



Dear reader,

This *Juridica International*, titled *International and National in Law*, on the one hand seeks to continue a tradition that was born with its very first issues published in the second half of the 1990s—to serve as an Estonian journal of law. On the other hand, the vocabulary and content of the articles imply international target audiences. There is also another tradition that we have committed ourselves to preserving, namely to dedicate each issue to a certain topic that consolidates approaches located at various distances from the centre, while some are closer and some are further away.

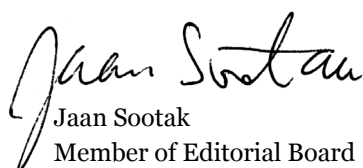
There are inherent controversies in both aspirations.

To focus on a single topic in an issue would turn it into a collective monograph, probably adding research value; yet with a population of 1.3 million, Estonia simply lacks sufficient research capacity for such efforts. Abandoning a central axis would certainly expedite the work of an author, but he or she would no longer need to consider the matters that are existential to Estonian research—to avoid ambiguity, to seek to address the most important topics, with little regard to perhaps intriguing but still marginal issues.

Focussing one's attention on only internationally significant topics would discount the simple fact that the law in the world these days is still largely national law, and it is the development of national law that drives the progress in classical international, supra- and transnational as well as European law. If the reader now takes a look out of the window, he or she will immediately realise that there is no abstract global national environment but it is the tree growing by his or her window that is unique. The constitutional rules must pass an international human rights' test, while the Constitution still governs the functioning of a particular country and its population. A referendum must be carried out with due regard to democratic principles, but it is the people who vote, not abstract subjects of law. Consumer protection has been thoroughly regulated on the EU level, but it is essentially experienced as the treatment you receive in a nearby supermarket or the amount of trust you have in your publisher's agent.

The second part of the title, *Reciprocal Impact*, sets out to demonstrate that it is a two-way street. The above reference to Estonia's population implies that we do not have the resources available to address all research topics. Yet we do not distinguish strictly between important and unimportant topics. All the topics discussed here are important, and only time will tell in due course which of them will have more influence on us and which will become our contribution to the development of internationally recognised jurisprudence. Perhaps some topics will sink into oblivion, but we are lucky not to know that yet; this is not likely either, given the substance and quality of the articles.

Dear reader, come and learn about Estonian law by reading this issue. And do not be concerned, you will not be leaving the international dimension while you go through the articles, based on their content and level. Estonian law does not detach itself from international jurisprudence, it is the very jurisprudence.


Jaan Sootak
Member of Editorial Board

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Ülle Madise

Professor of Constitutional Law
University of Tartu



Priit Vinkel

Assistant, University of Tartu
Advisor, Elections Department
of the Chancellery of Riigikogu

Constitutionality of Remote Internet Voting:

The Estonian Perspective

1. Introduction

Estonia has used remote Internet-based voting in five elections: twice each in municipal and Riigikogu (parliamentary) elections and once in European Parliament elections. The number of 'I-voters' has grown sharply from less than 10,000 in 2005's municipal elections to over 140,000 in the 2011 parliamentary elections. The latter account for 24.3% of all votes cast and 56.4% of the advance votes. Initially, no individual complaints claiming unconstitutionality of I-voting were filed in court. In 2011, the situation has changed: critical public debate has re-emerged, followed by several complaints.

Only Estonia, Switzerland, Norway and a few other countries allow legally binding remote I-voting, though some countries are on their way toward its countrywide use. The list of countries that have abandoned the use of e-voting in various forms is much longer, including the US, Germany, Finland, and the Netherlands.^{*1} France, for example, tries to keep alive the tradition of voting only at the polling station, as this ritualises citizenship^{*2}, but has allowed proxy voting and recently remote I-voting from abroad. The reasons for allowing or giving up on I-voting are different, but constitutional questions of whether fair and free voting can be secured in the case of remote I-voting have always been raised.

We are facing the pressure of the information society^{*3}: people require e-services, yet, on the other hand, cyber-threats are more serious than ever before.^{*4} Social changes have already forced countries to allow remote postal or proxy voting.^{*5} We have to admit that holding on to old traditions (one single elec-

¹ See the database for the Competence Center for Electronic Voting and Participation, at <http://db.e-voting.cc/>. German constitutional court decision to declare the use of voting machines unconstitutional: BVerfG, 2 BvC 3/07 vom 3.3.2009, Absatz-Nr. (1-163). Available at http://www.bverfg.de/entscheidungen/cs20090303_2bvc000307.html (9.10.2011). The core of the decision in German:

Der Grundsatz der Öffentlichkeit der Wahl aus Art. 38 in Verbindung mit Art. 20 Abs. 1 und Abs. 2 GG gebietet, dass alle wesentlichen Schritte der Wahl öffentlicher Überprüfbarkeit unterliegen, soweit nicht andere verfassungsrechtliche Belange eine Ausnahme rechtfertigen.

Beim Einsatz elektronischer Wahlgeräte müssen die wesentlichen Schritte der Wahlhandlung und der Ergebnisermittlung vom Bürger zuverlässig und ohne besondere Sachkenntnis überprüft werden können.

² L. Monnoyer-Smith. How I-voting technology challenges traditional concepts of citizenship: An analysis of French voting rituals. – R. Krimmer (ed.). *Electronic Voting 2006: 2nd International Workshop Co-organised by the Council of Europe, ESF TED, IFIP WG 8.6, and E-Voting.CC*. Bonn: Gesellschaft für Informatik 2006, pp. 63–64.

³ W. Drechsler. Dispatch from the Future. – *The Washington Post*, 5.11.2006.

⁴ J. Farwell, R. Rohozinski. Stuxnet and the Future of Cyber War. – *Survival* 2011 (53) 1, pp. 23–40.

⁵ See, e.g., the thorough overview of remote postal voting in N. Kersting. Briefwahl im Internationalen Vergleich. – *Österreichische Zeitschrift für Politikwissenschaft* 2004 (33) 3, pp. 325–328.

tion day, casting of paper ballots in a controlled environment as the only option, etc.) will not be possible in the future, but free and fair elections, anonymity of the vote, and the principle of uniformity must be guaranteed. The Council of Europe has adopted recommendation^{*6} and guidelines^{*7} for electronically enabled elections, and the OSCE/ODIHR is looking for ways to observe and evaluate various forms of e-voting, including I-voting. Estonia's I-voting experience is internationally followed with special attention; any failures would have very negative consequences not only for Estonian democracy but for all I-voting projects, worldwide.

The concept of the Estonian I-voting system is described and analysed here in the light of theoretical literature, judgements of the Supreme Court of Estonia, and the empirical data available. In addition to statistics, the results of sociological surveys are used.

2. Description of the concept of Estonian I-voting

Estonia's I-voting system is based on an electronic roll of voters, a compulsory e-ID, the public/private key infrastructure ('virtual double-envelope scheme'), and the right to change a vote given online ('virtual voting booth'). The elements of the system are meant to guarantee the compliance of the I-voting with constitutional principles of elections: only people entitled to vote can vote, access to voting shall be equal, one vote per voter shall be counted, free voting shall be granted, and both counting of the voting results and election results shall be fair and sound. Brief description of the elements of the Estonian I-voting system is given in this section; the constitutional analysis follows in Section 3.

2.1. Electronic Population Register

The Estonian Population Register is a uniform database of personal data of Estonian citizens and foreigners with Estonian residence permits. The Estonian voter roll is held on the basis of the Population Register, and voters do not have to enrol specially before elections. The Estonian electoral law^{*8} states that electoral rolls are drawn up 30 days before election day but additions to the list can be made until the very end of elections. This gives the list the property of being constantly up to date in practice. During Internet voting, the voting roll is updated daily.^{*9}

2.2. ID card and m-ID

The cornerstone of most e-services, public as well as private, is the e-ID.^{*10} Since 2002, an ID card has been the new generation's mandatory primary identification document. The ID cards are issued by the government and contain certificates for remote authentication and digital signature. Every Estonian citizen or resident alien above age 15 must have an ID card.

Each ID card contains two discrete PKI-based digital certificates—one for authentication and one for digital signing. The certificates contain only the holder's name and personal code and have two associated private keys on the card, each protected by a unique user PIN. The certificates have no restrictions of use: they are by nature universal and meant to be used in any form of communication, whether between private persons or organisations or within the government. The e-ID card can be used also for encryption of documents so that only the person intended to view the document can decrypt it. This is an efficient means for

⁶ Recommendation on legal, operational, and technical standards for e-voting, Rec(2004)11; Recommendation on electronic democracy, Rec(2009)1. Available on the Council of Europe Web site.

⁷ Certification of E-voting Systems, GGIS(2010)3E; Guidelines on transparency of e-enabled elections, GGIS(2010)5E. Available on the Council of Europe Web site.

⁸ Up-to-date translations of election laws are available on the National Electoral Committee Web site: <http://www.vvk.ee/?lang=en> (9.10.2011).

⁹ For more information, visit the Web site of the Ministry of Internal Affairs, specifically <http://www.siseministeerium.ee/35796/> (9.10.2011).

¹⁰ Detailed information about e-IDs, the areas of their use, etc. can be found at <http://www.id.ee/?lang=en> (9.10.2011).

secure transfer of documents over public networks. In addition, each ID card has all data printed on it also in electronic form, in a special publicly readable data file.

The number of ID cards issued grew in June 2010 to exceed 1.1 million. Over 2/3 of cardholders have used the e-ID card for remote personal identification and more than 1/3 for digital signature. Here it has to be noted that Internet voting has strongly promoted electronic use of ID cards. Another important promoting factor has been the agreement among banks to allow Internet banking only with an ID card or PIN calculator. The old password cards can be used only for very small transactions.

To use the ID card, one needs a smartcard reader and a computer with the relevant software installed (free for download from the Web page <https://installer.id.ee/>); an Internet connection; and a Windows, Mac, or Linux operating system.

A couple of years ago, a new e-ID solution was brought to the market: the m-ID, where a mobile telephone (via its SIM card) acts as an ID card and a card reader at the same time. In addition to having the functionality of an ordinary SIM, a mobile-ID SIM holds a person's mobile identity that enables providers of Internet services to identify the person and to issue digital signatures.^{*11} Personal identification and digital signature functionality are secured by up-to-date security technology and corresponding personal identification numbers. Making the solution more convenient, with this, one does not need an ID card reader for the computer any longer; instead, one can perform electronic transactions just as one would with an ID card: it enables logging in to databases, Internet banks, etc. and signing various types of contracts digitally. The m-ID certificate is issued by the state and is thereby an equally e-enabled document to the ID card. The m-ID can be used as a means of authentication and digital signature in elections from 2011.

In practice, an e-ID is used for user authentication with several databases^{*12}; the above-mentioned state portal serving as an e-service centre, e-tickets for public transportation, a customer loyalty programme identification tool in several private companies, and even insertion of comments for the online daily newspaper *Eesti Päevaleht*, which has prohibited anonymous comments in order to prevent libel cases. The use of e-ID is steadily widening, although the initial aim of combining e-ID with all possible other documents, such as driving licences, and replacing all possible password-based solutions has not been fulfilled yet.^{*13}

2.3. System architecture

The Estonian IT security experts in their security analysis^{*14} published in 2003 and revised in 2010 declared that in a **practical sense** the Estonian I-voting system was secure enough for implementation. In absolutely secure systems, unexpected events are not possible. One may dream about such systems, but they can never be realised in practice. This applies particularly to I-voting systems. Considering the security level of personal computers, it is impossible to design I-voting systems that are absolutely secure for every user. The most important security goal of voting is not to affect the final results and not to abuse the constitutional principles. Single incidents with users are still important, but they do not have an influence on the final result. Moreover, small-scale incidents are acceptable even in traditional voting systems.^{*15}

The part of I-voting in the whole process of organising elections is relatively small. The system uses existing information systems—the Population Register for the polling list, election information system of the National Electoral Committee (hereinafter referred to as the NEC) for the collection and publication of information on candidates and voting results, and the infrastructure of Certification Centre Ltd. for checking ID card (or m-ID) certificates.

The main components of the Estonian I-voting systems are the voter application; the Vote Forwarding Server; and the back office, which is divided in two: the Vote Storage Server and the Vote Counting Application. These components support the following processes:

¹¹ More about the m-ID project can be found at <http://id.ee/?id=10995>.

¹² For example, the Estonian Research Portal, at <https://www.etis.ee/index.aspx?lang=en>, which compiles information on all Estonian researchers and their scientific projects, publications, and activities.

¹³ Comprehensive coverage of the ID card can be found in the work of T. Martens and E. Maaten. E-voting is here to stay. – Baltic IT&T Review 2006 (1).

¹⁴ Available from the NEC Web site at http://www.vvk.ee/public/dok/E-voting_concept_security_analysis_and_measures_2010.pdf.

¹⁵ T. Mägi. Practical Security Analysis of I-voting Systems. Master's Thesis 2007. Available at <http://triinu.net/e-voting/master%20thesis%20e-voting%20security.pdf>.

- The voter application is a Web-based application or an application on voters' personal computers.
- The Vote Forwarding Server is responsible for authentication, checking of enfranchisement, sending a list of candidates to voters, and receiving signed and encrypted ballots.
- The network server immediately transfers the received encrypted ballots on the Vote Storage Server and transfers the acknowledgements of receipt from the Vote Storage Server to the voters. The network server completes the work when the I-voting period finishes.
- The Vote Storage Server receives encrypted ballots from the network server and stores them until the end of the voting period. The Vote Storage Server is responsible for cancellation and management of votes.
- The Vote Counting Application is an off-line program that summarises all encrypted ballots. The encrypted ballots are transferred from the Vote Storage Server to the Vote Counting Application via data carriers. The Vote Counting Application does not receive voters' digital signatures, and it does not know voters' personal data.

Additionally, the I-voting system delivers independent log files, which consist of tracing data for the received encrypted ballots from the Vote Forwarding Server, all annulled encrypted ballots, all encrypted ballots sent to the Vote Counting Application, and all counted encrypted ballots. The cryptographic protocol used links all records in the log files. The NEC has the right to use the log files to resolve disputes. Hence, there is an independent audit trail to verify the e-voting process and help solve problems should they appear.^{*16} The legality of all elections depends on the presence and proper functioning of these components.

2.4. Measures used to ensure voting secrecy

In order to understand how the I-voting system guarantees secret and equal voting, we should briefly describe the envelope voting method used in Estonia for advance paper voting. The latter gives the voter the possibility to vote outside the polling station for the voter's residence in any rural municipality or city. A voter presents a document for entry in the list of voters and then receives the ballot and two envelopes. The inner envelope has no information about the identity of the voter, and the ballot paper is put in it. The inner envelope is placed in an outer envelope, on which the voter's details are written, so that, after the end of the advance poll, the envelope can be delivered to the voter's polling station of residence. There it is verified whether the voter has the right to vote; then, the inner envelope is taken out and placed unopened into the ballot box. The two-envelope system guarantees that the voter's choice remains secret. The same system but electronically built is used in Internet voting.^{*17}

Asymmetric cryptography is used to guarantee the secrecy of votes. A pair of keys is generated for the system in a special safety module so that its private component never leaves this environment. The public component of the pair of keys is integrated into the voter application and is used to encrypt the votes. The private component of the pair of keys is used in the vote-counting application to open the votes on the evening of election day. The NEC can open the votes—i.e., use the private component—only collegially. After the period for dealing with any complaints has elapsed, the private key is destroyed.

2.5. 'Virtual voting booth'

In order to guarantee the freedom of voting, I-voters have the right to replace the vote cast on the Internet by means of another I-vote or a paper ballot. However, this can be done only on advance polling days. In the case of several I-votes being cast, only the last one is counted; in the event of contradiction between an I-vote and paper ballot, the paper ballot is deemed definitive. If multiple physical ballots are cast, all votes are declared invalid.^{*18} Thus the 'one voter—one vote' principle is guaranteed.

¹⁶ General description of the Estonian Internet voting system, 2010. Available at http://www.vvk.ee/public/dok/General_Description_E-Voting_2010.pdf (9.10.2011).

¹⁷ Details of the double-envelope scheme and description can be found in the General Overview document (Note 16).

¹⁸ Riigikogu Election Act (Riigikogu valimise seadus), §40 (6). – RT I 2002, 57, 355; RT I, 10.12.2010, 1 (in Estonian).

3. Analysis of the constitutionality of Internet voting

According to the Estonian Constitution^{*19}, members of the Riigikogu, as well as local government councils and the European Parliament shall be elected in free, general, equal, and direct elections, and voting shall be secret. There is no special regulation of I-voting in the Constitution. The legal framework for I-voting is laid down in electoral law. The provisions are almost the same in all legal acts regulating voting procedures. In the case of I-voting, almost all principles of democratic elections give rise to several questions in constitutional law and, more broadly, in social sciences.

3.1. A teleological interpretation of the principle of secrecy

The secrecy of voting has traditionally been viewed in Estonia as the right and obligation to cast one's vote alone in a voting booth. In the case of Internet voting, it is impossible to ensure the privacy aspect of the voting procedure. The voter's right to anonymity during the counting of the votes **can** be guaranteed, indeed to the extent to which this can be secured in the case of remote postal voting. Therefore, remote Internet voting requires rethinking of the privacy principle.

The principle of privacy is there to protect a person from any pressure or influence acting counter to his or her free expression of political preference. Such a teleological approach to the Constitution was the basis of the I-voting provisions from the very beginning of the whole project. In short, the provisions enabling Internet voting are based on the premise that the government has to trust the individual and avoid, whenever possible, interference with decision-making at the individual level.^{*20} The individual has to be aware of the risks—e.g., technical risks—and he or she has to have the right to decide whether or not to exercise the Internet voting opportunity. The Supreme Court has agreed with this teleological approach to the principle of secrecy.^{*21}

Buchstein, on the other hand, does not agree:

Mandatory secrecy is a principle which goes beyond constitutional law, its fundamentals are based on the idea of auto-paternalism and it is understood as a mechanism of self-binding of autonomous citizens in order to avoid situations of external pressure or corruption. In this concept, it is not the individual him- or herself, but a warranted outside agent or authority—normally the state—that is responsible for providing the necessary means to allow for the secret ballot.^{*22}

Indeed, postal voting as another form of absentee ballot is widespread and is becoming accepted in Germany. There, the Federal Constitutional Court has twice declared remote postal voting to be constitutional, arguing that facilitation of voter turnout outweighs, in this case, the problems possible in relation to security and public scrutiny of electoral processes.^{*23} In France, by contrast, postal voting was abolished in 1975 because of incidents of fraud.^{*24}

¹⁹ Translations of Estonian legal acts can be found at <http://www.just.ee/6906>. Up-to-date official versions of all legal acts are available from the State Gazette, at <http://www.riigiteataja.ee/> (in Estonian).

²⁰ The ideological foundation and parliamentary debates are explored by W. Drechsler, Ü. Madise. E-voting in Estonia. – *Trames* 2002 (6) 3, pp. 234–244; W. Drechsler, Ü. Madise. Electronic Voting in Estonia. – N. Kersting, H. Baldersheim (eds.). *Electronic Voting and Democracy: A Comparative Analysis*. Basingstoke: Palgrave Macmillan 2004, pp. 97–108.

²¹ Available at <http://www.nc.ee/?id=381> (9.10.2011).

²² H. Buchstein. Online Democracy. Is It Viable? Is It Desirable? Internet Voting and Normative Democratic Theory. – N. Kersting, H. Baldersheim (eds.). *Electronic Voting and Democracy: A Comparative Analysis*, Basingstoke: Palgrave Macmillan, pp. 39–58.

²³ BVerfGE 21, 200 (15.02.1967); BVerfGE 59, 119 (24.11.1981). Available at <http://www.wahlrecht.de/wahlpruefung/index.htm> (9.10.2011).

²⁴ L. Monnoyer-Smith (Note 2), p. 63.

3.2. Increase of turnout

One of the declared aims of launching online voting in Estonia was to increase voter turnout, which perhaps could be described more realistically as broadening access possibilities and stopping the decrease in participation. Scholars point out on the positive side of I-voting also that I-voting could and should better accommodate the needs of disabled voters.^{*25}

The actual impact of Internet voting on the turnout does not lend itself to objective analysis. One can determine the variations of turnout in different election years (comparing equivalent types of elections) and attempt to clarify the causes underpinning variations with the aid of sociological studies. Perhaps the most important question is what proportion of the electorate would not have participated in the voting had the Internet voting opportunity not been provided. There does not exist a way of obtaining empirical evidence. We must, therefore, come to terms with unverifiable claims made by the voters themselves. The only exception is the case where Internet voting provides the only possibility for the elector to vote and he or she takes advantage of this possibility. For example, the local government council elections in Estonia do not provide the possibility of voting abroad by postal ballot or at a diplomatic representation. Nonetheless, it is possible to vote over the Internet when abroad.^{*26}

Table 1. I-voting statistics for 2005–2011^{*27}

	2005 LE	2007 PE	2009 EPE	2009 LE	2011 PE
Number of I-votes	9,681	31,064	59,579	106,786	145,230
Repeated I-votes	364	789	910	2,373	4,384
Number of I-voters	9,317	30,275	58,669	104,413	140,846
I-votes cancelled by paper ballot	30	32	55	100	82
I-votes counted	9,287	30,243	58,614	104,313	140,764
Total number of votes cast	502,504	555,463	399,181	662,813	580,264
I-votes out of all votes cast	1.9%	5.5%	14.7%	15.8%	24.3%
I-votes among total advance votes	7.2%	17.6%	45.4%	44%	56.4%
I-votes cast abroad (no. of countries)	n.a.	2% (51)	3% (66)	2.8% (82)	3.9% (105)

Source: National Electoral Committee

I-voting seems to have had, in 2005, a slight effect on the increase in the turnout of voters who sometimes vote and sometimes not.^{*28} In 2007, approximately 10% of those I-voters questioned said that they certainly or probably would not have voted without having had the possibility to vote via the Internet. Moreover, Trechsel and Vassil show that the percentage of the I-voters questioned who certainly or probably would not have voted without having had the possibility to vote via the Internet has risen to 16.3%, which allows the conclusion that the overall turnout might have been as much as 2.6% lower in the absence of such a method of voting. That is already a significant marker when one looks at the impact of Internet voting on the overall turnout.^{*29}

^{*25} See, e.g., M. Loncke, J. Dumortier. Online voting: A legal perspective. – *International Review of Law, Computers & Technology* 2004 (18) 1, pp. 60–61.

^{*26} Ü. Madise, E. Maaten. Internet Voting in Estonia. – D. R. Insua, S. French (eds.). *Advances in Group Decisions and Negotiation Vol 5 e-Democracy: A Group Decision and Negotiation Perspective*. Dordrecht, Heidelberg, New York, London: Springer 2010, pp. 314–316.

^{*27} LE—Local Elections, PE—Parliament Elections, EPE—European Parliament Elections.

^{*28} F. Breuer, A. Trechsel. E-voting in the 2005 local elections in Estonia: Report for the Council of Europe 2006, available at the Council of Europe Web site.

^{*29} A. Trechsel, K. Vassil. Internet Voting in Estonia: A Comparative Analysis of Four Elections Since 2005. Council of Europe and European University Institute 2010. Available at http://www.vvk.ee/public/dok/Report_-_E-voting_in_Estonia_2005-2009.pdf (9.10.2011).

3.3. Uniformity

3.3.1. The digital divide and equal opportunities for representation

Trechsel *et al.* concluded in the report prepared for the Council of Europe following the experience of the Internet voting in 2005 and 2007 that education and income, as well as type of settlement, are insignificant factors in the choice of Internet voting over other voting methods. One of the most important findings of that study was that it is not so much the divide etc. between the Internet access 'have's and 'have-not's as, clearly, computing skills, frequency of Internet use, and trust in the I-voting procedure that direct voters' decisions to use or not use I-voting. Age has remained a significant factor for some years.^{*30} Moreover, some interesting conclusions have been drawn in the latest report by Trechsel and Vassil, in 2010, where they state that the ICT variables (computing knowledge and frequency of Internet usage) have disappeared since the 2009 elections as predictors of Internet voting usage.^{*31}

In the discussion of equal access to the place of voting, some authors^{*32} ignore the fact that in Estonia there are quite many different voting methods; for example, if a voter is unable to vote at a polling place as a result of his or her state of health or for another good reason, he or she may apply to vote by paper ballot at home on the day of election day (Riigikogu Election Act, §46 (1)).

The Estonian Supreme Court has stated:

The principle of equal treatment in the context of electing representative bodies does not mean that absolutely equal possibilities for performing the voting act in equal manner should be guaranteed to all persons with the right to vote. In fact, those who use the different voting methods provided by law (advance polls, voting outside the polling division of residence, voting in custodial institutions, home voting, voting in a foreign state, etc) are in different situations. For example, the voters who have to use the possibility of advance polls, are in a situation different from that of the voters who can exercise their right to vote on the election day. The guarantee of absolute actual equality of persons upon exercising the right to vote is infeasible in principle and not required by the Constitution.^{*33}

In the future, the number of people without Internet access will probably decrease, but the digital divide is going to be even deeper than before. People without Internet access will have significantly less information, no access to voting-advice applications, etc. In this case, it is not the access to I-voting (as long as other methods of voting remain) but access to the candidates' and parties' information that might be the constitutional problem.

3.3.2. Impact on the voting results

The most intriguing question for political parties is probably that of the impact of the use of I-voting on results. Impact on the voting results can result from the fact that votes cast by those voters who would not participate if I-voting did not exist may not be distributed proportionally over the political spectrum. However, studies have shown that the left–right auto-positioning of the voter does not play any important role in the choice of a voting channel. The same applies to the 2009^{*34} and 2011 elections.

³⁰ A. Trechsel. Internet voting in the March 2007 Parliamentary Elections in Estonia: Report for the Council of Europe, 2007. Available at http://www.vvk.ee/public/dok/CoE_and_NEC_Report_E-Voting_2007.pdf.

³¹ A. Trechsel, K. Vassil (Note 29).

³² See, e.g., S. Meagher. When Personal Computers Are Transformed into Ballot Boxes: How Internet Elections in Estonia Comply with the United Nations International Covenant on Civil and Political Rights. – American University International Law Review 2008/23, pp. 374–376.

³³ CRCSCd, 1.9.2005, 3-4-1-13-05, paragraph 24. Available at <http://www.nc.ee/?id=381> (9.10.2011).

³⁴ A. Trechsel, K. Vassil (Note 29).

Table 2. Relationship of I-votes to all votes cast for a political party

	2005 LE		2007 PE		2009 EPE		2009 LE		2011 PE	
	a)	b)	a)	b)	a)	b)	a)	b)	a)	b)
RP	32.7	3.6	34.5	6.8	20.1	19.3	25.1	23.7	37.0	31.7
PRU	10.4	2.3	26.7	8.2	17.3	20.9	22.5	25.5	25.4	30.3
PP	17.5	3.8	-	-	-	-	-	-	-	-
SD	9.9	2.9	13.3	6.9	10.4	17.6	10.7	22.6	18.0	25.8
GP	-	-	10.7	8.2	3.3	17.9	2.0	27.4	4.3	28.0
CP	8.7	0.6	9.1	1.9	10.9	6.2	14.7	7.4	9.9	10.4

Data: National Electoral Committee

a) = Percentage of I-votes

b) = Proportion of I-votes to total votes, in per cent

RP = Reform Party

PRU = Pro Patria and Res Publica Union (in 2005 only Res Publica)

PP = Pro Patria Union (merged with Res Publica to form PRU since 2007)

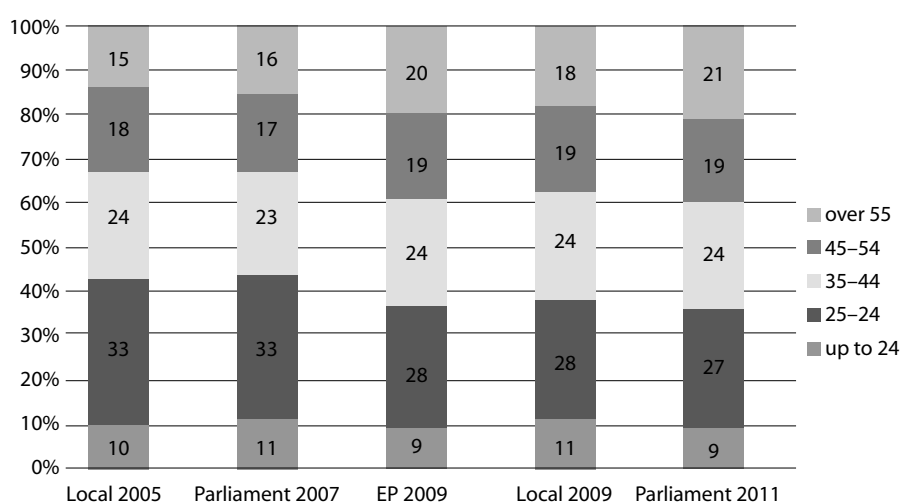
SD = Social Democratic Party

GP = Green Party

CP = Centre Party

In comparison of the overall distribution of votes in Internet voting or e-votes with that for total votes, not only the growing proportion of e-votes could be observed. According to Table 2, the party that is most popular in electronic voting is not always the one that profits the most from e-voting. The PRU (PP) and the GP (instead of the winner, RP) have been the greatest beneficiaries of Internet voting. The small numbers of e-votes on the account of the otherwise popular CP can be explained by that party's strong opposition to Internet voting from the very beginning³⁵ but probably also by specifics of the electorate.

The hypothesis that I-voting rewards advantages to urban voters found no proof. Gender is also not an important factor when one chooses I-voting from among the possible voting channels. Age, by contrast, is quite an important factor in choosing Internet voting.³⁶ Yet still, as can be seen in Figure 1, no age group is clearly dominant. The 55+ age group, with up to 20% of all Internet voters, is worthy of note here. So, while being younger correlates with use of the Internet as a means of voting, age does not give all the answers.



(Source: National Electoral Committee)

Figure 1. Age of I-voters in 2005 to 2011

³⁵ Ü. Madise, E. Maaten, P. Vinkel. Internet Voting at the Elections of Local Government Councils on [sic] October 2005, Report on Internet voting to the NEC, 2006. Available at <http://www.vvk.ee/public/dok/report2006.pdf> (9.10.2011).

³⁶ A. Trechsel, K. Vassil (Note 29).

It is, nevertheless, very interesting to compare the age groups taking part in Internet voting with the general electorate. For lack of a more comprehensive reference, we examine survey data from an exit poll conducted at the 2007 parliamentary elections by the Tartu University Department of Political Science.^{*37} According to the poll the age groups break down as follows: ages up to 24 accounting for 12.3%, 25–34 for 16.3%, 35–44 for 19.5%, 45–55 for 16.5%, and over-55s for 35.4%. When comparing these figures to the Internet voting results for 2007, we see a strong over-representation in the under-35 group and under-representation in the over-55 age group. This appears to be consistent with the importance of age in the decision to choose Internet voting as a voting method.

3.3.3. The right to change one's I-vote

The President refused to promulgate amendments, which allowed I-voting and gave to the I-voter the right to replace I-vote once given with another I-vote or paper-ballot, to the Local Government Council election act^{*38}, arguing that I-voters are in a better position when compared to other voters, who do not have any right to change their vote once cast.^{*39} The initial version of the I-voting law included the possibility of changing the I-vote with a paper ballot not only during advance voting but also on election day. To solve some of the problems indicated by the President, the Riigikogu restricted the time of I-voting to advance voting days. The chance to change their election preferences on Sunday after receiving additional information about candidates in the second half of the week had really placed I-voters in a better position. After this change, all voters who take advantage of advance poll possibilities were formally acting in the same conditions. The President did not see these changes as sufficient and initiated constitutional review.

The Supreme Court Chamber of Constitutional Review pointed out that, despite repeated electronic voting, there was no possibility of an I-voter affecting the voting results to a greater degree than can those voters who use other voting methods. From the standpoint of the voting results, this vote was deemed in no way more influential than a vote cast by paper ballot.

The most important arguments of the Supreme Court were the following. The principle of freedom of the vote gives rise to the obligation of the state to protect voters from persons attempting to influence their choice.

The aim of increasing voter turnout is without any doubt legitimate. The measures the state takes for ensuring the opportunity to vote for as many voters as possible are justified and advisable. Another aim in allowing I-voting is the modernisation of voting practices that coincides with the aims of I-voting listed in the recommendation Rec(2004)11, on legal, operational, and technical standards for I-voting, of the Council of Europe.

In accordance with the Penal Code, preventing a person from freely exercising his or her right to elect or be elected in an election or to vote in a referendum, if such prevention involves violence, deceit, or threat or takes advantage of a service, economic, or other dependency relationship of that person with the offender, is punishable by a pecuniary punishment or up to one year of imprisonment. The possibility for the voter to change the vote cast by electronic means throughout the advance polling period constitutes an essential supplementary guarantee to the observance of the principle of free elections and secret voting upon voting by electronic means.

A voter who has been illegally influenced or watched in the course of electronic voting can restore his or her freedom of election and the secrecy of voting by voting again, either electronically or via a ballot paper, after having been freed from the illegal influence. In addition to the possibility of subsequently rectifying a vote given under such influence, the possibility of voting again serves an important preventive function.

³⁷ R. Toomla. Results of 2007 Riigikogu elections exit polls. Conducted by the Department of Political Science of Tartu University. Unpublished, available to the authors.

³⁸ Draft No. 607 SE in X Riigikogu proceedings. The draft, information regarding parliamentary procedures, and motions to change the draft are available on the Parliament Web site at <http://www.riigikogu.ee/?page=eelnou2&op=ems&eid=607&aassembly=10&u=20110420131938> (9.10.2011) (in Estonian). The I-voting provisions were first adopted as a law in 2002; see drafts 747 SE, 748 SE, 771 SE, and 906 SE in IX Riigikogu proceedings. Right before the very first use of I-voting in 2005 municipal elections, the Riigikogu decided to change some I-voting provisions and the President used his suspensive veto foreseen in §107 of the Constitution of Estonia.

³⁹ Decision No. 873, 22.6.2005. Available at <http://vp2001-2006.president.ee/et/ametitegevus/otsused.php?gid=64640> (in Estonian).

When the law guarantees a voter who is voting electronically the possibility of changing a vote cast by electronic means, the motivation to influence him or her illegally decreases.

There are no measures as effective as the possibility of changing a vote cast by electronic means for guaranteeing the freedom of election and secrecy of voting upon electronic voting by means of an uncontrolled medium. The infringement of the right to equality and of uniformity, which the possibility of I-voters to change their vote an unlimited number of times can be regarded as amounting to, is not sufficiently intensive to outweigh the aim of increasing participation in elections and introducing new technological solutions.^{*40} Norwegian scholars arrived at similar principles independently before obtaining in-depth knowledge of the Estonian Internet voting system.^{*41}

In fact, the number of changed and replaced votes has been low in all elections. The maximum number of replaced votes has been 100, and the percentage of repeated votes does not exceed 4% of total e-votes.^{*42} So, any fears of misuse of these opportunities cannot be validated.

In short, the fact that the Internet voter is in a somewhat different position from the traditional voter does not in itself indicate an infringement of the constitutional values. The Supreme Court thus confirmed the constitutionality of one of the main premises of the remote Internet voting project.

3.3.4. Computing skills and security of the voter's computer

It has been noted that good computing skills have been an important factor in choosing Internet voting as a mode of voting in the 2005 and 2007 elections. Since 2009, the ICT variable has lost its meaning in defining the reasons behind the choice of using e-enabled voting. However, since the absolute number of Internet voters has steadily risen, the question of technical uniformity and usability emerges. I-voting has been offered in a variety of environments and on several platforms claiming to cover the maximum number of possible voters. In addition, comprehensive informational materials and a 24-hour help line are available.^{*43} However, a peculiar issue arose in the 2011 elections. There were a few voters who used a very rare combination of screen resolution, Windows 7, and font sizes on their computer. When these people used the Internet voting application, some of the interface and control buttons were left behind the Windows taskbar. This would not have been a greater problem unless some of the candidates' names too were covered by the taskbar. One of the candidates brought a complaint to the Supreme Court that stated:

The chamber adds that in organising Internet voting the state has to guarantee the accordance of the application with most common hardware, operating systems, resolutions, and fonts. In some cases, compliance cannot be guaranteed. In the event of such problems, the voter has the option of contacting the technical support staff. If the issues cannot be resolved, the voter can use the traditional means of voting.^{*44}

Therefore, ensuring the compatibility of the computer with the Internet voting application is clearly left to the user.

The security analysis of the Internet voting concept^{*45} states clearly that one of the fundamental security problems with electronically enabled voting is the necessity of trusting the voters' computer. The central system can be, and is, protected by the state. The spread of malware on private computers, on the other hand, cannot easily be limited—either by the state or through private efforts. The analysis even says that the modern personal computer is a 'black box' that nobody is able to control. Therefore, the security of the computer on which the voting application is run remains an issue in actuality. The user—the voter—can, of course, take actions to protect the computer, but, nevertheless, this cannot resolve all possible consequences. Accordingly, the security of the voting application is a topic that is being given extra attention.

⁴⁰ CCRSCd, 1.9.2005, 3-4-1-13-05 (Note 33).

⁴¹ G. Skagestein, A. V. Haug, E. Nodtvedt, J. Rossebo. How to create trust in electronic voting over an untrusted platform. – R. Krimmer (ed.) (Note 2), p. 108.

⁴² See Table 1 for further data.

⁴³ Available at http://www.valimised.ee/internet_eng.html (9.10.2011).

⁴⁴ In 3-4-1-6-11. Available at <http://www.riigikohus.ee/?id=11&tekst=RK/3-4-1-6-11> (in Estonian).

⁴⁵ See Note 14.

However, the issue of secrecy became prominent during the 2011 elections when a computer enthusiast hacked his own vote in the voting application on his own computer. He was able to modify the vote and create an illusion of the vote not having been sent to the central system. He was also keen to go public with his discovery (to national media) and later bring the issue up to the Supreme Court. It is important to state that all of the problems and situations discovered were monitored in the central system and that the threats revealed had been discussed already in the 2003 security analysis.

Subsequently, the Supreme Court, in its judgement No. 3-4-1-4-11^{*46}, stated that knowingly manipulating one's own vote cannot be seen as grounds for indictment of the overall security of the Internet voting system. In an analogy with traditional voting, a voter could easily go to the polling booth and make the polling paper invalid (by scrapping or doodling on the paper, etc.). That is a conscious decision and is completely legitimate.

However, the debate about secrecy is never resolved. Another issue that was raised by the computer enthusiast described earlier is the traceability of a vote. The reasoning behind this is that the online environment cannot be trusted and additional external proof of compliance has to be generated. A very interesting Internet voting pilot project is to be introduced in late 2011 in Norway.^{*47} In this project, external means of confirming one's choices are used. Namely, voters receive a special printed polling card (by post) with all candidates who are running for election represented by code names. After voting, the voter can request the code name matching the vote cast, via independent channels. This should, in theory, guarantee that the vote can be traced and that it has been accepted.

However, some additional concerns arise with this. Firstly, new channels of communication have to be built and secured between the state and the voter. Secondly, issues with the principle of anonymity come up where the voter has to understand that under some circumstances the state knows how he or she has voted. Thirdly, how does this traceability affect the possibility of buying or selling one's vote over the Internet?

4. Certification and auditing

Certification is, in broader term, a process of confirmation that an e-voting system is in compliance with prescribed requirements and standards and that it at least includes provisions for ascertaining that the system is functioning as intended. This can be done through measures ranging from testing and auditing to formal certification. The end result is a report and/or a certificate. An audit is an independent pre- or post-election evaluation of a person, organisation, system, process, entity, project, or product, which includes quantitative and qualitative analysis.^{*48}

Currently, there is no domestic or international public body that would be ready to certify and audit all the elements of an entire I-voting system before, during, and after election procedures. In Estonia, hired specialists performed comprehensive tests in order to check the functionality and accuracy of the system both as experienced by testers and in public (in demo voting). A third party audits the source code and the procedures that have been carried out.

The Estonian I-voting system was developed to follow the principle that all components of the system must be transparent for audit purposes. Procedures should be fully documented, with those that are critical being logged, audited, observed, and videotaped as they are conducted. A common requirement is that the source code of the voting application be available for auditing. In Estonia, though the code is not universally available, it could be audited if so agreed by the NEC.

As a rule, the process audit is ordered from external internationally certified IT auditors. The audit reviews and monitors sensitive aspects of the process, such as updating of the list of voters, preparation of hardware and its installation, loading of election data, maintenance and updating of election data, and the process of counting the votes etc. At the counting event on election day, auditors publicly declare their opinion about the soundness of the procedures of the electoral administration to that point. The report of the auditors, released after all procedures are complete (including the destruction of all voting equipment—

⁴⁶ Available at <http://www.riigikohus.ee/?id=11&tekst=RK/3-4-1-4-11> (9.10.2011) (in Estonian).

⁴⁷ For more information about the Norwegian Internet voting system, see <http://www.regjeringen.no/en/dep/krd/prosjekter/e-vote-2011-project.html?id=597658> (9.10.2011).

⁴⁸ Council of Europe Rec(2004)11 and guidelines based on that recommendation (see Note 7).

I-votes along with it), states whether the I-voting procedures followed the rules described in the system's documentation and whether the integrity and confidentiality of the system was not endangered. To date, all reports have been positive.

The I-voting system produces a wealth of system log information that can be used to monitor the work of the system thoroughly. In its different stages, the I-voting system produces a variety of logs concerning received, cancelled, and counted votes, also invalid and valid votes. The audit application enables determining what happened to an I-vote cast by a specific person without revealing the voter's choice. These logs provide external auditors as well as observers with information that they can use to ensure that the system is working correctly.

According to the Estonian electoral laws, all activities related to elections are public. Observers have access to the meetings of all election committees and can follow all electoral activities, including the voting process, the counting, and tabulation of results. Internet voting is no different. All significant documents describing the I-voting system are public. In order to enhance the observers' knowledge of the system, the political parties are invited to take part in a training course before each election, in which I-voting is used. Besides political parties, auditors and other persons interested in the I-voting system take part in the training. In addition, observers are invited to follow the testing of the whole process and take part in other preparatory procedures. However, few political parties have so far exercised their opportunity to observe the I-voting procedures.^{*49} It is important that observers be deployed for an amount of time that suffices to allow meaningful observation. If some important stages influencing the correctness of final results have not been observed, conclusions cannot be made as to the integrity of the system.

The OSCE did audit the 2007 elections, and in its report it states that the "election administration implemented the [I-voting] system in a fully transparent manner, and appeared to take measures to safeguard the conduct of Internet voting to the extent possible".^{*50} Professional, independent, reliable, and comprehensive IT audit and certification procedures should compensate for the lack of simple public scrutiny.

5. Conclusions

In Estonia, as well as in many other countries that have prepared systems for, and allowed, postal voting, advance voting, and other supplementary voting methods, voting at a polling station has virtually lost its significance as a ritual of transforming people into a nation-state and a carrier of sovereign nationhood.

In discussion surrounding the introduction of I-voting, the classical arguments concerning the conformity of I-voting with the principles of fair elections (including the reliability of the electronic voting systems) have gained renewed force. For example, one of the typical arguments against I-voting is that people who have no commitment to go to the polling station to execute their citizen's duty should not participate in governing at all, which contradicts the axiom that the higher the turnout the better.

A possible lack of legitimacy of the election results could result from either of the following situations:

- The privacy of individual I-voting procedure cannot be supervised by authorities or observed in a traditional way. Therefore, massive buying and selling of votes, as well as exercise of other influence or pressure on the voter, is possible.
- The people themselves cannot verify the I-voting results, and people need to have absolute faith in the accuracy, honesty, and security of the whole electoral system (its people, procedures, software, and hardware) if it is to be legitimate. For people who didn't take part in developing the system, the computer operations can be verified only by knowing the input and comparing the expected with the actual output. In a secret ballot system, there is no known input, nor is there any expected output with which to compare the electoral results.^{*51}

Therefore, the question of whether remote Internet voting with binding results in public political elections complies with the constitutional principles of fair voting cannot be answered simply with a 'yes' or

⁴⁹ E. Maaten, T. Hall. Improving the Transparency of Remote I-voting: The Estonian Experience. – R. Krimmer, R. Grimm (eds.), *Electronic Voting 2008*, Gesellschaft für Informatik, Bonn 2008, pp. 31–43.

⁵⁰ OSCE/ODIHR 2007. Election Assessment Mission Report, Republic of Estonia, Parliamentary Elections, 4 March 2007. Available at http://vvk.ee/public/dok/OSCE_report_EST_2007.pdf (9.10.2011).

⁵¹ Ü. Madise, T. Maaten (Note 26).

‘no’. Actually, the question and answer should be divided into two parts. The first sub-question should be whether the legal norms in the abstract comply with the constitutional provisions and the second whether the technical solution used to conduct voting procedures in a certain election guarantees constitutionality.

The first sub-question can be answered on the basis of theoretical analysis, but the second should be examined before and after the relevant elections. The fact that it is possible not to fulfil the legal requirements set for an I-voting system is not enough *per se* for declaring I-voting as a concept unconstitutional. As a matter of fact, this underscores the importance of qualified certification and auditing of the system as well as the need for a new approach in electoral observation. The second sub-question can be answered with a ‘yes’ only if sufficient measures are in place to check whether the IT solutions work properly. This leads to a requirement that auditing, certification, and evaluation as required in the Council of Europe guidelines^{*52} be foreseen by law or NEC regulation.

In the Estonian case, the first sub-question could be answered ‘yes’, as e-ID enables secure remote identification, e-ID has wide penetration, all advance voters are placed in the same conditions, and the ‘virtual voting booth’ (the right to replace an I-vote with another I-vote or a paper ballot) and ‘virtual double-envelope system’ ensure freedom of voting and uniformity of elections. Moreover, the system is justified by the aim to guarantee universal suffrage in an information society where e-services (including Internet voting) are demanded by a significant proportion of the electorate. Whilst formal equality can be provided, the questions of material equality and the issue of the digital divide remain. In addition, complying with the principle of secrecy poses new obstacles for many countries. According to the above teleological interpretation of the principle of secrecy, the voting act is to be seen not as an aim but as a measure to guarantee freedom of voting, and the anonymity aspect of the principle of secrecy can be guaranteed. The analysis of the compliance of the Estonian I-voting system with the United Nations International Covenant on Civil and Political Rights has given positive result as well^{*53} but emphasises the importance of special procedures to facilitate auditing and observation of I-voting.^{*54}

The answer to the second sub-question is more complicated. Internet voting in concrete election is constitutional if the provisions of the law are fulfilled in practice: only people entitled to vote can vote, e-votes cast over the Internet are recorded and counted properly, and only one vote per voter shall be counted. Independent IT auditing that covers all aspects of the system can prove its soundness. The proper performance of the IT system should be certified and audited before, during, and after voting. The personal computer and the Internet remain a weak point of the system. The scholars are probably right in saying that “[a]lthough perfect real-time knowledge of all cyber threats is an impossible goal, it is realistic to do much better at providing a richer, better integrated picture of our cyber security to the technologists, attorneys, and political leaders who will have to collaborate to avert the next cyber attack”.^{*55} Both new threats and I-voting are part of the information society.

⁵² See Note 7.

⁵³ S. Meagher (Note 32), pp. 349–380.

⁵⁴ *Ibid.*, pp. 384–386.

⁵⁵ Th. C. Wingfield, E. Tikk. Frameworks for International Cyber Security: The Cube, the Pyramid, and the Screen. – International Cyber Security. Legal & Policy Proceedings. Tallinn: CCD COE Publications 2010, p. 21.



Ero Liivik

Lecturer

Estonian Academy of Security Sciences

Referendum in the Estonian Constitution:

Historical and Comparative Constitutional Aspects

The opportunities offered by and the limitations of direct democracy became important in constitutional law in the past decade in connection with the enlargement of the European Union and especially in the context of reforms in which different referendums have played a significant role.^{*1} This has also resulted in the bulking up of literature dealing with the problems of direct democracy.^{*2} The application of direct democracy is directly associated with the principle of subsidiarity. The principle of people's sovereignty mainly puts emphasis on the people as the bearer and source of the power of state and their role: the rights of organising political power and determining its structure are vested in the people while such rights must be linked with the legitimacy and will emanating from the people. It means, in particular, that the constitutional power (*pouvoir constituant*) is vested in the people.^{*3} This is to be understood to be imperative—state power may proceed solely from the people. Pursuant to §56 of the Constitution of the Republic of Estonia^{*4} (hereinafter referred to as the Constitution), the supreme power of state is exercised by the people through citizens with the right to vote by electing the Riigikogu and through a referendum. At that, pursuant to §162 of the Constitution, the provisions dealing with the fundamental principles and the procedure of their amendment (Chapters I and XV) may be amended only by a referendum.

This article explores the position of referendum provisions in the Constitution and also, more broadly, the subject of direct democracy in the context of Estonian constitutional law and in international comparison.

¹ For example, the referendums on the Treaty establishing a Constitution for Europe in France and Holland in 2005; the referendums held in 2008 and 2009 in Ireland on the ratification of the Treaty of Lisbon. There were 24 referendums on the European Union treaties and accession to the EU between 1998 and 2008.

² Here the following sources can be cited: S. Binzer Hobold. *Europe in Question: Referendums on European Integration*. Oxford: Oxford University Press 2009; M. Setälä, T. Schiller. *Referendums and Representative Democracy: Responsiveness, Accountability and Deliberation*. Routledge/ECPR Studies in European Political Science 2009; Z. T. Pallinger, B. Kaufmann, W. Marxer, T. Schiller. *Direct Democracy in Europe. Developments and Prospects*. Wiesbaden: VS Verlag für Sozialwissenschaften/GWV Fachverlage GmbH 2007; M. Qvortrup. *A Comparative Study of Referendums: Government by the People*. Manchester University Press 2005; T. Schiller. *Direkte Demokratie. Forschung und Perspektiven*. Westdeutscher Verlag 2003. There is also an abundance of other articles. As regards Estonia, there is a significant monograph by Vallo Olle. *Kohaliku omavalitsuse teostamine vahetu demokraatia vormis: kohalik rahvaalgatus ja rahvahääletus* (Exercising Local Government in the Form of Direct Democracy: Local Citizens' Initiatives and Referendums). Tartu Ülikooli Kirjastus 2002 (in Estonian).

³ M. Suksi. *Bringing in the People. A Comparison of Constitutional Forms and Practices of the Referendum*. Martinus Nijhoff Publishers, Kluwer Academic Publishers 1993, pp. 16–28.

⁴ Eesti Vabariigi põhiseadus. – RT 1992, 26, 349; RT I 2007, 33, 210 (in Estonian).

1. Referendum typology and application in the world

Direct democracy operates in two ways: either by a referendum or a citizen initiated referendum. In literature, various forms of referendum are distinguished between⁵:

- 1) mandatory constitutional referendum—set out *expressis verbis* in the constitution of the country as a mechanism required to make decisions related to the sovereignty of the state or amend the constitution; the outcome of a referendum is binding and mandatory for all of the public bodies; used, e.g., in Australia, Denmark, Ireland and Switzerland;
- 2) abrogative referendum—a procedure allowing the people to decide on a law already passed in the parliament; it has also been called facultative or veto referendum. For example, in Sweden and Austria such a referendum may be initiated by at least one third of the members of the parliament; in Italy such a referendum may be initiated either by a part of the parliament, citizens (at least 500,000) or regional councils (at least five). In Italy such a referendum may repeal any law (including those already enforced), elsewhere it is used to reject new laws (referendum is held before enforcement). The outcome is binding;
- 3) consultative referendum—also called the plebiscite or *ad hoc* referendum. A referendum may address any issues and is initiated either by the government or parliament. The outcome is non-binding. Such a regulation may be incorporated in the constitution (e.g., in France), be provided for by a special act (e.g., in Canada) or in the decision on the initiation of a referendum itself (e.g., in Great Britain).

As a rule, a referendum is general and direct; it may be held over a certain issue, including a draft act. A referendum should be distinguished from a public poll and a citizen initiated referendum.⁶ With the latter, a draft act is initiated by the people and requires collection of a certain amount of signatures from the citizens. The number of signatures required to initiate a referendum varies and is prescribed either in the constitution or in a special act. The outcome of a referendum is usually binding, although its legitimacy may sometimes be assessed by a court or the parliament (e.g., in Switzerland, New-Zealand and some states of the US).

Jurisprudent Markku Suksi believes that the provisions containing direct democracy in some form are present in 85 constitutions of the world.⁷ The table on the application of direct democracy (see Table 1) shows that direct democracy is more existent in European countries. In Europe, Switzerland has the greatest tradition of applying direct democracy—between 1945 and 2006 it held 396 direct democratic referendums.⁸ In other European countries, direct democracy was widely applied in the enlargement process of the European Union.

Table 1. Application of direct democracy in the continents of the world in 1951–2010

Period	Europe	Asia	North and South America	Australia and Oceania	Africa	Total	Average
1951–1960	38	13	3	5	9	68	6.8
1961–1970	44	22	4	7	19	96	9.6
1971–1980	116	50	8	14	34	222	22.2
1981–1990	129	30	12	7	22	200	20.0
1991–2000	235	24	76	15	35	385	38.5
2001–2010	167	30	44	22	35	298	29.8

Note: The table is based on data from the Initiative & Referendum Institute (hereinafter referred to as the IRI) Europe.⁹

⁵ L. LeDuc. *The Politics of Direct Democracy: referendums in global perspective*. Broadview Press 2003, p. 39.

⁶ Committee for Expert Analysis of the Constitution, final report. Kommentaarid põhiseaduse 3. peatükile „Rahvas“ (Comments on Chapter 3 ‘People’ of the Constitution). Available at <http://www.just.ee/10726> (19.3.2011) (in Estonian).

⁷ M. Suksi (Note 3), p. 137.

⁸ M. Gallagher. *Elections and Referendums*. – D. Caramani (ed.). *Comparative Politics*. Oxford: Oxford University Press 2008, p. 257.

⁹ The IRI Guidebook to Direct Democracy in Switzerland and beyond 2010. Kőniz: Initiative & Referendum Institute Europe, Ast & Jakob, Vetsch AG, 2010, p. 208.

To sum up, alongside representative democracy direct democracy in its various forms is being applied worldwide, including in Europe as an active mechanism of democracy.

2. Referendum and citizen initiated referendum in Estonian law

Next let us have a look at the position of referendum clauses in Estonian legal order.

Two sections of the Constitution regulate referendums: §§105 and 106. Section 105 provides that the Riigikogu has the right to submit a draft act or other national issue to a referendum; the decision of the people shall be made by a majority of the participants in the voting. A law which is passed by a referendum shall promptly be proclaimed by the President of the Republic; the decision of the referendum shall be binding on all state institutions. If a draft act which is submitted to a referendum does not receive a majority of votes in favour, the President of the Republic shall declare extraordinary elections to the Riigikogu. Section 106 of the Constitution provides that issues regarding the budget, taxation, financial obligations of the state, ratification and denunciation of international treaties, the declaration or termination of a state of emergency, or national defence shall not be submitted to a referendum. An act adopted by referendum normally has the same legal power as any act adopted by the parliament. The stance of the Constitutional Review Chamber of the Supreme Court is that the Riigikogu may submit an issue to a referendum only where such an issue is in the remit of the Riigikogu and holding a referendum is not prohibited under §106 of the Constitution; for example, deciding on the extraordinary elections to the Riigikogu is not within the powers of the Riigikogu—pursuant to §78 3) of the Constitution such elections are proclaimed by the President of the Republic and therefore the Riigikogu cannot submit that issue to a referendum.^{*10}

Such forms of direct democracy as referendum and citizen initiated referendum were also present in the constitutions of the Republic of Estonia before 1940. Section 29 of the constitution adopted by the Constituent Assembly in 1920 gave extensive powers to the people—besides elections of the Riigikogu and the form of a referendum, it also provided for the institute of a citizen initiated referendum. The people, i.e., the active citizenship, even had the right to step up as a legislator under the referendum regime—they could issue, amend or repeal acts (§31).

What was significant was that the active citizenship had exclusive rights to amend the constitution, whether by a citizen initiated referendum^{*11} or by the Riigikogu (§88).^{*12} Section 29 of the 1933 constitution provided that the people exercise the power of state by a referendum, citizen initiated referendum, election of the Riigikogu and election of the Riigivanem (president).

The 1938 constitution relinquished, *inter alia*, the referendum and kept only the institute of citizen initiated referendum (§35 4)).

Returning to current law, besides the Constitution the issues related to referendum are regulated also by a specific act. Clause 104 5) of the Constitution provides that the Referendum Act belongs to the constitutional laws, i.e., it may be passed and amended only by a majority of the membership of the Riigikogu. The Referendum Act^{*13} (hereinafter referred to as the RA) was adopted by the Riigikogu on 13 March 2002 and entered into force on 6 April 2002. Section 1 of the act provides for the issues already addressed in the Constitution (repeats the provisions of §§105 and 106 of the Constitution). A referendum is free, general, uniform and direct. Voting is secret, each voter has one vote. An Estonian citizen who has attained eighteen years of age by the date of a referendum may participate in the referendum. A person cannot participate in the voting if he or she has been divested of his or her active legal capacity by a court judgment or has been convicted by a court and is serving a sentence in a custodial institution (RA §2). Section 3 of the RA provides for the time of referendum so that a referendum is held not earlier than three months after the passage of a

¹⁰ CRCSCd, 30.10.2009, 3-4-1-20-09.

¹¹ In comparison, it should be pointed out that currently, under §161, the right to initiate amendment of the Constitution rests with not less than one-fifth of the membership of the Riigikogu and with the President of the Republic (subsection 1).

¹² H. Schneider. Riigiteoreetilisi probleeme: miks nad on tekkinud ja kuidas neid lahendada? (Theoretical Constitutional Problems: Why Have They Emerged and How to Solve Them?) – Juridica 1998/7, p. 355 (in Estonian).

¹³ Rahvahääletuse seadus. – RT I 2002, 30, 176; 2009, 29, 175 (in Estonian). The act repealed the Referendum Act which had been in force since 19 June 1994 (RT I 1994, 41, 659; 2000, 95, 610).

resolution to this effect by the Riigikogu (subsection 1) whilst a referendum is not held at a time when less than ninety days remain until elections to the Riigikogu. A referendum on a draft act to amend the Constitution or on another national issue may be scheduled for a time after the next elections to the Riigikogu; a referendum on another draft Act must not be scheduled for a time after the next elections to the Riigikogu; a referendum may be scheduled for the same day as Riigikogu elections or local government council elections (subsection 3). What is also important is the principle that referendums are not held on the same day on issues which are mutually exclusive or for the passage of acts which are in conflict with each other (subsection 4). Subsection 30 (1) of the RA provides that if a draft act is submitted to a referendum, the title of the draft act or, pursuant to a resolution of the Riigikogu, the text of the draft act, the question “*Kas Teie olete seaduseelnõu seadusena vastuvõtmise poolt?*” [Are you in favour of passage of the draft Act?] and spaces marked with the possible answers “*jah*” [yes] and “*ei*” [no] are entered on the ballot paper. If another national issue is submitted to a referendum, the wording of the issue and spaces marked with the possible answers “*jah*” [yes] and “*ei*” [no] are entered on the ballot paper.

A referendum is initiated pursuant to the provisions of Chapter 14 of the Riigikogu Rules of Procedure and Internal Rules Act^{*14} (hereinafter referred to as the RRPIRA). Pursuant to §128 (1) of the RRPIRA a member of the Riigikogu, a faction and a committee have the right to initiate a referendum.^{*15} Pursuant to §129 (6) of the RRPIRA a decision to hold a referendum in order for an act to be passed is taken by the Riigikogu by a final vote on the draft resolution at the third reading and in order for the draft resolution to be passed, a majority of votes in favour is required. In order to submit to a referendum draft acts of the laws listed in §104 (2) of the Constitution, the draft act must have a majority of the votes in favour of the membership of the Riigikogu. If the draft resolution is not adopted, the draft act is also deemed to have been rejected (RRPIRA §129 (7)). In order for the draft resolution on submitting other national issues to a referendum to be passed, a majority of votes in favour is required (RRPIRA §130 (2)). Pursuant to §6 (2) of the RA, the Riigikogu shall not amend or repeal a resolution to hold a referendum. Pursuant to §7 (1) of the RA, a referendum is postponed if a state of emergency or a state of war is declared. In case of a state of emergency, the Riigikogu may postpone the referendum by a resolution (subsection 2). The Riigikogu determines a new date for the referendum within two weeks after the reasons cease to exist, observing the term prescribed in §3 (1) of the RA which shall be calculated from the date on which the resolution of the Riigikogu determining the new referendum date is passed. Subsection 8 (1) of the RA provides that a referendum is not held if:

- 1) the Supreme Court repeals the resolution of the Riigikogu concerning submission of a draft act or other national issue to a referendum;
- 2) the Riigikogu has not passed a resolution determining a new date for the referendum within the term prescribed in §7 (3);
- 3) the time of the referendum is not in accordance with §3 (3) of the RA due to extraordinary Riigikogu elections being called.

In addition to a referendum, it was possible during a limited time period after the adoption of the Constitution in Estonia to call forth a citizen initiated referendum. Second paragraph of §8 of the Constitution of the Republic of Estonia Implementation Act^{*16} provided that the right to initiate amendment of the Constitution during the three years following the adoption of the Constitution by a referendum also rests, by way of public initiative, with not less than ten thousand citizens with the right to vote. However, no law was passed to specify the procedure of a citizen initiated referendum. In 1994, 10,632 citizens of Estonia with the right to vote initiated a draft act to amend the Constitution. The draft act proposed to amend §28 of the

¹⁴ Riigikogu kodu- ja töökorra seadus. – RT I 2003, 24, 148; 2010, 28, 144 (in Estonian).

¹⁵ Pursuant to §40 (1) of the RRPIRA a faction may be formed by and must comprise not less than five members of the Riigikogu who are elected from a list of candidates of the same political party. Pursuant to §17 of the RRPIRA the Riigikogu has standing committees, select committees, committees of investigation and study committees. Pursuant to §18 (2) of the RRPIRA committees prepare draft legislation for deliberation by the plenary assembly of the Riigikogu, exercise supervision over the exercise of executive power within their particular field and perform other functions assigned to the committees by law or by a resolution of the Riigikogu. Standing committees are formed under law; select committees are formed by a resolution of the Riigikogu which sets out the composition, including an alternate member to substitute for each committee member, functions and procedure for reporting on the activities of the committee (RRPIRA §19 (2)); committees of investigation and study are formed by a resolution of the Riigikogu which sets out the composition, including an alternate member to substitute for each committee member, functions and term of authority of the committee (RRPIRA §20 (2) and §21 (2)).

¹⁶ Põhiseaduse rakendamise seadus. – RT I 1992, 26, 350 (in Estonian).

Constitution to incorporate a guaranteed pension to everybody according to their labour input, and §56, supplementing it with the provision that the president is to be elected directly by the people.^{*17} The draft act was rejected without a debate by the Riigikogu in the autumn of the same year (with the votes 32 in favour, three against and four undecided).^{*18}

The current law of Estonia provides only for a referendum. Also, in addition to a citizen initiated referendum the current law does not provide for the institute of a public poll. A public poll is favoured by the principle of democracy according to which it is essential to take the opinions of the people into consideration—in such a case, the public authorities would have the right to ask non-binding opinions from the people in order to get information about the feelings and stances of the people. The Supreme Court has noted that the term ‘public poll’ is not used in the Constitution. The outcome of a public poll is, unlike the outcome of a referendum, not binding to a state or local government body and is limited just to the clarification of the opinion of the persons entitled to participate in a public poll.^{*19} The non-binding nature of a public poll, however, would be a problem—in terms of politics a public poll would acquire a binding substance and thus a referendum should be preferred to a public poll.^{*20}

3. Application of direct democracy in Estonia

A total of seven referendums and one citizen initiated referendum have been held in Estonia’s history (see Table 2).^{*21}

Pre-1940, direct democracy was applied in Estonia in five instances. Only two referendums were held during the prolonged Soviet occupation and the restoration of Estonia’s independence—the referendum on independence (3 March 1991) and the referendum on the constitution (28 June 1992) were the major political events of the transitional period and though close in time they took place under totally different circumstances.^{*22}

Just one referendum has been held under the current Constitution: On 14 September 2003, the Constitution of the Republic of Estonia Amendment Act^{*23} was adopted by a referendum. It was not possible to ratify the Treaty on accession to the European Union by a referendum as §106 of the Constitution prohibits to submit the issues related to the ratification and denunciation of international treaties to a referendum and there was no desire to amend §106 of the Constitution. It was important to amend the Constitution and hold a referendum as accession to the European Union was a matter of principle in terms of the nationhood and future of Estonia. A referendum was needed to amend the Constitution as the nature of such sections was altered whose amendment is possible only by a referendum; the decision of the Riigikogu on holding a referendum^{*24} was based on §§105, 162, 163, 164 and 167 of the Constitution and §30 (1) of the RA. The ballot paper presented the following question: “*Kas Teie olete Euroopa Liiduga ühinemise ja Eesti Vabariigi põhiseaduse täiendamise seaduse vastuvõtmise poolt?*” [Are you in favour of accession to the European

¹⁷ Pursuant to §79 of the Constitution, the President of the Republic is elected by the Riigikogu or an electoral body. The electoral body is comprised of members of the Riigikogu and representatives of the local government councils. Each local government council elects at least one representative to the electoral body, who must be an Estonian citizen. The specific procedure for the election of the President of the Republic is provided by the President of the Republic Election Act (Vabariigi Presidendi valimise seadus. – RT I 1996, 30, 595; RT I, 16.11.2010, 9 (in Estonian)).

¹⁸ A. Leps. Eesti põhiseaduse muutmisest (On the Amendment of the Estonian Constitution). – Akadeemia 1999/3, p. 461 (in Estonian).

¹⁹ CRCSCd, No. III-4/1-2/93, 11.8.1993. – RT I 1993, 59, 841 (in Estonian).

²⁰ T. Annus. Riigiõigus (Constitutional Law). AS Juura 2006, p. 56 (in Estonian).

²¹ The following sources were used in the table: Eesti Entsüklopeedia (Encyclopaedia of Estonia). Vol. 7. Eesti Entsüklopeediakirjastus 1994, article “Rahvahääletus” (Public Poll), p. 674; T. Raitviir. Eesti üleminekuperioodi valimiste (1989–1993) võrdlev uurimine (Elections in Estonia during the Transition Period: A Comparative Study (1989–1993)). Institute of International and Social Studies. Tallinn: Teaduste Akadeemia Kirjastus 1996, pp. 165–181; informative Web site of the Electoral Committee of the Republic, available at <http://www.vvk.ee> (25.3.2011).

²² T. Raitviir (Note 21); J. Ruus. Estonia. – Direct Democracy: The Eastern and Central European Experience. A. Auer, M. Butzer (ed.). Ashgate 2001, pp. 51–55.

²³ Eesti Vabariigi põhiseaduse täiendamise seadus. – RT I 2003, 64, 429 (in Estonian).

²⁴ Decision of the Riigikogu “Rahvahääletuse korraldamine Euroopa Liiduga ühinemise ja Eesti Vabariigi Põhiseaduse täiendamise küsimuses” (Holding a Referendum on Accession to the European Union and Amendment of the Constitution of the Republic of Estonia). Adopted and entered into force 18.12.2002. – RT I 2003, 60 (in Estonian).

Union and the passage of the Constitution of the Republic of Estonia Amendment Act?].^{*25} However, a member of the Riigikogu Igor Gräzin noted that the legally correct question would have been “*Kas olete nõus loobuma Eesti praegusest iseseisvusest Eesti astumise korral Euroopa Liitu?*” [Are you in favour of relinquishing the current independence of Estonia upon Estonia’s accession to the European Union?] “as the State of Estonia ceases to exist in the form we know albeit the sovereignty of the nation (the right to an armed resurrection, national self-determination, etc. is inalienable”.^{*26} Jurisprudent Lauri Mälksoo finds that irrespective of the form and title of the amendment, in essence the Constitution was changed. Adoption of the Constitution Amendment Act enabled the Riigikogu to ratify the already signed treaty on Estonia’s accession to the European Union.^{*27} Section 1 of the adopted act provided that Estonia may belong to the European Union in accordance with the fundamental principles of the Constitution of the Republic of Estonia and §2 provided that as of Estonia’s accession to the European Union, the Constitution of the Republic of Estonia applies taking account of the rights and obligations arising from the Accession Treaty. The Constitution Amendment Act can be amended only by a referendum, meaning that should the legal nature of the European Union change drastically in the future and become unacceptable to Estonia and contrary to the provisions of the Constitution Amendment Act, the latter can be amended. The Riigikogu has the exclusive powers to organise a referendum, i.e., the Riigikogu must decide whether, for example, an issue concerning the future structure of the European Union is so fundamental that in order to form a stance a referendum is required to be held in Estonia.

The 2003 referendum was disputed quite actively and some disputes were referred to the Supreme Court.^{*28} However, none of the complaints was successful as the voting procedure had not been violated; the accession to the European Union was also disputed by neither the Chancellor of Justice nor the President of the Republic.^{*29}

Just one referendum has been held under the current Constitution. However, the Riigikogu has on several occasions attempted to broaden the forms of direct democracy: The 10th and 11th compositions of the Riigikogu conducted a proceeding on a draft act which sought to amend the Constitution in order to legitimise citizen initiated referendums (210SE) and the 11th composition conducted a proceeding on a draft act (477SE) seeking to introduce the institute of a local referendum.^{*30} The Government of the Republic was unsupportive of both draft acts. As regards the legitimisation of citizen initiated referendums, the Government of the Republic noted that the circle of subjects entitled under §103 of the Constitution (*inter alia*, every member of the Riigikogu has the right to initiate laws) is sufficient to ensure that all the draft acts enjoying considerable support in society will eventually be proceeded by the Riigikogu. There is no need to broaden the options of a legislative initiative^{*31}. As regards the draft Local Referendum Act, the Government of the Republic noted that the draft act was unnecessary and, moreover, adds excess financial liability upon local self-governments.^{*32}

²⁵ J. Laffranque. Euroopa Liidu õigussüsteem ja Eesti õiguse koht selles (European Union Legal System and Estonia’s Place in It). AS Juura 2006, pp. 69–71 (in Estonian); A. Albi. EU Enlargement and the Constitutions of Central and Eastern Europe. Cambridge 2005, pp. 138–162.

²⁶ I. Gräzin. Eesti põhiseadus ja Euroopa Liidu referendum (Estonian Constitution and European Union referendum). – Riigikogu Toimetised 2002 (5). Available at <http://www.riigikogu.ee/rito/index.php?id=11891&highlight=Gräzin&op=archive2> (25.3.2011) (in Estonian).

²⁷ L. Mälksoo. Eesti suveräänsus 1988–2008. Iganenud või igavene? – Tekste kaasaegsest suveräänsusest (Estonia’s Sovereignty 1998–2008. Obsolete or Infinite?—Texts on Modern Sovereignty). H. Kalmo, M. Luts-Sootak (ed.). Tartu Ülikooli Kirjastus 2010, p. 141 (in Estonian).

²⁸ CRCSCr, 12.9.2003, 3-4-1-10-03; CRCSCr, 24.9.2003, 3-4-1-11-03; CRCSCd, 29.9.2001, 3-4-1-12-03; CRCSCr, 30.9.2003, 3-4-1-15-03; CRCSCd, 2.10.2003, 3-4-1-13-03; CRCSCd, 2.10.2003, 3-4-1-16-03; CRCSCd, 3.10.2003, 3-4-1-17-03; CRCSCr, 10.10.2003, 3-4-1-20-03; CRCSCd, 14.10.2003, 3-4-1-19-03; CRCSCr, 17.10.2003, 3-4-1-21-03; CRCSCr, 26.2.2004, 3-4-1-6-04.

²⁹ J. Laffranque (Note 26), pp. 72–73.

³⁰ E. Liivik. Legitimacy through Direct Democracy in the EU Member State: Direct Democratic Initiatives in the Estonian Parliament. The Proceedings of the Institute for European Studies. – Journal of Tallinn University of Technology 2010/8, pp. 91–93.

³¹ Opinion of the Republic of the Government on draft act 210SE, 4.2008, No. 10.2-3/3174. Available at http://www.riigikogu.ee/index.php?page=en_vaade&op=ems&eid=254354 (25.3.2011) (in Estonian); draft act No. 210 SE II, initiated 28.2.2008. Available at http://www.riigikogu.ee/index.php?page=en_vaade&op=ems&eid=254354 (25.3.2011) (in Estonian).

³² Opinion of the Government of the Republic on draft act No. 477SE, 4.6.2009, No. 10.2-3/5487. Available at http://www.riigikogu.ee/?page=en_vaade&op=ems&eid=611481 (25.3.2011) (in Estonian); draft act No. 477 SE II-1. Available at http://www.riigikogu.ee/?page=en_vaade&op=ems&eid=611481 (25.3.2011) (in Estonian).

Table 2. Application of direct democracy in Estonia in 1923–2003

Time	Form of direct democracy	Issue put on vote	Out-come	Distribution of votes
17–19.2.1923	Referendum	Proposal by the Christian Party to make religious studies compulsory in general education schools	Yes	In favour 328,369 (71.9%), against 130,476
13–15.8.1932	Referendum	Draft act by the Riigikogu to amend the constitution	No	In favour 333,979 (49.2%), against 345,215
10–12.6.1933	Referendum	Draft act by the Riigikogu to amend the constitution	No	In favour 161,598 (32.7%), against 333,188
14–16.10.1933	Citizen initiated referendum	Draft act to amend the constitution tabled by the Veterans ^{*25}	Yes	In favour 416,878 (56.3%), against 156,894
23–25.2.1936	Referendum	President's proposal to set up a two-chamber National Assembly to amend the constitution or draft a new constitution	Yes	In favour 474,218 (75.3%), against 148,824
3.3.1991	Referendum	Restoration of Estonia's sovereignty (independence from the Soviet Union)	Yes	In favour 737,964 (77.8%), against 203,199
28.6.1992	Referendum	Draft Constitution and its implementation act; additional question on whether to allow the applicants for Estonian citizenship to participate in the elections of the parliament and the president	Yes	In favour 407,478 (91.3%), against 36,147 (8%); additional question: in favour 205,980 (46.13%), against 236,819 (53.04%)
14.9.2003	Referendum	Amendment of the Constitution in connection with joining the European Union	Yes	In favour 369,657 (66.83%), against 183,454 (33.17%)

³³ The League of Veterans (in Estonian *vabadussõjalased* or *vapsid*)—in actuality the League of Veterans of the Estonian War of Independence was founded in 1929. It was headed by General Andres Larka (1879–1943) and lawyer Artur Sirk (1900–1937). The veterans sought, among other things, to introduce the institute of a president in the constitution. In 1934, the leaders of the veterans were imprisoned upon the initiative of the then Prime Minister Konstantin Päts. See A. Kasekamp. *Vaps. – World Fascism. A Historical Encyclopedia*. C. P. Blamires, P. Jackson (eds.). ABC-CLIO, Inc California 2006, Vol. 2: L–Z, p. 696.

Also, the Treaty establishing a Constitution for Europe (Treaty of Lisbon) caused the question whether or not a referendum should be held to approve the treaty. For instance, the then Chancellor of Justice noted that a referendum was required to approve the treaty, reasoning that: the question of whether Estonia agrees to share its sovereignty with other Member States to that extent should be posed to the bearer of the supreme power—the people. It would also be helpful in that the nation would subsequently embrace the Treaty establishing a Constitution for Europe. It is not insignificant that one of the key objectives of the treaty is to bring the European Union closer and make it more understandable to people and thus the practical added value of a referendum should not be underestimated.^{*34} The group of experts formed within the constitutional committee of the Riigikogu noted that holding a referendum under §6 was out of question as the issue concerned the ratification of a foreign treaty. The Riigikogu considered holding a referendum unnecessary and approved the treaty (in favour 91, against 1).^{*35}

4. Problems related to the referendum provisions of the Constitution

David E. Butler and Austin Ranney, who have analysed issues related to direct democracy, note that citizens themselves consider a referendum to be the most authentic and direct way to express their will. Therefore the decisions adopted by a referendum are more legitimate than the decisions based on representative democracy. However, Butler and Ranney note that this does not mean that the decisions made in direct democracy are necessarily wiser or that all the decisions made within a political system should be directly democratic, but rather the question is primarily about the legitimacy of politics.^{*36} The application of direct democracy does not concern just the question of legitimacy but has many other aspects—both positive and negative (see Table 3).^{*37}

Table 3. Positive and negative aspects of a referendum

Positive aspects	Negative aspects
Referendums promote democracy as the people are directly involved in decision making.	Professional politicians have decision-making know-how, entitling everyone to decide reduces the quality of decisions.
Referendums allow addressing issues in the clearest and most direct way.	Participants in a referendum base their decision on external circumstances, thus election behaviour and the final outcome are not indicative of the correct/actual interests.
A decision made by the people has greater legitimacy; this is especially important in issues of great relevance for the society.	A referendum facilitates the minority to be suppressed by the inconsiderate or prejudiced majority.
A referendum as a process raises the awareness of those participating in it as things are thoroughly discussed.	Those who participate in a referendum are predominantly those who have a (very) clear opinion/stance in the matter; as such referendums work against those who are moderate and less interested.
A reasonably implemented referendum enhances representative democracy.	The implementation of a referendum trivialises the decision process, i.e., referendum topics become mundane, participants are less motivated to understand things or search for information.

³⁴ A. Jõks. Rahvahääletust ei ole vaja karta (No Need to Fear the Referendum). – Postimees, 28.4.2005. Available at http://www.postimees.ee/280405/esileht/arvamus/164191_1.php (25.3.2011) (in Estonian).

³⁵ Lissaboni lepingu, millega muudetakse Euroopa Liidu lepingut ja Euroopa Ühenduse asutamise lepingut, ratifitseerimise seadus (Act Ratifying the Treaty of Lisbon amending the Treaty on European Union and the Treaty establishing the European Community). – RT II 2008, 14, 36 (in Estonian). Information about the proceeding of the draft act available at http://www.riigikogu.ee/?page=en_vaade&op=ems&eid=240477&u=20110408144446 (29.3.2011) (in Estonian).

³⁶ D. Butler, A. Ranney. *Referendums Around the World: The Growing Use of Direct Democracy*. AEI Press 1994, pp. 14–15.

³⁷ M. Gallagher (Note 8), p. 256.

At the same time, the main objective of applying direct democracy—to ensure that the people as the bearer of the supreme power of state can express their will beyond parliamentary elections—does not mean that the political decision-making process becomes uncontrollable or that the fulfilment of the functions of state becomes paralysed. The drafting of the current constitution was guided by the principle that Estonia is a parliamentary republic and the application of direct democracy depends mainly on parliamentary decisions; thus a provision was made for a referendum but not for a citizen initiated referendum. Some jurisprudents have maintained that direct democracy should have been more broadly provided for in the constitution. The lawyers who prepared the report of the Committee for Expert Analysis of the Constitution pointed out that the current constitution was too Riigikogu-centred and that the people were not sufficiently trusted to exercise the powers of state. The State expects acknowledgement from all individuals through the people, but does not sufficiently take the opinions of the people in direct consideration.^{*38} This standpoint was shared by several jurisprudents already while the Constitution was being drafted. Professor Ilmar Rebane noted in his analysis of the draft constitution (wording of 15 December 1991) tabled in the Constitutional Assembly that the opportunities for the people to exercise the supreme power of state are rather negligible and limited just to the election of the Riigikogu and referendums. Exercise of the power of state via public polls was omitted (a provision to that effect was contained in one of the original versions) and the right of citizen initiated referendums was also not provided for.^{*39} Dr. Heinrich Schneider has claimed that the Estonian experience speaks not only about the need to broaden the functions and powers of the people but also about preventing the restriction of existing functions and ensuring their realisations. This, however, was not considered in drafting the 1992 Constitution, empowering the Riigikogu to decide on the holding of a referendum (Constitution §65 (2)).^{*40}

There is some conceptual confusion regarding the referendum clauses of the current Constitution: A referendum is in part mandatory (e.g., to amend certain provisions of the Constitution), however, in part it is optional (as in other issues, holding a referendum depends purely on the relevant decisions and choices of the Riigikogu) but notwithstanding the outcome of a referendum is binding upon all public bodies. It may well be that the fourth paragraph of §105 of the Constitution requiring that if a draft act is rejected at a referendum, the Riigikogu should be dismissed curbs the parliament's enthusiasm to submit any draft acts to a referendum.^{*41} In essence, the fourth paragraph of §105 makes the whole section redundant as there is no parliament that would risk holding a referendum if the failure of the submitted draft act results in extraordinary parliamentary elections. Jurisprudent G. Carcassonne opined in the expert analysis of the Constitution that it is most likely that no referendums will be held.^{*42} However, it should be pointed out that the negative outcome of a referendum in other national issues does not cause extraordinary elections.^{*43}

The substantial problems related to the application of direct democracy do not preclude the need to analyse the referendum clauses of the Constitution and discuss, for example, the need to legitimise citizen initiated referendums. Jurisprudent Rait Maruste has highlighted the latter point in recent debates on the amendment of the Constitution.^{*44} The opinion of the Committee for Expert Analysis of the Constitution also proposed to recreate the institute of a citizen initiated referendum in a restricted form, making its outcome politically but not legally binding.^{*45} It may be added here that citizens' political initiatives were granted recently at the EU level in order to bridge the alienation between the government level and the citizens (so-called deficit of democracy). The Treaty of Lisbon provided for a citizens' initiative which in substance means citizen initiated referendums. Namely, the citizens who are nationals of the European Union Member States may, under Article 11 (4) of the Treaty establishing the European Union, take the initiative of inviting the European Commission, within the framework of its powers, to submit any appro-

^{*38} Committee for Expert Analysis of the Constitution (Note 6).

^{*39} Põhiseadus ja põhiseaduse assamblee. Koguteos (Constitution and the Constitutional Assembly. The Complete Work). Eesti Vabariigi Justiitsministeerium; Juura, Õigusteabe AS 1997, p. 1290 (in Estonian).

^{*40} H. Schneider (Note 12).

^{*41} T. Annus (Note 20), pp. 54–55.

^{*42} K. Merusk, R. Narits. Eesti konstitutsiooniõigusest (On Estonian Constitutional Law). AS Juura 1998, pp. 39–40 (in Estonian).

^{*43} M. Suksi (Note 3), p. 121.

^{*44} R. Maruste. Miks põhiseadus vajab korrastamist (Why Constitution Needs Structuring). – Riigikogu Toimetised 2010 (22), p. 33 (in Estonian).

^{*45} Committee for Expert Analysis of the Constitution (Note 6).

priate proposal on matters where citizens consider that a legal act of the Union is required for the purpose of implementing the Treaties.^{*46} One million citizens from at least one quarter of the EU Member States can invite the European Commission to bring forward proposals for legal acts in areas where the Commission has the power to do so. The organisers of a citizens' initiative, a citizens' committee composed of at least seven EU citizens who are resident in at least seven different Member States, will have one year to collect the necessary statements of support. The number of statements of support has to be certified by the competent authorities in the Member States. The Commission will then have three months to examine the initiative and decide how to act on it. European citizens' initiatives can be launched as from 1 April 2012. The procedure and conditions of the European citizens' initiative have been set out in Regulation No. 211/2011 of the European Parliament and the Council (16 February 2011).^{*47} In addition to the already realised initiative, a proposal has been tabled to provide for a pan-European referendum—important EU agreements would no longer be debated in individual Member States (i.e., the states which allow referendums) but in the European Union as a whole and all citizens of the European Union can participate.^{*48}

5. Conclusions

The principle of people's sovereignty mainly places emphasis on the people as the bearer of the power of state and its role as a source of legitimacy. The people express their will through elections and various forms of direct democracy; direct democracy is being increasingly applied throughout the world—the most recent instances are related to the reform process of the European Union. The provisions of direct democracy are present in the constitutions of many countries. Referendums are addressed in §§105 and 106 of the current Constitution of the Republic of Estonia, and also in the Referendum Act. A referendum, as set out in the Constitution, covers both the referendums to amend the Constitution, referendums on other draft acts and referendums on other national issues. An act adopted by referendum normally has the same legal power as any act adopted by the parliament. Just one referendum has been held in Estonia under the current Constitution, although draft acts have on several occasions been tabled in the Riigikogu seeking to broaden the forms of direct democracy (local referendum, citizen initiated referendum). There have also been developments in European Union legislation (legitimisation of a pan-European citizens' initiative). Such a development dynamic justifies the need to analyse the justifiability of the application of direct democracy in Estonian legal regime.

⁴⁶ European citizens' initiative. Available at http://ec.europa.eu/dgs/secretariat_general/citizens_initiative/index_et.htm (25.3.2011).

⁴⁷ OJ L 65, 11.3.2011, p. 1. Available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2011:065:0001:0022:ET:PDF> (4.7.2011).

⁴⁸ R. Rose. The case for pan-European referendums. *Europe's World*, Spring 2011. Available at http://www.europesworld.org/NewEnglish/Home_old/Article/tabid/191/ArticleType/articleview/ArticleID/21795/language/en-US/Default.aspx (25.6.2011).



Gaabriel Tavits

*Docent of Labour and Social Welfare Law
University of Tartu*

International Standards for Social Security and Their Fulfilment in Estonia:

Changes in Pension and Health Insurance and Their Constitutionality

Two important issues concerning the backing of social security schemes have emerged in Estonia. A recently published study arrived at the conclusion that the Estonian health insurance financing system is not sustainable and proper health care remains unavailable to individuals in the long run.^{*1} Secondly, the parliament of the Republic of Estonia—the Riigikogu—had to decide on raising the retirement age^{*2}; also subject to discussion has been the abolition of special pensions, depriving a certain group of people of their legal right to receive social benefits.^{*3} The future of two important social security schemes has, therefore, been under discussion. Both social security schemes are, among other things, closely related to the economic situation of the country, but also to international requirements by which the Republic of Estonia is bound.

This article analyses the compliance of the amendments made in Estonian health insurance and pension insurance with international requirements and the principles set forth in the Constitution.

1. The right to social security as a fundamental right

The right to social security has been recognised as one of the fundamental rights. In Estonia, the rights related to social security are regulated by §28 of the Constitution.^{*4} Pursuant to subsection 2 of that section, a person has the right to state assistance in the event of old age, incapacity for work, loss of someone on whom he depends, and need. With that provision, the Estonian state has assumed the responsibility to ensure the payment of social benefits necessary for an individual in the above-mentioned circumstances.

¹ See analysis Responding to the challenge of financial sustainability in Estonia's health system. WHO 2010. Available at <http://www.haigekassa.ee/uploads/userfiles/E93542.pdf> (9.10.2011).

² Riikliku pensionikindlustuse seaduse muutmise ja sellega seonduvalt teiste seaduste muutmise seadus (Act Amending the State Pension Insurance Act and Other Related Acts), §7 (1). – RT I 2010, 18, 97 (in Estonian).

³ See, e.g., 'Valitsus püüab eripensione kaotada järk järgult' (Government Tries to Abolish Special Pensions Gradually). – Postimees, 18.5.2010. Available at <http://www.postimees.ee> (in Estonian); 'Valitsus tahab eripensionid kaotada' (Government Set to Abolish Special Pensions). – Postimees.ee, 28.4.2011. Available at www.reporter.ee/2011/04/28 (in Estonian).

⁴ Eesti Vabariigi põhiseadus. – RT 1992, 26, 349; RT I 2007, 33, 210 (in Estonian).

Pursuant to §28 (1) of the Constitution of the Republic of Estonia, everybody is entitled to health protection. This provision has sparked discussions^{*5} of whether the right to health protection would automatically entail the right to health insurance, or if the right provided by the Constitution means only a person's right to receive state-warranted health care in cases of emergency (e.g., accident), while routine treatment is not covered by §28 (1) of the Constitution.^{*6}

The Constitution presumes that the state has to ensure a decent existence for everyone. Social rights, therefore, consist in a person's right to receive benefits from the state. At the same time, the state is obliged to take active steps to ensure these benefits.^{*7} It is important to keep in mind that fundamental social rights (incl. the right to social security) are so-called soft rights, meaning that the state can only provide benefits to the extent for which it has the resources.^{*8} As a result, the standards that states follow may indeed be identical while the actual economic value (purchasing power) of the benefits provided through social security varies greatly by country.

In the past year, several fundamental reforms intended to ensure the sustainability of the national social security system have been carried out in Estonia. Important changes have been made in pension insurance. With regard to this field of insurance, the retirement age was raised and state instalments in the second pension pillar were suspended.^{*9} International opinion on the sustainability of the Estonian health insurance system is negative, since the financing founded on the principle of solidarity used thus far is not sustainable and is hence in need of reform.^{*10}

2. International legal instruments in the field of social security that are binding on Estonia

Various requirements have been set for social security at the international level. The main organisations enforcing these requirements are the International Labour Organization (hereinafter referred to as the ILO) and the Council of Europe.^{*11} Two documents of the Council of Europe in the area of social security—the European Social Charter^{*12} and the European Code of Social Security^{*13}—are binding on Estonia. These two documents jointly prescribe the development and functioning of health insurance and pension insurance systems to Member States.

Estonia has not ratified ILO conventions for regulation of the field of social security. Nor is there currently any need for Estonia to ratify these conventions, because, bound by the documents approved by the Council of Europe, Estonia has met all of the international requirements set for social security systems.

⁵ See M. Malvet, *Õigus sotsiaalkindlustusele kui põhiõigus*. Magistritöö (Right to Social Security as a Fundamental Right. Master's Thesis). Tartu 2006, pp. 40–41 (in Estonian).

⁶ T. Annus, A. Nõmper, *The Right to Health Protection in the Estonian Constitution*. – *Juridica International* 2002 (VII), pp. 122–35.

⁷ See: *Põhiseadus: kommenteeritud väljaanne* (Constitution: Commented Edition). 2nd edition. Tallinn 2008, §28 comment 1 (in Estonian). The duties prescribed to the state have been provided by the European Social Charter. Article 12 of the European Social Charter thus provides that member states shall create or maintain a social security system, as well as ensure the conformity of the social security system to the conditions of the European Code of Social Security.

⁸ *Põhiseadus: kommenteeritud väljaanne* (Note 7), §28 comment 3. See also *The International Covenant on Economic, Social and Cultural Rights*, Article 2. – RT II 1993, 10/11, 13.

⁹ From this year (1.1.2011), pension contributions to the second pillar have partially been restored. Here it is relevant to give a brief description of the Estonian pension system. According to the proposal made by the Estonian pension reform committee, Estonia's pension system comprises so-called three pillars: 1st pillar—state pension system, which is backed by the state. The second pension pillar is the mandatory funded pension. Every person of working age in Estonia is required to subscribe to the second pension pillar. The second pension pillar is administered by various private pension funds. Pension funds are a subset of investment funds. The third pillar of the pension reform is the voluntary funded pension. With this pillar, it is up to the person to decide if he wants to insure himself in this pillar or not. See <http://www.pensionikeskus.ee/?lang=en>.

¹⁰ Responding to the challenge of financial sustainability in Estonia's health system. WHO 2010. Available at <http://www.haigekassa.ee/uploads/userfiles/E93542.pdf> (9.10.2011).

¹¹ F. Pennings, *An overview of interpretation issues of international social security standards*. – F. Pennings, *International Social Security Standards*. Intersentia 2007, pp. 1–30.

¹² *European Social Charter*, revised version. – RT II 2000, 15, 93.

¹³ *European Code of Social Security*. – RT II 2004, 6, 17.

3. Changes in pension insurance

3.1. Raising the retirement age

Various countries have begun to seek options for reforming the social security systems effective in their jurisdiction. A major part of the social security systems to be reformed is pension insurance.^{*14} One of the main reasons for reforming pension insurance is the ageing of the population.

Both the European Code of Social Security and ILO Convention 128 set the age of retirement at 65 but permit raising the retirement age.^{*15} The current age for old-age pension in Estonia is 63, but the Riigikogu recently decided to raise the retirement age to 65.^{*16} Behind this decision is the demographic situation of Estonia, which clearly points to the inevitability of an increased retirement age.^{*17}

The demographic situation leaves the state a choice between, on the one hand, leaving the age limit required for receiving old-age pension at the same level and raising the relevant taxes to the levels needed for financing pension insurance and, on the other hand, raising the retirement age and thereby in the longer term ensuring the functioning of the pension system and a fundamental right—the right to a decent standard of living and state assistance in the event of old age. Although it may seem at first sight that raising or not raising the retirement age is more of a demographic issue, it also has legal consequences. The retirement age is an important condition by which receipt of a pension can be ensured also for future generations. Pursuant to the State Pension Insurance Act^{*18}, the pension is a monthly monetary payment based on the principle of solidarity (§2). According to that principle, the older generation presumes that the younger generations pay for the pensions of the older. Not raising the retirement age creates a situation wherein the younger generations are no longer able to finance pensions and the principle of solidarity provided by the State Pension Insurance Act is violated as well. That, in turn, entails violation of §28 (2) of the Constitution, pursuant to which a person is entitled to state assistance in old age. The non-functioning of the principle of solidarity also follows from the fact that the younger generation supposed to enter the labour market are doing so later and later in life. Today's pensioners typically started their working life at the age of 14–15, while nowadays professional careers begin at 20 at the earliest, and in some cases even later.^{*19} It can therefore be said that professional life has shortened by 10 years when compared to that of today's pensioners. Accordingly, the shorter life span that has emerged as a main argument in current discussions^{*20} is not the only serious argument for not raising the retirement age.

Insofar as international standards retain the option of raising the retirement age, each country is entitled to do so. In fact, it can be argued that not raising the retirement age might entail legal problems in the context of international documents, as well as with respect to the right to assistance in old age prescribed by the Estonian Constitution. It follows from the above that raising the retirement age does not violate international standards or the right to state assistance due to old age prescribed by §28 (2) of the Constitution.

¹⁴ See, e.g. T. Sakellariopoulos, M. Angelaki. *The Politics of Pension Reform in South European Welfare States*. – J. van Langendonck. *The Right to Social Security*. Intersentia 2007, pp. 121–139.

¹⁵ European Code of Social Security, Article 26; ILO Convention 128, Article 15.

¹⁶ The retirement age of 65 years will enter into force on 1.1.2017.

¹⁷ In political discussions, the demographic (rhetorical) objection that if the retirement age is to be raised, the life-span of persons must be increased as well, has been raised at once (See M. Lauristin. *Esmalt tuleb tõsta inimeste eluiga* (At First, People's Life-span Must be Increased)). – Postimees, 23.3.2010. Available at <http://www.postimees.ee> (in Estonian). At the same time, it must be kept in mind that when the part of population of working age decreases, the revenue base of the state is inevitably diminished. As a result, the system of social benefits is also no longer sustainable.

¹⁸ Riikliku pensionikindlustuse seadus. – RT I 2001, 100, 648; RT I 2010, 41, 240 (in Estonian).

¹⁹ B. Contini. *Youth Employment in Europe: Institutions and Social Capital Explain. Better than Mainstream Economics 2010*, p. 6, etc. Available at <http://ftp.iza.org/dp4718.pdf>.

²⁰ H. Pevkur: *Pensioniea tõstmise kaitseb* (Raising the Retirement Age Protects). – Postimees, 25.3.2010. Available at <http://www.postimees.ee> (in Estonian); S. Oviir. *Pensioniea tõstmise karistab* (Raising the Retirement Age Penalises). – Postimees, 25.3.2010. Available at <http://www.postimees.ee> (in Estonian); L. Leppik. *Mida teha pensionieaga* (What to Do with the Retirement Age). – Eesti Päevaleht, 26.2.2009. Available at <http://www.epl.ee> (in Estonian).

3.2. Enforcing additional pension schemes

Another major aspect of reform to pension insurance, in addition to that of the ageing population, is states' wish to make the population itself take responsibility for its pensions. These ideas have served as the basis for the Estonian pension reform^{*21}, whose components are the mandatory funded pension and voluntary funded pension.

The mandatory funded pension has to provide old-age pensioners with the chance to receive an old-age pension. Pursuant to the Funded Pensions Act^{*22} §40 (1), a person is entitled to receive a mandatory funded pension once he has reached the old-age pension age. In keeping with this requirement, the legislator has provided that if a person receives a state old-age pension, he shall also receive a mandatory funded pension, which jointly with the state old-age pension should guarantee him a pension equal to at least half of his former wages.^{*23}

An important aspect of the functioning of a mandatory funded pension system is the financing of that system. The financing of the Estonian pension system is divided between the insured person and the state. The insured person thus pays 2% of his wages into the pension fund and the state adds to that another 4% from the social tax received on the behalf of said person.^{*24} Such a financing scheme means in broad terms that 6% of labourers' earnings goes toward financing the funded pension.

The institution of the mandatory funded pension as such may raise the question of whether it is possible, constitutionally, to enforce a pension insurance scheme that is based on private insurance^{*25} and for which the state is not directly responsible.^{*26} Pursuant to the Constitution, a person shall have the right to turn to the state for assistance if the need is due to old age (§28 (2)). The Constitution does not forbid the creation of additional mandatory social security schemes in a situation where a state insurance mechanism has been ensured. Given that the State Pension Insurance Act has been adopted and functions in Estonia, the minimum requirement of the creation and existence of a state pension system, as set forth by the Constitution, has been fulfilled.

Insofar as the mandatory funded pension is a supplementary scheme created by the state, that scheme need not be administered by the state even by international standards. According to the requirements of both the European Code of Social Security^{*27} and the corresponding ILO convention, pension systems should be administered by public institutions. However, neither the European Code of Social Security nor ILO Convention 128 prohibits the creation of supplementary private pension schemes. The mandatory funded pension is a pension type that is primarily intended to supplement and support state pension insurance. By means of this system, the state is able to show that it has fulfilled its duty to maintain the pension system at the required level, but, at the same time, no international requirements have been set for mandatory funded pension systems.

The state, therefore, is free to create additional social security mechanisms and delegate the administration of such supplementary social security schemes to private persons.

The supplementary pension scheme is, however, subject to the provision for protection of property that follows from the Constitution. Pursuant to §32 of the Constitution, everybody's property is inviolable. Property may be expropriated in the public interest for a fair price in cases provided by law. Although this provision is not directly linked to social security benefits, one's years of pensionable service for social security (with the right of claim to future pension) have, in a sense, been regarded as property of the insured

²¹ The Estonian pension reform was initiated in 1999, when the social tax was transformed into an individually registered tax. The social tax is a tax by which both health insurance and pension insurance are financed. The state pension system became insurance-based as well. The last stage of the pension reform took place in 2002, when regulation on mandatory funded pension as well as voluntary funded pension entered into force. See Monetary Developments & Policy Survey: Estonian Pension Reform and its Implications on Balanced Budget. Bank of Estonia 2003. Available at http://www.eestipank.info/pub/en/dokumendid/publikatsioonid/seeriad/ylevaade/_2003_01/_2003_01/_2mar_taust.pdf?ok=1.

²² Kogumispensionide seadus. – RT I 2004, 37, 252; RT I 24.3.2011, 1 (in Estonian).

²³ For information on mandatory funded pension, see <http://www.pensionikeskus.ee>.

²⁴ The percentage of social tax collected into the budget of state pension insurance is 20% of the wage fund paid by the employer. The rate of social tax as a whole is 33%, of which 13% is collected into the health insurance budget.

²⁵ Different pension funds responsible for the mandatory funded pension are essentially private investment funds.

²⁶ It should be added that both the European Code of Social Security and ILO Convention 128 include the principle that if the old-age benefit is not ensured by a public institution, representatives of public authority shall participate in the activity of said institutions.

²⁷ European Code of Social Security Article 71, ILO Convention 128, Articles 35 and 36.

person.^{*28} Accordingly, these years of pensionable service cannot be taken away from the insured person or reduced without fair compensation being offered in return.

In order to reduce the budgetary expenses of the state and taking into account the unstable economic situation, the Estonian state decided in 2009 to no longer contribute to the mandatory funded pension.^{*29} That decision was based on the need to prevent the under-financing of state pensions and to avoid a situation in which the state is unable to fulfil its Constitutional obligation to ensure protection to people in their old age. Such a decision, with which the state unilaterally withdraws from financing the social security scheme, can legally be considered violation of an agreement between the state and an individual. At the same time, one may ask whether this behaviour by the state was justified or not.

Here it must be pointed out that the decision of the Estonian state to stop making payments to the mandatory funded pension fund is of a temporary nature; in other words, the payment of state contributions has not been terminated but was suspended until 1 January 2011. The state has also provided for a certain compensatory mechanism, according to which state contributions will be restored step by step, then, in a later phase, the state will compensate for the uncollected amounts at a higher percentage rate. While the rate normally is 4%, it will become 6% after some time.^{*30} So it seems, at first sight, that no expropriation of property has occurred in the mandatory funded pension system.

However, expropriation of property may be seen as occurring in the mandatory funded pension system if the state were to fail, for whatever reason, to resume its payments into the mandatory funded pension fund after 1 January 2012. In that case, persons who have voluntarily continued to make contributions to the mandatory funded pension fund would be entitled to file a claim against the state, since the state, by promising to resume making contributions to the mandatory funded pension fund at a certain time and then failing to do so, would be breaching its promise and violating the legal expectation of future pensioners to receive a supplementary pension.

4. The right to health protection and health insurance

Health insurance benefits are divided into two kinds. On the one hand, health insurance is used for providing health services; at the same time, the health insurance system is intended to provide benefits in the event of temporary incapacity for work.

4.1. Payment of benefits in cases of temporary incapacity for work

Although the Constitution of the Republic of Estonia does not prescribe that a person must be provided with assistance through the health insurance system in cases of illness, §28 (2) of the Constitution provides that a person is entitled to state assistance in the event of need. Pursuant to the notes added to the Constitution, need primarily signifies a person's right to social assistance here^{*31}, but at the same time the Constitution leaves open the possibility of regarding as need also other situations wherein the person loses his income and as a result must receive social-security-related benefits.

Up to 30 June 2009, benefits responding to temporary incapacity for work were paid through the Estonian Health Insurance Fund.^{*32} From 1 July 2009, the payment of benefits for those with temporary incapacity for work has been distributed between the employer and the Health Insurance Fund: for the first eight days of sickness, liability for maintaining income has been transferred from the Health Insurance

²⁸ M. Cousins. *Social Security as a Possession*. – The European Convention on Human Rights and Social Security Law. Intersentia 2008, pp. 17–45.

²⁹ Kogumispensionide seaduse ja sotsiaalmaksuseaduse muutmise seadus (Act for the Amendment of Funded Pensions Act and Social Tax Act), §1. – RT I 2009, 26, 161 (in Estonian); see also L. Leppik. II pensionisamba külmutamine ei ole ainus võimalus (Freezing the 2nd Pension Pillar is Not the Only Option). – ERR News, 6.4.2010. Available at <http://uudised.err.ee/index.php?06160447> (9.10.2011) (in Estonian).

³⁰ In 2011 state pays 2%, in 2012–2013 state pays 4%, 2014–2017 state pays 6%. Since 2018 the normal system 2+4 will be restored. See <http://www.pensionikeskus.ee/?id=3006>.

³¹ Põhiseadus: kommenteeritud väljaanne (Note 7), §28 comment 10.4.4.

³² The Estonian Health Insurance Fund is a legal person in public law that is responsible for health services and the payment of benefits for temporary incapacity for work.

Fund to the employer. With this amendment, the labourer is deprived of health insurance benefits for the first three days; for sickness days 4–8 the employer shall pay the labourer a benefit that equals 70% of the labourer's average wages, and on day 9 the Health Insurance Fund takes over the obligation to pay health insurance benefit. The reason behind this amendment is the determination to reduce the expenses of the Health Insurance Fund related to the amounts of benefits paid for temporary incapacity for work. However, the matter of payment of health insurance benefits for days 4–8 on the employer's account has, in the main, so far been only partially resolved.^{*33}

Pursuant to the Occupational Health and Safety Act^{*34}, the employer is given the same rights as the Health Insurance Fund in some cases (§12²), but the realisation of these rights remains unclear. One problem, for instance, is the right of the Health Insurance Fund to refuse to pay the benefit for those with temporary incapacity for work if the temporary incapacity for work developed while the worker was in an intoxicated state.^{*35} Since the Health Insurance Fund has been given the right not to pay the benefit in question in that case, the same right is provided to the employer. The employer may, therefore, refuse to pay the benefit if the certificate of temporary incapacity for work^{*36} states that the insured person was in a state of intoxication. If the insured person nevertheless wishes to receive money in compensation, he needs to turn to the county court (civil court) to settle the dispute.^{*37}

The right of the employer to check the legality of issue of a certificate of temporary incapacity for work might also prove problematic. Under §60 (2) of the Health Insurance Act, the Health Insurance Fund is entitled to delay the payment of benefits related to temporary incapacity for work by up to 30 days if there is suspicion that the certificate of incapacity for work may not have been issued properly. The Health Insurance Fund has been given this right in order to prevent abuse of the Health Insurance Fund's resources, but it remains unclear to what extent an employer might or could exercise this right and delay the payment of health insurance benefits.

The basis for calculation of the benefit differs as well—the Health Insurance Fund calculates the benefit on the basis of the previous year's income taxed with social tax, whereas the employer must pay a benefit to the labourer at the rate of 70% of his average wages.^{*38}

Obliging the employer to pay benefits to a labourer at a time when the labourer is unable to fulfil his duties is not by nature in contradiction with the Constitution or with social security in general, but the duties and rights entailed with respect to it must be specified. At present, it can be said that the situation analysed above does not provide the labourer with a sense of security about the extent to which the employer can refuse to pay the benefit for sickness days 4–8, and the employer's situation is not clear either, because the employer's authority in the payment of this benefit has not been explicitly defined.^{*39}

³³ Increasing the liability of the insured person is not an issue. Both the European Code of Social Security and ILO Conventions allow not paying benefits to the insured person during the first three days.

³⁴ Töötervishoiu ja tööohutuse seadus. – RT I 1999, 60, 616; RT I, 2010, 31, 158 (in Estonian).

³⁵ Ravikindlustuse seadus (Health Insurance Act), §60 (1) 2). – RT I 2002, 62, 377; RT I, 10.06.2011, 7 (in Estonian).

³⁶ Certificate of temporary incapacity for work is a document issued by a physician that certifies the insured person's temporary incapacity for work.

³⁷ However, if the Health Insurance Fund refuses to pay benefits, the labourer may turn to administrative court. It is therefore theoretically possible that the insured person must simultaneously turn to two courts to receive benefits, in order to convince both the employer and the Health Insurance Fund that there is no causal relationship between the intoxicated state of the insured person and the temporary incapacity for work.

³⁸ In addition to this problem, the nature of the benefit paid by the employer poses a specific problem: should it be regarded as wages or as health insurance benefit? The difference lies in the fact that health insurance benefits are not subject to social security tax, whereas any sums that the employer pays on the basis of the employment contract of the labourer are also to be taxed with social security contributions.

³⁹ In his statement to the Estonian Employers' Confederation, the Chancellor of Justice has also reached the conclusion that the new regulation contradicts §12 of the Constitution, namely that the principle of equality before law has been violated, but also §§13 and 14 of the Constitution, which provide the principle of legal clarity. That means, above all, that if the state has established certain rules, these rules must be clear to the appliers of these rules. See: Õiguskantsleri märgukiri (Memorandum of the Chancellor of Justice) 10.9.2010. Available at <http://www.oiguskantsler.ee> (in Estonian) (9.10.2011). Although the Chancellor of Justice has in principle expressed the opinion that the procedure for the payment of these benefits is unconstitutional, no amendments have so far been made in Estonian laws and employers are still obligated to pay benefits pursuant to §12 (2) of the Occupational Health and Safety Act.

4.2. Financing of health insurance

In order for the right to health protection to be ensured for every person, it is important that the financing of health insurance be ensured as well. In the Estonian health insurance system, those covered by health insurance include persons who pay health insurance contributions or who have been equated with insured persons for social reasons. The Estonian health insurance scheme has been founded on financing that is based on the principle of solidarity. In accordance with that principle, the health insurance scheme is financed only from the sums collected from insured persons. In Estonia, as in other Member States of the European Union, the percentage of elderly people is on the rise.^{*40} Because of that trend, the number of people who are able to finance a social security system based on the principle of solidarity is growing smaller. In the longer term, this will lead to a situation wherein Estonia is unable to provide health insurance because there are not enough people who are able to finance this system. As a result, the Constitutional requirement that each person have access to health protection will not be satisfied. Although the Constitution does not specify that it is the state, in particular, that needs to ensure health protection and in no other form than health insurance, the state's obligation to guarantee health services remains. A study published in March 2010 clearly indicated that the current Estonian health insurance financing scheme is not sustainable and also endangers the principle mentioned in §28 (1) of the Constitution.^{*41} In order to find a solution to this problem, the 'future concept'^{*42} prescribes four distinct approaches:

- 1) expanding the revenue base of the public sector and bringing additional revenues to the health system—i.e., state contribution to the providing of health insurance must increase;
- 2) changing the scope of insurance cover with respect to the right to health insurance, the range of benefits, and elements of cost-sharing (application of this requires reduction of the number of persons equated with insured persons, as well as an increase in cost-sharing by the insured person^{*43});
- 3) making the management of budgetary resources more efficient;
- 4) strengthening the strategic management of the health sector.

4.3. Ensuring health insurance for everyone

Subsection 28 (1) does not prescribe that health insurance should extend to all persons. According to Health Insurance Fund statistics^{*44}, 1,216,000 residents of Estonia were covered by health insurance as of 31.12.2010. Given that Estonia's population totals 1.34 million people, this means that about 80,000 people in Estonia currently have no health insurance cover. Accordingly, the question of how and on what conditions these 80,000 people may exercise the right to health protection as well has become the main concern of the Estonian state. In the current discussion^{*45}, there is no clear consensus that these 80,000 people should gain full protection in the health insurance system, but an opportunity to ensure at least first-contact care, or access to family physicians, is being sought. Since the Estonian health insurance system is based on the Bismarck model, the system includes from the start the principle that health insurance is provided only to those who finance that system. As mentioned above, this system also benefits certain persons who do not finance the system themselves. At the same time, Estonia has not made a clear decision that the right to health care should be universal and that all persons in Estonia should be able to realise that right.

⁴⁰ A. Maamägi. Eesti võimalik rahvaarv ja vanuskoosseis aastani 2050 (Potential Population and Age Distribution of Estonia up to Year 2050). Available at <http://www.stat.ee/rahvastikupyramiid> (in Estonian) (9.10.2011).

⁴¹ Responding to the challenge of financial sustainability in Estonian's health system (Note 10).

⁴² *Ibid.*

⁴³ Considering that the rate of cost-sharing is already high enough, i.e., in addition to the sums collected into the health insurance budget, persons need to cover an additional ca 26%, the application of this principle is not realistic.

⁴⁴ See www.haigekassa.ee.

⁴⁵ See: G. Härmsalu, K. Palu, P. Talpsepp. Ravikindlustusega hõlmamata isikute olukord Eesti Vabariigi kohalikes omavalitsustes. Õiguskantsleri kantselei 2009 (Situation of Persons without Health Insurance Cover in the Municipalities of the Republic of Estonia. Office of the Chancellor of Justice 2009). Available at <http://www.oiguskantsler.ee> (9.10.2011) (in Estonian); Ravikindlustuseta saab üksnes vältimatut abi (Only Emergency Care Available without Health Insurance). See Medistsiiniuudised <http://www.mu.ee/> (9.10.2011) (in Estonian).

5. Conclusions

Estonia has managed to create a social security system that covers most of the social risks included in the European Code of Social Security and ILO Convention 128. As for the only risk still not covered, Estonia has thus far not managed to create a system for occupational accident insurance and occupational disease insurance.

The Estonian Constitution also establishes the state's duty to ensure state assistance in cases of old age, incapacity for work, or loss of a provider of livelihood. At the same time, the Constitution provides a person's right to health protection. Even though Estonia is bound by the requirements of the European Code of Social Security and the European Social Charter, there are still situations wherein the state needs to make radical changes in the social security system, both for practical reasons and due to economic situation. Although such changes may not go against international requirements, they might be in violation of the Constitution (e.g., §28 (1) of the Constitution's right to health protection or the Constitution's §32's inviolability of property). As a result, we can say today that the changes made for the purpose of achieving economic welfare may entail a danger of direct violation of the social-security-related requirements guaranteed to members of the public.



Annika Talmar-Pere
LL.M., Researcher
Estonian Academy of
Security Sciences



Raul Narits
Professor
of Comparative Jurisprudence
University of Tartu



Aare Kasemets
Head, Better Regulation and
Security Research Group
Estonian Academy of Security Sciences

Applying the Concept of Better Regulation to Internal Security Policy

In line with contemporary understanding of the state based on the rule of law, law is practically the only means available to a state by which it can and is entitled to order human behaviour. At the same time, the state as a sovereign entity is competent to decide on the area of human reality that it wishes to regulate by legal rules. Likewise, it is for the state itself to decide what the respective (normative) order should look like in its ideal.

This article concentrates on the ordering by rules of the internal security of a state as an absolutely important area of practical reality. In adopting this emphasis, we are interested less in the content of the respective legal rules than we are in the problems related to the application of the principles of better regulation where the ordering of the area of internal security is concerned. The subject matter is of vital importance for Estonia as the ministries responsible for internal security and the respective legal regulation—the so-called internal security law—are facing certain difficulties in meeting the requirements set forth by the principles of better regulation.*¹

The authors are of the opinion that better regulation, or, primarily, following of the requirements of better regulation does not replace but rather complements political decision-making. It is precisely because of that supportive function that the link between the main instruments touching upon the area of internal security policy in Estonia and the implementation of the respective policies has to be recognised. As indicated above, this implementation is possible only by and with the aid of legal rules and other utterances of law. Approaching the problem from that perspective, one can establish the necessary connection between that contained in the instruments of internal security policy (i.e., concepts, measures, means of governance, etc.), and the principles of better regulation in the legislative process at both national and EU level.*²

In this article, the essence of better regulation, the main features of internal security in the context of the actual state of internal security of Estonia, and the implementation side of better regulation with an emphasis on the internal security policy instruments of Estonia shall be discussed.

¹ A. Kasemets. Lõhe õigusloome normide ja faktide vahel mõjude hindamise ja huvirühmade kaasamise teabe esitamisel (The Gap between Law-making Norms and Facts (1998–2009) in the Field of Impact Assessment and Civic Engagement). – Riigikogu Toimetised 2009 (19), pp. 104–115 (in Estonian).

² In order to refer to problematic areas as regards rule-making in the field of internal security, the authors use the concept of 'selective compliance with the rules of rule-making' throughout the text. The term in itself implies certain problems in this area.

1. Better regulation

1.1. The concept of better regulation

In the last few decades, governments in most well-developed Western countries have made increasing efforts to improve the quality of legislation by means of various 'better regulation' (hereinafter referred to as the BR) programmes.^{*3} Better regulation as a concept lacks a universal definition and therefore serves as an umbrella term to cover a myriad of initiatives, such as deregulation, reducing the administrative burden, improving the quality of impact assessment, reducing the quantity of legislation, and simplification.^{*4}

According to C. Radaelli, better regulation is a *process* addressing the whole life cycle of the regulations, laying down general rules for determination, assessment, enforcement, implementation, and *ex post* assessment of legal rules. Consequently, the guidelines for better regulation may embrace a vast array of measures, including simplification of administrative procedures, consolidation of legal acts, alleviation of the administrative burden, use of market-friendly alternatives, risk-based review, funds allocated for rule-making, standards for consultation of interest groups, assessment of the sustainability of the existing as well as of the new regulation, and *ex post* review of the effects. Of the elements of the better regulation 'package', regulatory impact analysis (hereinafter referred to as the RIA) has to be regarded as the most important.^{*5}

RIA is a set of procedures to be followed in order to appraise regulation. It can be used both *ex ante* (i.e., at the stage of policy formulation, to appraise proposals) and *ex post*. It typically revolves around the steps of problem definition, the identification of a range of options, consultation, the classification of costs and benefits, a plan for monitoring and review, and the choice of an option on the basis of certain decision-making criteria (such as cost-effectiveness, minimisation of the administrative burden, cost-benefit analysis ratios, or thresholds).^{*6}

The fact that RIA has been considered the most important element of BR programmes might be explained by the strong instrumental view of legislation, which is the predominant way of understanding the role and functions of regulation for politicians, within governmental bureaucracies, and also for most stakeholders. First and foremost, legal regulations are simply understood as means for those in power to achieve the desired goals. Therefore, the outcome of regulation is currently perceived as the basic issue, linked to the quality of legislation, and not, for example, the question of the legitimacy and justification of the government for intervening in the behaviour of ordinary people or companies.^{*7} But it also has strong potential in terms of evidence-based policy, accountability, and transparency of policy formulation processes. RIA is a general procedure applicable to a large number of initiatives, from proposals for new legislation coming from the government to departmental/ministerial regulation (such as statutory instruments in the UK) and rule-making delegated to independent agencies.

In most countries, the RIA is carried out by the government, not by Parliament, but MPs and also state audit offices, interest groups, etc. outside Parliament are among the users of RIA-related information, since it assists in describing the socio-legal problems, alternatives, and consequences of policy and legislation. It should also be noted that discussions of RIA are only beginning to rise from governmental to parliamentary level as far as parliamentary functions, such as representation, legislation, and supervision of the executive power, are concerned.^{*8}

In pursuit of reaching the ultimate goal of uniform quality in legislation at the national, regional, and international level, drafters and commentators in both the civil and common law systems have turned to compilations of principles of drafting that could lead to consistently successful legislation.^{*9} On the inter-

³ J. Tala. Better regulation through programs and quality standards—are new perspectives needed? – *Legisprudence* 2010, p. 193.

⁴ L. Clapinska. Post-Legislative Scrutiny of Legislation Derived from the European Union. – *European Journal of Law Reform* 2007, p. 343.

⁵ C. M. Radaelli. Regulating Rule-Making via Impact Assessment. – *Governance* 2010/1, p. 90.

⁶ OECD. Policy Recommendations on Regulatory Reform. Regulatory Impact Analysis: Best Practices in OECD Countries. OECD/PUMA, Paris 1997; OECD Sigma. Regulatory Management Capacities of New EU Member States, Paris 2004.

⁷ J. Tala (Note 3), pp. 203–204.

⁸ A. Kasemets. Impact Assessment of Legislation for Parliament and Civil Society: A Comparative Study. (22 countries). Proceedings of ECPRD seminar. Riigikogu Kantslei. Tallinn 2001.

⁹ H. Xanthaki. Drafting Manuals and Quality in Legislation: Positive contribution towards certainty in the law or impediment to the necessity for dynamism of rules? – *Legisprudence* 2010, p. 112.

national scene of regulation, the Organisation for Economic Co-operation and Development (hereinafter referred to as the OECD) has since the beginning of the 1990s had the leading role in enhancing principles and ideas of BR and quality standards for regulation. The OECD has been able to collect experiences and research data from its member countries, on the basis of which it has formulated programmes, recommendations, and policy guidebooks for the member countries for the successful adoption and implementation of RIA.^{*10}

In the European Union, the subject matter of better regulation began being considered more intensely after the analysis carried out by the OECD in the area of regulatory reforms in the Member States^{*11}, and the Lisbon (European Council) Summit where the high-level advisory group chaired by M. Mandelkern (hereinafter referred to as the Mandelkern Group) was formed. The Mandelkern Group Report, serving as the first agreement aimed at better regulation on the European Union level, includes seven recommendations aimed at achieving better regulation: 1) considering the full range of options regarding policy implementation; 2) regulatory impact assessment; 3) consultation with interested parties; 4) simplification; 5) better access to regulation; 6) dealing with the respective supporting structures and co-ordination, and 7) effective implementation of European regulation.^{*12}

Newer Member States have been encouraged, and indirectly requested, to pass legislation on drafting laws as a means of responding to the European Commission's insistence that implementation of the *acquis* for the purposes of accession means correct implementation of EU law with national transposition measures of good quality.^{*13}

In Estonia, the training and other development measures to build the conditions needed for better regulation and regulatory impact assessment were initiated in co-operation with the OECD in 1998.^{*14} Given the experience of OECD and EU Member States in the 1990s, there is no reason to think that good law-making and governance practices will start to function without political commitment in regulatory policy, methodological guidelines, systematic training, and basic surveillance mechanisms.^{*15} To respond to those problems and to harmonise the processes and terminology of impact assessment, the concept of regulatory impact analysis was developed at national level in Estonia by the Ministry of Justice in 2007–2009 and the Development Plan for Legal Policy until 2018 was adopted by the Riigikogu (Parliament) on 23 February 2011. It should be emphasised that now Estonia belongs to the OECD family of better regulation.^{*16}

1.2. Problems in the application of better regulation

But why should politicians, civil servants, and different stakeholders be interested in better regulation? One potential function of BR programmes and quality standards for legislation could be that following them increases the legitimacy and acceptance of the proposed rules.^{*17} These, in turn, are preconditions for a state based on the rule of law. The legitimacy of rules is especially crucial in internal security policy because here the rules directly constrain people's constitutional rights.^{*18} It is worth mentioning here that many of the security-related policy documents described below emphasise the importance of the rule of law in Estonia.

¹⁰ J. Tala (Note 3), p. 197; OECD. Building an Institutional Framework for Regulatory Impact Analysis (RIA): Guidance for Policy Makers. Paris 2008.

¹¹ OECD. Reducing the risk of policy failure: Challenges for regulatory compliance. Paris 2000. Available at <http://www.oecd.org/dataoecd/23/37/46466287.pdf> (5.4.2011).

¹² Mandelkern Group on Better Regulation. Final Report. 13 November 2001. Available at http://ec.europa.eu/governance/better_regulation/documents/mandelkern_report.pdf (5.4.2011).

¹³ H. Xanthaki (Note 9), p. 121.

¹⁴ See for example M. Ben-Gera. Impact Assessment: Role, Procedures, Methods and Good Practices in OECD and CEE Countries. – Society, Parliament and Legislation. A. Kasemets *et al.* (eds.). Tallinn: Riigikogu Kantslei 1999, pp. 27–35.

¹⁵ A. Kasemets. Teadmistepõhise ning säästva poliitika institutsionaalsed eeldused Eestis (The Institutional Preconditions for Knowledge-based and Sustainable Politics in Estonia). – Riigikogu Toimetised 2006 (14), pp. 152–160 (in Estonian).

¹⁶ Justiitsministeerium. Õigusaktide mõjude analüüsi süsteemi üldkirjeldus. Õiguspoliitika osakond (Ministry of Justice. General Description of impact assessment system. Legislative Policy Department), 2008. Available at <http://www.just.ee/41314> (5.4.2011) (in Estonian); Õiguspoliitika arengusuunad aastani 2018 (Development Plan for Legal Policy until 2018). – RT III, 7.3.2011, 1 (in Estonian).

¹⁷ J. Tala (Note 3), p. 207.

¹⁸ D. Bigo, S. Carrera, E. Guild, R. Walker. The changing landscape of European liberty and security. – International Social Science Journal 2008/59, pp. 283–308.

Therefore, if a gap exists between the principle of rule of law and actual better regulation measures (impact assessment, civic engagement, simplification, etc.), it indicates serious problems in governance, because without regulatory impact assessment information, it is difficult to talk about knowledge-based and responsible law-making and public administration.^{*19}

Jyrki Tala points out another risk is BR—namely, that genuine, formal decision-makers in the law-making process (the politicians) are left almost completely outside any BR activities:

The borderline between law drafters and policy planners on the one hand and the political decision makers, responsible principally to their electors on the other, is sharply maintained. Of course, the courts are also left outside the scope of BR measures, when developing the content of the legal system by means of decisions in single cases.^{*20}

Correspondingly, the man on the street, often the main target of the regulation, obviously has very little say in those processes.^{*21} Thus bad implementation and bad judicial application may interfere with the results of BR. The extent of the margin for incorrect implementation and judicial application is directly linked to the quality of the draft legislation, of course, but it is possible that the error in the draft may be attributed to a fault in the content of the policy pursued or in the calculations in the regulatory impact assessment made for the allocation of resources for implementation.^{*22}

In most European countries, the analytical information on social, budgetary, economic, environmental, and administrative objectives and impacts of proposed legislation has to be given in an explanatory memorandum (in note or letter form) accompanying the draft law. The explanatory memorandum on the draft law is (and indeed has to be) a normatively structured legal document that includes the results of socio-legal impact assessment and public consultations.^{*23} If the draft law is not accompanied by impact assessment documentation, the legislator cannot vow and declare that the new law is in conformity with the rule of law or the constitutional norms.

Even more, if the target groups and effects on their lives are not specified in the memoranda, the EU better regulation assessment principles cannot be applied. The Mandelkern Group Report's principles describe a comprehensive overall approach with a set of seven core principles: necessity, proportionality, subsidiarity, transparency, accountability, accessibility, and simplicity.^{*24} In Estonia, those principles are further supplemented by legality, legal certainty, openness, and responsibility.^{*25}

The same applies *a fortiori* to internal security regulations, for the reasons described above.

And, naturally, the task of analysing the impact of legislation would go partly uncompleted if it were not followed by specific activities to enhance the quality of legislation by various methods (such as simplification and/or codification).^{*26} For example, the UK Better Regulation Task Force, which was set up in 1997, recommends that a rolling programme of simplification be developed to identify regulations that can be simplified, repealed, reformed, and/or consolidated.^{*27} Regulators should undertake more frequent and better post-implementation reviews of regulation. Such reviews should assess whether the measure is working as expected, whether the costs and benefits are as predicted, whether there have been unintended consequences, and whether there is scope for simplification. The results of these reviews should feed in to

¹⁹ Rule of law, i.e., legal certainty and predictability of administrative actions and decisions, which refers to the principle of legality as opposed to arbitrariness in public decision-making and to the need for respect of legitimate expectations of individuals. Openness and transparency, accountability and efficiency are also specified as common standards for action within public administration. OECD Sigma. Preparing Public Administration for the European Administrative Space. Sigma No. 23. Paris 1998.

²⁰ J. Tala (Note 3), p. 203.

²¹ *Ibid.*, p. 205.

²² H. Xanthaki (Note 9), pp. 114–115.

²³ See for example M. Kiviorg. Õigusakti mõju ja rakendamise analüüs (Analysis of the Effect and Application of a Legal Act); – K. Merusk *et al.* Õigusriigi printsiip ja normitehnika (Principle and Normative Techniques of a State Based of the Rule of Law). Tartu: Sihtasutus Eesti Õiguskeskus 1999, pp. 19–39 (in Estonian); R. Narits. Good Law Making Practice and Legislative Drafting Conforming to It in the Republic of Estonia. – *Juridica International* 2004 (IX), pp. 4–13.

²⁴ Mandelkern (Note 12).

²⁵ Ministry of Justice (Note 16).

²⁶ R. Narits. Systematisation of Objective Law. – *Juridica International* 2005 (X), p. 164.

²⁷ L. Clapinska (Note 4), p. 339.

future policymaking and simplification proposals.^{*28} The authors of this article have similar considerations in mind concerning the internal security law in Estonia. That will be discussed in the next two parts of this contribution.

2. Internal security policy

Before any system can be developed, the definitions in it must be agreed upon. Definitions are decisive for any system because only after clarification of the definitions can norms be arranged in a uniform system.^{*29}

Defining internal security itself has proved to be a difficult task. It traditionally referred to the territorial state and its geographic borders beyond which 'inner' should become 'outer' and where security is traditionally one-dimensional, as military security.^{*30} Olivier Brenninkmeijer states that security priorities have now shifted. They encompass the prevention of crime and of illegal transnational trafficking and smuggling, the control of clandestine migration, and the fight against urban juvenile delinquency.^{*31}

The European Security Research and Innovation Forum (hereinafter referred to as the ESRIF) stated in its final report that, on one hand, its role was not to define security policy but, on the other, it aims for a common understanding of security, research, and innovation to support a more harmonised approach.^{*32} The report further assures that 'the ESRIF took a holistic approach to security, taking the widest definition of security and examining how that can be achieved regarding society itself and the freedoms we want to maintain or enhance'.^{*33}

The Internal Security Strategy for the European Union gives an overall definition: 'In this context EU internal security means protecting people and the values of freedom and democracy, so that everyone can enjoy their daily lives without fear.'^{*34} The strategy also emphasises the importance of a broad-based approach to the concept of security:

The concept of internal security must be understood as a wide and comprehensive concept which straddles multiple sectors in order to address these major threats and others which have a direct impact on the lives, safety, and well-being of citizens, including natural and man-made disasters such as forest fires, earthquakes, floods and storms.^{*35}

Defining internal security through threats posed to people and measures taken to avoid these threats is quite common. All of the Estonian policy documents on security that are mentioned below take this approach. Internal security is not defined precisely; rather, a number of threats, activities, or actors are listed and analysed. The Internal Security Strategy also attempts to concretise the concept by describing the measures encompassed in it. A horizontal dimension of security is described: 'to reach an adequate level of internal security in a complex global environment requires the involvement of law-enforcement and border-management authorities, with the support of judicial co-operation, civil protection agencies and also of the political, economic, financial, social and private sectors, including non-governmental organisations'; also, there is a vertical dimension: 'international co-operation, EU-level security policies and initiatives, regional co-operation between Member States and Member States' own national, regional and local policies.'^{*36}

^{*28} Better Regulation Task Force, Regulation—Less is More. Reducing Burdens, Improving Outcomes. A BRTF report to the Prime Minister. United Kingdom 2005, p. 33.

^{*29} R. Narits, *Objektiivse õiguse korraastamisest Eestis: kodifitseerimisest õiguse ümberkujundamiseni* (Systematisation of Objective Law in Estonia: From Codification to Reformation of Law). – *Riigikogu Toimetised* 2005 (12), pp. 71–79 (in Estonian).

^{*30} O. Brenninkmeijer. *Internal Security Beyond Borders: Public Insecurity In Europe And The New Challenges To State And Society*. Peter Lang Pub Inc. 2001, pp. 30–31.

^{*31} *Ibid.*

^{*32} European Security Research and Innovation Forum. ESRIF Final Report. December 2009, p. 12. Available at http://www.esrif.eu/documents/esrif_final_report.pdf (5.4.2011).

^{*33} *Ibid.*, p. 11.

^{*34} Council of the European Union. *Internal Security Strategy for the European Union*. Brussels. 25.2.2010. 6870/10 (Presse 44).

^{*35} *Ibid.*

^{*36} *Ibid.*

The notion of security, particularly as related to the expression 'internal security', has become increasingly diversified also in the sense of both the overall security that the state offers to society and the feeling of personal safety of the citizen. It contrasts with what used to be major security concerns of both state and citizen—namely, external aggression by a foreign power. Rather than that, internal security is now considered to encompass such diverse issues as economic security, the prevention of all forms of crime and violence, and social security.^{*37}

The vice-chancellor of the Ministry of the Interior, Erkki Koort, categorises a problem as being part of internal security if a certain act brings with it danger to people's life and health.^{*38} In today's Europe, those acts are considered to consist of terrorism, serious and organised crime, drug trafficking, cyber-crime, trafficking in human beings, sexual exploitation of minors and child pornography, economic crime and corruption, trafficking in arms, and cross-border crime.^{*39} As we can see, many of those cannot be considered merely internal threats. This might be one of the reasons it is so hard to separate the 'internal' from 'external security (i.e., security from defence) and give a clear definition to both. As the internal security strategy action plan states, '[i]nternal security cannot be achieved in isolation from the rest of the world, and it is therefore important to ensure coherence and complementarity between the internal and external aspects of [EU] security'.^{*40}

Three common factors can be found in the attempts made to define internal security: 1) it must be seen as a wide and comprehensive concept; 2) it cannot be looked at separately from the 'outer' security, and 3) it involves an increasingly diversified situation. Regardless of such specification, a uniform definition clearly has not formed yet.

3. Better regulation and internal security

In the view of the authors of this contribution, better regulation is especially important in the field of internal security. Rules concerning people's security, their rights and obligations toward a state, and infringements of their constitutional rights must be very clear and thoroughly analysed. We will now turn to some of the key policy documents of Estonian internal security in order to find out whether or not they embrace the concept of better regulation. Policy documents are analysed because they form the basis for ministerial measures in internal security—including legislation, planning, and allocation of funds. If better regulation is not included on that level, it cannot be transformed into knowledge-based draft legislation procedures, adequate laws, or an effective internal security policy.

We can find some minor pieces of comparative research on implementation of better regulation tools in the field of internal security regulation and regulatory management. Three policy documents are analysed here. The analysis focuses on whether and to what extent better regulation guidelines are related to the concept of internal security policy and to its objective and methods.^{*41}

The National Security Concept of the Republic of Estonia (2004) specifies that:

Estonia's Internal Security Policy encompasses the functions of the state's internal security agencies and the general structure of the system as well as participation in activities ensuring international security. The main functions of the Internal Security Policy, for achieving the goal of the National Security Policy, are the ensuring of domestic stability and the protecting and saving of human lives.

The importance of government based on the rule of law is also emphasised, but the policy process and better regulation concept as a precondition for a sustainable policy process is not mentioned in the document.^{*42}

³⁷ O. Brenninkmeijer (Note 30), p. 42.

³⁸ E. Koort. Siseturvalisus või sisejulgeolek (Internal Safety or Internal Security). – L. Tabur, E. Koort (eds.). Turvalisuspoliitika 2010 (Safety Policies 2010). Tallinn 2010, pp. 39–43 (in Estonian).

³⁹ Internal Security Strategy for the European Union (Note 34).

⁴⁰ European Commission. The EU Internal Security Strategy in Action: Five steps towards a more secure Europe. Brussels. 22.11.2010. COM(2010) 673 final. Parenthesis added.

⁴¹ Mandelkern Group on Better Regulation Final Report (2001). Available at http://ec.europa.eu/governance/better_regulation/documents/mandelkern_report.pdf (5.4.2011).

⁴² Eesti Vabariigi julgeolekupiitika alused (The National Security Concept of the Republic of Estonia). – RT I 2004, 49, 344 (in Estonian). Available at <http://www.vm.ee/?q=node/4107> (5.4.2011).

The Main Guidelines of Estonia's Security Policy Until 2015 develops this policy further and 'specifies the standard principles, vision, directions and long-term effect-based objectives of the security policy—principles which must be adhered to, and objectives which must be facilitated by the public sector, non-profit sector and the private sector'. Three policy planning phases are described in the definition of security policy—development, improvement, and implementation of legal acts; development plans and activity plans with the aim of preventing threats to public order; and, in cases of a suspected threat, ascertaining and eliminating them.^{*43}

This is amended by the definition of security:

[A] social state of affairs which is created with the help of many, which allows individuals to feel protected, and which ensures a truly safe living environment by reducing the probability of hazardous situations as well as enhancing the ability to react to threats and alleviate the damage caused by realisation of the threat.

The generally accepted principles of involvement of stakeholders and public consultations are also stressed as a method for preventing deviant behaviour, which is a positive step toward better regulation.^{*44} Some guidelines for impact assessment, involvement, and better regulation are specified in the implementation-related parts of the policy document, but their emphasis remains on the implementation of said policy itself, not its quality as a whole.

The Development Plan for the Ministry of the Interior for 2011–2014 states that the field of internal security encompasses the creation of an internal security policy that is composed of crisis management, rescue, migration, border guard, law enforcement, and criminal justice policies and also internal security education.

Better regulation concepts and activities are not included in the body of this document, in spite of the fact that more 'effective and transparent processes' are foreseen as one of the objectives of it. However some of the concepts—e.g., consultations, risk analysis, and administrative burden—are mentioned in the annexes ('Overview of the current situation') to the document.^{*45}

The analysis confirms that better regulation guidelines are not systematically integrated with the concept or development measures for internal security policy. They are, however, occasionally mentioned in annexes or background information. Unlike equivalent work of many other ministries in Estonia, the Development Plan of the Ministry of Interior does not include a special portion on organisational development measures, where better regulation guidelines usually belong.

Therefore, it is too early at this stage to speak about systematic implementation of better regulation guidelines in the context of internal security. Some significant improvements have been made in recent years, but the importance of the quality and sustainability of the whole policy process is still not emphasised enough.

The question of institutional analysis is this: At what level do the factors precluding the implementation of better regulation principles in internal security policy exist? In connection to Estonia, three observations can be made: 1) There are no international obstacles, and the better regulation programmes apply to Estonia;^{*46} 2) Estonia took a step closer to the countries leading the OECD by approving the Development Plan for Legal Policy on 23.2.2011;^{*47} and 3) the application of better regulation principles depends greatly on the choices made by vice-chancellors and departments, and on their values, work routines, and understandings of the better regulation policy.^{*48}

It seems therefore that political commitment in relation to the principles of good legislation is one of the most important conditions for introducing the methods of RIA. To be useful, impact assessment should be institutionally linked to decision-making and the creation of laws. The White Paper on European

⁴³ Eesti turvalisuspoliitika põhisuunad aastani 2015 (Main Guidelines of Estonia's Security Policy until 2015). – RT I 2008, 25, 165 (in Estonian). English text available at <http://www.siseministeerium.ee/29744/> (5.4.2011).

⁴⁴ Kaasamise hea tava (The Good Practice of Public Participation). Available at <http://www.valitsus.ee/et/riigikantslei/valitsuskommunikatsioon/kaasamine/kaasamise-hea-tava> (5.4.2011) (in Estonian).

⁴⁵ Siseministeeriumi valitsemisala arengukava 2011–2014 (The Development Plan of the Ministry of Interior 2011–2014). Available at <http://www.siseministeerium.ee/17410/> (5.4.2011) (in Estonian).

⁴⁶ Mandelkern (Note 12), OECD (Note 10).

⁴⁷ See Note 16.

⁴⁸ A. Kasemets. Teadmistepõhise ning säästva poliitika institutsionaalsed eeldused Eestis (Institutional Prerequisites of Knowledge-based and Sustainable Policy in Estonia). – Riigikogu Toimetised 2006 (14), p. 154 (in Estonian).

Governance (2001) also raises the important question of political will: 'Carrying these actions forward does not necessarily require new Treaties. It is first and foremost a question of political will.'⁴⁹

Another problem worth mentioning is the absence of a consistent definition of internal security policy in Estonia, which probably precludes effective communication between the political-administrative and operational management and also affects consultation with target groups. This could lead to much worse results when action is needed urgently.

Correspondingly, the actual laws of internal security cannot be of the best possible quality. Mapping of Estonian regulations in the field of internal security reveals that there are roughly 150 relevant laws in force today.⁵⁰ This is an overwhelming quantity in light of the fact that almost all of these laws have 'lower' (implementing) acts as well. This mass of laws and regulations taken as a whole is deemed the law of internal security today, but such situations are not new or recently developed. As French scholar E. Catta states, many deficiencies exist in the laws of virtually every state today. Chief among these are overabundance (usually it is unclear how many laws there are in any given state), pileup of laws (usually the legislator does not summarise former laws or abolish the contradicting, excessive, or expired and therefore useless text), and instability (many laws or even paragraphs are changed several times in a year).⁵¹ All of these deficiencies seem to be found in Estonian internal security law.

Problems such as these can be solved through the better regulation instruments enumerated above. Along with these instruments, Catta suggests a few practical steps: 1) compilation: the grouping of texts by subject area, or in chronological order; 2) consolidation: amendments being inserted in the initial law to achieve a uniform and up-to-date work; and 3) codification: use of the previous two solutions to classify norms and integrate them by areas of law.⁵²

The Development Plan of the Ministry of the Interior for 2011–2014 and the Main Guidelines for Estonia's security policy until 2015 foresee the codification in the area of crisis management.⁵³ But it is of vital importance to map out the whole internal security area before work is started on codifying a specific part of it. If an overall analysis is not conducted, the codification will probably have gaps and contradictions in it.

In light of the imperfections described above that internal security law faces, the authors suggest systematising this field of law. Systematising objective law is not merely a technical task. Systematisation of legal provisions creates and develops the system of concepts that frames all legal thinking—including clarification of the content of legal provisions. In its final stage, systematisation of objective law is an essential tool in implementing the rule of law as an idea in applied form. It is, therefore, not correct to reduce codification as a traditional element of systematising legal provisions to mere compilation of a code from different parts of a legal order or set of laws.⁵⁴ The aim in codification is, above all, to create legal certainty and clarity by making it easier for those applying the law to find the necessary regulation and providing a more general view of the applicable law.⁵⁵

The Development Plan of the Ministry of Justice of the Republic of Estonia that applied until 2005 stipulated as one of the main functions of the ministry the correspondence of laws to society's expectations. To that end, the development plan provided for preparations for so-called codification plans. The document included observations of the idea of, need for, and methods of codification, along with recommendations on how to codify Estonian law.⁵⁶ Unfortunately, the development plan for the next period did not include such codification plans.

The French doctrine of codification prescribes four types of codification: reformatory codification, codification of constant law, consolidation, and compilation. In the context of this article, the second type of codification proves interesting and may even be feasible in connection with internal security law. Codifi-

⁴⁹ European Commission. European Governance. A White Paper. Brussels, 25.7.01, COM(2001) 428. Available at http://europa.eu.int/comm/governance/white_paper/en.pdf (5.4.2011).

⁵⁰ See Note 45.

⁵¹ E. Catta. Kodifitseerimise ja süstematiseerimise tähtsus õige seaduse leidmise lihtsustamisel (Importance of Codification and Systematisation in Simplifying the Finding of a Correct Act). – *Juridica* 2002/9, pp. 588–589 (in Estonian).

⁵² *Ibid.*, p. 589.

⁵³ Note 45. As stated in the latter document: A general legal act will be established in the field of crisis management, organising the entire legislative basis for crisis management.

⁵⁴ R. Narits (Note 26), pp. 161–162.

⁵⁵ *Ibid.*, p. 163.

⁵⁶ *Ibid.*

cation of constant law is aimed at gathering and structuring objective law as it is, not as it should be. An overview is made of the current state of affairs that paves the way to necessary reforms.^{*57} This is systematic codification that is thematic; i.e., systems of law as well as laws and regulations that belong to the same subject field are organised in a code. A homogenous and well-integrated collection must be achieved without gaps and superficiality.^{*58} Constant law is, above all, valid, applicable law. If deficiencies exist in the law (overabundance, pileup, instability, etc.), it could be very hard to find out what constant law is.^{*59}

If the systematisation of internal security law reveals that such a uniform field of law indeed exists, common denominators in each law should be pointed out and a 'General Part' formed for internal security law.

4. Conclusions

A subtle connection exists between what is contained in the instruments of internal security policy (i.e., concepts, measures, means of governance, etc.) and the principles of better regulation in the legislative process. But analysis of the quality of draft regulations and the excessive number of laws in the field of internal security gives evidence of a lack of both *ex ante* and *ex post* systematic regulatory impact assessment.

Owing to the fact that implementation of the common principles of the Main Guidelines of the Security Policy as well as attainment of the objectives is supervised by the Ministry of the Interior, the authors offer some suggestions that could be included in the development plans in the future:

- 1) Regulatory impact assessment guidelines should be drafted for the development plans and laws in the field of internal security, to increase the analytical and administrative capacities of the ministries concerned.
- 2) In connection with the excessive quantity of laws in force in the field of internal security, an integral analysis should be conducted before any new laws are drawn up. Comprehensive systematisation and/or partial codification of law in force should be considered.
- 3) Training for civil servants should be conducted before drafting and adoption of any new laws on internal security.

In this contribution, the authors have been able to take only a glimpse at the given problem but, nonetheless, hope they have demonstrated that the connection between internal security policy and better regulation deserves further research.

⁵⁷ E. Catta (Note 51), p. 589.

⁵⁸ *Ibid.*, p. 590.

⁵⁹ *Ibid.*, p. 591.



Margus Kingisepp
Docent of Civil Law
University of Tartu



Age Värvi
LL.M., Lecturer of Civil Law
University of Tartu

The Notion of Consumer in EU Consumer Acquis and the Consumer Rights Directive— a Significant Change of Paradigm?

The word ‘consumer’ is used in various meanings in practice. The notion of consumer as it is known in law differs from the concept of consumer as used in marketing and sociology. In law, precise definition of the ‘consumer’ is essential in order to delimit the circle of persons entitled to extended legal protection in relations with traders whose position is stronger. The wider the circle of persons covered by the definition of consumer, the more extensive the scope of consumer law provisions is and the less reason there is to speak about consumer law as a special regulation concerning a narrow group of persons.

In recent years, as the EU consumer *acquis* is being systematically revised and the fundamental principles of European contract law are being drafted, the academic discussion in international legal literature has mainly been focussed on the aims and principles of consumer contract regulation.^{*1} On the other hand, the issue of determination of the circle of persons entitled to extended protection as consumers has been relatively less touched upon in the discussion hitherto. In this article the authors attempt to bridge this gap and address in greater detail the bases of the concept of consumer in the light of the changing EU consumer *acquis*. The article analyses the concept of consumer in current EU consumer *acquis* and from the perspective of Member States, in particular from that of Estonian national law. Then the impact of the recent EU consumer law initiatives on the concept of consumer is explored, relying on the new consumer rights directive adopted by the European Parliament.^{*2} For that purpose, the main bases of changes are highlighted while addressing the potential risks and challenges of implementing the law in the future.

¹ See, e.g., J. Karsten, A. R. Sinai. The Action Plan on European Contract Law: Perspectives for the Future of European Contract Law and EC Consumer Law. – Journal of Consumer Policy 2003/26; G. Howells, R. Schulze. Modernising and Harmonising Consumer Contract Law. Munich: Selliers 2009; H. Schulte-Nölke. Perspectives for European Consumer Law. Munich: Selliers 2010.

² Position of the European Union adopted at first reading on 23 June 2011 with a view to the adoption of Directive 2011/.../EU of the European Parliament and of the Council on consumer rights, amending Council Directive 93/13/EEC and Directive 1999/44/EC of the European Parliament and of the Council and repealing Council Directive 85/577/EEC and Directive 97/7/EC of the European Parliament and of the Council (P7_TC1-COD(2008)0196). Available at <http://www.europa.eu/sides/getDoc.do?type=TA&reference=P7-TA-2011-0293&format=XML&language=ET#BKMD-21>.

1. Notion of consumer *de lege lata*

1.1. The notion of consumer in current EU consumer *acquis*

In current EU consumer *acquis*, the notion of consumer has been specified separately in each adopted instrument. Thus the notion of consumer has been defined in several directives in the area of contract law^{*3}; in the area of non-contractual obligations, a ‘consumer’ has been defined in the EU producer liability directive^{*4} (85/374/EC) and, in the area of procedural law, in the regulations Brussels I^{*5} and Rome I.^{*6}

The definitions of consumer, as provided for in various EL instruments, do not entirely coincide. A majority of current EU directives defines the consumer as a natural person who, in transactions covered by the directive, is acting for purposes which are outside his trade, business or profession.^{*7}

The notion of consumer as defined in the price indication directive and the original doorstep selling directive is essentially similar, treating the consumer as any natural person who, in transactions covered by the directive, is acting for purposes that do not fall within the sphere of his commercial or professional activity. Albeit differently worded, the scope of the notion of consumer is, in essence, the same in the Brussels I and Rome I regulations, pursuant to which a consumer is a natural person who has concluded a contract for a purpose outside his commerce or profession. Article 2 (a) of the unfair commercial practices directive goes a little further and excludes from among the persons who can be regarded as having the characteristics of a consumer such persons who operate in crafts (‘is acting for purposes which are outside his trade, business, **craft** or profession’).

Thus, as evidenced above, the definitions of consumer as provided in EU legislation do not completely overlap as far as their content is concerned. Nevertheless, having analysed the notion of consumer in the current EU consumer *acquis* it can be said that most instruments describe a consumer as sharing two central characteristics:

- (a) a consumer is a natural person, and
- (b) in concluding a contract he is acting for purposes which are outside his commercial or professional activities.^{*8}

As already said, this applies to most of the legislative acts. The package travel directive^{*9} is exceptional among the other directives in that in Article 2 (4) it defines consumer as a person ‘who takes or agrees to take the package (‘the principal contractor’), or any person on whose behalf the principal contractor agrees to purchase the package (‘the other beneficiaries’) or any person to whom the principal contractor or any of the other beneficiaries transfers the package (‘the transferee’)’. Though said directive includes a definition of consumer, as do other directives regulating the area of contract law, it is clearly different from the other directives in that the notion of consumer covers not just natural persons but all other buyers of package travel, including persons who conclude a package travel contract inside their commercial or professional activities.^{*10}

³ Article 2 of the original doorstep selling directive (85/577/EEC) and Article 2 (2) of the distance contracts directive (97/7/EC); Article 2 (b) of the unfair terms directive (93/13/EEC); Article 1 (2) a) of the consumer sales directive (99/44/EC); Article 2 (e) of the electronic commerce directive (2000/31/EC); Article 2 e) of the price indication directive (98/6/EC); Article 2 (1) f) of the new timeshare directive (2008/122/EC); Article 2 (D) of the distance marketing of consumer financial services directive (2002/65/EC); Article 2 (a) of the unfair commercial practices directive (2005/29); Article 4 (11) of the new payment services directive (2007/64/EC); Article 2 (4) of the package travel directive (90/314/EEC); Article 3 (a) of the original consumer credit directive and Article 3 (a) of the new consumer credit directive (2008/48/EC).

⁴ Council Directive 85/374/EEC of 25 July 1985 on the approximation of the laws, regulations and administrative provisions of the Member States concerning liability for defective products. – OJ L 210, 7.8.1985, p. 29.

⁵ Council Regulation (EC) No. 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters. Said act replaces the Brussels I convention of 27 September 1968.

⁶ Regulation (EC) No. 593/2008 of the European Parliament and Council of 17 June 2008 on the law applicable to contractual relations (Rome I). – OJ L 177, 4.7.2008.

⁷ Such a definition can be found in the consumer sale, unfair terms, e-commerce, distance marketing of consumer financial services and payment services directives as well as in the new consumer credit directive.

⁸ M. Ebers. The notion of ‘consumer’. – H. Schulte-Nölke, C. Twigg-Flesner, M. Ebers. EC Consumer Law Compendium. Comparative Analysis, 2008. Available at www.eu-consumer-law.org/consumerstudy_part3a_en.pdf (1.7.2011).

⁹ Council Directive 90/314/EEC of 13 June 1990 on package travel, package holidays and package tours. – OJ L 158, 23.6.1990, pp. 0059–0064.

¹⁰ In transposing the directive, the Estonian legislator managed to avoid terminological confusion in Law of Obligations Act by using the term ‘traveller’ instead of ‘consumer’ in its provisions dealing with package travel contracts (§866 ff.).

1.2. The notion of consumer in Member States' law

While exploring the notion of consumer as defined in EU Member States' national law, a rather mottled picture unravels influenced by the Member States' legal traditions and facilitated by the principle of minimal harmonisation used in EU directives to date. Several Member States, such as Estonia, Germany, Belgium, Poland and others, provide for a negative definition of consumer. For example, pursuant to §2 (1) of the Estonian Consumer Protection Act^{*11} (hereinafter referred to as the CPA), consumer means a natural person to whom goods or services are offered or who acquires or uses goods or services for purposes **not related** to his or her business or professional activities. Several other Member States (e.g., Finland, Sweden) use the so-called positive method to define consumer by listing the characteristics of a consumer.^{*12}

In transposing the directives, some Member States (e.g., Hungary, United Kingdom, Cyprus, Ireland, and Luxembourg) have followed the example of the directives and incorporated the definition of consumer into each instrument transposing an EU legislative act. However, several Member States have adopted an approach to develop a general definition of consumer applicable to all of the transposed directives.^{*13}

Estonia is among those Member States which have several general definitions of consumer.^{*14} Besides the definition provided in the CPA, consumer has also been defined in the Estonian Law of Obligations Act^{*15} (hereinafter referred to as the LOA). Section 34 of the LOA sets out that for the purposes of the LOA, a consumer is a natural person who performs a transaction not related to an independent economic or professional activity. This definition does not fully overlap with that provided for in §2 (1) of the CPA. Firstly, as formulated in the LOA, a consumer is a person who **performs a transaction** and not a person to whom **goods are offered**, i.e., a person who might not enter into the transaction. However, the criterion of transaction is not necessarily the decisive constitutive element in clarifying the position of the consumer, as the LOA also sometimes uses the notion of consumer in a context where there is no transaction *per se* (e.g., LOA §99: Provision of goods or services not ordered). Another difference between §34 of the LOA and §2 (1) of the CPA is more fundamental by its nature: Namely, the definition provided in the LOA makes no reference to the *purpose* for which the consumer is purchasing or using the goods or services, but limits itself to transactions **not related** to an independent economic or professional activity. Therefore, it can be argued that LOA's definition is broader than that of the CPA and allows a much wider circle of contracts to be treated as consumer contracts. This conclusion is corroborated by earlier Estonian case-law regarding the contracts of suretyship entered into by the members of the management board of a legal person to guarantee the fulfilment of the obligations of the person. Combining §34 of the LOA and §2 (1) of the CPA, the Supreme Court has taken the view that a person who enters into a contract of suretyship due to having interest in the economic activities of the company cannot be deemed to be a consumer.^{*16} In other words, the court has found that the definition of consumer contained in §34 of the LOA should be delimited and used the definition provided in the CPA for that purpose. It is, however, true that as of 5 April 2011 this practice of the Supreme Court no longer applies to the suretyship issued by a member of the management board because, in order to improve the situation of all sureties who are natural persons^{*17}, §143 (1) of the LOA was amended so that a contract of consumer surety is a contract of suretyship where the surety is a **natural person**.

Teleological interpretation of the definition of consumer as specified in §2 (1) of the CPA leads to the conclusion that the law delimits the notion of consumer only to such a person who purchases or uses goods or services **solely** outside his economic or professional activity. For example, the Austrian and Belgian regulations follow similar principles, while several Member States (Finland, Sweden, Denmark, etc.) proceed

^{*11} Tarbijakaitseadus. – RT I 2004, 13, 86; 2010, 31, 158 (in Estonian).

^{*12} C. Joustra. Consumer Law. – A. Hartkamp *et al.* Towards a European Civil Code. Kluwer Law International 1998, pp. 143–144.

^{*13} Research Group on the Existing EC Private Law. Principles of the Existing EC Contract Law. Contract II—General Provisions, Delivery of Goods, Package Travel and Payment Services. Munich: Sellier, European Law Publishers 2009, p. 56.

^{*14} Belgium, Lithuania, Portugal and Slovakia use a similar approach. See M. Ebers. The notion of 'consumer'. – H. Schulte-Nölke, C. Twigg-Flesner, M. Ebers. EC Consumer Law Compendium. Comparative Analysis 2008, p. 456.

^{*15} Võlaõigusseadus. – RT I 2001, 81, 487; RT I, 4.2.2011, 2 (in Estonian).

^{*16} CCSCd, 23.3.2006, 3-2-1-8-06, paragraph 15; 8.12.2009, 3-2-1-126-09, paragraph 12.

^{*17} Võlgade ümberkujundamise ja võlakaitse seaduse eelnõu seletuskiri (Explanatory memorandum to the Draft Act on Restructuring of Debts and Debt Protection). Available at <http://www.riigikogu.ee/?page=eelnou&op=ems&emshelp=true&eid=1004095&u=20110530145824> (1.4.2011) (in Estonian).

from the **principal** purpose of use, i.e., the predominant purpose of use.^{*18} The original wording of the CPA (1.4.2003) too defined a consumer as a natural person who intends to purchase or use goods or services for a purpose which is not **directly** related to his economic or professional activity.^{*19} However, in the course of processing the draft, the definition of consumer was changed and protection was precluded for persons who use, even if just in part, the goods or services in their economic or professional activities.

As evidenced above, similarly to several other Member States and the EU consumer *acquis*, the general notion of consumer as provided for in current Estonian law, as a rule^{*20}, proceeds from a narrow definition of consumer, delimiting the concept to a natural person who uses the commodity solely outside his economic or professional activity. There are, however, Member States which, under certain circumstances, also extend consumer protection provisions to legal persons. As far as the purpose of consumer transactions is concerned, based on the national law of most Member States it cannot be said whether treating a contract as a consumer contract depends on the **principal** purpose of the contract or if just any connection with the person's professional activity precludes the application of consumer provisions.^{*21}

2. Main characteristics of the concept of consumer in the context of the changing EU consumer *acquis*

2.1. Revision of the EU consumer *acquis*

The revision of the EU consumer *acquis* is a part of the measures implemented to apply Community's contract law uniformly and improve the functioning of the internal market. The review was necessitated by the need to tackle the fragmentation of consumer protection legislation and to modernise and simplify the system of rules which had become out-dated due to rapid development of technical capabilities. The procedure was initiated back in 2004 by the Commission, with its communication^{*22}, and it covers eight consumer directives.^{*23} The Green Paper on the review of Community's consumer *acquis*, published in February 2007, notes that the overarching aim of the Review is to 'achieve a real consumer internal market striking the right balance between a high level of consumer protection and the competitiveness of enterprises, while ensuring the strict respect of the principle of subsidiarity' and at the end of the exercise it should, ideally, be possible to say to EU consumers 'wherever you are in the EU or wherever you buy from it makes no difference: your essential rights are the same'.^{*24} The Green Paper also notes that there are certain issues which are common to all directives of the consumer *acquis* which could be extracted from the existing directives and regulated in a horizontal instrument. The notion of consumer is one of such issues: The Commission stresses that a consistent definition of the notions of consumer and professional is important since it permits to delimit the scope of the *acquis* more accurately and that during the review the widening of the definitions to cover transactions for mixed purposes should be considered.^{*25}

¹⁸ Research Group on the Existing EC Private Law. Contract II—Principles of the Existing EC Contract Law. Sellier. European Law Publishers 2009, p. 55.

¹⁹ Clause 2 1) of the original draft Consumer Protection Act (SE 14, 1.4.2003) defined consumer as follows: a natural person who intends to purchase or purchases and uses goods and services for a purpose which is not directly related to his economic or professional activity.

²⁰ One exception to the rule is, e.g., the Electronic Communications Act (elektroonilise side seadus. – RT I 2004, 87, 593; RT I, 23.03.2011, 1 (in Estonian)) whose §2 55) sets out that a consumer is an end-user who is a natural person and who mainly does not use electronic communications services in his or her economic or professional activities. The current regulation does not specify the criteria of predominant use.

²¹ There are 20 of such Member States. See M. Ebers. The notion of 'consumer'. – H. Schulte-Nölke, C. Twigg-Flesner, M. Ebers. EC Consumer Law Compendium. Comparative Analysis, 2008. Available at www.eu-consumer-law.org/consumerstudy_part3a_en.pdf (30.5.2011).

²² Communication of the Commission to the European Parliament and Council. European Contract Law and the revision of the *acquis*: the way forward. Brussels 11.10.2004. COM(2004) 651 final. – OJ C 14, 20.1.2005, p. 3 ff.

²³ Directive 85/577/EEC to protect the consumer in respect of contracts negotiated away from business premises; directive 93/13/EEC on unfair terms in consumer contracts; directive 97/7/EC on the protection of consumers in respect of distance contracts; directive 1999/44/EC on certain aspects of the sale of consumer goods and associated guarantees.

²⁴ Green Paper on the Review of the Consumer *Acqui*. Brussels 8.2.2007, COM(2006) final, p. 3.

²⁵ Green Paper, pp. 11 and 15.

The new consumer credit directive^{*26} and timeshare contract directive^{*27}, replacing previous directives, were the first to be adopted during the revision of the EU consumer *acquis*. The new directives approach the notion of consumer the same way as the original directives and, as a result, each directive defines the notion of consumer separately but not in the same wording. Thus, it can be said that unlike the emphasis of the Green Paper, it was not deemed necessary to use a uniform and consistent approach to the notion of consumer in the first revised directives.

In October 2008, in the framework of revising the consumer *acquis* the Commission tabled a proposal for a directive on consumer rights.^{*28} The European Parliament adopted the new directive on 23 June 2011. The new directive, in whose drafting the standpoints that had evolved during the drafting of the Draft Common Frame of Reference^{*29} (hereinafter referred to as the DCFR) were taken into account, combines into one whole two previous EU directives.^{*30} The goal is to enhance consumers' trust and curb the bureaucracy which has hindered companies' activities in other EU Member States, thus stripping the consumers of the freedom of choice and competing offers. In legal literature the new directive has already been seen as a suitable foundation for a future European code of consumer rights (contracts).^{*31} The consumer rights directive uses for the first time in the EU consumer *acquis* a uniform general notion of a consumer applicable to all of the consumer contracts covered by the framework directive.

2.2. Consumer as a natural person

As noted above, in the EU consumer *acquis* the notion of consumer covers as a rule just natural persons. This has been on several occasions emphasised in the case law of European Court of Justice. In joined cases *Idealservice* the European Court of Justice took a firm stance in interpreting the unfair terms directive^{*32} that the notion of consumer covers only natural persons.^{*33}

In the *Di Pinto* case the European Court of Justice interpreted, for the purposes of the doorstep selling directive^{*34}, the notion of consumer in a narrower sense, noting that a trader canvassed with a view to the sale of his business is not to be regarded as a consumer protected by the directive and explained that the directive does not afford protection to legal persons even if they are in a position similar to that of a consumer.^{*35}

In a number of Member States, including in Estonia's current law and case-law, the notion of consumer is solely delimited to natural persons^{*36} and this position is also supported in legal literature.^{*37}

In the discussions held in the Commission on the consumer regulation of the Draft Common Frame of Reference, the experts agreed that the notion of consumer should cover solely natural persons.^{*38} This

^{*26} Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on credit agreements for consumers and repealing Council Directive 87/102/EEC. – OJ L 133, 22.5.2008, pp. 66–92.

^{*27} Directive 2008/122/EC of the European Parliament and of the Council of 14 January 2009 on the protection of consumers in respect of certain aspects of timeshare, long-term holiday product, resale and exchange contract. – OJ L 033, 3.2.2009, pp. 0010–0030.

^{*28} Proposal of the EC Commission for a Directive of the European Parliament and of the Council on consumer rights COM(2008) 614 final, 8.10.2008.

^{*29} C. von Bar, E. Clive, S. Nölke (eds.). Principles, Definitions and Model Rules of European Private Law. Draft Common Frame of Reference (DCFR). Munich: Selliers 2009.

^{*30} Doorstep selling directive and distance contracts directive; in addition, the unfair terms directive and consumer sale directive will be amended; the Commission originally intended to replace all four directives with a new directive.

^{*31} M. W. Hesselink. Towards a Sharp Distinction between B2B and B2C? On Consumer, Commercial and General Contract Law after the Consumer Rights Directive (June 8, 2009). – Centre for the Study of European Contract Law Working Paper Series 2009/06.

^{*32} Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts. – OJ L 095, 21.04.1993, pp. 0029–0034.

^{*33} ECJ, 22.11.2001, joined cases C-541/99 and C-542/99, *Idealservice*, paragraph 17. – ECR 2001, pp. I-09049.

^{*34} Council Directive 85/577/EEC of 20 December 1985 to protect the consumer in respect of contracts negotiated away from business premises. – OJ L 372, 31.12.1985, pp. 0031–0033.

^{*35} ECJ, 14.3.2003, C-361/89, *Patrice Di Pinto*, paragraphs 19 and 23. – ECR 1991, p. I-01189.

^{*36} See CCSCd, 3-2-1-126-09, paragraph 12; 3-2-1-111-10, paragraph 11; 3-2-1-118-05, paragraph 34. In the latter case the Supreme Court clearly noted that a consumer is also regarded as a natural person under §34 of LOA.

^{*37} I. Kull, M. Käerdi, V. Kõve. *Võlaõigus I: Üldosa* (Law of Obligations I. General Part). Tallinn 2004, p. 122 (in Estonian).

^{*38} Commissions Second Progress Report on the Draft Common Frame of Reference, COM(2007) 447 final, 25.7.2007, p. 3.

stance is also expressed in the DCFR: Pursuant to Article I.-1:105 of the DCFR, a consumer is a natural person. Legal persons performing transactions outside their normal economic or professional activities are not regarded as consumers.

Pursuant to Article 2 (1) of the proposal for a consumer rights directive^{*39} the notion of consumer initially covered just natural persons. The opinion published on 16 July 2009 by the European Economic and Social Committee^{*40}, however, noted that the framework directive should adopt a clear position, *inter alia*, regarding whether the notion of consumer could be extended to certain legal persons, as a number of Member States have done. Based on the opinion of the European Economic and Social Committee, the proposal for a directive was supplemented by a clause to the effect that the Member States may maintain or extend the rules of the directives to natural or legal persons who are not consumers within the meaning of the directive.^{*41}

Recital 13 of the adopted directive includes the right of the Member States to maintain or introduce national legislation corresponding to the provisions of the directive or certain of its provisions in relation to transactions that fall outside the scope of the directive. However, the same recital sets out the right of the Member States to decide to extend the application of the rules of the directive to legal persons or to natural persons who are not 'consumers' within the meaning of the directive, such as non-governmental organisations, start-ups or small and medium-sized enterprises.

This clause may be seen as being different from the original proposal for a directive, as proposed by the Commission, whose aim was maximum harmonisation, but rather as the retention of the principle of minimum harmonisation and concession to those Member States which have provided in their current laws for an option to regard certain legal persons as consumers (e.g., Spain, Belgium, Slovakia, Denmark, Greece, and Austria).^{*42}

For those countries, the requirement of maximum harmonisation would have meant significant restriction of the scope of the consumer *acquis*. It has been likewise noted in legal literature that in such a situation maximum harmonisation does not widen the consumer's rights but instead restricts them.^{*43}

On 9 October 2010, the European Commission published an unofficial note to the proposal for a consumer rights directive^{*44}, which is intended to serve as a guide to the implementation of the proposal for a directive as regards certain types of contracts. The note provides clarification as to who might be these legal or natural persons which are not 'consumers' in the meaning of Article 2 (1) regarding whom the Member States may maintain or extend the application of the rules of the proposal. According to the note, a Member State may, e.g., give NGOs or small businessmen status equal to that of consumers. However, it is pointed out that such persons that have equal rights with the consumers should not be referred to as 'consumers' as that would be incompatible with the definitions in the proposal for a directive.^{*45}

Given that the initiatives of the past few years do not directly regard legal persons as consumers and continue to stress the need to delimit the notion of consumer to just natural persons, one may conclude that there have not been significant changes in the paradigm of EU law regarding this issue.

³⁹ Proposal of the EC Commission for a Directive of the European Parliament and of the Council on consumer rights COM(2008) 614 final, 8.10.2008.

⁴⁰ European Economic and Social Committee. Opinion on the Proposal for a Directive of the European Parliament and of the Council on consumer rights (16.7.2009), p. 5.4.1. INT/464 – CESE 1190/2009 – 2008/0196 (COD). Available at <http://www.europarl.europa.eu/oeil/FindByProcnum.do?lang=2&procnum=COD/2008/0196> (1.7.2011).

⁴¹ Draft European Parliament Legislative Resolution on the proposal for a directive of the European Parliament and the Council on consumer rights (COM(2008)0614 – C7-0349/2008 – 2008/0196(COD)). Ordinary legislative procedure—first reading. Amendment 59 (Article 2—point 1). Available at <http://www.europarl.europa.eu/sides/getDoc.do?type=REPORT&mode=XML&reference=A7-2011-0038&language=EN> (1.7.2011).

⁴² Research Group on the Existing EC Private Law. Contract II—Principles of the Existing EC Contract Law. Sellier. European Law Publishers 2009, p. 59.

⁴³ G. Howells, R. Schulze. Modernising and Harmonising Consumer Contract Law. Sellier European Law Publishers 2009, p. 10.

⁴⁴ European Community Note (9.10.2010—working document). The Proposal for a Directive on Consumer Rights: Scope, relationship with national general contract law and relationship with other community legislation. Available at http://ec.europa.eu/consumers/rights/docs/note_CDR_en.pdf (1.7.2011).

⁴⁵ *Ibid.*

2.3. Consumer acting outside his economic or professional capacity

As a rule, the wording of the consumer directives does not provide a clear answer to the question whether or not consumer protection is also extended to a natural person in cases where his transaction is at least slightly connected with his economic or professional activity.^{*46}

The European Court of Justice has in its earlier case-law supported the approach that even the minor connection with professional activity is sufficient to preclude the application of consumer provisions. In the *Dietzinger* case, the European Court of Justice adopted in 1998 the position that a contract of guarantee concluded by a private person for the purpose of guaranteeing the obligations of a building firm cannot be treated as a consumer contract in the meaning of the doorstep selling directive 85/577. The court noted that as regards a guarantee, the provisions applicable to a consumer can be implemented only if the commitment is entered into for a purpose which is unconnected with the guarantor's trade or profession.^{*47} The European Court of Justice has also found that a person who had entered into a contract for the purpose of engaging in business in the future cannot be treated as a consumer.^{*48}

In the 2005 *Gruber* case^{*49}, the European Court of Justice demonstrated a somewhat more accommodating approach. In that case, a decision was needed on whether a contract entered into by a farmer for the purpose of buying roof tiles was a consumer contract in view of the fact that the area of the building used for personal purposes was slightly more than 60% of the total floor area. The European Court of Justice found that a person may be treated as a consumer where the link between the purpose of a transaction and the trade or profession is so slight as to be **marginal**. Hence, the European Court of Justice acknowledged that a slight connection to a professional activity does not preclude the application of the consumer provisions. As mentioned above, it cannot be unambiguously said on the basis of the national laws of the majority of Member States whether or not a contract should be regarded as a consumer contract on the basis of the **primary** purpose of use.^{*50} A number of Member States have extended the application of consumer provisions to transactions primarily entered into outside professional either *expressis verbis* (Denmark, Finland, and Sweden) or address the issue in their case-law (Germany). It is precisely from the German case-law that the often cited in legal literature example of a lawyer who buys a car, which he then uses both for business and private purposes, comes.^{*51} Likewise it has been concluded in Estonian legal literature that where a natural person enters into a contract which is partly linked to his professional activities, the contract is qualified depending on the predominant purpose of the transaction.^{*52}

The Commission's Green Book notes that during the review of consumer *acquis* the widening of the definitions is needed to cover transactions for mixed purposes, i.e., transactions whose object is used in part to satisfy personal needs, in part for business or professional activity.^{*53} This would be a major conceptual change in the definition of a consumer compared to the current approach employed in EU consumer *acquis* which does not recognise transactions for mixed purposes as consumer transactions. The DCFR too mirrors the changes in the perception of the extent of the concept of a consumer: pursuant to Article I-1:105 (1), a consumer is any natural person who is acting primarily for purposes which are not related to his or her trade, business or profession. However, the definition of consumer as worded in the DCFR allows partial use of the transaction object in trade or profession (so-called dual use). The DCFR also regards as consumer contracts such contracts whose purpose is to generate one-time profit—for example, resale of a purchased item, unless such activity is regular. The frequency and volume of transactions determine whether or not such resale activity qualifies as a consumer contract.^{*54} Article I-1:105 (3) of the DCFR deals with contracts

⁴⁶ Article 9 (b) ii of directive 85/374 is exceptional in that it speaks about the main purpose of use.

⁴⁷ ECJd 17.3.1998, C-45/96, *Bearish Hypothesen- und Wechselbank AG v. E. Dietzinger*. – ECR 1998, p. I-1199, paragraph 22. Here, parallels may be drawn regarding the Supreme Court's case-law on suretyship issued for the purpose of guaranteeing the obligations of a legal person dealt with above in the text.

⁴⁸ ECJd, 3.7.1997, C-269/95, *Francesco Benincasa/.Dentalkit Srl*.

⁴⁹ ECJd, 20.1.2005, C-464/01, *Gruber*. – ECJ Cases 2005, p. I-00439.

⁵⁰ M. Ebers. The Notion of 'consumer'. – H. Schulte-Nölke, C. Twigg-Flesner, M. Ebers. EC Consumer Law Compendium. Comparative Analysis, 2008. Available at www.eu-consumer-law.org/consumerstudy_part3a_en.pdf (30.5.2011).

⁵¹ OLG Celle, 7 U 193/06. Available at <http://app.olg-ol.niedersachsen.de/efundus/volltext.php4?id=4389> (1.4.2011).

⁵² P. Varul *et al.* *Võlaõigusseadus I. Kommenteeritud väljaanne* (Law of Obligations Act. Commented Edition). Tallinn: Juura 2006, §34 comment 2 (in Estonian).

⁵³ Green Book, Annex I, clause 4.1.

⁵⁴ DCFR, p. 92.

that have different purposes of use. If a person can be treated both as a consumer and a trader, he is deemed to be a consumer in the context of provisions providing protection to consumers. This clause is intended to solve those situations where a transaction carries a personal as well as trade and profession related purpose. Thus, a person who buys a computer which he primarily uses for personal purposes and, to a slight extent, also for the purposes of trade, is a consumer.^{*55}

Article 2 (1) of the original proposal tabled by the Commission regarding the consumer rights directive defined a consumer as any natural person who, in contracts covered by the directive, is acting for purposes which are outside his trade, business, craft or profession. This approach matched the more narrow approach that had become rooted in EU consumer *acquis* but differed significantly from the approach to consumers employed in the DCFR, and, as such, the proposal was criticised in the legal literature exploring the proposed directive.^{*56} Also, the opinion of 16 July 2009 of the European Economic and Social Committee, mentioned above, referred to a contradiction between the proposed directive and the approach of several Member States regarding the transactions for mixed purposes.

Pursuant to the note of the European Commission dated 9 October 2010, the scope of the directive includes contracts concluded both for professional and private purposes when the private purpose is clearly predominant. The note recommends that the predominant purpose be assessed by national courts on a case by case basis.^{*57} The legal definition of a consumer was changed in the proposal for a directive submitted on 24 March 2011 to the European Parliament for the first reading^{*58}, defining it as follows: ‘consumer’ means any natural person who, in contracts covered by this directive, is acting **primarily** for purposes which are outside his trade, business, craft or profession.

Article 2 (1) of the consumer rights directive adopted by the European Parliament defines a consumer as any natural person who, in contracts covered by the directive, is acting for purposes which are outside his trade, business, craft or profession. This regulation should be viewed in conjunction with Recital 17 of the directive, pursuant to which if the contract is concluded for purposes partly within and partly outside the person’s trade (dual purpose contracts) and the trade purpose is so limited as not to be predominant in the overall context of the supply, that person should also be considered as a consumer.

The authors hold that considering a person as a consumer based on the main goal of the transaction represents, at the EU level, a significant paradigmatic change in the concept of a consumer, resulting in a major expansion of the scope of consumer provisions.

Therefore it is all the more surprising how the definition of a consumer has been structured in the two already revised directives compared with the DCFR and the new consumer rights directive. Namely, Article 3a of the new consumer credit directive and Article 2 (1) of the timeshare contract directive are based on the early dogmatic approach that a natural person can be regarded as a consumer only if the purpose of his transactions is in no way related to his economic or professional activity. At that, Article 22 (1) of the consumer credit directive sets out that Member States may not maintain or introduce in their national law provisions diverging from those laid down in this directive. For the Estonian legislator, e.g., it means that a contradiction between the directive and §403 (2) of the LOA needed to be removed as it extends the definition of consumer credit to cover also the transactions entered into to start a business. As the Estonian legislator did not want to relinquish the already existing protection of the recipient of loan or credit^{*59}, the following solution was found: a natural person who concludes a contract to take out credit in order to start independent economic or professional activity is not considered as a consumer, however, consumer credit provisions apply to such a contract.

⁵⁵ DCFR, p. 94.

⁵⁶ G. Howells, R. Schulze. *Modernising and Harmonising Consumer Contract Law*. Sellier European Law Publishers 2009, p. 12; M. B. M. Loos. *Review of the European Consumer Acquis*. Sellier European Law Publishers 2008, p. 11.

⁵⁷ European Community Note (9.10.2010—working document). The Proposal for a Directive on Consumer Rights: Scope, relationship with national general contract law and relationship with other community legislation. Available at http://ec.europa.eu/consumers/rights/docs/note_CDR_en.pdf (1.4.2011).

⁵⁸ Proposal for a directive of the European Parliament and of the Council on consumer rights (COM(2008)0614 – C6-0349/2008 – 2008/0196(COD)). Ordinary legislative procedure: first reading. Amendment 59 Article 2-point 1. Available at <http://www.europarl.europa.eu/sides/getDoc.do?type=TA&language=EN&reference=P7-TA-2011-0116> (1.7.2011).

⁵⁹ Seletuskiri võlaõigusseaduse ja teiste seaduste muutmise seaduse eelnõu juurde (Riigikogu XI koosseisu eelnõu 761 SE III) (Explanatory Memorandum to the Draft Act Amending the Law of Obligations Act and Other Acts (draft 761 SE III of the 11th composition of the Riigikogu)), p. 12. Available at <http://www.riigikogu.ee/?page=eelnou&op=ems&emshelp=true&id=1033413&u=201101312101> (in Estonian).

Upon enforcement of the consumer rights directive, there is also a question on how to address the situation where under national law the same general definition of a consumer applies both to consumer credit and consumer sale (as it is under Estonian law), but EU directives foresee concepts of a consumer with varying scope for those contracts. The authors believe that in such a situation it would be reasonable to proceed from the wider general definition of a consumer and provide for necessary restrictions for specific types of contracts. One must, however, acknowledge that such a regulative method is justified only as long as the wider general definition covers more types of contracts than contracts to which the more narrow definition applies. Several Member States have attempted to introduce a general definition of a consumer in their national law on the basis of EU consumer *acquis*; however, as things stand currently, the situation is much better in those Member States which have defined the notion of a consumer in each law separately. This is a paradox given that the main goal of revising the consumer *acquis* is to achieve greater coherence and that the Commission has in the Green Book emphasised the need to harmonise basic terms.

2.4. Recognition of a person as a consumer—a subjective or objective approach?

Having concluded that the provisions protecting consumers also apply to natural persons (Section 2.2) who primarily enter into transactions outside their economic or professional activity (Section 2.3), a question emerges whether the interpretation of his conduct by the other party is relevant in recognising a person as a consumer. In other words, if a natural person enters into a transaction in his economic or professional activity but that purpose is not recognisable to his contractual partner, should the consumer provisions be applied to such a transaction? Or should the consumer provisions also be applied in a case where a person enters into the contract for personal purposes but his conduct creates an impression that he is a person engaged in economic or professional activity?

An example from German Supreme Court case-law illustrates such a situation.^{*60} A car dealer wished to sell a used car only to such a person who is not a consumer because he wanted to use the possibility to exclude the seller's guarantee. The buyer, who wanted the car for personal use, was aware of the fact; however, as the case was, the car would not have been sold to him and so he maintained that he was buying it for his economic and professional activity. Later, the buyer wished to withdraw from the contract due to the seller's breach and invoked that the contract was a consumer contract. The court found that a person who deceives his contractual partner in order to avoid the contract being qualified as a consumer contract cannot, based on the principle of good faith, subsequently enjoy legal remedies designed for consumers.

Under Estonian positive law and the case-law to date, it is also possible to restrict the rights of a contractual party who, in concluding the contract, poses as an undertaking but wishes to invoke consumer protection provisions in submitting claims arising out of the contract. The authors find that such conduct has elements of contradictory conduct (*venire contra factum proprium*). Pursuant to §138 (1) of the General Part of the Civil Code Act^{*61} (hereinafter referred to as the GPCCA), rights shall be exercised and obligations shall be performed in good faith. Under §6 (1) and (2) of the LOA, obligees and obligors shall act in good faith in their relations with one another and nothing arising from law, a usage or a transaction shall be applied to an obligation if its contrary to the principle of good faith. The Supreme Court's case-law has several examples where the principle of good faith has been used to restrict the claims of a person due to his contradictory conduct.^{*62}

The same question has been raised in the case-law of European Court of Justice. In the above cited *Gruber* case the court found that the consumer contract provisions of the Brussels convention do not apply where the supposed consumer had in fact, by his own conduct with respect to the future contractual party, given the latter the impression that he was acting for business or professional purposes (e.g., the person uses corporate letterheads, asks the goods to be delivered to a business address, etc.). According to the approach of the European Court of Justice, such a conduct should be treated as waiver of the protection

⁶⁰ BGH NJW 2005, 1045 *ff.*

⁶¹ Tsiviilseadustiku üldosa seadus. – RT I 2002, 35, 216; RT I, 6.12.2010, 12 (in Estonian).

⁶² E.g., decisions of the Civil Chamber of the Supreme Court 3-2-1-37-00 (acceptance of unsatisfactory performance, creating an impression that the performance was satisfactory, and later invoking breach of contract); 3-2-1-66-05 (failure to submit timely penalty claims and invoices and subsequent claiming of damages) and 3-2-1-32-06 (invoking the nullity of standard terms by the very user of the standard terms).

provided for by the consumer provisions.^{*63} The authors of the DCFR also hold that if a consumer, upon entering into a contract, knowingly gives the other party impression of being an undertaking (or 'business'), the provisions protecting the consumer should not be applied as the person's conduct is contrary to the principle of good faith.^{*64}

EU consumer *acquis* does not impose a general duty to act in good faith. The Green Paper addresses the option to provide for such a principle and notes that the inclusion of such a principle, which would act as a safety net, would fill in any future regulatory gap and ensure that the *acquis* remains future proof.^{*65} However, neither the already revised directives nor the new consumer rights directives foresee such a good faith clause. The principle of good faith and fair trading has been expressed in the DCFR. Direct contradictory conduct is addressed in Article I.-1:103 (2) under which conduct of a person is contrary to good faith if it contradicts his previous conduct or representations.

The authors of the article hold that the approach according to which a natural person can objectively be regarded, upon entering into a contract, as a consumer is justified and the concluded contract should be treated as a consumer contract. But if, upon concluding a contract, a person creates an impression of being an undertaking, the application of the consumer provisions is not justified. The authors build their opinion, firstly, on the fact that it is important for an undertaking to know whether or not the other party is a consumer already before entering into the contract as this may determine the extent of the undertaking's pre-contractual and contractual obligations. For example, if an undertaking enters into a contract with a consumer he may be required to disclose more pre-contractual information, one must also take into account some specifics in using contractual legal remedies or restricting liability by agreement or in using standard terms. Therefore, an undertaking must be able to rely, upon concluding a contract, on the conduct and representations of the other party. Secondly, the authors hold that the duty to act in good faith should not only rest with undertakings but also with consumers—treating the consumer as the weaker part of a transaction does not mean that he should be allowed to behave contradictorily.

3. Conclusions

To date, the EU consumer *acquis* has employed an approach to incorporate the definition of a consumer in each separate legislative instrument and these definitions do not coincide. While the Commission notes in its Green Paper that the definition of a consumer is one of the issues which should be uniformly regulated in all of the directives to be revised, the two directives adopted in the consumer *acquis* revision process do not follow the principle. This conclusion is based on the observation that the definitions of a consumer in the new consumer credit directive, timeshare contracts directive and consumer rights directive do not match. As far as the consumer rights directive is concerned, there is also a reason to speak about a significant change in the concept of consumer as, although firmly holding on to the principle that a consumer is a natural person, unlike the EU consumer *acquis* to date, any natural person who acts **primarily** for a purpose not linked to his trade or business is also considered a consumer.

Hence, it can be said that the revision of the directives has not led to a greater consistency in the consumer *acquis* as far as the notion of consumer is concerned and if, until now, it could be said that the EU consumer *acquis* proceeded from a narrow definition of a consumer, two clearly differing doctrines are emerging at the legislative level. Member States who to date have limited themselves to just transposing the minimum criteria set out in the directives and have used one general definition of a consumer in the process, are now forced to decide whether to widen the definitions for certain types of contracts (which renders the idea of one general definition questionable) or amend the general definition (which involves a significant change in the addressees of the provision and its application instances, which requires a thorough analysis as well as legal and political decisions). The legislators of the Member States continue to face the challenge of tackling the problem of taking over EU legislation into their national laws where the instruments do not coincide. And paradoxically the problem related to the regulation of the definition of a consumer arises out of the revision of the EU consumer *acquis* whose goal is to achieve better coherence of *acquis*.

⁶³ ECJd, 20.1.2005, C-464/01, *Gruber*, paragraphs 52 and 53. – ECR 2005, p. I-00439.

⁶⁴ The approach employed in the *Gruber* case is considered too harsh as the court deemed wrong impression given by the consumer out of carelessness to be sufficient to preclude the consumer provisions. See C. Von Bar, E. Clive. Draft Common Frame of Reference (DCFR). München: Sellier 2009, p. 103.

⁶⁵ Green Paper, p. 18.



Karin Sein

Docent of Civil Law
University of Tartu

Protection of Consumers against Unfair Jurisdiction and Arbitration Clauses in Jurisprudence of the European Court of Justice

1. Introduction

The jurisdiction and arbitration clauses contained in consumer contracts can significantly limit the constitutional right of consumers to have recourse to the courts for protecting their rights. This particularly applies if such a clause is contained in the standard terms of the contract prepared by the other party, as a result of which the consumer cannot influence the substance of the contract. In such cases, the consumer has in fact been forced to agree that the disputes arising from the contract will be settled in the arbitral tribunal or court chosen by the seller or supplier if the consumer wishes to acquire the desired goods or service. However, such contracts are relatively frequent in the practice of the European countries, which has given rise to the judgements of the European Court of Justice such as *Oceano Grupo*^{*1}, *Mostaza Claro*^{*2}, *Asturcom*^{*3}, *Pannon*^{*4} and *Pénzügyi Lízing*.^{*5}

The objective of this paper is to analyse how the European Court of Justice has sought to protect consumers against the jurisdiction and arbitration clauses contained in standard terms and what duties would arise from the above-mentioned judgements for the judges of Member States, including Estonia. The paper demonstrates that although the European Union legislator does not have general competence to regulate the civil proceedings of the Member States, the judgements of the European Court of Justice examined have considerable impact on the civil proceedings of the Member States, including the principles of procedural autonomy and the adversary principle of the parties.

¹ Case 27.6.2000, joined cases C-240/98–C-244/98, *Océano Grupo Editorial and Salvat Editores*. – ECR 2000, p. I-4941.

² Case 26.10.2006, C-168/05, *Mostaza Claro v. Centro Móvil Milenium SL*. – ECR 2006, p. I-10421.

³ Case 6.10.2009, C-40/08, *Asturcom Telecomunicaciones SL v. Cristina Rodríguez Nogueira*. – ECR 2009, p. I-9579.

⁴ Case 4.6.2009, C-243/08, *Pannon GSM Zrt. v. Erzsébet Sustikné Győrfi*. – ECR 2009, p. I-4713.

⁵ Case 9.11.2010, C-137/08, *Pénzügyi Lízing Zrt v. Ferenc Schneider*. – OJ C 13, 15.1.2011, p. 2.

2. Jurisdiction and arbitration clauses as unfair contract terms

There is no general prohibition in Estonian law on arbitration or jurisdiction clauses in consumer contracts. However, according to §104 (3) 1) of the Code of Civil Procedure⁶ (hereinafter referred to as the CCP), the agreement on jurisdiction between the business and the consumer is valid only if concluded after the arising of the dispute. Section 105 of the CCP still enables the court to also accept a jurisdiction agreement concluded before the arising of the dispute on the precondition that the consumer (defendant) responds to the action without contesting jurisdiction and also in cases where the defendant does not respond to the action but participates in a court session without contesting jurisdiction. Yet, Estonian law, somewhat surprisingly, imposes on arbitration agreements only the requirement of a written form (CCP §719 (2))⁷, but does not prohibit entry into them before the arising of a dispute.

A legal situation is considerably more complicated if the agreement on jurisdiction or arbitration is contained in standard terms. The issues related to the standard terms contained in consumer contracts are governed by Council Directive 93/13/EEC on unfair terms in consumer contracts⁸ (hereinafter referred to as the Directive). Article 3 (1) of the Directive provides that a contractual term which has not been individually negotiated shall be regarded as unfair if, contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations arising under the contract, to the detriment of the consumer. Article 3 (3) of the Directive refers to the Annex to the Directive that contains 'an indicative and non-exhaustive list of the terms which may be regarded as unfair'⁹ and according to its clause 1 q, a term which has the object or effect of excluding or hindering the consumer's right to take legal action, particularly by requiring the consumer to take disputes exclusively to arbitration, can be regarded as unfair.

The provisions of Directive 93/13/EEC have been harmonised in Division 2 of Chapter 2 of the Law of Obligations Act¹⁰ (hereinafter referred to as the LOA). According to LOA §42 (1) and (3) 10), a standard term is unfair, hence void, if it deprives the other party of the opportunity to protect his rights in court or unreasonably hinders such opportunity from being exercised. It cannot be unambiguously inferred from the wording of the provision whether and what kind of agreements on arbitration and jurisdiction should be considered as unfair according to Estonian law, while comments on the Law of Obligations Act do not ensure full clarity either.¹¹ Here we have to note that the European Court of Justice is not competent to decide on the unfair nature of a particular arbitration or jurisdiction clause¹², but this can only be done by a national court that has to take into account national legislation and the circumstances of the dispute when forming its opinion, while also observing the general criteria developed by the European Court of Justice for assessing the unfairness of standard terms.¹³

Opinions vary across different Member States about whether and on what conditions the arbitration clause contained in the standard terms must be considered as unfair for the purposes of the Directive. For example, in German law, the arbitration clauses contained in consumer contracts are not regarded *a priori* as unfair but must be assessed against, e.g., the distance of the arbitral tribunal from the residence of the consumer and the cost of the procedure for the consumer.¹⁴ In Spanish law, however, submission to arbi-

⁶ Tsiviilkohtumenetluse seadustik. – RT I 2005, 26, 197; RT I, 30.12.2010, 2 (in Estonian).

⁷ Failure to comply with a formal requirement does not influence the validity of an agreement if the parties agree to the resolution of the dispute by an arbitral tribunal, CCP §719 (3).

⁸ Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts. – OJ L 95, 21.4.1993, p. 29.

⁹ Case 1.4.2004, C-237/02, *Freiburger Kommunalbauten GmbH Baugesellschaft & Co. KG v. Ludger Hofstetter and Ulrike Hofstetter*, paragraph 20. – ECR 2004, p. I-03403.

¹⁰ Võlaõigusseadus. – RT I 2001, 81, 487; RT I, 4.2.2011, 2 (in Estonian).

¹¹ P. Varul, I. Kull, V. Kõve, M. Käerdi. Võlaõigusseadus I. Kommenteeritud väljaanne (Law of Obligations Act I. Commented Edition). Tallinn: Tallinn 2006, p. 156 (in Estonian). Neither does the Estonian Constitution discuss the question whether and to what extent a contract may limit the constitutional right of individuals to have recourse to the courts for the protection of their rights. See E.-J. Truuväli *et al.* Eesti Vabariigi põhiseadus: Kommenteeritud väljaanne (Constitution of the Republic of Estonia. Commented edition). 2nd, revised edition. Tallinn: Juura 2008, p. 162 ff. (in Estonian).

¹² *Mostaza Claro* (Note 2), paragraph 22; *Pénzügyi Lízing* (Note 5), paragraphs 43, 44.

¹³ *Freiburger Kommunalbauten* (Note 9), paragraphs 21, 22; *Pénzügyi Lízing* (Note 1), paragraph 44.

¹⁴ K. Hilbig. Absoluter Verbraucherschutz bei unzulässigen AGB-Schiedsvereinbarungen? – Zeitschrift für Schiedsverfahren 2010, p. 76. For the law of other Member States, see, e.g., N. Reich. More clarity after 'Claro'? Arbitration clauses in consumer contracts as an ADR (alternative dispute resolution) mechanism for effective and speedy conflict resolution, or as 'deni de justice'? – European Review of Contract Law 2007/3, pp. 44–49.

tration other than consumer arbitration, except in the case of arbitration bodies established by statutory provision in respect of a specific sector or circumstances is considered unfair.^{*15}

As mentioned above, there is no universal position in Estonian law on when an arbitration clause contained in standard terms of a consumer contract can be regarded as a unfair standard term for the purposes of LOA §42 (3) 10). Neither have such standard terms become common in practice in Estonia, yet. As the first ones are already in place, sooner or later we must develop our own position on this issue.

The author agrees with Advocate General Trstenjak, delivering her opinion in the *Asturcom* case, that there are serious doubts about the independence and neutrality of the courts of arbitration since arbitrators may possibly have a personal interest in conducting the arbitration proceeding and hence disregarding the voidness of the arbitration clause.^{*16} As the remuneration of arbitrators depends on the conducting of arbitration proceedings as a rule, the arbitrators need not always be willing to establish the voidness of the arbitration clause and refuse to conduct the proceedings. Also, the basis for solving a dispute in arbitration proceedings is the fact that the parties have, of their free will, given up on the adjudication of the matter in national court and submitted the settlement of disputes to the competence of the court of arbitration. The development of the consumer's free will in the case of standard terms is rather doubtful because of the unequal negotiation position of the parties. Besides these problems, unlike, e.g., in German law^{*17}, the decisions of national arbitral tribunals existing on a permanent basis in Estonia are automatically enforceable (CCP §753 (1)) and hence are subject to the supervision of the national judicial system only on the consumer's request.^{*18} Since according to European law—as indicated above—the unfair nature of standard terms must be *inter alia* assessed in the context of domestic law, the author is of the opinion that the latter fact serves as a reason to consider the arbitration clauses contained in standard terms in Estonian law usually as unfair and hence void. A contrary position would seriously undermine the objective set out in the Directive—to effectively protect consumer against unfair standard terms.

It is somewhat more difficult to assess the unfair nature of jurisdiction clauses as here the consumer is not deprived of the opportunity to have recourse to the national judicial system but the consumer's opportunity to settle the dispute in the court prescribed by law is simply precluded or limited. Although according to Estonian procedural law, the jurisdiction clause contained in standard terms is usually void (CCP §104 (3) 1))^{*19}, it need not be the same way in the law of other Member States and this has given rise to several references for preliminary ruling lodged with the European Court of Justice. Emphasising that the assessment of the unfair nature of a specific provision lies with the competence of courts of the Member State, the European Court of Justice has still concluded that, e.g., a standard term contained in an agreement entered into between a consumer and undertaking, which confers the jurisdiction for the dispute only to the court in the territorial jurisdiction of which the seller or supplier has its principal place of business could be regarded as unfair.^{*20} Such a clause compels the consumer to accept that the dispute can be settled only in a court that may be located far from the consumer's place of residence, which in turn complicates the appearance of the consumer before the court. In the case of disputes concerning limited amounts of money, the costs relating

¹⁵ *Mostazo Claro* (Note 2), paragraph 11. E.g., in French law, arbitration agreements are not allowed in consumer contracts (see N. Reich (Note 14), p. 47) and in Austrian law, the arbitration clauses contained in standard terms are prohibited (see K. Hilbig (Note 14), p. 75).

¹⁶ Opinion of Advocate General Verica Trstenjak in Case 14.5.2009, C-40/08, *Asturcom Telecomunicaciones SL gegen Cristina Rodríguez Nogueira*. Available at [http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:62008C0040:DE:HTML\(13.4.2011\)](http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:62008C0040:DE:HTML(13.4.2011)).

¹⁷ According to §1060 (1) of the German Code of Civil Procedure (ZPO), an arbitral award can be enforced only if it has been declared enforceable by court.

¹⁸ The CCP does not explain the notion of 'permanent arbitral tribunals' and does not establish any criteria for an arbitral tribunal to be considered permanent. Perhaps all the arbitral tribunals that are not ad hoc arbitral tribunals can be considered as permanent arbitral tribunals, hence in principle also an arbitral tribunal having one arbitrator, existing with, e.g., an undertaking, which adjudicates a couple of times a year.

¹⁹ A regulation analogous to that of Estonia also applies in German law, for details, see C. Meyer. Missbräuchliche Gerichtsstandsvereinbarungen in Verbraucherverträgen: Anmerkung zu EuGH Urteil Pannon. – Zeitschrift für Gemeinschaftsprivat Recht 2009, pp. 221–223.

²⁰ *Pannon* (Note 4), paragraph 44; the same also in *Oceano* (Note 1), paragraph 24. For details, see T. Pfeiffer. Prüfung missbräuchlicher Klauseln von Amts wegen (Gerichtsstand) – Günstigkeitsprinzip nach Wahl des Verbrauchers. – Neue Juristische Wochenschrift 2009, pp. 2367–2369. It must be noted in addition that according to Article II.-9:409 of the Draft Common Frame of Reference, such agreements on jurisdiction are unfair standard terms. According to the DCFR, this is the only standard term included in the black list or automatically void; in the case of all other standard terms, their unfair nature is only presumed, see DCFR Article II.-9:410.

to the consumer's entering an appearance could be a deterrent and cause him to forgo any legal remedy or defence.^{*21} In the context of Estonian law, it may be important to consider these guidelines of the European Court of Justice in the cases in which the agreement on jurisdiction was indeed reached after the arising of the dispute but still on the standard terms drafted by the operator (e.g., the operator has prepared an annex to the contract after the arising of the dispute, containing an agreement on jurisdiction described above).

At the same time, it cannot be precluded that the consumer does desire the settlement of the dispute in the (arbitral) tribunal prescribed by the standard terms, and in such a case, it would be unreasonable to deny the consumer this option from the point of view of procedural economy. That is why in its judgement on *Pannon*, the Court of Justice assumed the position that the court had to inform the consumer about the invalidity of such a clause and ask whether the consumer wished to settle the dispute in that court regardless thereof.^{*22} Taking into account the principle of interpretation in conformity with the Directive^{*23}, the mere participation of the consumer in the proceeding (cf. CCP §105) is not enough to approve jurisdiction but it is necessary that the court first explain that the standard term prescribing jurisdiction is void and hence the consumer is not required to participate in the proceedings. It is only when the consumer participates in the proceeding regardless of this that the national court may proceed with the discussion of the subject of the matter.

3. Duties of the court in establishing unfairness of standard term

The European Court of Justice has time after time expressed the opinion that the national court may assess the unfairness of standard terms *ex officio*.^{*24} In later judgements it has already been established that the national court does not only have the right thereto but also an obligation. Hence, the European Court of Justice observed in the *Pannon* case that the national court had to examine the possible unfairness of the jurisdiction agreement *ex officio* even if the consumer had not relied on that^{*25} while the position was reasserted in the case *Pénzügyi Lízing*.^{*26} This also applies in the case in which the court assesses if the case falls within its jurisdiction or not. The point of departure of Estonian law is, in principle, similar, as according to CCP §75 (1), the court must verify the jurisdiction of the matter *ex officio* anyway.^{*27} The Supreme Court of Estonia has repeatedly stressed that the court must examine the validity of the standard terms even if the parties have not relied on it.^{*28}

A distinction must be made between the above question and the question of whether the court must *ex officio* also examine whether an agreement on arbitration or jurisdiction is a standard term at all (which may not be clear at all if the contract contains just a few clauses). In other words: if the consumer does not at all during the proceedings rely on the fact that standard terms have been imposed on him, does the court still have to examine that issue of its own motion? This question was answered in the case *Pénzügyi Lízing*.^{*29} Here the court, referring for the preliminary ruling, asked the European Court of Justice whether the national court was required to examine, of its own motion, the unfairness of a contractual term where it had available to it all the legal and factual elements necessary for the task, or the examination of unfairness of a contractual term also meant that the national court was obliged to undertake, of its own motion, an investigation with a view to establishing the factual and legal elements necessary to assess whether a term is unfair. More precisely, the court requested from the European Court of Justice an answer to the question

^{*21} *Oceano* (Note 1), paragraph 22.

^{*22} *Pannon* (Note 4), paragraphs 33, 35.

^{*23} For this, see, e.g., case 13.11.1990, C-106/89, *Marleasing*. – ECR 1990, p. I-4135, paragraph 8; ALCSCd, 16.6.2010, 3-3-1-36-10, paragraph 19.

^{*24} See *Oceano* (Note 1), paragraph 29; Case 21.11.2002, C-473/00, *Codifis*, paragraph 38. – ECR 2002, p. I-10875.

^{*25} *Pannon* (Note 4), paragraph 32.

^{*26} *Pénzügyi Lízing* (Note 5), paragraph 56.

^{*27} It is perhaps important to emphasise that this also applies if the case derives from an order for payment procedure, but the consumer lodges a general objection without separate contestation of jurisdiction.

^{*28} See CCSCd, 3-2-1-155-05, paragraph 19; 3-2-1-2-08, paragraph 13; 3-2-1-56-08, paragraph 13; 3-2-1-2-11, paragraph 12.

^{*29} *Pénzügyi Lízing* (Note 5), paragraph 25.

that if the national court itself observed, where the parties to the dispute had made no application to that effect, that a contractual term was potentially unfair, could it undertake, of its own motion, an examination with a view to establishing the factual and legal elements necessary to that examination where the national procedural rules permitted that only if the parties so requested?

When answering the question, it is necessary to first recall the principle of procedural autonomy of the Member States, i.e., that outside a few special cases, the European Court of Justice does not have the general competence to regulate national civil procedures. Traditionally, the adversary principle and the principle of passivity of the court apply to the civil procedures of the Member States, i.e., the parties determine the extent of claim as well as the circumstances and evidence serving as its basis.^{*30} The European Court of Justice has recognised the principle of passivity of the court in the *van Schijndel* judgement, establishing that the court could act of its own motion in a civil suit only in special cases if required by public interest.^{*31}

In the case *Pénzügyi Lízing*, however, the European Court of Justice arrived at the conclusion that in order to ensure the effectiveness of consumer protection ‘in the exercise of the functions incumbent upon it under the provisions of the Directive, the national court must ascertain whether a contractual term which is the subject of the dispute before it falls within the scope of that Directive’^{*32}. Hence, the European Court of Justice assumed a position that the national court was required *ex officio* to examine if standard terms were concerned. The Court stressed that the national court had such an obligation also in case the national procedural law provided otherwise.^{*33} Hence, at this point, the court can no longer proceed from the request of the parties and the adversary principle is replaced by the inquisitorial principle that is in fact not characteristic of civil procedure. Such an approach is not actually new to Estonian judicial practice, although the position of the Supreme Court has varied on this issue over the years. The initial prevailing opinion in judicial practice was that the court was obliged to examine if a term could be a standard term.^{*34} In 2006, the Supreme Court adopted a contrary position, stating that ‘the party who wishes that the court apply to the terms of the contract the regulation of the standard terms in the Law of Obligations Act, must pursuant to LOA §35 (1) and (2) plead and prove the circumstances based on which the term of the contract can be qualified as a standard term according to LOA §35 (1)’.^{*35} It was only recently that the Supreme Court returned, emphasising that ‘upon the reopening of the matter, the court must of its own motion assess also whether the above-mentioned contract clauses are standard terms’^{*36}. Hence, the present position of the Supreme Court on this issue coincides with that of the European Court of Justice.^{*37}

At least to date, the European Court of Justice has not adopted a position whether the obligation to examine *ex officio* the unfairness of standard terms extends to arbitral tribunals. In legal literature, the unwillingness of the European Court of Justice to express its opinion about this issue has been ascribed to the fact that it is an extremely sensitive issue from the point of view of legal policy relating to the interrelationships between European Union law, national procedural law and arbitration law.^{*38} The author thinks that it would be reasonable for arbitral tribunals to also observe the principles provided in the judgements of the European Court of Justice to preclude—as will be soon demonstrated—the possibility to assess the unfairness of arbitration clauses and as a result annul the judgements of arbitral tribunals later on.

^{*30} See for details M. Ebers, From Oceano to Asturcom: Mandatory Consumer Law, Ex Officio Application of European Union Law and Res Judicata. – European Review of Private Law 2010/4, pp. 825–828.

^{*31} See case 14.12.1995, joined cases C-430-431/93, *van Schijndel*. – ECR I-4705, p. 21.

^{*32} *Pénzügyi Lízing* (Note 5), paragraphs 49, 56.

^{*33} *Pénzügyi Lízing* (Note 5), paragraph 51. The excess interference by the Court of Justice in the procedural autonomy of the Member States has also been criticised. See T. Pfeiffer, EuGH: Kompetenzen des EuGH bei der Auslegung der Klauselrichtlinie und die Pflicht der nationalen Gerichte zur Amtsermittlung. Kommentierte BGH-Rechtsprechung Lindenmaier-Möhring (LMK) 2010, 311868.

^{*34} See CCSCd, 3-2-1-59-05, paragraph 17; 3-2-1-140-05, paragraph 12. A similar position is upheld in the Comments on the Law of Obligations Act (Note 10), pp. 126–127.

^{*35} See CCSCd, 3-2-1-150-06, paragraph 17; the same position was repeated in decision 3-2-1-45-07, paragraph 11.

^{*36} See CCSCd, 3-2-1-2-11, paragraph 12.

^{*37} The position of German law has been rather similar. It is namely held that in principle the consumer has to plead and prove that it was a standard term; yet the obligation is considered fulfilled already after the terms of the contract have been presented to the court in a printed or otherwise reproduced form. See Münchener Kommentar zum Bürgerliches Gesetzbuch. Band 2. Schuldrecht Allgemeiner Teil. Kommentator: E.-M. Kieninger. 5. Aufl. 2007, §305, margin No. 43.

^{*38} C. Mak, Judgement of the Court (First Chamber) of 6 October 2009, *Asturcom Telecomunicaciones SL v. Cristina Rodrigues Nogueira*, Case C-40/08. – European Review of Contract Law 2010/4, pp. 443–444.

4. Possibility to assess the unfairness of arbitration clauses in post-judgement stage

As a result of the request for preliminary ruling submitted by two Spanish courts, the European Court of Justice had to decide whether it could derive from European Union law that the voidness of unfair arbitration clauses could also be taken into account after the arbitral tribunal had made an award in the case. Moreover, could such an opportunity exist even if the national procedural law of the Member States did not allow it? And if yes, then if and under what circumstances should the court annul an award made by such an arbitral tribunal?

The case of *Mostaza Claro* gave rise to the question whether in a situation in which the consumer had not at all participated in the arbitration proceedings, but later on submitted an action for the annulment of the award of the arbitral tribunal, a court could *ex officio* assess the unfair nature of the arbitration clause and annul the award of the arbitral tribunal as a result. In this case, the settlement of disputes related to the contract was subordinated to an arbitral tribunal in the standard terms of a mobile telephone contract entered into with the consumer. The consumer presented her objections to the action in the arbitral proceedings but did not contest the competence of the arbitral tribunal or claim the unfairness of the arbitration agreement. The arbitrator found against her. After that, the consumer contested the arbitration decision before the court, applied for the annulment of the arbitration award and for the first time claimed that the arbitration agreement had served as an unfair standard term and thus the arbitration agreement had been void from the start.^{*39} The court that had received the action for annulment referred to the European Court of Justice for a preliminary ruling and posed the following question:

May the protection of consumers under Council Directive 93/13/EEC [...] require the court hearing an action for annulment of an arbitration award determine whether the arbitration agreement is void and to annul the award if it finds that the arbitration agreement contains an unfair term to the consumer's detriment, when that issue is raised in the action for annulment but was not raised by the consumer in the arbitration proceedings?^{*40}

The European Court of Justice stressed that in the case of standard terms, the consumer was in a weaker position vis-à-vis an operator and such an imbalance might only be corrected by positive action unconnected with the actual parties. It was the nature and importance of public interest underlying the protection which the Directive conferred on consumers that justified, according to the European Court of Justice, that the national court could determine of its own motion the unfair nature of the term and compensate this way for the imbalance which existed between the consumer and the seller or supplier.^{*41} As a result, the European Court of Justice assumed the position that the national court seised of an action for annulment of an arbitration award had to determine whether the arbitration agreement was void and annul that award where that agreement contained an unfair term, even though the consumer had not pleaded that invalidity in the course of arbitration proceedings, but only in that of the action for annulment.^{*42}

The Estonian court must also consider the positions provided in the *Mostaza Claro* judgement when interpreting CCP §751 (1) 2). Namely, according to CCP §751 (1) 2), the court shall annul a decision of an arbitral tribunal made in Estonia if the party proves that the arbitration agreement is null and void pursuant to the laws of Estonia or another state, based on whose law the parties agreed to assess the validity of the arbitration agreement. Hence, the possible unfairness of an arbitration agreement contained in standard terms in accordance with LOA §42 (3) 10) must be assessed also when deciding on the action for annulment of the decision of an arbitral tribunal. However, it is questionable if indeed the consumer should prove the voidness of an arbitration clause, as it derives from the wording of CCP §751 (1) 2), or the duty of the court to identify the voidness of standard terms *ex officio* deriving from the earlier judgements of the

³⁹ *Mostaza Claro* (Note 2), paragraphs 16–18.

⁴⁰ *Ibid.*, paragraph 20.

⁴¹ *Ibid.*, paragraphs 25, 26, 38.

⁴² *Ibid.*, p 39. The author supposes that the unfairness of an arbitration clause should be taken into account also when a consumer has recourse to the courts against an operator and the operator contests the competence of the court, relying on the existence of the arbitration clause. However, N. Reich (Note 14), p. 43, holds a different opinion.

European Court of Justice^{*43} should be recognised here as well. The author supports approval of the latter position. This is also supported by the conclusion of the *Mostaza Claro* judgement, according to which the court 'must determine whether the arbitration agreement is void'. Hence, CCP §751 (1) 2) is obviously not in accordance with European Union law in that part and, based on the principle of interpretation in conformity with the directive, the provision should be interpreted so that in such a situation as set out in the provision, the court determining the voidness of the arbitration award must determine *ex officio* whether the arbitration agreement contained in standard terms is void.

While the *Mostaza Claro* case arose from the problem that the consumer did not rely on the voidness of the arbitration clause during arbitral proceedings, the behaviour of the consumer was even more passive in the *Asturcom* case. Namely, throughout the arbitration proceedings, the consumer had not expressed any objection to the competence of the court of arbitration or the claim lodged against her. The consumer did not contest the arbitration award in a national court during the period prescribed for that in Spanish law either. Hence, the arbitration award entered into force and was submitted to a national court to be declared enforceable. When deciding on the enforceability of the arbitration award, the court had the question of whether, based on the Directive on unfair terms, it could determine of its own motion whether it was an unfair standard term to the detriment of the consumer and if yes, if it could annul the arbitration award on these grounds. To obtain an answer, the court referred the matter for preliminary ruling to the European Court of Justice.^{*44}

This case saw the collision of three important principles that are also recognised by the European Court of Justice: the principle of protection of consumers, the principle of efficient arbitration proceedings and the principle of *res judicata*, and the European Court of Justice had to seek a reasonable balance between these principles. When expressing its opinion, the European Court of Justice referred to its previous judicial practice, according to which the Member States are generally free to apply national procedural rules (principle of procedural autonomy of the Member States), but the freedom is restricted by a) the principle of effectiveness and b) the principle of equivalence.^{*45} The principle of effectiveness means that the national procedural order of a Member State may not render the exercise of individual rights conferred by European Union law impossible or excessively difficult. According to the principle of equivalence, the national procedural rules of a Member State must not place individuals in a less favourable situation upon exercising the individual right arising from European Union law than those governing domestic actions.^{*46} The European Court of Justice noted that Spanish procedural rules were in line with the principle of effectiveness but identified an opportunity to allow for the limited examination of the validity of arbitration clauses via the principle of equivalence.

The European Court of Justice namely established that pursuant to the principle of equivalence, it was required that the conditions of applying the legal provision of the European Union arising from national law would not be less favourable than the conditions of the application of the national provisions of the same ranking of its own motion. The Court further stated that Article 6 of the Directive on unfair terms served as a provision that was extensively based on public interest (protection of consumers against unfair terms), and that is why Article 6 of the Directive had to be regarded as a provision of equal standing to national rules which rank, within the domestic legal system, as rules of public policy.^{*47} Hence, Article 6 of the Directive, pursuant to which the Member States must ensure that unfair terms are not binding on the consumer, was promoted to the rank of public policy (*ordre public*).

The procedural laws of many Member States provide for the possibility of annulment of arbitration awards provided that the arbitration award is in conflict with the rules of public policy but not all the Member States allow for its assessment *ex officio*.^{*48} Against this background, the European Court of Justice established the following rule: inasmuch as the national court or tribunal seised of an action for enforce-

⁴³ For this, see Chapter 3.

⁴⁴ *Asturcom* (Note 3), paragraphs 20–27.

⁴⁵ *Mostaza Claro* (Note 2), paragraph 24; *Asturcom* (Note 3), paragraph 38.

⁴⁶ *Mostaza Claro* (Note 2), paragraph 24. For the principles, see—particularly in the context of the *Asturcom* case—H. Schebesta. Does the National Court Know European Law? A Note on Ex Officio Application after *Asturcom*. – European Review of Private Law 2010/4, pp. 857–859 and 877–878.

⁴⁷ *Asturcom* (Note 3), paragraphs 49, 52.

⁴⁸ This is disputable, for example, in Spanish law that is why the Spanish court finally decided to declare the arbitration award enforceable. See C. Mak (Note 38), pp. 446–447.

ment of a final arbitration award is required, in accordance with domestic rules of procedure, to assess of its own motion whether an arbitration clause is in conflict with domestic rules of public policy, it is also obliged to assess of its own motion whether that clause is unfair standard term. The Court emphasised that the national court or tribunal was also under such an obligation where, under the domestic legal system, it had a discretion, i.e., right to consider of its own motion whether such a clause was in conflict with national rules of public policy.^{*49}

Hence, there cannot be an unambiguous answer to the question whether a court determining the enforceability of an arbitration award can avoid declaring the arbitration award enforceable because of the unfair nature of the arbitration award based on European Union law and the answer will depend on the national procedural law of the Member State. If the national procedural law of a Member State does not allow for the annulment of an arbitration award that is in conflict with national rules of public policy of the court's own motion, the court cannot do that based on the provisions of consumer protection of the European Union either.^{*50} In an opposite case, the national court must annul the arbitration award.^{*51}

According to CCP §751 (2) 1), the court shall annul a decision of an arbitral tribunal based on the request of a party or at the court's initiative if the court establishes that pursuant to Estonian law, the dispute should not have been adjudicated by an arbitral tribunal. The court has a similar right if the decision of the arbitral tribunal is contrary to Estonian public order or good morals (CCP §751 (2) 2). According to CCP §753 (2), the court shall dismiss a petition for declaring a decision of an arbitral tribunal to be subject to enforcement and shall annul the decision if a cause for annulment of the decision of the arbitral tribunal exists. Thus, considering the rule provided in the *Asturcom* case and the principle of interpreting in conformity with the Directive, an Estonian court must refrain from declaring the decision of an arbitral tribunal enforceable and annul the decision of its own motion. The positions provided in the *Asturcom* and *Pénzügyi Lízing* cases could give grounds to infer an even more extensive right of examination the court: namely, upon the receipt of a request for the enforcement of an arbitration award the court must *ex officio* examine whether it was a consumer dispute^{*52}, whether the arbitration clause was null and void and if yes, annul the arbitration award of its own motion. According to CCP §753 (1), this can be considered only in the case of a decision by a non-permanent arbitral tribunal, since a decision made in a proceeding of an arbitral tribunal operating in Estonia on a permanent basis is subject to recognition and enforcement without separate recognition and declaration of enforceability by the court.

5. Conclusions

Although the European Court of Justice can interpret general criteria used by the Community legislature in order to define the concept of unfair terms, the European Court of Justice is not competent to decide which arbitration and jurisdiction clauses can be regarded as unfair standard terms in a particular case. This falls within the competence of a national court that must consider, *inter alia*, the circumstances of a particular case and the context of national law upon the assessment of a standard term. The author supports the opinion that in the context of Estonian law, a standard term that deprives the consumer of the opportunity to have recourse to the courts and instead forces the consumer to settle potential disputes in an arbitral tribunal, must be generally regarded as unfair according to LOA §42 (3) 10) and hence void. The question of regarding an jurisdiction agreement entered into with the consumer as unfair does not play an important role in Estonian law since the agreements on jurisdiction contained in standard terms are, as a rule, void in consumer contracts according to CCP §104 (3) 1) because they were entered into before the arising of the dispute.

In the cases discussed in the paper, the European Court of Justice has significantly interfered with the principle of procedural autonomy and the adversary principle of the Member States. Namely, the European Court of Justice has emphasised several times that in certain cases the national court has to abandon its

⁴⁹ *Asturcom* (Note 3), paragraphs 53, 54.

⁵⁰ M. Ebers (Note 30), pp. 840, 846.

⁵¹ *Asturcom* (Note 3), end of paragraph 59.

⁵² This could be inferred, *inter alia*, from the prerequisite provided in paragraph 32 of the *Pannon* case: 'where it has available to it the legal and factual elements necessary for that task', which later in the *Pénzügyi Lízing* case were defined as the obligation of the court to examine of its own motion if the term falls within the scope of the Directive, see Chapter 3 above.

passive role and examine certain circumstances of its own motion, as it would otherwise be impossible to achieve the objective of consumer protection provided in the Directive on unfair terms. Hence, a national court has a duty to *ex officio* verify whether the terms of the contract are standard terms. The court must also assess the possible unfairness of standard terms of its own motion. A national court is under certain circumstances obliged to annul an arbitration award made on the basis of an unfair arbitration clause and do this even though the consumer has not contested the competence of the arbitral tribunal during the arbitration proceedings.

The arbitral tribunals should also observe the principles provided in the judgements of the European Court of Justice in order to avoid annulment of arbitration awards later on. This in turn means that it would generally be reasonable for operators to avoid using arbitration clauses in standard contracts entered into with consumers, and negotiate those terms individually.



Piia Kalamees

Magister artium, Lecturer of Civil Law

University of Tartu

Hierarchy of Buyer's Remedies in Case of Lack of Conformity of the Goods

1. Introduction

If a buyer has received from the seller goods that do not conform to the contract, the buyer has, as a rule, recourse to several remedies. According to the Estonian Law of Obligations Act^{*1} (hereinafter referred to as the LOA), if relevant prerequisites are fulfilled, the buyer can have recourse to the following remedies:

- claim the performance of the contract through replacement or repair of the thing (LOA §222),
- withhold performance (LOA §111),
- claim compensation for damage (LOA §115),
- terminate the contract (LOA §116 (1)) or
- reduce the price (LOA §112).

The Estonian regulation of sales contracts has been largely founded on the United Nations Convention on Contracts for the International Sale of Goods^{*2} (hereinafter referred to as the CISG), but also on the German, Dutch, Swiss, Italian, etc. law provisions concerning contracts of sale of goods.^{*3} Directive 1999/44/EC^{*4} (hereinafter referred to as the Consumer Sales Directive) has served as the basis regarding contracts entered into with consumers.^{*5} At the same time, the provisions of the Consumer Sales Directive have not always been adopted solely in regard to the regulations on consumer sales but often also in regard to the provisions that are applied to all sales contracts.^{*6}

This article focuses on the question of whether the buyer has (both in cases where the buyer is a consumer and where he is not) the right to freely choose between the remedies available to him in the case of defective goods or whether his choice is limited according to the LOA. This question is of interest, above all, with regard to the attempts to harmonise the regulation of consumer rights in the European Union.

¹ Võlaõigusseadus. – RT I 2001, 81, 487; RT I, 4.4.2011, 3 (in Estonian).

² RT II 1993, 21/22, 52.

³ 116 SE I. Võlaõigusseadus (Law of Obligations Act. Draft). Available at <http://web.riigikogu.ee/ems/saros-bin/mgetdoc?it=emid=991610001&login=proov&password=&system=ems&server=ragne11> (28.3.2010) (in Estonian).

⁴ Directive 1999/44/EC of the European Parliament and of the Council of 25 May 1999 on certain aspects of the sale of consumer goods and associated guarantees. – OJ L 171, 7.7.1999, pp. 12–16.

⁵ 116 SE I. Law of Obligations Act. Draft (Note 3).

⁶ See, e.g., LOA §222 (demand for performance of contract as a remedy), §223 (fundamental breach of contract by the seller).

Namely, the text of the new draft Directive on consumer rights^{*7} (hereinafter referred to as the draft Directive) published in 2008 prescribed the hierarchy of remedies of the buyer like the currently applicable Consumer Sales Directive does.^{*8} Moreover, according to Article 4 of the draft Directive, the Directive was aimed at maximum harmonisation. The issue of the hierarchy of the buyer's remedies has been excluded from the current text of the directive adopted by the European Parliament.^{*9} However the establishment by a directive of such a hierarchy in all the European Union Member States has been considered for a long time. In several Member States the latter would have brought about a reduction in the level of protection of consumer rights.^{*10}

At the same time, on 3 May 2011, the text of the draft version of an Optional Instrument^{*11} (hereinafter referred to as the Optional Instrument) was published, which the European Commission could use as a 'toolbox' in the further regulation of European contract law.^{*12} The latest text of the draft version of the Optional Instrument was published on 19 August 2011.^{*13} According to its Article 107 (3) 1), the consumer may use any remedies mentioned in the instrument without granting the seller an option to cure. Hence, it is recommended by the Optional Instrument to provide for the absence of hierarchy of the consumer's remedies and in addition to that also for the right of the consumer not to grant the seller a possibility to cure his non-performance.

This article shows that according to the LOA, both a buyer who is a consumer and a buyer who is not a consumer have in case of defective goods the right to freely choose a remedy suitable for him subject only to right of the seller to cure the non-performance. This means that the LOA lacks a hierarchy of the buyer's remedies. The hierarchy of remedies would exist if the buyer was able to use other remedies only after he claimed from the seller performance through replacement or repair (LOA §222 (1)), or granted an additional time for the performance of the obligation (LOA §114 (1)).^{*14} It will also be demonstrated below that the rights of the buyer and the seller are balanced provided that the remedies used by the buyer are not in hierarchy but the buyer's opportunity to resort to any of the remedies is limited solely by the seller's right to cure his non-performance.

2. General rule on the buyer's choice of remedy

A general rule on the freedom to choose a remedy is contained in LOA §101 (2). According to that rule, in the case of non-performance, the obligee may resort to any remedy separately or resort simultaneously to all remedies which arise from law or the contract and which can be invoked simultaneously, unless otherwise provided by law or the contract. Hence it could be concluded that a buyer who has received from the seller defective goods should, as a rule, be able to independently decide to which of the above-mentioned remedies he wishes to resort. However before assuming such a position, it must be identified if, in the case of the sale of defective goods, the law contains special provisions providing for a hierarchy of remedies. In addition it should be noted that the parties are free to agree upon the sequence of using remedies in the contract and thus the right of the buyer to choose the remedy may be subject to such contractual restraints. The latter topic is however not addressed in this article.

⁷ COM(2008) 614, 8.10.2008.

⁸ Proposal for a Directive of the European Parliament and the Council on Consumer Rights COM (2008) 614 final. Explanatory Memorandum; Proposal on Consumer Rights Directive, preamble, No. 4, p. 3.

⁹ European Parliament legislative resolution of 23 June 2011 on the proposal for a directive of the European Parliament and of the Council on consumer rights (COM(2008)0614 – C6-0349/2008 – 2008/0196(COD)). Available at <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P7-TA-2011-0293+0+DOC+XML+Vo//EN&language=EN#BKMD-21> (25.7.2011).

¹⁰ K. Lilleholt. Notes on the Proposal for a New Directive on Consumer Rights. – European Review of Private Law 2009/3, p. 338.

¹¹ A European contract law for consumers and businesses: Publication of the results of the feasibility study carried out by the Expert Group on European contract law for stakeholders' and legal practitioners' Feedback. Available at http://ec.europa.eu/justice/policies/consumer/docs/explanatory_note_results_feasibility_study_05_2011_en.pdf (24.5.2011).

¹² *Ibid.*, p. 8.

¹³ Available at http://ec.europa.eu/justice/contract/files/feasibility-study_en.pdf (5.10.2011).

¹⁴ E.g., M. Schmidt-Kessel is in the same position concerning the furnishing of the notion of hierarchy with the content. The Right to Specific Performance under the DCFR. – G. Wagner (ed.). The Common Frame of Reference: A View from Law and Economics. Sellier 2009, p. 85.

The comments on the LOA note about the hierarchy of remedies that in the case of lack of conformity of a thing, the buyer can only request from the seller the performance of the contract under LOA §222 (1) and as a rule other remedies are secondary.^{*15} The EC Consumer Law Compendium sets out that Estonia has adopted the hierarchy of remedies that enables the consumer first to request only replacement or repair.^{*16} However, it remains questionable on what bases the positions described have been assumed, as the LOA contains no specific provision establishing such hierarchy.

As mentioned before, the freedom of the obligor to choose a remedy can be limited by the law itself, as provided in LOA §101 (2).^{*17} The regulation of termination of the contract (LOA §116 (1)) and reduction of price (LOA §112 (1)) in the case of sales contracts will be analysed below in order to trace any references to a hierarchy of remedies. One of the arguments supporting the existence of a hierarchy of remedies has been claimed to be the fact that the Consumer Sales Directive that served as one of the sources when drafting the relevant provisions of the LOA provides for a hierarchy of remedies in the case of defective goods.^{*18} Pursuant to Article 3 of the Directive, the buyer's primary remedies are the claim for replacement and repair, between which the consumer can choose^{*19}, and only after the replacement or repair become impossible or have not been carried out in timely manner or have brought about significant inconvenience for the consumer can the consumer resort to other remedies.^{*20} The Directive does not provide for the seller's opportunity to cure the non-performance.^{*21} This article limits itself only to the regulation of the termination of the contract and the reduction of the price, because termination and reduction of the price are secondary remedies according to the Consumer Sales Directive. At the same time, the Consumer Sales Directive does not regulate issues related to compensation for damages. Because of this and the volume of the article, the aspects of compensation for damage are not addressed here. Besides, the provisions governing the buyer's remaining remedies in the Chapter of the LOA on the sales contract lack references to the potential hierarchy of remedies.^{*22}

3. Buyer's right of termination in system of remedies

3.1. Regulation of the buyer's right of termination in LOA

According to LOA §116 (1), a fundamental breach of contract serves as a precondition for the termination of a contract. There are no other preconditions (e.g., grant of an additional term before termination) arising from LOA §116 (1).

LOA §116 (2) provides an illustrative list of circumstances considered as a fundamental breach of the contract.^{*23} LOA §116 (2) 1)–4) list the types of non-performance by an obligor that are regarded as

¹⁵ P. Varul *et al.* *Võlaõigusseadus II. Kommenteeritud väljaanne* (Law of Obligations II. Commented Edition). Tallinn: Juura 2007, p. 37 (in Estonian).

¹⁶ H. Schulte-Nölke, M. Ebers (eds.). *EC Consumer Law Compendium. The Consumer Aquis and its Transposition in the Member States*. Sellier 2008, p. 427.

¹⁷ P. Varul *et al.* *Võlaõigusseadus I. Kommenteeritud väljaanne* (Law of Obligations Act I. Commented edition). Juura 2006, p. 321 (in Estonian).

¹⁸ See M. Kingisepp. *Tarbijakaitseõigus Euroopa Liidus ja Eestis* (Consumer protection law in the European Union and Estonia). Läte 2011, p. 232 (in Estonian).

¹⁹ M. Loos. *Consumer Sales Law in the Proposal for a Consumer Rights Directive*. – *European Review of Private Law* 2010/1, p. 37; C. Twigg-Flesner. *Fit For Purpose? The Proposals on Sale*. – *Modernising and Harmonising Consumer Contract Law*. G. Howells, R. Schulze (eds.). Sellier 2009, p. 159; E. Grabitz, M. Hilf, M. Nettesheim. *Das Recht der Europäischen Union*. München 2009, Article 3, margin No. 20; R. O. Sale. *Italianische Rechtsprechung zum Gemeinschaftsprivatrecht – Der Verbrauchsgüterkauf zwischen Haftung des Verkäufers für Vertragswidrigkeit und Schutz des Verkäufers nach der Geltendmachung der dem Verbraucher zustehenden Rechtsbehelfe*. – *GPR* 2010/3, p. 146.

²⁰ M. Loos (Note 19), p. 36; C. M. Bianca, S. Grundmann. *EU Sales Directive. Commentary*. Intersentia 2002, p. 159, 168; Directorate General for International Policies. *The Potential Impact of the Consumer Rights Directive on Member States' Contract Law*, 2009, p. 25. Available at http://www.directsellingeurope.eu/public/Analysis_and_background_documents/European%20Parliament%20-%20study_ConsRights_ImpactMS_09.pdf (7.4.2011).

²¹ M. Schmidt-Kessel. *Remedies for Breach of Contract in European Private Law*. – R. Schulze. *New Features in Contract Law*. Sellier 2007, p. 195.

²² Here LOA §222 serves as an exception, providing for in its subsection 2 that when choosing between the replacement and repair of the thing, the buyer may in first place claim the repair if the given contract of sale is not a contract of consumer sale. However, the provision does not have a wider impact on the buyer's right to use different remedies.

²³ V. Kõve. *Draft Common Frame of Reference and Estonian Law of Obligations Act: Similarities and Differences in the System of Contractual Liability*. – *Juridica International* 2008 (XIV), p. 204.

fundamental. Thus, for example, according to LOA §116 (2) 2), a breach of contract is fundamental if strict compliance with the obligation which has not been performed is the precondition for the other party's continued interest in the performance of the contract, and according to LOA §116 (2) 3), if non-performance of an obligation was intentional or due to gross negligence. LOA §116 (2) 5) sets out that a breach of contract is fundamental also if the other party fails to perform any obligation thereof during an additional term for performance granted by the obligee or gives notice that he will not perform the obligation during such term. Hence, LOA §116 (2) 5) enables the obligee to terminate the contract also upon a non-fundamental breach if the obligor does not eliminate the breach during the specified term.^{*24}

Although in the event indicated in LOA §116 (2) 5), the obligee must essentially require performance of the obligation before termination of the contract, this does not serve as a general prerequisite for the right to termination. It only provides for an additional possibility for the termination of the contract in cases where grounds of fundamental breach of the contract would in normal circumstances be denied. Hence, if it is not possible to prove that the obligor has failed to perform an obligation in a manner that would allow to consider his breach fundamental as defined in LOA §116 (2) 1)–4), the obligee may nevertheless turn the obligor's breach of contract into a fundamental breach by requiring performance of the obligation within an additional term. LOA §116 (2) 5) is of considerable practical importance as it enables the obligee to free himself of the uncertainty about whether the non-performance by the obligor can be regarded as fundamental.^{*25} Taking into account that the wording of the situations of fundamental breach of contract listed in LOA §116 (2) 1)–4) are rather general, it is often advisable in practice to grant the obligor an additional term for performance before terminating contract. Despite the abovementioned, the author of this article is not of the opinion that the objective of LOA §116 (2) 5) is to establish a hierarchy among the remedies, but the idea is rather to give the obligee an additional opportunity to demonstrate the fundamental nature of the non-performance by the obligor.

In the event of fundamental breach of contract as defined in LOA §116 (2) 1)–4), the buyer should be entitled to terminate the contract by submitting a timely declaration of termination and the previous claim for performance does not serve as a prerequisite for the right of termination (there is no hierarchy between the two remedies). The buyer's immediate right of termination is in certain cases limited only by LOA §116 (4), according to which termination of a contract without granting an additional term for performance is prohibited if the damage suffered by the non-performing party in the case of the termination would be disproportionate in relation to the expenses incurred in the performance or preparation for the performance of the obligation. However, terminating the contract without granting an additional term is permitted in the event of non-performance of an obligation specified in §116 (2) 2)^{*26} or if the other party gives notice that the party will not perform the obligation thereof (the second sentence of LOA §116 (4)). Consequently, a buyer who wishes to terminate the contract must generally consider whether the termination would cause disproportionate damage to the seller in relation to the expenses incurred in the performance or preparation for the performance of the obligation. If the exercise of the right of termination would cause such damage and the situations specified in the second sentence of LOA §116 (4) are not present, the buyer must grant the seller an additional term for performing the obligation (essentially demand performance before terminating the contract). Since it can be difficult for the buyer to foresee the damage incurred by the seller, it has generally been considered advisable to grant an additional term before termination.^{*27} Yet, it has been noted in legal literature about LOA §116 (2) and (4) that the effect of the provisions on each other remains unclear.^{*28}

Based on the above, the author is of the opinion that according to the regulation of the termination of the contract contained in the general part of the LOA, the buyer is not, as a rule, obliged to grant an additional term for the seller to perform the obligation and, as a result, there is no hierarchy between the claim for performance and the right of termination. Nevertheless such a hierarchy may arise in regard to specific

²⁴ It is not, however acceptable, to allow for termination under LOA §116 (2) 5) if the breach is of inferior importance in respect of the entire contract. P. Varul *et al.* (Note 17), p. 402.

²⁵ P. Varul *et al.* (Note 17), p. 402.

²⁶ According to LOA §116 (2) 2), breach is a fundamental breach of contract if strict compliance with the obligation which has not been performed is the precondition for the other party's continued interest in the performance of the contract.

²⁷ P. Varul *et al.* (Note 17), p. 402.

²⁸ V. Kõve (Note 23), p. 204.

circumstances emerging in practice and in such cases it may be necessary to grant the obligor an additional term for performance based on LOA §116 (2) 5) or (4).

However, there is often no need for a buyer receiving goods that lack conformity to demonstrate a fundamental breach of the seller based on LOA §116. Namely, in the case of a sales contract, LOA §223 (1) and (2) complement the list provided in LOA §116 (2) with additional cases of a fundamental breach of the contract.^{*29} According to LOA §223 (1), the seller is deemed to be in fundamental breach of the sales contract also if

- 1) the repair or replacement of a thing is not possible or fails;
- 2) the seller refuses to repair or replace a thing without good reason, or
- 3) the seller fails to repair or replace a thing within a reasonable period of time after the seller is notified of the lack of conformity.

Pursuant to the third alternative of LOA §223 (1), the seller is already in fundamental breach of his obligations if he fails to give notice of his intention to cure at his own initiative within a reasonable period of time (LOA §107^{*30}). The same position has been expressed by the Supreme Court, noting that according to LOA §223 (1) it is not only the case where the claim of the buyer for repair or replacement of the goods has not been fulfilled by the seller that constitutes a fundamental breach.^{*31}

Pursuant to LOA §223 (2), in the event of consumer sale, any unreasonable inconvenience caused to the buyer by the repair or replacement of a thing is also deemed to be a fundamental breach of the contract by the seller. The situation of such significant breach of contract as described above can only occur if the buyer has demanded from the seller performance of the obligation (LOA §222 (1)) or the seller has undertaken to cure the breach at his own initiative (LOA §107).

If the breach of contract is fundamental, as defined in LOA §223 (1) or (2), then LOA §223 (3) enables the buyer to terminate the contract without granting the seller an additional term for performing the obligation. This provision once more reinforces the principle arising from LOA §116, according to which the buyer is not obliged to grant the seller an additional term for performing the obligation as a precondition for terminating the contract in the case of a fundamental breach of contract.^{*32}

Based on the above, one can assume the position that there is generally no hierarchy between the claim for the replacement or repair of the goods and the termination of the contract as remedies in the event of a fundamental breach of the contract. Provided that the preconditions for resorting to these remedies are met, the buyer can choose termination as the first remedy to be used. The buyer must naturally take into account the principle of good faith set out in LOA §6 and General Part of the Civil Code Act^{*33} (hereinafter referred to as the GPCCA) §138. This means that one cannot terminate the contract when one acts in bad faith while exercising the right to terminate.^{*34} At the same time the buyer's obligation to act in good faith when terminating the contract certainly does not make the claim to perform the obligation (LOA §222 (1)) a primary remedy and the right of termination a secondary remedy.

²⁹ P. Varul *et al.* (Note 15), p. 63.

³⁰ According to LOA §107 (1), a party who fails to perform a contractual obligation may cure the non-performance, including improving or replacing defective performance, as long as the other party has not terminated or cancelled the contract or demanded compensation for damage in lieu of performance, provided that:

- 1) cure is reasonable in the circumstances, and
- 2) cure does not cause unreasonable inconvenience or expenses to the injured party, and
- 3) the injured party has no legitimate interest in refusing cure.

According to subsection 3 of the same section, the injured party may withhold performance as of receipt of the notice of cure until completion or failure of the cure. During the time for cure, the injured party may use other remedies only if these are not inconsistent with the cure.

³¹ CCSCd, 3-2-1-11-10, paragraph 11. – RT III 2010, 11, 80 (in Estonian).

³² See also P. Varul *et al.* (Note 15), p. 64.

³³ Tsiviilseadustiku üldosa seadus. – RT I 2002, 35, 216; RT I, 06.12.2010, 12 (in Estonian).

³⁴ P. Varul *et al.* (Note 17), p. 402.

3.2. Buyer's right to terminate in CISG, DCFR^{*35}, Consumer Sales Directive, German Civil Code^{*36} and Optional Instrument

The above position is also supported by the sources serving as the basis for the regulation of the termination of the sales contract in the LOA. For example, CISG Article 49 (1) a) provides for the buyer's opportunity to avoid the contract if the object of the contract is defective. According to this, the buyer may declare the contract avoided if the failure by the seller to perform any of his obligations amounts to a fundamental breach of the contract. The wording of the provision, or the provision in conjunction with the other provisions of the CISG, does not suggest that the buyer should have previously claimed replacement or repair of the goods. Hence, the CISG is also subject to the rule that the termination may be the first remedy to be used by the buyer^{*37}, while the seller can limit the opportunity of the buyer to resort to it only by exercising his right of cure (CISG Article 48).^{*38}

Chapter 4 of Part A in Book IV that governs contracts for sale in the DCFR does not provide for major differences compared to the general regulation of remedies in the DCFR.^{*39} Article III.-3:502 (1) of the DCFR gives grounds for termination; according to it, the creditor may terminate the contract if the debtor's non-performance of a contractual obligation is fundamental. In the case of deficiencies that represent a fundamental breach of the contract, the buyer can resort to termination of the contract as a primary remedy and need not first claim replacement or repair or grant an additional term for the performance of the obligation. Hence, the rule is that the buyer can choose any remedy if the necessary preconditions exist.^{*40}

The regulation of BGB §440^{*41} and Articles 3 (3) and (5) of the Consumer Sales Directive that served as the basis for drafting the relevant provisions on the contract of sale in the LOA differ from those described. The main difference here is that pursuant to both the Consumer Sales Directive^{*42} as well as BGB §440^{*43} the previous claim for the replacement or repair of the goods and the failure to satisfy the claim by the seller generally serves as a precondition for the buyer's right of termination.^{*44} Thus termination is a secondary remedy according to the Consumer Sales Directive as well as the BGB. However as the Consumer Sales Directive requires minimum harmonisation^{*45}, the regulation of the LOA diverging from the Directive in favour of the buyer is allowed with regard to consumer sales and in accordance with the EU law.

The above once more confirms the author's opinion that pursuant to the LOA, the buyer who received non-conforming goods need not as a rule claim performance before exercising the right of termination if the breach is fundamental. Namely, in the BGB and the Consumer Sales Directive, the hierarchy of remedies arises directly from the wording of the provisions concerned. As demonstrated, the wording of the LOA does not point to such a hierarchy. Hence, the approach chosen in the LOA is similar to that of the CISG^{*46}, and according to this, the buyer usually has the freedom to choose between different remedies.

Article 115 of the Optional Instrument does not prescribe the previous claim for performance as a precondition for the exercise of the buyer's right of termination either. Unlike the regulation of the LOA,

³⁵ C. von Bar, E. Clive, H. Schulte-Nölke (eds.). Principles, Definitions and Model Rules of European Private Law: Draft Common Frame of Reference. Interim Outline Edition. München: Sellier 2009.

³⁶ *Bürgerliches Gesetzbuch*, adopted on 18.8.1896. – RGBL., p. 195.

³⁷ P. Schlechtriem, I. Schwenzer. Commentay on the UN Convention on the International Sale of Goods (CISG). 3rd ed. Oxford University Press 2010, Article 45, comment 12; T. Bachmann. Die elektive Konkurrenz. Berlin: Duncker & Humboldt 2010, p. 238; A. Mittmann. Einheitliches UN-Kaufrecht und Europäische Verbrauchsgüterkauf-Richtlinie. Peter Lang 2004, p. 135.

³⁸ K. Lilleholt (Note 10), p. 338; B. S. Markesinis, H. Unberath, A. Johnston. The German Law of Contract. A Comparative Treatise. 2nd ed. Hart Publishing 2006, p. 389.

³⁹ M. Loos (Note 19), p. 27.

⁴⁰ *Ibid.*, p. 28.

⁴¹ P. Varul *et al.* (Note 15), p. 63.

⁴² M. Loos (Note 19), p. 37; E. Grabitz, M. Hilf, M. Nettesheim (Note 19), Article 3, margin No. 20.

⁴³ H. P. Westermann. Münchener Kommentar zum BGB. 5. Aufl. München: Verlag C. H. Beck 2008, §440, margin No. 3, 5.

⁴⁴ *Ibid.*, §434, margin No. 47; H. Amann, G. Brambring, C. Hertel. Der Schuldrechtsferorm in der Vertragspraxis. München: Verlag C. H. Beck 2002, p. 114; S. Lorenz. Selbstvornahme der Mängelbeseitigung im Kaufrecht. NJW 2003, 1417; U. Verwey. Die Käufrechtsbehelfe des UN-Kaufrechts im Vergleich zu denen des neuen internen deutschen Handelskaufsrechts aus Sicht eines deutschen Warenexporteurs. Peter Lang 2005, p. 72.

⁴⁵ H. Schulte-Nölke, M. Ebers (eds.) (Note 16), p. 427.

⁴⁶ H. Sivesand. The Buyers Remedies for Non-Conforming Goods. Should There be Free Choice or are Restrictions Necessary? Vol 2. Sellier 2005, p. 127.

according to Article 115 (2) of the Optional Instrument, the consumer may terminate the contract in case of non-conformity of the goods, unless the non-conformity is insignificant. In case of non-consumer sales, subsection 1 still provides for fundamental breach as a precondition for termination. Thus under the Optional Instrument in the case of a consumer sale, the buyer enjoys a considerably wider opportunity of terminating the contract than permitted by the legislation and model act described above.

The absence of hierarchy between the buyer's right of termination and the claim for performance as described above helps appropriately balance the rights of the buyer and the seller. For example, it is possible that a fundamental breach by the seller is so serious that the buyer has lost trust in the seller. In such a case, it is reasonable to enable the buyer to terminate the contract immediately without compelling him to submit an additional claim.^{*47} The buyer may also incur additional damage or inconvenience over time while he is waiting for the replacement or repair.^{*48}

4. Buyer's right to reduce the price in LOA's system of remedies

The general regulation concerning the reduction of the price is in LOA §112. According to subsection 1, a party may reduce the price, if the party accepts defective performance. This section does not require the obligee to grant an additional term (LOA §114) for the obligor to perform the obligation before reducing the price. Yet, it has been established that the obligation to grant an additional term may in certain cases arise from the principle of good faith (LOA §6, GPCCA §138).^{*49} However, granting an additional term for the performance of an obligation is not, as a rule, a precondition for the obligee to reduce the price.

When it comes to reducing the price, an additional regulation^{*50} is provided by LOA §224, according to which the buyer may not reduce the purchase price:

- 1) if the seller repairs the thing or replaces it (clause 1);
- 2) if the buyer unreasonably refuses to accept the proposal of the seller concerning the repair or replacement of the thing (clause 2), or
- 3) upon the purchase of a used thing which is sold by public auction (clause 3).

According to legal literature clauses 1 and 2 essentially preclude the reduction of the price by the buyer if the seller is willing to repair or replace the non-conforming goods and does it within a reasonable period of time.^{*51}

LOA §224 2) precludes the buyer's right to reduce the price if the seller has offered cure (LOA §107). Clause 1 precludes the buyer's opportunity to reduce the price if the seller has cured the non-performance or the buyer has claimed replacement or repair and the seller has satisfied the relevant claim. Hence, the provision does not oblige the buyer to claim replacement or repair of the goods before reducing the price. In other words, the wording of LOA §224 does not presume that the buyer has claimed the replacement or repair of the goods prior to the reduction of the price. However, proceeding from the above, one must agree with the position taken in the comment on the LOA that the seller's right to replace or repair (to cure within the meaning of LOA §107) the non-performance has priority over the right of the buyer to reduce the price.^{*52}

The opinion that the buyer need not claim replacement or repair of the non-conforming goods before reducing the price is also supported by CISG Article 50 that serves as an example for drafting the relevant provisions of the LOA. Pursuant to the second sentence of Article 50, the buyer's right to reduce the price is precluded if the seller cures any failure to perform his obligations or offers cure and the buyer refuses it without good reason. This means that even if the buyer has made a declaration of price reduction along with the notice of lack of conformity of the goods, the seller may still replace or repair the goods.^{*53} Therefore,

⁴⁷ M. Loos (Note 19), p. 41.

⁴⁸ *Ibid.*, p. 40.

⁴⁹ P. Varul *et al.* (Note 17), p. 374.

⁵⁰ P. Varul *et al.* (Note 15), p. 65.

⁵¹ *Ibid.*

⁵² In relation with the contractor's liability for work that lacks conformity with the contract, this has been stated by the Supreme Court in its decision 3-2-1-148-08, paragraph 12. – RT III 2009, 10, 73 (in Estonian).

⁵³ P. Schlechtriem, I. Schwenzer (Note 37), Article 50, comment 7.

CISG Article 50 does not impose the previous claim for replacement or repair as a precondition for reduction of price (Article 46 (2) and (3)).⁵⁴

Just as in the LOA, price reduction is not a secondary remedy in the DCFR either. As in Estonian law, the right to price reduction in the DCFR is limited only by the seller's right to cure the non-performance (through replacement or repair of the goods).⁵⁵ The regulation found in the Optional Instrument is generally similar. Article 121 of the Optional Instrument does not impose on the buyer the obligation to claim performance before reduction of the price. The regulation of the BGB on the other hand differs from the above by setting out the priority of the claim for performance over the right of price reduction.⁵⁶ The relevant regulation of the BGB, however, has not served as a source for drafting LOA §224.⁵⁷

The regulation according to which the price reduction is not a secondary remedy must be regarded as appropriate. In such a case, the buyer retains the opportunity to keep the defective goods, if he so wishes (and if the seller does not wish to cure his non-performance) and start to use them immediately without having to claim the repair or replacement of the goods, which can be time-consuming.

5. Impact of the seller's right to cure on buyer's right to terminate the contract and reduce the price

From the seller's point of view, the buyer's freedom to choose without limitations a remedy suitable for him brings about a degree of uncertainty and can disproportionately damage the seller's rights. As demonstrated before, according to the Consumer Sales Directive⁵⁸ and BGB⁵⁹, the seller is protected against the negative consequences that could be inflicted on him through granting priority to the claim for performance. In both instruments, the legislator has aimed at keeping the contract unchanged, i.e. as it was concluded between parties, for as long as possible (*pacta sunt servanda*).⁶⁰

This has also been the goal of the Estonian legislator when drafting the LOA⁶¹, but the means to achieve the goal have been different. Namely, the LOA enables the seller to cure non-performance (LOA §107).⁶² According to that, the seller who has delivered defective goods can replace or repair the non-performance as long as the buyer has not terminated the contract or claimed damages in lieu of performance. LOA §107 (1) 1)–3) and (2) impose additional limitations on the exercise of the right to cure. Allowing cure for the obligor is an expression of the general principle of good faith⁶³ and like in the LOA it has also been provided for in the CISG⁶⁴ and DCFR.⁶⁵

If the buyer wishes to reduce the price based on the defects of the goods sold, his right to resort to the remedy is limited by the seller's right to cure his non-performance (LOA §224).

The relationship between the seller's right to cure and the buyer's right to terminate the contract is different. As noted above, LOA §107 (1) provides that the seller may cure the non-performance, as long as the buyer has not terminated the contract. Thus, at the moment the buyer has terminated the contract on the grounds of the defects of the goods, the seller is deprived of the right to cure the non-performance.⁶⁶ However, as long as the buyer has not made a declaration of termination (but has, for example, notified the

⁵⁴ T. Bachmann (Note 37), p. 232; P. Schlechtriem, I. Schwenzer (Note 37), Article 47, comment 2.

⁵⁵ C. von Bar, E. Clive, H. Schulte-Nölke (eds.) (Note 35), p. 1341.

⁵⁶ H. P. Westermann (Note 43), §441, margin No. 1; T. Bachmann (Note 37), p. 233; B. S. Markesinis, H. Unberath, A. Johnston (Note 38), p. 510.

⁵⁷ P. Varul *et al.* (Note 15), p. 65.

⁵⁸ E. Grabitz, M. Hilf, M. Nettesheim (Note 19), Article 3, margin No. 15.

⁵⁹ B. S. Markesinis, H. Unberath, A. Johnston (Note 38), p. 514.

⁶⁰ E. Grabitz, M. Hilf, M. Nettesheim (Note 19), Article 3, margin No. 20; B. S. Markesinis, H. Unberath, A. Johnston (Note 38), p. 514.

⁶¹ P. Varul *et al.* (Note 17), p. 341.

⁶² See Note 29.

⁶³ P. Varul *et al.* (Note 17), p. 341.

⁶⁴ Article 48.

⁶⁵ Article III.-3:202.

⁶⁶ P. Varul *et al.* (Note 17), p. 343.

seller of the defects under LOA §220), the seller as a rule has the right to cure his non-performance. Also, according to Estonian law, the buyer's right to terminate the contract can depend on the seller's right to cure through the notion of fundamental breach of contract set out in LOA §223 (1) and (2). As indicated in Section 3.1 of this article, the seller can in certain cases preclude the buyer's opportunity to rely on fundamental breach of the seller's obligation if the seller cures the non-performance during a reasonable period of time.

Hence, the LOA usually prioritises the seller's right to perform his obligation according to the contract. By granting the seller the opportunity to cure the breach the buyer's recourse to different remedies is limited. Unlike claiming performance and granting an additional term for performing the obligation, in the case of cure of the breach the initiative to eliminate the breach originates from the seller.^{*67} That is why the seller's right to cure does not, in the opinion of the author of the article, introduce hierarchy to the system of buyer's remedies. Due to the nature of right to cure, it cannot be considered interchangeable with the use of a remedy by the buyer.^{*68}

For example, let us imagine a situation in which the buyer buys goods that turn out to be defective and informs the seller of the defect (LOA §220). The notice about the defect does not contain any other information. By submitting the notice, the buyer has in fact given the seller an opportunity to cure the non-performance but has not claimed performance from him (replacement or repair). In order to consider the claim of performance submitted, the buyer's relevant expression of will would be required. However, this cannot be identified merely from a notice about defects. Consequently, there is no hierarchy between the buyer's remedies in the LOA, yet the buyer's right to choose any remedy is as a rule limited by the seller's right to cure his non-performance.

The consumer sales regulation provided in the Optional Instrument differs from the description presented above. Article 110 (2) provides for the seller an opportunity to cure his non-performance. At the same time, according to Article 107 (3) 1), the seller's right to cure is precluded if the failure concerns a consumer sales contract. However, if the buyer is not a consumer, the seller has been granted an opportunity to cure his non-performance (subsection 2). Thus, in the case of a consumer sale, the consumer is pursuant to the Optional Instrument absolutely free to opt for any remedies of those specified in Article 107. The author of this article believes that this may have increased the level of protection of consumer rights but the seller has been forced to a considerably unfavourable position. This is especially true, considering the fact that according to the Optional Instrument, a consumer is entitled to terminate the contract already in the case of an insignificant breach of the contract (see Section 3.2 of this article).

The opportunity to cure after the failure to perform an obligation gives the seller as a rule in the case of non-performance an opportunity to perform his obligation and thereby preclude the buyer's right to resort to different remedies. The author of this article finds that the system is justified and appropriately balances the rights of the buyer and the seller.^{*69} It would be disproportionate to impose on the buyer an obligation to submit claim for performance against the seller before using other remedies because the seller has failed to perform his obligation. However, if the buyer is allowed to resort to any remedy, this can considerably damage the seller's interests.^{*70} Hence, it is appropriate to limit the buyer's rights, for example, through granting the seller the right to cure.^{*71} The advantage of the right to cure over prioritising the claim for performance is the fact that it compels the seller to act quickly to cure the non-performance, which also brings prompter legal clarity for the buyer about whether the seller intends to perform his obligation or not.^{*72}

Through cure, the seller has an opportunity to limit the buyer's options to use remedies but he must do it at his own initiative. Since he is also the party in breach of the contract, it should be in his own interests to do anything to perform his obligation as required (cure the non-performance).^{*73} At the same time, the permission to cure should not bring about considerable damage to the interests of either parties (including

⁶⁷ P. Huber. CISG – the Structure of Remedies. *Rabels Zeitschrift für ausländisches und internationales Privatrecht*. Bd. 71. 2007, p. 21.

⁶⁸ M. Schmidt-Kessel (Note 14), p. 194.

⁶⁹ In relation to the DCFR, the same position has been assumed by C. von Bar, E. Clive, H. Schulte-Nölke (eds.) (Note 35), p. 812.

⁷⁰ V. Mak. Performance-Oriented Remedies in European Sale of Goods Law. Article Publishing 2009, p. 184.

⁷¹ H. Sivesand (Note 46), p. 117.

⁷² *Ibid.*

⁷³ V. Mak (Note 70), p. 202.

the reduction in the level of protection of the rights of a buyer who is a consumer) because both parties have the performance of the contract as their primary interest. Permitting cure is also economically justified.⁷⁴

6. Conclusions

The analysis of the LOA provisions contained in the article showed that according to the regulation of a sales contract, the remedies that the buyer could use in the case of lack of conformity are not in hierarchical relationship to each other. There is no hierarchy among the buyer's remedies regardless of whether it is a consumer sales contract or any other sales contract.

The buyer's freedom of choice does not unreasonably damage the seller's rights either. Namely, according to LOA §107, the seller as a rule has the right to cure his non-performance as long as the buyer has not terminated the contract with the seller. By this, the Estonian legislator has provided as a rule for the seller an opportunity to limit the buyer's choice of remedies if the seller so wishes. Pursuant to LOA §107 (3), the buyer may usually not use other remedies apart from withholding performance as long as the seller cures his non-performance within the framework prescribed by law (above all, during a reasonable period of time after giving notice of his intention to cure). The regulation described thus grants the seller an opportunity to perform his obligation after the initial failure to do so.

It may be concluded that both the buyer's and seller's interests have been taken into account when drafting the regulation of the sales contract in the LOA and that the interests have been successfully balanced through a system of remedies, complemented by the seller's right to cure. Keeping in mind the developments of the European law specified at the beginning of the article, it would thus not be correct to impose on the buyer an obligation by all means to claim performance from the seller (also through the obligation to grant an additional term) before resorting to other remedies, as it had been prescribed by the draft directive on consumer rights for a long time. The demand for granting an additional term for performance as a prerequisite for using remedies is justified in legal systems in which the obligor is not entitled to the opportunity to cure (e.g., BGB). At the same time the value of the solution offered in the Optional Instrument, according to which a buyer who is a consumer could terminate the contract without granting the seller an opportunity to cure, should be seriously considered. This would ensure a great freedom of choice for the consumer but would probably leave the sellers' interests unprotected to a considerable degree.

⁷⁴ *Ibid.*, p. 149.



Olavi-Jüri Luik

Magister iuris

Attorney-at-law, Lextal Law Firm

Do the Principles of European Insurance Contract Law Go Too Far in Protecting the Policyholder?

1. Introduction

One of the purposes of the European Union (hereinafter referred to as the EU) is a functioning uniform internal market. However, a common market is largely based on contract law. The EU contains 27 different contract laws, making cross-border activity complicated and expensive. The European Commission is about to develop the Common Frame of Reference (hereinafter referred to as the CFR) for European contract law, one part of which is to cover insurance contracts (in the Principles of European Insurance Contract Law¹—hereinafter referred to as the PEICL²). The 1.7.2010 Green Paper from the European Commission on policy options for progress toward a European contract law for consumers and businesses³ was presented for public discussion with the aim of consultation concerning the possibilities for further developing the field of European contract law. In its Green Paper, the European Commission in essence proposes seven approaches for improving the coherence of European contract law, including an optional European Contract Law (i.e., the ‘28th regime’⁴ or the ‘second regime’), which would be an optional instrument for consumers and undertakings to apply in their contractual relationships.⁵ This optional right would be an

¹ Principles of European Insurance Contract Law: Project Group ‘Restatement of European Insurance Contract Law’, Common Frame of Reference. Chapter III, Section IX1. Insurance Contract. Available at <http://restatement.info/cfr/Draft-CFR-Insurance-Contract-17122007-FINAL.pdf> (1.3.2011).

² The general part (I part) and the non-life insurance part (II part) of the PEICL were first published and presented to the European Commission in December 2007, the III and the IV part are not complete yet, but will include life insurance and civil liability insurance (Project Group ‘Restatement of European Insurance Contract Law’. Available at <http://www.restatement.info/> (1.3.2011).

³ European Commission, COM(2010)348 final. Available at <http://eur-lex.europa.eu/Notice.do?mode=dbl&lang=et&lng1=et,en&lng2=bg,cs,da,de,el,en,es,et,fi,fr,hu,it,lt,lv,mt,nl,pl,pt,ro,sk,sl,sv,&val=518792:cs&page=1&hwords=Euroopa+lepingu%C3%B5iguse+loomise+v%C3%B5imalused+tarbijate+ja+ettev%C3%B5tjate+jaoks%7E> (1.3.2011).

⁴ ‘Internal’ Contract Law of the 27 Member States vs. the 28th regime, that is, a 2nd regime for all Member States. The European optional procedure will become a part of the national law of the Member States similarly to other sources of the European law. The 2nd regime would give the parties an opportunity to choose between two regimes of national contract law, one of which is being enforced by the legislator of the Member State and another by the European legislator. This is an alternative to traditional approximation of legislations.

⁵ Also see the opinion of the European Economic and Social Committee on ‘28th regime—an alternative allowing less lawmaking at Community level’ (own-initiative opinion). – OJ C 21, 21.1.2011, p. 26.

alternative to the national contract laws in force. Specialists in European insurance law have found that the 28th regime idea should be guided from within the field of insurance law^{*6}; a similar conclusion was stated in the European Economic and Social Committee's opinion on the European Insurance Contract.^{*7} The Green Paper solicited 319 distinct positions in the course of public consultations.^{*8} As to the answers given in relation to the questions on the PEICL presented for the Green Paper, it may be assumed that the central issue from the point of view of the insurance sector is not whether to support the optional instrument and whether it should be applied to B2B and/or B2C contracts but whether the PEICL protects the consumers/policyholders too radically^{*9} and whether a win-win situation is involved. The objective of this article is to analyse the PEICL with respect to the question of whether the policyholder is protected too radically, studying the differences of the PEICL from the regulation of insurance contracts^{*10} in the Estonian Law of Obligations Act^{*11} (hereinafter referred to as the LOA). On account of the question asked in the title of this piece and in view of criticism of the PEICL by some of the European interest groups, the author limits this analysis in accordance with the norms of the PEICL that are more beneficial to the policyholder than is the regulation of the LOA.^{*12}

2. Pre-insurance-contract legal relationships

2.1. The pre-contractual information duty of the policyholder

There are two main ways to regulate the pre-contractual information duty in insurance contracts:

- 1) the insurer shall present a questionnaire to the policyholder and the policyholder answers all of the questions;
- 2) the policyholder shall inform the insurer of everything relevant.^{*13}

⁶ J. Basedow, J. Birds, M. Clark *et al.* Principles of European Insurance Contract Law (PEICL). Sellier European Law Publishers 2009, p. lxi. Also see the opinion of the Project Group 'Restatement of European insurance contract law' on the Green Paper. Available at http://ec.europa.eu/justice/news/consulting_public/0052/contributions/284_en.pdf (8.6.2011).

⁷ OJ C 157, 28.6.2005, p. 1.

⁸ European Commission. Available at http://ec.europa.eu/justice/news/consulting_public/news_consulting_0052_en.htm (8.6.2011).

⁹ German Insurance Association, European Financial Services Round Table and Allianz SE find in their response to the Green Paper in supporting the idea of PEICL that since PEICL is not based on a win-win situation and protects the policyholders too radically, it needs further development (available at http://ec.europa.eu/justice/news/consulting_public/0052/contributions/163_en.pdf (8.6.2011), <http://www.eur-lex.be/documents/5Cpublication%5C72.2011.02.%20EFR%20signed%20letter%20on%20European%20Contract%20Law%2031.01.2011.2011.pdf> (8.6.2011) and http://ec.europa.eu/justice/news/consulting_public/0052/contributions/7_en.pdf (8.6.2011)). However, the Belgium Consumer Protection Board has pointed out that in comparison with the Belgian law, PEICL has advantages in only four issues, whereas in 16 issues the national law protects the consumer better (H. Heiss, M. Lakhan. Principles of European Insurance Contract Law: A Model Optional Instrument. Sellier European Law Publishers 2011, p. 96).

¹⁰ Although the number of actions against insurers filed to courts of first instance is not high, the insurers tend to lose the disputes in litigations. In accordance with the judicial decision registry held by the Ministry of Justice of the Republic of Estonia (available at <http://www.kohus.ee/kohtulahendid/index.aspx> (10.6.2011)) and the specifying request for information submitted by the author to the Ministry of Justice (the author possesses the 9.6.2011 reply), the insurers won 28% of the cases in relation to the proceedings of the court of first instance in 2009, and on 72% of the cases, the policyholders won (also including the compromises made during the judicial proceedings, i.e., situations in which the position of the policyholder improved as a result of the judicial proceedings; the statistics does not include the actions by the policyholders that the court did not accept due to judicial shortcomings by the plaintiff). In 2010, 16.66% of the solutions were positive for the insurers and 83.34% to the policyholders. In 2009, the number of actions against the insurers increased by 7.5% in comparison with the previous year, and in 2010, this rate was 23.25%. In 2009, 43 actions were filed against the insurers and 42 decisions made, in 2010, 53 actions were filed and 39 decisions made.

¹¹ In Estonia, insurance contracts are regulated by Chapter 4 of the Law of Obligations Act (Võlaõigusseadus. – RT I 2001, 81, 487; RT I, 8.7.2011, 6 (in Estonian)). In English, the wording of 2009 is available at <http://www.legaltext.ee/et/andmebaas/tekst.asp?loc=text&dok=X30085K3&keel=en&pg=1&ptyp=RT&tyyp=X&query=v%F5la%F5igusseadus> (10.6.2011).

¹² There are situations in which the LOA is more beneficial to the policyholder than the PEICL, but they are not as relevant to the regular policyholder—i.e., the LOA does not enable to not return the insurance premium, unlike Article 2:104 of the PEICL; according to the LOA, the parties may also conclude an insurance contract for an unspecified term. The LOA (§§499–504) is also more beneficial in protection of the mortgagee's rights than the PEICL. There are also norms in which it is debatable which regulation is more beneficial to the policyholder.

¹³ The difference between these two regulations lies in the party that should bear the risk for ascertaining all of the relevant circumstances as to the insurance contract.

According to Article 2:101 (1) of the PEICL, the applicant, when concluding the contract, shall inform the insurer of circumstances of which he is or ought to be aware, and which are the subject of clear and precise questions put to him by the insurer.^{*14} Therefore, the PEICL prefers the person responsible to be the insurer. The objective of the PEICL regulation is to present an insurer with a right to ask for information on the circumstances of risk and to decide either to enter into an insurance contract or to decline it on the basis of the information given.^{*15} The selection of the question method stipulated in Article 2:101 is mostly explained by the fact that it is considerably more difficult for a policyholder to assess what kind of information is relevant in evaluation of insurance risk. Imposing an obligation on the insurer to ask clear and precise questions is more likely to reduce unnecessary transaction costs and rule out later disputes between the insurer and a policyholder. Therefore, in present insurance practice, the method of asking questions is more deep-seated than the so-called own-initiative rule that was a valid law in most European countries until recently.^{*16}

In Estonia, according to the LOA's §440 (1), upon entering into a contract, the policyholder shall inform the insurer of all circumstances known to the policyholder that, on account of their nature, may influence the insurer's decision to enter into the contract or to enter into the contract on the agreed terms (material circumstances). Material circumstances are presumed^{*17} to be circumstances concerning which the insurer has directly requested information in a format that can be reproduced in writing.

The biggest difference between the PEICL and the relevant part of the LOA's regulation is that in the Law of Obligations Act, the own-initiative rule has been chosen and the LOA covers only information that is known to the policyholder, whereas in the PEICL, information that is known or should be known to the policyholder is also important.^{*18} The author considers the PEICL approach preferable, since the so-called own-initiative rule brings about too many disputes in practice, because the policyholder may not always know of what the insurer needs to be informed.

Article 2:102 of the PEICL specifies that when the policyholder is in breach of the duty to inform, the insurer shall be entitled to propose a reasonable variation of the contract or to terminate the contract. To this end, the policyholder has a right to reject the proposal within one month after receipt of the notice. In the latter case, the insurer shall be entitled to terminate the contract within one month. As a rule, the right of withdrawal is limited in the PEICL to only cases of a wrongful breach. However, the PEICL also provides a right of withdrawal if the insurer is able to prove that it would not have concluded the contract if it had known the information concerned.

According to the LOA, providing wrongful information on the material circumstances has two consequences. If a policyholder has wrongfully violated the obligation to inform, the insurer may withdraw from the contract (LOA §441 (1)). If the violation of the obligation to notify on the part of the policyholder is not due to the fault of the policyholder, the law (LOA §460) provides that the insurer has a right to increase the insurance premium.^{*19}

Therefore, there are two main differences between the LOA and the PEICL regulation. Firstly, the LOA—unlike the PEICL—does not enable the insurer to demand changing of the insurance premium (i.e., changing of the contract) if the policyholder has wrongfully violated its duty to inform. Secondly, the LOA does not provide a right of withdrawal if the insurer is able to prove that it would not have concluded the contract had it known the information concerned. The author holds that the LOA's strict and favourable regulation with regard to termination of the contract is not justified by any means, nor is it in the best interests of either of the parties to the contract.^{*20}

¹⁴ J. Basedow *et al.* (Note 6), p. 77.

¹⁵ *Ibid.*

¹⁶ *Ibid.*, p. 78.

¹⁷ In legal literature, it has been found that in the LOA, a middle ground between two extreme regulations has been found: on one side, the policyholder shall inform the insurer on his own initiative of all circumstances known to the policyholder which are relevant in the terms of entering into the agreement, on the other, he must inform of the circumstances on which the insurer has directly requested information. See J. Lahe. *Kindlustusõigus* (Insurance Law). Tallinn 2007, p. 48 (in Estonian).

¹⁸ However, the author holds that a position should be taken that this difference is merely apparent, since according to the Law of Obligations Act, a negative consequence is only brought about by informed behaviour (LOA §441).

¹⁹ The condition for the right of increasing the insurance premium is that the insurer has no right to withdraw from a contract in relation to wrongful violation of the obligation to notify by the policyholder.

²⁰ The insurer should be able to choose in each separate case in accordance with the gravity of the violation of the policyholder, whether it wishes to withdraw from the contract or it is possible to continue with the contract by increasing the insurance premium. Exclusion of the request to change the insurance premium in case of wrongful violation leads to termination of

If a policyholder violates the pre-contractual obligation to inform and this is discovered after an insured event, the insurer has a right under §442 (2) of the LOA to withdraw from the contract on the basis specified in §441 of the LOA also after the insured event has occurred. However, the insurer is not freed from its obligation to fulfil the contract if the circumstances in relation to which the information was not provided had no bearing on the occurrence of the insured event and do not preclude or restrict the validity of the insurer's performance obligation. The second sentence of the LOA's §442 (2), considering assessment of exclusion or limitation, provides that, among other things, account shall be taken also of the ratio of the insurance premiums paid to those insurance premiums that should have been paid if information concerning the circumstances had been provided.^{*21}

When one is contrasting §442 and §460 of the LOA with the PEICL's Article 2:102 (5), it can be concluded that withdrawal from the contract by the insurer due to the policyholder's violation of the duty to inform and also obligation to pay insurance premiums in the situation in which an insured event has taken place are almost identical.

Article 2:104 of the PEICL regulates the situation in which an insurer has been led to conclude the contract by the policyholder's fraudulent breach of the pre-contractual duty to inform. The PEICL does not directly define fraudulent behaviour, and the comments refer to Article 4:107 (2) of the Principles of European Contract Law^{*22} (hereinafter referred to as the PECL), according to which a party's representation or non-disclosure is fraudulent if it was intended to deceive.^{*23} According to Article 2:104, an insurer has as many as three ways to respond to fraudulent violation. The first of these is to do nothing and let the contract continue. The second and third derive from Article 2:101 and enable the insurer to change the contract (and withdraw from the contract if it fails) or to withdraw from the contract. It is worth emphasising that the PEICL does not demand that the contract be invalid and gives the insurer an opportunity to decide whether it wishes to withdraw from the contract or would rather give preference to an increase in the insurance premium. If the insurer wishes to withdraw from the contract, this is done retroactively and presents the parties with an opportunity to demand reversal of decision.^{*24} Nevertheless, the PEICL's Article 2:104 deviates from the PECL regulation from the point of reversal of decision and maintains the insurer's right to keep those insurance premiums already paid and to demand payment of the insurance premiums due.^{*25} Provision of said right has been justified by a need to prevent fraudulent behaviour and not let insurers develop the following way of thinking: 'If the fraud succeeds, I'll benefit and if it doesn't, I'll lose nothing (except in the case in which no insured event has taken place).' Fraud that had no influence on the decision of the insurer (because the information was irrelevant or the insurer was aware of its incorrectness) also has no consequences.^{*26} No situation similar to the one of Article 2:104 of the PEICL has been regulated in the Law of Obligations Act; only §441 (5) of the LOA refers to the right of the insurer to terminate the contract due to deception on the basis of §94 of the General Part of the Civil Code Act. The author holds that this rigid regulation of the LOA, favouring termination of contract and not enabling the insurer still to offer insurance cover to the policyholder, is also not justified.

the contract by the parties. The author holds that the law should rather direct the parties to continue with the contract on different terms. The PEICL enables that. This is why the PEICL should be preferred in this situation, wherefore it enables the insurers to adequately react to the material circumstances. A change has also been made to the Switzerland's new Insurance Contract Act, enabling the insurer to choose on the basis of the circumstances whether it wishes for a contract to be terminated or the insurance premium to be increased and the contract continued on new terms. See F. Hasenböhler. Pre-contractual Obligation to Provide Information under Private Insurance Law, p. 118. Available at http://www.kpmg.ch/en/docs/20080505_Pre-contractual_obligation_to_provide_information.pdf (3.1.2011).

²¹ P. Varul *et al.* *Võlaõigusseadus II. Kommenteeritud väljaanne* (Law of Obligations Act. Commented Edition). Tallinn 2007, p. 479 (in Estonian).

²² Principles of European Contract Law. Available at http://frontpage.cbs.dk/law/commission_on_european_contract_law/PECL%20engelsk/engelsk_partI_og_II.htm (1.3.2011).

²³ J. Basedow *et al.* (Note 6), p. 89.

²⁴ This right is provided in Article 4:115 of the PEICL.

²⁵ H. Cousy. The Principles of European Insurance Contract Law: Duty of Disclosure and the Aggravation of Risk. – ERA-Forum, September 2008, Vol. 9, No. 0, p. 130.

²⁶ J. Basedow *et al.* (Note 6), p. 90.

2.2. The policyholder's pre-contractual duty to warn

According to Article 2:202 of the PEICL, the insurer shall warn the applicant of any inconsistencies between the cover offered and the applicant's requirements of which the insurer is or ought to be aware. The insurer shall, analogously, warn the applicant that cover will not begin until the contract is concluded, if he is or ought to be aware of the fact that the applicant mistakenly believes that the cover commenced at the time the application was submitted (Article 2:203). In both cases, not providing said warning may create a situation in which the insurer is responsible for all losses due to this violation and the policyholder has a right to terminate the agreement. The Law of Obligations Act has no such direct consumer-protecting regulation, and the author considers this to be a problematic issue in Estonian law. Article 2:502 of the PEICL states that if the terms of the insurance policy differ from those in the policyholder's application or any prior agreement between the parties, such differences in the later materials shall be deemed to have been given assent by the policyholder; unless he objects within one month of receipt of the policy, he is deemed to have accepted the changes. Section 436 of the LOA includes a similar regulation, but in Estonian law, the term for the policyholder's presentation of an objection is limited to 14 days.

3. Contractual legal relationships in insurance

3.1. The period of insurance

According to the PEICL, in Article 2:601, the duration of the insurance contract is one year (except for personal insurance); however, the parties may agree on a different period if indicated by the nature of the risk. The EU tries to avoid the US mistakes in which insurers conclude too many short-term contracts that enable them to change the insurance premium often.^{*27} An example of consideration of this 'nature of the risk' is travel insurance, which is generally shorter in duration, since the risk of an insured event taking place is set in a shorter time period than one year.

After the one-year period, the contract shall be extended according to the PEICL's Article 2:602 unless:

- the insurer has given written notice to the contrary at least one month before the end of the contract period stating the reasons for its decision or
- the policyholder has given written notice to the contrary by, at the latest, the day the contract period expires or within one month after having received the insurer's premium invoice, whichever date is later. In the latter case, the one-month period shall start to run only if it has been clearly stated on the invoice in **bold** print.

On the basis of §453 of the LOA, it is presumed that the insurance period is one year, but since this is a dispositive norm, the parties may agree on a shorter or a longer insurance period.

Therefore, according to Estonian law, insurers basically have an opportunity to enter into short-term-insurance-period contracts and, in so doing, change the insurance payments. However, short-term (i.e., with a term of less than a year) insurance contracts (excl. travel insurance) are not widespread, in the author's experience. When comparing the insurance period regulations of the LOA and the PEICL, the author holds that, both for consumer protection reasons and for purposes of optimising the expenses of the insurer, the PEICL regulation should be preferred. The corresponding regulation of the LOA does not impose a duty on the insurer to ensure constant control for the policyholder via constant insurance protection (in relation to the case of an automatically extended contract, the PEICL states that the client shall receive notification for the next period, or a declaration of cancellation, but according to the LOA, the insurer has no obligation to inform the client of the contract ending). This also damages mortgagees, since it has to check annually whether a policyholder has entered into a new contract. The interest of an insurer in the case of an automatically extended insurance contract may lie in cancellation of new pre-contractual negotiations and reduction of costs thereby.

²⁷ *Ibid.*, p. 142.

3.2. Withdrawal from an insurance contract after conclusion of the contract

According to the PEICL's Article 2:303, the policyholder shall be entitled to avoid the contract by giving written notice within two weeks after receipt of the insurance contract documents. This principle is not applicable to contracts that last one month or less, and to contracts that have been extended; also it pertains to certain particular types of contract (i.e., civil liability insurance, group insurance, and immediate insurance cover). LOA §433 (1) also provides a two-week withdrawal right for a policyholder. At the same time, the imperatively provided right of withdrawal in Estonian law is limited to contracts that last more than one year, and life insurance contracts. Therefore, the biggest difference between the PEICL and the LOA's regulation lies in the fact that the PEICL provides policyholders with a right to withdraw in two weeks also from contracts with a validity period of 31 days to one year. The corresponding regulation of the PEICL is based on Article 6 of Council Directive 2002/65/EC of the European Parliament and of the Council.^{*28} Although non-life insurance contracts of less than one year are not commonplace in Estonia (except in the field of travel insurance), the author holds that, for purposes of consumer protection, the Law of Obligations Act should be changed in relation to its discrepancy with Article 6 of Council Directive 2002/65/EC of the European Parliament and of the Council.

3.3. Payment of the insurance premium

In comparison of the Law of Obligations Act and the PEICL's regulation as to payment of periodic premiums, it becomes evident that the system currently in place in Estonia is formally more liberal from the insurer's point of view and more disadvantageous to the policyholder. Namely, the PEICL, in Article 5:102 (1), states that, as the first operation, the insurer shall issue an invoice stating the precise amount of the premium due as well as the date of payment and the place for payment; after the premium falls due, the insurer sends a reminder to the policyholder of the precise amount of premium due, granting an additional payment term of at least two weeks and describing the legal consequences of not making the payment, and once the additional period has expired without payment having been made, the insurer has a right to release itself from the obligation to fulfil the corresponding duties. The Law of Obligations Act does not require that an invoice be issued by the insurer. In practice, there have been cases in Estonia in which insurers present all subsequent premiums in one invoice and no separate invoices are issued for subsequent payments.^{*29} In the interests of legal clarity, the author holds that the PEICL regulation should be preferred.

Article 5:104 of the PEICL provides that if an insurance contract is terminated before the contract period has ended, the insurer shall be entitled to premiums in respect of only the part of the period prior to termination.^{*30} Section 459 of the LOA (in an imperative provision in accordance with §427 (1) of the LOA) provides that if a contract is terminated prematurely during a term of insurance by cancellation or withdrawal or for any other reason, the insurer is entitled to only those insurance premium for the time up to the termination of the contract. However, most of Estonia's insurance undertakings state the so-called operation costs in their standard terms.^{*31} Therefore, it can be asked whether collecting such additional amounts is legitimate or not. If one takes the position that the insurer has a right to establish operation

²⁸ OJ L 271, 9.10.2002, pp. 0016–0024.

²⁹ In judgement No. 3-2-1-51-06, the Supreme Court has provided that 'in insurance relations, it is reasonable to presume that before the valid policy ends, the insurer shall notify the policyholder of its contractual obligations, issue a corresponding invoice and a warning'.

³⁰ In the commented edition of the PEICL, it is pointed out that if an insurance premium has been prepaid, returning of the money shall take place on the *pro rata* principle, since modern information technology enables virtual expenseless calculation on the principle of *pro rata temporis* (1), and due to lessening of the peril, an insurance premium is no longer necessary from the point of view of the insurer's solvency (2), the insurance risk is divisible on the basis of days/months/years in an economic sense (3), 'preservance' of an insurance premium is not justifiable as a 'contractual penalty' (4) and keeping such premium could be viewed as punishing of the policyholder, which is unjustifiable (5). See J. Basedow *et al.* (Note 6), pp. 203–204.

³¹ For example, in Article 28.4 of the QBE Insurance (Europe) Limited Estonian branch home insurance conditions it has been stated that upon termination of a contract, the QBE has a right for the insurance premiums for the time until the termination of the contract, as well as operations expenditures that make up 20% of the insurance premium calculated for the insurance period. See QBE kodukindlustus. Koduvara määratud riskide kindlustus (QBE home insurance. Household insurance). Available at <http://www.qbeeurope.com/documents/estonia/Kodukindlustuse%20tingimused.pdf> (1.3.2011) (in Estonian).

costs, it would lead to a situation in which technically it would be possible to state in the standard terms that the amount of the so-called operations cost is as high as any insurance premium payment or the remaining insurance premiums through to the end of the period. It would be possible thus to create a situation in which the policyholder is obliged to pay insurance premiums for the whole insurance period regardless of the contract having been terminated. The author finds that, to address this issue, it would be reasonable to specify the terms of both the LOA and the PEICL additionally so as to avoid differing interpretations such that the insurance premium would always be returned on the *pro rata temporis* principle to a day's accuracy and with prohibition of deduction of any expenses.

3.4. Transfer of property

Section 494 of the LOA sets forth imperatively that if a policyholder transfers an insured thing, all the policyholder's rights and obligations arising from the insurance contract transfer to the acquirer of the thing. At that point, an insurer may cancel the insurance contract with respect to the acquirer of the thing within one month of becoming aware of the transfer of the thing if the insurer gives at least one month's notice of the cancellation (see §495 (1) of the LOA), and the acquirer of an insured thing may cancel the insurance contract by the end of the current period of insurance within one month from acquiring the thing (§495 (2) of the LOA). Thus, the LOA does not enable the acquirer of an insured thing to choose an acceptable insurer before the new period of insurance (which may theoretically mean that said person would have to remain in a relationship with an unwanted insurer for a year). If the insurer is not notified of the transfer of the thing in time, the insurer shall be released from its performance obligation according to §496 (2) of the LOA if an insured event occurs more than a month after the time when the insurer should have received corresponding notice. The corresponding regulation of the PEICL is considerably more flexible and concentrates more on the policyholder. Except in cases of inheritance and of agreement among the parties (insurer, policyholder, and acquirer) (Article 12:102 (3)), the insurance contract shall be terminated one month after the time of transfer, unless the policyholder and transferee agree on earlier termination (Article 12:102 (1)). The flexible approach of the PEICL is justified by the fact that an insurer cannot be forced to accept a policyholder whom it does not like and the acquirer may have just cause for not entering into a binding agreement that may not protect its economic interests.^{*32} The author agrees with these explanations and therefore considers the regulation in the PEICL to be more reasonable.

3.5. Agreed value

Insurable value is of central importance in property insurance contracts. The PEICL's Article 8:101 (2) provides that the insurer shall not be obliged to pay more than the amount necessary to indemnify losses actually suffered by the insured. In cases of agreed value, the agreed value shall be applied even if it is greater than the actual losses, with the proviso that no deception occurred or false information was given in agreement upon the agreed value. However, according to §480 (3) of the LOA, the agreed value shall not be deemed to be insurable value if, at the time of the occurrence of the insured event, it differs significantly from the actual insured value. In that case, the actual insured value applies. Therefore, the biggest difference between the PEICL and the LOA is in the fact that in cases of agreed value, the PEICL enables compensation for more than the actual value, where no deception or false information was involved in the agreement upon the agreed value. The author considers the corresponding PEICL regulation to be justified—the insurer is the professional in concluding an insurance contract, having, through its practice, fuller awareness of the value of the assets. Conventionally, an insurance payment is related to insurance value (this is not a linear relationship). By leaving the policyholder to bear the responsibility in cases of an agreed value determined in consequence of a mistake (or with knowledge but without intent to deceive), the balance of contractual rights is severely disrupted, since where the right to increase the insurance premium addressed in §481 of the LOA applies, it is difficult, if not even impossible, for the policyholder to calculate or check the amount of the actual insurance premium.

³² J. Basedow *et al.* (Note 6), p. 276.

4. Legal relationships before an insured event

4.1. The policyholder's non-compliance with precautionary measures

According to the PEICL's Article 4:102 (1), a clause providing that in the event of non-compliance with a precautionary measure the insurer shall be entitled to terminate the contract shall be without effect unless the policyholder or the insured has breached its obligation with intent to cause the loss or recklessly³³ and with knowledge that the loss would probably result. This blanket standard term according to the PEICL is used by insurers in Estonia. Since in the Law of Obligations Act, an insurer's withdrawal from the contract has been regulated in a mostly imperative manner and ignoring of the precautionary measures is not a basis for withdrawal, whether such a standard term is applicable under Estonian law is called into question. There is no judicial practice concerning this matter at the level of the Estonian Supreme Court.

Article 4:103 (1) of the PEICL provides that a clause stating that non-compliance with a precautionary measure exempts the insurer partially or completely from liability shall have effect only to the extent that the loss was caused by the non-compliance of the policyholder or insured with intent to cause the loss, or recklessly and with knowledge that the loss probably would result. Therefore, the PEICL considerably limits the insurer's opportunity to exercise legal remedies in the case of non-compliance with precautionary measures—that is, use of conditions that require the policyholder to behave in one or another way before an insured event takes place. It expressly states those conditions in which the insurer is freed from the obligation to compensate for the damage if the policyholder does not meet some prerequisite. It also addresses conditions for confirmation of doing (or not doing) something upon the breach of which the insurance cover terminates. When we compare the conditions of Estonian insurance undertakings with this provision³⁴, it emerges that the former are hostile toward the policyholder in comparison to the PEICL regulation. Numerous Estonian insurance undertakings³⁵ present a long catalogue of precautionary measures and their catalogue of cases of the insurer's exemption from liability states that non-compliance with any requirement of the precautionary measure catalogue (regardless of the form of guilt) causes the insurer to be exempted from liability. From the standpoint of protection of the policyholder's interests, the author finds the PEICL approach to be significantly more reasonable than the Estonian regulation is. The PEICL's Article 4:103 (2) states that in cases of a clear clause providing for reduction of the insurance money according to the degree of fault, the policyholder or the insured, as the case may be, shall be entitled to insurance money in respect of any loss caused by negligent non-compliance with a precautionary measure. If the insurance contract contains no corresponding clause, the policyholder shall be entitled to the insurance money in its full extent. The commented edition of the PEICL³⁶ emphasises that, in line with the main philosophy of insurance, an insurance contract is concluded not only to cover an incidental risk of accident but also for negligent conduct. Clause 452 (2) (1) of the LOA provides that the insurer is released from the performance obligation upon the occurrence of an insured event if the policyholder has violated an obligation or if the violation has affected the occurrence of damage or the extent thereof. The PEICL's Article 9:101, which provides for consideration of the policyholder's fault in causing a loss, is analogous with its Article 4:103; i.e., only intent and recklessness may be taken as a basis for reduction of denial of indemnity, and reduction on account of recklessness requires a corresponding clear provision in the terms of the insurance policy. Thus the PEICL principle concerning consequences of intent or recklessness goes further than the Law of Obligations Act regulation that only presumes a cause-and-effect relationship between violation and loss (or guilt).

³³ Recklessness is a lighter form of guilt than intent, but more severe than gross negligence and it originates from the Montreal Convention 1999 on international carriage. See J. Basedow *et al.* (Note 6), p. 247.

³⁴ For example, according to the home insurance conditions of ERGO Kindlustuse AS KT.0645.11 Article 17.1.4, the policyholder shall adhere to the instruction manuals of devices. The consequence of non-compliance with this obligation according to Article 20.1.1 of these conditions is partial or complete freeing of the insurer from the performance obligation, regardless of the form and extent of the guilt of the policyholder. Available at [http://www3.ergo.ee/HtmlPages/Kodu_tingimused_KT_0645_11/\\$file/Kodu_tingimused_KT_0645_11.pdf](http://www3.ergo.ee/HtmlPages/Kodu_tingimused_KT_0645_11/$file/Kodu_tingimused_KT_0645_11.pdf) (1.3.2011) (in Estonian).

³⁵ For example, ERGO Kindlustuse AS vehicle insurance conditions KT.0056.1 (ERGO Kindlustuse AS sõidukikindlustuse tingimused KT.0056.1). Available at [http://www3.ergo.ee/HtmlPages/S%C3%B5idukikindlustusetingimused/\\$file/sõidukikindlustuse_tingimused.pdf](http://www3.ergo.ee/HtmlPages/S%C3%B5idukikindlustusetingimused/$file/sõidukikindlustuse_tingimused.pdf) (1.3.2011) (in Estonian); Seesam Rahvusvahelise Kindlustuse AS home insurance conditions 1/2011 (Seesam Rahvusvaheline Kindlustuse AS kodukindlustuse tingimused 1/2011). Available at [http://www.seesam.ee/uploads/files/household-insurance/Kodukindlustuse%20tingimused%20\(01.01.2011\)_EST.pdf](http://www.seesam.ee/uploads/files/household-insurance/Kodukindlustuse%20tingimused%20(01.01.2011)_EST.pdf) (1.3.2011) (in Estonian).

³⁶ J. Basedow *et al.* (Note 6), p. 177.

Problems of non-compliance with precautionary measures are the main reason for which an insurer refuses indemnity. Therefore, the author considers the PEICL approach justified in comparison with the LOA.

5. Legal relationships after the insured event

5.1. Notice of an insured event

According to Article 6:101 of the PEICL, delay in notification of an insured event may reduce the money payable only to the extent in which the insurer proves that it has been prejudiced by undue delay. If a deadline for notifying of an insured event is set in the insurance conditions, it shall be reasonable and no less than five days.

In the standard terms of Estonian insurance undertakings, notice of an insured event is given a deadline of 2^{*37}–5^{*38} work days for reporting as soon as possible.^{*39} If a policyholder violates the obligation, stated in §448 (1) of the LOA, to inform the insurer immediately of the insured event, the result according to §449 (2) of the LOA is to immediately release it from its performance obligation, given that the violation was intentional. The author finds that, in essence, almost any delay in notice is intentional (unless the policyholder is ill, etc.) and, therefore, the insurer is almost always formally released from the performance obligation according to Estonian law in cases of late notice. In the event of unintentional violation, §449 (1) of the LOA, analogously with the PEICL's Article 6:101 (3), enables expressing the indemnity in the extent to which the insurer was prejudiced by undue delay. Since §448 of the LOA is a dispositive provision, the insurers have, in essence, an opportunity to set unreasonable deadlines for policyholders (i.e., the two-work-day deadline referred to above). The Supreme Court of the Republic of Estonia, in its decision 3-2-1-56-01 (before the Law of Obligations Act entered into force), affirmed the insurer's right to refuse an indemnity in a situation in which the policyholder notifies the insurer of the insured event after the deadline set in the standard terms and the delayed notice has no further impact on verification of the insurer's performance obligation. Therefore, the author considers the PEICL's regulation significantly more preferable as to reasoning and for consumer protection.^{*40}

5.2. Indemnity and the limitation period for claims

As to making the performance obligation of an insurer executable, the Law of Obligations Act's regulation is not as clear as the PEICL's. Namely, §450 (1) of the LOA states that becoming collectable depends on completion of the process of determining the extent of the insurer's performance, but if the corresponding activities have not been completed by one month after notice of the insured event, subsection 3 of the same section states that the policyholder may only request—in essence—a minimal advance payment that the insurer should pay. In practice, it enables avoiding advance payments to an insurer that acts with malice or making these payments to only an insignificant extent by also contesting the minimum extent of the loss to be indemnified. The insurer's obligation to perform a contract also comes into effect if, two months after notifying the insurer of the insured event, the policyholder requests an explanation from the insurer as to why the process of determining the extent of performance has not yet been completed and the insurer fails to respond to the enquiry within one month (LOA §450 (2)). However, the insurer can deviate easily from

³⁷ For example, Salva Kindlustuse AS general vehicle insurance conditions SÜ-11 (Salva Kindlustuse AS sõidukikindlustuse üldtingimused SÜ-11), Article 23.5. Available at <http://www.salva.ee/public/files/Kaskotingimused%20%28S%D11%29.doc.pdf> (1.3.2011) (in Estonian).

³⁸ For example, conditions of Codan Forsikring A/S Estonian branch's car insurance A101/2011 (Codan Forsikring A/S Eesti filiaali autokindlustuse tingimused A101/2011), Article 8.3.5. Available at http://rsa.all-tec.ee/public/eesti/RSA_Autokindlustus_tingimused_A101_2011_EST.pdf (1.3.2011) (in Estonian).

³⁹ For example, If P&C Insurance AS general insurance conditions ÜÜ 20021 (If P&C Insurance AS Kindlustuse üldtingimused ÜÜ 20021), Article 58. Available at <http://tingimused.if.ee/ViewPDF.aspx?ID=1d6efdf9-0353-4a03-ade8-f47da4370d20> (1.3.2011) (in Estonian).

⁴⁰ On certain cases, delayed notice may theoretically help to save the possible expenses for the insurer—for example, in a situation in which the windshield of a vehicle gets hit by a stone, replacing the windscreen immediately may not be in the best interests of the insurer since another analogous incident may happen during the insurance period, besides, delayed notice would not change anything as to investigation of the insured event (extent of damage does not change).

this obligation by acting maliciously and replying on the circumstances of the formal procedure. According to Article 6:103 (1) of the PEICL, the insurer shall take all reasonable steps to settle a claim promptly. Unless the insurer rejects a claim or defers acceptance of a claim through written notice giving reasons for its decision within one month after receipt of the relevant documents and other information, the claim shall be deemed to have been accepted (6:103 (1)). Therefore, under the PEICL, making the insurer's performance obligation executable is extended only when the insurer has not received the necessary information and documentation—receipt of these is ensured by the co-operation obligation of the policyholder stated in Article 6:102 of the PEICL.^{*41}

Unlike the LOA's insurance contract regulation, the PEICL directly stipulates the right of a policyholder to demand compensation for losses due to delay in payment of the indemnity (Article 6:105 (2))—i.e., in a situation in which the insurer acted in bad faith. In many European legal orders, a principle applies that the insurer is not responsible for losses caused by delay in indemnity and the insurer shall pay only the interest. However, in the modern legal literature, one finds that the insurer should compensate for all forecast losses that arise through delay in indemnity since the business activity of the insurer is to offer protection to the policyholder and the insurers are aware that delays in indemnity cause some sort of loss.^{*42} Although formally the policyholder could issue an analogous claim to the insurer for the compensation of damage on the basis of the general part of the Law of Obligations Act, the author holds that a corresponding regulation concerning insurance contracts (even as a reference to the general part) would preventively protect the interests of policyholders better.^{*43} Subsection 475 (1) of the LOA sets forth the rule that the limitation period for claims arising from an insurance contract is three years and that period commences at the end of the calendar year during which the claim falls due. However, §475 (3) of the LOA states that if the insurer denies the application for performance of its obligation, the insurer shall be released from the performance obligation if the policyholder does not file an action for compulsory performance of the obligation within one year, where the insurer has, in its response, informed the policyholder of the legal consequences of the expiry of the one-year term. Article 7:102 of the PEICL provides that action for insurance benefits shall be prescribed after a period of three years from the time when the insurer makes or is deemed to have made a final decision on the claim, or 10 years from the occurrence of the insured event. This enables emphasising that the corresponding regulation of the LOA^{*44} is significantly more to the disadvantage of the policyholder than is the PEICL. When we consider the applicable Estonian regulation, it can be pointed out also that the right of claim of the insurer against the policyholder (unpaid insurance premiums, subrogations, etc.) is three years (according to the regulation in §146 (1) of the General Part of the Civil Code Act^{*45}), whereas the right of claim of the policyholder applies in certain cases (LOA §475 (3)) for only one year—such inequality in the limitation periods ignores the equality of the parties. It is important to emphasise that Article 7:101 of the PEICL sets a shorter deadline for the right of claim of an insurance premium by the insurer: one year. In the PEICL's commented^{*46} edition, it is pointed out that the shorter deadline can be justified by the fact that policyholders generally pay the insurance premiums in parts (whether monthly or quarterly).

⁴¹ Article 6:102 of the PEICL states that if the policyholder, insured or beneficiary, shall not co-operate with the insurer in the investigation of the insured event (i.e., does not guarantee access to the insured location, does not provide information, proof or documentation of the insured event), the insurance money payable may be reduced to the extent that the insurer proves that has been prejudiced by the breach. In the event of any breach committed with intent to cause prejudice or recklessly, the insurer shall not be obliged to pay the insurance money. The analogous obligation stated in §448 (2) of the LOA is more restrictive to the policyholder—according to Estonian law, the policyholder shall give reasonable amount of information which is necessary to determine the obligation to perform the contract. Willing non-compliance with this obligation frees the insurer immediately of the obligation to compensate according to §449 (2) of the LOA and in case of other form of guilt, the insurer may reduce the amount to be paid in an extent of the loss incurred to it.

⁴² J. Basedow *et al.* (Note 6), p. 221.

⁴³ The author implies that willing delay in a loss adjustment process enables the insurer to earn additional profit (i.e., as interests) at the expense of unpaid indemnities. The author holds that the result of breach of the implied covenant of good faith and fair dealing cannot simply be paying a fine for delay to the policyholder, since the policyholder has a justified expectation that by buying an insurance cover, the results of the possible loss event will be covered in a fast loss adjustment process and thus, if compensation for the loss is delayed due to behaviour of the insurer in bad faith, obligating the latter to compensate the loss due to such behaviour is justified.

⁴⁴ Subsection 12 (3) of the German Insurance Contract Act (*Versicherungsvertragsgesetz*) that was used as a 'model' for the corresponding norm of the LOA has been revoked.

⁴⁵ Tsiviilseadustiku üldosa seadus. – RT I 2002, 35, 216; RT I, 6.12.2010, 1 (in Estonian).

⁴⁶ J. Basedow *et al.* (Note 6), pp. 223–224.

6. Conclusions

As an answer to the question stated in the title, the author finds that the PEICL as the European *ius commune* is considerably more consumer-oriented and flexible than the LOA is and limits the insurer's liberation from the performance obligation. However, this is not excessively radical; it balances the interests and opportunities of the parties reasonably. A win-win situation cannot be found in simply optimising the insurer's expenses by unifying the insurance products into a 'pan-European insurance product'. While one achieves a 'win' in terms of savings in expenses, the other party too has to win something. As a rule, the policyholder cannot be compared with the insurer in its knowledge and economic capabilities; therefore, protection of its rights needs heightened attention. The author holds that both saving on expenses and simplicity of provision of the service in the pan-European activity should be the arguments for insurers choosing the PEICL even in a situation in which the national law would be more favourable to them.



Maarja Torga

Lecturer of Civil Law, University of Tartu
Adviser to the Civil Chamber, Supreme Court of Estonia

Characterisation in Estonian Private International Law— a Proper Tool for Achieving Justice between the Parties?

1. Introduction

The purpose of the present article is to illustrate how the method of characterisation could be used in Estonian private international law in order to achieve justice between the parties. It is not surprising that neither the Estonian Code of Civil Procedure^{*1} (hereinafter referred to as the ECC) nor the Private International Law Act^{*2} (hereinafter referred to as the PILA) contains any provisions addressing how the characterisation/classification (*kvalifitseerimine/karakteriseerimine*) should be done—this is a question that various jurisdictions have traditionally left to be decided by the case law and legal theory.^{*3}

In general, there are three approaches to how the problems of characterisation can be solved. First, a court can characterise the issue at hand by its own domestic rules (characterisation by the *lex fori* approach). Secondly, a court can characterise the particular issue by the law that is expected to be applicable to the issue (characterisation by the *lex causae* approach). Although characterisation by *lex causae* might be favoured for achieving uniformity of judgements between courts of two different states (especially if these courts both follow similar choice of law rules), the *lex fori* approach is generally preferred for its practical advantages. After all, a court is best equipped with knowledge of its own substantive law, and in-depth analysis of foreign characterisation rules in the phase of choosing the applicable law would be burdensome to the parties, if not even unjust and contrary to their reasonable expectations. Even though there is no clear statutory rule in Estonian law as to how the characterisation should take place, some Estonian authors have expressed

¹ Tsiviilkohtumenetluse seadustik. – RT I 2005, 26, 197; RT I, 30.12.2010, 2 (in Estonian). English text available at <http://www.just.ee/23295> (1.7.2011).

² Rahvusvahelise eraõiguse seadus. – RT I 2002, 35, 217; RT I 2009, 59, 385 (in Estonian). English text available at <http://www.just.ee/23295> (1.7.2011).

³ Taking into account the long history of the problem, an exhaustive reference to the sources relating to the characterisation is impossible to make. However, for the most recent treatments of the topic, see R. Baratta. General Issues of Private International Law in the European System Reflections by Italian Scholars The Process of Characterization in the EC Conflict of Laws: Suggesting a Flexible Approach. – Yearbook of Private International Law 2004/6, pp. 155–169; J. Fawcett, J. M. Carruthers. Cheshire, North & Fawcett Private International Law. 14th ed. New York: Oxford University Press 2008, pp. 75–109; L. Collins (ed.). Dicey, Morris and Collins on the Conflict of Laws. Volume I. 14th ed. London: Sweet & Maxwell 2006, pp. 37–59.

a view that the characterisation by the Estonian courts should generally be done according to the *lex fori* and not by the *lex causae*^{*4}, provided, of course, that a particular problem in the case does not derive from a European or international instrument, in which case an autonomous interpretation should be preferred. Developing such autonomous concepts forms the third solution to the problem of characterisation, which prevails in the EC conflict of laws.

The author proposes that, though each of these approaches has its benefits, neither of these methods should be taken as the absolute rule in Estonian private international law. Though clear-cut rules are advantageous as they advance certainty in legal disputes, the method of characterisation should be flexible in order to realise justice between the parties.

2. The different approaches to characterisation

2.1. The use of autonomous definitions in Estonian private international law

A court may give meaning to a particular term used in a private international law rule by reference to certain autonomous definitions. Such definitions are created with account taken of the purpose of particular conflict rules and the findings of comparative law. They are not composed by reference to the substantive law of the forum or *lex causae*, and they differ according to the particular international instrument or system of rules in which the given term is used. For example, the term ‘tort’ can have a slightly different meaning in a European or bilateral instrument.

The autonomous concepts can be found in most European private international law instruments and international conventions. For example, it is to be expected that the problem of characterising certain issues as contractual or tortious will lose its meaning in Estonian private international law as more and more contractual and extra-contractual commercial disputes will be governed by the new Rome I^{*5} and Rome II^{*6} regulations, which will gradually replace the Estonian PILA rules on the law applicable to contractual and extra-contractual relationships. Naturally, recourse to autonomous concepts should prevail if the Estonian courts would apply the Hague Conventions or other conventions that are binding on the Republic of Estonia.^{*7}

Similarly, in interpretation of the concepts contained in the bilateral treaties concluded between the Republic of Estonia on one side and the Republic of Latvia, the Republic of Lithuania^{*8}, the Republic of Poland^{*9}, the Russian Federation^{*10}, or the Ukraine^{*11} on the other, there is a strong argument in favour of developing the autonomous definitions when giving meaning to the terms used in such treaties. Otherwise, a plurality of solutions might arise, depending on which courts are about to resolve a particular legal dispute, or, if the tractable concept is contained in a harmonised jurisdiction rule, confusion might even arise as to which court is competent to settle the dispute at hand. The bilateral treaties concluded with the Republic

⁴ I. Nurmela. *Rahvusvaheline eraõigus* (International Private Law). 3rd ed. Tallinn: Juura 2008, p. 50 (in Estonian). On the distinction between the characterisation according to *lex fori* and *lex causae* in the context of personal connecting factors, see K. Sein. *Law Applicable to Persons Pursuant to Draft Private International Law Act*. – *Juridica International* 2001 (VI), pp. 135–136.

⁵ Regulation (EC) No. 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I). – OJ L 177, 4.7.2008, pp. 0006–0016.

⁶ Regulation (EC) No. 864/2007 of the European Parliament and of the Council of 11 July 2007 on the law applicable to non-contractual obligations (Rome II). – OJ L 199, 31.7.2007, pp. 0040–0049.

⁷ Estonia is bound by thirteen Hague Conventions and the Hague (2007) Protocol. See www.hcch.net (1.4.2011).

⁸ Eesti Vabariigi, Leedu Vabariigi ja Läti Vabariigi õigusabi ja õigussuhete leping (Treaty between the Republic of Estonia, the Republic of Lithuania and the Republic of Latvia on the legal aid and legal relations). – RT II 1993, 6, 5 (in Estonian)

⁹ Eesti Vabariigi ja Poola Vabariigi vaheline leping õigusabi osutamise ja õigussuhete kohta tsiviil-, töö- ning kriminaalasjades (Treaty between the Republic of Estonia and the Republic of Poland on the legal aid and legal relations in civil- employment- and criminal matters). – RT II 1999, 4, 22 (in Estonian).

¹⁰ Eesti Vabariigi ja Vene Föderatsiooni leping õigusabi ja õigussuhete kohta tsiviil-, perekonna- ja kriminaalasjades (Treaty between the Republic of Estonia and the Russian Federation on the legal aid and legal relations in civil- family- and criminal matters). – RT II 1993, 16, 27 (in Estonian).

¹¹ Eesti Vabariigi ja Ukraina leping õigusabi ja õigussuhete kohta tsiviil- ning kriminaalasjades (Treaty between the Republic of Estonia and the Russian Federation on the legal aid and legal relations in civil- and criminal matters). – RT II 1995, 13/14, 63 (in Estonian).

of Poland, Republic of Latvia, and Republic of Lithuania have for the most part been superseded by the relevant European private international law rules (for example, by the Brussels I Regulation^{*12} and Brussels II bis Regulation^{*13}), but the autonomous concepts developed by the case law of the European Court of Justice cannot be used when Ukrainian or Russian citizens are involved in Estonian court proceedings or where the matter falls outside the scope of the European regulations. The following example illustrates the potential problems that may face the courts when they characterise the terms found in the bilateral treaties by Estonian substantive law according to the *lex fori*.

The bilateral treaty concluded between the Republic of Estonia and the Russian Federation (the Estonian–Russian Treaty) uses the notion of the ‘place of residence’ (in Estonian, *elukoht*; in Russian, *местожительство*) as a general personal connecting factor. For example, under Article 40 (3) of the Estonian–Russian Treaty, an injured party may submit his tort claim to the court of a State Party in whose territory the tortfeasor has his ‘place of residence’. If the Estonian courts would characterise the ‘place of residence’ under the *lex fori* (i.e., under the Estonian substantive law rules), provisions from the General Part of the Civil Code Act^{*14} would apply. According to §15 (1) in conjunction with §8 (2) of the General Part of the Civil Code Act, a minor under the age of 18 is considered to reside in the place where his legal guardian (usually a parent) has residence. Only exceptionally can it be decided that a minor ‘resides’ separately from his guardian—if the guardian has given consent to such determination and if the minor actually lives away from his guardian. Thus it is that, in general, claims against such minors would have to be submitted to the court of the place where the guardian of the particular minor resides. For example, if a minor actually resided in Estonia but without his guardian’s consent and his guardian were to reside elsewhere, he might not be sued in Estonia at all if the concept of ‘residence’ would be characterised under the *lex fori* (i.e., according to Estonian substantive law) by the Estonian court. Then the minor’s residence would be equated to his guardian’s and the claimant might be unable to sue the minor in Estonia at all. Such a solution could be tolerated only if the claimant could sue this particular minor in Russia. However, if the ‘residence’ of a minor is characterised differently under Russian substantive law, it might come to pass that the claimant will not be able to submit his claim even to the Russian courts.

According to the Russian Civil Code’s^{*15} Article 2.20.2 (*Место жительства гражданина*), minors under the age of 14 are considered to live in the place where their legal representative resides. Therefore, if a 16-year old minor were actually to be living in Estonia, he would have a ‘residence’ in the meaning of the Estonian–Russian Treaty in Estonia in the eyes of the Russian courts but not in the view of the Estonian courts. Conversely, he might have a residence in Russia according to the Estonian courts but not in the eyes of the Russian courts. Such inconsistency should be avoided when one is interpreting the terms of the Estonian–Russian Treaty. An autonomous concept of ‘place of residence’ for the purposes of interpretation of this bilateral treaty should be developed in order to avoid situations wherein the claimant is not able to make his claim in either of the signatories’ courts. In order to do this, the judge should distance himself from his own substantial law rules and find a balance between the need to protect the interests of the minor(s) and the need to bring about justice between the two parties.

It can be assumed that the purpose of the general rule of jurisdiction, which requires a link between the defendant and the forum, is to balance out the advantages that the claimant has gained through having the initial choice of whether to commence proceedings or not. Such an objective would lose its meaning if the defendant cannot really use the advantages that the ties to the home state would otherwise be destined to give him. Hence, the general rules of procedural representation should be taken into account when one is developing an autonomous term ‘place of residence’ for minors in the context of the bilateral treaties. For example, under the Estonian Code of Civil Procedure, in §202 (2), only those minors who have reached the age of 15 have the right to participate in the legal proceedings jointly with their legal representative. There-

¹² Council Regulation (EC) No. 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters. – OJ L 012, 16.1.2001, pp. 0001–0023.

¹³ Council Regulation (EC) No. 2201/2003 of 27 November 2003 concerning jurisdiction and the recognition and enforcement of judgments in matrimonial matters and the matters of parental responsibility, repealing Regulation (EC) No. 1347/2000. – OJ L 338, 23.12.2003, pp. 0001–0029.

¹⁴ Tsiviilseadustiku üldosa seadus. – RT I 2002, 35, 216; RT I, 6.12.2010, 1 (in Estonian). English text available at <http://www.just.ee/23295> (1.7.2011).

¹⁵ Гражданский кодекс российской федерации от 30.11.1994 N 51-ФЗ. Available at <http://www.consultant.ru/popular/gkrf1/> (1.07.2011).

fore, in the case where a minor who lives in Estonia and apart from his legal guardian is younger than 15 years, it is highly questionable whether the claimant should be able to sue said minor in the Estonian courts under the Estonian–Russian Treaty. This is because, in this case, the legal guardian of the minor who would have to be involved in the proceedings in the stead of the minor himself would not have any fundamental ties to Estonia.

Although autonomous concepts can create more certainty in the characterisation phase, recourse to such concepts is not always possible, for practical reasons. Not all Estonian conflict rules are contained in European or bilateral instruments. In addition, although there exists an authoritative organ for giving meaning to the autonomous concepts found in the European instruments—the ECJ—no such organ exists when the bilateral treaties come into play and the judges might be tempted, therefore, to turn to the *lex fori* or *lex causae* when faced with characterisation problems.

2.2. Characterisation by the *lex fori* or by the *lex causae*?

In certain cases, the *lex fori* approach is already expressly provided by the Estonian private international law rules themselves. For example, in order to determine the ‘residence’ of a natural person in the meaning of the PILA, a reference to Estonian substantive law is clearly made by the PILA’s §10 itself.^{*16} Such examples are, however, rare and will not be considered further, on account of their specific nature and scope. The existence of particular references to *lex fori* in some of the Estonian conflict rules should not necessarily be taken to mean that there is an absolute characterisation rule in Estonian private international law in favour of the *lex fori*. As practical as this solution might be for the Estonian legal practitioner, an absolute characterisation rule according to the *lex fori* must surely have exceptions, since strict adherence to the *lex fori* is not always even possible if the Estonian courts are faced with concepts that the domestic legislator has never foreseen. In such cases, a characterisation by the *lex causae* might be more appropriate in order to locate the issue under the Estonian private international law rule.

Examples illustrating the problem of recourse to *lex fori* not always being preferable include *mahr* (the bride price in Islamic law), which has not yet drawn the attention of the Estonian courts but has, for example, been ruled on by the neighbouring Swedish courts.^{*17} According to the Swedish authorities, the *mahr* could under Swedish law be characterised in two ways—if the *mahr* is intended to provide the divorced wife with the everyday necessities of life, it seems natural to consider it to be a kind of lump-sum maintenance, while conflict rules on the division of matrimonial property are closer to hand if the *mahr* appears to have more to do with the equalisation of the property situation of the spouses.^{*18} Should the Estonian courts encounter concepts alien to Estonian law (such as the *mahr*), a similar characterisation rule seems preferable. It should be noted, however, that this problem could soon be resolved on the European level as the European Commission has presented its proposal for a Council Regulation on jurisdiction, applicable law, and the recognition and enforcement of decisions in relation to matters of matrimonial property regimes (COM (2011) 126 of 16 March 2011).^{*19} It will be interesting to see how the scope of the proposed regulation would interact with the scope of the existing Maintenance Regulation.^{*20}

In addition, blind characterisation by the *lex fori* might in certain cases even lead to the violation of basic rights and freedoms of the parties, not to mention their reasonable expectations. A good example here would be a same-sex marriage or same-sex partnership entered into or registered abroad, a possibility for which several Member States of the European Union have already provided.^{*21} Under the Estonian

^{*16} This reference leads to the General Part of the Civil Code Act §14 (1), which states that the residence of a natural person is in the place where the person habitually or principally lives.

^{*17} M. Bogdan. International Encyclopaedia for Private International Law. Sweden. Suppl. 17 (April 2008). Kluwer Law International 2008, p. 37.

^{*18} *Ibid.*

^{*19} Proposal for a Council Regulation on jurisdiction, applicable law and the recognition and enforcement of decisions regarding the property consequences of registered partnerships (COM (2011) 127 of 16 March 2011. Available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0126:FIN:EN:PDF> (1.7.2011).

^{*20} Council Regulation (EC) No. 4/2009 of 18 December 2008 on jurisdiction, applicable law, recognition and enforcement of decisions and cooperation in matters relating to maintenance obligations. – OJ L 007, 10.1.2009, pp. 0001–0079.

^{*21} For a general overview on this development, see K. Boele-Woelki. Family Law. The Legal Recognition of Same Sex Relationships Within the European Union. – Tulane Law Review 2007–2008 (82), pp. 1954–1960.

domestic family law rules^{*22}, a marriage can only be celebrated between a man and a woman and no same-sex partnership (let alone same-sex marriage) is provided for by any domestic legal acts. However, many of the Estonian conflict rules still simply refer to ‘marriage’ while no reference is made in the PILA to a civil or registered partnership, which is not known to Estonian private international law. Accordingly, the issue of whether same-sex partners are ‘married’ in the Estonian private international law sense is likely to arise in the Estonian courts at some point as such relationships are not expressly regulated by the Estonian conflict rules.

The issue of characterising same-sex marriage would most probably arise in the form of a preliminary (incidental) question in a maintenance, succession, or even parentage dispute. For example, under PILA §56 (1), the prerequisites for and obstacles to the celebration of a marriage and the consequences arising out of the marriage are governed by the law of the state of residence of the prospective spouses. It is possible that the issue of whether the same-sex parties are married or not can arise in a succession case if the rules applicable to succession allow the surviving partner to inherit from the deceased partner. Where the main issue (marriage) had no proximity to Estonia for the better part of the marital life of the spouses but the succession dispute ends up in the Estonian court (for example, because a spouse moved to Estonia shortly before his or her death), it is questionable whether the policy considerations of Estonian substantive law should influence the characterisation of the legal relationship between the foreign spouses. It might be more appropriate to characterise the legal relationship between the spouses as marital in the meaning of PILA §56 (1) and to consider the relevant policy considerations in the later phase of application of the foreign substantive law rule.

This solution could be presented by PILA §7, according to which foreign law will not be applied if the result of such application would be in obvious conflict with the essential principles of Estonian law (public policy). In such a case, the substantive rules of Estonian law will be applied. It has often been held that the application of a public policy clause should depend on the proximity that a particular legal relationship has with the forum. For example, A. Mills identifies a range of considerations that the courts should take into account when refusing to apply foreign rules on the grounds of public policy. According to Mills, these considerations include the proximity of the dispute with the forum state, the relativity of the norm that is breached, and the seriousness of the breach.^{*23}

The public policy clause in PILA §7 allows the courts to opt for a flexible approach toward foreign same-sex marriages. Addressing the issue of the same-sex marriage in the conflicts phase would allow the courts to evaluate what would be the exact result of the application of a relevant foreign rule in a particular case, what the proximity of the case to Estonia is, and what types of interests are at stake in each particular case and, hence, come to a conclusion as to whether a flexible solution would be in substantial conflict with Estonian public policy. However, if the claims of the surviving spouse were to be knocked down in the initial phase of characterisation (as would be the case if the characterisation is carried out according to the *lex fori*), such claimants might be left without any rights under the applicable substantive succession law, even if they have lived for most of their marital life with the expectation of being granted such rights after the death of their spouse. Neutrality of the conflict rule should be achieved, and the only way to achieve this is to characterise the ‘marriage’ in the meaning of the PILA as liberally as possible. A neutral conflict rule without any substantial assessment as to who is a proper ‘spouse’ in a marriage would accord respect to the differences of foreign law and the reasonable expectations of the parties and would reduce the possibility of relationships wherein persons would have different legal status in different jurisdictions. One might borrow the words of A. V. M. Struycken here: ‘[The recognition of foreign law as a law] is a sign of respect not only for the foreign law but for the legal community behind it. It is an attitude of respect and tolerance’^{*24}—an attitude that should not be ruled out in Estonian private international law simply because Estonian domestic law has traditionally been opposed to same-sex marriages.

Another example of how characterisation by the *lex fori* might not serve the reasonable expectations of the same-sex parties arises in the case of maintenance claims. PILA §61 provides a general conflict rule

²² See the Family Law Act (Perekonnaseadus) §1 (1). – RT I 2009, 60, 395; RT I, 21.12.2010, 4 (in Estonian). English text available at <http://www.just.ee/23295> (1.7.2011).

²³ A. Mills. The Dimensions of Public Policy in Private International Law. – Journal of Private International Law 2008 (August), pp. 210–218.

²⁴ A. V. M. Struycken. Co-ordination and Co-operation in Respectful Disagreement. General Course on Private International Law. Leiden/Boston: Martinus Nijhoff Publishers 2009, p. 318.

for the maintenance cases in ‘family relationships’ with reference to the Hague Maintenance Convention of 1973^{*25}, which Estonia became a party to on 22 October 2001 and which entered into force in relation to Estonia on 1 January 2002. Some authors have expressed a view that the notion of ‘family relationship’ in the meaning of the 1973 Hague Convention should be construed autonomously and liberally.^{*26} However, the voices from the Hague have recently asserted that the characterisation of such ‘family relationships’ as involving same-sex partnerships would continue to be left to the decision of the Member State even after the new Hague 2007 Maintenance Protocol^{*27} became applicable. As a member state of the European Union, Estonia is bound, by the Maintenance Regulation’s Article 15, to apply the Hague 2007 Maintenance Protocol from 18 June 2011.

According to the explanatory report drawn up by Andrea Bonomi on the new Hague 2007 Maintenance Protocol, ‘[t]he existence and the validity of same sex marriages or partnerships [...] continues to be covered by the national law of the Contracting States, including their rules of private international law. Moreover, the Protocol does not specify whether maintenance obligations arising out of such relationships are included within its scope; this omission is intentional, in order to avoid the draft Protocol running up against the fundamental opposition existing between the States of these issues’.^{*28} However, as previously argued, Estonian courts should not exclude same-sex partnerships when characterising even ‘family relationships’ in the meaning of the Hague 1973 Convention Protocol or the Hague 2007 Maintenance Convention. The opposite solution would make it impossible to take into account both the interests of the forum and the interests of the parties, which can better be achieved with the general bar of public policy provided by both—the convention^{*29} and the protocol.^{*30}

Finally, it is worth mentioning that there is no constitutional limit in Estonian law as to the different forms of marriage or family relationships. In line with §27 (2) of the Estonian Constitution^{*31}, it has simply been stated that the spouses have equal rights, but no mention of a requirement that such spouses be of opposite sexes has been made. According to §27 (1) of the Constitution, everyone has the right to the inviolability of private and family life. The intent of the Constitution is to grant such rights also to those citizens of foreign states or stateless persons engaged in proceedings in the Estonian courts—as derived from §9 (1) of the Constitution, the rights, freedoms, and duties of each and every person, as set out in the Constitution, shall be equal for Estonian citizens and for citizens of foreign states and stateless persons in Estonia. The interpretation of the Constitution should evolve as the society itself evolves. Recently, the questions of same-sex partnership and same-sex marriage have been heavily discussed in Estonian general public discourse.^{*32} Although the prevailing opinion on these questions still seems to be rather conservative (for example, most members of the newly elected Riigikogu are against the establishment of such institutions in the Estonian substantive law)^{*33}, problems related to foreign same-sex partnerships could be cured by the neutral conflict rules, which would allow the courts to respect the foreign institutions without necessarily implementing such institutions in Estonian domestic law.

²⁵ Convention of 2 October 1973 on the Law Applicable to Maintenance Obligations. Available at http://www.hcch.net/index_en.php?act=conventions.text&cid=86 (1.4.2011).

²⁶ H. Watts. The legal position in international law of heads of states, heads of governments and foreign ministers. – *Recueil des Cours* 1994 (247) 3, p. 189.

²⁷ Protocol of 23 November 2007 on the Law Applicable to Maintenance Obligations. Available at http://www.hcch.net/index_en.php?act=conventions.text&cid=133 (1.7.2011).

²⁸ Protocol of 23 November 2007 on the Law Applicable to Maintenance Obligations. Explanatory Report drawn up by Andrea Bonomi. Hague Conference on Private International Law, October 2009, p. 12. Available at <http://www.hcch.net/upload/wop/expl39e.pdf> (1.7.2011).

²⁹ See Article 11 of the Hague 1973 Convention.

³⁰ See Article 13 of the Hague 2007 Maintenance Protocol.

³¹ Eesti Vabariigi Põhiseadus. – RT 1992, 26, 349; RT I 2007, 33, 210 (in Estonian). English text available at <http://www.just.ee/23295> (1.4.2011).

³² See, for example, the analysis published by the Estonian Ministry of Justice on the unregistered partnerships and the legal consequences of such partnerships A. Olm. *Mitteabieluline kooselu ja selle õiguslik regulatsioon* (Non-marital Cohabitation and Its Legal Regulation). Eraõiguse Talitus, Õiguspoliitika osakond, Justiitsministeerium. Tallinn 2009. Available at <http://www.just.ee/orb.aw/class=file/action=preview/id=44568/Mitteabieluline+kooselu+ja+selle+%25F5iguslik+regulatsioon.pdf> (1.4.2011) (in Estonian).

³³ As reported by the main Estonian daily newspaper Postimees on 15 March 2011. See Riigikokku pääsenud samasooliste kooselu ei seadustaks (Members of the Riigikogu Would Not Legalise Same-sex Cohabitation). – *Postimees*, 15.3.2011. Available at <http://poliitika.postimees.ee/?id=403033> (1.7.2011) (in Estonian).

2.3. Avoiding the characterisation problems by implementing the rules of recognition

The Estonian legislator has sometimes solved the problems of characterisation by developing corresponding rules on recognition of foreign acts or documents. For example, PILA §24 contains a general conflict rule on succession, according to which the law of the state of the last residence of the deceased generally applies to succession. Among other things, this law determines who is capable of inheriting (PILA §26 (2)). However, a court may be freed from the characterisation problems it faces when applying these conflict rules because under the Law of Succession Act's³⁴ §165 (4) a succession certificate prepared in a foreign state is recognised in Estonia if the procedure for the preparation and the legal effect thereof are comparable to the provisions of Estonian law concerning succession certificates. Thus an interesting solution is achieved—although the court might be able to avoid recourse to the conflict rule, it is still required to carry out a comparison between the Estonian substantive law and the relevant foreign law in order to evaluate whether a person is entitled to inherit. This has been done by the courts on several occasions and so far has not given rise to any problems (at least when comparisons with the laws of the neighbouring Scandinavian states have been carried out).³⁵ However, the recourse to recognition and enforcement does not always solve the characterisation problems, since often such recourse is not possible, if a relevant document or judgement does not exist.

3. Illustration of the problem of characterisation—some recent examples from Estonian case law

3.1. Distinction between substance and procedure

It has traditionally been accepted that matters of procedure should be governed by the rules of the court (*lex fori*) whereas the substantive issues may also be governed by foreign law, if such foreign law is applicable to a particular legal relationship (*lex causae*).³⁶ However, this distinction between matters of procedure and matters of substance is not necessarily an easy one to draw, since the procedural norms can often be found in the substantive law codes and *vice versa*.

Even the essence of the conflict rules themselves is not clear-cut—when reference is made to a foreign law, a private international lawyer is always faced with the question of whether the reference should be interpreted as leading toward that foreign law as a whole including its conflict-of-laws rules or only to foreign substantive law norms. This particular problem is usually solved by the doctrine of *renvoi* accepted in the forum that is resolving the case. No such question arises in relation to foreign procedural norms related, for example, to the taking of evidence or service of documents—for practical reasons, it is generally assumed that foreign procedural norms are never applicable in the court deciding a particular case. However, the mere possibility that a foreign conflict rule might be applicable in a domestic court reflects the thinking that such rules are not simply procedural but relate to various substantive policy considerations such as the protection of weaker groups or the fulfilment of parties' best expectations as to the potentially applicable law. The limitation of claims and the question of the reduction of damages are the issues best illustrating the rivalry between procedural- and substantial-law arguments in Estonian private international law, which have recently demanded the attention of the Estonian courts.

³⁴ Pärimisseadus. – RT I 2008, 7, 52; RT I 2010, 38, 231 (in Estonian). English text available at <http://www.just.ee/23295> (1.7.2011).

³⁵ For the case involving a succession certificate issued in Finland, see Harju Maakohus, Court decision, 2.11.2010, No. 2-10-21311. For the case involving a succession certificate issued in Sweden, see Harju Maakohus, Court decision, 14.9.2010, No. 2-10-33314.

³⁶ On the particular characterisation problems relating to the issues of substance and procedure, see the recent works of J. M. Carruthers. Substance and Procedure in the Conflict of Laws: A Continuing Debate in Relation to Damages. – International and Comparative Law Quarterly 2004 (53), pp. 691–711; C. Forsyth. "Mind the Gap": A Practical Example of the Characterisation of Prescription/Limitation Rules. – Journal of Private International Law 2006, April, pp. 169–180.

3.2. Time limitations on enforcement of foreign judgements

The leading solution in modern European private international law has been to characterise the issues of limitation of claims generally as pertaining to substance rather than to procedure.^{*37} The same conclusion has been reached in the Estonian case law regarding the PILA, wherein the foreign rules on limitation periods have been applied as part of the *lex causae* applicable to a particular international contract.^{*38} Therefore, in general, the question of how to characterise the question of the limitation of claims has been resolved in Estonian private international law. However, an interesting problem is presented by the Estonian General Part of the Civil Code Act (hereinafter referred to as the GPCCA) in its §157, which deals with, among other things, the limitation period for enforcing foreign judgements in Estonia.

According to the above-mentioned §157, the limitation period for claims arising out of enforceable court judgements and from the agreements approved by a court or from other execution documents is 10 years. Questions as to the execution of judgements should generally be subject to the law of the forum, since they are the integral parts of the process, which the claimant has elected to adopt when suing in a particular forum.^{*39} Thus, GPCCA §157 should, from the point of view of private international law, be considered to be procedural and not substantive.

Taking into account the 10-year limitation set forth by GPCCA §157, one might ask why the Estonian legislator should uphold claims that might have already been time-barred in the state of the original judgement or under the law that the parties have chosen to be the applicable law. However, such foreign judgements might very well have been made in a case involving parties of whom at least one had a close connection to Estonia, which justifies the application of the limitation period found in §157. In addition, although it is possible to argue that the limitation of claims arising from contract, tort, or similar legal relationships is a matter that the parties could foresee if they foresee the law applicable to such a legal relationship, it is quite another thing to say that a person entering into a contract would, by a mere choice of law, foresee the legal effects of the judgement decided under such applicable law.

Finally, there is one other argument for treating GPCCA §157 as procedural in the private international law sense. If the application of GPCCA §157 were to depend on the choice of law made by the parties, different judgements would be treated differently, depending on the parties' choice of law, since foreign law is presumably more often relied upon in foreign proceedings. It would be more than odd if the enforcement of foreign judgements were subject to different time limits, when compared to local judgements, given that the enforceable foreign judgements and local judgements are otherwise regarded as equal under the Estonian domestic rules of enforcement (see the Code of Enforcement Procedure^{*40}, §2 (1) 2 and §2 (1) 5)). In this connection, it is worth noting that GPCCA §157 was recently amended (with effect from 5 April 2011) such that the previous 30-year limit was replaced with a 20-year-shorter limitation period. This is to be welcomed, since the 30-year limitation involved a remarkably long period. However, there remains a problem for the parties if the foreign law prescribes a shorter limitation period than the current 10 years found in GPCCA §157.

3.3. Reduction of damages by the Estonian courts

Certain problems of characterisation related to the reduction of damages can be raised in light of the recent case law of the Supreme Court of Estonia to illustrate the rivalry between the procedural and substantive law interests in the characterisation process. This development is related to the rule in the Estonian substantive law act—the Law of Obligations Act^{*41} (hereinafter referred to as the LOA), in §140—that allows the Estonian courts to reduce the amount of compensation for damages if compensation in full would be grossly unfair with regard to the person so obliged or for any other reason not reasonably acceptable. In such cases,

³⁷ On the opposite view held in the older English common law see L. Collins (ed.). Dicey, Morris and Collins on the Conflict of Laws. 14th ed. London: Sweet & Maxwell 2006, pp. 196–198.

³⁸ See: Pärnu Maakohus, Court decision, 29.11.2010, No. 2-09-27841.

³⁹ J. Fawcett, J. M. Carruthers (Note 3), p. 109.

⁴⁰ Täitemenetluse seadustik. – RT I 2005, 27, 198; RT I 14.03.2011, 1 (in Estonian). English text available at <http://www.just.ee/23295> (1.4.2011).

⁴¹ Võlaõigusseadus. – RT I 2001, 81, 487; RT I, 4.2.2011, 2 (in Estonian). English text available at <http://www.just.ee/23295> (1.7.2011).

all circumstances, especially the nature of the liability; the relationships between the persons; and their economic situations, including insurance coverage, shall be taken into account. Because of its location in the general part of the LOA, this provision is applicable in both contractual and tort liability cases.

From the standpoint of private international law, it is questionable whether §140 of the LOA should be characterised as a procedural or a substantive rule. In order for us to resolve this question, two considerations must be taken into account. First, is the application of this rule purely left to the discretion of the courts, and are the courts bound by this provision in every case, regardless of the arguments presented by the parties? If so, there is an argument in favour of deciding that said norm is a procedural one. Secondly, is the application of this rule something that the parties could have foreseen when they chose Estonian law as the substantially applicable law? If it is, then there is an argument in favour of considering this norm to be a substantive rather than procedural one.

For a long time, the prevailing view in the Estonian legal theory was that the application of LOA §140 did not depend on whether the obliged person relied on that provision; that is, a court could have reduced the amount of damages on its own initiative.^{*42} However, in its recent decisions, the Supreme Court has explicitly stressed that a court does not have to apply this provision on its own initiative^{*43} and, even more, that the court can turn to this provision only if it has been relied upon by one of the parties.^{*44} Thus the reduction of damages is something that a party has to plead for, which would make it substantive, not a procedural rule. A similar solution has been adopted in Estonian case law with regard to the limitation of claims^{*45}, which is an issue that has generally been characterised in modern private international law as substantive rather than procedural.^{*46}

Because of the location of LOA §140 in a substantive law act, it should also be assumed that the parties, when choosing Estonian law as the law applicable to contract or tort, must foresee the possible application of this provision as a part of the chosen law. Therefore, there is another argument in favour of characterising the issue of reduction of damages in Estonian law as a substantive rather than a procedural issue.

It has sometimes been argued that the ‘thing’ characterised should be not the legal norm but the issue itself, since the language of the conflict of laws is written in terms that connect categories of legal issue with a particular choice of law.^{*47} The ‘issue’ to be characterised in the case of reduction of damages is related to the extent of the liability of the debtor. Although not worded as a classical rule of liability, LOA §140 has as its purpose limitation of the liability of the debtor by the assessment of the proper damages to be awarded. Such issues should probably be dealt with under the Rome I Regulation as the question of ‘limitation of liability’ in the sense of Article 15 (b) of the regulation, as has been done in addressing the statutory reduction clauses found in Portuguese, Swedish, and Dutch law.^{*48} Since LOA §140 could also be applicable in contractual disputes, a similar characterisation should be achieved in the context of the Rome I Regulation. It is noteworthy that the list of issues pertaining to the scope of the applicable law (based on Article 12 of the Rome I Regulation^{*49}) is not exhaustive. Therefore, the inclusion of LOA §140 within the scope of Article 12 of the Rome I Regulation should not be problematic. In addition, it has been stressed expressly by the commentators on said regulation that if the applicable law limits the amount of compensation, such a rule will apply notwithstanding the existence of a contrary rules of the *lex fori*.^{*50}

^{*42} P. Varul *et al.* (eds.). *Võlaõigusseadus I. Üldosa (§§1–207)*. Kommenteeritud väljaanne (Law of Obligations Act I. Commented Edition). Tallinn: Juura 2006, p. 491 (in Estonian).

^{*43} CCSCd, 13.4.2011, 3-2-1-11-11, paragraph 16.

^{*44} CCSCd, 9.3.2011, 3-2-1-169-10, paragraph 16.

^{*45} CCSCd, 3.6.2003, 3-2-1-70-03, paragraph 13.

^{*46} For example, such is the solution under the Rome I Regulation Article 12 (d) and Rome II Regulation Article 15 (h).

^{*47} A. Briggs. *The Conflict of Laws*. 2nd ed. New York: Oxford University Press 2008, p. 12.

^{*48} R. Plender, M. Wilderspin. *The European Private International Law of Obligations*. 3rd ed. London: Sweet & Maxwell 2009, p. 442, Note 45.

^{*49} According Article 12 of the Rome I Regulation: 1. The law applicable to a contract by virtue of this Regulation shall govern in particular: (a) interpretation; (b) performance (c) within the limits of the powers conferred on the courts by its procedural law, the consequences of a total or partial breach of obligations, including the assessment of damages in so far as it is governed by rules of law; (d) the various ways of extinguishing obligations, and prescription and limitation of actions; (e) the consequences of nullity of the contract. 2. In relation to the manner of performance and the steps to be taken in the event of defective performance, regard shall be had to the law of the country in which performance takes place.

^{*50} R. Plender, M. Wilderspin (Note 48), p. 415.

One might argue that the characterisation of the issue of the reduction of damages as substantive rather than procedural deprives the Estonian courts of the possibility to uphold justice between the parties since LOA §140 expressly allows the Estonian courts to take into account the reasonable expectations of the obliged person and the ‘gross unfairness’ of the possible amount of compensation. However, with the need to secure the reasonable expectations of both (contracting) parties taken into consideration, it is probably a good thing that this rule is not given universal application as a procedural rule. Otherwise, parties who have chosen foreign law to govern their legal relationship but who have come before the Estonian courts to resolve their dispute would suddenly be faced with a vaguely worded procedural norm hidden away in a substantive law code leaving them to the mercy of the discretion of the court.

4. Conclusions

No comprehensive theory of characterisation has yet been established in Estonian private international law. Therefore, Estonian courts are faced with the difficult task of finding a proper legal category for factual issues, relationships, and connections to which the Estonian legislator has not paid enough attention when enacting the Estonian private international and domestic law rules. Although many of the characterisation problems have already been solved and more will probably be solved by the European legislator, the issue of characterisation remains when the domestic private international rules or the bilateral treaties concluded with the Republic of Estonia come into play. It is hoped that the Estonian courts will solve such problems in a flexible manner, taking into account the need to achieve justice between the parties.



Margit Piirman

Adviser to the Civil Chamber
Supreme Court of Estonia

Patentability of Inventions Related to Human Embryonic Stem Cells

1. Introduction

Imagine the case where it is possible to treat patients who have suffered a spinal cord injury by using human embryonic stem cell^{*1} (hereinafter referred to as the hESC) therapy. At first glance, this might seem impossible, but Geron Corporation has already initiated a clinical trial of hESC-derived oligodendrocyte progenitor cells. At that time, in 2010, Geron's president, Thomas B. Okarma, considered this clinical trial a milestone for the field of hESC-based therapies.^{*2} Embryonic stem cells are stem cells derived from the blastocyst stage of the embryo (5–7-day embryo).^{*3} These stem cells are pluripotent; that is, they have the capacity to develop into any of the 200 cell types that make up the human body^{*4} and can proliferate in the laboratory (*in vitro*) indefinitely.^{*5} It is hoped that, because of the properties stem cells possess, it will become possible to use them in therapy for degenerative diseases or injuries^{*6}, to use them to replace whole cells, and to manipulate them to regenerate defective tissues or organs and cause them to grow back.^{*7} Clearly, the potential benefit for mankind from hESCs cannot be underestimated. Still, hESC research, especially the patentability of inventions pertaining to hESCs, has created heated debate in Europe. One reason for this is that, for obtaining the hESCs from the blastocyst stage of the embryo, the embryo is usually destroyed.^{*8}

¹ A stem cell is a precursor cell that gives rise to specialised cells of various types as well as to more stem cells. It is an undifferentiated cell that can divide without limit and whose progeny includes both further stem cells or cells destined to differentiate. See D. P. Clark, N. J. Pazdernik. *Biotechnology: Applying the Genetic Revolution*. Amsterdam etc.: Elsevier/Academic Press 2009, p. 733; G. Van Overwalle. European Commission, European Group on Ethics in Science and New Technologies to the European Commission. Study on the patenting of inventions related to human stem cell research, 30.12.2001. Luxembourg 2002, p. 8.

² Geron Initiates Clinical Trial of Human Embryonic Stem Cell-Based Therapy. Available at <http://www.geron.com/media/pressview.aspx?id=1235> (2.4.2011).

³ D. P. Clark, N. J. Pazdernik (Note 1), p. 709.

⁴ G. Laurie. Patenting Stem Cells of Human Origin. – *European Intellectual Property Review* 2004 (26) 2, p. 60.

⁵ G. Van Overwalle (Note 1), p. 8.

⁶ European Group on Ethics in sciences and new technologies to the European Commission. Opinion on ethical aspects of patenting inventions involving human stem cells. Opinion No. 16, 7 May 2002. Luxembourg 2002, p. 5.

⁷ D. P. Clark, N. J. Pazdernik (Note 1), p. 488.

⁸ M. Eder-Rieder. Aspekte der Stammzellentechnologie im Besonderen in Großbritannien, Deutschland, Österreich und der Schweiz. – *ZfEV* 2007/4, p. 18; J. A. Johnson *et al.* *Stem Cell Research – CRS Report for Congress*. – Practising Law Institute. Patents, Copyrights, Trademarks, and Literary Property Course Handbook Series, September 2005, p. 359. (840 PLI/Pat 351).

The purpose of this article is to analyse the problems related to the patentability of inventions related to hESCs, especially the questions raised in the case *Oliver Brüstle vs. Greenpeace eV*⁹, which was brought before the European Court of Justice (hereinafter referred to as the ECJ) for a preliminary ruling. The main questions raised in the *Brüstle* case that the author will consider in this article are the following: What is meant by the term 'human embryos' in Article 6 (2) (c) of Directive 98/44/EC? What is meant by the expression 'uses of human embryos for industrial or commercial purposes'? The author analyses these questions in light of Estonian laws, including the Estonian Patents Act¹⁰ (hereinafter referred to as the EstPA), and attempts to interpret the relevant paragraphs of the EstPA, considering also Community law and Directive 98/44/EC of the European Parliament and of the Council of 6 July 1998 on the Legal Protection of Biotechnological Invention¹¹ (hereinafter referred to as 'the Biotech Directive'). It is important to note that, as of the time of writing, no judgement has been issued by the ECJ in the *Brüstle* case yet; it is hoped that a ruling will resolve the relevant questions raised. In the meantime, however, as there is already the opinion of the Advocate General¹² available in this case, it has been possible to analyse the solutions offered by the Advocate General. The author also briefly points to the problems arising in evaluation of the patentability of inventions related to pluripotent stem cells under a general *ordre public* or morality clause. The aim of this article is also to offer a possible new wording for the EstPA (and the Biotech Directive) concerning the patentability of hESC-related inventions. An accompanying aim is to create discussion among Estonian lawyers about the patentability of inventions related to hESCs. So far, there has been no public discussion of this in Estonia. There also has been no official statement of the Estonian Patent Office about the patentability of hESC-related inventions. Because the ethics questions surrounding the patentability of inventions related to hESCs have been raised mainly in the European Union, this article does not give great attention to regulations and practice outside the European Union.

2. Legal framework

In Estonia, in order for us to consider whether hESC-related inventions are patentable, it is important to look at §7 of the EstPA, which gives a list of inventions that are considered unpatentable. According to §7 (1) 1) of the EstPA, inventions that are contrary to public order and morality shall not be protected by a patent. Further, §7 (2) 3) of the EstPA stipulates that uses of human embryos for commercial purposes, including processes prohibited by the Artificial Insemination and Embryo Protection Act, are biotechnological inventions, which shall not be protected by a patent.

As Estonia is a Member State of the European Union, it is important to look at Directive 98/44/EC also. According to Article 6 (1) of the Biotech Directive, inventions shall be considered unpatentable where their commercial exploitation would be contrary to *ordre public* or morality; however, exploitation shall not be deemed to be so contrary merely because it is prohibited by law or regulation. Article 53 (a) of the European Patent Convention¹³ (hereinafter referred to as the EPC) and Article 27 (2) of the Agreement

⁹ Reference for a preliminary ruling from the Bundesgerichtshof (Germany) lodged on 21 January 2010. See Prof. Dr. Oliver Brüstle v. Greenpeace e.V (Case C-34/10). Available at <http://curia.europa.eu/jurisp/cgi-bin/form.pl?lang=en&alljur=alljur&juredj=juredj&jurtpi=jurtpi&jurftp=jurftp&numaff=&nomusuel=BrC14stle&docnodecision=docnodecision&allcommjo=allcommjo&affint=affint&affclose=affclose&alldocrec=allldocrec&docor=docor&docav=docav&docsom=docsom&docinf=docinf&alldocnored=allldocnored&docnoor=docnoor&docppoag=docppoag&radtypeord=on&newform=newform&docj=docj&docop=docop&docnoj=docnoj&typeord=ALL&domaine=&mots=&resmax=100&Submit=Rechercher> (3.4.2011).

¹⁰ Patendiseadus. – RT I 1994, 25, 406; 2010, 22, 108 (in Estonian). English text available at <http://www.legaltext.ee/> (2.4.2011).

¹¹ Directive 98/44/EC of the European Parliament and of the Council of 6 July 1998 on the legal protection of biotechnological inventions. Available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31998L0044:EN:HTML> (2.4.2011).

¹² Opinion of Advocate General Bot, delivered on 10 March 2011. See Case C-34/10, Oliver Brüstle v. Greenpeace eV. Available at <http://curia.europa.eu/jurisp/cgi-bin/form.pl?lang=en&alljur=alljur&juredj=juredj&jurtpi=jurtpi&jurftp=jurftp&numaff=&nomusuel=BrC14stle&docnodecision=docnodecision&allcommjo=allcommjo&affint=affint&affclose=affclose&alldocrec=allldocrec&docor=docor&docav=docav&docsom=docsom&docinf=docinf&alldocnored=allldocnored&docnoor=docnoor&docppoag=docppoag&radtypeord=on&newform=newform&docj=docj&docop=docop&docnoj=docnoj&typeord=ALL&domaine=&mots=&resmax=100&Submit=Rechercher> (11.4.2011).

¹³ European Patent Convention, 5 October 1973. Available at <http://www.epo.org/law-practice/legal-texts/html/epc/1973/e/ma1.html> (5.4.2011).

on Trade-Related Aspects of Intellectual Property Rights^{*14} (hereinafter referred to as the TRIPS) contain a similar *ordre public* and morality clause. Article 6 (2) (c) of the Biotech Directive stipulates that, on the basis of paragraph 1, the following, in particular, shall be considered unpatentable: 'uses of human embryos for industrial or commercial purposes'.^{*15}

The author examines first whether hESC-related inventions could be unpatentable under §7 (2) 3) of the EstPA and Article 6 (2) (c) of the Biotech Directive, what might be the definition of 'embryo', and what is meant by use of human embryos for 'industrial or commercial purposes'. Then, the work briefly points to the problems arising when one evaluates the patentability of inventions related to pluripotent stem cells under a general *ordre public* or morality clause.

3. The definition of 'embryo'

For us to reach a conclusion as to whether hESC-related inventions are patentable or fall within the exception laid down in §7 (2) 3) of the EstPA, it is important to examine first what an 'embryo' is within the meaning of that paragraph. The question of what is meant by the term 'human embryos' in Article 6 (2) (c) of the Biotech Directive was raised also by the German courts (the *Bundesgerichtshof*), before the ECJ for a preliminary ruling in case C-34/10, the *Brüstle* case.^{*16} This case involves a German patent, filed on 19 December 1997, the holder of which is Mr. Brüstle and which concerns isolated and purified neural precursor cells, processes for their production from embryonic stem cells, and the use of neural precursor cells for the treatment of neural defects. Greenpeace eV brought an action for the annulment of the patent filed by Brüstle insofar as certain claims under that patent pertain to precursor cells obtained from hESCs. The Federal Patent Court allowed the application made by Greenpeace in part and declared the patent filed by Brüstle invalid insofar as the first claim is related to precursor cells obtained from hESCs and the twelfth and sixteenth claims pertain to processes for the production of precursor cells. Brüstle appealed against that judgement with the *Bundesgerichtshof*, who considered the outcome of the case to depend on the interpretation of certain provisions of Directive 98/44.^{*17}

At first glance, it seems that defining the term 'embryo' is the simplest task. In Estonia, the EstPA does not define 'embryo'. However, in Estonia, §3 of the Artificial Insemination and Embryo Protection Act^{*18} (hereinafter referred to as the AIEPA) stipulates that an 'embryo' is the embryo/foetus in its early stage of development from the time of fertilisation of the ovum. Also, for the purposes of said act, 'embryo' refers to a human embryo unless otherwise provided therein. This is clearly a very general definition. It also raises the question of whether the aim of the legislator has also been that this definition should be used in interpretation of §7 (2) 3) of the EstPA. As §7 (2) 3) of the EstPA makes clear reference to the processes prohibited by the AIEPA as unpatentable inventions, it can be assumed that in interpretation of the term 'embryo' within the meaning of §7 (2) 3), it is also necessary to consider paragraphs in the AIEPA, including §3. Although it might seem that §3 of the AIEPA resolves the question of what an embryo is, the questions raised in the *Brüstle* case show that the task is much more complicated than one might think. The ECJ has the task of answering the following questions concerning the term 'human embryos': Does the term 'human embryos' in Article 6 (2) (c) of Directive 98/44 include all stages of the development of human life, beginning with the fertilisation of the ovum, or must further requirements, such as the attainment of a certain stage of development, be satisfied? Are the following organisms also included: unfertilised human ova into which a cell nucleus from a mature human cell has been transplanted and unfertilised human ova whose division and further development have been stimulated by parthenogenesis? Are stem cells obtained from human embryos at the blastocyst stage also included?^{*19}

¹⁴ The Trade Related Aspects of Intellectual Property Rights Agreement – Annex 1C of the Marrakesh Agreement Establishing the World Trade Organization, 15.4.1994. Available at http://www.wto.org/english/tratop_e/trips_e/t_agmo_e.htm (8.4.2011).

¹⁵ The similar rule is also included into the Implementing Regulations to the Convention on the Grant of European Patent of 5 October 1973. Available at <http://www.epo.org/law-practice/legal-texts/html/epc/1973/e/ma2.html> (8.4.2011).

¹⁶ Reference for a preliminary ruling from the *Bundesgerichtshof* (Note 9).

¹⁷ Opinion of Advocate General (Note 12), paragraphs 26, 32–34.

¹⁸ Kunstliku viljastamise ja embrüokaitse seadus. – RT I 1997, 51, 824; RT I, 3.3.2011, 1 (in Estonian). English text available at <http://www.legaltext.ee/> (2.4.2011).

¹⁹ Reference for a preliminary ruling (Note 9).

Looking at the ‘embryo’ definition in the AIEPA, one can see that the criterion for status as an embryo is the fertilisation of the ovum. No further requirements (for example, the transplantation of the fertilised ovum into the uterus) are needed before the fertilised ovum is termed an embryo, at least according to §3. Does this mean that all the other possibilities listed in the questions above are patentable? Of course not, but the term ‘embryo’ seems to be defined restrictively in §3 in comparison to, for example, the German *Embryonenschutzgesetz*^{*20} (hereinafter referred to as the ESchG) (Embryo Protection Act). According to §8 (1) of the ESchG, an embryo is a fertilised human ovum capable of development, from the time of karyogamy, and any totipotent cell removed from an embryo that is able to divide and develop into an individual, provided that the other necessary conditions are satisfied. Therefore, in Germany, not only a fertilised human ovum is considered an embryo, but also totipotent cells removed from an embryo are. Totipotent cells are stem cells with the capacity to become a complete and separate embryo.^{*21}

As expected, the Biotech Directive itself does not define the concept of a human embryo. The Advocate General notes in the *Brüstle* case that the drafting history of this directive does not give any indication of the intended substance of the concept. Also, as one might expect, there is no unanimous conception among Member States of the European Union.^{*22} This raises the question of why there are no special articles in the directive concerning patentability of hESCs. One obvious reason for this is that the possibility of deriving human stem cells from embryos only arose in the year in which the Biotech Directive was adopted.^{*23}

Before the *Brüstle* case, the Enlarged Board of Appeal (hereinafter referred to as the EBA) of the European Patent Office (hereinafter referred to as the EPO) too faced the problem of defining ‘embryo’, in the *WARF* case^{*24}, which also dealt with hESC-related inventions. The EBA presumed that ‘embryo’ was not to be given any restrictive meaning and that what is an embryo is a question of fact in the context of any particular patent application.^{*25} This is a slightly different view than that seen in the opinion of the Advocate General in the *Brüstle* case: the Advocate General finds that the concept of the human embryo must be subject to common understanding in all Member States of the EU.^{*26} The handling of the *WARF* case is greatly criticised, and it has been argued (by P.L.C. Torremans, for example) that the EBA did not define the term ‘embryo’ in the case at all. The Board simply refused to adopt the one restrictive definition that was put to it and proceeded to leave the term undefined.^{*27}

When looking at the *Brüstle* case, the Advocate General took the view that the concept of a human embryo applies from the fertilisation stage to the initial totipotent cells and to the entire ensuing process of development and formation of the human body. As totipotent cells represent the first stage of the human body that they will become, they must be legally categorised as embryos.^{*28} Although, in Estonia, §3 of the AIEPA does not literally classify totipotent cells with the concept of an embryo, the author finds it reasonable to interpret §7 (2) 3) of the EstPA in a similar way, such that the term ‘embryo’ also includes totipotent stem cells, which are able to develop into a human being. The author is of the opinion that, as one of the main objectives of the exception to patentability of an ‘embryo’ is to preclude the commoditisation of human life, the criterion under which the term ‘embryo’ within the meaning of §7 (2) 3) of the EstPA (and also within the meaning of Article 6 (2) (c) of the Biotech Directive) could be evaluated could be the following: Is it capable of developing into a human being? When the answer to this question is ‘yes’, it can be considered an ‘embryo’ within the sense of §7 (2) 3) of the EstPA (and also within that of Article 6 (2) (c) of the Biotech Directive).

²⁰ Gesetz zum Schutz von Embryonen (Embryonenschutzgesetz – ESchG). – 13. Dezember 1990 BGBl. I p. 2746; 23. Oktober 2001 BGBl. I p. 2702. Available at <http://www.gesetze-im-internet.de/eschg/BJNRO27460990.html> (3.4.2011).

²¹ G. Laurie (Note 4), p. 60.

²² Opinion of Advocate General (Note 12), paragraphs 64, 66.

²³ G. Laurie (Note 4), p. 59; J. A. Thompson *et al.* Embryonic Stem Cell Lines Derived from Human Blastocyst. – Science, 6 November 1998, Vol. 282, No. 5391, pp. 1145–1147. Available at <http://www.sciencemag.org/content/282/5391/1145.full> (3.4.2011).

²⁴ G 2/06 (WARF) (25 November 2008). Available at http://archive.epo.org/epo/pubs/ojoo09/05_09/05_3069.pdf (6.4.2011).

²⁵ *Ibid.*, paragraph 20.

²⁶ Opinion of Advocate General (Note 12), paragraph 7.

²⁷ P. L. C. Torremans. The Construction of the Directive’s Moral Exclusions under the EPC. – A. Plomer, P. Torremans (eds.). Embryonic Stem Cell Patents: European Law and Ethics. New York: Oxford University Press 2009, p. 165.

²⁸ Opinion of Advocate General (Note 12), paragraph 85.

Looking at the *Brüstle* case, the Advocate General also finds that every totipotent cell, whatever the means by which it has been obtained, is an embryo and that any patentability must be excluded. This definition, therefore, covers unfertilised ova into which a cell nucleus from a mature cell has been transplanted and unfertilised ova whose division has been stimulated by parthenogenesis insofar as totipotent cells would be obtained in that way. The Advocate General also includes a blastocyst within the ‘embryo’ concept, as it is one of the stages of development of the human body.^{*29} The author finds no objection to including blastocysts under the concept, within the meaning of §7 (2) 3) of the EstPA (and also within that of Article 6 (2) (c) of the Biotech Directive). This kind of interpretation is also in accordance with §3 of the AIEPA, as it refers to the ‘embryo in the early stage of development’. A 5–7-day-old organism (blastocyst) is, without a doubt, in the early stage of development, and it also meets the criterion of being capable of developing into a human being.

Although ‘embryo’ is not defined in the EstPA and it can be difficult to understand what is meant by it in §7 (2) 3) of the EstPA (or Article 6 (2) (c) of the Biotech Directive), the author does not think that this definition should be included in the EstPA or the Biotech Directive itself. Defining the term in the EstPA would not resolve the question of whether inventions related to pluripotent stem cells are patentable or not. As the author reasons below, it would be wiser to stipulate concrete inventions (related to hESCs) that are unpatentable. This could prevent differing interpretations of the term.

4. Pluripotent stem cells

As noted above, the next question to analyse is whether stem cells obtained from human embryos at the blastocyst stage are also included in the definition of ‘embryo’. In *Brüstle*, the Advocate General takes the view that a pluripotent stem cell in isolation cannot be regarded as constituting an embryo itself, because, although it can develop into all kinds of cells, it cannot develop separately into a complete human being.^{*30} The author finds that this view is in accordance with §8 (1) of the German ESchG and definitely with §3 of Estonia’s AIEPA. As the Advocate General refers also to the fact that a pluripotent stem cell cannot develop into a complete human being, this would be in accordance also with the criteria offered by the author for evaluating whether something is considered an ‘embryo’ or not. Given the conclusion that pluripotent stem cells are not considered embryos, it could be assumed that inventions related to pluripotent stem cells should not fall within the scope of Article 6 (2) (c) of the Biotech Directive, since it prohibits patenting of uses of ‘human embryos’ for industrial or commercial purposes. However, this does not mean that those inventions should not be precluded from patentability under Article 6 (1) of the Biotech Directive (the general clause on *ordre public* or morality).

The Advocate General nonetheless goes further and finds that it is not possible to ignore the origin of these pluripotent cells. He explains that the pluripotent stem cell in the present case is removed from the blastocyst, which itself constitutes an embryo—one of the stages in the formation and development of the human body, which the removal will destroy. The Advocate General does not support the view that the way in which the cell has been removed and the consequences of such removal do not have to be taken into account, for reasons connected with *ordre public* and morality. The Advocate General concludes that it must be agreed, if only for the sake of consistency, that inventions related to pluripotent stem cells can be patentable only if they are not obtained to the detriment of an embryo, whether its destruction or its modification.^{*31}

The reference to *ordre public* and morality leads the author to wonder whether it is meant also that Article 6 (1) of the Biotech Directive should be applied in this case. As the questions referred to the ECJ pertain only to Article 6 (2) (c), this is questionable, although Article 6 (2) also refers to Article 6 (1) as a basis.

²⁹ *Ibid.*, paragraphs 91, 94–95.

³⁰ *Ibid.*, paragraphs 93, 98, 100.

³¹ *Ibid.*, paragraphs 103–105, 109.

More problematic is the reference to *ordre public* and morality made by the Advocate General in light of the case *Commission v. Italy*³² (hereinafter referred to as the *Italy* case), where the ECJ stated:

Unlike Article 6(1) of the Directive, which allows the administrative authorities and courts of the Member States a wide discretion in applying the exclusion from patentability of inventions whose commercial exploitation would be contrary to *ordre public* (public policy) and morality, Article 6(2) allows the Member States no discretion with regard to the unpatentability of the processes and uses which it sets out, since the very purpose of this provision is to give definition to the exclusion laid down in Article 6(1) (see, to this effect, *Netherlands v Parliament and Council*, paragraphs 37 to 39). [...] It follows that, by expressly excluding from patentability the processes and uses to which it refers, Article 6(2) of the Directive seeks to grant specific rights in this regard.³³

This decision has been criticised by A. Plomer for the ECJ's insistence that the test to be applied in the interpretation of the list of specific exclusions is definitional, not moral. The implication is that, when reading and interpreting the specific exclusion in Article 6 (2) of the Biotech Directive, one must give the words their natural meaning. Plomer also suggests that, in view of the *Italy* case, additional words should not be imported to vary, broaden, or narrow the exclusion in order to instantiate the alleged underlying moral consensus, since, as stated by the ECJ, the specific exclusions are already illustrative of the principle. The analysis shows that there is no consensus in Europe to the effect that destructive uses of human embryos are morally impermissible. Neither is there consensus to the effect that uses of hESCs and related inventions or products is immoral when obtained by destruction of human embryos. Plomer finds that, in consideration of the *Italy* case, Article 6 (2) (c) cannot be read as excluding patents for hESC-based inventions and related industrial products whose derivation necessarily involved destruction of human embryos. Instead, the *Italy* case indicates that the exclusion is restricted to inventions involving commercial uses of human 'embryos'.³⁴ The author agrees with Plomer's opinion that, in view of the *Italy* case, it is problematic to conclude that the uses of pluripotent stem cells (or patenting of pluripotent-stem-cell-related inventions) that are obtained by destruction of human embryos are considered immoral or contrary to *ordre public* in every Member State of the EU. As scientific research concerning hESCs is allowed in, for example, Estonia, there is no certainty that those inventions (or their commercial exploitation) that involve pluripotent stem cells obtained by destruction of human embryos would be considered immoral or contrary to *ordre public* in Estonia.

Therefore, if the ECJ follows the opinion of the Advocate General that pluripotent stem cells do not constitute embryos, the author finds that inventions related to pluripotent stem cells cannot be excluded from patentability under Article 6 (2) (c) of the Biotech Directive. As noted above, this does not mean that those inventions should not be precluded from patentability under Article 6 (1) (the general clause on *ordre public* or morality). Considering the *Italy* case, the author finds that the decision as to whether pluripotent stem cells are excluded from patentability under the *ordre public* and morality clause is at the discretion of each Member State.

So what could explain the conclusion that inventions that are related to pluripotent stem cells derived from embryos are not patentable under Article 6 (2) (c) of the Biotech Directive, when it has been found that pluripotent stem cells are not considered 'embryos'? The reason for this might be to resolve the long debate over the patentability of inventions related to hESCs in the EU conclusively. By agreeing with the opinion of the Advocate General, the ECJ could provide clarity for all parties concerned—Member States, biotechnology companies, scientists, courts, etc. With the question open for the Member States to resolve, the outcome in different Member States could be very different. Outcomes differing by state in relation to this important issue would definitely confuse the biotechnology companies and could also lead to a situa-

³² Case C-456/03, *Commission v. Italy*. Available at <http://curia.europa.eu/jurisp/cgi-bin/form.pl?lang=en&alljur=alljur&jurcdj=juredj&jurtpi=jurtpi&jurftp=jurftp&numaff=C-456/03&nomusuel=&docnodecision=docnodecision&allcommjo=allcommjo&affint=affint&affclose=affclose&alldocrec=allldocrec&docor=docor&docav=docav&docsom=docsom&docinf=docinf&alldocnorec=allldocnorec&docnoor=docnoor&docppoag=docppoag&radtypeord=on&newform=newform&docj=docj&docop=docop&docnoj=docnoj&typeord=ALL&domaine=&mots=&resmax=100&Submit=Rechercher> (3.4.2011).

³³ *Ibid.*, paragraphs 78–79.

³⁴ A. Plomer. Towards Systematic Legal Conflict: Article 6 (2) (c) of the EU Directive on Biotechnological Inventions. – A. Plomer, P. Torremans (eds.). *Embryonic Stem Cell Patents: European Law and Ethics*. New York: Oxford University Press 2009, p. 189.

tion in which companies start to apply for the associated patents only in a Member State that supports the patenting of hESCs.

Would the outcome with §7 (2) 3) of the EstPA be different? As noted above, §7 (2) 3) of the EstPA also refers to the processes prohibited by the AIEPA. There is a list of prohibited acts with embryos in §35 of the AIEPA, which states that it is prohibited to perform the following acts in connection with artificial insemination of a woman: 1) artificial fertilisation of an ovum with a sperm that has been selected on the basis of the sex chromosome contained therein, except in cases where a gamete is selected for avoidance of a serious sex-linked inheritable disease being passed on to the child; 2) creation, by way of replacement of the nucleus of a fertilised ovum with a somatic cell of another embryo, a foetus, or a living or dead person, of an embryo with genetic information identical to that of said embryo, foetus, or living or dead person; 3) fusion of embryos with differing genetic information in order to create a cell fusion if at least one of the embryos is a human embryo, or fusion of a human embryo with a cell that contains genetic information different from that of the cells of the embryo and which may develop further together with the embryo; and 4) creation of an embryo capable of developing by fertilisation of a human ovum with animal sperm or an animal ovum with human sperm. As can be seen, although §35 of the AIEPA gives examples of prohibited acts involving embryos, it does not say anything about the pluripotent stem cells derived from the embryo. Therefore, it offers no more guidance on this issue than the Biotech Directive does. Also, the author finds that it has to be taken into consideration that §35 of the AIEPA refers to acts in connection with artificial insemination of a woman. The issue surrounding the patentability of pluripotent stem cells does not involve the insemination of a woman.

Considering that pluripotent stem cells are not able to develop into a complete human being and under this criterion cannot be considered 'embryos', the author finds that the patentability of inventions related to pluripotent stem cells should under Estonian law be evaluated also under §7 (1) 1) of the EstPA (under the general *ordre public* and morality clause). Interestingly, it has been argued that the altered wording of embryo exclusion and the direct reference to medical legislation makes it probable that patent applications for hESC inventions would be treated rather strictly in Estonia.^{*35} The author calls this argument into question, since the reference in §7 (2) 3) of the EstPA to the processes stipulated in the AIEPA is only illustrative, not conclusive.

5. The uses of human embryos for industrial or commercial purposes

After analysing the concept of 'embryo', one who wishes to say that something is unpatentable according to Article 6 (2) (c) of the Biotech Directive (and §7 (2) 3) of the EstPA) must next examine what is meant by 'uses of human embryos for industrial or commercial purposes'. Questions of this sort have also been referred to the ECJ in the *Brüstle* case. Interestingly, §7 (2) 3) of the EstPA does not include uses of human embryos for 'industrial purposes' in the exclusion and refers only to 'uses of human embryos for commercial purposes'.

In the *WARF* case, the EBA took the view that, since the embryos used to perform the invention in question are destroyed, they are used for industrial or commercial purposes, because patentability is considered only if the invention is to the benefit of the embryo itself.^{*36} The Advocate General takes the same view and argues that it is clear from the drafting history of the directive that, by introducing the concept 'for industrial or commercial purposes', the Council wished to draw a contrast between such uses and inventions for therapeutic or diagnostic purposes that are applied to the human embryo and are useful to it.^{*37} It is true that Recital 42 of the Biotech Directive states that uses of human embryos for industrial or commercial purposes must also be excluded from patentability, although this exclusion on no account is intended to affect inventions for therapeutic or diagnostic purposes that are applied to the human embryo and are useful to it. However, the author agrees with Torremans that, while diagnosis and treatment as applied to an embryo

³⁵ Å. Hellstadius. A Comparative Analysis of the National Implementation of the Directive's Morality Clause. – A. Plomer, P. Torremans (eds.). *Embryonic Stem Cell Patents: European Law and Ethics*. New York: Oxford University Press 2009, p. 124.

³⁶ G 2/06 (Note 24), paragraph 27.

³⁷ Opinion of Advocate General (Note 12), paragraph 111.

surely is not excluded from patentability, it is also hardly relevant in this context. A treatment (or diagnosis) that is beneficial to the embryo will hardly ever involve 'use' of the embryo; therefore, this cannot be the criterion for distinguishing industrial or commercial use from permitted use.^{*38}

The Advocate General finds in his opinion that use for industrial or commercial purposes requires large-scale production. Industrial and commercial exploitation would presuppose cell cultures intended for pharmaceutical laboratories with a view to the manufacture of medicines. The more the technique allows cases to be treated, the larger the production of cells, requiring recourse to a proportional number of embryos, which would, therefore, be created only to be destroyed a few days later. He further finds that a definition that in its essence authorises such a practice would not be consistent with the concept of *ordre public*, or with an ethical conception that could be shared by all Member States.^{*39} The author holds the opinion that the argument about the production of more and more embryos to be destroyed is questionable, considering Estonian laws. According to §29 of the AIEPA, an ovum shall be fertilised *in vitro* only with the aim of transfer of said ovum to a woman. This means that the creation of embryos for research or some commercial purpose is banned. According to §32 (1) of the AIEPA, embryos that are not transferred to a woman and embryos that have remained unused may be utilised for scientific research. Accordingly, at least in Estonia, it would be forbidden to start creating embryos for industrial or commercial purposes. Furthermore, at the European level, creation of embryos for research purposes has been banned by the Additional Protocol to the Biomedicine Convention with Regard to the Application of Biology and Medicine, on the Prohibition of Cloning Human Beings.^{*40} If the emphasis is on the fact that the embryos are destroyed, then, at least in Estonia, according to §30 (2) of the AIEPA, if an embryo is not transferred to a woman within a specified term, the embryo shall be used for scientific research or destroyed. Subsection 34 (1) of the AIEPA states that an embryo may be preserved or used on the grounds set forth in §31 or §32 of the act, within 14 days after fertilisation of the ovum. Preservation or use of embryos after expiry of the specified term is prohibited. Therefore, according to the laws of Estonia, the supernumerary embryos from *in vitro* fertilisation treatment are supposed to be destroyed when not used in research.

Torremans argues that the moral purpose of the provision in the Biotech Directive is to preclude instrumentalisation of the human embryo through direct use of the embryo as a raw material in a repetitive (technical) process or, alternatively, embryo commoditisation through uses of embryos that involve monetary exchanges and trade.^{*41} Patents that directly claim repetitive use of the human embryo in a technical process would be excluded from patentability, and patents that claim products derived from a human embryo would not contravene the morality clause. This would have the effect of rendering processes for extracting hESCs from a human blastocyst non-patentable whilst pluripotent cells as products and methods related to their use would fall outside the scope of the special embryo exclusion and instead (as also suggested by the author) be evaluated under the general patent morality exception.^{*42} The EBA in the *WARF* case and the Advocate General in the *Brüstle* case are clearly of differing opinions: The Advocate General stated in his opinion that, even though the claims under the patent did not specify that human embryos are used for the exploitation of the invention, they actually are and the patentability of such an invention must be excluded.^{*43} The EBA concluded in the *WARF* case that it is important to look at not just the explicit wording of the claims but the technical teaching of the application as a whole as to how the invention is to be performed. Since in the case referred to the EBA the only teaching of how to perform the invention to create hESC cultures is the use of human embryos (involving their destruction), this invention falls under the prohibition of Rule 28 (c) (formerly 23d (c)) of the EPC.^{*44} The EBA did not, however, consider the argument that the exclusion from patentability would go much too far if one were to consider all of the steps preceding an invention.^{*45}

³⁸ P. L. C. Torremans (Note 27), p. 167.

³⁹ Opinion of Advocate General (Note 12), paragraphs 113–114.

⁴⁰ R. M. Isasi, B. M. Knoppers. Towards Commonality?—Policy Approaches to Human Embryonic Stem Cell Research in Europe. — A. Plomer, P. Torremans (eds.). Embryonic Stem Cell Patents: European Law and Ethics. New York: Oxford University Press 2009, p. 39.

⁴¹ P. L. C. Torremans (Note 27), p. 151.

⁴² *Ibid.*, p. 163.

⁴³ Opinion of Advocate General (Note 12), paragraph 108.

⁴⁴ G 2/06 (Note 24), paragraph 22.

⁴⁵ *Ibid.*, paragraph 23.

The author finds that if there is a common understanding in the EU that human pluripotent stem cells and other hESC-related inventions, which require at some stage the destruction of an embryo, should be beyond the scope of patentability in the EU, it would be better for there to be a clear paragraph stating the same. For example, §7 (2) 3) of the EstPA (and similarly Article 6 (2) (c) of the Biotech Directive) could be formulated in the following way: 'The following biotechnological inventions shall not be protected by a patent: (3) uses of human embryos for commercial purposes, including processes prohibited by the Artificial Insemination and Embryo Protection Act, and inventions that involve the destruction of a human embryo.'

6. *Ordre public* and morality exclusion

The task of evaluating the patentability of inventions related to pluripotent stem cells in light of the general *ordre public* and morality clause is not an easy one. The first problem arises when one considers Article 53 (a) of the EPC or Article 6 (1) of the Biotech Directive, or §7 (1) 1) of the EstPA, because there is no substantive definition addressing what morality is within the European context.^{*46} The author argues that, although the EPO has made it clear in case law that *ordre public* and morality are two distinct concepts, it actually uses them as synonyms.^{*47} According to a decision of the EPO Technical Board of Appeal (*Plant Genetic Systems v. Greenpeace*), 'the concept of "ordre public" covers the protection of public security and the physical integrity of individuals as part of society'. The Board continues as follows:

This concept encompasses also the protection of the environment. Accordingly, under Article 53(a) EPC, inventions the exploitation of which is likely to breach public peace or social order (for example, through acts of terrorism) or to seriously prejudice the environment are to be excluded from patentability as being contrary to "ordre public". The concept of morality is related to the belief that some behaviour is right and acceptable whereas other behaviour is wrong, this belief being founded on the totality of the accepted norms which are deeply rooted in a particular culture. For the purposes of the EPC, the culture in question is the culture inherent in European society and civilisation. Accordingly, under Article 53(a) of the EPC, inventions the exploitation of which is not in conformity with the conventionally-accepted standards of conduct pertaining to this culture are to be excluded from patentability as being contrary to morality.^{*48}

Although this is nicely worded, the author argues that it does not give a definition of morality or *ordre public*, which would allow the courts and patent offices to apply it with ease. There is no general framework or criteria concerning how to determine what would be contrary to morality in a non-arbitrary or non-biased fashion.^{*49} The author agrees with T. Wasescha that we cannot ignore the fact that concepts such as that of *ordre public* or morality are fundamentally linked to national perceptions.^{*50} That *ordre public* is connected to national perceptions is also referred to in private international law.^{*51} This means that finding common criteria for determining which inventions (and commercial exploitation thereof) would be contrary to morality or *ordre public* in the context of the EU could be nearly impossible.

It is also interesting that §7 (1) of the EstPA does not make any reference to commercial exploitation, as Article 27 (2) of the TRIPS, Article 6 (1) of the Biotech Directive and Article 53 (a) of the EPC do. Subsection 7 (1) of the EstPA states only that inventions contrary to public order and morality shall not be protected by a patent. This makes the author wonder whether the wording of §7 (1) of the EstPA was a conscious choice by the drafters and whether it is in compliance with the above-mentioned articles of regional and international instruments. The reasonable way to interpret §7 (1) of the EstPA is to interpret it such that it would be in accordance with the articles of the TRIPS, EPC, and Biotech Directive.

⁴⁶ A. M. Viens. Morality Provisions in Law Concerning the Commercialization of Human Embryos and Stem Cells. – A. Plomer, P. Torremans (eds.). *Embryonic Stem Cell Patents: European Law and Ethics*. New York: Oxford University Press 2009, p. 87.

⁴⁷ *Ibid.*, p. 88.

⁴⁸ T 356/93, *Plant Genetic Systems*. – OJ 8/1995, 545. Available at <http://legal.european-patent-office.org/dg3/biblio/t930356ep1.htm> (5.4.2011).

⁴⁹ A. M. Viens (Note 46), p. 89.

⁵⁰ European Group on Ethics (Note 6), p. 89.

⁵¹ I. Nurmela *et al.* *Rahvusvaheline eraõigus* (International Private Law). Tallinn: Kirjastus Juura 2008, p. 65 (in Estonian).

There is also a problem surrounding what is meant by the expression ‘the commercial exploitation would be contrary to *ordre public* or morality’. Also questioned (by A. Plomer and Å. Hellstadius, for example) is whether patent examiners (qualified to assess the technical features of inventions) are also ready to make ethics evaluations.⁵² The author agrees that without special instructions and criteria available to patent examiners, the assessment could be very subjective and might express only the moral values of the specific patent examiner who assesses the invention. Therefore, when pluripotent stem cells are not considered an ‘embryo’, the difficulties in assessing their patentability under the general *ordre public* and morality clause are only beginning. Consequently, as the author has already suggested, when there is a policy that human pluripotent stem cells should lie outside the scope of patentability, it would be better that there be a clear paragraph stating this. This exception could be included in §7 (2) 3) of the EstPA (and, similarly, in Article 6 (2) (c) of the Biotech Directive).

Even if the ECJ finds that hESC-related inventions that include the destruction of an embryo are unpatentable, this does not affect the policy on the use of embryos for hESC research in Member States. And it is important to note that it is also already possible to create pluripotent stem cells without destroying the embryo (with the genetic reprogramming technology used to create induced pluripotent stem (iPS) cells⁵³). These kinds of inventions should not give rise to such ethical considerations as hESC-related inventions that involve the destruction of an embryo do.

7. Conclusions

In conclusion, it can be seen that the questions concerning patentability of hESC-related inventions are, even after years of discussions, still highly subject to debate. Defining an ‘embryo’ in patent law is harder than expected. If the ECJ agrees with the Advocate General in the *Brüstle* case and finds that hESC-related inventions are not patentable under Article 6 (2) (c) of the Biotech Directive when the process of making the invention involves destruction of human embryos or uses human embryos as a base material, this interpretation would be binding also in Estonia, even though the wording of §7 (2) 3) of the EstPA is slightly modified in comparison. If the ECJ finds that inventions pertaining to pluripotent stem cells should be evaluated under the general *ordre public* and morality clause, it might be possible for each Member State to decide whether patentability of inventions related to pluripotent stem cells would be contrary to *ordre public* or morality. This could end up problematic, as there are no clear frameworks or criteria for how patent offices and courts should assess this clause. It is also probable that in different Member States the outcome would be different. Where the policy direction is to preclude the patentability of pluripotent-stem-cell-related inventions the making of which requires the destruction of an embryo, this conclusion should be clearly stipulated in patent laws, including the EstPA. The author therefore has suggested formulating §7 (2) 3) of the EstPA (and similarly Article 6 (2) (c) of the Biotech Directive) in the following way: ‘The following biotechnological inventions shall not be protected by a patent: (3) uses of human embryos for commercial purposes, including processes prohibited by the Artificial Insemination and Embryo Protection Act, and inventions that involve the destruction of a human embryo.’

⁵² Å. Hellstadius (Note 35), p. 129.

⁵³ S. Russell. Britain grants patent for iPS cells. – Nature, 28 January 2010. Available at <http://www.nature.com.ezproxy.utlib.ee/news/2010/100128/full/news.2010.43.html> (5.4.2011).



Elise Vasamäe

Magister iuris

Attorney-at-law, Aavik & Partners Law Office

A Collective Licensing Scheme for Lending of Phonograms from Digital Libraries

1. Introduction

Copyright law has always been shaped by the technology of the day. Each new technological development has brought with it discussion of the necessity of renewing the corresponding legislation, followed, as a rule, by changes in laws and regulations. The same holds true with rights related to copyright (below referred to also as related rights). In this process, the position and strength of right-holders has been one of the decisive factors.

The various social and economic implications of the information society serve controversial aims. They require that the specific traditional and well-established (exclusive) rights of right-holders be taken into account. At the same time, it is essential to encourage global exchange of information and development of culture, science, and education.

The main difficulty has, throughout history, laid in finding the appropriate balance among the interests of the right-holders, the users of protected content, and the general public, and that holds today too, as it probably will in the future. In this article, the author concentrates on the legal issues related to the lending of phonograms from digital libraries. When establishing the rules of digital libraries and opportunities for using copyrighted content in the everyday activities of these institutions, one is bound to the current legal framework. The creation of digital libraries brings with it a very crucial legal debate as to whether it would be balanced to limit the existing exclusive rights of right-holders and to what extent this would be justified. Can the balance be based on thinking in old categories ('old thinking'), or should we start an era of 'new thinking', based on different concepts and preferences? The issue concerning digital libraries is one of the challenges for this 'new thinking'.

The author of this article holds the opinion that it should be possible in the digitalised dimension of the global environment to access copyrighted content easily via the Internet in order to use it for scientific, research, educational, and cultural purposes. The possibility of lending the phonograms is important mainly for cultural diversity and development but also serves entertainment purposes. It is difficult to draw a line between cultural purposes and entertainment purposes, just as it is impossible to determine the exact objective of every person accessing the phonograms made available in digital libraries—though, in comparison with books, the phonograms are more likely to serve an amusement or hedonistic purpose.

The necessity of the creation of digital libraries has been under discussion in the European Union for some years now. In 2008, the European Commission issued the Green Paper on Copyright in the Knowl-

edge Economy, which deals also with issues related to digital libraries.^{*1} The purpose of that document was to foster debate on how knowledge for research, science, and education can best be disseminated in the online environment. Copyright ensures the maintenance and development of creativity in the interests of authors, producers, consumers, and the public at large. The Green Paper is aimed at addressing the issues in a traditional 'old' and balanced manner that takes into account the perspectives of right-holders, groups of users, and the general public.

At the EU level, two main projects related to digital libraries have been launched so far—the Europeana Project^{*2} and the Arrow Project.^{*3} The goal of the Europeana Project is to make Europe's cultural and scientific heritage accessible to the public. The main aim of the Arrow (Accessible Registries of Rights Information and Orphan Works towards Europeana) Project is to enable libraries as well as other users to obtain information on who the relevant right-holders are, which the relevant rights concerned are, who owns and administers them, and how and where one can seek permission to digitise the work and/or make it available to user groups.

This article concentrates on some fundamental questions of lending of phonograms from digital libraries and its differentiation from the public lending right exercised in the analogue environment. The main problem is that, whereas the phonogram producers do not enjoy an exclusive public lending right in most EU countries, the making available and reproduction rights of phonogram producers that are being exercised in lending of the phonograms from digital libraries are granted as an exclusive right that requires the digital library to obtain a licence from every single right-holder.

The author contends that, as far as lending of phonograms from digital libraries is concerned, the rights of different stakeholders are at the moment in imbalance and there should be a solution for overcoming this imbalance. The main focus of this article is on finding the solution for balancing the rights of different stakeholders (phonogram producers, digital libraries, and the general public) in a digital environment—i.e., how to enable the public to access the phonograms in digital libraries without unreasonably limiting the exclusive rights of phonogram producers to make available and reproduce the material. The author analyses whether the lending of phonograms from digital libraries should be subject to a collective licensing scheme (compulsory or extended).

2. Public lending right in the analogue environment

The concept of 'phonogram' is a jumping-off point for considering the topic of this article. The legal definition of 'phonogram' derives from Article 2 (b) of the WIPO Performances and Phonograms Treaty^{*4} (hereinafter referred to as the WPPT). The WPPT provides that a 'phonogram is the fixation of the sounds of a performance or of other sounds, or a representation of sounds, other than in the form of a fixation incorporated in a cinematographic or other audiovisual work'.

The term 'fixation' is technology-neutral, in that it is not limited to particular forms of fixation such as discs, vinyl records, cylinders, and other forms in which phonograms have been historically embodied.^{*5} According to the legal definition contained in the WPPT, the fixation may also be of 'representation of sounds', which covers the case of phonograms produced by means of digital technology that fixes data and that can be used to generate sounds through use of the appropriate electronic equipment even though no sounds have yet been reproduced as such.

In the definition given by WIPO, the term 'lending' means the transfer of possession of a copy of a work or an object of related rights for a limited period of time for non-profit-making purposes. Unlike rental, lending, in general, is not covered by any international norms for the protection of copyright and related

¹ Green Paper on Copyright in the Knowledge Economy, Brussels, COM(2008) 466/3. Available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2008:0466:FIN:EN:PDF> (9.10.2011).

² See more information available at <http://www.europeana.eu/portal/>.

³ See more information available at <http://www.arrow-net.eu/>.

⁴ The Republic of Estonia ratified WPPT on 16.7.2006. See: Maailma Intellektuaalse Omandi Organisatsiooni esitus- ja fonogrammilepingu ratifitseerimise seadus (Ratification Act of WIPO Performances and Phonograms Treaty). – RT II 2006, 14, 40 (in Estonian). English text available at http://www.wipo.int/treaties/en/ip/wppt/trtdocs_wo034.html.

⁵ M. Fisor. *The Law of Copyright and the Internet. The 1996 WIPO Treaties, Their Interpretation and Implementation*. Oxford University Press 2002, p. 1241.

rights.^{*6} WIPO defines rental as the transfer of the possession of a copy or a work or an object of related rights for a limited period of time, and for direct or indirect economic or commercial advantage.^{*7}

Article 13 of the WPPT stipulates that producers of phonograms shall enjoy the exclusive right of authorising the commercial rental to the public of the original and copies of their phonograms, even after distribution of them, by or pursuant to authorisation by the producer.

The public lending right of phonogram producers as a right independent of rental right is not provided for in international treaties concerning copyright and related rights. The European Union already in 1992 adopted a directive^{*8} regulating issues related to the public lending right of phonogram producers.

Mainly in the law of the EU Member States, the right-holders enjoy public lending right subject to various limitations. The legal basis for phonogram producers' public lending right is at the moment quite weak, since phonogram producers enjoy the public lending right only in those countries whose national legislation has introduced it.

For instance, since 15 May 2008, under the Estonian Copyright Act^{*9}, phonogram producers have not had the right to prohibit the lending of copies of phonograms from libraries, but they are entitled to receive remuneration for such lending. According to §13³ of the Estonian Copyright Act, 'home lending' is prohibited, unless the phonogram has already been legally distributed in Estonia for more than four months. This term may be reduced with the consent of the right-holder. The remuneration will be paid to the collective societies managing the respective rights.

When the concepts of 'rental' and 'lending' rights are under discussion, it is important to note that both of these rights are closely related to the concept of 'distribution', which is the most decisive factor when one is drawing distinctions between lending phonograms from libraries in an analogue environment and lending phonograms from digital libraries.

The term 'distribution' in the broader sense means the making available of the original or copies of a work or an object of related rights to the public (i) by sale or other transfer of ownership or (ii) by rental, lending, or other transfer of possession. In a narrower sense, it is the making available of the original or copies of a work or an object of related rights to the public by sale or other transfer of ownership.^{*10}

Article 1 (d) of the Convention for the Protection of Producers of Phonograms against Unauthorized Duplication of Their Phonograms defines 'distribution to the public' as meaning any act by which duplicates of a phonogram are offered, directly or indirectly, to the general public or any portion thereof. Article 12 (1) of the WPPT provides that producers of phonograms shall enjoy the exclusive right of authorising the making available to the public of the original and copies of their phonograms through sale or by other transfer of ownership.

At the level of national legislation, the concept of 'distribution' is given different meaning, either according to its broader sense or in the narrower sense. In Estonia, the distribution right and the rental and lending right have been separated. Clause 70 (1) 3) of the Estonian Copyright Act stipulates that a producer of phonograms has the exclusive right to authorise or prohibit the distribution of said phonograms to the public, and §70 (1) 4) of the Estonian Copyright Act grants a phonogram producer the exclusive right to rental or lending of copies of the phonograms. The author concludes from the foregoing that a separate right of rental and lending is granted through an exception to the exhaustion of the right of distribution with the first sale of (or other first transfer of property in) the copies concerned in respect of their rental.

The principle of exhaustion of rights has been developed in order to avoid conflict of interest between the copyright-owner and the owner of a physical copy of the work.^{*11} Since there is no distribution of physical copies in the digital environment, the author of this article agrees with the opinion that the above-mentioned principle could not cover the public lending of phonograms from digital libraries and, therefore, will not analyse the principle of exhaustion of rights further in this article.

⁶ Guide to the Copyright and Related Rights Treaties administered by WIPO and Glossary of Copyright and Related Rights Terms. WIPO Publications No. 891(E) 2004, p. 294.

⁷ *Ibid.*, p. 307.

⁸ Council Directive 92/100/EEC of 19 November 1992 on Rental Right and Lending Right and on Certain Rights Related to Copyright in the Field of Intellectual Property.

⁹ Autoriõiguse seadus. – RT I 1992, 49, 615; RT I, 6.1.2011, 34 (in Estonian).

¹⁰ WIPO (Note 6), p. 238.

¹¹ P.-L. Haarmann. Tekijänoikeus ja lähioikeudet. Helsinki 2005, p. 166.

The author of this article considers it to be clear that, whether or not the national legislation differentiates between lending and rental rights, most Member States' libraries are authorised within the current legal framework to lend phonograms in the analogue environment quite easily in order to enable the public to access the protected content. As discussed above, in Estonia, the issues related to lending rights in the analogue environment are regulated by uphold the highest standards in the promotion and protection of human rights, and shall fully cooperate with the §13³ of the Estonian Copyright Act.

The author of this article holds that Article 5 of the rental and lending directive mentioned above gives EU Member States very large scale authority to limit the public lending right of authors and other right-holders. According to said directive, there is no strict harmonisation of public lending rights within the EU. Member States have the right to establish their own legal schemes in this field. This is the reason the corresponding copyright regulations concerning the lending right vary greatly from one Member State to the next, yet in most of the EU's Member States the libraries enjoy the right to use phonograms in public lending quite easily.

3. Lending of phonograms from libraries in the digital environment

There are opinions that since, in practice, the lending of phonograms in digital format has the same substance and meaning as the lending of phonograms as physical copies, it would be reasonable to apply the same rental and lending right also in the digital environment.^{*12} At the same time, there are opponents to this approach who claim that the rental and lending must be regarded strictly as the transfer of possession of phonograms that are in physical form.^{*13}

In an analogue environment, a copy of the phonogram not only is the embodiment of it but also constitutes the object of the transaction. With the Internet, ownership of physical copies is no longer transferred. This makes it very difficult to monitor the circulation of copies, as well as to determine whether the copies are made available with the authorisation of right-holders.^{*14}

Phonograms in digital format may be stored locally on the computers of the library or accessed remotely via computer networks. In an analogue environment, the phonograms are located only on the premises of public libraries; this means also that their use is restricted and monitored according to the internal rules of the library in question.

When considering the issues related to lending of phonograms from digital libraries, one has to conclude that the rights of public lending and rental are not involved anymore. The use of phonograms accessible through digital libraries is covered by the right of reproduction and making available.

The substance of the latter right is basically to unite the right of reproduction and that of communication. These two rights are exercised simultaneously when protected content is made available on the Internet, since its communication to users necessitates several acts of reproduction, on different sites, during transmission over the network.^{*15} In fact, in definition of the right of making available, the means and devices by which the phonograms have been made available have no importance.^{*16} The situation described above can be cited as an example of how technological developments and basic principles of copyright law are being confronted. Recent developments in the global information society in these areas have great impact also on the genesis and various changes of copyright law.

The digitisation of the phonogram, as well as its upload and download to and from a computer or to and from the server, constitutes an act of reproduction.^{*17} Therefore, digitisation does involve the exploitation

¹² P. Vandoren. – Future of Copyright in a Digital Environment. B. Hugenholtz (ed.). Kluwer Law International 1996, p. 164.

¹³ J. Passa. The Protection of Copyright on the Internet under French Law. – The Internet and Authors' Rights. F. Pollaud-Dulian (ed.). Sweet & Maxwell Limited 1999, p. 62.

¹⁴ J. Spoor. The Copyright Approach to Copying on the Internet: (Over)Stretching the Reproduction Right? – Future of Copyright in a Digital Environment. B. Hugenholtz (ed.). Kluwer Law International 1996, pp. 77–78.

¹⁵ Y. Gaubiac. Remarks about the Internet in International Copyright Conventions. – M. Blakeney (ed.). The Internet and Authors' Rights. Sweet & Maxwell Limited 1999, p. 111.

¹⁶ S. Ricketson, J. Ginsburg. International Copyright and Neighbouring Rights. The Berne Convention and Beyond. 2nd ed. Oxford University Press 2006, p 747.

¹⁷ P. Hugenholtz. Adapting Copyright in the Information Superhighway. – Future of Copyright in a Digital Environment. B. Hugenholtz (ed.). Kluwer Law International 1996, p. 87.

of reproduction rights: changing the format of a work or other protected content such as phonograms from analogue into digital form requires making a reproduction thereof.

Digital libraries provide endless possibilities for everyone who has Internet access. In contrast to a time only a few decades ago, the availability of digitised content is not a prerogative or something really exclusive. Although it is beyond any doubt that promotion of cultural diversity is crucial, one has to ask whether and to what extent easily accessible digital libraries influence the legal market for phonograms.^{*18} It is inevitable that an urgent need arises to determine what would be the best solution for handling the issues related to lending of phonograms from digital libraries.

The author of this article finds that there are two possibilities for regulation of the legal state of play related to the lending of phonograms from digital libraries, including the substance of rights granted to different categories of stakeholders and limitations introduced to those rights. First, one could remain within the current legal framework and make no amendments at all. Secondly, it would be grounded to establish new balance by amending the current principle that phonogram producers enjoy exclusive rights of making available and reproduction, without limitations. The answer as to which approach to choose is given in the next section of this article.

4. Balance between the interests of the stakeholders concerned

The newest challenge in the field of copyright is making it increasingly clear that the traditional system might be incapable of addressing the global exchange of information. The impulse to exchange information freely can be applied to challenge information and cultural ownership because it defies the boundaries that copyright-owners wish to create between themselves and the public.^{*19}

There is no doubt that advances in information technology have disrupted the field of copyright protection. Nevertheless, a number of legislative initiatives have been taken to restore the legal balance between right-holders and users. However, a problem arises in that the technology does not always allow for the maintenance of the balances established by the law and can, in particular, prevent uses that are permitted by the legislation.^{*20}

Copyright legislation, originally designed to protect the author and provide incentives for the right-holder to engage in creation for the benefit of society, is used more and more often nowadays as a mechanism to protect investments, without taking into account the impact on future creativity. This change of paradigm has had a certain influence over the free use of information.^{*21}

Existing copyright laws have traditionally been designed to strike a balance between ensuring a reward for past creation and investment, on one hand, and the future dissemination of knowledge products, on the other, by introducing a list of exceptions and limitations to allow for certain, specific activities that are associated also with scientific research, education, and cultural purposes and the activities of libraries.

The need for balancing of interests has been recognised from the very beginning. Balancing means not only exceptions and limitations; balance among various interests may also be achieved through the way the protection system is established and the rights are granted. It seems evident that the more generous the basic norms of a protection system are and the broader and more general the rights granted, the stronger the need may be for some types of exceptions and limitations, and *vice versa*.^{*22}

The question about balance of interests among phonogram producers, digital libraries, and the general public may be regarded also as that of fixing an equitable balance between economic and social interests in society. From the economic point of view, the phonogram producers would be interested in prohibiting

¹⁸ P.-L. Haarmann (Note 11), p. 334.

¹⁹ D. J. Halbert. *Intellectual Property in the Information Age. The Politics of Expanding Ownership Rights*. Connecticut & London: Quorum Books 1999, p. 141.

²⁰ Ch. Geiger. *The Private Copy Exception, an Area of Freedom (Temporarily) Preserved in the Digital Environment*. – IIC International Review of Intellectual Property and Competition Law 2006 (37) 1, pp. 74–75.

²¹ Ch. Geiger. *Flexibilising Copyright – Remedies to the Privatisation of Information by Copyright Law*. – IIC International Review of Intellectual Property and Competition Law 2008 (39) 2, p. 178.

²² M. Fisor (Note 5), pp. 257–259.

use of phonograms to digital libraries in all cases wherein lending of the relevant phonogram from digital libraries is economically impractical or even damaging. At the same time, the public need digital access to libraries, including access to phonograms.

In recent years, the lending of phonograms has become a burden to phonogram producers' economic balance. Since only a few EU states have granted phonogram producers an exclusive right to public lending, the lending of phonograms tends to damage the economic interests of phonogram producers. More and more people prefer not to buy phonograms but to borrow or rent them from libraries. Also it is often possible to make copies of the phonogram that was lent or rented. Although lending does not have an economic objective, only the possibility of reproducing phonograms makes lending problematic also from right-holders' point of view.^{*23} Once a copyrighted work is uploaded to the Internet, the ability to control it is reduced to almost zero. It seems beyond doubt that digital libraries should prevent their clients from making reproductions of phonograms.

Until recently, the idea that copyright might conflict with freedom of expression had never occurred to courts and commentators. Moreover, to the extent that any interaction between the two was acknowledged, it was accepted that each serves precisely to enhance the other. At the same time, all exclusive rights will, by definition, impose restriction on the actions of fellow citizens. The inescapable fact is that, as a privately held right, copyright grants an individual the power to dictate the scope of other citizens' lawful behaviour.^{*24}

The public demands easy access to and usage of copyrighted content, while the right-holder wishes to secure as many exclusive rights as possible. The element of freedom of expression is nowhere in sight. To some extent, this makes sense, because, at the end of the day, intellectual property legislation is structured around precisely this fundamental conflict. The entire body of copyright law is nothing but a balancing act, an attempt to accommodate both of those—contradictory—goals.^{*25}

Cultural, social, and scientific research interests as well as pragmatic factors have led to the establishment of limitations to right-holders' exclusive rights, including limits to the lending right. The limitations are necessary to guarantee that people are able to enjoy some of the basic constitutional rights, such as the right to freedom of speech and free self-expression. Although usually one uses the wording 'limitations to exclusive rights', Haarmann finds that it would be more precise and accurate in this context to use the expression 'limits of copyrights', since the limitations are laid down in order to determine the actual limits of exclusive rights.^{*26} It follows that, in order to establish a just and proper balance among the interests of all stakeholders concerned, a system of exceptions and limitation should be used.

The limitations to exclusive rights may be classified under different criteria. First, it is possible to consider the objectives of the limitations—whether a limitation is established in private, cultural, or social interests. Secondly, one is able to classify the limitations on the basis of the type of the protected content—whether the limitation is applicable to a literary work, musical work, performance, phonogram, or audio-visual work. Thirdly, it is possible to divide the limitations into groups based on the nature of the specific exclusive right with respect to which the limitations have been established: whether the right to make reproductions, the right to distribute, or the right of communication to the public. Fourth, the most decisive distinction may be made on the basis of whether the right-holders maintain, despite the limitations, the right to benefit from the use of the protected content or, instead, all terms for the exploitation of protected content, including the licence fee, have been laid down as a result of negotiations between the user and a collective society while the individual right-holder has no ability to influence the conditions of licence agreements or prohibit the use of protected content.^{*27} There is debate, though, as to whether the latter type of limitations Haarmann has mentioned should be regarded as a limitation or, rather, as a form of managing the rights collectively. Member States can adopt legislation concerning the management of rights such as extended collective licences. Those derogations were made because of the extended collective licensing schemes that have been applicable in Nordic countries.^{*28}

²³ J. A. L. Sterling. *World Copyright Law*. 2nd ed. London: Sweet & Maxwell 2003, p. 372.

²⁴ Ch. J. Angelopoulos. *Freedom of Expression and Copyright: The Double Balancing Act*. – *Intellectual Property Quarterly* 2008/3, p. 328.

²⁵ *Ibid.*, p. 332.

²⁶ P.-L. Haarmann (Note 11), p. 154.

²⁷ *Ibid.*, pp. 156–157.

²⁸ *Ibid.*, p. 258.

The primary reason for having such a list of exceptions appears to be to limit Member States' ability to introduce new exceptions or extend the scope of the existing ones beyond what is allowed under the Information Society Directive.^{*29} The list of exceptions as contained in the Information Society Directive has brought about a certain degree of harmonisation; in creating an exhaustive list of exceptions, it does not allow Member States to maintain or introduce exceptions that are not listed. EU Member States have often formulated exceptions narrower than those permitted in the Information Society Directive.^{*30}

According to the provisions laid down in the Information Society Directive, the publicly accessible libraries can benefit from two exceptions, listed in Article 5. Firstly, under Article 5 (2) c), publicly accessible libraries are allowed to make certain reproductions for specific non-commercial purposes. Secondly, according to Article 5 (3) n), they are entitled to use the protected content in acts of communication to the public and making available in order to conduct research or private study by means of dedicated terminals on their own premises.

It follows that, in the current legal framework at EU level, libraries do not enjoy a blanket exception from the right of reproduction. Reproductions are allowed in specific cases only, which arguably would cover certain acts necessary for the preservation of works contained in the libraries' catalogues.

The author of this article finds that, at the moment, when one discusses the lending of phonograms from digital libraries, the rights of the various stakeholders concerned are not balanced. In a digital environment, the phonograms should be more readily accessible. In comparison with the legal state of play in the analogue environment, where the phonogram producers' position is weak, the regulation applicable in the digital environment is too restrictive for the other stakeholders. For finding the proper balance among the right holders, there are many possibilities. First, one could subject the phonogram producers' right of making available, as far as it concerns the lending of phonograms from digital libraries, to legal licence. A second option is to introduce a 'fair remuneration system', while a third approach is to enable the libraries to use the phonograms freely without paying any fee and a fourth is to maintain the exclusive right of phonogram producers but establish a compulsory and/or extended collective licensing scheme in order to facilitate the use of phonograms by digital libraries and the general public. This article concentrates on the legal issues related to a collection-based licensing scheme. Lending of the phonograms from digital libraries and therefore the options for managing the phonogram producers' rights concerning the lending of phonograms from digital libraries are analysed below.

5. Options for managing the lending right

Copyright and related rights can be exercised individually or collectively. In addition to the legal framework of the phonogram producers' right to authorise the lending of phonograms from digital libraries, it is important to examine whether the phonogram producers should be entitled to exercise their right individually or only through societies that manage their rights collectively.

Collective societies provide useful services to all interested parties. These societies are useful to right-holders, in monitoring the exploitation of rights and bargaining on their behalf with respect to the conditions of such exploitation; to users, enabling them to acquire a single licence in a simple and cost-effective manner; and also to society in general.^{*31}

Collective rights management serves three main functions in general. First, it improves the bargaining power of the individual right-holder vis-à-vis users and user organisations. Secondly, by representing a substantial repertoire, collective rights management equally serves the user, as it allows legitimate access to the rights of many right-holders. Thirdly, the collective rights management system operates social and cultural schemes to protect the members and to support emerging artists. In all of these respects, collective rights management contributes to cultural diversity at national and international level.^{*32}

²⁹ Directive of 22 May 2001 on the Harmonization of Certain Aspects of Copyright and Related Rights in the Information Society.

³⁰ Green Paper on Copyright in the Knowledge Economy, pp. 4–5.

³¹ Ph. Gilliéron. *Collecting Societies and the Digital Environment*. – IIC International Review of Intellectual Property and Competition Law 2006 (37) 8, pp. 966–967.

³² A. Schierholz. *Collective Rights Management in Europe – Practice and Legal Framework*. European Copyright Law. A Commentary. M. Fisor, S. von Levinski (eds.). Oxford University Press 2010, p. 1152.

One very important objective of the collective licensing scheme is to facilitate the acquisition of authorisation in the areas where contacting every single right holder would be very difficult and unreasonable or costly.

Collective management, even if it might be possible from the standpoint of the relevant international norms and the *acquis communautaire*, is justified only where individuals' exercise of rights is impossible or at least highly impractical. That might obtain in cases where there are a large number of holders or users of rights or when other circumstances of a particular use justify it.^{*33} In the case of an exclusive right, obligatory collective management may be prescribed only where the relevant international norms allow this, either by permitting the prescription of conditions for the exercise of rights or through its limitation to a right to remuneration in certain cases.^{*34} It follows that when wanting to apply collective licensing scheme to certain exercise of rights, one has to verify whether there is a limitation imposed to that right or whether there is a prescription concerning the conditions for the exercise of rights permitted.

The collective management of exercise of rights may be either voluntary or compulsory. In the case of obligatory collective management, the right-holders have no 'opt-out' option.

An extended collective licensing scheme is a legal institution between a voluntary and compulsory licence. Those right-holders who are not members of the collective society negotiating the terms and signing the licence agreement do not have any opportunity to exert an influence, and for them this kind of legal obligatory representation right for the collection society yields results similar to those that would be seen with a compulsory licence. An extended collective licensing scheme was introduced in Finland in 1961.^{*35}

Collective licensing is exploited mainly in cases of widespread use—for example, broadcasting via radio etc. When taking into consideration the interests of digital libraries and their 'clients' (i.e., the public in general) on the one hand and the interests of phonogram producers on the other hand, one has to note that extended collective licensing might be justified also in this case. Making any limitations to the right to make available, which is the most important exclusive right of the phonogram producers in the digital environment, including limiting the possibility to exercise this right freely, seems to be impossible in the current legal framework. Accordingly, there is a need for introducing some amendments to the legislative rules in this respect.

The Estonian Copyright Act does not include the legal institution of the so-called Nordic model of extended collective management, although it has been laid down in said act that in some specific cases obligatory collective management is required. Exercise of rights by collective management organisations is mandatory upon cable retransmission of a work or an object of related rights and in the cases specified in §§14 (6) and (7), §§15 and 27, §§68 (4) of that act.^{*36}

Considering the current legal practice wherein it is, in general, only the major phonogram producers who are really capable of exercising their right to make available individually, while the smaller ones are willing to pass the exercise of their rights to a collection society, it must be pointed out that, when one considers the situation with a broader and pragmatic approach, application of a collective licensing scheme (compulsory or extended) in lending of phonograms from digital libraries would be reasonable. Although the institution of extended collective licensing is quite a new instrument for copyright regulations, it would be justified in light of the foregoing analysis. Therefore, when talking about a collective licensing scheme to be applied to lending of phonograms from digital libraries, the author of this article finds that there would be, in essence, two possibilities: obligatory and extended collective licensing. Since the right-holders have no possibility of 'opting out' in the case of obligatory collective management, the author of this article holds that a compulsory collective licensing scheme could harm the rights and interest of phonogram producers too broadly, such that balance among the rights and interests of the various stakeholders would not be reached.

³³ M. Fisor. Collective Management of Copyright in the International Environment. European Conference in the framework of the Hellenic Presidency 7th – 8th April 2003. Culture, Copyright and Information Society. Hellenic Ministry of Culture/EU Direction/Copyright Organisation 2003, p. 48.

³⁴ *Ibid.*, pp. 47–50.

³⁵ P.-L. Haarmann (Note 11), p. 227.

³⁶ Estonian Copyright Act §76 (3).

6. Conclusions

The creation of digital libraries has brought with it a very crucial legal debate as to whether it would be balanced to limit the existing exclusive rights of right holders and to what extent doing so would be justified. Lending rights have in recent years had quite a considerable economic impact on the record industry and others, since it does not exhaust and therefore enables phonogram producers to maintain control over the phonograms that have already been published. Nevertheless, a rigorous and effective system for the protection of copyright and related rights is necessary if we are to provide right-holders with a reward for their input to creativity and to encourage them to invest in creative works and innovation. One has to address the issues in a balanced manner, taking into account the perspectives of right holders, various groups of users, and the public at large.

It is clear that the public is in urgent need of access to phonograms from digital libraries and that it is, in practice, difficult for libraries to obtain all of the corresponding licences from each separate right holder. Therefore, a system of collective management would be the right tool for balancing interests among the stakeholders concerned—phonogram producers, libraries, and the general public.

The author of this article is of the opinion that, for reasons of cultural, educational, scientific, and research purposes in the digital environment, the general public should have access to phonograms in digital libraries. At the same time, there should not be absolutely free access to phonograms in such libraries, because the public lending right being exercised in the analogue environment has less significant economic impact in the exercise of the rights of making available and reproducing.

The author thinks that, as an important tool for encouraging sustainable development in respect of all stakeholders with an interest in the lending of phonograms from digital libraries, an extended collective licensing scheme should be applied. Extended collective licensing schemes may offer the appropriate legal opportunities to ensure sustainable development, when those legal institutions are applied in a balanced manner. This balance has to be arrived at among the rights of three subjects—right-holders, the users of rights, and the users of rights in a broader sense (the public in general).

It follows from the foregoing analysis that extended collective licensing schemes would be an answer to overcome the difficulties that the legal issues of lending of phonograms from digital libraries have brought with them. Collective licensing schemes provide phonogram producers with a guarantee that the collection societies negotiate, on their behalf, fair licensing terms and take into consideration the rights and interests of phonogram producers, whereas on the other side the digital libraries would benefit too, as they are enabled to obtain all of the necessary licensing from a single organisation. The author of this article therefore concludes that for lending of phonograms from digital libraries, an extended collective licensing regulation should be introduced. In the case of an obligatory collective management scheme, the right-holders have no possibility of 'opting out'; therefore, the author of this article holds that instating compulsory collective licensing could impair the rights and interests of phonogram producers too much and balance would not be achieved/maintained among the rights of the different stakeholder groups.



Irina Nossova

*Master of Arts in Law
Associate at Law Office Varul*

Cold Arctic and Hot Caspian Side by Side: New Legal Regimes Emerging?

A Russian Perspective

1. Introduction

If we were to ask ourselves what the Arctic Ocean and Caspian Sea have in common, the first answer to come to mind would probably be: ‘Nothing—except both being large and important reservoirs.’ It is, no doubt, true that the climate, history, and perspectives for development of these regions are significantly different. Furthermore, a legal expert would probably argue that the juridical concepts for these two bodies of water are quite different: the former is unanimously considered an ocean, whereas the Caspian is disputed, either a semi-enclosed sea or an international lake.

However, thorough consideration based on recent developments reveals several common features that unite the seemingly unrelated cold Arctic and hot Caspian. Representatives of both Arctic and Caspian countries have already expressed opinions that, for various reasons, their regions are in strong need of a new, comprehensive legal regime. The point of our particular interest in this article would then be whether there really are any new regimes under international law that can be expected to emerge in the near future. The article takes a glance at these possible new legal regimes and investigates why—and how—Arctic and Caspian states strive for new international agreements or, on the contrary, refrain from them.

In addressing these questions, the article presents a brief case study considering how contemporary international law emerges. Proceeding from the assumption that there is a need for new legal regimes in both regions, the article offers insight on the new treaties via the prism of state interests. Thereafter, the article focuses on examining what the real payoffs and legal forces are that would lead states to accept or reject the Arctic Treaty or Caspian Convention. Particular emphasis is placed on how the ‘common player’ in both the Arctic and the Caspian case, the Russian Federation, proceeds with its own juridical foreign policy in the respective areas.

The methodological insight applied in this article is the so-called rational choice theory, here stating that international law emerges from states acting rationally to maximise their interests, given their perception of the interests of other states and distribution of state power.¹ According to the theory of rational choice, by entering into new treaties the states attempt to resolve problems of co-operation, to commit to a particular code of conduct, and to gain assurance regarding what other states will do in the future. Thus

¹ J. Goldsmith, E. Posner. *Limits of International Law*. Oxford University Press 2005, p. 3.

rational choice theory explains that states strive for new treaty law only if it benefits their interests, both political and economic.

But apart from political and economic payoffs playing, understandably, an important role in determining the state's decision to enter into and obey the new legal commitments, there are similarly important legal forces to consider. Andrew T. Guzman, a professor of law at the Berkeley School of Law in the United States, explains in his book *How International Law Works* that 'international agreements are valuable because the forces of reputation, retaliation, and reciprocity give states an incentive to comply with their legal obligations or, more accurately, with their promises, whether or not these are termed "legal"'.² Under the so-called compliance theory, a state's reputation for compliance with legal obligation consists of judgements of the state's past behaviour and predictions made about future compliance on the basis of that behaviour. The better the state's reputation, the more credibly it can commit to a particular course of action. Abuse of reputation is followed by a sanction in reputation terms, or the cost imposed on a state when its reputation is damaged. Reciprocity refers to actions that will often be taken in response to violation of an agreement. Retaliation describes actions that are costly to the retaliating state and intended to punish the violating party.³

It has been observed that legal forces do not function very effectively in pure co-ordination games among states. These are games in which all players have an incentive to co-operate but also co-operation requires that they co-ordinate their actions.⁴ There are many variations on the pure co-ordination game. However, if a game that looks like a co-ordination game has some probability of becoming a more difficult case of co-operation, with different state interests colliding, then reputation, reciprocity, and retaliation come into play.

Assuming now that states act as rational players led by economic, political, and legal factors, and proceeding from the need for new legal regimes in the Arctic and Caspian regions, we shall try to analyse the possible content of the treaties from this perspective. In other words, we are interested in which forces determine (a) the content of the treaties and (b) the decisions of states to negotiate and enter into new international agreements. In particular, we will explore the forces underlying Russian legal thinking and behaviour. We will also try to determine whether the Arctic and Caspian treaties both define 'pure co-ordination games'.

2. The need for the Arctic Treaty and the Caspian Convention

Although the introductory part of this article proceeds from the assumption of a need for a new, comprehensive legal regime to manage the Arctic, there is neither agreement on whether such a regime is necessary nor, among those who do regard it as necessary, agreement on either the type or content of such a regime. For instance, in May 2008, representatives of the five Arctic states (Canada, Denmark (through Greenland), Norway, Russia, and the United States) met in Ilulissat, Greenland, to underscore their commitment to the legal framework provided by the 1982 United Nations Convention on the Law of the Sea (hereinafter referred to as the UNCLOS) and to the orderly settlement of any possible overlapping claims. Other legal scholars strongly believe that the UNCLOS is not sufficient to resolve the emerging issues in the Arctic region.⁵ Current Arctic issues such as the melting of the Arctic sea ice and its effects on nature, resource access, and navigation routes, as well as rising tensions associated with continental shelf claims, prove the need for a new regime.

The need for a legally binding treaty in the Caspian has totally different grounds. Thus far, there has been no general agreement on the legal status of the Caspian. The Caspian Sea is completely landlocked, creating controversy over whether it is a sea or a lake. Since the collapse of the USSR, the Caspian Sea,

² A. Guzman. *How International Law Works*. Oxford University Press 2008, p. 133.

³ *Ibid.*, p. 34.

⁴ *Ibid.*, p. 26.

⁵ E.g., D. Rothwell. *The Arctic in International Affairs: Time for a New Regime? – The Brown Journal of World Affairs* 2008 (XV) 1, p. 251.

which was previously shared by the USSR and Iran under bilateral treaties of 1921, 1935, and 1940, has had to be shared by five littoral states: Iran, Kazakhstan, the Russian Federation, Azerbaijan, and Turkmenistan. Since the years of legal vacuum that followed the collapse of the USSR in 1991, some important steps have been taken toward a generally accepted legal solution for the Caspian. As the negotiations demonstrate, all states in the region in one way or another support the division of the Caspian Sea. Therefore, on the second meeting of the heads of Caspian littoral states, in Tehran in 2007, the agenda for developing a Caspian Convention was laid down.

Although the need for a new treaty is more clearly understood and less disputed in the Caspian region whilst subject to general argument in the Arctic, it seems that there is a general perception in both cases that the existing legal framework does not provide sufficient regulation to settle the emerging issues in the regions. Considering the inadequacy of the existing treaty framework in the regions, understanding the need to resolve ongoing territorial disputes, and remembering that states are rational actors that enter into agreements to achieve gains, one can see a strong possibility that a new international legal regime given form in written multilateral agreements will emerge.

3. The anticipated content of the new treaties

In both the Arctic and the Caspian, there are territorial and maritime border disputes that need to be resolved in the first step.^{*6} Dividing the Arctic and Caspian territories means dividing the resources of the subsoil. In 2009, the United States Geological Survey estimated that the Arctic Ocean contains some 30% of the world's undiscovered natural gas and about 13% of the world's undiscovered oil, mainly offshore under less than 500 metres of water.^{*7} Experts from the United States Department of Energy estimated that proven oil reserves in the Caspian Sea range from 17 to 33 billion barrels. Clearly, therefore, huge material payoffs are at stake. In addition, climate change is opening prospective new sea lanes and lines of communication in the Arctic Ocean; the northern sea route across the north of Russia; the Northwest Passage through the Canadian archipelago; or even, possibly by mid-century, a direct route across the North Pole. The new sea lanes of the Arctic are of great economic significance. The Caspian, in turn, has for centuries been crossed by important transportation routes connecting Europe and Central Asia. The nature of the division of the Arctic and Caspian territories by the littoral states shall determine the extent to which the parties will gain control over them.

In order to find a solution for the territorial disputes in the Arctic region, the Arctic countries need a treaty that will secure the interests of each party concerned, either by division of a disputed area or by creating a joint management zone. Both approaches are based on equidistance, a fundamental principle of maritime boundary delimitation prescribed by the UNCLOS.^{*8} Hence, Canada and Denmark support the median line method according to which the Arctic Ocean would be divided according to the length of the countries' nearest coastline. Under this approach, the seabed next to internal waters would be under the full sovereignty of the coastal state, resulting in the passage of the North Pole to Denmark and a moderate gate to Canada. Russia, in contrast, is a strong proponent of the sector method, which would take the North Pole as a centre point and draw lines along the meridians. In the past, the United States was opposed to the sector method, but in a 1990 treaty with Russia, the United States accepted a boundary delimitation approach based on the sector method. Disagreements over delimitation methods will further delay the settlement process. The five Arctic parties are in need of an arrangement that would allow them to preserve the strength of their territorial claims and to prevent territorial claims of other countries or intergovernmental bodies. At present, there is no clear consensus on whether this should be a binding 'hard-law' instrument or a package of 'soft-law' recommendations.

Along with resolution of maritime border disputes in the Arctic, the proponents of the Arctic Treaty see a need for a comprehensive framework for regional co-operation and joint ecosystem-based management

⁶ E.g., in the Arctic, Canada claims the Canadian Arctic Archipelago its internal waters; Russia is claiming a large extended continental shelf; there also are disputes regarding what passages constitute 'international seaways' and rights to passage along them (Northwest passage). In the Caspian, Azerbaijan's, Turkmenistan's and Iran's sectors are not fully defined.

⁷ M. Blunden. *The New Problem of Arctic Stability*. – *Survival: Global Politics and Strategy* 2009 (51) 5, p. 122.

⁸ M. Rajabov. *Melting Ice and Heated Conflicts: A Multilateral Treaty as a Preferable Settlement for the Arctic Territorial Disputes*. – *Southwestern Journal of International Law* 2009 (15), p. 438.

in the Arctic. For instance, in April 2010, the WWF presented a report for the WWF International Arctic Programme^{*9} with a proposal for a legally binding instrument with its objectives being the protection and preservation of the Arctic marine environment; the long-term conservation and sustainable and equitable use of Arctic marine resources and marine ecosystems and their functions; maintaining peace, order, and stability in the Arctic; and ensuring socio-economic benefits for present and future generations, with special reference to indigenous Arctic peoples. The need for an agreement on additional protection of the Arctic environment is sensed by many other actors; again, there is no agreement as to whether it should be enacted in the Arctic Treaty or a separate environmental treaty.

The Caspian states, in turn, have agreed that the Caspian Convention should settle the matter of delimitation of territorial waters, fisheries, and common waters of the Caspian; determine maritime boundaries of the littoral states; grant all Caspian states freedom of shipping, fishing, and transit passage in the common waters; and provide a legal framework for co-operation in the spheres of use, protection, and recovery of biological resources.^{*10} The convention has been under development for years, and the Caspian countries have expressed an opinion that it might be adopted already this year.^{*11} As the Caspian states have already ratified the Framework Convention for the Protection of the Marine Environment of the Caspian Sea, in 2003^{*12}, the upcoming Caspian Convention shall encompass just a few environmental issues.

4. Co-operation or co-ordination?

It seems that all parties in both the Arctic and Caspian disputes share the idea of common, peaceful, and sustainable division and use of the seas. It is evident that the countries are ready to co-operate and negotiate the terms of any new agreements. So, can this process be viewed as a co-ordination game with an international agreement defining the co-operation among states? The Arctic Treaty is often seen as modelled on the Antarctic Treaty regime.^{*13} Initially, the Antarctic Treaty was an effort to resolve a co-ordination game. The states involved wanted to preserve the territory for scientific purposes and keep it free of military activity and weapons testing. However, the interests of the parties changed over time and additional environmental issues have become important, resulting in additional environmental legislation. Thus it is that the Antarctic Treaty work started as a co-ordination exercise but subsequently changed into a more challenging co-operative exercise.^{*14} Since both the Arctic Treaty and the Caspian Convention, though originating in a general environment of co-operation, face rather difficult problems of colliding interests, it seems safe to assume that the situation around them cannot be viewed as simply a co-ordination of purposeful behaviour of each individual state involved but, rather, should be approached as a much more difficult and complicated co-operation task. This assumption, in turn, implies that both treaties might soon follow the route of the Antarctic Treaty.

⁹ T. Koivurova, E. J. Molenaar. A Proposal for Legally Binding Instrument. International Governance and Regulation of the Marine Arctic. Three reports prepared for the WWF International Arctic Programme. December 2009. Available at assets.panda.org/downloads/3in1_final.pdf (14.6.2011).

¹⁰ О. Цыганов, Ш. Меджидов, А. Караваев. Море новых возможностей (The Sea of New Possibilities). – Известия, 26.11.2009, р. 4.

¹¹ Конвенция по статусу Каспия может быть принята уже в этом году (Caspian Convention might be adopted already this year). – Вестник Кавказа, 26.4.2011. Available at <http://www.vestikavkaza.ru/news/obshestvo/diaspora/36274.html> (14.6.2011).

¹² Framework Convention for the Protection of the Marine Environment of the Caspian Sea has been criticised for not attracting the public into environmental protection issues as does, for instance, Convention on the Protection of the Marine Environment of the Baltic Sea Area from 1992.

¹³ See Note 7, p. 125.

¹⁴ See Note 2, pp. 58, 127.

5. The Russian Federation as a common player: Russian interests in the treaties

The Russian Federation is one of the largest players in the Arctic and by far the largest player in the Caspian. As a rational player, Russia intends to obtain as many resources and benefits in the regions as possible. The voice protecting Russian national interests has usually been loud and demanding. Accordingly, on 20 December 2001, four years after the UNCLOS became effective, the Russian Federation presented a submission to the Commission on the Limits of the Continental Shelf to extend the limits of its shelf beyond 200 nautical miles from the baselines. After requesting additional materials from Russia and carefully considering the submission, the commission neither denied the request nor approved it. Instead, the commission requested provision of additional data by 2009. To gather said data, Russia launched the Arctica-2007 expedition to take samples from the Lomonosov Ridge at the points of its conjugation with the Laptev Sea and the East Siberian Sea. Additionally, Russia planted the controversial titanium Russian flag under the North Pole. Recently, Russia's Minister of Natural Resources Yuri Trutnev stated that the analysis of samples taken from the ridge showed that the Lomonosov Ridge is part of the structural continuation of the Siberian continental platform and the North Pole belongs to Russia.^{*15}

Not only is Russia putting forward emotional arguments of ownership over the Arctic; the corresponding national policy is laid down in 'Foundations of Russian Federation State Policy in the Arctic through 2020 and Beyond', which the Russian president approved in 2008.^{*16} The strategy clearly emphasises the region's importance to Russia's economy as a major source of revenue, mainly in view of issues of energy production and profitable maritime transport. Russia planned to document its claims to territory lying beyond its current economic zone before the end of 2010 and to establish the outer borders of its Arctic zone by 2015 in order to 'exercise on this basis Russia's competitive advantages in the production and transport of energy resources', according to the Russian Arctic strategy paper. If Russia's diplomatic efforts succeed, by 2020 the Arctic will become 'one of the Russian Federation's leading strategic resource bases'^{*17}.

Additionally, some Russian legal scholars argue that the sector method supported by Russia for division of the Arctic evolved in the 1920s as a customary international norm according to which all water and land falling within the state's sector is under its complete sovereignty. Though the claimed customary international law norm is not enshrined in the UNCLOS, these scholars believe that Article 234, stating that 'Coastal States have the right to adopt and enforce non-discriminatory laws and regulations for the prevention, reduction and control of marine pollution from vessels in ice-covered areas', does not rule out sector-based division of the Arctic and, moreover, entitles the coastal states to give Arctic areas a 'special status'.^{*18}

According to the Russian Federation's maritime doctrine for the period until 2020, the Caspian is viewed as a 'region with unique mineral and biological resources. One of the long-term goals set under this regional development is to determine the international legal regime for the Caspian Sea and use of fisheries and of oil and gas resources that would benefit the Russian Federation'^{*19}. According to the Russian position, the Soviet–Iranian treaties from 1921, 1935, and 1940 that settled on equal and exclusive rights for the Soviet Union and Iran to conduct maritime activities in the Caspian are, in the absence of a new convention, still in force. The treaties established a status for the Caspian as a closed sea, which was generally accepted by the international community. Taking into account that the newly emerged Caspian

¹⁵ See Note 7, p. 427.

¹⁶ Основы государственной политики Российской Федерации в Арктике на период до 2020 года и дальнейшую перспективу (Foundations of Russian Federation State Policy in the Arctic through 2020 and Beyond). Утверждена президентом РФ Д. Медведевым 18.9.2008. Пр 1969. Available at <http://www.rg.ru/2009/03/30/arktika-osnovy-dok.html> (18.7.2011).

¹⁷ D. Trenin. The Arctic: A Front for Cooperation not Competition. The Arctic. A view from Moscow. Carnegie Endowment for International Peace 2010, p. 9.

¹⁸ А. Ковалев. Международно-правовой режим Арктики и интересы России (International Legal Regime of the Arctic and Interest of Russian Federation). Available at http://www.pircenter.org/data/publications/sirus3-09/115-124_Analiz-Kovalev.pdf (15.6.2011).

¹⁹ Морская доктрина Российской Федерации на период до 2020 года (Russian federation maritime doctrine for the period until 2020). Утверждена президентом РФ В. Путиным 27.6.2001, Пр 1387. Available at <http://www.scrf.gov.ru/documents/34.html> (8.4.2011).

countries agreed to follow the international treaties signed by the Soviet Union, as well as the fact that international law does not vest a country with a right to alter its maritime borders unilaterally, there are no legal grounds to deny the validity of the old 'Soviet' treaties. The outcome of this position would mean that the Caspian can be solely used by the littoral states while being closed to the rest of the world. Russia agrees that the Soviet–Iranian treaties are outdated (since they do not mention and in that sense regulate the use of the seabed and subsoil) but stands firm on adherence to them. More precisely, the Russian position concerning possible division of the Caspian is held as 'divided seabed, common waters'.

There is also an interesting opinion expressed by Russian political scientist Pavel Baev, that 'Russian economic interest in resources camouflages the "lofty ideal" of Russian sovereignty over the Arctic'²⁰ and the Caspian. 'While the lure of oil and gas wealth is no doubt attractive, the romantic idea of establishing a hold over new—or old as once belonged to—territories and possessing the ocean depths and icy expanses holds greater appeal,' Baev maintains. It does not seem at all unlikely that, because the Caspian has for several centuries been within the Russian realm, the Russian patriotic desire to retain control over its territory might also be at work in this particular case.

6. Constraints on Russian legal behaviour

Had the Russian Federation been the only rational player in the games for Arctic and Caspian resources (a rather trivial case of a game), it would most probably get the new international agreements to serve its interests, achieve the desired maximisation of its benefits, and satisfy all mentioned claims and pretensions. As seen from the references mentioned above, Russia is willing to adhere to the Arctic Treaty only if the latter establishes sector-based division of the Arctic Ocean. Unless and until that happens, Russia will continue to gain legal grounds to support its territorial claims from Article 234 and other UNCLOS provisions. There are even opinions that Russia is adhering well to the applicable rule of law; at a minimum, Russia's conduct in the Arctic appears broadly comparable to the conduct of other states with a presence in the region.²¹

Similarly, Russia favours the Caspian Convention only if the countries agree to the concept of divided bottom and common waters. Otherwise Russia's intention is to stick firmly to the outdated bilateral treaties between the USSR and Iran. It is widely believed that from the political point of view Russia benefits from the absence of a precise treaty in the Caspian region: on the one hand, it enables Moscow—as well as Tehran—to impede building of a trans-Caspian pipeline, a project that would be in the interest of diversifying the energy supply in the European Union, thereby increasing the importance of Turkmenistan and Azerbaijan. On the other hand, the status quo allows Russia to put pressure on both Turkmenistan and Kazakhstan, as the latter still use oil and gas energy supply resources via Russian territory.

We must remember, however, that the Russian Federation is surrounded by other states trying to act rationally, so the rather trivial scenario of a new international agreement, as described above, is, obviously, unlikely. Also, the situation in reality is somewhat different from the Russian perception. Planting a flag on the sea floor of the North Pole was an impressive technical achievement but carried no legal significance for the other states. It neither bolstered nor confirmed a Russian claim to the Arctic seabed, nor did it constitute a violation of international law. Rather, it signalled to the West the Russian intention and ability to continue pressing a legal claim to a significant portion of the continental shelf beneath the Arctic Ocean.²² The current ice conditions in the Arctic make gathering of precise and detailed information to meet UNCLOS continental shelf prolongation requirements almost impossible. The lack of evidence proving that the Lomonosov Ridge is a natural prolongation for any particular party to the disputes makes Russian, Canadian, and Danish claims to the North Pole vulnerable. The fact that the Lomonosov Ridge extends from the coasts of three states creates grounds for legitimate territorial claims, but the existing ice conditions prevent these states from affirming their position through sample drilling.

Russia perfectly understands the difficulty of amassing a factual basis for its legal claims. No-one has been able to collect rock samples from the Lomonosov Ridge, even from a depth of just a few metres. Geo-

²⁰ P. Baev. Russian Policy in the Arctic. A Reality Check. The Arctic. A view from Moscow. Carnegie Endowment for International Peace 2010, p. 25.

²¹ M. Becker. Russia and the Arctic: Opportunities for Engagement Within the Existing Legal Framework. – Am. U. Int'l L. Rev. 2009–2010, p. 249.

²² *Ibid.*, p. 225.

physical and seismological methods—as well as numerous samples of sediment from the seabed—provide no conclusive evidence of the continental origin of these ridges, and Russia does not have the technical capability for deep drilling. The only way to resolve this problem would be to take part in international programmes studying the ocean floor^{*23}, which would require co-operation as well as huge financial investments from the participants.

In addition to the economic difficulties Russia needs to overcome in order to pursue the desired content for the new agreements, there are legal forces that restrain Russian actions. In the late 1980s and early 1990s, the Soviet Union and (after its collapse) Russia went to considerable lengths to rebuild a reputation for compliance with international legal obligations. Following the collapse of the Soviet Union in 1991, the new Russian government announced that it would honour existing Soviet debt despite the change in regime. Had it chosen to repudiate the debt, the new Russia would have compromised its reputation and undermined its efforts to develop financial ties with the West. Abiding by international norms helped Russia to build a new reputation that, in turn, increased its ability to attract financial assistance from the West.^{*24}

Though Russian behaviour with respect to preserving a reputation of compliance has never been perfect, Russia is aware that in a large-scale co-operation game with other economically strong game partners, any violation of its legal obligations or promises might result in reputation sanctions too costly to be paid. Reputational sanctions do not require states to choose to impose costly sanctions in an effort to generate future compliance; they reflect the updating of beliefs by self-interested states. Reputation sanctions of other Arctic players may result in co-operation without Russia: scientific research without Russian scientists, claims of an extended continental shelf, etc. In the Caspian, reputation sanctions could result in bilateral agreements between other states and increased presence of the United States in the region. In addition, mechanisms of reciprocity would mean the remaining states' reciprocal reaction to Russian violation, and retaliation in the form of costly sanctions can be applied.

As a rational player amongst other players, Russia is interested both in co-operation with others and in avoiding reputation-associated sanctions. The country and its leaders understand that only co-operation can lead to a treaty that will grant Russia its desired resources and control. Despite some rather emotional actions, such as the one involving the titanium flag at the North Pole, there are sufficient grounds for expecting Russia to be open to negotiations over the new treaties, to hold back some of its pretentious claims, and to remain in line with its legal obligations and grounded promises—all these in order to reach agreements that shall in one way or another maximise Russian benefits. Even in situations that seem to be dominated by a collision of interest, there is a co-operative element to discern. It seems, therefore, that the emergence of new legal regimes is only a matter of time.

7. Conclusions

The processes surrounding the Arctic and Caspian, dissimilar at first glance, are nevertheless good examples of how contemporary international law emerges. This article has provided a brief case study concerning the real payoffs as well as legal forces that would lead Arctic and Caspian states to conclusion, or rejection, of the new Arctic Treaty or the Caspian Convention. The article gave insight into possible content of the new treaties, with the author also discussing whether the Arctic Treaty and Caspian Convention are pure co-ordination games and looking at the forces that define particularly Russian juridical behaviour with respect to these treaties.

The article proceeded from the assumption that both regions are in need of a new legal regime. Namely, there are maritime border disputes in both seas that need to be settled. Agreement on maritime delimitation would mean dividing the subsoil resources and control over transportation routes among the littoral states. Obviously, huge material payoffs are at stake. In addition, environmental and co-operation issues—especially those arising with the melting of the ice in the Arctic—must be resolved. Arctic and Caspian countries feel a strong incentive to co-operate in the creation of new legal regimes, even though there is still no consensus on how this should be done.

²³ See Note 8, p. 27.

²⁴ See Note 2, p. 89.

The article has applied the methodology of rational choice theory, which posits that states, being rational players, act in a way that maximises their benefits, both political and economic. However, along with possible material payoffs, legal forces, such as reputation, reciprocity, and retaliation, can play a similarly important role in the final decision of a state about entering into a treaty and complying with it. As one such rational actor, the Russian Federation stands firm in protecting its interests in the Arctic and Caspian. It seems perfectly natural that any country will support the conclusion of new treaties only if they serve its interests, and, obviously, the Russian Federation is not the only rational player in these games. But in a world that is increasingly becoming one large global village, in which every party is more conscious and aware of the intentions and actions of others in whatever game they might be involved in, the need to co-operate and to sustain one's reputation for legal compliance become almost as important as any possible material payoff. Accordingly, Russia's rational choice and legal behaviour will be significantly restrained by the desire to keep its reputation for legal compliance intact, as well as by concern over reputation sanctions, reciprocity, and retaliation. Being a rational player that also wants to achieve co-operation, Russia needs to consider the interests and legal behaviour of other countries involved. Thus we have shown that the notion of rationality, as defined by rational choice theory, can, in a sense, in our particular case be extended to include a behaviour that, rather than focusing on material payoffs alone, also considers possible legal 'payoffs', such as reputation sanctions, reciprocity, retaliation, and the like. (After all, it would be hard to say that a state has acted 'rationally' if it were to gain material benefits at the expense of its reputation, co-operation, and the trust of its partners.)

To sum up, the author of this article believes that the Arctic Treaty and Caspian Convention shall find their place among historically important legal documents. The article also has included an attempt to show that the process of birth of new international legal regimes has already started, and that it is going to be difficult but nevertheless very engaging. When and how exactly the Arctic Treaty and the Caspian Convention will be concluded is, the author is convinced, a question for the immediate future.



Kaarel Relve

LL.M., Lecturer of Environmental Law

University of Tartu

Definition of an Environmental Organisation in the Aarhus Convention, Environmental Directives and Estonian Law

There is an on-going extensive environmental reform in Estonia. In the process, on 16 February 2011, the Estonian Parliament adopted the General Part of the Environmental Code Act^{*1} (hereinafter referred to as the GPECA) which, for the first time ever, provides for a universal legal definition of an environmental organisation in Estonian law.^{*2} The definition is paramount for implementation of the code as the provisions of the general part were drafted in line with the principle that environmental organisations carry a special role in the protection of environment-related public interest.^{*3} The requirement to recognise environmental organisations also stems from the Aarhus convention^{*4} and certain environmental directives.^{*5} The convention, directives and Estonian law all ascribe a special status to environmental organisations in environmental proceedings and access to justice in environmental matters. This article aims to clarify the conditions an organisation must meet in order to be treated as an environmental organisation for the purposes of the Aarhus convention, directives and Estonian law and, ultimately, to provide an answer as to whether or not the Estonian definition of an environmental organisation meets the framework conditions of the Aarhus convention and environmental directives. In view of the limited space afforded to this article, the focus will be on the definition of environmental organisations in the context of access to a review procedure.

¹ RT I, 28.2.2011, 1 (in Estonian).

² GPECA §31.

³ Keskkonnaseadustiku üldosa seaduse kontseptsioon (Concept of GPECA), p. 66. Available at <http://www.just.ee/orb.aw/class=file/action=preview/id=44910/Keskkonnaseadustiku+%FCllosa+seaduse+kontseptsioon.pdf> (14.6.2011) (in Estonian).

⁴ The UN convention on accession to information, public participation in decision-making and access to justice in environmental matters was opened for signature on 25 June 1998 at the 4th conference of ministers of environment in Århus on 25 June 1998. The convention entered into force on 30 October 2001. Available at <http://www.unece.org/env/pp/treatytext.htm> (14.6.2011).

⁵ In particular, the following directives are relevant: Council directive 85/337/EEC of 27 June 1985 on the assessment of the effects of certain public and private projects on the environment (hereinafter referred to as EIA directive). – OJ L 175, 5.7.1985, pp. 40–48; directive 2004/35/EC of the European Parliament and Council of 21 April 2004 on environmental liability with regard to the prevention and remedying of environmental damage (hereinafter referred to as Environmental Liability Directive). – OJ L 143, 30.4.2004, pp. 56–7; directive of the European Parliament and Council 2008/1/EC of 15 January 2008 concerning integrated pollution and control (codified version) (hereinafter referred to as IPPC directive). – OJ L 24, 29.1.2008, pp. 8–29. As from 7.1.2014 the IPPC directive will be replaced by directive 2010/75/EU of the European Parliament and Council of 24 November 2010/75/EU on industrial emissions. – OJ L 334, 17.12.2010, pp. 17–119.

1. Arguments in favour of restrictions imposed on limited jurisdiction

The more apparent the restrictions imposed by the environment on the exercise of fundamental rights, the more rooted the understanding that the protection of the environment is not merely a public interest but rather that everyone should personally invest in the condition of the environment. Alas one cannot but acknowledge that the implementation of environmental law by the public authorities is far from perfect.^{*6} The governments lack the resources and, every so often, the will. Such an observation has contributed to the conviction that the general public should have a greater say in environmental matters. Effective access to a review procedure in environmental matters is an essential precondition in ensuring the greater say of the general public. Access to justice in environmental matters has been restricted throughout history.^{*7} In many countries, access continues to be significantly restricted whereas restrictively interpreted terms of standing is one of the main obstacles.^{*8} Arguments in favour of restrictions of standing typically rely on the overburdening of courts and halting of economic development and associated potential abuse of standing.^{*9}

Very often the restriction of standing is justified by the need to protect the courts against overburdening. This argument seems to be rooted in the belief that should a court become just a little more accessible, there will be plenty of those who rush to bring forth their complaints. Such a causal link has not been proven. For example, a survey was conducted in 2002 which focused on the court cases initiated in the public interest in eight European Union Member States between 1996 and 2001. The survey showed that the number of environment-related court cases was relatively very low, less than 150 in most countries, and could not be linked to the scope of standing in the countries.^{*10} Also, no increase in the number of complaints has been observed in Estonia's court practice after the environmental standing was substantially expanded.

The overburdening of courts is sometimes associated with the actions of the so-called professional complainants who bring trivial matters to courts. Such behaviour may also be regarded as an abuse of standing. Strict restrictions on standing will hardly curb the ardour of professional complainants, though they can be expected to help the courts in fending off such complaints. However, strict restrictions limit access to justice in serious matters. Trivial complaints should, therefore, not be fought with general restrictions of standing but rather with specific regulations designed to filter out trivial complaints.

The second argument—putting a halt to economic development—is caused by a fear that a wide standing may postpone the implementation of projects important for the country's economy and increase the costs of implementation. This would eventually result in a general insecurity which suppresses new investments. In principle, this argument is difficult to contest: it seemingly justifies certain restrictions on standing.^{*11} It should, however, be stressed that economic development should not occur at any cost. The principle of sustainable development requires that besides economic arguments social and environmental considerations should also be taken into account. The understanding that the say of the general public in environmental matters should be increased results, to a large extent, from the fact that economic interests tend to overshadow other interests.

The argument of halted growth is also associated with the fear that standing will be abused by using the pretext of public interest to interfere with projects which are not compatible with the complainant's actual interests, mainly business interests. Even if such complaints are ultimately rejected, the time spent on disputes may significantly hold back a project. This argument is difficult to overturn or agree with as there is no reliable information on abuse. For instance, in Estonia popular complaints in planning matters have

⁶ Directive of the European Parliament and Council on access to justice in environmental matters [COM(2003)624], p. 2. Available at http://eur-lex.europa.eu/LexUriServ/site/en/com/2003/c.om2003_0624en01.pdf (14.6.2011).

⁷ J. Ebbesson. *Comparative Introduction / Introduction Comparative*. – J. Ebbesson (ed.). *Access to justice in Environmental Matters in the EU / Accès à la justice en matière d'environnement dans l'UE*. The Hague: Kluwer Law International 2002, p. 5.

⁸ G. Pring, C. Pring. *Greening Justice. Creating and Improving Environmental Courts and Tribunals*. The Access Initiative, 2009, p. 33. Available at http://www.accessinitiative.org/sites/default/files/Greening%20Justice%20Final_31399_WRI_o.pdf (14.6.2011).

⁹ See, e.g., *ibid.*, p. 33; M. Dross. *Access to Justice in EU Member States*. – *Journal for European Environmental and Planning Law* 2005 (2) 1, p. 23.

¹⁰ N. Sadeleer, G. Roller, M. Dross. *Access to Justice in Environmental Matters*. ENV.A.3/ETU/2002/0030 Final Report 2002, pp. 3 and 5. Available at http://ec.europa.eu/environment/aarhus/pdf/accesstojustice_final.pdf (14.6.2011).

¹¹ See G. Pring, C. Pring (Note 8), p. 39.

been allowed for years, however, there is no reliable information regarding the extent (if any) to which wide standing has caused an increase in the instances of abuse. Given that abuse is extremely difficult to prove, it is even unclear whether or not such an overview would be possible to be compiled. It would be, however, naive to think that no one would actually resort to using public interest as a pretext. Therefore, some restrictions on standing seem justified to prevent abuse. On the other hand, the hypothetical risk of abuse should not be overemphasised. Abuse cannot be totally prevented even if a very limited circle of people were to be entitled to standing.

2. Definition of an environmental organisation in the Aarhus convention and EU directives

The Aarhus convention and EU environmental directives regard environmental organisations as a special part of the interested public who should be involved in certain proceedings and to whom a right of access to justice should be ensured in certain cases. Specific requirements to ensure specific standing to environmental organisations arise out of Article 9 (2) of the Aarhus convention, the EIA and IPPC directives which secure the convention at the EU level, and the Environmental Liability Directive. Article 6 of the convention requires that environmental organisations participate in a procedure in which permission to engage in activities which have a significant impact on the environment is being decided. Pursuant to Article 9 (2) of the convention, environmental organisations must be ensured access to a review procedure to challenge the substantive and procedural legality of any decision, act or omission subject to the provisions of Article 6. EIA and IPPC directives provide for access to a review procedure which is virtually identical to that of Article 9 (2). Under Article 12 of the Environmental Liability Directive, a Member State is required to allow environmental organisations submitting to the competent authority any observations relating to instances of environmental damage or an imminent threat of such damage and requesting the competent authority to take preventive or remedying action. Article 13 of the directive sets out the obligation to ensure access to justice, in order to contest the procedural and substantive legality of the decisions, acts or failure to act under the directive. Both the convention and the directives contain the same definition of an environmental organisation: a non-governmental organisation which promotes environmental protection and meets any requirements under national law.^{*12} One can guess that the lack of more specific criteria is due to inability to reach a compromise. Requirements concerning associations of persons are significantly different across Europe.^{*13} The European Commission has attempted to put national requirements in a certain framework. In October 2003, the Commission tabled a draft directive in which criteria regarding environmental associations form an essential part.^{*14} However, it seems that today the initiative has faded away due to strong opposition from the Member States.

2.1. Elements of the definition of an environmental organisation: non-governmental and promotion of environmental protection

The convention does not define what 'non-governmental' means. Pursuant to a widespread approach, a non-governmental organisation (hereinafter referred to as the NGO) is any organisation which is independent from the government and non-profit, acts for a legitimate purpose and is not a political party.^{*15} The implementation guideline of the convention too mentions both the non-governmental and legitimate

¹² Article 2 (5) of the convention; Article 2 (15) of the IPPC directive; Article 1 (2) of the EIA directive; Article 12 (1) of the Environmental Liability Directive. Given that the definitions set out in the directives repeat that of the convention, the analysis below makes reference to the directives only where their provisions are different from the regulation provided for in the convention.

¹³ See, e.g., N. Sadeleer. *Synthesis of the National Reports*. – N. Sadeleer, G. Roller, M. Dross *et al.* Access to Justice in Environmental Matters and the Role of NGOs. Groningen: Europa Law Publishing 2005.

¹⁴ Directive of the European Parliament and Council on access to justice in environmental matters [COM(2003)624. Available at http://eur-lex.europa.eu/LexUriServ/site/en/com/2003/c.om2003_0624en01.pdf (14.6.2011).

¹⁵ P. Willetts. What is a Non-Governmental Organization? UNESCO Encyclopaedia of Life Support Systems. Section 1 Institutional and Infrastructure Resource Issues. Article 1.44.3.7. Available at <http://www.ihrnetwork.org/files/3.%20What%20is%20an%20NGO.PDF> (14.6.2011).

purpose.^{*16} Being non-profit means that companies cannot, as a rule, be regarded as environmental organisations, since their primary aim is to earn profits. The definition of a ‘public authority’ as defined in Article 2 (2) of the convention helps delimit the requirement of being non-governmental, i.e., any organisation meeting this definition cannot be regarded as an environmental organisation for the purposes of the convention.

The convention also does not provide instructions as regards how to define the second criterion—promotion of environmental protection. Firstly, it is not clear from the convention what should be considered ‘promotion’. For example, should an environmental purpose be formulated in the articles of association or do actual activities count more? Secondly, the exact scope of the notion of ‘environment’ is unclear. The convention does not define the environment, though it is indirectly defined in the definition of ‘environmental information’ provided for in Article 2 (3). It emerges from the definition that the environment covers at least such elements as air, atmosphere, water, soil, land, landscape and natural sites, biological diversity and its components. This definition of environmental information may be helpful if one needs to reinforce the conviction as to a particular environmental organisation. But it is not so safe to rely on the indirect and incomplete definition of the environment as provided in the convention in deciding that an organisation is not an environmental organisation. Thirdly, it is unclear what ‘environmental protection’ is for the purposes of the convention. Who and what is actually protected in protecting the environment? Concrete human interests, general interests or intrinsic value? However, Article 1 of the convention—the convention objective—clarifies that at least the protection of every person of present and future generations to live in an environment adequate to his or her health and well-being should be regarded as environmental protection. In addition, nature conservation should be regarded as environmental protection for the purposes of the convention. Such a conclusion is supported both by the wide definition of environmental information which, *inter alia*, makes a reference to biodiversity, as well as the need to ensure that all environmental considerations are taken into account in decision-making. Issues related to nature conservation are definitely covered by the definition of environmental protection as regards the Environmental Liability Directive which focuses on the protection of natural values.

To sum up, it can be said that both the conventions and directives allow the Member States a wide degree of discretion in specifying the inherent criteria of environmental organisations. However, such discretion is not unlimited. Besides the requirements of being non-governmental and promoting environmental protection, national law must take into account the general requirements of the directives and the objectives of their adoption^{*17} and, where necessary, guarantee effective implementation of this legislation. For example, the European Court of Justice has judged that the requirement under Swedish law that the existence of 2000 members is a condition precedent to standing is contrary to the objectives of the EIA directive. Due to such a criterion, just two associations qualify as environmental organisations and right of standing is precluded for small local organisations. The directive does not, however, deal only with national projects. Although smaller organisations could bring action via larger organisations such a filter would be in direct contrast to the spirit of the directive. A large organisation might not have the same interest in a local project. And a large organisation is also likely to receive many requests for action and must select which to accept. A small organisation is in no position to dispute such a selection.^{*18}

2.2. The criterion of concern in the convention and directives

The requirements of being non-governmental and promoting environmental protection are linked to the nature of an environmental organisation. If these requirements are met, an organisation may, in principle, be regarded as an environmental organisation. Besides inherent conditions, the convention also includes the criterion of concern which shows whether or not an organisation has standing regarding a particular point of dispute. The criterion of concern is set out in Article 9 (2) of the convention:

¹⁶ UNECE. The Aarhus Convention Implementation Guide, p. 32. Available at <http://www.unece.org/env/pp/publications.htm> (14.6.2011).

¹⁷ In particular the 18th paragraph of the convention preamble, 25th paragraph of the preamble of the Environmental Liability Directive and Articles 1 and 3 of the convention.

¹⁸ Case C-263/08, 15.10.2009, *Djurgården-Lilla Värtans Miljöskyddsförening v. Stockholms kommun genom dess marknämnd*.

Each Party shall, within the framework of its national legislation, ensure that members of the public concerned (a) Having a sufficient interest or, alternatively, (b) Maintaining impairment of a right, where the administrative procedural law of a Party requires this as a precondition, have access to a review procedure [...]

What constitutes a sufficient interest and impairment of a right shall be determined in accordance with the requirements of national law and consistently with the objective of giving the public concerned wide access to justice within the scope of this Convention. To this end, the interest of any non-governmental organization meeting the requirements referred to in article 2, paragraph 5 shall be deemed sufficient for the purpose of subparagraph (a) above. Such organizations shall also be deemed to have rights capable of being impaired for the purpose of subparagraph (b) above.

The alternative bases of standing as set out in Article 9 (2) are not intended to create a choice for the parties: alternative options are provided in order to accommodate differing legal systems of the parties.^{*19} In other words, Article 9 (2) refers to existing national standards of standing, though the provision emphasises that existing standards should be interpreted widely.^{*20} The main innovation introduced by the convention in connection with environmental organisations can be found in the second paragraph of Article 9 (2). At first glance, the paragraph seems unambiguous: an environmental organisation must automatically be guaranteed the right of a review procedure.^{*21} When explored further, such an interpretation becomes questionable. Firstly, the paragraph does not directly provide for an automatic right of standing but just states that as regards the standing of environmental organisations, it is presumed that the national standards of standing are met. This raises the question as to how narrowly a state may prescribe a basis of standing. This was the problem that Germany faced when implementing the EIA directive. In Germany, a violation of a subjective public right forms the basis of standing. In other words, the complainant needs to point out that a provision which also protects his or her individual interests, in addition to public interest, has been violated. As far as recognised environmental organisations are concerned, the only presumption is that they have the same rights as individuals though, under German law, they do not and cannot have such rights. In other words: environmental organisations can protect just the interests of individuals but not public interest. However, a lot of environmental issues are solely within the sphere of public interest and do not directly concern the interests of individuals. The Advocate General of the European Court of Justice took a stance, in proceedings for the preliminary ruling, that a Member State cannot restrict an environmental organisation's standing by using the narrow definition of standing. The wording and context of judicial protection in the EIA directive implies that an environmental organisation may invoke a violation of their right even if such a violation cannot exist under the country's legal system. Be it the case, violation of a "fictitious" right must be presumed. In other words, the Advocate General reasserted her position that the provision gives automatic standing to environmental organisations.^{*22} The European Court of Justice adopted a slightly different stance. The court held that, in principle, a Member State is free to decide what to treat as a violation of a right in the context of the provision. However, a Member State still needs to follow the principle of effectiveness according to which they must not render virtually impossible or excessively difficult the exercise of rights conferred by the directive. A large portion of environmental law is aimed at protecting public and not individual interest. The requirement that environmental organisations may invoke solely subjective rights is contrary to the principle of effectiveness and to the goal that the public concerned must be ensured a broad access to justice. In short, the court took the stance that a Member State must ensure that environmental organisations have a standing even where the national provisions which transpose EU law or directly applicable EU provisions, whose aim is to protect just public interest, are being violated.^{*23}

¹⁹ Implementation Guide (Note 16), p. 129.

²⁰ It should be pointed out that the Environmental Liability Directive does not provide for a clause on guaranteeing wide access.

²¹ Such a position was adopted, e.g., by the Advocate General in case C-263/08, Opinion of Advocate General Sharpston, 2.7.2009, *Djurgården-Lilla Värtans Miljöskyddsförening v. Stockholms kommun genom dess marknämnd*, paragraph 43.

²² Opinion of Advocate General Sharpston, 16.12.2010, case C-115/09, *Bund für Umwelt und Naturschutz Deutschland, Landesverband Nordrhein-Westfalen eV v. Bezirksregierung Arnsberg Trianel Kohlekraftwerk Lünen*, paragraphs 46–67.

²³ Case C-115/09, 12.5.2011, *Bund für Umwelt und Naturschutz Deutschland, Landesverband Nordrhein-Westfalen eV v. Bezirksregierung Arnsberg Trianel Kohlekraftwerk Lünen*, paragraphs 43–50.

The judgment of the European Court of Justice does not clarify the limits within which a state may define the standing of environmental organisations. However, the opinion of the court is in greater accord with the convention than the Advocate General's interpretation of an automatic standing because the convention does not distinguish between the criterion of the concern of an organisation and other criteria that relate to the nature of an organisation. If one were to adopt a position that environmental organisations do have automatic standing, it would create a situation where every organisation should be given standing in any environment-related matter. Of course, it is not generally thought that an environmental organisation should be entitled to standing no matter what the case. For example, pursuant to the draft directive of the Commission, access to justice is based, *inter alia*, on a condition that the matter of review in respect of which an action is brought is covered specifically by the statutory activities of the organisation and the review falls within the specific geographical area of activities of that organisation.^{*24} If automatic standing were to be presumed, it would not be clear whether a state could impose such conditions as they may form a part of a national standard of standing which an environmental organisation is supposed to meet. For example, in France in administrative matters standing is generally based on 'interest'. The existence of an interest of certain organisations is, among other things, assessed on the basis of the statutory goal and area of activity of the organisation concerned.^{*25}

To sum up, I hold that the meaning of the provisions of Articles 2 (5) and 9 (2) of the Convention is as follows as regards the criteria of concern. Firstly, the provisions preclude the interpretation that an environmental organisation is without concern because the general criterion of standing in national law principally excludes an environmental organisation being concerned. For example, the interpretation that an environmental organisation cannot be concerned insofar that nobody's subjective rights have been violated has to be incorrect. Secondly, the provisions do not oblige to presume automatically that every environmental organisation is entitled to standing in any environmental matter: the parties may specify the criteria of concern in national law. Thirdly, the provisions require that the special role of environmental organisations in the protection of environment be acknowledged. Such requirements of concern in national law which do not allow environmental organisations to fulfil this role are not permitted. Those requirements of national law which, in case of disputes related to Article 9 (2), do not entitle an environmental organisation to standing are definitely contrary to the Convention.

3. Definition of an environmental organisation in Estonian law

Estonia ratified the Aarhus convention on 6 June 2001. The provisions of the directives regulating legal protection had to be transposed by 25 June 2005 and 30 April 2007 at the latest. Nevertheless, for a long time the notion of an environmental organisation was defined in Estonian law solely in the context of environmental liability.^{*26} In Estonia, a violation of subjective rights is the principal basis of access to justice and one might have presumed that in practice the standing of environmental organisations would be extremely limited. In reality, however, it turned out to be notably wide because the principal institution in charge of reviewing environmental matters—the administrative court—has preferred a broad interpretation of Article 9 (2) of the convention^{*27} and has applied it directly. In environmental matters, courts have accepted complaints from non-profit associations, the standing of foundations and, in principle, the standing of civil law partnerships.^{*28} On one occasion the court of first instance even seems to recognise the standing of private

²⁴ Draft directive [COM(2003) 624] (Note 6), Article 5 (1).

²⁵ Milieu Ltd., Measures on access to justice in environmental matters (Article 9 (3)) Country report for France, pp. 19–20. Available at http://ec.europa.eu/environment/aarhus/study_access.htm (14.6.2011).

²⁶ Keskkonnastutuse seadus (Environmental Liability Act), adopted 14.11.2007. – RT I 2007, 62, 396 (in Estonian).

²⁷ The Supreme Court holds that standing under Article 9 (2) extends to any decision and action within the scope of the convention provided that the decision or action can, by its nature, be contested in an administrative court. See ALCSCd, 29.1.2004, 3-3-1-81-03.

²⁸ E.g., the decision of 24.11.2003 of the Pärnu Administrative Court in administrative case 3-119/2003 recognised the Estonian Ornithological Society, the decision of 2.12.2002 of the Tartu Administrative Court in administrative case 3-289/2002 recognised the Estonian Nature Conservation Society, the decision of 17.10.2003 the Tallinn Administrative Court in administrative case 3-1398/2003 recognised the Estonian Green Movement, the decision of 11.9.2003 of the Tallinn Administrative Court

limited companies as an environmental organisation.^{*29} As a rule, the courts have been rather laconic in their arguments. They have usually limited themselves to a reference to the articles of association or other relevant documents of an association indicating that environmental protection is an objective of that association. Such laconism may be due to the fact that a majority of the complaining associations have been renowned environmental organisations. Respondents might also have had a role in this, failing to provide convincing arguments as to why the complaining association cannot be regarded as an organisation promoting environmental protection. One should also not overlook the fact that the Supreme Court has, in several ground-breaking decisions, stressed the singularity and importance of environmental matters. Perhaps the most significant is the decision in which the Supreme Court took the stance that as far as environmental matters are concerned, it is not necessary to invoke a violation of a right in filing a complaint but rather it is possible to refer to an essential and real concern in connection with the disputed administrative act or action.^{*30}

The environmental law of Estonia has been codified since 2007. The process does not involve just the consolidation and systematisation of existing law but also includes a critical review of current law, tackling of contradictions and bridging of gaps—in other words, the codification is substantive.^{*31} In the process, on 16 February 2011, the General Part of the Environmental Code Act was adopted, §31 of which provides for a definition of an environmental organisation. However, the definition is not legally valid as the GPECA has not yet entered into force and the date of enforcement has not been scheduled.^{*32} Nevertheless, current law defines the notion of an environmental organisation as far as the most important issue is concerned, i.e., access to justice in environmental matters. As a result of an infringement procedure initiated against Estonia^{*33}, the special provision of the GPECA on standing was exceptionally added to the draft Code of Administrative Act Procedure^{*34} and it was enforced ahead of the other provisions of the draft.^{*35} As the provision is so recent, there is no case-law regarding its implementation.

3.1. Inherent criteria of an environmental organisation in the Code of Administrative Court Procedure

Pursuant to §292 (2) of the Code of Administrative Court Procedure^{*36} (hereinafter referred to as the CACP), a non-governmental environmental organisation means a non-profit association and a foundation whose statutory goal is environmental protection and who promotes environmental protection in its activity; also an association which is not a legal person who, subject to a written agreement of its members, promotes environmental protection and represents the views of a significant part of the local population. Thus, the Estonian definition establishes three inherent criteria for environmental organisations: they must be non-

in administrative case 3-1207/03 recognised Nõmme Tee Society, the decision of 24.11.2003 of the Pärnu Administrative Court in administrative case 3-119/2003 recognised the Estonian Fund for Nature, and the decision of 4.3.2005 of the Tartu Administrative Court in administrative case 3-596/04 recognised civil law partnership Green Urvaste as environmental organisations for the purposes of the convention.

²⁹ The decision of the Tallinn Administrative Court in administrative case 3-78/2005.

³⁰ ALCSd, 28.2.2007, 3-3-1-86-06.

³¹ Explanatory Memorandum to the GPECA, p. 2. Available at <http://www.riigikogu.ee/?page=eelnou&op=ems&emshelp=true&eid=1147282&u=20110616182716> (14.6.2010) (in Estonian).

³² Pursuant to §63 of the GPECA, the Act will enter into force at the same time as its special part. Pursuant to the agenda of the governing alliance, the special part will be adopted by 2015 at the latest. See Erakonna Isamaa ja Res Publica ning Eesti Reformierakonna valitsusliidu programm aastateks 2011–2015 (Agenda of the Governing Alliance Union of Pro Patria and Res Publica and the Estonian Reform Party for 2011–2015). Õiguskord 4.b. Available at <http://valitsus.ee/UserFiles/valitsus/et/uudised/taustamaterjalid/Valitsusliit%20I.pdf> (14.6.2011) (in Estonian).

³³ Infringement procedure 2008/2292. The European Commission has adopted a position that, *inter alia*, Estonia has not properly transposed the provisions of the IPPC directive regulating legal protection. At this time (spring 2011), the procedure is still on-going: The Commission has submitted its reasoned opinion and Estonia has responded, however, the Commission has not notified about the closing of the procedure or about its referral to the court. The Estonian Ministry of Foreign Affairs treats the documents of the ongoing infringement procedure as information to which the general public has no access. The author relies on the reasoning presented on page 60 of the Explanatory Memorandum to the Draft Code of Administrative Court Procedure and on the letters exchanged with the Ministry of Foreign Affairs.

³⁴ Explanatory Memorandum to the GPECA, p. 60. Available at <http://www.riigikogu.ee/?page=eelnou&op=ems&emshelp=true&eid=1020325&u=20110616183217> (14.6.2010) (in Estonian).

³⁵ The provision entered into force on 5.3.2011, the draft as a whole will enter into force on 1.1.2012. CACP §315.

³⁶ Halduskohtumenetluse seadustik. – RT I 1999, 31, 425; RT I, 23.02.2011, 3 (in Estonian).

governmental, operate in a certain form and promote environmental protection. In addition, such associations that are not legal persons must represent the views of a significant part of the local population.

The CACP regards a non-profit association, a foundation and an association which is not a legal person as the forms of an environmental organisation. Acceptance of the form of a non-profit association obviously needs no justification insofar as it is the ideal form of a non-governmental organisation. Recognition of a foundation as an environmental organisation is more dubious. This is because the public may have very little leverage to affect how a foundation operates.^{*37} A foundation has no members, it is controlled by a supervisory board, which may have just three members, and the appointment and removal of board members is specified in the articles of association.^{*38} To compare, the highest body of a non-profit association is the general meeting of its members and anybody who meets the requirements set out in the articles may become a member.^{*39} In other words, whether or not the public can have a say in the activity of a foundation is largely dependent on the articles of association of a foundation. At the same time one should not overlook the fact that the articles of association of a foundation may grant the public a big say as regards the organisation of the foundation's activity. Likewise, the public having leverage to greatly affect the activity of an organisation need not be central in recognising an association as an environmental organisation. I hold that what is more important than the option for control granted to the public is the organisation's dedication to the protection of environment-related public interests and its capability to actually protect such interests. In Estonia, there are several active and capable organisations promoting environmental protection which operate in the form of a foundation.^{*40} It should also be stressed that the foundation has been recognised by all instances of court. To sum up, I hold that in Estonia the recognition of the form of a foundation is justified.

In addition to non-profit associations and foundations, the CACP also recognises an association which is not a legal person. This form is recognised based on the presumption that it is highly likely that local residents can file individual complaints in issues affecting their living environment.^{*41} Unlike non-profit associations and foundations, an association which is not a legal person must represent the views of a significant part of the local population. This requirement, too, refers to the fact that the primary goal of recognising an association which is not a legal person has been to simplify the protection of the shared environment-related interests of the local population. The CACP does not clarify the number of persons who should be regarded as a significant part of the local population. It is also unclear what exactly is meant by the representation of interests. However, a ground-breaking judgement of the Supreme Court provides certain guidance.^{*42} The judgement precedes the provision of the CACP but should be nevertheless considered in interpreting §292 of the CACP as obviously the wording of said section is modelled on the judgement of the Supreme Court. The court took the stance that an association which is not a legal person and has just two members can, in principle, file a complaint as an environmental organisation. In order to avoid abuse, such an association must represent the views of at least a significant part of the local population, especially if the association has been founded recently. An organisation can be regarded as a representative of the local people if the views or opinions of the organisation and a significant part of the population (considered as the general public) coincide and the general public accepts such a representative and its relevant activities in one form or other. An informal association must, if it resorts to a court of law, be able to demonstrate that it meets such conditions. The court may presume that the general public accepts an association if it has in its previous activity enjoyed public support in a particular area. The court held that the requirement of

³⁷ E.g., in drafting the Environmental Code, the government of Sweden held that only such associations may be regarded as environmental organisations which are open to the general public, in which anybody may become a member and express his or her opinions and direct the activity of the organisation. For that reason, foundations or other organisations, including Greenpeace which is not governed by a body elected by its members, cannot be regarded as environmental organisations. Milieu Ltd, Measures on access to justice in environmental matters (Article 9 (3)) Country report for Sweden, p. 11. Available at http://ec.europa.eu/environment/aarhus/study_access.htm (14.6.2011).

³⁸ Subsection 1 (1), §8 9), §24, §26 (1) of the Foundations Act (sihtasutuste seadus). – RT I 1995, 92, 1604; RT I, 17.12.2010, 20 (in Estonian).

³⁹ Subsection 12 (1), §18 (1) of the Non-profit Associations Act (mittetulundusühingute seadus). – RT I 1996, 42, 811 (in Estonian).

⁴⁰ E.g., the Estonian Fund For Nature, Web site www.elfond.ee; the Institute of Sustainable Estonia (SEI Tallinn), Web site www.seit.ee; the Estonian Environmental Law Center, Web site www.k6k.ee.

⁴¹ Concept of the CPECA (Note 3), p. 76.

⁴² ALCSCd, 28.11.2006, 3-3-1-43-06.

representation was met in the case under consideration as, *inter alia*, 546 local residents had supported the organisation with their signature.

Pursuant to §292 of the CACP, being non-governmental is one of the features of an environmental organisation. CACP does not define clearly what being non-governmental means. The requirement of being non-profit, as contained in the criterion, should be guaranteed already through the acceptable forms of environmental organisations. Thus, the CACP's criterion of being non-governmental should be primarily understood as being independent from the government. For example, the Environmental Investment Centre cannot be regarded as an environmental organisation as it is the vehicle via which the state finances environmental projects. The said centre is, in its form, a foundation which carries out administrative duties in accordance with its articles of association. The criterion of being non-governmental also does not allow treating local government associations as environmental organisations. Though the say of local governments in environmental matters affecting local life should be self-evident, in the broad sense, local governments form a part of the government. The Supreme Court has adopted the same position.^{*43} Unfortunately, the criterion of being non-governmental has not been worded the best in the CACP. Namely, §292 (2) of the CACP does not define an environmental organisation whose being non-governmental is one of its features but a 'non-governmental environmental organisation' which has a certain form and the promotion of environmental protection as its features.^{*44} Thus, if one were to read §292 (2) of the CACP literally, one could conclude that for the purposes of the CACP a non-governmental environmental organisation also includes organisations set up by the state for the fulfilment of administrative duties.

The third feature of an environmental organisation is that the goal of protecting the environment has been laid down in its articles of association and that in its activities the organisation promotes environmental protection. These requirements are cumulative. However, it appears from §292 (4) of the CACP that the recognition of an association as an environmental organisation does not necessarily require that the association has been previously active. According to the subsection, in assessing the promotion of environmental protection, the association's capability to implement its statutory goals must be considered in view of the association's activity to date; if there has been no activity, the organisational structure, number of members and the qualification criteria for membership as set out in the articles should be considered. In other words, for the purposes of the CACP, an association which has environmental protection as its statutory goal and which is capable of actually promoting its goal to protect the environment can be regarded as an environmental organisation. In assessing capability, the activity to date must be considered; if there has been no activity, capability should be assessed indirectly by exploring the association's organisational structure, number of members and statutory qualification criteria for membership.

The CACP does not define the notion of 'environment' and the exact scope of this notion cannot be found elsewhere in current law. The notion has not been defined in the GPECA albeit using it in a broad sense. Under §1 of the GPECA, the objective of the code is, *inter alia*, to promote sustainable development, protect biodiversity and reduce environment degradation as far as possible with a view to protecting the well-being and property and cultural heritage of people. Neither does the CACP fully define the notion of 'environmental protection'. Subsection 292 (3) of the CACP stipulates that the protection of environmental elements in the name of the health and well-being of people and the exploration and promotion of nature and natural heritage are *also* regarded as environmental protection. CACP does not specify what lies at the core of environmental protection. Based on the Explanatory Memorandum to the GPECA, nature conservation appears to be that core.^{*45}

The promotion of environmental protection is the key inherent requirement, as it is through promotion that it should be possible to ensure that only those associations which really desire, and are capable of, standing for public environmental interests are regarded as environmental organisations. However, the fact that under the CACP environmental protection need not be the main goal of an organisation may pose problems. Lack of such clarification allows arguments that those associations whose main goal may compete

⁴³ *Ibid.*

⁴⁴ Subsection 292 (2) of the CACP sets out: "For the purposes of this Code, a non-governmental organisations means:

- 1) a non-profit association and a foundation whose statutory goals is environmental protection and who promotes environmental protection in its activity;
- 2) an association which is not a legal person who, subject to a written agreement of its members, promotes environmental protection and represents the views of a significant part of local population."

⁴⁵ Pursuant to the Explanatory Memorandum to the draft GPECA, the protection of the natural environment is primarily understood as the promotion of environmental protection. See Explanatory Memorandum to the CPECA (Note 31), p. 34.

with the public environmental interest should also be treated as environmental organisations. This, in turn, causes the question whether the public environmental interest is really at the heart of a complaint of an organisation. For instance, the primary goal of a non profit association of undertakings of certain industry is to promote the (business) interests of their members but such organisation may also have promotion of environmental protection as an ancillary goal. I am convinced that such associations cannot be regarded as environmental organisations; however, one must concede that the CACP does not provide for a clear basis to preclude such associations from the definition of an environmental organisation.

3.2. The criteria of concern in the CACP

The requirement of concern has been provided for broadly. Pursuant to §292 (1) of the CACP, it is presumed that where a non-governmental organisation disputes an administrative act established or an action performed in the area of environmental protection, such organisation either has justified interest or its rights have been violated if the disputed administrative act or action is linked to the environmental goals of the organisation or to its area of activity in environmental protection to date. The code does not specify how narrowly a goal or an area of activity should be delimited in order to give rise to concern. Given that an organisation can change its statutory goals and area of activity at discretion, a requirement of exact coincidence would probably be excessive. Although the code does not require concern with the geographical area of activity, this requirement is applicable, to a certain extent, to an association which is not a legal person where the precondition to the recognition is that it represents the views of a significant part of local population. Given the smallness of Estonia, a requirement of geographical concern would not obviously be justified.

4. Conclusions

This article aimed to clarify which are those conditions an organisation must meet in order to be regarded as an environmental organisation for the purposes of the Aarhus convention, directives and Estonian law. It arises from the convention and the directives that in certain issues, the special standing of non-governmental organisations which promote environmental protection must be accepted. Promotion of environmental protection covers both the protection of environmental elements to ensure the health and well-being of people as well as nature conservation. Neither the convention nor the directives require automatic presumption that any environmental organisation is concerned with any environmental matter—the Member States are free to decide on the details of concern. At the same time, Member States are required to acknowledge the special role of environmental organisations in environmental protection. Such requirements of concern in national law which do not allow environmental organisations to fulfil this role are not permitted. The provisions preclude, *inter alia*, the interpretation as if an environmental organisation cannot be concerned with a concrete case because the general criterion of standing in national law principally excludes an environmental organisation having concern in such issues.

The definition of an environmental organisation in §292 of the CACP is broad. Such formal criteria as a minimum number or minimum period of activity have been avoided. The Estonian definition includes three inherent criteria applicable to environmental organisations: being non-governmental, obligation to operate in the form of a non-profit organisation, foundation or an association which is not a legal person, and the promotion of environmental protection. In addition, associations which are not legal persons must represent the views of a significant part of the local population. The latter requirement points to the fact that the recognition of an association which is not a legal person is intended primarily to simplify the protection of the shared environmental interests of the local population. Of the conditions mentioned above, the promotion of environmental protection is the key inherent requirement as it is through promotion that it should be possible to ensure that only those associations which really desire, and are capable of, standing for public environmental interests are regarded as environmental organisations. For the purposes of the CACP, environmental protection mostly covers nature conservation, but also the protection of environmental elements with a view to protecting the health and well-being of people as well as the exploration and promotion of nature and natural heritage. Under the CACP, in evaluating the promotion of environmental protection, the

association's ability to implement its statutory goals must be considered in view of the association's activity to date; if there has been no activity, the organisational structure, number of members and the qualification criteria for membership as set out in the articles should be considered.

The inherent conditions applicable to an Estonian environmental organisation are in keeping with the objectives of the convention and with two concrete criteria, i.e., those of being non-governmental and the promotion of environmental protection. However, it is questionable whether the solution according to which environmental protection needs to be just one and not the main goal of an organisation completely matches the spirit of the convention. Lack of such clarification allows arguments that those associations whose main goal may compete with the public environmental interest should also be treated as environmental organisations.

Under Estonian law, it is presumed that where a non-governmental organisation disputes an administrative act established or an action performed in the area of environmental protection, such an organisation either has justified interest or its rights have been violated if the disputed administrative act or action is linked to the environmental goals of the organisation or to its activity in environmental protection to date. Such a definition of concern matches the spirit of the convention and the directives.



Hannes Veinla

*Docent of Environmental Law
University of Tartu*

Problems in Transposing the European Union's Nature Conservation Directives into Estonian Law and Plans for Solving Them

1. The problem

This is a very exciting and eventful time for Estonian environmental law. The codification of environmental law that was started in 2007¹ is being continued with a final aim of establishing the Environmental Code. On 16 February of this year, the Riigikogu adopted the General Part of the Environmental Code Act² (hereinafter referred to as the GPECA), which sets forth the fundamental concepts of environmental law, the principles of environmental protection, the main environmental obligations, environmental rights, and the procedure for the new integrated environmental permit. However, the GPECA is still just the first step in codification of environmental law. In December 2010, the Environmental Law Codification Working Group, which the author of this article heads, presented the first version of the voluminous draft (with more than 1,100 sections) of the Special Part of the Environmental Code (hereinafter referred to as the SPEC) to the Minister of Justice. This was then presented to various ministries and the most important interest groups³ by the time this article was written. In addition, what is known as the (extended) Draft General Part of the Environmental Code Act⁴ has been prepared, containing regulation of environmental impact assessments, environmental monitoring, environmental supervision, and environmental liability. Work on these two drafts is what has given the author inspiration for writing this article.

¹ See H. Veinla. Basic Structures of the Draft General Part of Environmental Code Act. – *Juridica International* 2010 (XVII), pp. 128–129.

² Keskkonnaseadustiku üldosa seadus. – RT I, 28.2.2011, 1 (in Estonian). The Act enters into force together with entry into force of the Special Part of the Environmental Code.

³ The Draft is available at <http://www.just.ee/orb.aw/class=file/action=preview/id=53099/Keskkonnaseadustiku+eriosa+seaduse+eel%F5u.pdf> (11.4.2011) (in Estonian).

⁴ I would like to clarify that passing of the Environmental Code in the Riigikogu takes place in different stages according to the plan. The first, General Part of Environmental Code Act, has already been passed, although this small general part has to be improved in the future with new chapters on the so-called horizontal areas of the environmental law (environmental impact assessment, monitoring, environmental liability, environmental supervision) that are applicable in all areas of environmental protection. These new chapters have been delayed so far because plenty of disputes are still inconclusive on these issues.

The objective of codification of the Special Part of the Environmental Code is to arrange the regulation of different areas of environmental protection and to co-ordinate it with the newly adopted General Part. From among the above-mentioned areas, this article covers nature protection—partly because the author was one of the main authors of the nature protection chapter of the SPEC. Many issues need to be resolved in codification of the nature conservation legislation. Given the limited space available, this article covers only some of the issues subject to debate in relation to the transposition and implementation of European Union nature conservation legislation in Estonia. It needs to be said that most of these problems are also being discussed in the other EU member states. For example, in 2006, a pan-European conference was held on this subject at the University of Krakow, in which the author of this article also participated and made a presentation.^{*5}

The article is based on the hypothesis that current law in Estonia is not sufficient for ensuring implementation of the EU nature conservation directives' objectives, and it highlights the possible solutions offered in the course of drawing up of the Draft SPEC. First, the article analyses the general impact of the EU's nature conservation legislation on the national nature conservation legislation, and whether the chosen method of transposition—integration of the EU's nature directives into the Estonian traditional nature conservation system—can be considered justified. It also brings out what kind of additional legal regulation would be necessary for ensuring the contribution expected from Estonia for establishment of the pan-European nature conservation network Natura 2000. After that, the analysis turns to what kind of additional legal regulation would be needed to ensure functioning of the Natura 2000 network in Estonia in a way that ensures reaching of the objective of the EU's nature conservation legislation—a favourable conservation situation for the relevant habitat types and species. This is done on the basis of the example of environmental impact assessment.

2. The current development of Estonia's nature conservation legislation and the impact of the European Union legislation

2.1. The development and principles of Estonia's nature conservation legislation

The legal regulation of Estonia's nature conservation has a long history. Already in 1297, King of Denmark Erik Menved had forbidden logging on three islands near Tallinn. Although it may be presumed that the actual purpose of this prohibition was more likely related to navigation, because islands covered in forests are good seamarks, it is nevertheless considered to be the first clearly dated nature conservation act in Estonia. Nature conservation in its classical form was born in the 19th century when academic circles started to highlight the aesthetic, ecological, and cultural values of exceptional natural objects and monuments, and the preserved pristine areas. Estonia followed likewise, with nature conservation coming about in the 19th century, primarily as a result of the natural sciences activity of the cultural circles of the Baltic Germans.^{*6} In 1935, the first Nature Conservation Act was passed—it was very progressive for the world of its time, since it organised protection of nature as a whole outside protected areas as well. In 1938, another Nature Conservation Act was passed—this one also expanded to tourism and home decoration. In 1957, the third Nature Conservation Act of Estonia was passed, on the basis of which numerous protected areas were established, many of them still in place. In 1990, the Law on Conservation of Nature was passed, but it was not restricted to nature conservation; it also regulated the general principles of environmental management. The Protected Natural Objects Act was passed in 1994.^{*7} The currently valid Nature Conservation Act^{*8}, adopted in 2004, is considered the sixth act to regulate nature conservation in the territory of Estonia. In

⁵ See Avosetta meeting 13/14 January 2006, Krakow. EC Nature Protection Law and its Implementation in the Member States. Available at <http://www.avosetta.org> (11.4.2011).

⁶ See Looduskaitse ajalugu (History of Nature Conservation). Available at <http://www.loodus.envir.ee/1page.html> (12.4.2011) (in Estonian).

⁷ Also see H. Veinla. Estonia. Naturschutzrecht im Ostseeraum. – Landesberichte. E. V. Heyen (Hrsg.). Baden-Baden 1998, pp. 127–128.

⁸ Looduskaitse seadus. – RT I 2004, 38, 258; RT I, 10.06.2011, 3 (in Estonian).

the context of this article, it must be emphasised that one of the reasons for development of the Nature Conservation Act as currently in force was the need to transpose the EU's nature conservation legislation.

Ever since the first Nature Conservation Act as passed in 1935, Estonian nature conservation legislation has been based on the same principles. These principles in general are as follows. In nature protection, preservation of as many forms of manifestation of biodiversity as possible in favourable conservation conditions must be ensured. In this case, biological diversity, or biodiversity, must be taken as variety on all levels, starting with genetic diversity and ending with the diversity of ecosystems. Natural capital and resources shall be treated as national wealth⁹, and legal regulation shall support the sustainable use of these resources to ensure their continuation to the next generations. The principle of nature conservation refers to not only passive conservation of natural resources but also positive activity for maintenance of nature and the landscape; contribution to natural processes; and, to a certain extent, restoration of the natural values that have perished or are disappearing. Nature is protected not only for its objective value but also to ensure nature-dependent well-being of humans. For this reason, nature-related cultural-historical, aesthetic, and recreation-related interests and values are also taken into consideration in conservation of nature.¹⁰

2.2. The impact of the European Union nature conservation legislation on the national legislation

Although European Union nature conservation legislation is easily adapted to the above-mentioned principles of Estonian traditional nature conservation legislation, becoming a member of the European Union has nevertheless presented some new challenges. One of the greatest problems for Estonia in implementation of the EU's environmental *acquis* probably is achieving the objectives of the EC's nature conservation directives.

A large number of natural values, species, and habitats that have already perished elsewhere in Europe have been preserved in Estonia. By virtue of that, we also have a relatively large network of Natura sites—especially in the coastal and marine areas and on islands.¹¹ On the Natura sites (but also outside them), highly significant limitations to economic activities resulting from the EC nature conservation directives and the relevant Estonian laws need to be taken into consideration.

Thus far, Estonian nature conservation legislation has been characterised by the main criteria for placing something under protection having been its endangerment; rarity; representativeness; or scientific, historical-cultural, or aesthetic value mainly from the standpoint of our own nature. The nature conservation legislation of the European Union, however, adds a pan-European dimension. The establishment of the pan-European Natura network is based on the principles stated in the preamble to the Nature Directive¹² (92/43/EC), according to which it is 'an essential objective of general interest pursued by the Community'. The protected areas that make up the network are 'sites of Community interest'. Hence, the EU's nature conservation legislation treats the Member States as guardians of the common natural heritage. Treating the environment as the common heritage of mankind is also a principle of modern international environmental law, resting on the fact that nature has no political boundaries.¹³

Accordingly, as a result of European Union legislation, the right to place certain natural values under protection in the Republic of Estonia will be replaced by an obligation to do so. The discretionary power of a Member State of the European Union in placing certain natural areas under protection is clearly limited. A Member State is obliged to place under protection all those areas that are suitable and necessary for place-

⁹ Section 5 of the valid Constitution is directly based on this principle.

¹⁰ See: Keskkonnaseadustiku eriosa seaduse eelnõu seletuskiri (the Explanatory Memorandum to the Draft of the Special Part of the Environmental Code), pp. 121–122. Available at <http://www.just.ee/orb.aw/class=file/action=preview/id=53100/Keskkonnaseadustiku+eriosa+seaduse+eelnu%F5u+seletuskiri.pdf> (12.4.2011) (in Estonian).

¹¹ According to the National Audit Office, approximately half of Estonia's shore belongs to the European Union Natura 2000 network of protected areas. Pärnu river is almost entirely a Natura 2000 network site. Approximately 20% of the shore and 45% of the water areas of Pepisi and Lämmijärve lakes belong to Natura 2000 network. See the National Audit Office's audit „Ehitustegevus rannal ja kaldal“ (Construction Activities on the Beach and Shore), p. 5. Available at <http://www.riigikontroll.ee/tabid/206/Audit/2013/Area/15/language/et-EE/Default.aspx#results> (20.7.2011) (in Estonian).

¹² Available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31992L0043:EN:HTML> (12.4.2011).

¹³ P. Sands. Principles of International Environmental Law. Frameworks, Standards and Implementation. Manchester University Press 1995, pp. 170–173.

ment under protection on the basis of the (ecological) criteria following from the Habitats Directive and the Birds Directive^{*14} (79/409/EC).^{*15} N. de Sadeleer has stated that placement of the areas of pan-European importance under protection in a Member State is not political but a clearly scientific decision that may be based only on ecological considerations stemming from the objective value of the natural objects.^{*16}

The above-mentioned change, supplementation of the national dimension of nature conservation with a pan-European one, also requires certain changes in legal regulation of placement of areas under protection but first, and foremost, change in the base criteria for the procedure, as well as the protection regime. As will become evident below, our current legislation has a number of shortcomings in this area and the need for additional regulation is obvious.

There are several possible methods for transposition of the nature conservation legislation of the European Union. One of the most important choices lies in whether we should try to fit the present implementation mechanism for the EU directives into the existing nature conservation system or to establish a parallel system of the natural objects protected by the EU legislation. Both of these methods are in use, in different Member States. However, the materials from the above-mentioned Krakow Conference reveal that the first method has been chosen in most of the countries in question. Only a few countries, among them the Czech Republic, Poland, and Italy^{*17}, use a different method, with a special type of protected area established for the Natura sites protected under EU law.

As for Estonia, the first method is used. There is no special type of protected area specified for the Natura sites. Special conservation areas are an exception in a way. In the Explanatory Memorandum to the Nature Conservation Act, it has been noted that the need for special conservation areas stems from the obligation to implement the Birds Directive and the Nature Directive, and that although a large proportion of our existing protected areas became Natura 2000 sites, these nevertheless did not include enough of the habitats the protection of which is now requested by the European Union. There is not always a need to establish a protected area to protect large sea areas, rivers and lakes, semi-natural grasslands, and other habitats, while it is still important to ensure preservation of the habitats in these areas—that is why special conservation areas were established.^{*18} The implementation of a new type of protected area—special conservation areas—in 2004 came about mainly because a very large number of areas were specified as Natura sites all at once, covering large territories. The protection procedure for a special conservation area is simpler than that for other protected areas, special conservation areas have no protection rules or protected zone, and the main method of ensuring the protection procedure is the special conservation area notice. Hence it must be assumed that establishment of special conservation areas is also largely conditioned by the need to reduce the administrative burden. However, in preparation of the Special Part of the Environmental Code, it was presumed that the current protection procedure may still not be sufficient for protection of the Natura sites. The rationale has mostly to do with environmental impact assessments of the activities performed in the special conservation area and with decisions based on such assessments. According to §33 (1) of the Nature Conservation Act, the possessor of an immovable located within the boundaries of a special conservation area shall submit notification to the administrator of the special conservation area if certain activities are planned. However, subsection 5 of the same section provides that the administrator of the special conservation area shall assess the compliance of the planned activities with the requirements stated in §32 of the Nature Conservation Act within one month after the date of submission of the notification. On the basis of this assessment, the administrator of the special conservation area shall approve the notice and allows the planned activities to commence unconditionally, set additional terms and conditions for the applicant that enable commencement of the planned activities if complied with, or forbid the work that endangers preservation of the species under protection or the favourable condition of the habitats for which the special conservation area was established. There are several problems in the current regulation, but I wish to point out the most important one: it is not possible to understand what kind of assessment is

¹⁴ Available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:1979:103:0001:0005:EN:HTML> (12.4.2011).

¹⁵ H. Veinla. The Influence of European Union Law on the Conservation of Estonian Biological Diversity – the Case of Natura 2000 Areas. – *Juridica International* 2009 (XVI), pp. 170–171.

¹⁶ N. de Sadeleer. Habitats Conservation in EC Law ± From Nature Sanctuaries to Ecological Networks. – *Yearbook of European Environmental Law* 2005 (5), p. 223.

¹⁷ See E. Kruzikova, J. Guth. Czech National Report; B. Iwanska, P. Czepiel. National Report Poland; M. Montini. Report on Italy. Available at <http://www.avosetta.org> (12.4.2011).

¹⁸ Available at http://www.riigikogu.ee/?op=emsplain&content_type=text/html&page=mgetdoc&itemid=040570018 (12.4.2011).

meant by the Nature Conservation Act and under what procedure it shall be carried out. If a special conservation area belongs to the Natura 2000 network, EU legislation provides that the so-called Natura assessment shall be carried out. It is also unclear when an activity should be banned; the Nature Conservation Act refers to threat to favourable conservation status, but this is very vague.

As an interim summary, it could be said that, in general, the method used for transposing the EU's nature conservation legislation—integration of the EU's nature conservation into the Estonian traditional nature conservation system—could be considered justified. Most of the other Member States have followed this route. Establishment of a special protection system for the Natura sites would have been associated with a significantly increased administrative burden. Nevertheless, the currently implemented method too still requires presence of large-scale additional regulation to ensure complete implementation of the EU's nature conservation legislation in Estonia.

3. Problems related to the national regulation of the Natura network and the solutions presented in the Draft SPEC

3.1. The composition of the Natura network in Estonia

The legislation in force covers definition of Natura sites in a very general manner in the Nature Conservation Act's §§69–70¹.

Section 69 of the Nature Conservation Act defines the areas the Natura 2000 network of the European Union consists of and specifies that it is formed of areas hosting birds of which Estonia has informed the European Commission pursuant to the Birds Directive and the areas that the Commission, pursuant to the Habitats Directive, considers to be of common European importance. In view of the judicial practice of the Court of Justice of the EU, mainly the case *Bund Naturschutz**¹⁹, such regulation is not sufficient. The problem concerns the areas defined pursuant to the Council directive on the conservation of natural habitats and of wild fauna and flora. According to the Court, protection of these areas must be ensured already before the Commission adds these to the list of areas of common European importance. In the *Bund Naturschutz* case, the EU court found that, regardless of the fact that the protection procedure pursuant to the Habitats Directive extends to areas only when added to the list of areas of common European importance on the basis of Article 4 (2) of the directive and approved by the European Commission (paragraphs 35–36), certain protection measures need to be implemented earlier. In addition, the Court explains in the *Draggagi* case*²⁰ (paragraph 39) that, in order to preserve the environmental characteristics of the so-called pre-selection areas offered for the Natura network, the Member States shall adopt appropriate measures also before these sites are added to the list of sites of Community interest. In the *Bund Naturschutz* case, answering the question of the German *Verwaltungsgerichtshof* as to whether the protection procedure that shall be applied (to pre-selection areas) results from Community law or, instead, the Member States have to ensure protection of the specified areas only via national protection measures (paragraph 26), the Court held that the details of the protection procedure to be applied belong under the national legal order of each Member State.

In order to take these cases into account in the Estonian legislation, a clause has been added to the regulation in the Draft SPEC for definition of the Natura network's composition, providing that the Natura network is also considered to include the sites the European Commission has never entered on the list of areas of Community interest but that have been presented to the European Commission for entry on said list and that are either placed under protection nationally or have had a procedure for coming under protection initiated. It should be stated that, although the Nature Conservation Act does not provide it, this is the practice applied today. With such an approach, Estonian law would also correspond to the relevant positions of the Court of Justice of the EU and ensure preservation of the natural values important for currently only potential union until a decision is made on the Natura sites.

¹⁹ Case C-244/05. Available at http://eur-lex.europa.eu/LexUriServ/site/en/oj/2006/c_281/c_28120061118en00160016.pdf (12.4.2011).

²⁰ Case C-117/03. Available at http://eur-lex.europa.eu/LexUriServ/site/en/oj/2005/c_057/c_05720050305en00070007.pdf (12.4.2011).

3.2. National regulation needed for establishment of the Natura network

Our current law remains short on words regarding the procedure for, and organisation of, establishment of the Natura network. Subsection 91 (6) of the Nature Conservation Act provides that the list of areas included in the Natura 2000 network to be submitted to the Commission shall be approved by an order of the Government of the Republic and the areas included in the Natura 2000 network shall be designated in adherence to the requirements set out in paragraphs 1 and 2 of Article 4 of the Birds Directive and paragraph 1 of Article 4 of the Habitats Directive. This regulation should probably be considered insufficient. In the Draft SPEC, somewhat more detailed regulation has been added concerning organisation of establishment of the Natura network. The draft provides that the areas shall still be presented to the European Commission for inclusion in the Natura 2000 network by order of the Government of the Republic, but it is specified that selection of the areas shall be organised by the Ministry of the Environment.

The applicable law provides that the authority competent to initiate proceedings for placement under protection shall arrange for expert assessment of the justification of placing the natural object under protection and the purposefulness of the planned restrictions (§8 (3) of the Nature Conservation Act). For example, in case 3-08-166 deliberated by the Tallinn Administrative Court, a question arose as to whether the inventory of Natura 2000 sites carried out before placement under protection may be equated to the above-mentioned expert assessment. A position has been taken in the Draft SPEC that, since the detailed criteria and conditions provided in the Birds Directive and the Habitats Directive, as well as their annexes (not in national legislation), shall be taken as a basis in determination of the Natura network sites, carrying out an expert procedure as provided for in §8 (3) of the Nature Conservation Act is not always necessary and if the compliance of the area with the ecological criteria under EU legislation is evident, application of expertise may be omitted.

According to the directive on the conservation of natural habitats and of wild fauna and flora, the formation of the Natura 2000 network and application of the protection regime provided in the directive to its sites takes place in stages. The nature of these stages and their national legal meaning have also remained unregulated in the law now in force. The stages of formation of the Natura network under the Habitats Directive are as follows:

- 1) Each Member State shall propose a list of sites indicating which natural habitat types in Annex I and which species in Annex II that are native to its territory the sites host (Article 4 (1)). In Estonia, this has been done by order of the Government of the Republic.^{*21}
- 2) The Commission shall establish, in agreement with each Member State, a draft list of sites of Community importance drawn from the Member States' lists (Article 4 (2)), carrying out a consultation procedure if necessary (Article 5).
- 3) As a result of entry on the list, paragraphs 2, 3, and 4 of Article 6 of the Habitats Directive (on taking measures for avoidance of deterioration of the natural and other habitats of species, as well as assessment of effects of the programmes and projects that have potential to affect these sites), shall immediately apply.
- 4) The Member States shall designate that site as a special area of conservation as soon as possible and within six years from entry of the site on the list of sites of Community interest (Article 4 (4)).^{*22}

Below, the legal problems related to the first; in passing, the second; and the fourth stage are discussed.

In practice (incl. in the above-mentioned Tallinn Administrative Court case), there have been problems as to the legal meaning of the list approved by order of the Government of the Republic and as to whether a site's inclusion on this list would create some kind of legal consequences for landowners. Actually, at least indirectly, an explanation responding to this problem has been given in the case *Markku Sahlstedt and Others*^{*23}, in which the Court of Justice of the EU noted that approval of the list of sites of Community importance does not affect the landowners of these sites personally or in a special way, since the sites have been selected under the ecological criteria and the list is in no way aimed at causing direct legal consequences for specific landowners (paragraphs 20 and 24). It may be concluded all the more clearly that no legal consequences can be brought about by the list of sites that have been presented by the Member State for inclusion on this European-Commission-approved list.

²¹ The first of such orders was No. 615-k, Proposed Natura 2000 Sites in Estonia, 5.8.2004.

²² In Estonia, this deadline is at the end of 2013.

²³ Case C-362/06. Available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2009:141:0002:0002:EN:PDF> (12.4.2011).

Compiling the list of sites to be presented for the Natura 2000 network and informing the European Commission of it could be viewed as an establishing and informing activity from the legal point of view, necessary for fulfilment of the obligations under the Habitats Directive. When a country has plenty of room for decision-making in the procedure for placing an area under national protection (proceeding from the fact that the prerequisites for placement under protection have been set forth very generally in the Nature Conservation Act), then in selection of the Natura 2000 network sites, the specific criteria provided in the Habitats Directive shall be taken as a basis and the Member State has little option for not including the sites that fulfil the criteria (only the ecological criteria may be applied as a basis in selection of the sites). It can be concluded from here that by presenting the Natura 2000 site list, the country only meets its obligation under the Habitats Directive to establish the sites needing protection and conforming to the criteria in the directive, and to present these to the commission. Compilation of the national list of sites is only the first preparatory stage for final approval of the list of Natura sites. According to the Habitats Directive, this list will be compiled as an outcome of dialogue between the Commission and the Member States. The purpose of presenting national lists is to ensure that the Commission has an exhaustive list of all sites that could be included in the Natura network. The objective of the Habitats Directive is to ensure protection of species and habitats not by the Member States but with regard to their natural habitat, which often extends into the territory of several Member States (Article 3 (1)). The purpose of the directive is not conservation of nature but conservation of one part of it, that which forms the common heritage of the European nations—the sites of Community interest. Since no Member State has sufficient information on the situation of species and habitat types in the other Member States, all must include in the national list all sites that may have relevance in establishment of the Natura network. Therefore, the national lists are only, as it were, the raw material from which the sites relevant for the purposes of the directive—ensuring a favourable situation of habitat types and species in the European Union (*FirstCorporateShipping*, paragraphs 22 and 23)*²⁴—will be selected. This is repeated by the Court in the *Bund Naturschutz* case (paragraph 39), referred to above. The Commission is assisted in compiling the final list on the basis of the national lists by a committee formed under Article 20 of the Habitats Directive and the so-called biological seminars organised by it.

The fact that the Commission lays down the list of sites of Community interest on the basis of the list provided by the country therefore has no influence on the rights of individuals (i.e., registered immovable owners). Laying down of the list of sites of Community interest places new obligations on the country—to ensure protection of the sites on the list. In order to ensure such protection, a procedure for placing a site under national protection shall be initiated. The procedure is open to all interested parties who can protect their rights thereby.

The fourth stage of establishment of the Nature network—definition of special areas of conservation—is not regulated at all in the valid law of Estonia. That is why the Draft SPEC includes completely new provisions that regulate definition of specially protected areas.^{*25} The need for such regulation results from Article 4 (4) of the Habitats Directive, stating that the Member States shall declare the sites as special areas of conservation as soon as possible and within six years at most. In Estonia, this would mean that the currently protected areas would simply be renamed as special areas of conservation and no change would follow for the landowners. This is take-up of the Habitats Directive's terminology. However, not all sites in the Natura network are associated with this obligation, only those sites established on the basis of the Habitats Directive that are added to the list of sites of Community interest approved by the Commission. Article 4 (4) of the Habitats Directive provides that '[f]or special areas of conservation, Member States shall establish the necessary conservation measures involving, if need be, appropriate management plans specifically designed for the sites or integrated into other development plans, and appropriate statutory, administrative or contractual measures which correspond to the ecological requirements of the natural habitat types in Annex I and the species in Annex II present on the sites'. In determination of the protection regime, the Estonian nature conservation system is mainly based on legal instruments provided for in the protection rules for the sites. The importance of other instruments—administrative and contractual—is marginal. As stated above, a considerable number of the Natura sites in Estonia have the status of special conservation areas. However, there are no protection rules for these areas. There is concern that the main protection instrument for a special conservation area—notice of a special conservation area—may still not be sufficient for meeting of

²⁴ Case C-371/98. Available at <http://europa.eu.int/eur-lex/lex/LexUriServ/LexUriServ.do?uri=CELEX:61998JO371:EN:HTML> (12.4.2011).

²⁵ Subsection 2 (3) of the Nature Conservation Chapter of the SPEC Draft.

the obligations under the EU legislation and ensuring that all activities that may have an unfavourable effect on the environmental characteristics of the area are excluded.

The draft provides that management plans shall be established concerning all special conservation areas belonging to the Natura network; the valid law does not provide the management plans, but these are necessary for fulfilment of the requirements of Article 4 (4) of the Habitats Directive. A management plan is a basis for planning the activities necessary for organising protection, allocating resources, and implementing the activities. According to the Draft SPEC, the management plan is a piece of legislation with a non-administrative effect and that is why its drafting must take place in open proceedings. According to the draft, areas are declared special areas of conservation under a protection rule when these are protected areas or permanent habitats, and by a management plan in the case of special conservation areas. One of the most important objectives of declaring an area to be a special area of conservation is unambiguous and legally binding emphasis that, although these are natural objects under protection and belonging to the Estonian national system, the special features of their protection procedures derive from the European Union legislation. The other main purpose for defining special areas of conservation is the clear and detailed highlighting of the protection objectives of the areas and the aspects (activities) endangering them. After all, the cornerstone of the protection of Natura sites is the protection objectives of the area, since, as a general rule, all activities that can have a significant unfavourable effect in view of this objective are forbidden.^{*26} The valid legislation (protection rules of the areas^{*27}) covers definition of the protection objectives in a very general way (only the habitat types and species under protection are listed), and there is no obligation to specify the aspects (activities) that endanger the area. These shortcomings of the valid law have also been highlighted and admitted by the Ministry of the Environment.

4. Problems related to ensuring the protection procedure for Natura network sites and their possible solutions

4.1. The need for regulating the peculiarities of environmental impact assessment for activities that could affect Natura sites

The protection procedure for the Natura sites is ensured by different legal measures, but at the centre of these is a requirement for environmental impact assessment for those activities that could affect the area (the so-called Natura assessment requirement). This procedure is regulated by the above-mentioned (extended) Draft General Part of the Environmental Code Act (hereinafter referred to as the extended draft of the GPECA). Although this draft was prepared by the working group a full two years ago, it has still not been discussed more widely, and, therefore, the following solutions can only be seen as legal-political ideas, not as materialised regulations.^{*28} Hence, the references to the solutions offered in the draft shall also be considered conditional. The objective of this part of the draft is to reflect the EU legislation and the peculiarities of the Natura assessment more clearly in comparison to the other types of environmental assessment that the valid Estonian law does not cover with sufficient precision. In Estonia, attempts have been made to integrate Natura assessment with the regular EU Directive on Environmental Impact Assessment^{*29} (85/337/EC). N. de Sadeleer finds such a method unacceptable since the enforcement area for assessment in accordance with Directive 85/337/EC is limited with the listing of projects in the annexes of the Directive, but the Natura assessment involves practically all activities that may have an impact on the site.^{*30} There is reason to agree with this opinion, but it must be added that there are several other notable

²⁶ See: Keskkonnaseadustiku eriosa seaduse eelnõu seletuskiri (Explanatory Memorandum to the Draft of the Special Part of the Environmental Code), p. 122. Available at <http://www.just.ee/orb.aw/class=file/action=preview/id=53100/Keskkonnaseadustiku+eriosa+seaduse+eeln%F5u+seletuskiri.pdf> (12.4.2011) (in Estonian).

²⁷ I.e., see Government of the Republic Regulation No. 240. Protection Rules for Anne Nature Reserve (Anne looduskaitseala kaitse-eeskiri), adopted on 15.9.2005. – RT I 2005, 51, 407 (in Estonian); No. 97 Protection Rules for Kõpu Nature Reserve (Kõpu looduskaitseala kaitse-eeskiri), adopted on 30.3.2007. – RT I 2007, 29, 169 (in Estonian).

²⁸ The Draft is currently not available to public as well.

²⁹ Available at <http://eur-lex.europa.eu/LexUriServ/site/et/consleg/1985/L/01985L0337-20030625-et.pdf> (12.4.2011).

³⁰ N. de Sadeleer. Habitats Conservation in EC Law—From Nature Sanctuaries to Ecological Networks. – Yearbook of European Environmental Law 2005 (5), p. 245.

peculiarities in the Natura assessment. These have been expressed the most clearly in the so-called *Waddenzee* case^{*31}, and the law applicable in Estonia does not reflect them sufficiently. To be more precise, the law in effect in Estonia does not bring about distinctness for Natura assessment at all, although, as will become clear below, it is evident.

4.2. The enforcement area for Natura assessment

The extended draft of the GPECA takes into consideration the EU court cases *Draggagi* and *Bund Naturschutz*, in which the Court has established that, even with the areas presented to the European Commission and entered in the national list (so-called pre-selection areas), the appropriate protection procedure requires that the Member States not approve activities that could significantly damage the environmental characteristics of these areas. Therefore, the Member States must ensure that the condition of these areas does not deteriorate before the final list of Natura sites is published. The working group who prepared this draft found that this objective set by the EU court can be reached only through implementation of the Natura assessment obligation in the pre-selection areas—that is, in areas that have been presented to the Commission but have not been entered on the list of areas of Community interest yet.

Article 6 (3) of the Habitats Directive provides that any plan or project likely to have a significant effect on the site shall be subject to appropriate assessment. This means that those projects and plans that do not need permission or any other form of approval by the administrative authority for their implementation should also be assessed. According to the extended draft of the GPECA, however, a Natura assessment should be made only if permission is needed for implementation of the project—an environmental protection permit, a building permit, or some other activity licence. Apparently, it may be violation of the EU legislation if the Natura assessment were to be linked only to activities that need permission, but, on the other hand, in Estonian conditions, it is not possible to imagine a working mechanism for the use of different assessments for controlling the activities that do not require any permission—it is simply not practicable. No such mechanism has been found in the other Member States either.

4.3. The initiation, scope, and binding nature of the Natura assessment

The first peculiarity of Natura assessment is related to its initiation. An environmental impact assessment in accordance with Directive 85/337/EEC will be initiated only if the planned activity will presumably have a significant environmental effect; the same applies to strategic environmental assessment. However, the EU court found in the *Waddenzee* case that, for the projects or plans indicated in Article 6 (3) of the Habitats Directive, the potential significant effect on the area should always be taken into consideration and, thus, the effect of all these projects and plans should be assessed. An assessment may be left uninitiated for only those plans and projects whose significant effect has been reasonably excluded. A solution has been offered in the extended draft of the GPECA on the basis of this, providing that if a significant environmental disturbance on a Natura 2000 network site has not been reasonably excluded, the originator of the plan or the decision-maker shall initiate assessment of its effect on the Natura 2000 network site.^{*32}

The other peculiarity of the Natura assessment is that it is more purposeful and definite, since the Natura assessment concentrates more on the protection objective and integrity of the Natura site, whereas all other environmental impact assessments measure the total effect of the project on the environment as a whole. It is also important that if, in the case of assessment in accordance with Directive 85/337/EEC, the actual alternatives need to be taken into consideration, allowing a project that has a significant negative effect on a Natura 2000 network site requires the complete lack of alternatives as an important precondition, regardless of whether the alternative is reasonable from the point of view of the performer or not.^{*33}

³¹ Case C-127/02. Available at http://eur-lex.europa.eu/LexUriServ/site/en/oj/2004/c_262/c_26220041023en00020002.pdf (12.4.2011).

³² Also see J. Jans. European Environmental Law. Europa Law Publishing 2008, pp. 460–461.

³³ See Managing Natura 2000 sites. The Provisions of Article 6 of the Habitats Directive. European Commission 2000, p. 43. Available at http://ec.europa.eu/environment/nature/natura2000/management/docs/art6/provision_of_art6_en.pdf (12.4.2011).

Since Natura assessment is aimed at a sufficiently specific objective (that of making sure whether the planned activity may have a significant negative effect on the integrity of the site), the requirement for performance of a full assessment that completely conforms with the requirements of Directive 85/337/EEC, if the obligation to assess the impact arises only because of the need for Natura assessment, would be disproportionately burdensome for the applicant. For that reason, a simplified assessment procedure has been proposed in the extended draft of the GPECA. The working group holds that, given the very low threshold for initiation of a Natura assessment, as well as the expected large number of assessments, this is the only possible solution. Preserving such a full-scale open procedure in all events of assessment would be clearly too burdensome and would unnecessarily hinder the projects that do not have a negative effect on Natura sites. In the course of simplified proceedings of Natura assessment, a full-scale open proceeding shall not be carried out in combination with a public presentation and discussion, as in the procedure under Directive 85/337/EEC. According to the draft, an expert shall reply in his or her report to the questions asked of him or her and give a clear answer as to significant effect in view of the protection objective: is integrity of the site possible, or is it reasonably excluded? Natura assessment may require highly specific knowledge of species and habitats, and that is why the draft provides that the assessment may be done by an expert who may be a natural person with many years of experience in studying the species or the habitat under protection and who has given trustworthy assessments of the protection of this species or habitat type.

Whether a plan or project may be allowed is also regulated more precisely in the draft than in the currently valid legislation. Again, the draft is based on the EU legislation. The EU court found in the *Waddenzee* case that a project or plan with potential effect on a Natura site may be allowed if the competent authorities of the Member State have made sure that the plan or project has no negative effect on the site. The Court holds that this is so if there is no scientifically reasonable doubt as to whether a negative effect on the integrity of the site is excluded. Consequently, if reasonable doubt as to the possibility of a negative effect remains after the assessment, the competent authorities have no right to allow the plan or project to continue. Hence, unlike in the assessment under Directive 85/337/EEC, in which the result of the assessment is not binding for the decision-maker, the result of the Natura assessment is binding on the decision-makers (the granter of permission or approver of the plan).

4.4. Making exceptions

In what exceptional cases potentially negative projects may be allowed is regulated by Article 6 (4) of the Habitats Directive. Projects with a potential negative effect may be allowed when three preconditions have been fulfilled. The first of these is the lack of alternatives. The second precondition is that implementation of the plan or project is determined by some superior and imperative public interest. The third condition is taking of compensation measures. If all of the above conditions have been met, a plan or project with a negative effect on the site may be allowed. As to making of exceptions, the valid Estonian legislation is in accordance with the EU legislation and the draft will preserve its contents, proposing only some formal changes.

5. Conclusions

This article was based on the hypothesis that the current law in Estonia is not sufficient for ensuring implementation of the EU nature conservation directives' objectives. This hypothesis proved correct: the analysis revealed that, although the method of transposing the EU nature conservation legislation and its integration into Estonia's traditional nature conservation system may be considered successful in general, the valid Estonian law still lacks numerous provisions that should regulate establishment of the Natura network and its various stages and proceedings. Also, what kinds of areas form the national part of the pan-European Natura network must be specified. At the moment, there is no regulation of the fourth stage of establishment of the Natura network, the definition and status of special areas of conservation. Estonian legislation also does not take into consideration the differences in the so-called Natura assessment, mostly arising from the practice of the EU court. In summary, it is safe to say that there are problems in Estonia as to transposition of the EU nature conservation legislation. Solutions to these are being sought in the course of codification of Estonian environmental law; some possible solutions for the most burning issues were also proposed in this article.



Anu Kõve

Lawyer, Financial Supervision Authority

Current and Savings Deposits in Conventional and Islamic Retail Banking in the EU

1. Introduction

In recent decades, the 15,000,000 Muslims in the European Union have become more and more interested in managing their finances by using financial services that are in conformity with Sharia—Islamic law. Today there are more than 350 Islamic financial institutions, all over the world, in some 75 countries^{*1}, and the turnover of Islamic financial services has been estimated as increasing some 10–15%^{*2} or even 20% a year.^{*3} We can conclude from the numbers that the development of Islamic financial services deserves every attention, in view of, *inter alia*, the possibility that Islamic financial services may soon be available in Estonia (e.g., by means of exercise of the freedom of establishment and the freedom to provide services within the framework of EU rules for financial services).

This article's aim is to compare the essence of current and savings accounts in conventional banks, of which some Estonian credit institutions are taken as examples, and Islamic banks, in which connection the services provided by the Islamic Bank of Britain have been studied. Although the comparison here may sometimes indicate that the differences between the services provided by conventional and Islamic banking differ in their details but not in their principles, it is essential to keep in mind the very basic principles of Islamic banking as well as the Islamic moral economy as a whole. The Quran prohibits interest (*riba*)^{*4} as usury, which is condemned.^{*5} As a consequence of condemning interest, the Islamic moral economy also prohibits a fixed return generated by interest. Therefore, capital cannot gain any fixed return by itself without any risks being borne. *Vice versa*, according to the Islamic moral economy, capital can increase by means of economic activity and participation in the real economy rather than in the financial industry only. The Islamic moral economy involves the position that money does not have any inherent value and that it is important that the resources, real activity, and risk-bearing are involved in any generation of any new resources. Thus, the principle of profit- and loss-sharing between the parties, the participatory nature of

¹ M. El Qorchi. Islamic Finance Gears Up. – International Monetary Fund Finance & Development December 2005 (42) 4. Available at <http://www.imf.org/external/pubs/ft/fandd/2005/12/qorchi.htm> (31.3.2010).

² FSA encourages growth of Islamic finance in the UK, 28 November 2007. Available at <http://www.fsa.gov.uk/pages/Library/Communication/PR/2007/121.shtml> (31.3.2010).

³ T. Wülfing. Rechtliche Aspekte des islamischen Bankwesens & Scharia-konformer Investments, p. 4. Available at http://www.competence-site.de/downloads/od/2b/i_file_43534/Vorlesung_Islamic_Banking-Skript_deutsch.pdf (31.3.2010).

⁴ رِبَا, “riba”, interest, usurious interest, usury: H. Wehr. A Dictionary of Modern Written Arabic. J. Milton Cowan (ed.). 4th ed. Considerably enl. and amended by the author. Spoken Language Services, Inc., Urbana, IL, US 1994, p. 375.

⁵ Quran, Suura 2:275.

economic and business activities, is the crucial element of Islamic financial instruments, which are aimed, *inter alia*, at avoiding concentration of the wealth in the hands of a small circle of persons and *expressis verbis* prohibiting enrichment by means of anything that is prohibited in Islam (alcohol, gambling, pork, etc.). Hence, although the religion prohibits interest, trading is allowed (the prophet Mohammed was a merchant himself) and profit as a return from business activities is allowed. The structures of partnerships in the Islamic financial structures provide that if a joint venture is successful, everybody involved will be entitled to a share in the profit, according to the pre-agreed ratio. At the same time, where a joint venture is not successful, both parties bear the loss. Thus the differences between profit and (forbidden) interest can be depicted as follows^{*6}:

Interest	Profit
return on capital	return on a project
interest guaranteed	risk of loss involved
fixed return	variable return
return on deposit	return on joint ventures

The background of Islamic financial services dates back to the times of Mohammed. However, they consider that some Islamic financial services (e.g., *murabaha*^{*7}—a transaction whereby an item will be resold and there will be added to the price a share from the profit as agreed beforehand as well as a fee for the service—and *musharaka*^{*8}, flexible partnership, wherein all parties contribute capital for financing a project and share the profit as agreed beforehand, with any loss to be covered by all of the partners in proportion to the capital they contributed to the project^{*9}) date back to pre-Islamic times.

Although it was in the 1920s when the early Islamic banking services began to provide pilgrims from Dutch Indonesia with money exchange services in Jeddah^{*10}, the development of modern Islamic banking services and of providers of such services has been connected mainly with the increase in use of oil products in the latter part of the 20th century.^{*11} It was in 2004 when the first Islamic bank—the Islamic Bank of Britain—was licensed in the EU, in the United Kingdom. The above distinction between interest and profit within the concept of a deposit was an essential factor for prolonging the licensing procedure to nearly 24 months—much longer than was usual for licensing procedures^{*12} and almost twice as long as is set forth for the licensing period in EU Directive 2000/12 on the establishment and pursuit of banking activities (up to 12 months).^{*13} Pursuant to the principle of sharing profit as well as loss, it is quite acceptable that a depositor of an Islamic deposit will not get the deposited money back to the full extent, since an Islamic deposit is composed of the money contributed by one party and the business management of the other party. Thus the returns from the deposit will be shared between the depositor of the money and the party who provided the business management of the deposited resources. On the other hand, if the business management is not successful and there is no profit, the loss would be borne by the contributor of the capital—the depositor—and the bank will lose the resources (of know-how and administration costs) it invested in the management of the deposit. The UK Financial Services Authority did not accept such a concept for a deposit, and in the course of its licensing procedure, the Islamic Bank of Britain agreed to the concept of a deposit entitling the depositor to a full refund of the deposit. However, the Islamic Bank of Britain's deposit contract accommodates both the EU requirements for deposits and the Sharia-compliant provisions. The term added by the

⁶ M. Asutay. Islamic Banking and Finance and Its Role in the GCC-EU Relationship: Principles, Developments and the Bridge Role of Islamic Finance. Gulf Research Centre 2010, p. 7.

⁷ مرابحة, "murabaha", resale with the specification of gain, resale with advance (Isl. Law): H. Wehr. A Dictionary of Modern Written Arabic. J. Milton Cowan (ed.). 4th ed. Considerably enl. and amended by the author. Spoken Language Services, Inc., Urbana, IL, US 1994, p. 371.

⁸ مشاركة, "musharaka", partnership, participation, co-operation: H. Wehr. A Dictionary of Modern Written Arabic. J. Milton Cowan (ed.). 4th ed. Edition Considerably enl. and amended by the author. Spoken Language Services, Inc., Urbana, IL, US 1994, p. 548.

⁹ Bank of London and Middle East, glossary. Available at <http://www.blme.com/glossary.php#letterm> (31.3.2010).

¹⁰ R. Wilson. Islamic Finance in Europe. RSCAS Policy Papers 2004/02 MUSMINE – Muslim Minorities in Europe. European University Institute, Florence, Robert Schuman Centre for Advanced Studies Policy Papers 2007/02, p. 2.

¹¹ M. Lewis, L. M. Algaoud. Islamic Banking. MPG Books Ltd, Bodmin Cornwall 2001, p. 4, 11–12.

¹² Islamic Finance in the UK: Regulation and Challenges, November 2007, p. 14.

¹³ Directive 2000/12/EC of the European Parliament and of the Council of 20 March 2000 relating to the taking up and pursuit of the business of credit institutions, Article 10. – OJ L 126, 25.6.2000, p. 1.

Islamic Bank of Britain does not prevent providers of Islamic banking services from complying with their obligation under EU directives^{*14} to take part in a deposit guarantee scheme.

This paper will deal with some characteristic features of Islamic banking services, examining current and savings accounts in comparison with similar services in conventional banking. The article does not claim to be an exhaustive analysis of the issues; attention has been paid first and foremost to the issues that deserve to be addressed in a situation where Islamic banking is still a relatively unfamiliar phenomenon but at the same time has undergone essential developments in recent years.

2. The practice for interest in current and savings accounts in conventional (Estonian) retail banking versus the counterparts of interest in Islamic retail banking

Since the ban on interest is one of the main characteristic features among the principles of Islamic finance, it is proper to explore what opportunities exist for Islamic depositors to gain revenues from their deposits. The basic banking services in conventional banks are current account and term deposits, whereby the depositor is entitled to receive interest. In the Islamic banking system, one can define three basic types of deposit accounts: current accounts (*Amanah*^{*15} accounts), savings accounts, and investment accounts.^{*16}

Current account are used mainly for daily needs. The resources on such accounts will be payable on demand, whereby neither interest nor profit may be paid on them in Islamic banking. The money deposited in the bank by the client will be regarded as a benevolent loan, *al-qard al hasan*^{*17}, with the account-holder being a lender and the bank being a borrower and distributor of the resources. The term *al-qard al-hasan* refers to a beneficial, benevolent, or gratuitous loan^{*18}, whereby the lender will not be entitled to more than was initially given. AAOIFI^{*19} Sharia Standard No. 19, 'Qard' (Loan), describes *qard* as a transfer of ownership in fungible wealth to a person who will be obliged to return wealth similar to the original. It is strictly forbidden to agree upon anything in addition to the return of the original loan: AAOIFI states that the stipulation of an excess for the lender is prohibited and it is considered to be *riba* regardless of whether the excess be in terms of quality or quantity or whether the excess be a tangible asset or a benefit, whether the excess were stipulated upon the conclusion of the contract, or whether the stipulation were in writing or part of customary practice.^{*20}

It is possible for some banks even to apply charges for current account service; however, others do not, provided that a minimum balance will be maintained on the account.^{*21} In the above-mentioned oldest Islamic bank in the EU, the Islamic Bank of Britain^{*22}, waiver of the fee will be applicable if the average balance of the current account was at least £1,500 for the previous month or the total average balance across all savings accounts was more than £5,000 for the previous month. In the event that the resources on the account(s) have remained below the above-mentioned thresholds, there will be applicable a fee of £2 per

¹⁴ Directive 2009/14/EC of the European Parliament and of the Council of 11 March 2009 amending Directive 94/19/EC on deposit-guarantee schemes as regards the coverage level and the payout delay. – OJ L 68, 13.3.2009, pp. 3–7.

¹⁵ أمانة, "amana", deposition in trust: H. Wehr. A Dictionary of Modern Written Arabic. J. Milton Cowan (ed.). 4th ed. Considerably enl. and amended by the author. Spoken Language Services, Inc., Urbana, IL, US 1994, p. 36.

¹⁶ S. Tamer. The Islamic Financial System. A Critical Analysis and Suggestions for Improving its Efficiency. – European University Studies. Series V. Economics and Management. Peter Lang Europäischer Verlag der Wissenschaften, p. 75.

¹⁷ قرض حسن, "qard hasan", interest-free loan with unstipulated due date: H. Wehr. A Dictionary of Modern Written Arabic. J. Milton Cowan (ed.). 4th ed. Considerably enl. and amended by the author. Spoken Language Services, Inc., Urbana, IL, US 1994, p. 886.

¹⁸ S. Atan. The Concept of Al-Qard Ul-Hasan, p. 1. Available at <http://www.scribd.com/doc/22013726/Qard-Hassan> (9.8.2011).

¹⁹ Accounting and Auditing Organization for Islamic Financial Institutions. Available at www.aoofi.org (16.8.2011).

²⁰ AAOIFI, Shari'a Standard No. 19 Qard (Loan) adopted by Shari'a Board on 15–19 May 2004.

²¹ S. Tamer. The Islamic Financial System. A Critical Analysis and Suggestions for Improving its Efficiency. – European University Studies. Europäische Hochschulschriften. Series V. Economics and Management. Peter Lang Europäischer Verlag der Wissenschaften 2003, p. 75.

²² Hereinafter the mostly the Islamic Bank of Britain is referred to, the only full Islamic bank in the UK providing retail banking services.

visit (i.e., for using the services of a branch counter, for services such as depositing cash or cheques, making withdrawals of cash, or transferring money to another account—within the Islamic Bank of Britain or some other bank). However, the client will be charged for no more than one visit per day: any further visits on the same day will be free, and there will be no limit to the number of transactions one may perform at the branch counter in any visit. When one further compares the price lists of the Islamic bank and Estonian credit institutions, it is worth mentioning that cash-machine withdrawals from Islamic Bank of Britain and other UK cash machines are free of charge (unless extra charges are applicable for withdrawals via some cash machines, with prior notification), while most Estonian credit institutions apply fees for cash withdrawals with debit cards from the cash machines of other credit institutions.^{*23} Estonian credit institutions also pay interest on the resources on current accounts, but the banks providing Islamic current account services state *expressis verbis* that no credit or debit interest will be paid for such an account.^{*24}

The resources that remain after daily activities can be deposited on savings accounts. The main difference between deposit accounts in conventional banking and Islamic banking is that in Islamic banking it is not possible to agree about the revenues entailed by the deposited resources beforehand—in contrast to conventional banking, wherein interest rates are displayed as guaranteed. A deposit account in Islamic banking is treated as a contractual agency for the purpose of protecting wealth (*al-wadiah*^{*25}) whereby the depositor has authorised the financial institution to use the resources, provided that the depositor will be entitled to regain the resources to their full extent and also participate in the division of profits with the institution. The Islamic Bank of Britain offers a variety of savings accounts. The On Demand Savings Account^{*26} is most comparable with the operating deposit offered by AS Eesti Krediidipank^{*27}, from the angle that no notice is required for making a withdrawal from the On Demand Savings Account of the Islamic Bank of Britain and just one day's notice is required for making a free withdrawal from the operating deposit with AS Eesti Krediidipank.^{*28} Additionally, there are no limits to the number of withdrawals that can be made in any given month, provided that there are sufficient resources on the account. On the other hand, there are no requirements regarding the amount for opening an operating account with AS Eesti Krediidipank, but in order to open an On Demand Savings Account, one has to make a minimum initial deposit of £500 or set up an order mandate for at least £50 a month, to ensure regular deposits into the On Demand Savings Account.^{*29}

Once the funds are available on the account to be invested by an institution providing Islamic financial services, the institution and the depositor will agree with respect to the calculation period being a period equivalent to a calendar month. The Islamic financial institution will use the deposited sum as a contribution to the pool of funds during the agreed calculation period. From the gross income—i.e., all revenue generated by the pool of funds during the calculation period—deductions will be made to cover the administrative and other costs of the investment. The Islamic Bank of Britain states that the maximum annual percentage for such costs will not exceed 1.5% of the average balance of the pool of funds during the calculation period. After that, the bank shall deduct its share of the profit (50% in the case of the Islamic Bank of Britain) from the net income. Then the depositor's final share of the profit will be calculated through

^{*23} Complete price list of Swedbank services for private and corporate clients <https://www.swedbank.ee/private/home/more/pricesrates?language=EST> (9.8.2011) (in Estonian); SEB rates and interest rates <http://www.seb.ee/hinnakiri> (9.8.2011) (in Estonian); Banking Service Charges: Sampo Pank, p. 5.1, 5.2. Available at http://www.sampopank.ee/public/price_list/Pangateenuste_hinnakiri_EST.pdf (9.8.2011) (in Estonian).

^{*24} General Terms and Conditions Current Accounts terms and Conditions Savings Accounts Terms and Conditions, HSCB Amanah bank account p. 8.2. Available at <http://www.hsbc.co.uk/1/2/personal/travel-international/hsbc-amanah/amanah-bank-account> (9.8.2011).

^{*25} *وَضِيعَةٌ*, "wadiah", entrusted to custody, deposit, trust: H. Wehr. A Dictionary of Modern Written Arabic. J. Milton Cowan (ed.). 4th ed. Considerably enl. and amended by the author. Spoken Language Services, Inc., Urbana, IL, US 1994, p. 1263.

^{*26} On Demand Savings Account, Islamic Bank of Britain. Available at <http://islamic-bank.com/personal-banking/savings-products/demand-savings-account/> (4.8.2011).

^{*27} Terms of the Operating Deposit, AS Eesti Krediidipank. Available at <http://www.krediidipank.ee/era/hoiused/kasutushoius/index.html> (9.8.2011) (in Estonian).

^{*28} The operating accounts available in other Estonian credit institutions provide for longer notice periods for withdrawals, e.g., three days in SEB Bank: see Contract Terms of the Operating Deposit of SEB Bank (available at <http://www.seb.ee/hoiused-ja-investeerimine/hoiused/kasutushoius> (9.8.2011) (in Estonian)) and 10 banking days in Sampo Pank: see Contract Terms of Growth Deposit (available at http://www.sampopank.ee/public/agreement/Kasvuhoiuse_tingimused_EST.pdf (9.8.2011) (in Estonian)).

^{*29} On Demand Savings Account, Islamic Bank of Britain. Available at <http://www.islamic-bank.com/personal-banking/savings-products/demand-savings-account> (9.8.2011).

deduction of a contribution to a profit stabilisation reserve, with the latter amount limited to 20% of the depositor's gross share of the profit.^{*30}

Thus, in calculation of the depositor's share of the profit, the profit payable to the depositor passes through several stages: a) gross income, b) net income; c) gross share of profit, d) the deduction of the share of the profit for the provider of the Islamic banking services, and finally e) deduction of the profit stabilisation reserve contribution. Roughly speaking, the crediting of the account of the depositor is the sixth step in the overall arrangement.

Depending on the sum deposited and the success of the investment of the pool of funds, the share of profit payable to the depositor may be equal to the interest payable to a depositor with a conventional bank. As the share of profit payable to a depositor with a provider of Islamic banking services is, the interest payable to a depositor with a conventional bank will be dependent on the following two variables, in the main: 1) the sum deposited (which is at the same time a loan to the provider of banking services) and 2) the calculation period. These two factors are common to Islamic and conventional deposits. The third variable influencing the return from a conventional deposit comprises a number of variables, including the expected inflation rate for the calculation period, the risk of default payments, general need for a loan, etc.^{*31} With respect to the revenues from an operating account with AS Eesti Krediitipank, they will be calculated on the basis of the monthly average balance in accordance with the interest rate disclosed beforehand. The returns from the On Demand Savings Account could also be estimated on the basis of the target profit rates disclosed on the Web site of the bank; however, there is a disclaimer that such rates may be subject to change due to potential volatility in Commodity Murabaha markets and the bank will notify clients of the changes as soon as possible.

Higher profit rates are available for sums that have been deposited in Direct Savings Accounts of Islamic banks, which have some features in common with the term deposits and operating accounts of conventional banks. With the Islamic Bank of Britain, a minimum deposit of £1,000 is required for opening a Direct Savings Account. The sum shall be deposited within 14 days of opening of the account, and it is obligatory to maintain a minimum balance of £1,000. It is worth mentioning that payments into the Direct Savings Account cannot be made in cash; only electronic means, sending a cheque to the bank, or other means are allowed. Neither can the money be withdrawn in cash; one must perform an online transfer to another account or instruct the bank to make a payment on behalf of a third party.^{*32}

The revenues from Direct Savings Accounts will be calculated according to a formula similar to that applicable for the On Demand Savings Account. However, there are also some diverging factors. As with regard to the On Demand Savings Account, first the gross income will be calculated and after that the net income will be determined through deduction of direct costs, fees, and expenses incurred in the investment of the pooled funds (such costs, fees, and expenses shall not exceed 1.5% of the average pooled funds for the calculation period). The third step constitutes the first crucial difference in the schemes for calculating the revenues that are due to the depositor—calculation of the distributable profit. In the calculation of the share of profit due to a depositor in an On Demand Savings Account, the third step is deduction of the bank's share of the profit from the net income, while the third step of calculation with the Direct Savings Account is calculation of the distributable profit from the net income via deduction of a stabilisation reserve contribution (up to 20%). After that, the bank's share of the profit (up to 40%) from the distributable profit will be calculated and the share of profit of the depositor will be credited to the account of the depositor. Withdrawals from the Direct Savings Account in any given month will not be limited, provided that a minimum balance of £1,000 is retained.

The calculation of revenues from the on-demand savings and direct savings has much in common with the calculation of revenues for the Young Person's Savings Account, which can be opened in a child's name by a guardian (parent, sibling, grandparent, aunt or uncle, or legal guardian) as a trustee to the account. The account can be opened with £20, and the minimum continuing account balance is £1. Withdrawals from the account on the child's behalf will be authorised until the child reaches 14 years of age; however, the guardian must always act in the best interest of the child. After the child reaches age 14 (becoming what

³⁰ On Demand Savings Account Special Conditions; Islamic Bank of Britain, p. 5.2. Available at <http://www.islamic-bank.com/personal-banking/savings-products/demand-savings-account> (9.8.2011).

³¹ N. E. Sheppard, D. C. Baillie. *Compound Interest*. University of Toronto Press, Canada 1973, pp. 3–4.

³² Direct Savings Account Special Conditions; Islamic Bank of Britain. Available at <http://www.islamic-bank.com/personal-banking/savings-products/direct-savings-account/> (6.8.2011).

is hereinafter referred to as a young person), a conditional access letter will be signed by the guardian and the young person and returned to the bank; thereby, the young person is entitled to make withdrawals from the account of up to £100 a day while the adult retains the right to make withdrawals from the account. At the age of 16, the funds on the Young Person's Savings Account will be made available to the young person in other forms—the bank will inform of the possibilities for continuing the relationship with the young person.^{*33}

In the same way as other resources managed by Islamic banks, the sums deposited on the Young Person's Savings Account will be invested in the pooled funds in a Sharia-compliant way. On the calculation date—i.e., the last working day of each month—the bank will calculate the gross income and then calculate the net income by deducting the costs, fees, and expenses of the investment of the pooled funds (in total, up to 1.5% of the average pooled funds during the calculation period). After that, up to 20% will be allocated to the profit stabilisation reserve, then up to 50% will be the share of the profit for the bank. Finally, there remains the young person's share of profit, which will be credited to the bank account.^{*34} On 5 August 2011, the 'Indicative Expected Profit Rate' (gross per annum) for a Young Person's Savings Account was 0.1%.

Estonian banks too make services available for saving money for children. The two largest banks provide investment accounts for raising funds for children, but in some credit institutions there are also children's deposits (e.g., in the Estonian branch of Nordea Bank and at AS Eesti Krediidipank). Unlike the Young Person's Savings Account, a child's account at AS Eesti Krediidipank can be opened by the legal guardian of the child only, but contributions can be made to the account by other persons as well. The interest rate on the children's deposit account with Nordea Bank is 1.2%^{*35}, and for Eesti Krediidipank it is 4%.^{*36} The latter bank states that if the children's deposit account holds over 150,000 EUR, the bank will not pay any interest on the amount in excess of 150,000 EUR. The bank expects regular payments to the children's deposit account—at least 72 EUR a year. After the conclusion of the contract, the bank will contribute premium interest in the amount of 50 EUR on the child's account. In cases where the account's value is at least 30,000 EUR, the legal guardian does not have to continue regular payments to the child's deposit account. A legal guardian can apply for withdrawal from the deposit account only in the month when the child reaches seven, 10, or 15 years of age, provided that the contract has been in force for at least three years and the withdrawal is necessary to cover the daily needs of the child. The bank is entitled to limit the maximum amount in a child's deposit account. Once the child reaches 18 years of age, the resources on the deposit account will be made available for the child on his or her own account.^{*37}

We can conclude that the children's deposit in Estonian banking and the Young Person's Savings Account of the Islamic Bank of Britain have a common aim—to start raising funds for the young person from an early age. The children's deposits provided for in the Estonian banks largely target the needs of a child who is coming of age, while the resources contributed to the Young Person's Savings Account are available far more readily in the time when the child is growing up. That explains the significant difference between the expected revenues from the child's account in Estonia (4% from Eesti Krediidipank and 1.2% from Nordea) and the Indicative Expected Profit Rate for a Young Person's Savings Account—0.1% gross per annum.

Thus it is that in cases where the projects in which the pool of funds is involved are successful, those depositors with an On Demand Savings Account, Direct Savings Account, or Young Person's Savings Account will be entitled to a share of profit that could in certain circumstances be comparable with the interest due from a deposit of the same size in conventional banking. On the other hand, according to the principles of Sharia all financial arrangements that are operated on the basis of profit-sharing also involve the risk that the invested capital could suffer loss if the pool of funds returns a loss. However, the Islamic banks in the United Kingdom have taken measures to address such occasions and reduce the depositors' potential losses. That is, there is applicable a rule by which the Islamic bank forgoes some of the deductions

³³ Young Person's Savings Account Special Conditions, Islamic Bank of Britain. Available at <http://www.islamic-bank.com/personal-banking/savings-products/young-persons-savings-account/> (9.8.2011).

³⁴ Young Person's Savings Account Islamic Bank of Britain, p. 5.4.

³⁵ Child Deposit, Estonian branch of Nordea Bank AB. Available at <http://www.nordea.ee/Teenused+erakliendile/Hoiused/Lastehoius/60542.html> (9.8.2011) (in Estonian).

³⁶ Child Deposit, Interest, AS Eesti Krediidipank. Available at <http://www.krediidipank.ee/intressid/index.html> (9.8.2011) (in Estonian).

³⁷ General Terms of the Child Deposit, AS Eesti Krediidipank 1.1.2011, especially pp. 2.4–2.6, 3.2, 5.1.3, 5.2. Available at http://www.krediidipank.ee/pank/tingimused/lastehoiuse_tingimused_01.01.2011_eesti.pdf (9.8.2011) (in Estonian).

from the investments with the pool of funds and the profit stabilisation reserve account will be administered so as to compensate for any capital losses of the depositor. It is even possible that the deposit—i.e., the invested resources—will suffer from such a loss that the funds invested are fully exhausted. In such a case, the Islamic financial institution would not earn anything either and its loss also includes the expenditures for expertise and administration costs etc. involved in the arrangement. According to the EU principles of deposit guarantee^{*38}, all deposits with banks incorporated in the EU are guaranteed by means of deposit guarantee schemes, which are mainly maintained by the banks. Accordingly, those banks providing Islamic banking services and that attract deposits first and foremost in the EU also have to make contributions to a guarantee scheme and the relevant information is disclosed in the terms of contract for the deposits. However, such a deposit guarantee scheme is not a Sharia-compliant system. The deposit contracts also comprise a section stating that if the pool of funds returns a loss, the bank will, in line with the UK banking regulations and policy, offer to make good the depositor's loss and the depositor will be entitled to the deposited resources to their full extent. Nevertheless, the depositor is entitled to refuse this offer, and the Sharia boards of Islamic banks also advise that a depositor who accepts the offer by the Islamic bank to redress any shortfall is not acting in a Sharia-compliant way.

Islamic banks in the UK also provide further rules with regard to the application of deposit guarantee scheme arrangements in relation to loss of resources deposited with the Islamic financial institution and being part of the pool of funds. If the provider of Islamic banking services will not be able to return the amount deposited, the depositor is entitled to apply to the UK Financial Services Compensation Scheme in order to receive compensation. However, if the depositor has suffered loss and refused the offer of payment by the provider of Islamic banking services, the depositor will not be able to apply to the Financial Services Compensation Scheme for payment. It is worth reiterating here that all banks operating in the EU are bound by the obligation to participate in the deposit compensation schemes; therefore, all banks providing Islamic banking services under a banking licence of the EU are subject to the same obligation—making payments to the deposit compensation schemes in order to redress any losses of the deposits for depositors whose bank has failed. The regular payments by the banks to the deposit guarantee scheme are a financial obligation and especially burdensome to a bank whose practices in general do not approve the means of deposit guarantee schemes and whose customers have been constantly advised accordingly that applying for compensation from a deposit guarantee scheme is not a Sharia-compliant behaviour. *Inter alia*, it is not Sharia-compliant since most funds in the deposit guarantee schemes have been raised by conventional banks that do not pay attention to what is permissible or impermissible from the point of view of Sharia scholars: paying and receiving interest and/or earning from the alcohol, gambling, and pork industries; even music-related industries are regarded as *haram* (forbidden) from the point of view of several Sharia scholars.

3. Term deposits

The Islamic savings accounts touched upon above entitle the depositor to easy access to the resources deposited, enabling the depositors to take care of their daily financial needs as well as earn some profit from the deposited money. Higher profit rates are available for term deposits both in conventional banks and in Islamic banks. The Islamic Bank of Britain makes available fixed-term deposits of three, six, 12, 18, and 24 months. With Estonian banks, it is possible to deposit money for 1–12, 24, 36, 48, or 60 months. In cases of larger sums, it is also possible to deposit money for shorter terms with Estonian banks: two days or 1–3 weeks.^{*39}

Both the Islamic Bank of Britain and Estonian credit institutions apply the requirement of a minimum deposit for term deposits. With regard to the minimum sums in Estonian banks, this is 100–200 EUR at most Estonian credit institutions^{*40} and 350 EUR at Marfin Bank.^{*41} In Estonian banks, the minimum

³⁸ Directive 2009/14/EC of the European Parliament and of the Council of 11 March 2009 amending Directive 94/19/EC on deposit-guarantee schemes as regards the coverage level and the payout delay. – OJ L 68, 13.3.2009, pp. 3–7.

³⁹ Interest rates of deposits, Swedbank. Available at <https://www.swedbank.ee/private/investor/deposits/my/interests> (in Estonian); Deposit interest rates, Sampo Pank. Available at <http://www.sampopank.ee/en/25489.html> (6.8.2011).

⁴⁰ Interest rates of deposits, Swedbank. Available at <https://www.swedbank.ee/private/investor/deposits/my/interests>; Interest rates, term deposits SEB Bank. Available at <http://www.seb.ee/en/investments-and-deposits/deposits/term-deposit#interest-rates> (4.8.2011).

⁴¹ Interest rate, Marfin Bank. Available at <http://www.marfinbank.ee/?id=4549e113> (4.8.2011).

amount that can be deposited also may vary, depending on whether the money is deposited at the bank office, via phone services of the bank, or via Internet banking facilities. Usually the thresholds for the minimum amount are higher when the deposit contract will be concluded in the bank office or via phone services and lower in cases wherein the contract will be concluded by means of Internet banking—the minimum amounts at AS Sampo Pank being 300 EUR for deposit contracts concluded in the bank office or via Sampo Telephone Bank and 65 EUR (or the equivalent in other currencies) if the money will be deposited via Sampo Internet Bank.^{*42} The Islamic Bank of Britain requires that at least £1,000 be deposited, and only pounds sterling will be acceptable.

With regard to the revenue from the deposits, in the Islamic Bank of Britain the profits for three-, six-, and 12-month term deposits will be calculated and paid on maturity, but in the case of an 18- or 24-month deposit, the depositor can choose whether the profits will be paid quarterly or retained on the depositor's account to be reinvested along with the deposited amount, with the full amount paid on maturity. The idea in the Islamic Bank of Britain under which the 18- and 24-month deposits' profits can be paid quarterly may seem unusual in that it diverges from the practice of several Estonian credit institutions.^{*43} At the same time, it is understandable from the perspective of Islamic economic principles—the Fixed Term Deposit Account is a joint venture of the bank acting as an agent and the depositor, so if the joint venture is successful, it is fair to distribute profits already in the course of the venture. However, as a rule, the client cannot terminate the Fixed Term Deposit Account, nor may he or she withdraw funds from it (or add them) before the arrival of the maturity date.

The Fixed Term Deposit Account is operated on the 'wakala principle'^{*44}; that is, the deposited money will be invested by the bank in Sharia-compliant transactions. The bank will calculate the profit generated on the deposit and credit the account of the depositor on the basis of accrual as of the payment date—i.e., upon the deadline set in the contract coming to pass. Unlike in the cases of the other accounts discussed above, the scheme for calculating the share of profit has not been specified for this account; in the Special Conditions, in paragraph 2.6.4, the Islamic Bank of Britain indicates only that 'we will endeavour to achieve the expected profit rate'^{*45}. For the Fixed Term Deposit Account, the bank will be entitled to an agency fee (*wakala* fee) of £1 and any profit generated through investment of the deposit amount that exceeds the expected profit as an incentive. If only the expected profit rate is achieved, the bank will be entitled to only the *wakala* fee.

Before one enters into a contract, it is always advisable to study the expectations of the bank regarding the possible revenue. The expected profit rate for the latter fixed-term deposits range from 0.1% gross per annum for three-month deposits to 4% gross per annum for two-year deposits. Although the presentation of the Indicative Expected Profit Rates (gross per annum) of banks providing Islamic banking services looks very similar to the presentation of interest by banks engaged in conventional banking, it is nevertheless different, since the Islamic Bank of Britain indicates in its special conditions for various accounts that the bank will not be liable for any shortfall of the actual profit paid for the deposit on the payment date from the profit expected in view of the published expected profit rate.^{*46}

The fees and profits will be calculated according to the same system in the case of a 60 Day Notice Account—the *wakala* fee is £1, and the bank will be entitled to any profit generated by investment of the deposit amount that exceeds profit at the expected profit rate. The expected profit rate for a 60 Day Notice Account is 1%. This is most comparable to the expected profit rate for a Fixed Term Deposit Account for six months, which is 1.25%. As the name of the 60 Day Notice Account indicates, 60 days-notice will be necessary for making a withdrawal from the account. The 60-day notice to make a withdrawal is a term of

^{*42} Deposit interest rates, Sampo Pank. Available at: <http://www.sampopank.ee/en/25489.html> (7.8.2011).

^{*43} In Sampo Pank the interests will be paid on maturity, see: Term Deposit. Overview. Available at <http://www.sampopank.ee/et/10435.html> (09.08.2011) (in Estonian). In Swedbank there are monthly interest payments available for term depositors, in such cases lower interest rates will be applicable, e.g., for a 24-month deposit of EUR 2000 with the interest payable upon maturity the interest rate of 2.5 will be applicable, but in case of monthly interest payments, the interest rate of 2.00% will be applicable. Interest rates of deposits; Swedbank. Available at <https://www.swedbank.ee/private/investor/deposits/my/interests> (6.8.2011).

^{*44} لَوَا, "wakala", entrust, assign, put in charge: H. Wehr. A Dictionary of Modern Written Arabic. J. Milton Cowan (ed.). 4th ed. Considerably enl. and amended by the author, Spoken Language Services, Inc., Urbana, IL, US 1994, p. 1283.

^{*45} Special Conditions, Fixed Term Deposit Account p. 7.4, Islamic Bank of Britain, 6.8.2011.

^{*46} Target Profit Rates, Savings and Term Deposit Profit Rates, Islamic Bank of Britain. Available at <http://www.islamic-bank.com/target-profit-rates/> (6.8.2011).

contract with utmost bindingness—the Special Conditions of the 60 Day Notice Account (paragraph 4.6) state that in the case where the client has declared upon giving the 60-day withdrawal notice that the money will be collected in person and the withdrawal has not been made within 21 days, the bank shall deem the notice to have expired and a further 60-day term of notice will be applicable.

The consequences of cancellation of a term deposit differ significantly between Islamic banking and the Estonian credit institutions we have taken as examples of conventional banking. Estonian banks state in their contract terms that if a client initiates the cancellation of a term deposit, the client will be entitled to only the amount of the deposit and not to the interest.^{*47} Furthermore, in some cases, a contractual penalty will be applicable.^{*48} If the Islamic Bank of Britain agrees to an early withdrawal from a 60 Day Notice Account, the bank will return the sum for whose early withdrawal the client applied from the account (up to the full deposit amount—the minimum opening balance for a 60 Day Notice Account is £250; the amount in the deposit account may later fall to below £250, though the bank is entitled to close the account on the basis of available funds only if there is a zero balance for three consecutive months^{*49}) and an amount of expected profit that is equal to the minimum profit expected from the savings account funds available in the bank. The expected profit rate for 60 Day Notice Accounts is 1% gross per annum, and the lowest Indicative Expected Profit Rate (gross) per annum was 0.05% for an On Demand Savings Account as of 5 August 2011. Therefore, if the client applied for an early withdrawal from a 60 Day Notice Account, the client will have the amount required from the account (up to the full deposit amount) and instead of the expected profit rate applicable to a 60 Day Notice account, the client will be entitled to profit at 0.05% gross per annum. We can conclude from the above comparison that in some respects—namely, elements of early withdrawal—term deposit contracts with the Islamic Bank of Britain are more favourable to the client than are term deposit contracts in the Estonian banks, where the client will lose the interest and in some cases even the deposited amount will be reduced by a contractual penalty.

With regard to protection of the interests of depositors, clients will be notified if there are changes in the expected profit rates. In case the deposit amount is at risk due to unforeseen circumstances, the bank goes beyond this information procedure by terminating the deposit contract immediately and returning the full amount deposited, along with the profit accrued up to the date of termination.^{*50} Unlike those for the accounts discussed earlier in this article, the contracts for the Fixed Term Deposit Account and 60 Day Notice Account do not give any special advice^{*51} on deposit guarantee schemes, which are compulsory according to EU directives on deposit guarantees. However, the outlined Special Conditions for the Fixed Term Deposit Account (paragraph 2.5.6) and the Special Conditions of the 60 Day Notice Account (paragraph 2.6.5), in fact, could be regarded as more favourable for the depositor than is the EU deposit guarantee mechanism, since in paragraph 2.5.6 the bank commits itself to returning the deposit and accrued profits to their full extent in the event of unexpected failure, for a maximum deposit of £100,000 for a 24-month fixed-term deposit. Thus the maximum deposit guaranteed by the Islamic Bank of Britain is greater than the guarantee provided for in Directive 2009/14/EC of the European Parliament and of the Council of 11 March 2009 amending Directive 94/19 on deposit guarantee schemes where the coverage level and pay-out delay are concerned, with Article 1 (3) stating that from 31 December 2010 on, the coverage for all aggregate deposits of each depositor will be 100,000 EUR in the event of deposits being unavailable.^{*52} Since on 5 August 2011 the euro–sterling exchange rate was 1 EUR = 0.86905 GBP^{*53}, one cannot deny that the guarantee given by the Islamic Bank of Britain to depositors under the contract for a Fixed Term Deposit Account or 60 Day Notice Account could in some circumstances be more favourable than the relevant arrangements provided for in the EU directive.

⁴⁷ Term Deposit. Terms and Conditions, SEB, p. 3.5, 3.6. Available at http://www.seb.ee/files/tingimused/tahtajalise_hoiuse_tingimused_est.pdf (9.8.2011) (in Estonian).

⁴⁸ Terms and Conditions of Receiving and Serving Term Deposits, Citadele pank, p. 6.4.3. Available at http://www.citadele.ee/common/img/uploaded/doc/ee/term_and_cond_term_dep_private_ee.pdf (in Estonian); Term Deposit, Citadele bank. Available at <http://www.citadele.ee/ee/fees/deposits/term/> (9.8.2011) (in Estonian).

⁴⁹ Special Conditions, p. 1.9 and 1.10, 60 Day Notice Account, Islamic Bank of Britain, 9.8.2011.

⁵⁰ Special Conditions, p. 2.5.6, Fixed Term Deposit Account, Islamic Bank of Britain.

⁵¹ Just a footnote on the last page of the Special Conditions of the Fixed Term Deposit Account and 60 Day Notice Account.

⁵² Directive 2009/14/EC of the European Parliament and of the Council of 11 March 2009 amending Directive 94/19 on deposit-guarantee schemes as regards the coverage level and the payout delay. – OJ L 68, 13.3.2009, pp. 3–8.

⁵³ Euro exchange rated GBP, European Central Bank. Available at <http://www.ecb.int/stats/exchange/eurofxref/html/eurofxref-graph-gbp.en.html> (6.8.2011).

4. Conclusions

From the descriptions above for different Islamic savings products, we can see that, before entering into a contract with the bank, a customer can learn how the expected share of profit will be calculated and thereby also the relevant operation fees and expenses determined, but only in the form of a percentage of the average pooled funds during the calculation period. Likewise, the bank's share of the distributable profit will be provided in terms of a percentage of the distributable profit (which is 50% with the On Demand Savings Account, 50% for a Young Person's Savings Account, and 40% where a Direct Savings Account is concerned). Although banks providing Islamic banking services in the EU also inform their clients of the possibilities within the framework of deposit guarantee schemes, the obligation of which arises from the relevant EU directive, the Islamic Bank of Britain underscores the deduction from the net income from the investment as a contribution to a profit stabilisation reserve (20%).^{*54} The resources in the profit stabilisation reserve account may be used for improving the distributable profits. However, in the event of the bank being subjected to liquidation according to a court order, the resources in the profit stabilisation reserve account will be given to charities, according to the special conditions for the On Demand Savings Account, Direct Savings Account, and Young Person's Saving Account.^{*55} With regard to the variety of percentages pointed out above—deductions from the profit to cover the operation fees and expenses, contributions to the profit stabilisation reserve, and the share of the bank in the profit—the bank highlights that the percentages are maximum figures and the bank may, at its discretion, reduce all of them: its share in the profit, the operation fees and expenses, and the contributions to the profit stabilisation reserve.^{*56}

The above calculations explain how the Islamic counterpart of interest in savings contracts functions. In civil law, interest can be described 1) as a contractual fee for the temporary use of capital or 2) as damages for default payment—a measure of legal protection. In both cases, in conventional financing arrangements there are applicable the principles for calculation of interest in contractual relationships in the EU, adhering therein, *inter alia*, to the interest rate applicable to the main refinancing operations of the European Central Bank, with the relevant Estonian legislation being the Law of Obligations Act^{*57}'s §94. Although said section concentrates on interest and not interest-like measures, to address default payments we do note that in the event of default, the additional rules would be applicable—in the Estonian legislation, the Law of Obligations Act in its §113 (1) states that the interest on delay / penalty for late payment includes the interest rate applicable to the main refinancing operations of the European Central Bank and additionally 7% per year unless an interest rate exceeding the rate provided by law has been agreed upon beforehand.

Therefore, when comparing the returns to the depositor with a provider of Islamic banking services with the interest payable to the depositor with a conventional bank, one should leave the treatment of penalty interest for delay outside the scope of consideration. In Islamic banking, there are different principles for addressing the payment, for fulfilling contractual obligations.^{*58} When depositing resources in a conventional bank, the depositor will know the amount of the return—the return of the transaction that is guaranteed as soon as the amount and period of the deposit have been fixed—beforehand, since the Credit Institutions Act^{*59} (§89 (5)) and also other relevant legal acts in the EU provide that banks have to disclose, among other data, the interest rates. When making a deposit in the Islamic banking system, one can only consult the list of expected returns. The Islamic Bank of Britain meets the requirement for disclosing information on returns through displaying, monthly, the Indicative Expected Profit Rates (gross) under the nomination of target profit rates, with an additional disclaimer stating that the target profit rates may be subject to change due to potential volatility in Commodity Murabaha markets.

We can conclude that, although revenues from Islamic savings deposits may be similar to interest on deposits with conventional banks in certain circumstances, the ideology behind interest in conventional banking and profit in Islamic banking differ. In both cases, the deposited money will be managed so as to generate returns; however, it will be calculated in accordance with different principles.

⁵⁴ Profit Sharing Ratio, Islamic Bank of Britain. Available at <http://www.islamic-bank.com/target-profit-rates/profit-sharing-ratio/> (6.8.2011).

⁵⁵ Special Conditions Direct Savings Account, Islamic Bank of Britain. Available at <http://www.islamic-bank.com/personal-banking/savings-products/direct-savings-account/> (6.8.2011).

⁵⁶ Profit Sharing Ratio, Islamic Bank of Britain. Available at <http://www.islamic-bank.com/target-profit-rates/profit-sharing-ratio/> (6.8.2011).

⁵⁷ Võlaõigusseadus. – RT I 2001, 81, 487; RT I, 8.7.2011, 6 (in Estonian).

⁵⁸ AAOIFI Shari'a Standard No. 3 Default in Payment by a Debtor, 2000.

⁵⁹ Krediidiasutuste seadus. – RT I 1999, 23, 349; RT I, 8.7.2011, 6 (in Estonian).



Kaspar Lind

Magister iuris

Attorney-at-law, Casus Law Firm

VAT Fraud and the Fight against It in Estonia:

Laws and the Practice of the Administrative
Law Chamber of the Supreme Court

1. Introduction

In the past 50–60 years, VAT has become one of the main sources of revenue for many countries, including Estonia. According to the 2011 state budget of the Republic of Estonia, the planned income from VAT is 1.3 billion euros for the year.^{*1} There is currently no real alternative to VAT that would replace the revenues received from VAT and could be collected as easily.^{*2} The administration of this tax is relatively easy, since a large burden in tax collection has been placed on persons involved in business who sell goods and services to consumers. For instance, there is no need to conduct complicated and controversial evaluations as in the case of taxation of assets. Some advantages can be highlighted also in comparison to the taxation of income.

However, when turnover tax is applied as a value added tax, several risks emerge, and the literature has pointed out that such a system is susceptible to fiscal fraud.^{*3} The reason for this lies in the fact that applying the value added system increases the incidence of tax loss for the state and, at the same time, fiscal fraud is hard to detect. With this increase, as a result of unlawful activity, a situation may arise wherein a person reduces his tax liability or creates excess payment by means of unjustified deduction of input VAT. This is a peculiarity of the technical application of VAT.^{*4} The detection of VAT fraud, however, is complicated by the

¹ 2011. aasta riigieelarve seadus (State Budget Act of 2011). – RT I, 28.12.2010, 6 (in Estonian). According to the state budget, VAT makes up 1,299,962,931 euros of the total revenue in the state budget, which is 5,609,205,346 euros.

² The explanatory memorandum on the draft of the State Budget Act of 2011 says, among other things: 'The relative importance of consumption taxes increases from the 2010 level of 39.9% to 41% in 2011. In the medium term, the increase in the relative importance of consumption taxes occurs more quickly than the rise in the relative importance of labour taxes, reaching 42.4% by 2014. The main source of increase is the receipt of VAT.' See Seaduseelnõu nr 822 seletuskiri. Riigikogu 11. koosseis (Explanatory memorandum on the draft Act No. 822. The 11th composition of the Riigikogu.) Available at www.riigikogu.ee (4.2.2011) (in Estonian).

³ See D. Birk. *Steuerrecht*. 11. Aufl. Heidelberg 2008, p. 453. Also H. Stadie. *Umsatzsteuergesetz. Kommentar*. Köln 2009, p. 123. The same view is expressed by C. Hasler, G. Sautebin. *Strafrecht im Geltungsbereich der Mehrwertsteuer. Eine Praxisorientierte Darstellung*. Bern 2007, p. 75.

⁴ Wrong conclusions have been drawn from this in the Estonian penal law, where the creation of excess payment is a separate composition that entails a stricter punishment pursuant to the Penal Code (Karistusseadustik. – RT I 2001, 61, 364; RT I 30.06.2011, 6 (in Estonian); hereinafter referred to as the PC). The general composition is PC §3891, whereas PC §3892 is special composition in cases where the person creates a claim for refund or unlawfully increases the claim for refund. As mentioned, the punishment prescribed for the special composition is stricter. The logic behind the provision cannot be

fact that it is impossible for the state to check all transactions, as well as the fact that cross-border transactions make the identification of circumstances difficult and time-consuming for the tax authority.

This article focuses on the issues of fiscal fraud, closing of transactions, and good faith. The objective of the article is to analyse Estonian legislation and the practice of the Supreme Court and its development in the past 10 years, and to compare it to the practice of the European Court of Justice.

2. The scope of VAT fraud

There are no data on the precise scale and percentage of fiscal fraud. On 31 May 2006, the European Commission issued a Communication concerning the need to develop a co-ordinated strategy to improve the fight against fiscal fraud (COM(2006) 254)⁵, which pointed out, among other things, that ‘on the other hand, there are only very few estimates available on the amount of taxes not collected due to fiscal fraud. In general, the economic literature mentions that fraud accounts for approximately 2 to 2.5% of GDP. Therefore, the interests at stake in the case of fiscal fraud are extremely important’. This is echoed in the 31.5.2006 memorandum 06/221⁶, but the latter cites German and British data, according to which the uncollected amount of VAT is estimated at 17 billion euros per year in Germany (that number includes carousel fraud as well as the black economy, unjustified deductions of input VAT, and bankruptcies). In the UK, the uncollected portion of the total VAT income due is estimated at 13.5% and the rate of carousel fraud at 1.5–3 billion euros per year. That is 1.5–2.5% of the total VAT intake due. The Communication does not cite economic literature in more detail. One must probably be content with such numbers, given that any data on the black economy, fiscal fraud, and other unlawful activity can only be estimated.⁷

There are no reliable sources or analyses in Estonia considering the basis on which to assess the percentage of VAT fraud. In relation to the fuel sector, the amount of VAT from the sale of liquid fuel not collected for the state budget in 2010 has recently been estimated at 732 million kroons (i.e., 46.78 million euros).⁸ According to the tax authority, the checks conducted in 2010 determined that persons left a total of 63 million euros’ (980 million kroons’) worth of taxes undeclared and unpaid in 2010. Of that, 70% was accounted for by VAT-related infringements, and the tax authority specifically mentions the use of fictitious invoices as the greatest problem.⁹

3. The main types of VAT fraud in Estonia

The simplest type of fraud is the underreporting of supply from sales, which is most commonplace in fields where services can be provided or goods sold for cash. That applies, above all, to small enterprises, and the overall importance of this type of fraud is small. In connection to the European Union, one could mention abuse of the 0% tax rate, in which goods are transferred to another Member State in such a way that they are left untaxed in the country of destination. The deduction of input VAT from non-business-related expenses

considered valid, since the stricter punishment of the person depends on whether his taxable turnover is taxed at the 0% rate or 20% rate. The authors of the draft cited Swiss law as the model for this amendment. Alas, the Swiss law does not provide for such regulation. See Karistussseadustik. Kommenteeritud väljaanne (Penal Code. Commented Edition). Tallinn 2009, p. 979 (in Estonian).

⁵ Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee concerning the need to develop a co-ordinated strategy to improve the fight against fiscal fraud. COM(2006) 254 final. Available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2006:0254:FIN:ET:PDF> (27.9.2010).

⁶ EU coherent strategy against fiscal fraud – Frequently Asked Questions. MEMO/06/221. Available at <http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/06/221&format=HTML&aged=0&language=en&guiLanguage=en> (16.1.2011).

⁷ The recently published VAT Green Paper does not make any more specific references either. See Green Paper. On the future of VAT. Towards a simpler, more robust and efficient VAT system. COM(2010) 695 final, pp. 5 etc. Available at http://ec.europa.eu/taxation_customs/resources/documents/common/consultations/tax/future_vat/com%282010%29695_et.pdf (21.2.2011).

⁸ Vedelkütuse seaduse ja käibemaksuseaduse muutmise seadus. Seaduseelnõu nr 895 seletuskiri. Riigikogu 11. koosseis (Liquid Fuel Act and Value Added Tax Act Amendment Act. Explanatory memorandum on draft Act No. 895. The 11th composition of the Riigikogu). Available at www.riigikogu.ee (4.2.2011) (in Estonian).

⁹ 21.2.2011 press release by the Estonian Tax and Customs Board. Available at <http://www.emta.ee/index.php?id=29645&tpl=1026> (21.2.2011) (in Estonian).

or expenses related to supply exempt from VAT can also be regarded as fiscal fraud. This article deals primarily with fictitious transactions, as the most widespread fraud in Estonia. With such types of fraud, shadow organisations are used in such a way that the latter organisations issue invoices while the goods or services are actually provided by another person, or invoices do not correspond to any supply of goods or services at all. Transaction chains are sometimes used, consisting of actual organisations (so-called buffers) that make it more difficult to detect the fraud. In this respect, there are similarities to carousel fraud.^{*10} It can be said right away that carousel fraud has not been dealt with by the Administrative Law Chamber of the Supreme Court of Estonia and hence will also not be addressed further in this article.

4. Legal regulation

The amendment and improvement of tax laws is an ongoing process, because persons are always motivated in the payment of taxes to find discordances or contradictions to use to their advantage. That applies to both legal and illegal tax planning, areas in which regulators often enforce additional rules to fight against fiscal fraud and ensure better receipt of taxes. The main code of relevance here in the field of VAT concerns the reverse charge, but legal regulation of due diligence and its fulfilment has also been attempted in various countries. Furthermore, new options for improving VAT intake are being sought.

4.1. Reverse charge

As mentioned above, one of the measures often used in fighting fiscal fraud is the reverse charge. With the reverse charge, the liability rests fully with another person and the taxpayer is relieved of all obligations (as well as responsibility) related to the calculation and payment of tax.^{*11} The taxation of timber was carried out in this manner for a long time in Estonia. Provisions concerning the reverse charge for timber were introduced in the earlier Value Added Tax Act (*käibemaksuseadus*) with the law that was passed on 17.11.1999 and entered into force on 1.1.2000. In the law effective at that time, regulation was distributed among three provisions: §10 (4), §15 (3)¹, and §18 (3)¹ of the Value Added Tax Act. These provisions were amended on numerous occasions, with the amendments typically specifying the scope of the object of taxation.^{*12} On 13.6.2001, the Riigikogu passed the new Value Added Tax Act, which entered into force on 1.1.2002.^{*13} That law also prescribed the reverse charge for various types of timber (in its §32). In connection with accession to the European Union, yet another Value Added Tax Act entered into force in Estonia, on 1.4.2004^{*14}, this time without the reverse charge provisions.

However, reverse charge provisions have been reintroduced to the relevant law by now, and, analysing the reasons behind this move, one sees that it is clearly intended to fight fiscal fraud.^{*15} Pursuant to §41¹ of

¹⁰ In the case of a carousel fraud, the same goods circulate within the Union from one Member State to the next, where they are re-sold without reaching the end consumer. In the simplest form, this type of fraud requires three enterprisers who have been registered as taxable persons in two different member states. The nature of carousel frauds has been explained in the 16 April 2004 Communication to the Council and the European Parliament on the use of administrative cooperation arrangements in the fight against VAT fraud (COM(2004) 260). Available at [http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2004:0260:FIN:DE:PDF\(10.10.2010\)](http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2004:0260:FIN:DE:PDF(10.10.2010)).

¹¹ Reverse charge differs from the institution of withholding of tax in that in the latter case, the withholder of tax and the taxpayer share solidary responsibility for tax liability.

¹² As a result of the amendments, the object of reverse charge was greatly extended, leading to a competitive advantage for exporting enterprisers. The distortion of competition consisted in the fact that one economic sector gained advantages in terms of cash flow compared to other sectors, since the buyers, processors and exporters of timber did not have to pay VAT to their suppliers, while the buyers, processors and exporters of other materials do. The distortion of competition was also evident in the fact that the exporters and processors of timber received tax benefits on account of their suppliers, given that the importers, purveyors, transporters etc. needed to request from the tax authority the refund of overpaid VAT in the scope of the whole input VAT.

¹³ RT I 2001, 64, 368.

¹⁴ RT I 2003, 82, 554.

¹⁵ The explanatory memorandum on the draft of the Value Added Tax Act Amendment Act explicitly states: 'Reverse charge helps to prevent VAT frauds that have become more frequent with the supply of immovables and waste metal, whereby the buyer of the goods deducts the VAT, on the basis of the received invoice, from the VAT calculated on his taxable supply, whereas the seller fails to pay the amount of VAT received from the buyer to the state budget.' Seaduseelnõu nr 797 seletuskiri.

the Amendment Act of the Value Added Tax Act^{*16} that entered into force on 1.1.2011, immovables^{*17} and waste metal^{*18} are subject to reverse charge in accordance with Council of the European Union Directive 2006/112/EC (hereinafter referred to as the 'VAT Directive') Article 199 (1).

Although the reverse charge has been considered an effective tool^{*19}, it is hard to justify its use in certain fields only. Looking at Article 199 (1) of the VAT Directive, one sees that these fields can be considered special in terms of tax risks, but the content of Article 199 (1) is far from perfect. It is time to consider enforcing the reverse charge in as widespread a manner as possible above a certain margin rate for transactions throughout the European Union.^{*20}

4.2. Legal regulation of due diligence

In addition to the reverse charge, setting in place legal rules for distinguishing between honest and dishonest VAT-payers may be considered. This concerns the provision and regulation of due diligence in the Value Added Tax Act, on which judicial practice has largely focused so far (more on this below). An example of this is §25 d of the German Value Added Tax Act^{*21}, pursuant to which the buyer acquires a solidary liability with the seller if he or she is aware, or should have been aware, that the seller was unwilling to pay VAT. A somewhat similar regulation has been in effect in the UK with regard to electronic devices.^{*22} It is noteworthy that in Germany, a person's obligation of due diligence (i.e., the person knew or should have known) depends on whether that person concluded the transaction below or at market price. If the person has concluded the transaction below market price and is unable to prove that the price formation is economically justified, circumstances may lead to the conclusion that he has acted in bad faith.^{*23} Focusing on the price in this case indicates the desire to make it harder to use so-called carousel fraud, wherein goods become cheaper in the sales chain, and that should make the buyer suspicious, according to the regulator. The literature takes a critical stance toward the regulation, since the fact that the person knew or should have known about the intentions of the seller of the goods or the supplier of the service cannot create a tax liability, because unlawful behaviour would have to serve as a ground for imputation (the German *Zurechnungsgrund*) for the creation of tax liability. In essence, there is an opinion that the fact that a person knew or should have known of another person's fiscal fraud cannot serve as the basis for liability for non-receipt of taxes. The prevailing opinion in the literature is, therefore, that the provision in this form contradicts the

Riigikogu 11. koosseis (Explanatory memorandum on draft Act No. 797. The 11th composition of the Riigikogu). Available at www.riigikogu.ee (4.2.2011) (in Estonian).

¹⁶ Käibemaksuseaduse muutmise seadus. – RT I, 10.12.2010, 3 (in Estonian).

¹⁷ Reverse charge is applied in the case of transferring an immovable, of whose taxation the transferor of the immovable has notified the tax authority pursuant to §16 (3) of the Value Added Tax Act; otherwise it would be supply exempt from tax. Reverse charge does not concern apartments or other residential spaces, because in their case taxation cannot be chosen.

¹⁸ Pursuant to §104 of the Waste Act (jäätmeseadus. – RT I 2004, 9, 52; 31.12.2010, 2 (in Estonian)), waste metal, in terms of principal composition, is waste consisting of pure ferrous metal or non-ferrous metal or their alloys. The qualified list of waste metal is enforced by a regulation of the Minister of the Environment in conformity to the list of waste compiled pursuant to §2 (4) of the Waste Act. A qualified list of waste metal has been enforced by regulation No. 17 of the Minister of the Environment dating from 15 April 2004 (RTL 2004, 49, 843). This list is similar to a nomenclature of goods in terms of structure, and it classifies waste by origin and material. Admittedly, the identification of the object of reverse charge is complicated and time-consuming.

¹⁹ This has been noted, for example, of the reverse charge of construction services in the Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee concerning the need to develop a co-ordinated strategy to improve the fight against fiscal fraud. COM(2006) 254 final. Available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2006:0254:FIN:ET:PDF> (27.9.2010).

²⁰ See Study in respect of introducing an optional reverse charge mechanism in the EU VAT Directive Final Report to the European Commission. Available at http://ec.europa.eu/taxation_customs/resources/documents/common/consultations/tax/4209_study_en.pdf (7.2.2011).

²¹ Value Added Tax Act of the Federal Republic of Germany. Available at http://www.gesetze-im-internet.de/bundesrecht/ustg_1980/gesamt.pdf (21.2.2011).

²² In the UK, the State Budget Act of 2003 (§§17 and 18) enforced a special regulation of the Value Added Tax Act (VAT Act 1994). Pursuant to its Article 77A and §4 of Annex 11, the tax authority was entitled to request a security in the case of some electronic devices. Secondly, presumptions of responsibility were enforced, whereby it was possible to presume that the person is responsible for the seller's tax liability (especially if the person acquired the goods too cheaply). Essentially, these were measures designed to fight against carousel frauds. The European Court of Justice has analysed the appropriateness of the British regulation in an 11.5.2006 judgment in the case C-384/04. – ECR 2006, p. I-04191.

²³ H. Stadie. Umsatzsteuergesetz. Kommentar. Leipzig 2009, p. 1298.

principle of prohibition of arbitrary exercise of state authority (German *verfassungsrechtliches Willkürverbot*) prescribed in the Constitution.^{*24}

In Estonia, the regulator has not enforced separate regulations with regard to due diligence or solidary liability. One of the reasons might be that judicial practice does not point up the use of carousel schemes or their detection by the tax authority. Secondly, it can be argued that the enforcement of such regulations is problematic, since the evidence and circumstances that occur in practice are extremely varied and typically a set of evidence is evaluated (more on this below). Furthermore, criteria for assessing persons' involvement in a fraud, the good faith of buyers, and ordinary business care have been developed in the practice of the European Court of Justice as well as that of several Member States and, accordingly, legal regulation would be more or less redundant.

4.3. Alternative measures in fighting fiscal fraud

One of the most common measures that is also starting to be used in Estonia is the institution of securities. Institution of securities can take place in different ways (e.g., for start-up entrepreneurs). In connection with the above-mentioned fiscal fraud in the fuel sector, a separate regulation has been enforced in Estonia for fuel-sellers, who need to submit a security to the tax authority.^{*25} As a result of these amendments, the security required of a fuel-seller upon authorisation of fuel for consumption is one million euros. In the case of fuel already authorised for consumption, the security is 100,000 euros.^{*26} The purpose of the amendments, which entered into force on 1.4.2011, is to prevent situations in which shadow organisations that do not fulfil their tax liabilities operate in the fuel market. The application of securities to absolutely all entrepreneurs would be unrealistic, because that would start to restrict free enterprise, which is why it can only be applied in select areas.

Given that fiscal frauds are a serious problem, the VAT Green Paper mentions additional four models^{*27} for improving VAT receipt. Even though such models have not even been discussed in Estonia yet, they deserve to be mentioned here. According to the first model, the payment for goods or services would take place through the bank, and the bank would divide the payment into two parts (the price of the goods or services and the amount of tax), of which the amount of VAT would be paid directly to the tax authority. With the second scheme, a central database is created for invoices taxed with VAT that the tax authority can monitor in real time. Thirdly, separate VAT databases are used that are very easy for the tax authority to access in order to check invoices. Certification is seen as a fourth solution. Aside from the reverse charge, the first solution is considered the most effective; however, it would require a substantial transformation of the existing system. The other three models might improve supervision but do not directly ensure a better receipt of taxes.

5. Judicial practice

Fiscal frauds become evident in judicial practice first because the regulator typically responds to problems with a certain delay. That is why the primary burden in resolving the problems that have occurred in practice lies on judicial practice. Estonia is no exception: numerous cases of fiscal fraud, as well as cases concerning fictitious transactions and good faith of buyers, have been resolved in Supreme Court practice in the last 10 years. Where bad faith or failure to exercise due diligence is concerned, different compositions have explicitly been brought out in Supreme Court practice in a judgment from 5.5.2010, with regard to administrative matter 3-3-1-18-10. In light of that judgment, both the tax authority and the courts need to determine whether the fact that the buyer is involved in fiscal fraud or that the buyer knew that the seller was not the actual seller or the conclusion that the buyer must have known that the seller was not the actual seller

²⁴ *Ibid.*, p. 1299. In the Estonian Constitution, the prohibition of arbitrary exercise of state authority is based on §13 (2), pursuant to which the law protects everybody against the arbitrary exercise of state authority.

²⁵ Vedelkütuse seaduse ja käibemaksuseaduse muutmise seadus (Liquid Fuel Act and Value Added Tax Act Amendment Act). – RT I, 15.3.2011, 11 (in Estonian).

²⁶ Subsections 4² (1) and (2) of the Liquid Fuel Act.

²⁷ Green Paper (Note 7), p. 20.

serves as a factual basis for tax liability (paragraph 10 of the judgment). Next, I will address three different compositions on the basis of the above-mentioned decision. Although the Supreme Court of Estonia has reached dozens of decisions in such cases, I will refer to only the most important of these in this article.

5.1. Participation in fiscal fraud

Starting from the most extreme option, this refers to a situation wherein the buyer is involved or directly participates in fiscal fraud. By fiscal fraud, I do not mean the submission of false data under the Penal Code so much as VAT fraud in the sense accepted in tax law that can also be described as an abuse where the deduction of input VAT is ruled out.^{*28}

As regards participation in fiscal fraud, the following opinion expressed in a 5 May 2003 judgment of the Administrative Law Chamber of the Supreme Court, on administrative matter 3-3-1-39-03, deserves to be quoted at length: ‘Participation in fiscal fraud can mean, above all, that the persons organising the economic activity of the other party to the transaction work to the instructions of, under the control of, in prior agreement with, or with the knowledge of the board members of the company seeking the VAT refund. Participation in fiscal fraud can mean, for example, that the amount of money paid by the buyer to the seller as VAT is returned to the buyer or persons related to the buyer—i.e., the buyer benefits economically from the fiscal fraud. Various circumstances may point to the involvement of the buyer in fiscal fraud, such as close family, work, or business relations between the board members of the buyer and persons who have the right of representation of, or who are responsible for conducting the economic activity of, the seller violating the tax law. Information on who has taken possession of the money paid by the buyer to the seller may also indicate involvement of the buyer in fiscal fraud’ (paragraph 12 of the judgment).

Given that the above-mentioned decision lists diverse options to which it is difficult to add anything, that decision has been cited in Supreme Court practice on numerous occasions. Essentially, the Supreme Court judgment describes the work of the classic ‘invoice mill’ in practice wherein payments made on the basis of fictitious invoices move back to the maker of the payment through a dummy. At the same time, the approach even allows one to presume involvement in fiscal fraud in some cases. If there is a close professional relationship between the persons involved, it may be inferred, from the Supreme Court’s perspective, that it connects these persons to each other. However, the author of this article believes that this must not be overstated, given that, regardless of personal relations, the buyer might be able to prove that he has not participated in fiscal fraud.^{*29}

In addition to the previously mentioned possibilities for a person being involved in fiscal fraud, a situation could arise wherein that person in fact lacks the goods or services. In this case, it may be presumed that the person is submitting false information on purpose and wants to get an unjustified right to deduct input VAT. If there are no goods or services, deduction of input VAT can be ruled out automatically, and in that case it is, in fact, immaterial whether the person participated in fiscal fraud or has exercised sufficient due diligence; in essence, this can be equated with the perpetration of fiscal fraud. Given that the receipt of goods or the supply of service to a taxable person that would serve as the condition for the deduction of input VAT is absent, the person lacks the right to deduct input VAT.

²⁸ ALCSCd, 7.12.2006, 3-3-1-63-06, paragraph 11 refers to a 21.2.2006 judgment of the European Court of Justice in the case C-255/02 (ECR 2006, p. I-01609). The Supreme Court has cited the view expressed in that judgment that a taxable person has no right to deduce input VAT if the transactions serving as the basis for that deduction consist in abuse.

²⁹ For example, a situation may arise where an employee or another person who has a close relationship with the buyer uses their good relations to intentionally deceive the buyer about the circumstances in order to get a refund from the invoice mill himself. However, the burden of proof of such circumstances clearly lies with the buyer. This has been stressed by the Administrative Law Chamber of the Supreme Court in its ALCSCd, 2.10.2003, 3-3-1-50-03, where paragraph 10 of the judgment explains: ‘If the seller indicated on the invoice has not actually sold the goods or service, and there is reason to suspect that the buyer is involved in VAT fraud and the buyer fails to present additional evidence to remove that suspicion, the buyer has no right to deduct VAT.’

5.2. Awareness and due diligence

In the deduction of input VAT, objectively and subjectively judged circumstances on which the deduction of input VAT is based can be distinguished. The presence of goods or services and also the existence of an invoice and meeting of the requirements set for invoices are objective circumstances that normally ensure that the person in question may deduct input VAT. However, from judicial practice, subjective elements on which basis the right to deduct input VAT is assessed are additionally derived—involving the taxable person's awareness of, or obligation to be aware of, circumstances that would indicate the unlawful behaviour of the seller. In that respect, Estonian judicial practice conforms to the practice of the European Court of Justice (in the so-called *Kittel* case), in which the person's awareness and obligation of awareness of the unlawful behaviour of the seller are similarly distinguished.^{*30} The Supreme Court of Estonia (both the Administrative Law Chamber and the Criminal Chamber) has so far issued, in total, 18 decisions that address due diligence in the deduction of input VAT, and 14 decisions can be cited that address the same issue in relation to the imposition of VAT.^{*31} Next, I will consider the most important cases among these.

5.2.1. Cases wherein the buyer knew that the seller was not the real seller

In the above-mentioned *Kittel* judgment, the European Court of Justice has explained: 'In the same way, a taxable person who knew or should have known that, by his purchase, he was taking part in a transaction connected with fraudulent evasion of VAT must, for the purposes of the Sixth Directive, be regarded as a participant in that fraud, irrespective of whether or not he profited by the resale of the goods' (paragraph 56 of the judgment). The same opinion has been expressed on numerous occasions by the Supreme Court in its practice.^{*32} Indeed, if the issuer of the invoice and the transferor of the goods or services do not coincide and the buyer knows this, the person can also not have the right to deduct input VAT. Otherwise the correspondence of VAT would not be guaranteed.

The Administrative Law Chamber of the Supreme Court has further explained, in its 19.5.2009 judgment on administrative matter 3-3-1-32-09, that 'if an absence of actual economic activity by sellers is detected, the bad faith of the buyer is confirmed already if the buyer knew or should have known that the sellers in fact lacked economic activity. Being aware of that, the buyer should also have known that the seller could not have provided a service to him'. On the basis of this conclusion, a case can be constructed wherein, with a stable transaction partner, another person's invoice is delivered for the same service or goods at one point, which is how the buyer learns that a so-called shadow organisation is used for issuing invoices while the service is still provided or the goods transferred by the seller known to him from before. Although the buyer is not directly involved in fiscal fraud and does not in any way benefit from it, it follows from judicial practice that the buyer cannot in this case deduct input VAT. The question already addressed earlier (in Section 4.2 of this article)—namely that of the basis on which the buyer develops a greater tax liability by being aware of someone else's unlawful behaviour—arises here.

It must be said that cases in which it has been concluded that the buyer participated in the fiscal fraud or should have known that the seller is not the real seller are predominant in the practice of the Supreme Court in this field. There are virtually no cases where it has been determined that the person knew that the seller is not the real seller.

³⁰ Judgment of the European Court of Justice, 6.6.2006, in the joint case C-439/04 and C-440/04. – ECR 2006, p. I-06161.

³¹ No cases addressing the issue of good faith of persons in the event of intra-Community supply have thus far been adjudicated in the practice of the Supreme Court of Estonia. However, such cases have been adjudicated by lower-level courts (see Tallinn Circuit Court judgment, 24.10.2010, in administrative matter 3-08-1465). Such cases have been addressed on numerous occasions in the practice of the European Court of Justice (e.g., judgment of the European Court of Justice, 27.8.2007, in the case C-409/04. – ECR 2007, p. I-07797, or judgment of the European Court of Justice, 21.2.2008, in the case C-271/06. – ECR 2008, p. I-00771).

³² In the practice of the Supreme Court, the criterion 'knew or should have known' was first brought out in ALCSCd, 5.6.2006, 3-3-1-34-06, paragraph 12.

5.2.2. Cases where the buyer should have known that the seller is not the real seller

It follows from the above-mentioned *Kittel* case that even if a person does not participate in fiscal fraud and is also unaware of the fiscal fraud committed by the seller, he may develop tax liability (he cannot deduct input VAT). The person would gain such awareness if he exercised the due diligence required of him. A 20.1.2010 judgment of the Administrative Law Chamber of the Supreme Court, concerning administrative matter 3-3-1-74-09, states, among other things, that the 'should have known' condition means that the taxable person had information on circumstances indicating that the seller is not the real seller (paragraph 11 of the judgment). That view has been specified in judgment 3-3-1-18-10 of the Supreme Court, dating from 5.5.2010: 'The conclusion that the taxable person should have known that the seller was not the real seller can be drawn if the taxable person had information on circumstances that indicate that the seller is not the real seller or if the taxable person could have learned of such circumstances by exercising due diligence' (paragraph 15).

Defining due diligence, or ordinary business care, is extremely problematic.^{*33} Typically, tax law does not consider circumstances outside tax law to be relevant and instead relies on the actual situation. In the evaluation of economic activity, whether the person has all of the required permits, licences, and registrations is, therefore, irrelevant. Similarly, even the question of whether the person's activity is lawful or unlawful is irrelevant where taxation is concerned. Taxation is value-neutral, meaning that the activity can even be contrary to good morals while the payment and calculation of taxes nevertheless functions as normal. With due diligence, however, it is precisely the question of whether and to what extent the seller fulfils these requirements derived from other fields of law that is strictly pursued. In Estonian judicial practice, observing the rules for preventing money laundering has been considered important in the case of cash payments^{*34}, while the importance of having certificates of conformity has been emphasised in the case of fuel.^{*35} The Supreme Court has indeed pointed out that the person thereby only acquires an additional burden of proof^{*36}, but in practical terms it still means that the taxable person must carefully follow laws outside the scope of tax law. Given that the limitation period for imposing taxes is six years at most^{*37}, it may prove virtually impossible to submit additional evidence later.

It should be pointed out that making a distinction between different compositions is significant not only in terms of the imposition of VAT. The imposition of income tax directly depends on the evaluation of circumstances. It has been repeatedly stressed in the practice of the Supreme Court that the burden of proof is much lighter in the accounting of income tax than in the accounting of VAT. The Supreme Court has noted that the fulfilment of due diligence requirements in connection with identifying the identity of the seller is irrelevant in the context of income tax as the identity of the seller is irrelevant in identifying the VAT obligation of the buyer.^{*38} This distinction results from the fact that the scope of due diligence and the

³³ This is also acknowledged in the so-called Green Paper, which states: 'Tax administrations must prove such knowledge in each individual case. This is a lengthy, costly and complicated procedure. In addition, it risks leaving taxable persons in a vulnerable position, particularly when dealing with a new supplier. They have to perform additional checks on the compliance of each supplier. Bona fide businesses nonetheless run a risk that their right to deduct will be challenged because they have inadvertently been dealing with fraudsters.' See Green Paper (Note 7), p. 20.

³⁴ ALCSCd, 8.5.2003, 3-3-1-43-03. That judgment referred to §5 (1) 2) and §7 (3) of the Money Laundering Prevention Act (rahapesu tõkestamise seadus) in effect at the time, as well as the obligation resulting from these provisions to identify persons upon using cash amounts above 100,000 kroons to settle accounts and to make a copy of the document presented for personal identification. By now the legal situation has changed—pursuant to §3 (1) 5) and §12 (2) 2) of the current Money Laundering and Terrorist Financing Prevention Act (rahapesu ja terrorismi rahastamise tõkestamise seadus. – RT I 2008, 3, 21; 2010, 26, 129 (in Estonian)), due diligence must be exercised in the event of a transaction exceeding 15,000 euros in value (incl. cash transaction).

³⁵ ALCSCd, 3.6.2003, 3-3-1-40-03 refers in relation to the exercise of due diligence to fuel certificates that were required by the 7 October 1998 regulation No. 30 of the Ministry of Economic Affairs 'Procedure for Proving the Compliance of Liquid Fuel' enforced on the basis of §11 (2) of the Energy Act in effect at the time of the transactions. Pursuant to §9 (3) of the current Liquid Fuel Act, the compliance of fuel to set requirements must be proved upon importing the fuel, unless it is delivered to an excise warehouse, or upon authorising the fuel for consumption from an excise warehouse, except if a fuel dispatched from a Member State of the European Union is stored in a separate container in the excise warehouse. As a result, a certificate of conformity no longer needs to accompany each fuel transaction, which is why it cannot be requested upon exercising due diligence either. The lack of fuel certificates has also been cited as a violation of due diligence by the Supreme Court in ALCSCd, 5.6.2006, 3-3-1-34-06, paragraph 15.

³⁶ The Supreme Court has explicitly explained it in its 20.1.2010 judgment in administrative matter 3-3-1-74-09 (clause 18 of the judgment), for example.

³⁷ Maksukorralduse seadus (Taxation Act), §98 (1). – RT I 2002, 26, 150; RT I, 10.12.2010, 4 (in Estonian).

³⁸ ALCSCd, 5.6.2006, 3-3-1-34-06, paragraphs 14–15.

consequences of failure to meet these obligations differ between the cases of income tax and VAT.^{*39} If the buyer knew that the seller was not the real seller, the tax authority would be entitled to tax the compensation paid to said seller as a non-business-related expense.^{*40}

6. Conclusions

Analysis shows that the practice of the Supreme Court of Estonia conforms to the practice of the European Court of Justice. Similarly to the practice of the European Court of Justice, it rules out deduction of input VAT for buyers who participate or are otherwise involved in fiscal fraud. Deduction of input VAT is ruled out also if the buyer knew or should have known that the seller is not the real seller.

Analysing the situation as a whole, one finds this not to be the clearest and most reasonable solution for entrepreneurs. Interpreting due diligence is a creative activity that depends on the particular economic field and the scope of the person's activity, which is why it is extremely difficult for persons to assess their risks. The situation becomes more complicated for those entrepreneurs who wish to pursue economic activity in another Member State. Although they can draw general conclusions on how to act with regard to the VAT system, due diligence may depend greatly on each country's legal order and practice. As a result, it is very difficult for entrepreneurs to operate in different European Union Member States. Often entrepreneurs can learn of the exact content of their due diligence only in the course of judicial proceedings, but that might entail tax liability. Secondly, the fact that the buyer's tax liability depends on whether he knew or should have known of the seller's unlawful behaviour is controversial. It is especially problematic if the idea is expressed that the person should have been aware of these circumstances through the exercise of due diligence. In that case, the fundamental situation is that bad faith is presumed, which is unjustified in the opinion of the author of this article and imposes unreasonable obligations on taxable persons, forcing them to perform the work of the tax authority in order to check their transaction partners.

The situation could be resolved by means of the reverse charge, which should be more extensive and not be based on a select few areas of activity. Rather, it should occur above a certain taxable value. The fight against VAT fraud has so far been characterised by measures applied to only specific areas, and, as a result, their effect is restricted. A more extensive reverse charge would rule out the enforcement of a legal regulation that is used to regulate the presumption of good faith and the bases for buyer liability. The application of the reverse charge is currently restricted by the VAT Directive, whose Article 199 restricts the reverse charge to specific areas. The reverse charge would be much more effective if due diligence were legally regulated and the bases for restricting the deduction of input VAT were to be enforced. The reverse charge would also be more effective or easier to apply than other models proposed by the European Commission to date.

³⁹ ALCSCd, 20.10.2010, 3-3-1-74-09, paragraph 16.

⁴⁰ ALCSCd, 28.9.2006, 3-3-1-47-06, paragraphs 9–11.



Kristjan Kask
Ph.D., Researcher
University of Tartu

Comparison of Knowledge of Law Enforcement and Lay People Regarding Eyewitness Testimony^{*1}

1. Introduction

It has been repeatedly demonstrated in legal psychology writings that mistakes related to eyewitness testimony are one of the factors in many court errors.^{*2} The area of eyewitness testimony in legal psychology focuses mainly on problems related to identification and knowledge of the functioning of the witness's memory as well as the influences of a co-witness (e.g., how people remember certain events and what influences the accuracy of testimony). The errors in eyewitness testimony are considered to be misidentification (e.g., identification of an innocent individual instead of the suspect), misconceptions about the functioning of the witness's memory, reservations about the accuracy of testimony given by child witnesses and the elderly.

In the US, the investigation of old cases has been resumed after new technologies have been introduced (*Innocence Project*)^{*3} and to date^{*4} the conviction of 273 persons have been overturned as the results of a DNA analysis showed that they had not committed in the past the crimes of which they were convicted. Errors in eyewitness testimony had served as one of the causes for the conviction in three fourths of the cases^{*5} and they are not solely characteristic of the US but also exist in other legal systems in Europe.^{*6} As Magnussen *et al.* have indicated, the eyewitness testimony is important evidence in many criminal cases, while the court system need not defend the suspect as required against the emergence of such errors.^{*7}

¹ The survey was conducted within the framework of the project 'Interviewing minors in criminal proceedings', financed by the Ministry of Justice together with the European Social Fund through the Fund of Wise Decisions of the State Chancellery. The author would like to express his gratitude to Professor Jüri Saar for useful comments during the preparation of the article.

² B. Scheck, P. Neufeld, J. Dwyer. *Actual innocence: Five days to execution and other dispatches from the wrongly convicted*. New York: Doubleday 2000.

³ See innocenceproject.org.

⁴ As of 29 August 2011.

⁵ G. L. Wells, A. Memon, S. D. Penrod. Eyewitness evidence: Improving its probative value. – *Psychological Science in the Public Interest* 2006/2, pp. 45–75.

⁶ S. Sporer, R. S. Malpass, G. Köhnken (eds.). *Psychological issues in eyewitness identification*. Hillsdale, NJ: Lawrence Erlbaum 1996.

⁷ S. Magnussen, R. A. Wise, A. Q. Raja, M. A. Safer, N. Pawlenko, U. Stridbeck. What judges know about eyewitness testimony: A comparison of Norwegian and US judges. – *Psychology, Crime and Law* 2008/3, pp. 177–188.

It is difficult to eliminate the errors in eyewitness testimony completely, since distortions in our perception and memory are part of normal processing of information in human beings.^{*8} Therefore it is important that the participants in the legal system, such as judges, prosecutors and investigators who make important decisions be aware of the errors in eyewitness testimony and of the factors influencing them. For example, in the US, the judge can decide on the appearance of the lineup procedure and whether the accused has the right to the presence of his or her counsel during the lineup.^{*9} The judge also has the right to decide whether the procedure for the lineup was carried out as required or in a biased manner and point out to the jury the factors affecting the accuracy of the eyewitness testimony and the need for an expert witness.^{*10}

In several countries, the knowledge of and positions of law enforcement officials on eyewitness testimony have been studied and it has been established that both the knowledge of law enforcement officials in the field as well as the manner of taking the testimony significantly affect the reliability of the testimony.^{*11} Studies have been conducted with judges^{*12}, prosecutors^{*13} and preliminary investigators^{*14}, which have indicated limited knowledge of the factors affecting the eyewitness testimony. There have been also studies concerning what the representatives of the bodies conducting the proceedings know about areas such as lineup^{*15}, reliability of child witnesses^{*16}, and what the general beliefs of the public are in regards to the functioning of memory^{*17} or the factors affecting eyewitness testimony.^{*18}

Wise and Safer^{*19}, for instance, asked 160 US judges various questions about the factors affecting the accuracy of eyewitness testimony and established that the judges' knowledge of the eyewitness testimony was limited (on average, 55% of the propositions were assessed correctly). For example, the majority of the judges believed that the ability to recall details was a good indicator of accuracy (the surveys have not validated this) and were unaware of the process of normal forgetfulness. Such a lack of knowledge can affect their judgment of the eyewitness's testimony in criminal proceedings, which is also confirmed by the results of the Innocence Project so far. The results of the survey conducted among the US judges need not be applicable to judges in other countries and in different legal systems, which is why attempts have been made to also study the topic in other countries. Surveys involving Norwegian^{*20} and Chinese^{*21} judges have confirmed that the knowledge of judges regarding eyewitness testimony was also limited in these countries; hence, it can be regarded as a general problem in judicial practice.

Studies of lay people have identified a certain overlap between the opinion of experts^{*22} and that of law enforcement officials.^{*23} Yet, for example, the opinion about and the knowledge of the jury regarding

⁸ D. L. Schacter. *The seven sins of memory: How the mind forgets and remembers*. Boston, MA: Houghton Mifflin 2001.

⁹ *United States v. Ash*, 1973; *Kirby v. Illinois*, 1972; V. Stinson, J. L. Devenport, B. L. Cutler, D. A. Kravitz. How effective is the presence-of counsel safeguard? Attorney perceptions of suggestiveness, fairness, and correctability of biased line-up procedures. – *Journal of Applied Psychology* 1996/1, pp. 64–75.

¹⁰ *Neil v. Biggers*, 1972.

¹¹ S. M. Kassir, V. A. Tubbs, H. M. Hosch, A. Memon. On the 'general acceptance' of eyewitness testimony research: A new survey of the experts. – *American Psychologist* 2001/5, pp. 405–416; S. Magnussen *et al.* (Note 7); R. A. Wise, M. A. Safer. What US judges know and believe about eyewitness testimony. – *Applied Cognitive Psychology* 2004/4, pp. 427–443; R. A. Wise, N. Pawlenko, M. A. Safer, D. Meyer. What US prosecutors and defence attorneys know and believe about eyewitness testimony. – *Applied Cognitive Psychology* 2009/9, pp. 1266–1281.

¹² S. Magnussen *et al.* (Note 7).

¹³ V. Stinson *et al.* (Note 9).

¹⁴ A. D. Yarmey, H. P. T. Jones. Is the psychology of eyewitness identification a matter of common sense? – S. Lloyd-Bostock, B. R. Clifford (eds.). *Evaluating witness evidence*. Chichester, England: Wiley 1983, pp. 13–40.

¹⁵ V. Stinson, J. L. Devenport, B. L. Cutler, D. A. Kravitz. How effective is the motion-to-suppress safeguard? Judges' perceptions of the suggestiveness and fairness of biased line-up procedures. – *Journal of Applied Psychology* 1997/2, pp. 211–220.

¹⁶ A. Melinder, G. Goodman, D. E. Eilertsen, S. Magnussen. Beliefs about the child witness. A survey of professionals. – *Psychology, Crime and Law* 2004/4, pp. 247–365.

¹⁷ S. Magnussen *et al.* What people believe about memory. – *Memory* 2006/5, pp. 595–613.

¹⁸ R. P. Schmechel, T. P. O'Toole, C. Easterly, E. F. Loftus. 'Beyond the ken?' Testing jurors' understanding of eyewitness reliability evidence. – *Jurimetrics* 2006/2, pp. 177–214.

¹⁹ R. A. Wise, M. A. Safer (Note 11).

²⁰ S. Magnussen *et al.* (Note 7).

²¹ R. A. Wise, X. Gong, M. A. Safer, Y.-T. Lee. A comparison of Chinese judges' and US judges' knowledge and beliefs about eyewitness testimony. – *Psychology, Crime and Law* 2010/8, pp. 695–713.

²² An expert opinion based on research is meant in this context.

²³ R. P. Schmechel *et al.* (Note 18); T. R. Benton, D. F. Ross, E. Bradshaw, W. N. Thomas, G. S. Bradshaw. Eyewitness memory is still not common sense: Comparing jurors, judges, and law enforcement to eyewitness experts. – *Applied Cognitive Psychology* 2006/1, pp. 115–130.

the topic, as exemplified by the US, can significantly differ from that of the experts in the area, and consequently, it has become an established practice to educate the jury by using expert witnesses about the factors that can affect eyewitness testimony. The studies conducted by Magnussen as well as Wise and Safer^{*24} about the knowledge of judges have indicated that although their knowledge of legal psychology was also limited, they were of the opinion that the jurors knew even less about the field. Benton^{*25} confirmed with his survey that an average juror knew considerably less than an average judge about the factors affecting eyewitness testimony. To sum it up, the studies have demonstrated that the knowledge of the jurors regarding eyewitness testimony can be rather unrealistic.^{*26}

1.1. Objective of survey

The large majority of studies in the area of eyewitness testimony have been carried out in the Anglo-Saxon jurisdiction in North America or in the United Kingdom; thus, the results of the studies conducted in these countries need not be immediately applicable to the Continental jurisdiction and local context. This study examined the knowledge of eyewitness testimony that Estonian judges, prosecutors, preliminary investigators and juvenile police officers (hereinafter the officials are referred to as 'law enforcement') have, comparing them with the expert opinion based on research.^{*27} The study (1) examined the knowledge that law enforcement has of the field, (2) observed the difference in the knowledge of various officials, and (3) compared the knowledge of law enforcement with the base level, i.e., that of lay people who did not have a specialised education in psychology or law. The objective of the survey is to establish the familiarity of law enforcement with different factors affecting eyewitness testimony and identify the main differences between the opinion of law enforcement and the expert opinion based on research.

2. Participants and method

The body of participants in the study comprised 69 law enforcement officials and 96 lay persons. Of the law enforcement officials, 16 (23%) were judges, 11 (16%) prosecutors, 26 (38%) preliminary investigators and 16 (23%) juvenile police officers. According to regional division, 36 (52% of the respondents) worked in the Northern district, 24 (35%) in the Western district, 3 (4%) in the Eastern district and 6 participants (9%) in the Southern district. There were 56 females (81%) and 13 males (19%) among the participants. The average age of the participants was 39, ranging between 21 and 65. On average, a participant had served in his or her current position for 8.8 years, from a period of a few weeks up to 40 years.

The average age of lay people involved in the study was 35, ranging between 17 and 71. As to education, 4 (4%) had a basic education, 29 (31%) a secondary education, 18 (19%) a secondary specialised education, and 43 (46%) a higher education. The lay participants had to confirm that they were unrelated to psychology or law by their education or profession.

2.1. Questionnaire

The participants in the study completed a questionnaire prepared on the basis of Kassin *et al.* as well as Wise and Safer.^{*28} In the original questionnaire, the relevant American and European researchers^{*29} were asked to assess statements; based on the positions of 64 researchers, it was presumed whether the statements of the questionnaire were considered truthful, false or there was no common position yet among researchers

²⁴ S. Magnussen *et al.* (Note 7); R. A. Wise, M. A. Safer (Note 11).

²⁵ T. R. Benton *et al.* (Note 23).

²⁶ J. D. Read, S. L. Lay. Knowledge of Eyewitness Issues: A Canadian Evaluation. – *Applied Cognitive Psychology* 2009/3, pp. 301–326.

²⁷ S. M. Kassin *et al.* (Note 11); R. A. Wise, M. A. Safer (Note 11).

²⁸ S. M. Kassin *et al.* (Note 11); R. A. Wise, M. A. Safer (Note 11).

²⁹ The researchers participating in the study had, as of the moment of conducting the study, carried out surveys in the area of legal psychology within the past ten years and their research had been published in peer-reviewed journals or books.

at that point in time. The authors deemed that there were no expert opinions in those statements regarding which sufficient surveys were not yet available or where research had yielded controversial results.

The Estonian questionnaire comprised 32 statements (see Table 1) that the participants were asked to assess on a three-point Likert-type scale (agree, disagree, do not know). The law enforcement officials completed the questionnaire in the smartsurvey.co.uk environment and it was forwarded to them by the representatives of the Supreme Court, Public Prosecutor's Office and the Police Board; the lay people completed a paper and pencil version.

Table 1. Statements in the questionnaire.

Keyword	Statement
Identification speed	The more quickly a witness makes an identification upon seeing the lineup, the more accurate he or she is likely to be.
Effects of headwear	It is significantly harder for a witness to recognise a perpetrator who is wearing headwear during the commission of a crime.
Minor details	A witness's ability to recall minor details about a crime is a good indicator of the accuracy of the witness's identification of the accused later on.
Attitudes and expectations	An eyewitness's perception and memory of an event may be affected by his or her attitudes and expectations.
Conducting lineups	A preliminary investigator who knows which member of the lineup is the suspect should not conduct the lineup.
Effects of post-event information	Eyewitness testimony about an event often reflects not only what a witness actually saw but also information obtained later on from other witnesses, from the media, etc.
Confidence-accuracy	At trial, an eyewitness's confidence is a good predictor of his or her accuracy in identifying the suspect.
Confidence malleability	An eyewitness's confidence can be influenced by factors that are unrelated to identification accuracy.
Weapon focus	The presence of a weapon in the incident can impair an eyewitness's ability to accurately identify the perpetrator.
Mug-shot-induced bias	Exposure to mug shots of a suspect will increase the likelihood that the witness will later choose the same person from a lineup.
Lineup format	Witnesses are more likely to misidentify someone when a lineup is presented in a simultaneous (all members of a lineup are presented to the witness at the same time) as opposed to a sequential procedure (all members of a lineup are presented to the witness/victim individually).
Forgetting curve	The greatest source of risk after the event is the rate of memory loss for the event (i.e., memories about the event decrease over time).
Stress	High levels of stress impair the accuracy of eyewitness testimony.
Showups ^{*30}	The use of a one-person showup instead of a full lineup increases the risk of misidentification.
Lineup fairness	The more members of a lineup that resemble the suspect, the higher the likelihood that identification of the suspect is accurate.
Lineup instructions	Instructions by an official can affect an eyewitness's willingness to make an identification accurately during the lineup.
Exposure time	The less time an eyewitness has to observe an event, the less well he or she will remember it.

³⁰ Not to be confused with §77 of the Code of Criminal Procedure, i.e., confrontation; in this context, it is meant that only one person is presented to the witness/victim for identification.

Colour perception	Judgments of colour made under monochromatic light (e.g., an orange streetlight) are often unreliable.
Wording of questions	An eyewitness's testimony about an event can be affected by how the questions put to that witness are worded.
Unconscious transference	Eyewitnesses sometimes identify as a suspect someone they have seen in another situation or context.
Trained observers	Police officers consider themselves no more accurate as eyewitnesses than the average eyewitnesses or victims.
Hypnotic accuracy	Hypnosis increases the accuracy of an eyewitness's reported memory.
Hypnotic suggestibility	Hypnosis increases suggestibility to leading and misleading questions.
Event violence	Eyewitnesses have more difficulty remembering violent than non-violent events.
Cross-race bias	Eyewitnesses are more accurate when identifying members of their own race (compared to members of other races).
Alcoholic intoxication	Alcoholic intoxication impairs an eyewitness's later ability to recall persons and events.
Long-term repression	Traumatic experiences can be repressed for many years and then recovered.
False childhood memories	Memories people recover from their own childhood are often false or distorted in some way.
Discriminability	It is possible to reliably differentiate between true and false memories.
Child witness accuracy	Young children are less accurate as witnesses than are adults.
Child suggestibility	Young children are more vulnerable than adults to interviewer suggestion, peer/group pressures and other social influences.
Elderly witnesses	Elderly eyewitnesses are less accurate than are younger adults.

3. Results

3.1. Law enforcement knowledge of eyewitness testimonies

The opinions of law enforcement officials were similar to or coincided with those of the experts in the majority of the cases (see Table 2).^{*31} Just as the experts, the law enforcement officials found that child witnesses were more inaccurate and could be more easily led than adults. In the question about the lineup, law enforcement and experts alike thought that the speed of identifying the persons was related to the accuracy of their identification; it was more difficult to identify a disguised perpetrator; the presence of a weapon in the incident reduced the accuracy of identification, while exposure to a mug shot before the identification increased the likelihood of identifying the same person later on. In the statements concerning memory, it was reckoned similarly to the experts that the witness's attitudes influenced the perception of an event; the influence of co-witnesses on eyewitness testimonies was significant; alcoholic intoxication influenced the way the event was remembered and what questions were asked affected the eyewitness testimony.

Statistically significant differences ($p < .05$) between law enforcement and expert opinions appeared in six statements by using chi-square (χ^2) test^{*32}, in relation to lineup in four cases, and in perceiving the nature of the memory in two cases.

³¹ The asterisk in Table 2 shows the opinion of the experts about the statement; if the percentage of the law enforcement choosing the rating is low, this demonstrates the contradiction between the opinions expressed by the law enforcement and experts.

³² The chi-square test measures the difference between the frequency distribution of responses given by the groups compared.

Table 2. Distribution of assessments to statements by law enforcement and lay people related to eyewitness testimony (in percentages).

	Law enforcement						Lay people						p
	Agree	N	Dis-agree	n	Do not know	n	Agree	n	Dis-agree	n	Do not know	n	
Identification speed	84%*	58	9%	6	7%	5	75%	72	18%	17	7%	7	Ns
Effects of headwear	73%*	50	12%	8	15%	10	90%	86	6%	6	4%	4	.023
Minor details	81%	56	4%*	3	15%	10	74%	71	11%	11	15%	14	Ns
Attitudes and expectations	87%*	60	6%	4	7%	5	89%	85	4%	4	7%	7	Ns
Conducting lineups	23%*	16	52%	36	25%	17	58%	56	21%	20	21%	20	.001
Effects of post-event information	84%*	58	7%	5	9%	6	71%	68	18%	17	11%	11	Ns
Confidence-accuracy	48%	33	28%*	19	24%	17	38%	36	42%	40	20%	20	Ns
Confidence malleability	60%*	41	10%	7	30%	21	61%	59	9%	9	30%	28	Ns
Weapon focus	56%*	39	13%	9	31%	21	62%	60	23%	22	15%	14	.03
Mug-shot-induced bias	86%*	59	4%	3	10%	7	81%	78	13%	12	6%	6	Ns
Line-up format	8%*	5	46%	32	46%	32	25%	24	35%	34	40%	38	.03
Forgetting curve	96%*	66	4%	3	0%	0	89%	85	8%	8	3%	3	Ns
Stress	87%*	60	4%	3	9%	6	77%	74	12%	12	11%	10	Ns
Showups	23%*	16	26%	18	51%	35	31%	30	23%	22	46%	44	Ns
Lineup fairness	32%*	22	40%	28	28%	19	26%	25	60%	58	14%	13	.029
Lineup instructions	55%*	38	29%	20	16%	11	58%	56	23%	22	19%	18	Ns
Exposure time	56%*	39	34%	23	10%	7	66%	63	24%	23	10%	10	Ns
Colour perception	45%	31	19%	13	36%*	25	64%	61	4%	4	32%	31	.005
Wording of questions	84%*	58	9%	6	7%	5	91%	87	6%	6	3%	3	Ns
Unconscious transference	64%*	44	9%	6	27%	19	71%	68	6%	6	23%	22	Ns
Trained observers	33%	23	36%	25	31%*	21	16%	15	58%	56	26%	25	.01
Hypnotic accuracy	9%	6	12%*	8	79%	55	28%	27	14%	13	58%	56	.005
Hypnotic suggestibility	22%*	15	3%	2	75%	52	30%	29	9%	9	61%	58	Ns
Event violence	43%	30	29%	20	28%*	19	42%	40	46%	44	12%	12	.029
Cross-race bias	57%*	39	11%	8	32%	47	79%	76	8%	8	13%	12	.006
Alcoholic intoxication	97%*	67	1.5%	1	1.5%	1	98%	94	1%	1	1%	1	Ns
Long-term repression	96%	66	0%*	0	4%	3	92%	88	2%	2	6%	2	Ns
False childhood memories	41%*	28	24%	17	35%	24	51%	49	25%	24	24%	23	Ns
Discriminability	18%	12	40%*	28	42%	29	16%	15	49%	47	35%	34	Ns
Child witness accuracy	47%*	32	44%	30	9%	7	49%	47	26%	25	25%	24	.004
Child suggestibility	96%*	66	1%	1	3%	2	92%	88	4%	4	4%	4	Ns
Elderly witnesses	52%*	36	28%	19	20%	14	62%	60	19%	18	19%	18	Ns

Note: the asterisk (*) marks the prevailing expert opinion about the statement (Kassin *et al.* (Note 11); Wise and Safer (Note 11)); in some categories, the experts do not have a common opinion about the manifestation of an effect because the results of surveys have been contradictory; that is why the experts have submitted the answer 'cannot tell' to some statements.³³ The table shows the distribution of the ratings as percentages and as absolute values (n); while the statistical significance (p) has also been presented. Ns here shows the absence of a statistically different variation.

³³ S. M. Kassin *et al.* (Note 11); R. A. Wise, M. A. Safer (Note 11).

A witness's ability to recall minor details about a crime is a good indicator of the accuracy of the witness's identification of the suspect later on. Law enforcement officials agreed with the statement; however, research has found that at best, the connection between the ability to recall details and the accuracy of identification is not significant.^{*34} The difference here is that different sections of memory are used for active recollection and identification and there is no one-on-one relationship between them.^{*35} This can lead to a situation in which an individual remembers details of the incident but cannot identify the person or *vice versa*.

At trial, an eyewitness's confidence is a good predictor of his or her accuracy in identifying the suspect. Law enforcement agreed with the claim, but research has shown that the relationship between the confidence of the witness and the accuracy of identifying the suspect is not significant.^{*36} The witness's social skills and personality traits (e.g., an excellent and persuasive appearance in court) are only loosely related to the quality of his or her memory (the accuracy of identifying the suspect). For instance, it has been established in the US that the witness's confidence has a particularly significant effect on the jurors, who can be misled by that (since they need not know much about judicial procedures and psychology of memory).^{*37}

A preliminary investigator who knows which member of the lineup is the suspect should not conduct the lineup. In the case of this statement law enforcement officials believed that the lineup administrator did not have an effect on the identification of the suspect, whereas research has established that the administrator can lead the outcome in a suitable direction, for instance, transmit unwittingly nonverbal or verbal signals when instructing the witness (changes in the tone of voice or speaking speed, unintended gestures).^{*38}

Witnesses are more likely to misidentify someone when a lineup is presented simultaneously (all members of a lineup are presented to the witness at the same time) as opposed to a sequentially (all members of a lineup are presented to the witness/victim individually). Contrary to the survey results^{*39}, law enforcement thought that a simultaneous lineup would decrease misidentification. One of the most important debates in legal psychology over the past decades has been which lineup format has the fewest negative side-effects, that is, misidentification. To date, the prevailing opinion is that if persons are presented to the witness sequentially, that is, one by one, then in the case of each person seen the witness compares him or her to the memory of the perpetrator that he or she has and such an absolute judgment process is more accurate. However, simultaneous lineup starts a process of relative judgment in which the witness can erroneously identify a person who resembles the most (but not precisely) the image that he or she has of the perpetrator in his or her memory.^{*40}

In the case of the two latter statements, law enforcement officials thought that their activities did not have an effect on the witness's ability to identify the suspect. Yet it has to be kept in mind that errors made upon identification, particularly if this is one of the few pieces of evidence there is against the suspect, can lead to misidentification.

Eyewitnesses have larger difficulty remembering violent than non-violent events. Law enforcement considered the statement truthful, although based on research the experts are currently of the opinion that there could be no conclusive assessment on the effect of violent events on witnesses.^{*41} Some studies have found that it is more difficult to recall violent events (when actual crimes and their witnesses have been studied, i.e., studies carried out in an uncontrolled environment), whereas other studies have not identified such an effect (studies carried out in a laboratory and controlled environment where there is no immediate threat to the person's life).^{*42} Hence, according to experts, it is difficult to have a common position about the effect of violent events on human memory.

Traumatic experiences can be repressed for many years and then be recovered. Law enforcement is of the opinion that such a relationship existed, while there is no common opinion about the proposition

³⁴ S. M. Kassin *et al.* (Note 11).

³⁵ R. C. L. Lindsay, D. F. Ross, J. D. Read, M. P. Toglia. *Handbook of eyewitness psychology: Memory for People*. Mahwah, NJ: Lawrence Erlbaum 2006.

³⁶ S. M. Kassin *et al.* (Note 11); R. A. Wise, M. A. Safer (Note 11).

³⁷ G. L. Wells, A. Memon, S. D. Penrod. *Eyewitness Identification Procedures: Recommendations for Line-ups and Photo-spreads*. – *Law and Human Behavior* 1998/6, pp. 603–647.

³⁸ *Ibid.*; R. A. Wise, M. A. Safer (Note 11).

³⁹ S. M. Kassin *et al.* (Note 11); R. A. Wise, M. A. Safer (Note 11).

⁴⁰ G. L. Wells *et al.* (Note 37); G. L. Wells *et al.* (Note 5).

⁴¹ S. M. Kassin *et al.* (Note 11); R. A. Wise, M. A. Safer (Note 11).

⁴² K. A. Deffenbacher, B. H. Bornstein, S. D. Penrod, E. K. McGorty. *A meta-analytic review of the effects of high stress on eyewitness memory*. – *Law and Human Behavior* 2004/6, pp. 687–706.

among the experts.^{*43} Studies of traumatic experiences have demonstrated that the incidence of errors is significant when recalling repressed experiences compared to other memories, although there is no objection to the fact that memories could be repressed and then recovered after a period.^{*44} As a result, experts do not have a very clear position related to the surfacing of traumatic repressed experiences (which also highly depends on the individual).

It appeared across the three following statements (where there was no statistically significant difference compared to the experts) that the law enforcement officials were not certain in their assessments and rather replied 'do not know', while the experts shared a clear opinion based on the results of the survey.

Slightly more than one-half of law enforcement officials (51%) could not assume a position about the showup statement. Experts believe that the statement is truthful, that is, if a witness sees a presumed suspect and has to decide whether he or she is the person who attacked the witness, there is greater likelihood that the witness identifies the suspect compared to a situation in which the witness saw the suspect in a lineup with five or six persons.^{*45} Nearly 80% of the law enforcement officials responded to the statement about the hypnotic accuracy that they did not know; experts think that such a statement is false as the survey results have not confirmed the positive effect of hypnosis on the accuracy of eyewitness testimonies.^{*46} Of the law enforcement officials, 75% claimed that they did not know about hypnotic suggestibility, while the experts considered the statement as truthful. Surveys have confirmed that hypnosis increases susceptibility to leading questions, which is manifested as an increase in inaccurate information in the responses given by the witness.^{*47}

3.2. Knowledge of law enforcement according to office

When analysing the assessments submitted by judges, prosecutors, preliminary investigators and juvenile police officers to the statements separately, no differences emerged in most cases. This is indicative of a uniform approach to the preparation and training of law enforcement officials and could have been enhanced by the partial specialisation that has taken place among them (e.g., persons conducting proceedings only in offences against minors).

Statistically significant differences between the bodies conducting proceedings were revealed by chi-square test in the following five propositions (see Table 3, probability level $p < .05$), of which one was related to the role of memory in recalling the events and four statements were related to identification.

In the case of a statement related to the role of memory (violent nature of events), the agreement rate among judges and juvenile police officers was higher, the preliminary investigators disagreed and the prosecutors rather did not know. The experts are of the opinion that there is no conclusive and common position yet about the effects of violent experience on human memory.^{*48}

The positions of the representatives of various offices differed about the identification as regards the following propositions. The assessments submitted to the statement of lineup format by the preliminary investigators were mostly negative, whereas the rest of the participants predominantly said that they did not know. The prosecutors, preliminary investigators and juvenile police officers had mostly agreed to the statement about unconscious transference, just as the experts, whereas the judges had rather answered that they did not know. In the case of the proposition about conducting a lineup, the judges had similarly to the experts' position mostly agreed with it, while the preliminary investigators and prosecutors had mostly disagreed. Like the experts, the judges and prosecutors had rather agreed with the statement regarding lineup instructions and the preliminary investigators had disagreed.

⁴³ S. M. Kassir *et al.* (Note 11); R. A. Wise, M. A. Safer (Note 11).

⁴⁴ I. M. Cordón, M.-E. Pipe, L. Sayfan, A. Melinder, G. S. Goodman. Memory for traumatic experiences in early childhood. – *Developmental Review* 2004/1, pp. 101–132.

⁴⁵ B. W. Behrman, S. L. Davey. Eyewitness Identification in Actual Criminal Cases: An Archival Analysis. – *Law and Human Behavior* 2001/5, pp. 475–491.

⁴⁶ S. M. Kassir *et al.* (Note 11).

⁴⁷ P. T. Malinoski, S. J. Lynn. The plasticity of early memory reports: Social pressure, hypnotizability, compliance, and interrogative suggestibility. – *International Journal of Clinical and Experimental Hypnosis* 1999/4, pp. 320–345.

⁴⁸ *Ibid.*

Table 3. Distribution of assessments by law enforcement officials to the statements (in percentages).

Statement	Agree (%/n)	Disagree (%/n)	Do not know (%/n)
Event violence	43%	29%	28%*
Judge	44 (7)	38 (6)	18 (3)
Prosecutor	45 (5)	0	55 (6)
Preliminary investigator	31 (8)	54 (14)	15 (4)
Juvenile police officer	69 (11)	0	31 (5)
Lineup format	8%*	46%	46%
Judge	19 (3)	13 (2)	68 (11)
Prosecutor	18 (2)	36 (4)	45 (5)
Preliminary investigator	4 (1)	73 (19)	23 (6)
Juvenile police officer	0	31 (5)	69 (11)
Unconscious transference	64%*	9%	27%
Judge	44 (7)	0	56 (9)
Prosecutor	73 (8)	9 (1)	18 (2)
Preliminary investigator	69 (18)	19 (5)	12 (3)
Juvenile police officer	75 (16)	0	25 (4)
Conducting lineups	23%*	52%	25%
Judge	50 (8)	19 (3)	31 (5)
Prosecutor	18 (2)	55 (6)	27 (3)
Preliminary investigator	4 (1)	85 (22)	11 (3)
Juvenile police officer	25 (4)	38 (6)	38 (6)
Lineup instructions	55%*	29%	16%
Judge	82 (13)	12 (2)	6 (1)
Prosecutor	73 (8)	18 (2)	9 (1)
Preliminary investigator	31 (8)	65 (17)	4 (1)
Juvenile police officer	56 (9)	0	44 (7)

Note: the asterisk (*) marks the current prevailing opinion of foreign experts about the statements.^{*49} Absolute values are given in brackets.

In the case of a statement related to the role of memory (violent nature of events), the agreement rate among judges and juvenile police officers was higher, the preliminary investigators disagreed and the prosecutors rather did not know. The experts are of the opinion that there is no conclusive and common position yet about the effects of violent experience on human memory.^{*50}

The positions of the representatives of various offices differed about the identification as regards the following propositions. The assessments submitted to the statement of lineup format by the preliminary investigators were mostly negative, whereas the rest of the participants predominantly said that they did not know. The prosecutors, preliminary investigators and juvenile police officers had mostly agreed to the statement about unconscious transference, just as the experts, whereas the judges had rather answered that they did not know. In the case of the proposition about conducting a lineup, the judges had similarly to the experts' position mostly agreed with it, while the preliminary investigators and prosecutors had mostly disagreed. Like the experts, the judges and prosecutors had rather agreed with the statement regarding lineup instructions and the preliminary investigators had disagreed.

⁴⁹ R. A. Wise, M. A. Safer (Note 11).

⁵⁰ *Ibid.*

3.3. Comparison of assessments of law enforcement and lay people

When comparing the accuracy of the assessments of law enforcement officials with that of lay people, it appears that both were incorrect to an equal degree in their assessments (27.4%, see Table 4). The lay people were more accurate in considering the statements; law enforcement officials were more cautious and more often stated that they did not know, compared to the lay people. Such a result obviously stems from the fact that law enforcement has to weigh their judgments very carefully and they do not assume a position when they do not, for example, have the information, while lay people tend to form a judgment also when information is insufficient.

Table 4. Accuracy of assessments to the statements by law enforcement and lay people (in percentages).

	Accurate	Inaccurate	Do not know
Law enforcement	50.2% (n=1135)	27.4% (n=619)	22.4% (n=506)
Lay people	55.2% (n=1700)	27.4% (n=844)	17.4% (n=536)

Note: absolute values are given in brackets.

A statistically significant difference between the bodies conducting proceedings and lay people was identified in chi-square test in eleven statements (see Table 2). In some statements, the assessments of the lay people resembled more those of the experts than the assessments submitted by law enforcement. For example, in the statement about conducting the lineup, 58% of the lay people thought similarly to the experts that the lineup procedure had an effect on the accurate identification of the suspect (compared to 23% among the bodies conducting proceedings). A similar outcome appeared regarding the lineup format (sequential lineup decreases the number of erroneous identification compared to simultaneous lineup), use of head-wear for disguise (makes identification later on more difficult) and cross-race bias (people of the same race as the witness are identified more accurately than people of other races).

In some statements, the statistically significant difference between the assessments of law enforcement and lay people was caused by one or the other group choosing more often the answer 'I do not know' (such as law enforcement in lineup fairness and focus on a weapon and the lay people in child witness accuracy). As regards the violent nature of events, the lay people tended to rather agree or disagree with it, although no conclusive opinion could be detected among the law enforcement officials (and experts). A similar effect appeared to a lesser extent in the statement about the colour perception. The lay people thought more often than the law enforcement officials that the experience had no effect; law enforcement and lay people knew equally little about hypnotic accuracy, while the agreement rate concerning the statement was lower among law enforcement officials (responding more often that they did not know) than lay people.

4. Discussion

When comparing the assessments of law enforcement with the opinions of the experts regarding eyewitness testimony, they coincided in most parts. The largest differences were concerning accurate identification when comparing the opinions of law enforcement and experts (as well as between law enforcement officials themselves), especially regarding lineup and the factors affecting it. In Estonian law, the regulation of the procedure for a lineup is rather scanty⁵¹, namely that 'a person, thing or other object shall be presented for identification with at least two other similar objects'. It has not been expressly described how the act of presentation should be carried out (e.g., simultaneously or sequentially). Hence, it is understandable that Estonian law enforcement officials thought that a simultaneous lineup would be more efficient as this method is mainly used in practice. It can also be that law enforcement either (1) is not aware of the strengths and weaknesses of different lineup methods, or (2) there is no procedural precedent of using sequential lineups.

The difference between law enforcement and lay people was larger in areas that presumed better knowledge of legal psychology compared to common knowledge (e.g., alcoholic intoxication has an adverse effect

⁵¹ Subsection 81 (2) of the Code of Criminal Procedure (kriminaalmenetluse seadustik). – RT I 2003, 27, 166; RT I, 14.03.2011, 3 (in Estonian).

on a person's memory). The law enforcement officials were more cautious when assessing the statements, claiming more often that they did not know. Hence, if law enforcement officials are not confident about the truthfulness of the statement, they remain undecided and hypothesise less about the effect compared to the lay people, as the professional judgments of law enforcement are often quite weighty and consequential.

When we attempt to evaluate the knowledge of Estonian law enforcement with the factors having effects on eyewitness testimony, we must first underline that law enforcement officials (i.e., judges, prosecutors and preliminary investigators) were examined in Estonia, while judges have been examined elsewhere. The surveys carried out on judges in foreign countries have revealed that the judges' knowledge is rather limited.^{*52} In the case of US judges, the accuracy of assessing statements similar to the present survey amounted to 55%^{*53}, in China to 47%^{*54}, in Norway to 63%^{*55} (and 50.2% in Estonia). For example, in Norway, the authors believed that as the country was compact and there had been several high-profile cases (which had been discussed in the media), they had attracted more attention and the awareness of the factors having effects on the eyewitness testimony was better.^{*56} At the same time, it is emphasised that the surveys help identify shortcomings in the judges' knowledge and, for example, prepare relevant guidelines for improving their knowledge. Hence, it may be concluded that the knowledge of law enforcement in Estonia is similar to the results identified in other countries regarding the assessment of factors that influence eyewitness testimony.

It is important to highlight two areas to which law enforcement should pay more attention than before. The first concerns eyewitness testimony related to pre-trial procedure. This includes, for instance, the required lineup procedures as well as the efficient interviewing of witnesses and victims, proceeding from their peculiarities (and that of the event). This survey revealed that whereas the judges and prosecutors agreed to the statement that the instructions by an official could have an effect on the eyewitness's willingness to make an identification accurately in the lineup, the preliminary investigators disagreed. The instances in which a lineup is conducted by an investigator working on the case are rather frequent.^{*57} It is particularly dangerous in light of the outcome of the Innocence Project, where there are already enough examples of the adverse effect of eyewitness testimony on wrongful convictions. It is understandable that it complicates the work of the person conducting the proceedings if the lineup procedure is to be conducted by someone else (as this reduces the threat that the lineup administrator 'leaks' nonverbal information about the suspect); at the same time, the involvement of another person in conducting the proceedings increases the reliability that the witness/victim makes as accurate a decision as possible based on the memories that he or she has. Thus, better knowledge of eyewitness testimony would help achieve a more transparent pre-trial procedure than before. That is why it would be important to train the relevant law enforcement officials in the factors influencing eyewitness testimonies, for example, how to conduct lineups in an even more transparent manner.

Also, if in judicial proceedings, the judge is more familiar with the area of eyewitness testimony (has passed relevant training or read guidelines), he or she can (engaging an expert, if necessary) better evaluate the evidence collected during both the pre-trial and judicial proceedings (the person's testimony and reliability, issues related to lineups). In the Estonian legal system, an expert in forensic psychology often plays the role of a clinical psychologist (e.g., in the issues of the person's intellectual abilities or manifestation of emotional agitation) but the expert can also educate the court about issues regarding the memory and identification.^{*58} That is why besides using relevant training and guidelines, the author encourages using the help provided by experts for educating the parties in judicial proceedings.

⁵² R. A. Wise, M. A. Safer (Note 11); S. Magnussen *et al.* (Note 7); R. A. Wise *et al.* (Note 21).

⁵³ R. A. Wise, M. A. Safer (Note 11).

⁵⁴ R. A. Wise *et al.* (Note 21).

⁵⁵ S. Magnussen *et al.* (Note 7).

⁵⁶ *Ibid.*

⁵⁷ G. L. Wells *et al.* (Note 37).

⁵⁸ See, e.g., decision No. 1-10-3575 of the Tallinn Circuit Court, paragraph 6.

5. Conclusions

In conclusion, it can be said that the survey confirms the results of previous studies which have established that in some areas the opinions of law enforcement are very close to those of experts and some areas are characterised by larger differences.⁵⁹ As the lay people, based on their common knowledge, did not make considerably more mistakes than law enforcement, this implies the latter's limited knowledge of eyewitness testimony. To avoid the effect of erroneous eyewitness testimony on the legal system and the decisions made within its framework, it would be important to harmonise the knowledge of law enforcement with the area and keep up to date with the latest research results. Guidelines, training days or instructions about eyewitness testimony and the related factors would contribute to it.

⁵⁹ S. M. Kassir *et al.* (Note 11); R. A. Wise, M. A. Safer (Note 11); S. Magnussen *et al.* (Note 7); R. A. Wise *et al.* (Note 21).



Julia Laffranque

*Judge, European Court of Human Rights
Professor of European Law, University of Tartu
President of the Estonian Association for European Law
and President of FIDE 2011–2012*

FIDE—Uniting Great Minds of European Law:

50 years of the International Federation for European Law

Many people might associate ‘FIDE’, first and foremost, with the World Chess Federation (Fédération Internationale des Échecs, known as FIDE from its French initials). Among the legal profession, however, ‘FIDE’ refers to the International Federation for European Law (Fédération Internationale pour le Droit Européen). This has been the case for several decades already: FIDE is celebrating its 50th birthday in September 2011. To me, personally, this letter combination means even more: ‘F’ as in friends and friendship, ‘I’ as in interest and influence in European law, ‘D’ for dynamic development of ‘E’uropean law. Or one could just think of FIDE as ‘Friends of Institutions and Development of the European Union and its Law’!

FIDE—more than just an association

FIDE is not a regular not-for-profit organisation, nor is it an ordinary lawyers’ association. It is a federation that involves traditions and rules of conduct; it is an institution that has become a symbol of sorts in the field of European law and has shaped a particular cultural area of European law.

Established in September 1961 in Brussels, where the first FIDE congress also took place, FIDE is committed to research and development of European Union (hereinafter referred to as the EU) law and EU institutions.

Although FIDE specialises more narrowly in studying the law of the (former) European Communities, nowadays that of the European Union, that does not rule out dealing with European law generally, as the name of the association suggests. European law means, among other things, the European law drafted by the Council of Europe or the European Court of Human Rights as the latter interprets the European Convention on Human Rights. The law of the European Union is often closely related to European law in a broader sense, and increasingly so—for instance, the 2012 FIDE Congress is going to include a topic area in which we plan to analyse the connections between the law of the European Union, Member States’ laws, and the European Convention on Human Rights. It is clear that European law cannot be viewed separately from the law of Member States, and many fields of study and FIDE Congress topics address precisely the interpretation and application of European law in the context of Member States’ laws.

FIDE operates on the basis of its statutes¹, pursuant to which the federation is an impartial and non-profit-making association set up in accordance with Belgian law. Because the association has been growing rapidly and successfully and has gained popularity among many researchers of European law, there has been a need to supplement the statutes, especially the part concerned with admission to membership in FIDE, with additional guidelines: interpretation guidelines concerning criteria for admission to membership in FIDE, which were approved by the FIDE Comité Directeur at its meeting on 28 May 2008 in Linz, Austria.

FIDE comprises European law associations operating in various European countries. That explains the title ‘international federation’; i.e., this is an umbrella organisation. The FIDE members are European law associations from all Member States of the European Union, except Lithuania and Romania, where the respective national organisations are still being created. In addition to organisations from EU Member States, a European law association from EU-acceding state Croatia and corresponding associations from EFTA member states Switzerland and Norway have also joined FIDE. Therefore, FIDE has member organisations from, in total, 28 European countries.

To gain membership in FIDE, a national organisation must meet relatively strict criteria. Firstly, it has to be an association from a member state of the European Union or a state enjoying official candidate status with the European Union, or at the very least an organisation from a country where EU law is applied. In order to join FIDE, the country in question needs to have an association for European law, which, pursuant to the FIDE Statutes and their interpretation guidelines, must be not an economic enterprise intended to generate profit but a non-profit-making private association established under the law of the relevant state. Said association must be completely independent and impartial and must not be related to any state or public institution; for example, an institute providing education to generate income or even an EU law chair or department of a university cannot be a member of FIDE. An important criterion for admission to FIDE is that the applicant association must be devoted exclusively—I stress, exclusively—to European law research in its activity. It is, therefore, not enough to be an association dealing with international law in general: the association must be a European law association specifically. Also, legal questions must not be of secondary importance in the association. An organisation focusing mainly on general, economic, political, historical, and other such aspects of the European Union would therefore not qualify for FIDE membership. From each state, only one European law association may join FIDE. It is important that the association be representational in its country and comprise European law enthusiasts from as diverse legal professions as possible: professors, academics, judges, advocates, other practising lawyers, etc. Preferably, also it should include judges in the court system of the European Union who have been selected from the relevant state. In gaining of admission to membership in FIDE, the following factors play an important role: the extent and quality of the association’s activity in the area of ‘the study and development of the law and institutions of the European Union’ and the number and standing of the members of the association. Theoretically, another international organisation could join FIDE as well. However, no association has a subjective right to be admitted to membership in FIDE.

The highest directing body of FIDE is the executive committee, known by its French title ‘Comité Directeur’ (hereinafter referred to as the CD). It automatically includes the presidents of all so-called national FIDEs, who may also bring their deputies to meetings. The management of the European law associations of FIDE member states typically consist of their president, vice-president and/or secretary-general and treasurer; some associations may also have an honorary president. The Comité Directeur meets once a year and decides on all important issues related to the activity of FIDE; at these ‘CD meetings’, the future directions and developments of the organisation’s activity are determined, the admission of new members is decided upon, and international congresses are planned. Although English, French, and German all enjoy official status in FIDE, CD meetings take place in English.

The presidency of FIDE is held by the association of the member state where the FIDE Congress, organised every two years, is currently being held (or next to be held), and the president of FIDE is its president. The holding of the congress is one of FIDE’s main activities and its most important form of expression.

¹ Available at http://www.fide2012.eu/index.php?doc_id=4 (15.7.2011).

Interest in European law

Pursuant to the FIDE Statutes, the intended aims of FIDE are as follows^{*2}:

- to promote the objectives of the member associations, in particular by organising common events and by encouraging contacts and exchange of information between them
- to bring together lawyers who are interested in European law and the laws of European countries
- to study together the solutions to the legal problems that occur in all areas in consequence of the evolution of the structures and institutions of the European Community
- to make all who are interested aware of the importance of these problems.

At the time when FIDE was established, the European Communities had fewer than 10 Member States: the association was founded soon after the birth of the European Communities themselves, without even the first enlargement of the European Communities having yet taken place. During a colloquium on European law organised by German FIDE President Prof. Jürgen Schwarze and held at the University of Freiburg on 13 May 2011, Professor Ulrich Everling from Bonn, a former judge at the European Court of Justice and the head of the European Department of the German Federal Ministry of Economics, reminisced about the early years of the European Communities, calling the lawyers specialising in European law in the early 1960s ‘exotic’ in their work.^{*3} According to him, experts in European law formed an isotheric circle (*isotherischer Kreis*) at the time, not really a part of the school of constitutional lawyers or that of international law experts. In Germany, at least, the situation changed only in the 1980s when European law slowly started to be taken seriously as a separate research subject.^{*4} Prof. Everling’s comparison was very clever, and it accurately describes the situation in the early 1990s in Estonia—when it was a new candidate state—where I remember being looked at as if I were an alien from Mars for being interested in European law. According to former President of the European Commission Jacques Delors, the formation that has emerged as a result of European integration can be regarded as a UPO (unidentified political object)^{*5}; similarly, the researchers who specialised in European law in the early years of the European Communities/Union or before their respective country’s accession too were among the ‘little green men’. No wonder then that a small group of recognised researchers who were studying European law in depth came together from all over Europe and joined forces. That association developed into a very strong advocacy group whose importance in influencing the legislative drafting and judicial practice of the early years of the European Communities is hard to overestimate. FIDE successfully put into practice the view of Walter Hallstein, who was elected as President of the European Commission in 1958, on the central importance of legal framework for European integration. Hallstein found, namely, that violence and political pressure would be replaced by the dominion of law in the relationships between Member States: ‘In den Beziehungen zwischen den Mitgliedstaaten werden Gewalt und politischer Druck durch die Herrschaft des Rechts ersetzt.’^{*6} Today, the promotion of a state based on the rule of law and the protection of fundamental rights are still important bases for both the European Union and the activity of FIDE. The current motivation of FIDE should also be to expand the circle of people interested in European law and to involve young enthusiasts in its work.

Thus it was that interested people quickly began to influence European legislative drafting and development.

² See Article 4 of FIDE Statutes. Available at http://www.fide2012.eu/index.php?doc_id=4 (15.7.2011).

³ Professor Ulrich Everling, das Institut für Öffentliches Recht, Abteilung Europa- und Völkerrecht der Universität Freiburg, Fachtagung: ‘Das Verhältnis von nationalem Recht und Europarecht im Wandel der Zeit’, 12.–14.5.2011.

⁴ See also Morten Rasmussen, who finds that the situation with regard to European law generally began to change in the 1960s: M. Rasmussen. Constructing and Deconstructing “Constitutional” European Law. Some reflections on how to study the history of European law. – H. Koch, K. Hagel-Sørensen, U. Haltern, H. H. Joseph (eds.). Europe. The New Legal Realism. Essays in Honour of Hjalte Rasmussen. Djøf Publishing 2010 pp. 643.

⁵ Also Rodolphe Laffranque in his presentation ‘The Process of Constitutionalising EU/EC Treaties and the Sovereignty of Member States: Dilemma Seen from the Perspective of French Law’ (EL/EÜ lepingute konstitutsionaliseerimise protsess ja liikmesriikide suveräänsus: dilemma Prantsuse õiguse vaatepunktist nähtuna) in the framework of the Euro training programme for national officials organised by the Estonian Law Centre and the Ministry of Justice 17.2.2000. See also J. Laffranque. Kas ühinev Euroopa vajab ühtset konstitutsiooni? (Does the Merging Europe Need a Uniform Constitution?) – Juridica 2000/7, pp. 471–481 (in Estonian).

⁶ Nachlass Walter Hallstein. Bestand 1266. Koblenz 1998, p. 396. Die europäische Wirtschaftsgemeinschaft ist eine Rechtsgemeinschaft. Rede des Präsidenten der Kommission der Europäischen Wirtschaftsgemeinschaft Prof. Dr. Jur. Walter Hallstein vor der Universität Padu gehalten am 12. März 1962.

Influence on the development of European law. A platform for new ideas in European law

However, in addition to legislative drafting, the European (Union) Court of Justice and its jurisprudence also play an undisputedly irreplaceable role in the law of the European Union. One of the best options for establishing the jurisprudence of the European Court of Justice is the preliminary references of the courts of Member States to the supranational European Court of Justice. To ensure more systematic co-operation of national judiciaries in the application and development of European law, the establishment of an independent academic field of European law was needed. Morten Rasmussen writes that it was the creation of FIDE at the initiative of the French Association Française des Juristes Européens and in close co-operation with the legal service of the European Commission that was the first major step in that direction.^{*7} Rasmussen goes even further and finds that FIDE was behind the first round of test preliminary references from Dutch courts to the European Court of Justice, in particular of the *Van Gend en Loos* case in late 1962, which led to the so-called direct effect of the European Community (Union) law doctrine.^{*8} Indeed, it was the Dutch Association for European Law (Nederlandse Vereniging voor Europees Recht) that organised the second FIDE Congress, on the self-executing nature of EC founding treaties, held in the Hague in 1963 with the participation of lawyers who defended the transport company Van Gend en Loos before the Dutch Tariffcommissie.^{*9} Also, two of the five judges of the highest Dutch court (Hoge Raad) who requested a preliminary reference from the European Court of Justice in the *van Gend en Loos* case were members of the Dutch Association for European Law (the Dutch FIDE).^{*10}

The aim of FIDE has always been to contribute to the development of European law through discussion of the key themes of European law, giving advice both to the institutions of the European Union and to Member States. The best opportunity for that are the most important FIDE events, the conferences taking place every two years, called congresses, which have become top-class and among the biggest events for practitioners of EU law in the whole world. Russia has expressed interest in FIDE, and the congress publications are read even farther afield.

Previous congresses have taken place, in addition to Brussels and the Hague (as mentioned above), in Paris, Rome, Berlin, Luxembourg, Copenhagen, London, Dublin, Thessaloniki, Madrid, Lisbon, Stockholm, Helsinki, Limassol, and Linz, with some of these cities even being a host twice.

The topics covered include a wide variety of areas, from European agricultural policy to the foreign relations of the European Union.^{*11} One of the topics has always been economic law, mainly competition law, which attracts economic lawyers, as well as some more general and fundamental topics that are analysed also during the plenary meeting.

The FIDE Congress lasts two and a half days on average; at each congress, three main topics are discussed, each in one of three parallel teams, with the results summarised on the last day of the congress, at the plenary meeting. The three main topics are agreed on beforehand, and the general rapporteur for each

⁷ See M. Rasmussen (Note 4), p. 645.

⁸ *Ibid.*, p. 646.

⁹ Deuxième colloque International de droit européen organisé par l'Association Néerlandaise pour le Droit Européen. La Haye 24–26 October 1963, N.V. Uitgeversmaatschappij. W. E. J. Tjeenk Willink, Zwolle 1966, p. 49. See also the presentation by Professor Jacques Ziller from the University of Pavia, delivered in Freiburg on 13 May 2011, das Institut für Öffentliches Recht, Abteilung Europa- und Völkerrecht der Universität Freiburg, Fachtagung: 'Das Verhältnis von nationalem Recht und Europarecht im Wandel der Zeit', 12.–14.5.2011.

¹⁰ See M. Rasmussen (Note 4), p. 647 with further references to historical sources.

¹¹ The topics have included, for example, competition law and its modernisation and application in Member States, including their courts; the relationship between European law and domestic law; European law concerning agriculture and energetics; the judicial practice of the European Court of Justice; European integration; European economic policy; the free movement of persons and social policy; fundamental rights and freedoms; administrative proceeding in Europe; violation of European law and the sanctions imposed for it; the present day and future of the institutions of the European Union; taxation in the European Union; foreign relations of the European Union; media policy; insurance law; fight against dumping; right of establishment of enterprises; banking law; legal aspects of the European cultural policy; employment policy; civil aviation; application of directives; financial services; principle of subsidiarity and principle of loyalty; European environmental law; the right of asylum and immigration; European criminal law; right of state aid in the European Union; the effect of the new services directive on domestic law; the failure of the Treaty establishing a Constitution for Europe and the future of the European Union according to the Lisbon Treaty; private and public capital in the European Union and its legal regulation; the role of national parliaments in the European Union. See the website of FIDE XXV Congress for more information, available at <http://www.fide2012.eu/Previous+Congresses/id/122/> (15.7.2011).

topic has compiled a questionnaire for that topic for the national rapporteurs to fill in. Submitting a member state's report is the best way to influence the development of European law. In addition to the work of national rapporteurs, the topic is addressed in the responses of the rapporteur of EU institutions, who may be a top lawyer with the European Commission, the Council of the European Union, or the European Parliament. On the basis of all of the responses, the general rapporteur compiles a general report on his or her topic, which is printed, along with the questionnaires and all responses to these, in the congress publication and made available already during the congress. The FIDE national organisations decide for themselves who writes the report of the respective member state. These may be submitted in any of the three official languages of FIDE.

At the congress, a discussion is held on each topic; FIDE congresses are among these rare events where conversation flows effortlessly and there is no need to force someone to ask questions—speeches are spontaneous and spirited, and debates lead to new ideas that are born on the spot and are presented at the final meeting and later made available in a supplementary publication.

On the last day, a timely topic that also concerns the future of the European Union and is of interest to everybody is discussed, in addition to the three main topics. Traditionally, the president of the Court of Justice of the European Union is present at the FIDE Congress and also gives a key note speech. The Court of Justice of the European Union supports the country organising the conference by providing professional-level interpretation services, with simultaneous interpretation allowing all presentations and speeches at the congress to be followed in English, French, and German. Many judges and advocates-general participate in the congresses as session chairmen and audience members, as well as speakers. The legal services of other institutions of the European Union (the European Parliament, Council of the EU, and European Commission), led by their director generals, are also represented.

FIDE Congress publications, typically published by well-known publishers of legal literature (NOMOS Verlag, Cambridge University Press, etc.), have become important sources for studies of European law and are often cited.

On the initiative of the Spanish Association for European Law, all FIDE publications have been scanned and are also made available to FIDE members online.^{*12} The Portuguese Association for European Law has published all Portuguese reports presented at FIDE congresses as a separate publication.^{*13} There is always great interest in the publication outside the congress as well. Several acknowledged legal publishers from all over Europe who specialise in European law are also represented at the congress, offering their publications to participants at a reduced rate.

It should also be mentioned that FIDE congresses have been fortunate enough to gain the attention of top-level patrons. Congresses have thus been opened by royalty as well as national presidents, depending on the political order of the country organising the event, in addition to ministers of justice, chief justices of Supreme Courts, and speakers of Parliament, who have also organised receptions.

Friendships beyond borders

It is probably no exaggeration to say that the members of FIDE—who, despite the fact that the organisation is composed of organisations, are nevertheless, and above all, specific persons in charge of promoting European law in their respective countries—have become close friends and formed a community of sorts. Several member organisations are represented in the umbrella organisation by a distinguished and recognised expert in his or her field who is without doubt the life and soul of European law in his or her state and even elsewhere and without whom FIDE would not be the same. It is quite unbelievable that such an important organisation largely functions by very simple, established and unwritten rules of conduct, including gentlemen's agreements, under which an attempt is made to make most decisions by consensus.

The social programme is unquestionably an inseparable element of the congress and meetings. Each organising country of the FIDE Congress is not only the representative of its legal system in FIDE but also introduces its state, region, town, and culture to FIDE members and guests. The congress includes high-

¹² <http://www.fide-europe.eu/>, site temporarily disabled (18.7.2011).

¹³ FIDE/APDE (Associação Portuguesa de Direito Europeu), Estudos de Direito Europeu. Congressos da FIDE Relatórios Portugueses – 1990–2008. Princípio 2009.

level receptions, a cultural programme, formal dinners with a concert, and a special programme (excursions in the host city and sightseeing) for companions.

One could ask why it is important that the elite of EU law come together every two years, write reports, raise problematic issues, try to find solutions to them, and at the same time also relax and dine formally. But only a very small portion of that is financed directly from EU taxpayers' money; the FIDE Congress entry fee is high. Often participants must cover it from their own pocket, and sometimes the employer contributes to paying it, while the organising country of the congress also needs to find sponsors from the private sector in addition to the public sector to bear the expenses related to the congress. The European Union provides no concrete or direct support, apart from the above-mentioned interpretation service from the European Court of Justice. Of course, it would be important for FIDE to involve more young lawyers who are only beginning their careers and who would thereby catch the 'bug' of European law early on, as well as to raise public awareness of European law. To achieve that, participation at a reduced fee is often offered to students. However, it is interpersonal relations in particular that are essential and irreplaceable. Already Jean Monnet has said that it is not states in Europe but people that need to be united^{*14}, and many important directions, much knowledge, and ideas are formed on the basis of personal communication—so why not, then, at a splendid gala dinner in the Guildhall (e.g., at the FIDE Congress in London in 2002)? If a European law expert of one state knows whom to turn to in another country when considering a question that interests him or her, this provides a good basis for effective exchange of information and experience, which can only benefit the search for the perfect solution and which ultimately contributes to the effective protection of the rights of EU citizens.^{*15}

FIDE coming to Estonia

Estonia has been represented at the FIDE Congress already since 2000, when I had the wonderful opportunity and honour—together with my colleague at the time Imbi Markus from the Ministry of Justice—to participate in that year's FIDE Congress in Helsinki, where among other subjects, the fascinating topic of the principle of loyalty between the European Union and Member States, the key to the relationships between this union and its members, was discussed.^{*16} Since then, I have participated in all FIDE congresses, except that in Linz in 2008, where I was nevertheless a co-author of an Estonian report.^{*17} FIDE congresses have also been covered in Estonian legal literature.^{*18} The first national reports for FIDE collections were written by Estonian lawyers for the 2004 FIDE Congress^{*19}, which took place in Dublin and where the Estonian Association for European Law was officially admitted to FIDE, on the condition that all formalities for the establishment of the national FIDE be properly completed. Estonian delegations at FIDE congresses have grown little by little (the XXIV FIDE Congress, which took place in Madrid in 2010, probably boasted the record number of Estonian lawyers—almost a dozen, with Estonia presenting itself as the organiser of the next congress with a display stand there—so far a unique occurrence in FIDE's history), and Estonian reports have also been represented at all recent FIDE congresses.

¹⁴ Si je devais refaire l'Europe, je commencerais par la Culture – 'nous ne mettons pas ensemble les Etats; rassemblons les hommes'. J. Monnet. Mémoires. Paris: Fayard 1976.

¹⁵ On the pan-European co-operation between judges and its usefulness, see, e.g., B. van Lierop, Found in Translation: Some Remarks on International Co-operation Between Judges. Today's Multilayered Legal Order: Current Issues and Perspectives. Liber Amicorum Arjen W. H. Meij. T. Baumé, E.O. Elferink, P. Phoa, D. Thiaville (eds.). Paris 2011, pp. 175–181.

¹⁶ See also its coverage in the Juridica article, J. Laffranque. Lojaalsuse põhimõte Euroopa Liidus ja selle mõju Eestile (Principle of Loyalty in the European Union and its Effect on Estonia). – Juridica 2001/9, pp. 616–625 (in Estonian).

¹⁷ Contribution: Estonia with Lembit Uibo. Preparing the European Union for the Future? Necessary Revisions of Primary Law after the Non-Ratification of the Treaty establishing a Constitution for Europe. – FIDE XXIII Congress Linz 2008. Congress Publication Vol. 1. H. F. Koeck, M. M. Karollus (Hrsg.). Wien: Nomos 2008, pp. 81–113.

¹⁸ See the article by Julia Laffranque (Note 16), pp. 616–625; A. Albi. FIDE 2008. aasta kongress Linzis ning ettevalmistused 2012. aasta Tallinna kongressiks (FIDE 2008 Congress in Linz and Preparations for the 2012 Tallinn Congress). – Juridica 2009/7, pp. 476–477 (in Estonian).

¹⁹ A. Albi, J. Laffranque. National Report. Estonia FIDE Publication: Migration and Asylum Law and Policy in the European Union. – FIDE 2004 National Reports. I. Higin (ed.), K. Hailbronner (general rapporteur). Cambridge: Cambridge University Press 2004; also the contributions by Ilona Nurmela and Natalja Rüütel.

The Estonian Association for European Law (FIDE Estonia) was established on 13 November 2004^{*20}, shortly after Estonia's accession to the European Union, which had occurred a few months earlier in the year. The Estonian Association for European Law is one of the associations of the Estonian Lawyers' Association^{*21}; the latter also includes a business lawyers' association, an administrative lawyers' association, and an association for lawyers from law offices.

A justice of the Estonian Supreme Court, who is a current judge with the European Court of Human Rights and holds the professorship in European law at the University of Tartu (the author of this text), has been elected as the president of the Estonian FIDE ever since its establishment, and the vice-president is a senior lecturer at the University of Kent, Anneli Albi, PhD. There were 24 founding members, and the number of members has at least doubled since the association's establishment.

Among the members of FIDE Estonia are academics, national officials, judges, advocates, notaries, and representatives of many other legal fields. The members also include Estonian lawyers working at EU institutions, such as Estonian judges in the court system of the European Union, Dr. Uno Lõhmus and Mrs. Küllike Jürimäe.

The mission of FIDE Estonia is to contribute to the introduction of the law of the European Union in Estonia and to bring together lawyers interested in European law.

Of the major achievements of the Estonian Association for European Law so, two large-scale conferences in 2005 on the European Constitutional Treaty, each with 300–400 participants, deserve mention; one of these was international, involving acknowledged academics from all over Europe.^{*22} Also the conference titled 'European Law from Rome to Tartu in 50 Years: Half a Century of Treaties of Rome' (*Euroopa õigus 50 aastaga Roomast Tartusse. Pool sajandit Rooma lepinguid*), which took place in Tartu, involved guest lecturers and was co-organised by the Estonian Academic Law Society.^{*23} FIDE Estonia won the project competition for not-for-profit associations organised jointly by the European Union Information Office of the State Chancellery and the Open Estonia Foundation, called 'Estonia and the European Union' (*Eesti ja Euroopa Liit*). Three tutorials, in Haapsalu, Narva, and Põlva (in chronological order), took place in autumn 2005 in the framework of that project competition. In 2010, a conference on the Lisbon Treaty was organised in conjunction with the anniversary of the Estonian Lawyers' Association.

FIDE-Estonia members have constantly provided information and published articles on European law, as well as participated in the work of expert commissions on EU law.

In 2006, the Estonian Association for European Law announced its candidacy for organising a FIDE Congress; two years later, in 2008, Estonia was officially elected as the organising country for FIDE's XXV Congress. The one in Estonia was preceded by the XXIV FIDE Congress, in Madrid, and the next organisers will be Denmark, Hungary, and Portugal. Organising FIDE congresses is somewhat comparable to planning the Olympic Games—in the field of the law of the European Union, that is—so the next organiser definitely needs to introduce itself beforehand in order to take the lead.

Nominating ourselves was a challenge for us, of course, and demanded a lot of energy, but at least from the time Estonia's proposal was conclusively approved, the Estonian Association for European Law has been constantly making preparations for organising the Congress. Previous holders of the FIDE Presidency, such as Finland, Ireland, Austria, and Spain, have been of great help to us, and we have already imparted

²⁰ See A. Albi, J. Laffranque. Asutati Euroopa õiguse ühendus (The Association for European Law Has Been Founded). – *Juridica* 2004/9, pp. 648–649 (in Estonian); and similar articles *Õiguskeel* 2004/5 and *Eesti Majanduse Teataja* 2004/12 (in Estonian).

²¹ See the Statutes of the Association for European Law, available at http://www.juristideliit.ee/media/upload/fide_eeesti_pohimaarus.pdf (18.7.2011) (in Estonian).

²² Conference 'Constitutional Problems of the Treaty establishing a Constitution for Europe' (Euroopa põhiseaduse lepingu riigioiguslike probleeme) dedicated to the 16th anniversary of Estonian Lawyers' Association that took place on 10 March 2005 in Tallinn; an international conference on the Treaty establishing a Constitution for Europe: 'Ratification of the Treaty establishing a Constitution for Europe: Effects on National Constitutions' (Euroopa põhiseaduse lepingu ratifitseerimine: mõjud rahvuslikele põhiseadustele), 3.–4.11.2005. On the same subject, see also J. Laffranque. Euroopa põhiseaduse lepingu peied Tallinnas. Mis saab edasi? (A Wake for the Treaty establishing a Constitution for Europe in Tallinn. What Next?) – *Juridica* 2006/1, pp. 17–23 (in Estonian); J. Laffranque. Arutleti Euroopa põhiseaduslike arengute üle. Ülevaade rahvusvahelisest konverentsist "Euroopa põhiseaduse lepingu ratifitseerimine: mõjud rahvuslikele põhiseadustele" Tallinnas 2005. aasta novembris (European Constitutional Developments Were Discussed. An Overview of the International Conference 'Ratification of the Treaty establishing a Constitution for Europe: Effects on National Constitutions' in Tallinn in November 2005). – *Eesti Majanduse Teataja* 2006/2, pp. 8–12 (in Estonian).

²³ For an article inspired by this, see J. Laffranque. Euroopa õigus 50 aastaga Roomast Tartusse (European Law from Rome to Tartu in 50 Years). – *Diplomaatia* (No. 43) April 2007, pp. 7–9 (in Estonian).

our own experience to the next, Denmark. On 23 October 2008, a preparatory event was held at Tallinn Town Hall to celebrate the arrival of FIDE in Estonia, intended as a substantial introduction to the event for Estonian state agencies and other potential sponsors, where Professor Franz Heribert Köck of Austria shared his FIDE-Congress-organising experience.

On 27 May 2011, a FIDE CD meeting was held in Estonia for the first time. The constructive work conference took place in the building of the Estonian Parliament, the Riigikogu; it was preceded by a trip to Kaberneeme Peninsula and a tour of the Riigikogu and was followed by a reception at Tallinn Town Hall and an excursion within Tallinn. The CD meeting was special also, no doubt, thanks to the mini-conference organised in co-operation between ELSA (the European Law Students Association) and FIDE Estonia that took place the previous day and also took advantage of the presence of excellent lecturers who were going to arrive to the FIDE CD meeting the next day anyway.^{*24} The event turned out to be very popular and also provided a wonderful opportunity to reach out to the younger generation of lawyers of European law.

It is a great honour and challenge to Estonia to be the first Central and Eastern European country to organise a FIDE Congress.^{*25} As mentioned above, the event is going to take place in Tallinn quite soon, in 2012. The XXV FIDE Congress will be a major event for the public, participants, speakers, and sponsors, and we hope it is going to be covered in depth by the press. The media programme related to the congress should also help to explain the essence of the European Union better in language understood by ordinary Estonian people.

The congress will provide a great opportunity for FIDE member states and participants to contribute to shaping the European legal space. National and general reports on the main topics of the congress will be published in three separate volumes. Nearly 500 participants, from all over Europe and beyond, will participate in the FIDE Congress. The working languages of the congress will be, as usual, English, German, and French.

Tallinn is an ideal location for the congress, as delegates will have the opportunity to explore its mediaeval Old Town, a UNESCO World Heritage Site, which was once a major centre of the Hanseatic League. Tallinn's rich architectural heritage reflects Estonia's history from mediaeval to modern times, and the rapid economic progress made during the years of independence.

To ensure the success of this distinguished congress, we are proudly working in co-operation with the Estonian Ministry of Justice, the Estonian Ministry of Foreign Affairs, the Supreme Court of Estonia, the National Audit Office of Estonia, the University of Tartu, the Tallinn University of Technology, the European Parliament Information Office in Estonia, the Court of Justice of the European Union, the Representation of the European Commission in Estonia, the Estonian Bar Association, MAQS Law Firm, and the Tallinn City Government. We are glad to have received support also from Enterprise Estonia (EAS), established in 2000, which promotes business and regional development in Estonia.

The main topics of the XXV FIDE Congress are relevant to all European countries, including Estonia, as they touch upon the vital issues concerning all of us in Europe. They were carefully chosen in co-operation with Estonian research institutes, universities, state agencies, and government institutions as well as lawyers in private practice and Estonian lawyers working in EU institutions, including judges at EU courts, and agreed upon within the FIDE Comité Directeur by its members. The topics of the XXV FIDE Congress are as follows:

1. 'Protection of Fundamental Rights Post-Lisbon: The Interaction between the EU Charter of Fundamental Rights, the European Convention on Human Rights (ECHR) and National Constitutions', with Professor Leonard Besselink of the University of Utrecht as general rapporteur and as EU institutional rapporteur Dr. Clemens Ladenburger, Assistant to the Director-General, Legal Service, European Commission
2. 'The Interface between EU Energy, Environmental and Competition Law', with general rapporteur Professor Peter Cameron of the University of Dundee and EU institutional rapporteur Ms. Eva Kružikova, Principal Legal Adviser of the H-MIME Team (internal market for goods, energy

²⁴ ELSA Estonia organised in co-operation with the International Association for European Law a FIDE seminar 'Seminar on Fundamental Rights and Legal Principles vs Legislative Freedom', 26.5.2011, the seminar was opened by Ave-Geidi Jallai, the President of ELSA Estonia, and Julia Laffranque, the President of FIDE, moderated by the docent of European Law at the University of Tartu Carri Ginter, with speeches by Professors Mads Andenas from Norway and Philippa Watson from Great Britain, as well as research fellow Michal Bobek from the Czech Republic.

²⁵ See also the website of the Estonian Lawyers' Association, available at <http://www.juristideliit.ee/uus/index.php?page=81> (18.7.2011).

(including Euratom), enterprise, customs union, and environment), Legal Service, European Commission

3. 'Area of Freedom, Security and Justice, Including Information Society Issues', with general rapporteur Professor Valsamis Mitsilegas, Queen Mary University of London, and EU institutional rapporteur Mr. Ezio Perillo, Director, Directorate for Legislative Affairs, Legal Service, Secretariat of the European Parliament.

We are particularly enthusiastic about the opportunity to cover the protection of human rights and its importance under all three topics as an overarching theme, especially in the sphere of the first topic. Europe is verging on major changes, as the European Union is about to sign on to the European Convention on Human Rights and thereby contribute to extensive protection of fundamental rights and freedoms across the entire European continent, so that people can get help even if the institutions of the European Union itself violate the fundamental rights of EU citizens.

Furthermore, the president of the Court of Justice of the European Union has promised to appear at the congress, as most likely will the newly elected president of the European Court of Human Rights. Both plan to deliver keynote speeches. Several acknowledged experts—recognised lawyers and judges from FIDE member states, as well as members of the EU Court of Justice and the European Court of Human Rights—are also expected to chair teams at the congress. Jacob Söderman, the former European ombudsman has already agreed to be one of the chairs of the working parties. The organizers of XXV FIDE Congress have also received confirmation from Prof. Bruno De Witte and Prof. Joseph Weiler to speak in the plenary session on EU constitutional framework after the Lisbon Treaty.

The general discussion topic for the last day of the FIDE Congress is going to be 'The Lisbon Treaty and the EU's Constitutional Framework', which should also prove to be extremely timely.

The European Capital of Law

The XXV FIDE Congress has an in-depth Web site that we invite you to kindly visit.^{*26} We also hope that the idea of establishing a permanent FIDE Web site can be concretised; that would definitely donate to increasing the visibility of FIDE throughout Europe.

While the Congress will surely contribute to the development and enrichment of European law, it will also introduce Estonia, Tallinn, and the country's jurisprudence to European and global audiences and help Estonia prepare for the Estonian Presidency of the EU, in the first half of 2018.

Yet the EU and EU law are not just for lawyers and policymakers. The European Union ought to be viewed as an important part of our day-to-day life. Therefore, as hosts of the 2012 FIDE Congress, we would like to give the congress a much wider perspective and offer the people of Estonia and other Europeans for the whole of 2012 a unique opportunity to learn more about their rights under EU law and how they can influence policymaking at different levels. The best way to do so is to look at Tallinn as the Capital of European Law in 2012. As we know, it has become customary in Europe to designate European Capital of Culture locations, an honour that has been bestowed on Estonia's capital for 2011. Inspired by this tradition, Tallinn will be known as the Capital of European Law in the year following this, when it will host one of the most distinguished EU law conferences—i.e., the XXV FIDE Congress. We hope that the idea and designation of Capital of European Law, born in Estonia, will soon be followed by many other European cities, and we very much look forward to sharing this experience with you.

²⁶ See <http://www.fide2012.eu/eng/>.



Raul Narits

Professor of Comparative Jurisprudence, University of Tartu
President of the Law Philosophy Society of Estonia

Iurisprudentia est divinarum atque humanarum rerum notitia, iusti atque iniusti scientia

On 11 November 1997, lawyers gathered at the newly opened building of the Faculty of Law of the University of Tartu—Iuridicum, at Näituse 20—to establish the Estonian Society of Legal Philosophy. The founding members of the society were T. Anepaio, L. Auväärt, J. Ginter, P. Kask, S. Kaugia, T. Kerikmäe, A. Kiris, M. Kiviorg, I. Kull, L. Lehis, U. Liin, M. Luts, K. Merusk, M. Muda, R. Narits, V. Olle, I.-M. Orgo, P. Pruks, M. Sillaots, J. Sootak, and G. Tavits. Two years later, our society became the first in the Baltic region to be accepted unanimously as a member of the International Association for Philosophy of Law and Social Philosophy (hereinafter referred to as the IVR), at its World Congress in New York.

In New York, our application was mediated to the world organisation by Professor W. Krawietz. We were the 45th national branch of the society. Professor Krawietz was also the first one to notify us, writing in his fax:

Lieber Herr Narits! Aus New-York zurück, kann ich Ihnen mitteilen, dass Ihr Antrag erfolgreich abgewickelt wurde. Ich habe ihn (i) im Exekutivkomitee und (ii) im engeren Vorstand der IVR vorgetragen. Hier- wie in der Generalversammlung des Weltkongresses der IVR, wo es von dem amtierenden Weltpräsidenten Herrn Prof. Dr. Enrico Pattaro eingebracht wurde – wurde der Antrag der Estnischen Sektion einstimmig angenommen. Sie sind seit 29. Juni 1999. Die 45. Sektion im Rahmen der Welt-IVR (und die erste im Baltischen!). Gratuliere!

The 100th reporting meeting of the Estonian branch of the International Association for Philosophy of Law and Social Philosophy was held on 10 May this year. Amid the jubilee atmosphere of this reporting meeting, doctoral candidate of the Faculty of Law of the University of Tartu Ü. Vanaisak delivered a presentation that touched upon the problem of how the rights of a minor subject to proceedings should be protected in a state based on the rule of law. We have reached our 100th report meeting (there have been more reports than this because sometimes more than one is made during a meeting) by gathering every second Tuesday each month at 4:00 in the afternoon at Iuridicum. The interest in these reports has constantly been quite high. It has been mainly interest in legal philosophical issues that has brought the listeners to these meetings. It seems that people in the Faculty of Law of the University of Tartu do not share a certain scepticism towards philosophy that says that in its never-ending search for goodness and justice the philosophy of law careers into a situation in which human cognition has no solid anchor(s). It must be added that our report meetings are not merely listening events. Each presentation is always followed by a debate carried by the spirit of *liberum arbitrium*.

Both the selection of presenters and the subject matter has been broad and, of course, related to the research and cognition interests of the presenters. Approximately a tenth of the presentations for our soci-

ety have been made by foreign guests. I would especially like to emphasise that we have made good use of the opportunity to involve the guests of the annual *Academica Week* of the University of Tartu.^{*1} To cite just a few examples of the subject matter of these presentations, I could mention that this April we listened to a presentation on sociology of law as an underlying science of sociological jurisprudence (S. Kaugia); in February 2010, we discussed the limitations imposed by the Estonian Constitution on the President of Estonia (N. Parrest); in February 2009, T. Anepaio brought up the problem of the ‘Middle Ages’ in relation to the Estonian right of ownership; in February 2008, listeners enjoyed the Finnish A. Aarnio’s presentation ‘Reasonable As Rational—on Legal Argumentation and Justification’; in October 2007, the presentation by K. Saaremäel-Stoilov was titled ‘Sotsiaaliigi põhimõtte õigusliku sisustamise ja rakendamise probleemid’ (‘The Problems Related to Legal Furnishing and Implementation of the Principle of Social Justice’); as many as 73 people gathered to listen to I. Pilving’s presentation ‘Kohtute vastutus ja võimude lahusus’ (‘Liability of Courts and Separation of Powers’) in October 2006; in September 2005, a discussion was held on ‘codification’ of private law, led by Professor R. Schulze, from Münster (in Germany); in September 2004, the listeners were intrigued by Professor E. Hilgendorf (of Germany) with his ‘Die Diskussion um Folter’; in March 2003, as Estonia stood on the doorstep of the European Union, R. Narits made a presentation on survival of the Estonian Constitution; J. Rückert from Frankfurt gave the presentation ‘Free and Social: The Century’s Program for Law and State’ in October 2002; in November 2001, M. Luts took the stage at the society’s report meeting with a presentation titled ‘Eraõiguse ajalooline tüpoloogia’ (‘Historic Typology of Private Law’); in November 2000, H. Schneider delved deeply into the subject ‘iseorganiseerumine ühiskonnas kui õiguslik ja õigusteaduslik probleem’ (self-organisation in society as a judicial and legal problem); and in April 1999, Professor H. Siigur discussed the systematics of legal norms.^{*2}

The report meetings are attended not only by the people from Tartu, although most in the audience are scientists working at the University of Tartu and students of all levels (in bachelor’s, master’s, and doctoral studies). Our colleagues from the Supreme Court of Estonia are often present among the listeners. A few years ago, we tied in the activities of the society with the curriculum of the Faculty of Law. This means that from 2008, doctoral candidates in the Faculty of Law have been able not only to participate in the report meetings of the society but also to receive credit points in their doctoral studies for this, given that certain curriculum-related conditions have been fulfilled. For example, 18 doctoral candidates registered for the course in the 2010–2011 academic year, and quite a few of them have also made a presentation.

The European society is still largely a ‘teaching society’ in the sense that it provides instructions. On one hand, this is a good and necessary conception that requires certain action. At the same time, globalisation—in view of the future—is a challenge in which the perspective depends on whether or not we can also be a learning society. That is what the activity of the Estonian Section of the International Association for Philosophy of Law and Social Philosophy concentrates on—learning—and the vitality of its functioning indicates that the philosophical problems in law are not about being ‘philosophical’ in the sense of office science but a rational flow of thought that has obtained its observations from the legal (social) reality and is able to offer its own solutions for judicial—that is, fair—development of this reality.

¹ The University of Tartu has held an annual German-Estonian academic week since 1997. This week is a bridge to contemporary German academic and scientific environment. Lawyers are especially interested in this event since Estonian legal order has had the deepest and longest historical and legal cultural connections with the German judicial area and therefore presentations by German lawyers are of special interest and attention.

² Information on the report meetings of the Society: <http://www.ut.ee/oigusteaduskond>.

Abbreviations

RT	<i>Riigi Teataja</i> ('State Gazette')
RTL	<i>Riigi Teataja Lisa</i> ('Appendix to the State Gazette')
ALCSCd	Decision of the Administrative Law Chamber of the Supreme Court
ALCSCr	Regulation of the Administrative Law Chamber of the Supreme Court
CCSCd	Decision of the Civil Chamber of the Supreme Court
CCSCr	Regulation of the Civil Chamber of the Supreme Court
CLCSCd	Decision of the Criminal Law Chamber of the Supreme Court
CLCSCr	Regulation of the Criminal Law Chamber of the Supreme Court
CRCSCd	Decision of the Constitutional Review Chamber of the Supreme Court