Article

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Fundamental Rights, Contract Law and Transactional Justice

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Abstract: This article critically engages with Peter Benson’s theory of contract law. It explores whether his juridical conception of contract as a transfer of rights, which is governed by the contract law’s internal principles of transactional justice, can be reconciled with fundamental rights. The article argues that the conventional distinction between the direct and indirect horizontal effect of fundamental rights is problematic because it does not make it unequivocal which body of law – fundamental rights or contract law – substantially governs the relations between contracting parties and determines the outcome of disputes between them. The answer to this fundamental question, however, is crucial for the stability of Benson’s theory of contract law. Drawing on the European experience, the article shows that the relationship between fundamental rights and contract law can take the form of the subordination of contract law to fundamental rights or the complementarity between the two. While the latter is compatible with Benson’s theory, the former is in tension with it. For the sake of conceptual clarity, therefore, it is useful to distinguish between three forms of the horizontal effect of fundamental rights in contract law – direct horizontal effect, strong indirect horizontal effect, and weak indirect horizontal effect.

Keywords: complementarity, contract law, EU, fundamental rights, horizontal effect, subordination, transactional justice

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1 Introduction

In his book *Justice in Transactions*, Peter Benson develops a juridical conception of contract as a transfer of rights between the contracting parties as free and equal persons. Contract law, he argues, is categorically distinct from and independent of other domains – moral, economic, and political – of liberal society. As Benson observes:

‘Contract law – from its principles of formation to those governing fairness and remedies – is complete within its own framework and (…), within its purely non-distributive and transactional values, it can answer the main contractual issues that are essential to establishing, interpreting, and enforcing contractual relations’.2

Accordingly, distributive principles, such as fundamental rights, can only indirectly constrain individual transactions governed by contract law, without directly displacing or derogating from its own internal principles of transactional justice.3

This account of contract law thus touches upon the relationship between fundamental rights and contract law, giving rise to some intricate questions. In particular, can fundamental rights disrupt the stability of Benson’s theory of contract law as that part of law which is self-sufficient in its own terms and non-distributive in character?4 Or can, as Benson suggests, the impact of fundamental rights on contract law be reconciled with this juridical conception of contract, and, if so, how? In order to answer these questions, we need to revisit the relationship between the fundamental rights embodied in national constitutions or international instruments and contract law in European legal systems where it has been particularly widely debated in the past three decades or so.5 This debate has so far

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2 Benson, n 1 above, 457.
3 Benson, n 1 above, 456.
4 Following John Rawls, Benson understands the stability of a particular conception of justice as a state when it generates the right kind of support from citizens as fair and congruent with their individual and social good, and reflects the specific kind of normative conception that is at stake. See Benson, n 1 above, 395.
been dominated by the distinction between the direct and indirect horizontal effect of fundamental rights, which resonates in the contrast drawn by Benson between the direct and indirect application of distributive principles to contract law. The most widely understood difference between the two lies in the fact that while, in the case of direct horizontal effect, a private party has, in his action against another private party, a claim or a defence which is directly based on a fundamental right which overrides an otherwise applicable rule of private law, in the case of indirect horizontal effect, the claim or defence is based on a private law rule which is interpreted in the light of the fundamental right in question.

In outline, my narrative is that this distinction, or, more exactly, the way in which it has been applied in practice, is problematic because it does not make it unequivocal which body of law – fundamental rights or contract law – substantially governs the relations between contracting parties and determines the outcome of disputes between them. The answer to this fundamental question, however, is crucial for the stability of Benson’s theory of contract law. Using the examples from the case law of German and Dutch courts, I will show that the relationship between fundamental rights and contract law can take the form of the subordination of contract law to fundamental rights (Section 2) or the complementarity between the two (Section 3). While the latter is compatible with Benson’s theory of contract law, the former is in tension with it. For the sake of conceptual clarity, therefore, it is useful to distinguish between three forms of the horizontal effect of fundamental rights in contract law – direct horizontal effect, strong indirect horizontal effect, and weak indirect horizontal effect. Only weak indirect horizontal effect implies the relationship of complementarity between these two areas of law and thus fits into Benson’s juridical conception of contract. In contrast, direct horizontal effect and strong indirect horizontal effect lead to the subordination of contract law to fundamental rights, disrupting the stability of this conception. I will conclude with some observations on the role of fundamental rights in contract law today, taking into account the post-national dimension of fundamental rights protection in Europe (Section 4).


2 Subordination

The subordination of contract law to fundamental rights implies that fundamental rights have an immediate impact on the relations between contracting parties, directly constraining individual transactions. Fundamental rights determine the outcome of disputes between the parties, and the role of contract law is limited to providing tools for their effect in contractual relations. Fundamental rights thus do not merely influence contract law as a conceptually distinct and autonomous category. They govern contract law, thereby enjoying priority over its internal principles of justice. What would be compatible with fundamental rights in the contractual sphere is determined at the level of these rights and not within contract law.

The decision of the German Federal Constitutional Court (Bundesverfassungsgericht) in the famous Bürgschaft case provides a striking illustration of this model of the relationship between fundamental rights and contract law. In this case, the Federal Constitutional Court effectively invalidated the contract under which a daughter had acted as a surety for her father’s bank loan to the amount of Deutsche marks (DEM) 100,000 (Euros [EUR] 50,000) on the basis of her constitutional right to the free development of her personality as guaranteed by Article 2(1) of the German Federal Constitution (Grundgesetz), which had to be read in conjunction with the principle of the social state laid down in Article 20(1) and Article 28(1) of the same constitution. At the time of concluding the surety contract with the bank, the daughter was 21 years of age, did not have a high level of education, owned no property, and worked as an unskilled employee at a fish factory for a modest salary. According to the Federal Constitutional Court, in cases where a ‘structural inequality of bargaining power’ has led to a contract which is exceptionally onerous for the weaker party, private law courts are obliged to protect the constitutional right to private autonomy of this party by intervening within the framework of the general clauses (§ 138 (1) and 242 of the Civil Code (Bürgerliches Gesetzbuch)) concerning, respectively, good morals and good faith). In this case, a contractual imbalance existed because the bank had failed to sufficiently inform the daughter about the risk relating to the surety ship, although the risk was relatively high compared to her income. Therefore, the Federal Constitutional Court overturned the decision of the German Federal Supreme Court in private law matters (Bundesgerichtshof), which had not accepted the existence of such a duty to inform in contract law, reasoning that any person who has reached the age of majority knows that signing a surety contract entails a risk.

7 BVerfG 19 October 1993, BVerfGE 89, 214 (Bürgschaft).
Such an approach by the Federal Constitutional Court raises the question whether it follows its own formula of the relationship between fundamental rights and private law, as established in the Lüth case, which came to be known as the theory of ‘indirect effect’. According to Lüth, constitutional rights, as objective values for the whole legal order, were only to influence private law by affecting the interpretation of its existing rules; a dispute between private parties was to remain ‘substantively and procedurally a private law dispute’. This reasoning seemed to suggest that it was private law that determined the outcome of the case. It now appears, however, that in practice, a distinctive feature of the constitutionalization of contract law in Germany is that it is no longer contract law influenced by constitutional rights, but constitutional law which determines the outcome of disputes between contracting parties, and that the role of contract law is limited to implementing this outcome within itself. It can be argued, therefore, that contract law has become subordinate to constitutional law, even though the Lüth formula of the indirect horizontal effect was never formally overruled.

As the Bürgschaft case illustrates, the subordination of contract law to fundamental rights may result not only from the well-known direct horizontal effect, which has not been accepted as such in German law, but also from what may be called ‘strong indirect horizontal effect’. These two forms of the horizontal effect have in common that they do not recognize the autonomy of contract law from fundamental rights and presuppose that these rights must be respected in horizontal relations between contracting parties to the same extent as in vertical relations between public authorities and individuals. However, they differ with respect to the role of contract law in ensuring compliance with fundamental rights. In the case of the direct horizontal effect, a claim or a defence is directly based on a fundamental right, and there is thus no need to anchor it into contract law. The task of private law courts in contract law disputes is accordingly limited to applying

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8 BVerfG 15 January 1958, BVerfGE 7, 198 (Lüth).
10 Lüth, n 8 above, 205 (my translation and emphasis).
fundamental rights directly without the need to fall back on contract law in order to embed the outcome of fundamental rights adjudication into the existing norms of contract law. In contrast, in the case of the strong indirect horizontal effect, arguments based on fundamental rights must be embedded in contract law. In practical terms this means that in order to act in conformity with fundamental rights, private law courts need first to reach a decision at the level of fundamental rights and then to see how this decision can be based on contract law rules.

In essence, the Federal Constitutional Court granted strong indirect horizontal effect to the daughter’s fundamental right to private autonomy in Bürgschaft by obliging the private law courts to protect it within the general clauses of private law based on the constitutional interpretation of this right. While private autonomy lies at the core of contract law, the Federal Constitutional Court elevated it to the constitutional law level. This in turn allowed it to effect a major shift in contract law from the ‘formal’ freedom of contract between the parties to a surety contract (i.e., without regard to the parties’ bargaining power) towards the ‘substantive’ freedom of contract for both parties (i.e., with regard to their bargaining power).13

Importantly, this outcome of fundamental rights adjudication in a contract law dispute is not incompatible with the contract law’s own requirements of justice. In fact, in the family surety cases decided by the highest private law courts in the Netherlands and the UK during approximately the same period as the German Bürgschaft case, a result comparable to that reached by the German constitutional court on the basis of fundamental rights was achieved within the framework of contract law.14 In these legal systems, relief for the family sureties was provided on the basis of well-established contract law concepts, such as mistake (Article 6:228 of the Civil Code) in Dutch law and constructive notice in conjunction with undue influence in English law, without any prompting by fundamental rights. These private law doctrines were interpreted so as to include the bank’s duty to inform the family member of the principal debtor about the risks involved in acting as a surety. From the point of view of Benson’ juridical conception of contract, therefore, it is not the outcome of the Bürgschaft case which is problematic. As Benson points out: ‘The conception of freedom of contract required by contract law is not the doctrine of laissez-faire.’15 Rather, it is the reasoning of the German constitutional court that has led to this result which does not fit into Benson’s idea of a self-sufficient and autonomous contract law. After all, in the case of the strong indirect horizontal effect, the relations between contracting parties are substantially

14 See HR 1 June 1990, NJ (Van Lanschot Bankiers v Bink) and Barclays’ Bank plc v O’Brien [1994] 1 AC 180, for Dutch and English law, respectively.
15 Benson, n 1 above, 460.
governed by fundamental rights rather than contract law so that the general clauses of private law tend to become mere shelters for the application of fundamental rights. In such a situation the whole of contract law tends to become an entirely malleable vehicle for promoting fundamental rights.

3 Complementarity

Alternatively, the relationship between fundamental rights and contract law can develop along the lines of the complementarity model. The complementary relationship between the two implies that the relations between contracting parties are substantially governed by contract law as a conceptually distinct and autonomous category, which in turn is influenced by fundamental rights. While contract law must respect the values enshrined in fundamental rights, it is contract law which determines how and to what extent these values are accommodated within it. Contract law values, which are not simultaneously protected by fundamental rights, therefore, retain considerable potency when confronted with constitutional law values. Thus, contract law remains decisive for the outcome of disputes between contracting parties which are resolved in accordance with its own idea of justice.

A good illustration of what this could mean in practice can be found in Dutch law. Unlike in German law, the fundamental rights laid down in the Dutch Constitution (Grondwet) do not embody all fundamental principles of law. One of the most common ways in which fundamental rights have influenced Dutch contract law for more than half a century is the indirect horizontal effect these rights have as a result of the private law courts considering them as one of the relevant factors when applying open-textured private law norms. For example, in 1969, the Dutch Supreme Court in private law matters (Hoge Raad) had to decide the question of whether a contractual clause which barred the person concerned from teaching Mensendieck physiotherapy exercises for the rest of her life, if she failed to obtain the required diploma, was in fact void. This question was answered in the affirmative by the lower court which ruled that such a clause is per

17 HR 31 October 1969, NJ 1970, 57 (Mensendieck I). For other cases of this kind, see, e.g., HR 18 June 1971, NJ 1971, 407 (Mensendieck II); Hof Arnhem 25 October 1948, NJ 1949, 331 (Protestantse Vereniging/Hoogers); HR 22 January 1988, NJ 1988, 891 (Maimonides).
se contrary to public order and good morals (Article 3:40(1) of the Civil Code [Burgerlijk Wetboek]) on the ground that it is contrary to the right to freedom of education enshrined in Article 208(2) (now Article 23) of the Dutch Constitution. This decision was, however, overturned by the Supreme Court, which held that when considering whether a clause is contrary to public order and good morals, regard should also be had to the interest which the contract serves and to the question whether this interest is of such importance so as to justify an encroachment on the right to freedom of education. In this decision the Supreme Court thus clearly took the view that fundamental rights must not be the sole factor in determining whether a certain contract is contrary to public order and good morals and that contract law should play a decisive role in resolving this kind of issues.

A similar approach was also taken by the Dutch Supreme Court in the Aidstest II case18 where it needed to resolve the issue of whether the patient’s post-contractual obligations to a dentist, on the basis of the medical treatment contract, which included in case the patient’s obligation to undergo an AIDS test, constituted a violation of the patient’s constitutional right to bodily integrity guaranteed by Article 11 of the Dutch Constitution. The Supreme Court answered this question in the negative, upholding the decision of the District Court in this case. In its decision, the District Court had held that the duty to undergo an AIDS test did indeed constitute an intrusion upon the constitutional right to bodily integrity. At the same time, it noted that this constitutional right is limited by restrictions laid down by or pursuant to the law, either based on the general tort clause (Article 6:162 of the Civil Code) or according to the terms of the contract, and that in the circumstances of the case, the patient’s post-contractual duty to undergo an AIDS test served as such a restriction. After these considerations the Court turned to a balancing of the competing interests of the parties involved in this case and found that there was relatively little intrusion upon the patient’s right to bodily integrity when weighed against the compelling interest of the dentist in knowing whether or not he had been infected by the HIV virus.

At first sight, such an approach resembles the most far-reaching effect of fundamental rights between private parties: the private law court applies a fundamental right directly and examines whether its restriction can be justified on the basis of the limitation clause contained in a constitution or – as in other cases of this type – in the European Convention on Human Rights of 1950. On closer inspection, however, the direct horizontal effect in Dutch court decisions does not lead to the subordination of contract law to fundamental rights because the general clauses of private law are regarded as the limitations upon the exercise of these rights. Ultimately, therefore, in order to resolve a dispute between the parties, the

courts resort to a balancing of competing interests within the framework of contract law. For this purpose, they first translate a fundamental right into a private law interest and then weigh it against another private law interest. Thus, what formally can be considered to be the direct horizontal effect of fundamental rights, in substance comes down to their weak indirect horizontal effect.19

Weak indirect horizontal effect clearly proceeds from a relationship of complementarity between fundamental rights and contract law, closely resembling the initial theory of ‘indirect effect’ adopted by the German constitutional court. As in the case of the strong indirect horizontal effect, here it is contract law which applies to contractual relations and serves as the basis for the decisions of private law courts. In contrast to the strong indirect horizontal effect, however, the weak one preserves the leading role of contract law in resolving contractual disputes. In practical terms this means that the starting point for the private law court is to look for the solution in a particular case at the level of contract law and, in doing so, to consider any possible impact of fundamental rights. The private law court is considered to fulfil its duty if it has taken into account fundamental rights when applying contract law, and in reaching its decision the court enjoys a wide discretion which is guaranteed to it by constitutional and international human rights courts. In fact, if this approach had been used in the Bürgschaft case, the Federal Constitutional Court could have upheld the decision of the Federal Supreme Court, since the latter considered whether the daughter had freely concluded the surety agreement and so it did take into account her fundamental right to private autonomy.

The Federal Supreme Court can certainly be criticized for refusing to adopt a substantive conception of freedom of contract in this particular case and to have regard to the surety’s comprehension of the transaction and her ability to repay the loan within the framework of the general private law clauses.20 But the fact that the Court adhered to a formal understanding of freedom of contract does not necessarily mean that it violated the surety’s constitutional right to private autonomy. Furthermore, one should bear in mind that resorting to fundamental rights with a view to protecting the weaker party does not necessarily lead to the outcome that

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20 This is evidenced by the fact that in the years just following the German constitutional court’s decision in the Bürgschaft case, German private law courts developed extensive substantive protection of family members against disproportionate obligations under surety contracts on the basis of good morals. See, e.g., BGH, ZIP 2001, 189; BGH JuS 2001, 606; BGH, NJW 2002, 2228; BGH, NJW 2002, 2634.
would favour the interests of the weaker party. After all, both parties to a contract law dispute are likely to be able to clothe their legal arguments in terms of fundamental rights. In the Bürgschaft case, for instance, not only the family surety but also the bank seeking to enforce the surety contract could rely on the protection of private autonomy based on Article 2(1) of the Federal Constitution. The Federal Constitutional Court, therefore, had to strike the balance between the two broadly formulated rights at the constitutional law level.

Thus, while direct horizontal effect and strong indirect horizontal effect lead to the subordination of contract law to fundamental rights, weak indirect horizontal effect implies the complementarity between the two. In preserving the autonomy of contract law, the complementarity model fits into Benson’s theory of contract law. In fact, it is this model that Benson himself appears to have in mind when he suggests that the following approach would be appropriate:

‘It is contract law that, by its own internal requirements, must take [fundamental rights and distributive values] into account, bring out their salience, and fix their role. This is not direct vertical effect by another means. In this way, the basic liberties are ensured indirect application and continue to hold throughout the domain of private law, just as in other associations and institutions within the basic structure of society.’

The foregoing analysis also reveals that the extent of the constitutionalization of contract law in a particular legal system does not necessarily depend on the existence of a constitutional court. The reason for that is that in those legal systems where there is such a court, the latter may be reluctant to interfere with contract law, whereas in those legal systems where a constitutional court is absent, the far-reaching effect of fundamental rights in contract law may be granted by private law courts. What is crucial is the model of the relationship between fundamental rights – subordination or complementarity – which is adopted in a particular legal system.

4 Concluding Remarks

What does this account of the interplay between fundamental rights and contract law in European legal systems tell us about the possibility of reconciliation between Peter Benson’s juridical conception of contract and fundamental rights? Can fundamental rights and contract law, to use Benson’s words, ‘mutually support each other as distinct but integrated aspects of a more complete scheme

21 Cf H. Collins, n 5 above, 26, 55.
22 Benson, n 1 above, 465.
of ... justice? In the first place, it has become apparent that the answer to this question depends on the relationship between fundamental rights and contract law in a particular legal system. As the German experience shows, the subordination of contract law to fundamental rights, whereby the latter tend to substantially govern the relations between contracting parties and determine the outcome of disputes between them, is in tension with Benson’s theory of contract law. In contrast, there is no incompatibility between his understanding of contract as a form of transactional acquisition and fundamental rights in the case of complementarity between these rights and contract law, which can be observed, for instance, in the Netherlands. This model enables a dialogue between fundamental rights and contract law while preserving the autonomy of contract law.

In order to make it clear which body of law substantially governs the relations between contracting parties and determines the outcome of disputes between them, it is necessary to distinguish between three forms of the horizontal effect of fundamental rights in contract law – direct horizontal effect, strong indirect horizontal effect, and weak indirect horizontal effect. Direct horizontal effect and strong indirect horizontal effect lead to the subordination of contract law to fundamental rights and thus challenge the stability of Benson’s juridical conception of contract. Weak indirect horizontal effect, however, is consistent with his idea of transactional justice because it ensures the complementarity between fundamental rights and contract law as distinct but mutually supportive areas of law.

While Benson’s theory of contract law and fundamental rights are thus potentially reconcilable in the national law context, major challenges to the stability of his theory emerge in the post-national law setting, as evidenced by the harmonization of private law by the European Union (EU). In the pursuit of its objective of the completion of the internal market, the EU has enacted a number of directives and regulations – which collectively have been described as constituting EU private law – in the areas previously exclusively governed by traditional national private law, such as unfair terms in consumer contracts or financial services. In so doing, the EU has not, at least not explicitly, acknowledged the relevance of the conventional public/private distinction. The instrumental use of private law,

23 Benson, n 1 above, 396.
particularly contract law, by the EU legislator as well as the rise of public supervision and enforcement in this domain have blurred the dividing line between public regulation and private law. The emergence of EU private law has prompted or fostered the development of legal hybrids, such as ‘regulatory private law’ or ‘supervision private law’, profoundly challenging the traditional understanding of private law as it had evolved in national legal systems. Crucially, EU regulatory contract law as well as national law within its scope must comply with EU fundamental rights, notably the EU Charter of Fundamental Rights of the EU, and be interpreted and applied in accordance with these rights. An increasing entanglement of the public and private spheres and enforcement modes in the making of EU private law raises new questions about the role of transactional justice in Benson’s sense, and interpersonal justice more generally, in this post-national setting, and about the appropriate relationship between EU fundamental rights and contract law. Benson’s theory of contract law provides strong impetus for further debate on these fascinating issues.