rests closer to the Italian system, which as mentioned before, does not offer surety's protection either[258].

In such an absence of adequate protection, Albania is "captured" by the necessity to promote credit services for the overall economic development and the "imperative" of compliance with European standards, as a precondition for its integration.

First, there is a need to change certain provisions in the ACC dealing with suretyship cases. It would be more reasonable and also more responsive to the character of the suretyship contract, to oblige the creditor to first turn to the principal debtor and then to the surety, and not to leave the joint and several liability presumption a default one. Parties should not be required all the time to shape adequate protection measures through contractual language, but the law itself needs to offer some minimum standards which can not be overridden by the contract.

In addition, there should be added a provision which presupposes that in cases when the surety is a relative or someone related to the principal debtor, he lacks an economic interest in the transaction and therefore there is a high chance of a vitiated will on his side. What the British approach[259] might suggest to Albania, is to put on creditors duties of offering adequate information and assistance to the surety. It is true that most of the times, the relation surety-debtor, might be itself a burden in establishing a free self-determination, and the information will not have any impact on the surety, but the law can not erase undue influence in cases when this is impossible. What the law can achieve is to rise as much as it can, the level of certainty that the contract is being concluded on the parties` free will.

[258] Aurelia Colombi Ciacchi, *Non-Legislative Harmonization of Private Law under the European Constitution: The Case of Unfair Suretyships,* (13) 3 ERPL [285-308] at 305 (2005).
[259] Mel Kenny, *Standing Surety in Europe: Common Core or Tower of Babel?,* 70(2) MLR at 184-185 (2007)

Furthermore, there is a necessity to include a provision deriving from the French consumer approach[260], which would declare invalid suretyship agreements, in cases where there is a gross disproportion between the surety's obligation and his financial means, unless the surety is able to pay such an amount. The provision should also take into consideration specific circumstances in which the surety has acted.

The above enactment would certainly increase the level of sureties` protection, but left without a corresponding treatment in consumer credit agreements, its impact would not be complete. In addition to the necessity to have a general regulatory background for consumer credit agreements, such a regulation should afford proper protection to sureties as well. It should be born in mind that excluding suretyships from the scope of the latter, would easily translate into favoring the creditors. If the law aims at enhancing consumer protection and facilitating consumers` access to credit, protecting sureties who offer personal security in consumer credit agreements, is more than within the law's scope and focus. Despite this, if critics of the final Proposal for the EU Directive on Credit Agreements for Consumers[261], will be ignored, the situation seems to walk towards under-protecting sureties. If the future Directive will not include suretyships but will still impose a maximum harmonization as its implementing measure to Member States, the enactment of an Albanian law favorable to sureties, will clearly contradict the Directive. However, it is manifestly contrary to the aim of creating a single developed market in financial services, to limit the progress in consumer access to credit and their overall protection in this way.

[260] *id.*at 189

[261] Amended Proposal for a Directive of the European Parliament and of the Council on Credit Agreements for Consumers amending Council Directive 93/13 EC, COM(2005) 483 final, *available* at : <http://ec.europa.eu/consumers/cons_int/fina_serv/cons_directive/2ndproposal_en.pdf> (last visited March 25th, 2007).

Finally, what might follow for Albania, with regards to the proposal of the Project for applying the horizontal effect of fundamental human rights to cases of unfair suretyships[262], is the same image as that offered by other states that are already EU Members. Albania has already ratified the European Convention on Human Rights[263] and refers to it through the reference in the second paragraph of Article 17 of its Constitution[264]. According to the latter, the human rights limitations in no case may exceed the limitations provided in the ECHR. Thus, there is an already established background for applying the horizontal effect of fundamental human rights to cases of unfair suretyships, when the integration process is finalized with the membership of Albania in the EU.

At the end of this analysis, it is evident that reforms are more than necessary in Albania, not only for the purpose of the EU integration, but also in view of enhancing economic development through credit agreements and protecting vulnerable parties in suretyship contracts from over-indebtedness.

[262] supra note 258 at 294-295.
[263] Albania became a member of the Council of Europe on 13.07.1995. It ratified the ECHR on 2.10.1996, *available* at : <http://conventions.coe.int/Treaty/Commun/ListeTraites.asp?PO=ALB&MA=999&SI=2&CM=3&CL=ENG > (last visited March 25th, 2007).

CONCLUSIONS

Unfair suretyship agreements and regulations in different Member States, the developments of the EU Project, as well as the Albanian positioning in this respect, have been at the very attention of this thesis. It was noted a gradual increase in the degree of protection offered by Member States, starting from UK, then Germany and finally, the highest level of protection was attributed to France.

In UK, the unfair character of certain suretyships was found either in the lack of proper information given to the surety (misrepresentation), or in the undue influence exercised to him by the debtor. What the famous cases of the British Courts brought to the legal arena was indeed a summary of rules to be attended by the creditors when dealing with cases of suretyships, specifically enabling or warning independent legal advice. Consumer laws on the other side do not essentially reach surety's protection because of their indirect or direct exclusion from the "consumer" definition.

German law seems to stand in a higher level when it comes to sureties' protection. Despite its hesitation in directly connecting the "gross imbalance" factor with the immorality concept, German system tends to pass a step further in offering effective protection, through its substantial rather than procedural approach, through its immorality doctrine and good faith principle and through its division between "merchants" and non-professional sureties.

[264] *Kushtetuta e Republikes se Shqiperise*, [Constitution of the Republic of Albania], (28.11.1998), *available* at : <http://www.keshilliministrave.al/shqip/kushtetuta/kushtetuta.html#PJESA2> (last visited March 25th, 2007).

France on the other side shows a clear trend towards adapting to the new rhythm of "consumerization" that has strongly captured the European Union attention. With its mistake doctrine and the "manifest disproportion" element, and especially with its protection to professional and non-professional sureties, France certainly stays at the top of the level of protection offered by the three countries.

In light of the above divergences, taking also into consideration the Europeanized imperative of offering an equal level of protection to sureties in different Member States, the EU Project concerning unfair suretyships, has proposed, amongst others, a non-legislative harmonization approach through case law convergence. The doctrine of horizontal effect of fundamental human rights can be applied in unfair suretyship cases, since they involve fundamental human rights like the right to private life, which includes personal autonomy and self-determination. Also, the total codification of private law in the EU, or the maximum legislative harmonization may not result effective in offering adequate protection to sureties, given the divergences between Member States and the feasibility of reaching unification through judicial approximation.

The most critical analysis in this thesis has been addressed to the final proposal of the EU Commission for a new Directive on Credit Agreements for Consumers. The proposal leaves suretyship agreements totally out of its scope and this is certainly regressive and contrary to the aim of facilitating consumer access to credit.

As an ultimate result, a combination of judicial convergence approach, specific consumer protection legislative harmonization, and a promotion of self-regulatory measures by financial institutions and banks, is recommendable in order to unify the surety's degree of protection in different Member States.

The final analysis has addressed the situation in Albania regarding unfair suretyships. In the absence of special provisions for this specific type of suretyships, in the absence of legislation with regards to consumer credit agreements, and also in the absence of case-law, the only available grounds for avoiding liability of sureties are general grounds for annulling contracts. As a potential candidate country, but also leaded by the general aim of promoting a developed financial market, Albania needs to adopt regulatory measures in this respect. Amendments of its Civil Code provisions, the enactment of a Law regulating Consumer Credit Agreements, and the encouraging of self-regulatory measures by banks and financial institutions would bring the country closer to other Member States and also closer to its integration in the EU.

Future research and publications, concerning specifically the legal and factual situation of unfair suretyships in other EU candidate countries, might be more than recommendable.

Despite certain limitations, concerning mostly the absence of publications of the EU Project and its ongoing character, the lack of Albanian legal thought and case law on the issue, the thesis has addressed the crucial problems related to unfair suretyships. It comes as a contribution especially with its extension of comparative analysis from a supranational to a national level, with the novelty of including Albania in its focus.

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