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Estonia: A Model for Economic Success in Transition Economies

Kendra Pavkovic

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Estonia: A Model For Economic Success in Transition Economies

Kendra Pavkovic*

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I. INTRODUCTION

One of the key ingredients of a successful transition to a market economy is a strong legal foundation.¹ The collapse of the Soviet Union brought an opportunity for nations previously constrained by socialist economic principles to emerge independently as players in the world economy.² The former Soviet states began to reform their legal systems, accounting for each nation's individual economic circumstances,³ custom,⁴ and other outside influences that affect them as independent nations.⁵

Some of the former Soviet states have succeeded in making legal reforms effective in their transition to a successful market economy while others have not.⁶ Of the fifteen states that emerged after the breakup of the Soviet Union, only three have acceded to the European Union ("EU"). Joining the EU is important for enhancing economic prosperity because it broadens economic possibilities such as trade, employment possibilities, education, and political collaboration.⁷

The first ex-Soviet nation to begin negotiations with the EU was Estonia.⁸ Estonia was also the first Soviet Republic to take progressive action towards gaining independence and producing effective economic legislative reforms.⁹

1. AVINASH K DIXIT, *LAWLESSNESS AND ECONOMICS* 2 (Richard Blundell ed., Princeton University Press 2004).

2. See Kirsten Storin Doty, *Economic Legal Reforms as a Necessary Means for Eastern European Transition into the Twenty-First Century*, 33 INT'L LAW. 189, 190 (1999) (proposing that the ability of Eastern Europe to make successful transition to market economies and democracy will depend upon the new legal systems put into place).

3. See *id.* at 195 (stating that legislatures were not free to form laws and policy but were constrained by history and the economy).

4. See Young Lee & Patrick Meagher, *Misgovernance or Misperception? Law and Finance in Central Asia*, in ASSESSING THE VALUE OF LAW IN TRANSITION ECONOMIES 133, 165 (Peter Murrell ed., University of Michigan 2001) (noting that observers have suggested that law has the greatest impact on behavior when it leverages pre-existing social norms and customs).

5. Doty, *supra* note 2, at 193 (discussing how people's belief in communism can change, resulting in an immediate acceptance of democracy and a free market economy).

6. See Peter Daniel DiPaola, *The Criminal Time Bomb: An Examination of the Effect of the Russian Mafiya on the Newly Independent States of the Former Soviet Union*, 4 IND. J. GLOBAL LEG. STUD. 145, 145 (1996) (describing how the Russian economy has responded slowly to reform and that organized crime threatens to overwhelm Russian politics, economics and society). But see Christopher Osakwe, *Anatomy of the 1994 Civil Codes of Russia and Kazakhstan: A Biopsy of the Economic Constitutions of Two Post-Soviet Republics*, 73 NOTRE DAME L. REV. 1413, 1414 (1998) (proposing that Russian and Kazak post-Soviet civil codes will go down in history as superb examples of successful legal transplantations).

7. See Hollin K. Dickerson, *Judging the Judges: The State of Judicial Reform in Eastern Europe on the Eve of Accession*, 32 INT'L J. LEGAL INFO. 539, 546 (2004).

8. Barbi Applequist, *The European Union v. The North Atlantic Treaty Organization: Estonia's Conflicting Interests as a Party to the International Criminal Court*, 27 HASTINGS INT'L & COMP. L. REV. 77, 78 (2003).

9. Paul Varul, *Legal Policy and Decisions and Choices in the Creation of New Private Law in Estonia*, V JURIDICA INTERNATIONAL 104, 105 n.7 (2000), available at http://www.juridica.ee/international_en.php?document=en/international/2000/1/22592.SUM.php.

Estonia's bold economic and legal reforms have paid off, according to recent studies conducted by The World Bank and The Wall Street Journal. The recent World Bank study, *Doing Business in 2006*,¹⁰ ranked Estonia in the top thirty nations whose laws promote easy business development.¹¹ The Wall Street Journal ranked Estonia fourth in the *2005 Index of Economic Freedom*.¹² These studies reinforce the possibility that transition economies, such as Estonia, can successfully reform economic laws and policies to develop a business-friendly legal system that encourages foreign investment and bolsters an economy.

One of the most important changes in Estonia was the reformation of the legislation governing contract law.¹³ By creating new legislation, based on model codes and foreign examples, the *Law of Obligations Act* is a great example of how to restructure areas of private law that allow business transactions to function smoothly. The *Law of Obligations Act* introduces concepts that are new to Estonian practitioners, such as freedom of contract, principles of good faith in contractual relations, new concepts of contractual breach, and the imposition of damages in the event of a breach.¹⁴

In addition to reforming contract law legislation, the enactment of a new *Courts Act* introduces regulations that enable the judiciary to effectively enforce contracts in Estonia.¹⁵ The *Courts Act* imposes new rules that allow the judiciary to become accountable,¹⁶ more transparent,¹⁷ and less susceptible to corruption¹⁸ by introducing new disciplinary measures.¹⁹ Furthermore, the qualifications required for judicial service have been improved to ensure that those in a position to apply legal doctrines have proper credentials to do so.²⁰

10. See generally WORLD BANK, *DOING BUSINESS IN 2006: CREATING JOBS* (The International Bank for Reconstruction and Development/The World Bank 2006).

11. A high ranking does not indicate that businesses should conduct business solely with high-ranking countries, but rather that the countries have created regulatory environments conducive to business operations. See *id.* at 3.

12. The *Index* is a theoretical analysis of the most influential factors affecting the institutional setting of economic growth, where the findings suggest that countries with the most economic freedom have higher rates of long-term economic growth. See MARC A. MILES ET AL., *THE HERITAGE FOUNDATION, 2005 INDEX TO ECONOMIC FREEDOM 1* (The Heritage Foundation/Wall Street Journal 2005).

13. See Irene Kull, *European and Estonian Law of Obligations—Transposition of Law or Mutual Influence?* IX JURIDICA INTERNATIONAL 32, 35 (2004) (explaining that Estonia's task of ensuring uniform rights for all member states was completed upon adoption of the new *Law of Obligations Act*), available at http://www.juridica.ee/international_en.php?document=en/international/2004/1/75753.SUM.php.

14. See discussion *infra* Part III.b.

15. See discussion *infra* Part IV.b.

16. OPEN SOCIETY INSTITUTE, *MONITORING EU ACCESSION PROCESS: JUDICIAL INDEPENDENCE IN ESTONIA* 156 (2001) [hereinafter JUDICIAL INDEPENDENCE], available at http://www.eumap.org/reports/2001/judicial/sections/estonia/judicial_estonia.pdf.

17. Estonica, *Judicial System, General Principles of Judicial Proceedings and the Structure of the Judicial System*, <http://www.estonica.org> (stating that court sessions are made public) (last visited Mar. 27, 2006).

18. The Estonia Page, *Judicial Reform in Estonia*, <http://www.esis.ee> (last visited Mar. 27, 2006) (explaining that there are multiple guarantees of judicial independence).

19. Kohtute seadus [KS] [Courts Act] art. 88 (Est.).

20. *Id.* at art. 54(1).

To accompany legislative change, changes in the legal education have ensured the success of legal reform.²¹ As Estonia becomes increasingly integrated with the rest of Europe, lawyers will have to be prepared to work in a multinational legal society.²² The curriculum has been altered to allow for more courses relating to private law and European law, which will enable lawyers to adapt to further international integration.²³ Additionally, an increase in quality faculty members has produced a more accomplished body of educators, which has resulted in an increased publication of legal literature in Estonia.²⁴

This comment highlights the important legislative reforms that have allowed Estonia to develop successfully as a market economy.²⁵ Because of careful comparative study and the harmonization of their laws with those from other Western legal systems, Estonia has developed a clear and concise law to regulate contracts, which is the cornerstone of all business relations.²⁶ Additionally, the judicial system has been completely reformed, which ensures successful enforcement of business contracts in Estonia. Furthermore, legislative reforms have been introduced to practicing lawyers in Estonia, by way of substantial reforms in legal education. Without complementary reform in these three areas, Estonia would not be recognized among the top nations whose laws promote business development.

The impact of legislative change, utilizing comparative study, and consideration of contract laws from other European nations is considerable. By harmonizing new laws with those of potential trade partners, Estonia has facilitated business development and encouraged trade.²⁷ Harmonization allows different nations to align legal concepts that govern mandatory rules, standard default provisions, and concrete laws to provide an effective mechanism for enforcement.²⁸ Legal harmonization leads to lower transaction costs and the elimination of some uncertainty that occurs when transacting business transnationally.²⁹

This comment proposes that Estonia should be a model for other transition economies when looking to increase local business development. Furthermore,

21. See discussion *infra* Part IV.

22. See Varul, *supra* note 9, at 117.

23. See Kalle Merusk et al., *On Legal Basis and Process of Accreditation of Teaching of Law in Estonia*, I JURIDICA INTERNATIONAL 142, Annex 1 (1998), available at http://www.juridica.ee/international_en.php?document=en/international/1998/1/22563.SUM.php.

24. University of Tartu Faculty of Law, General Information, Development Plan, <http://www.iuri.dicum.ee> (last visited Mar. 27, 2006).

25. See Jenik Radon, *Permitted Unless Prohibited: The Changed Soviet Mentality*, 20 FORDHAM INT'L L.J. 365, 380 (1996) (stating that Estonia and Georgia have provided examples of effective legal reform, that are possible when reform is given the appropriate consideration); see also WORLD BANK, *supra* note 10, at 92.

26. See Danielle Mazzini, *Stable International Contracts in Emerging Markets: An Endangered Species?*, 15 B.U. INT'L L.J. 343, 344 (1997).

27. See discussion *infra* Part V.

28. See *infra* text accompanying notes 244-265.

29. See *infra* text accompanying notes 249-260.

Estonia provides an ideal environment for American businesses looking to expand internationally. Part II highlights certain changes to contract legislation that have harmonized Estonia with Western contract theory. Part III highlights changes to the Estonian judicial system that have enabled the enforcement of contracts between business entities. Part IV describes changes to the quality of legal education that will allow legal practitioners in Estonia to ensure the success of legislative reform by implementing new legal method in business transactions. Part V argues that by harmonizing legislation with the laws of other European nations, Estonia has created a legal system that can serve as a stepping-stone for further transition, in the event that the EU eventually unifies contract laws of member states.

II. REMOVING OBSTACLES TO GROWTH

When Estonia gained independence in 1991, the need to reform legislation was immediately apparent.³⁰ In particular, Soviet contract theory was not sufficiently adaptable to a market economy structure, and the pre-Soviet Estonian legislation governing contract law was outdated.³¹ Soviet contract theory lacked basic Western contract law principles, such as freedom of contract³² and principles mandating good faith among contracting parties. The implementation of the *Law of Obligations* introduced principles of freedom of contract and good faith into Estonian society.³³ Both concepts are of utmost importance for business contracting in a market economy and for furthering international trade.³⁴ Furthermore, by changing concepts of breach,³⁵ and allowing for the possibility of damages in the event of a breach,³⁶ the *Law of Obligations* guarantees that judges can find an appropriate remedy for an aggrieved party. The *Law of Obligations* provides an excellent example of how comparative study can produce a simple, yet still thorough law to govern contracts.

30. Estonia gained independence in August 1991, and work began in 1992 to establish an Estonian Civil Code. See Paul Varul & Heiki Pisuke, *Louisiana's Contribution to the Estonian Civil Code*, 73 TUL. L. REV. 1027, 1028 (1999); see also Peter Byrne & Philip G. Schrag, *Law Reform in Estonia: The Role of Georgetown University Law Center*, 25 LAW & POL'Y INT'L BUS. 449, 449 (1994) (explaining that, when the team from Georgetown arrived, they witnessed the economic ruins produced by communism—markets attempting to flourish without good law).

31. See generally Varul, *supra* note 9, at 108-14 (explaining that although other Estonian legislation was modeled after pre-Soviet legislation, the 1940 draft Civil Code from pre-Soviet occupation could not be used as a model for future legislation because it was outdated).

32. *Id.* at 104 n.1.

33. See Võlaõigusseadus [Law of Obligations Act] art. 6, 16 (Est.).

34. The ability of parties to decide matters are "the cornerstones of an open, market-oriented and competitive international economic order." The parties' duty to act in good faith "is of such a fundamental nature that the parties may not contractually exclude or limit it." See INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW, UNIDROIT PRINCIPLES OF INTERNATIONAL COMMERCIAL CONTRACTS art.1.1 cmt. 1, 1.8 cmt. 4 (Unidroit 2004).

35. See Võlaõigusseadus [Law of Obligations Act] art.103 (Est.).

36. See *id.* at art. 220(3).

A. Contracting in Soviet Society

Socialist legal theory differs significantly from Western perspectives.³⁷ In former socialist countries, law was used as a political mechanism for achieving party goals.³⁸ In an effort to overcome unequal distribution of economic resources, the state is the owner of all property and loans issued to economic entities for use.³⁹ Likewise, contracts are governed by regulations, which grant limited autonomy over the exchange of property without state involvement.⁴⁰ As one scholar describes, “[c]ontract law operated more in the shadow of the law, instead of being a central part of the law itself as in market economies.”⁴¹ This is because contractual interactions were subject to the will of the Communist party,⁴² and personal property was the only area of contract law that parties were allowed to contract without state involvement. Even the limited autonomy that was granted to individuals regarding personal property was only granted to further individual and family use.⁴³ The result was the increased use of black market transactions to avoid the restrictive nature of state control.⁴⁴

Not only did Soviet contract law differ with regard to the theoretical differences underlying basic principles of contracting, but also there were differences with respect to contract formalities. Soviet contract law distinguished between ordinary contracts and economic contracts.⁴⁵ Economic contracts were formed on behalf of a Soviet organization to further the planned economic activity of a government agency, which was essentially the representative of the people.⁴⁶ Consequently, any breach of contract was considered a breach on

37. See Villu Kove, *Applicable Law in the Light of Modern Law of Obligations and Bases for the Preparation of the Law of Obligations Act*, VI JURIDICA INTERNATIONAL 30, 34 (2001), available at http://www.juridica.ee/international_en.php?document=en/international/2001/1/24039.SUM.php (noting that despite continued use of the old code after gaining independence, it would be inconceivable to continue to use the old code for future legislation because it was created based upon a different ideology concerning the relationships between contracting parties).

38. See Doty, *supra* note 2, at 194.

39. See Norbert Reich, *Transformation of Contract Law and Civil Justice in the New EU Member Countries—The Example of the Baltic States, Hungary and Poland*, 23 PENN ST. INT’L L. REV. 587, 592 (2005); see also Kove, *supra* note 37, at 30 (explaining that the main distinction between Soviet civil codes and other European civil codes was the lack of regulatory codes regarding real property).

40. Reich, *supra* note 39, at 592.

41. *Id.* at 593.

42. See *id.* at 592-93; see also F.J.M. FELDBRUGGE ET AL., *ENCYCLOPEDIA OF SOVIET LAW* 171 (1985) (stating that freedom of will between contracts among citizens was limited by “principles of communist morality”).

43. Reich, *supra* note 39, at 592.

44. See Reich, *supra* note 39, at 593; see also DiPaola, *supra* note 6, at 170 (providing an example, in Estonia, of how authorities often permit organized crime to continue because of its economic benefit).

45. FELDBRUGGE, *supra* note 42, at 170.

46. See *id.* at 171; see also OLIMPIAD S. IOFFE, *SOVIET CIVIL LAW* 150 (F.J.M. Feldbrugge ed., 1988).

society and a social obligation because contractual relationships were based on principles of socialist public ownership.⁴⁷

To protect the weaker party, freedom to contract was restricted in favor of a justice-oriented approach.⁴⁸ Restrictions on freedom to contract enabled those who could not protect their interests to distribute the risk that accompanied contractual relationships.⁴⁹ There were no requirements mandating that contracting parties act in good faith.⁵⁰ The objective was to promote actual performance of contractual obligations, and consequently, specific performance was the favored remedy in the event of a breach.⁵¹

Because specific performance was the favored remedy in Soviet civil law, damages were only awarded in limited circumstances,⁵² and often times a breach resulted in a penalty or fine.⁵³ If a debtor were to neglect performing an obligation under the contract, the creditor had a right to demand performance, but any negative consequences of the breach, such as damages, were not imposed.⁵⁴ Furthermore, any liability resulting from breach of contract was determined by the extent of culpability on behalf of the breaching party.⁵⁵

B. *Law of Obligations Act*

Despite regaining independence from the Soviet Union, the Civil Code of the Estonian Soviet Socialist Republic (“Estonian SSR”) continued to regulate private law in Estonia until the civil code was complete.⁵⁶ When Estonia declared independence, all legislation prepared prior to Soviet occupation was used as the basis for an entirely new codification of laws.⁵⁷ This new body of law not only reflected Estonian traditions, but also reflected current European legal norms and EU requirements.⁵⁸ The *Law of Obligations Act*, which governs contract

47. Lisa A. Granik, *Soviet Contract Law and Perestroika*, 78 GEO. L.J. 231, 236 (1989).

48. Irene Kull, *Legal Integration and Reforms—Innovations and Traditions*, V JURIDICA INTERNATIONAL 119, 122 (2000), available at http://www.juridica.ee/get_doc.php?id=335.

49. *Id.*

50. *Id.*

51. Granik, *supra* note 47, at 236.

52. Such as providing liquidated damages, if stipulated to, in the contract. *See id.*

53. *Id.* at 236-37.

54. This was also true in the case of delayed performance. The creditor was legally allowed to refuse performance if delayed but negative consequences were not imposed as a result of the breach. *See IOFFE, supra* note 46, at 176.

55. *See* FELDBRUGGE, *supra* note 57, at 178; *see also* IOFFE, *supra* note 46, at 205.

56. The Civil Code consists of five acts, which were enacted in pieces. The *Law of Property Act* entered into force in 1993. The *General Part of the Civil Code Act* entered into force in 1994 followed by *The Family Law Act* in 1995. The *Law of Succession Act* entered into force in 1996 and finally, the *Law of Obligations Act* became effective in 2002. *See* Varul, *supra* note 30, at 1028-30; *see also* Varul, *supra* note 9, at 110 (explaining that the reason for passing the *Law of Property Act* first was to ensure that further reforms were successful).

57. *See* Priidu Parna, *Legal Reform in Estonia*, 33 INT’L J. LEGAL INFO. 219, 223 (2005).

58. *See id.* (explaining that new legislation was written to harmonize 80,000 pages of European legislation, thereby creating a simple legal system that was easily understood by foreigners).

formation in Estonia, became effective on July 1, 2002.⁵⁹ Models of other civil codes were used in the creation of the Estonian civil code, namely the German civil code, the Swiss civil code, the Austrian civil code, and the Baltic Code of Private Law, which was used prior to Soviet occupation.⁶⁰ Guided by the Principles of European Contract Law (“PECL”) and the Principles of International Commercial Contracts (“UNIDROIT”),⁶¹ Estonia included basic transactional rules in its civil code.⁶² Contract law directives of the EU were incorporated,⁶³ and drafts of the *Law of Obligations Act* were approached with the theory that the unification of European contract laws was necessary to develop a single European market.⁶⁴

New concepts of contract theory were added to the legal culture of Estonia by the adoption of the *Law of Obligations Act*.⁶⁵ For example, parties are now allowed the freedom to contract, guaranteeing parties autonomy in contract formation.⁶⁶ A new mandatory provision requiring parties to contract in good faith will ensure that parties enter into business relations for proper purposes and negotiate without malicious intentions.⁶⁷ Since the binding force of contracts has now become a reality, parties will not neglect obligations due to inconvenience.⁶⁸ Finally, the introduction of negative consequences, in the form of damages, will ensure that contracts are taken seriously by all parties.⁶⁹

1. Freedom of Contract

One of the most important principles of private law is to allow parties the freedom to contract.⁷⁰ Contrary to principles of Soviet civil law, where freedom to contract was not recognized,⁷¹ the *Law of Obligations Act* allows contracts to

59. Kull, *supra* note 13, at 33.

60. Varul, *supra* note 9, at 108 (stating that models were also used from the civil codes of Denmark, France, Italy, Louisiana, Quebec, and the Nordic countries).

61. UNIDROIT, *supra* note 34.

62. This is different from the German *Law of Obligations*, which regulates trade transactions in a separate code. See Varul, *supra* note 9, at 110.

63. See *id.* at 107; see also Kove, *supra* note 37, at 36 (summarizing the EU directives that were incorporated into the draft *Law of Obligations Act*).

64. Irene Kull, *Legal Remedies Provided in the Estonia Draft Law of Obligations Act for Breach of Contractual Obligations*, IV JURIDICA INTERNATIONAL 147, 147 (1999), available at http://www.juridica.ee/international_en.php?document=en/international/1999/1/24310.SUM.php.

65. See *infra* text accompanying notes 70-120.

66. Võlaõigusseadus [Law of Obligations Act] art.5-6, 16 (Est.).

67. See *id.* at art.6; see also Kull, *supra* note 13, at 38.

68. Võlaõigusseadus [Law of Obligations Act] art.8(2) (Est.).

69. *Id.* at art.101.

70. See *id.* at art.5; see also Kull, *supra* note 13, at 36 (explaining that the parties may derogate from the act, unless precluded by another section).

71. Varul, *supra* note 9, at 104 n.1; Ole Lando, *CISG and Its Followers: A Proposal to Adopt Some International Principles of Contract Law*, 53 AM. J. COMP. L. 379, 387 (2005) (explaining that the wording of

be entered into freely, so long as the conditions of the contract are clear and decisions are made freely.⁷² Estonian courts have maintained allowing parties the freedom to contract⁷³ and have interfered only when the substantive fairness of a contract is at stake.⁷⁴ Moreover, contractual autonomy is encouraged, unless there are disproportionate obligations weighed against one of the parties.⁷⁵ Before finding a contract voidable by one of the parties, courts will review all the circumstances surrounding the transactions.⁷⁶ The freedom to contract will be restricted only if consent has been tainted by fraud, coercion, or unequal bargaining power.⁷⁷ Additionally, with the exception for contracts involving real property,⁷⁸ formal requirements are only imposed when necessary for the protection of one of the parties.⁷⁹ By allowing parties the freedom to contract, Estonia has codified “the cornerstones of an open, market-oriented, and competitive international economic order.”⁸⁰

2. Good Faith

Perhaps one of the most important additions to Estonian private law is the introduction of the general principle of good faith.⁸¹ Prior to the enactment of the *Law of Obligations Act*, there were no provisions requiring the parties to act in good faith when entering into contractual obligations.⁸² The *General Part of the Civil Code Act*, enacted in 1994, provides for an obligation to exercise good faith regarding basic civil rights.⁸³ The *Law of Obligations Act* sets forth an additional

many model codes allowing freedom to contract is contrary to principles of socialist economies where the government controls terms of a contract).

72. Völaõigusseadus [Law of Obligations Act] arts. 5-6, 16 (Est.).

73. Kull, *supra* note 13, at 36 (citing supreme court decision CCSCd 3-2-1-80-02.-RT III 2002, 27, 302) (concluding that contracts are voidable by the parties under extremely unfavorable conditions where one party has taken advantage of certain conditions to the detriment of the other party).

74. *Id.* at 36-37 (citing supreme court decision CCSCd 3-2-1-29-02-RT III 2002, 14, 164, where the court held that contracts that subject one party to full control—such as one where the management of a company was aware of upcoming bankruptcy and nonetheless bound one party to a ninety-nine year lease without a right of reviewing rental terms—are substantively unfair).

75. *See id.* at 36 (explaining that the supreme court has not found a contract void because of excessive interest rates alone).

76. *See id.* (circumstances such as experience, a forced situation, lack of power and other circumstances will be taken into consideration).

77. *See Lando, supra* note 71, at 388.

78. Referred to as an “immovable.” *See Völaõigusseadus* [Law of Obligations Act] art. 175(6) (Est.).

79. *See id.* at arts. 807, 144(2); *see also* Kull, *supra* note 13, at 37 (citing formal requirements for the declaration of intention by a consumer before or during entry into a contract).

80. UNIDROIT, *supra* note 34, at art1.1 cmt.1.

81. Völaõigusseadus [Law of Obligations Act] art. 6 (Est.).

82. Kull, *supra* note 48, at 122.

83. *Id.* (explaining that principles of good faith have only been cited by Estonian courts since 1998 because it is a relatively new concept).

requirement of good faith by requiring parties to adhere to principles of good faith during contractual negotiations.⁸⁴

Although the German civil code was used as an example for most of the Estonian civil code, the *Law of Obligations Act* broadens the scope of the German good faith application.⁸⁵ The general clause requiring good faith on behalf of contracting parties is modeled after German law.⁸⁶ The second part of the good faith requirement expands on the German definition with the addition of the following: “nothing arising from law, usage or transaction may be applied if it is contrary to good faith.”⁸⁷ Because the principle of good faith is a relatively new concept in Estonian legal practice, the courts have applied this concept in limited circumstances.⁸⁸

The introduction of good faith is also important for governing the rights and obligations of parties during precontractual negotiations, which were never before regulated.⁸⁹ Because there was no legal basis for enforcing precontractual promises, such as good faith, courts could not enforce such promises prior to the enactment of the *Law of Obligations Act*.⁹⁰ Furthermore, the establishment of a disclosure requirement has provided Estonia with a legal basis for allowing parties to claim damages for circumstances that arise out of precontractual negotiations.⁹¹

By mandating parties to act in accordance with good faith and fair dealing, the *Law of Obligations Act* protects against the abuse of rights by a party.⁹² This alleviates damage to a weaker party in the event that one party contracts without the intention of fulfilling its obligation.⁹³ Uniformity with regard to good faith is of utmost importance in the context of international trade because standards of practice may vary from one environment to another, depending on the legal culture.⁹⁴

84. See *Võlaõigusseadus* [Law of Obligations Act] art. 6 (Est.); see also Kull, *supra* note 13, at 38.

85. See *Võlaõigusseadus* [Law of Obligations Act] art. 6(2) (Est.); see also Kull, *supra* note 13, at 38 (explaining that the wording in the *Law of Obligations Act* provides that “nothing arising from law, a usage, or a transaction shall be applied to an obligation if it is contrary to the principle of good faith”).

86. Kull, *supra* note 13, at 38.

87. This definition of good faith is broader than the German counterpart on good faith. *Id.*

88. Irene Kull, *Principle of Good Faith and Constitutional Values in Contract Law*, VII JURIDICA INTERNATIONAL 142, 148 (2002), available at http://www.juridica.ee/international_en.php?document=en/international/2002/1/39981.SUM.php (citing dwelling disputes, labor disputes, and loan contracts as examples of instances where principles of good faith have been applied by Estonian courts).

89. *Id.* (proposing that the situation will likely change since negotiations are being regulated, which will improve the protection of constitutional values in private contractual relationships).

90. See Kull, *supra* note 48, at 123 (explaining that courts have repeatedly held preliminary agreements as non-binding in the past, because such agreements were not protected by previous laws).

91. *Võlaõigusseadus* [Law of Obligations Act] art. 14 (Est.).

92. UNIDROIT, *supra* note 34, at art. 1.8 cmt. 2.

93. *Id.*

94. *Id.* at art. 1.8 cmt. 3.

3. *Pacta Sunct Servunda*⁹⁵

The *Law of Obligations Act* adopts the UNIDROIT principles regarding the binding force of contracts.⁹⁶ Contracts are concluded by offer and acceptance, as long as there is a mutual declaration of intention that the parties have reached a sufficient agreement.⁹⁷ An offer may be withdrawn so long as the withdrawal is received prior to, or at the same time, as the offer.⁹⁸

Under the *Law of Obligations Act*, any failure to meet contractual obligations or any nonperformance is considered a breach.⁹⁹ Unlike Soviet law, a breach of contract may be excusable¹⁰⁰ or inexcusable,¹⁰¹ and damages incurred from a breach are not necessarily evaluated upon the presence of fault by one party.¹⁰² In the case of *force majeure*,¹⁰³ a contract may be automatically terminated without an expression of will on behalf of the parties.¹⁰⁴ Once the contractual obligation is terminated due to *force majeure*, the other party is not allowed to claim damages.¹⁰⁵ Additionally, the *Law of Obligations Act* imposes a notice requirement on parties claiming exemption from contractual obligations.¹⁰⁶ The aggrieved nonbreaching party must notify the breaching party within a reasonable time after the discovery of the breach.¹⁰⁷ The new provisions that are introduced in the *Law of Obligations Act* allow each contract to be assessed on an individual level and are no longer a breach on an entire society.¹⁰⁸ Furthermore, in situations where superior forces prevent the fulfillment of an obligation, the party is relieved of consequences that normally occur upon a breach.¹⁰⁹

95. This phrase endorses the principle that promises must be kept and is used to emphasize the binding force of contracts. See B. Sharon Byrd & Joachim Hruschka, *Kant on "Why Must I Keep My Promise?"*, 81 CHI.-KENT L. REV. 47, 72 (2006).

96. Võlaõigusseadus [Law of Obligations Act] art. 8(2) (Est.).

97. *Id.* at art. 9.

98. *Id.* at art. 18.

99. Kull, *supra* note 88, at 148 (stating that unlike German law, Estonia adopted a common concept of breach modeled after the Principles of European Contract Law).

100. Obligations are excused in cases of Force Majeure, which are when circumstances are beyond the control of the obligor. Võlaõigusseadus [Law of Obligations Act] art. 103 (Est.).

101. See *id.* (stating that "it is presumed that non-performance is not excused").

102. See Kull, *supra* note 88, at 148 (giving an overview of Soviet civil-law theory of culpability in analyzing cases of contractual breach).

103. See Wm. Cary Wright, *Force Majeure Clauses and the Insurability of Force Majeure Risks*, 23 FALL CONSTRUCTION LAW. 16, 16 (2003) (defining *force majeure* as a term to describe a superior force event, such as physical impossibility or frustration of purpose).

104. See Kull, *supra* note 88, at 150 (explaining that this provision is unlike CISG and U.S. Restatements, all of which require an expression of will in order to terminate a contract due to *force majeure*).

105. Võlaõigusseadus [Law of Obligations Act] art. 793 (Est.).

106. *Id.* at arts. 972, 978.

107. See *id.* at art. 978.

108. Granik, *supra* note 47, at 236.

109. Võlaõigusseadus [Law of Obligations Act] art. 793 (Est.).

4. Damages

The *Law of Obligations Act* introduces the right to compensation for damage inflicted by nonperformance of an obligation.¹¹⁰ An aggrieved party may also seek a penalty from the breaching party in the event of delayed performance.¹¹¹ Unlike the United Nations Convention on the International Sale of Goods (“CISG”), the *Law of Obligations Act* does not provide for punitive damages in the event of a breach,¹¹² but it does allow remedies such as specific performance,¹¹³ the right to withhold performance,¹¹⁴ the right to dissolve a contract,¹¹⁵ and the right to reduce price.¹¹⁶ Except in cases of material breach,¹¹⁷ the nonbreaching party has a right to cancel a contract for good reason, only after granting the parties an additional period to perform.¹¹⁸ In the case of fundamental breach, parties may cancel a contract without granting any additional period of performance.¹¹⁹

By providing negative consequences for a breach of contract, parties will be more likely to perform an obligation. The preferred Soviet method of ordering specific performance cannot accommodate an aggrieved party when performance is unlikely. Without negative consequences imposed on the parties, a lack of incentive to fulfill contractual obligations exists.¹²⁰

The introduction of new legislation governing contract law established Estonia’s presence in Europe. By harmonizing contract principles with those found in Western civil codes, the likelihood of success in international business is greater.¹²¹ These harmonized principles ensure that Estonians will not be taken by surprise when contracting with foreign entities, as their laws will be familiar to their foreign counterparts.¹²² As a result, foreign entities will feel more comfortable contracting with Estonian businesses because they will not be dissuaded in the law.¹²³

110. *Id.* at art. 101.

111. *Id.*

112. Kull, *supra* note 88, at 147 n.22.

113. See Völaõigusseadus [Law of Obligations Act] art.108 (Est.); see also UNIDROIT, *supra* note 34, at art. 7.2.1-7.2.2 (stating that specific performance is not always justified and monetary obligations are always performable).

114. See Völaõigusseadus [Law of Obligations Act] arts. 110-11 (Est.); see also Kull, *supra* note 88, at 154 (stating that under the old civil code, the right to this remedy was only allowed in limited circumstances).

115. See Völaõigusseadus [Law of Obligations Act] art. 116 (Est.); see also Kull, *supra* note 88, at 157 (explaining that wording in old civil code did not clearly define circumstances that allow dissolution as a remedy).

116. Völaõigusseadus [Law of Obligations Act] art. 112 (Est.).

117. This is referred to as a “fundamental breach,” which deprives the injured party its expectation, except in cases where there were unforeseeable consequences. See *id.* at art. 116(2)(1)-(5).

118. *Id.* at art.116(4).

119. Estonia adds intentional and gross negligence as a definition for fundamental breach contrary to the CISG, German, or Dutch civil codes. See *id.* at art. 116(6).

120. IOFFE, *supra* note 46, at 176.

121. See discussion *infra* Part V.

122. See *infra* text accompanying notes 249-260.

123. See *infra* text accompanying notes 255-260

III. ENSURING CONTRACT ENFORCEMENT

Ensured success of new contract legislation is largely dependent upon the enforceability of agreements. Judicial reform, by way of the newly enacted *Courts Act*,¹²⁴ is a positive step towards the establishment of an independent judiciary¹²⁵ capable of ensuring the enforcement of business contracts. Despite continued cooperation with the Ministry of Justice,¹²⁶ the *Courts Act* provides Estonia with the necessary legislative steps to improve the effectiveness of the judicial branch.¹²⁷

By establishing the necessary legislation to ensure separation of powers, the judiciary can act without influence from the executive branch.¹²⁸ Judicial independence guarantees that the judges will be held accountable and are less susceptible to corruption.¹²⁹ Furthermore, heightened requirements for judicial service ensures that legislation will be interpreted logically and more predictably,¹³⁰ and concrete disciplinary regulations ensure that judges who cannot conform to new regulations will be appropriately penalized.¹³¹

A. Soviet Judicial Society

Socialist legal theory emphasized the importance of written law and considers it to be the only correct source of legal decisions.¹³² Socialist theory views law as the result of carefully planned criteria that is to be governed by the

124. Kohtute seadus [KS] [Courts Act] (Est.).

125. See Julia Laffranque, *Dissenting Opinion and Judicial Independence*, VIII JURIDICA INTERNATIONAL 162, 167 (2003), available at http://www.juridica.ee/international_en.php?document=en/international/2003/1/65316.SUM.php (stating that only an independent judge can guarantee the recognition of the rule of law).

126. Continued oversight by the Ministry of Justice was noted as concerns during the EU accession process, despite the fact that most judges were publicly regarded as politically impartial. See FREEDOM HOUSE, NATIONS IN TRANSIT 2002: COUNTRY REPORT OF ESTONIA 175 (2002) [hereinafter NATIONS IN TRANSIT 2002], available at <http://unpan1.un.org/intradoc/groups/public/documents/nispacee/unpan007948.pdf>; see also JUDICIAL INDEPENDENCE, *supra* note 16, at 161 (stating that the Ministry of Justice is the appointed spokesperson for the judiciary as the judicial branch does not have an official body authorized to speak on its behalf).

127. See OPEN SOCIETY INSTITUTE, MONITORING EU ACCESSION PROCESS: JUDICIAL CAPACITY IN ESTONIA 95 (2002) [hereinafter JUDICIAL CAPACITY]. But see NATIONS IN TRANSIT 2002, *supra* note 126, at 175 (explaining that the draft *Courts Act* drew harsh criticism from judges for failure to remedy the level of management bestowed upon the Ministry of Justice and allowing judges to work within the Ministry of Justice, which could possibly exacerbate existing problems of judicial independence).

128. Rait Maruste, *Estonia: Leading Central Europe in Judicial Reform*, INTERNATIONAL JUDICIAL OBSERVER, January 1996, at 3.

129. Bradley L. Milkwick, *Feeling for Rocks While Crossing the River: The Gradual Evolution of Chinese Law*, 14 J. TRANSNAT'L L. & POL'Y 289, 303 (2005).

130. See Kohtute seadus [KS] [Courts Act] art. 54(1)(Est.).

131. *Id.* at art. 88.

132. Zdenek Kuhn, *Worlds Apart: Western and Central European Judicial Culture at the Onset of the European Enlargement*, 52 AM. J. COMP. L. 531, 541 (2004).

Communist Party.¹³³ Statutory interpretation was considered a mechanical process, and any judicial interpretation outside of written language was considered unacceptable.¹³⁴ The theory behind such a straightforward approach to legal texts was that this would discourage judges from altering the will of the ruling class, as in other bourgeois societies, where judges often create laws by interpretation.¹³⁵

Judges were not admired and they lacked the same prestige as those in comparable positions held in other Western societies.¹³⁶ The judiciary was underfunded¹³⁷ and under-qualified, and therefore did not have the resources available to properly handle complex cases.¹³⁸ Any citizen over the age of twenty-five could be elected as a judge, and appointments were made based on legal, political, and personal qualifications.¹³⁹ Although many of them had obtained higher legal education, this was not a requirement for judicial service.¹⁴⁰

Judges were appointed for a five-year term, and could be recalled by their constituency, the agency that elected them, or by criminal charges.¹⁴¹ Oversight by the Ministry of Justice was problematic for the insurance of judicial independence.¹⁴² The role of the Ministry of Justice was not only to provide organizational discretion over the court system,¹⁴³ but also to ensure that the judiciary was acting as an extension of the executive branch.¹⁴⁴ The lack of separate powers made judges less likely to rule in favor of justice for fear that they would be reprimanded if they ruled against the party.

B. The Courts Act

Legislative reforms in Estonia have introduced new methods of adjudication, including constitutional review¹⁴⁵ and administrative court proceedings.¹⁴⁶ The

133. *Id.*

134. *Id.* at 543.

135. *Id.* at 547-48.

136. *Id.* at 549.

137. *Id.*

138. *See id.* at 555; *see also* Paul H. Rubin, *Growing a Legal System in the Post-Communist Economies*, 27 CORNELL INT'L L.J. 1, 15 (1994).

139. W.E. BUTLER, *SOVIET LAW* 101 (2d ed. 1988).

140. *Id.*

141. AMERICAN BAR ASSOCIATION, *A CONTRAST BETWEEN THE LEGAL SYSTEMS IN THE UNITED STATES AND IN THE SOVIET UNION* 247 (1968).

142. *See* JUDICIAL INDEPENDENCE, *supra* note 16, at 150.

143. BUTLER, *supra* note 139, at 96.

144. *See* Maruste, *supra* note 128, at 3.

145. Kohtute seadus [KS] [Courts Act] art. 26(3) (Est.); Eesti Vabariigi põhiseadus [EVP] [Constitution] arts. 15, 152 (Est.).

146. Kohtute seadus [KS] [Courts Act] art. 18 (Est.). Administrative courts provide a venue for citizens to file a complaint against the executive branch and thus offering a guarantee for protecting fundamental rights and liberties. Constitutional review offers a check on the legislative branch by giving the courts jurisdiction to declare laws unconstitutional. *See* Maruste, *supra* note 128, at 3.

new *Courts Act* provides that justice will be only administered by the courts¹⁴⁷ and provides guarantees for an independent judiciary.¹⁴⁸ Judicial independence is guaranteed by granting judges life tenure,¹⁴⁹ providing for the possibility of removal from office,¹⁵⁰ and allowing the possibility of criminal charges to be brought against judges who violate the law.¹⁵¹ Provisions in the Constitution supplement the *Courts Act* by establishing a constitutional guarantee for the separation of powers.¹⁵² To ensure that judges on the bench are sufficiently qualified, new methods of training and removal have been introduced. Finally, increased transparency ensures that the judiciary will be held accountable to the public by allowing broad access to court operations and judgments.¹⁵³

1. Judicial Independence

The new *Courts Act* lists several methods to guarantee the independence of the judiciary. Judicial independence is guaranteed, by providing safeguards for confidential deliberations¹⁵⁴ and by permitting judges to issue dissenting opinions.¹⁵⁵ Judges are only allowed to hold judicial office, with an exception made for participation in teaching and research positions.¹⁵⁶ Judges are not permitted to hold the following positions: office in the legislature; member of a political party;¹⁵⁷ board of directors of a company; a trustee in bankruptcy; or arbitrator.¹⁵⁸ The *Courts Act* further improves judicial independence by limiting the position of Court Chairman to one consecutive term,¹⁵⁹ which allows those in

147. See Kohtute seadus [KS] [Courts Act] art. 2(1) (Est.); see also Eesti Vabariigi põhiseadus [EVP] [Constitution] art. 16 (Est.).

148. Eesti Vabariigi põhiseadus [EVP] [Constitution] art. 147 (Est.) (stating that guarantees for judicial independence shall be provided by law). But see JUDICIAL INDEPENDENCE, *supra* note 16, at 160 (explaining that although the *Courts Act* improves the independence of judges as individuals, the act does not focus enough on the independence of the judiciary as an institution).

149. See Kohtute seadus [KS] [Courts Act] art. 3(1) (Est.); see also Jaan Ginter, *Guarantees of Judicial Independence*, I JURIDICA INTERNATIONAL 75, § 2 (1996), available at http://www.juridica.ee/international_en.php?document=en/international/1996/1/6139.SUM.php (proposing that life tenure really means that judges may serve until they reach a certain age).

150. Kohtute seadus [KS] [Courts Act] art.3(2) (Est.).

151. See *id.* at art.3(3)-3(4); see also Eesti Vabariigi põhiseadus [EVP] [Constitution] art. 153 (Est.).

152. See Eesti Vabariigi põhiseadus [EVP] [Constitution] art. 4 (Est.); see also FREEDOM HOUSE, NATIONS IN TRANSIT 2003: COUNTRY REPORT OF ESTONIA 255 (2003) [hereinafter NATIONS IN TRANSIT 2003], available at <http://unpan1.un.org/intradoc/groups/public/documents/NISPAceec/UNPAN012419.pdf> (asserting that separation of powers is guaranteed by the constitution and is accepted in practice).

153. See JUDICIAL CAPACITY, *supra* note 127, at 100; see also Estonica, Judicial System, <http://www.estonica.org> (last visited Mar. 27, 2006).

154. See Kohtute seadus [KS] [Courts Act] art. 72 (Est.); see also Laffranque, *supra* note 125, at 162.

155. See Laffranque, *supra* note 125, at 166.

156. Kohtute seadus [KS] [Courts Act] art. 49(1) (Est.).

157. This sharply contrasts the judicial branch under the Soviet system where the courts functioned under the rule of the Communist party. See Maruste, *supra* note 128, at 3.

158. Kohtute seadus [KS] [Courts Act] art. 49 (Est.).

159. See *id.* at arts.12(9), 20(9), 24(9), 27(9).

this position to be more independent because they are less susceptible to the will of the executive branch with hopes of guaranteeing their re-election.¹⁶⁰

Judges are required to perform duties impartially and to refrain from behaving in a way that would damage the reputation of the court.¹⁶¹ They are subjected to a personal interview, during which the judge's examination committee assesses the suitability of candidates for office.¹⁶² The integrity of the judicial branch is further ensured by requiring judges to pass a security check¹⁶³ and to take an oath swearing to faithfully administer justice in accordance with the Constitution.¹⁶⁴ Only citizens of high moral character may be appointed as judge.¹⁶⁵ One cannot serve as a judge if (1) ever convicted of a criminal offense, (2) removed from office of judge, (3) expelled from the Estonian Bar Association, (4) disciplined while working in public service, or (5) declared bankruptcy.¹⁶⁶

The Constitution provides further guarantees of judicial independence. The Constitution declares, "[t]he courts shall be independent in their activities and shall administer justice in accordance with the [c]onstitution and the laws."¹⁶⁷ Judges are appointed for life and may only be removed from office by judgment from a court of law.¹⁶⁸ The Constitution provides that the supreme court is entrusted with constitutional review¹⁶⁹ and may review lower court judgments, which allows lower courts to be scrutinized if deciding cases unfairly.¹⁷⁰

2. Training

Even with independence guaranteed, inexperienced judges may hinder the effective implementation of new legislation.¹⁷¹ Many of the Soviet-era judges

160. See JUDICIAL CAPACITY, *supra* note 127, at 96. *But see* Laffranque, *supra* note 125, at 168 (stating that the requirement for re-election of the Constitutional Review Chamber requires the approval of the supreme court sitting en banc, and consequently justices seeking re-election may rule pursuant to the will of their colleagues on the supreme court).

161. Kohtute seadus [KS] [Courts Act] art. 70 (Est.).

162. *Id.* at art. 54(1).

163. *Id.* at art. 54(2).

164. *Id.* at art. 56.

165. *Id.*

166. *Id.* at art. 47.

167. Eesti Vabariigi põhiseadus [EVP] [Constitution] art. 146 (Est.).

168. *Id.* at art. 147.

169. Contrary to many other European countries, Estonia did not create a separate constitutional court, instead entrusting this task to its supreme court. See *id.* at art. 149; see also Bojan Bugaric, *Courts as Policy-Makers: Lessons from Transition*, 42 HARV. INT'L L.J. 247, 247 (2001) (providing that constitutional courts are elements of almost all Eastern European judiciaries).

170. See Eesti Vabariigi põhiseadus [EVP] [Constitution] arts. 149, 152 (Est.) (stating that the supreme court may invalidate any law that conflicts with the "provisions and spirit" of the constitution).

171. See JUDICIAL INDEPENDENCE, *supra* note 16, at 157 (citing the EU Regular Report on Estonia's progress towards accession 1999 that "inexperienced judges continue to pose major difficulties for the judicial

were removed; therefore, the judicial branch that emerged is largely young and inexperienced.¹⁷² The training of new judges no longer rests with the Ministry of Justice; it is now vested in a new Council for Judicial Training.¹⁷³ The Council for Judicial Training consists of two judges from each level: one representative from the Prosecutor's Office, one representative from the Ministry of Justice, and one representative from the University of Tartu.¹⁷⁴ A foundation has been established to govern all aspects of judicial training, including: creating protocols and training strategy; implementing procedures; providing a program for judge's examinations; and ensuring the program continues to improve by providing an annual review of the training program for The Training Council.¹⁷⁵

3. Removal

Any guarantees for judicial independence may be undermined if there are not proper procedures for removal of judges on disciplinary grounds.¹⁷⁶ Disciplinary proceedings may be initiated against a judge for failing to perform official duties.¹⁷⁷ The *Courts Act* provides a list of appropriate punishments¹⁷⁸ and enumerates details of procedure for commencing disciplinary action against a judge.¹⁷⁹ Authority to conduct disciplinary proceedings is entrusted to a Disciplinary Chamber and no longer rests with the Ministry of Justice.¹⁸⁰

Judges may be removed from office for a variety of reasons.¹⁸¹ A judge may be removed from office after three years if found unsuitable for office by the supreme court sitting *en banc*.¹⁸² Judges may also be removed pursuant to a decision rendered by the Disciplinary Chamber, or if the judge has been convicted of a crime.¹⁸³

system. Justice in lower level courts continues to be unsatisfactory, as there are many new, inexperienced and overburdened judges.”).

172. Maruste, *supra* note 128, at 3.

173. JUDICIAL CAPACITY, *supra* note 127, at 97 (stating that the new *Courts Act* transfers responsibility for training from the Ministry of Justice to the Council for Judicial Training).

174. Kohtute seadus [KS] [Courts Act] art. 44 (Est.).

175. *Id.* at art. 44(2).

176. Ginter, *supra* note 149, § 3.

177. See Kohtute seadus [KS] [Courts Act] art. 87 (Est.) (an indecent act is also grounds for disciplinary action against a judge).

178. *Id.* at art. 88.

179. *Id.* at arts. 87-98.

180. See NATIONS IN TRANSIT 2003, *supra* note 153, at 256; see also Kohtute seadus [KS] [Courts Act] art. 93 (Est.) (stating that the Disciplinary Chamber shall consist of five judges from each of the three levels of the court system).

181. Judges may be released at the request of another judge, at the age of retirement, due to unsuitability for office, for health reasons, due to liquidation of the court, or “if facts become evident which according to law preclude the appointment of the person as a judge.” See Kohtute seadus [KS] [Courts Act] art. 99 (Est.).

182. *Id.* at art. 100.

183. *Id.* at art. 101.

For the most part, reforms taken by Estonia are considered a positive step towards an efficient judiciary¹⁸⁴ and can only improve as the judiciary becomes accustomed to new legislation.¹⁸⁵ Court decisions are being complied with, and more cases are being upheld on appeal, which indicates that they are being decided correctly in the lower courts.¹⁸⁶ Although increasing the enforceability of court decisions consequently increases the number of lawsuits, sources show that the judiciary has adapted well to the new legislation, resulting in a decreasing backlog of court cases.¹⁸⁷ Facilities have improved,¹⁸⁸ and judges are now compensated at considerably higher than the average salary,¹⁸⁹ which may indicate a growing appreciation for the value of a competent judiciary.

IV. CONTINUED SUCCESS OF LEGISLATIVE REFORM

The success of new laws is impossible without the proper training of attorneys working within their respective legal systems, and a quality education being pursued by future lawyers of that region.¹⁹⁰ With the collapse of communism came an increased demand for law degrees.¹⁹¹ This increased demand for law degrees resulted in the creation of many unaccredited law schools that awarded diplomas without effectively training students to deal with a changing legal environment.¹⁹²

Integration with the rest of Europe brings to light additional complications that may arise when Estonian lawyers practice in other nations, and vice versa.¹⁹³ To learn the appropriate analytical tools, students in Europe need to be sufficiently educated so that they can effectively use foreign law as a variation of

184. JUDICIAL CAPACITY, *supra* note 127, at 96. *But see* JUDICIAL INDEPENDENCE, *supra* note 16, at 156 (suggesting that the success of judicial reforms may be undermined by the lack of public debate and concern regarding declining confidence in the judicial branch, which does not encourage politicians to take a decisive step towards building a completely independent judiciary).

185. *See* JUDICIAL CAPACITY, *supra* note 127, at 96 (stating that the potential for the new legal provisions in the *Courts Act* will depend upon effective implementation).

186. NATIONS IN TRANSIT 2002, *supra* note 126, at 175.

187. *See id.* at 174; *see also* The World Bank, Doing Business, Enforcing Contracts, [http://doingbusiness.org/ExploreTopics/Enforcing Contracts/](http://doingbusiness.org/ExploreTopics/EnforcingContracts/) (last visited Mar. 27, 2006) (comparing the number of days that is required to enforce a contract in Estonia (150) to the number of days required to enforce a contract in the Russian Federation (330)); NATIONS IN TRANSIT 2003, *supra* note 153, at 256 (stating that judicial decisions are being effectively implemented and the collection of money in court cases is improving).

188. *See* JUDICIAL INDEPENDENCE, *supra* note 16, at 169; *see also* Judicial Capacity, *supra* note 127, at 105.

189. JUDICIAL INDEPENDENCE, *supra* note 16, at 170.

190. Varul, *supra* note 9, at 117.

191. *See* CEELI Legal Education Reform Program, CEELI Focal Areas, www.abanet.org/ceeli/areas/legaled.html (last visited Mar. 27, 2006).

192. *Id.*

193. Ana M. Lopez-Rodriguez, *Towards a European Civil Code Without a Common European Legal Culture? The Link Between Law, Language and Culture*, 29 BROOKLYN J. INT'L L. 1195, 1216 (2004).

basic principles they already know.¹⁹⁴ One author even suggests that students should be taught to view respective national rules as a variation of a larger European law and should be encouraged to study abroad to gain an adequate understanding of foreign law.¹⁹⁵

A. University of Tartu

In addition to international legal opportunities created by foreign study and EU integration, the enhancement of the legal curriculum at the University of Tartu has been underway since Estonia declared independence in 1991.¹⁹⁶ The Faculty of Law reformed the curriculum, using examples from other European law schools, while also taking into account the independent needs of local Estonian lawyers.¹⁹⁷ Fortunately, many of the current faculty members assisted in the legislative reform process and therefore have first-hand experience working with many of the new laws currently in force.¹⁹⁸ These professors have multiplied the number of legal publications in Estonia, and foreign professors have been able to step in where the current faculty cannot provide an adequate level of education. In addition, the practical training aspect of legal education has shifted, so that legal scholars obtain a first-hand look at the inner workings of the Estonian court system. These changes have improved the level of legal education at the University of Tartu, so that students will be prepared to work in an international environment.

1. Curriculum

The new curriculum was devised after careful consideration, taking into account opinions from graduates, practicing lawyers, and faculty members from foreign universities.¹⁹⁹ The new curriculum has increased the number of private law courses,²⁰⁰ and includes courses relating to international law, European law, and also courses in basic legal theory.²⁰¹ Not only do students gain an education based on practical legal concepts, but also they are taught basic legal theory, so

194. *Id.*

195. *Id.*

196. See generally Peep Pruks, *Academic Legal Education in Estonia: Current State and Perspectives (Faculty of Law of the University of Tartu)*, 1 JURIDICA INTERNATIONAL 139 (1996), available at http://www.juridica.ee/international_en.php?document=en/international/1996/1/6165.SUM.php (providing an overview of changes in the educational system at the University of Tartu).

197. *Id.* § 1.3.

198. See *id.*; see also Byrne, *supra* note 30, at 458.

199. See Pruks, *supra* note 196, § 3.1; see also Merusk, *supra* note 23, § 6.1.

200. Courses in private law now constitute almost half of the prerequisites at the expense of legal historical disciplines and foreign language courses. With regard to the new concepts encompassed in the *Law of Obligations Act*, new courses were prepared. See Merusk, *supra* note 23, at Annex 1.

201. Pruks, *supra* note 197, § 3.1.

that they may adapt their legal knowledge to accommodate new legal principles if laws and legal norms change in the future.²⁰²

Influences from abroad have greatly affected the changes made to Estonian law school curriculum.²⁰³ The restructuring of the law school curriculum was designed to accompany Estonia's integration into Europe.²⁰⁴ Government regulations even designated funds to cover the cost of implementing a new department to concentrate only on EU law.²⁰⁵ Students have been able to study abroad,²⁰⁶ and visiting foreign lecturers have contributed in areas where current course options are deficient or lacking a faculty member with the appropriate level of expertise.²⁰⁷

2. *Practical Training*

The practical training aspect of the law curriculum has also changed to allow students the opportunity to gain a more effective level of experience in line with the everyday needs of practicing attorneys in Estonia.²⁰⁸ Instead of training with local lawyers, students now participate in a six-week practical training within the court system, which is coordinated by a member of the faculty.²⁰⁹ This allows students to gain insight into the substantive and procedural issues that arise in the Estonian court system, and further their knowledge of the internal workings of Estonian law and how it is applied in practice.²¹⁰

3. *Faculty*

The quality of the faculty at the University of Tartu has also improved, thereby providing additional benefits to the quality of legal education guiding the future lawyers of Estonia. Although many of the new faculty members are comparatively young, many have high-level degrees from foreign universities and foreign lecturers fill in where the current faculty cannot provide the adequate level of education.²¹¹

202. *Id.*

203. *Id.* § 3.2.

204. *Id.*

205. *See id.* § 5.1; *see also* Pruks, *supra* note 197, § 3.2 (explaining that the curriculum enables students to learn main concepts, principles, and theories that can be applied throughout Europe).

206. Pruks, *supra* note 197, at § 2.6.

207. *See id.* § 3.2 (stating that the assistance of visiting lecturers have allowed the faculty to implement new teaching methods and properly develop their courses).

208. *See id.* § 3.6.

209. *See id.*

210. *See id.*

211. *See id.* § 3.2; *see also* Merusk, *supra* note 23, § 5.1.

The Open Estonia Foundation has contributed vastly to aiding the faculty in publishing study materials,²¹² and this has resulted in an increased volume of study materials.²¹³ Additionally, the faculty publishes a law journal, *Juridica*, and its English edition, *Juridica International*, that facilitates the continuing legal thought and discussion legal policies in Estonia.²¹⁴

While the legal education is still improving, changes that have already taken place have assisted the successful progression of legal society in Estonia. Students have placed well in international moot court competitions,²¹⁵ and the law school is attracting foreign students to study in Estonia, which may indicate that Estonian legal education is thought to be comparable to that of other European educational institutions.²¹⁶

B. Riga Graduate School of Law

Programs that allow students to study law in foreign countries may enhance the ability of students in Estonia to compete with other European students in the legal field. One such program is already underway to help Baltic lawyers supplement their legal education already obtained in their native country and become acquainted with the principles used in Western legal systems.²¹⁷ The Foundation of the Riga Graduate School of Law ("RGSL") offers students an education based on the rule of law, human rights, and principles of democracy.²¹⁸ The program is designed to enable legal professionals to adapt successfully to legislative changes occurring in the Baltic region.²¹⁹ RGSL boldly states that its mission is "to function as a catalyst for change in the legal systems of the Baltic States."²²⁰

RGSL offers a fifteen-month LLM program that is geared towards providing recent law graduates from the Baltic countries with an understanding of international law, so that they will be prepared to practice in an international legal environment.²²¹ Although most of its students come from Latvia, RGSL hopes that the program eventually achieves an equal division of students from all

212. University of Tartu Faculty of Law, *General Information, Development Plan*, www.iuridicum.ee (last visited Mar. 27, 2006).

213. Merusk, *supra* note 23, § 4.2.

214. University of Tartu Faculty of Law, *General Information, Development Plan*, www.iuridicum.ee (last visited Mar. 27, 2006).

215. Merusk, *supra* note 23, § 2.5.

216. *See id.* (In 1998, there were nine foreign students).

217. *See* Norbert Reich & Linda Freiman, *Preparing for the European Future of Law Studies in the Baltic Countries*, 22 PENN ST. INT'L L. REV. 101, 102 (2003).

218. *Id.* at 101.

219. Riga Graduate School, *Philosophy*, <http://rgsl.edu.lv/> (last visited Mar. 27, 2006).

220. Reich & Freiman, *supra* note 217, at 102.

221. *Id.*

three Baltic countries.²²² The program at RGSL boasts that recent graduates are fully prepared for careers in both the public and private sector.²²³

The changes adopted at the University of Tartu and the introduction of international education can only encourage future Estonian lawyers to incorporate new laws and legal concepts into everyday practice. These future lawyers will be the parties drafting contracts on behalf of Estonian businesses that hope to trade internationally. The ensured success of legislative reforms in Estonia is largely dependent on how well these new concepts can be incorporated into Estonian legal culture, and the reformation of legal education is an efficient way to ensure assimilation of foreign concepts.

V. HARMONIZED CONTRACT LAW IN EUROPE

Legislative changes that have taken place in Estonia will only continue to improve the business environment in Estonia. In addition to benefits arising from established legal concepts in other nations, the harmonization of legal systems alleviates uncertainty that can arise from interacting with foreign entities.²²⁴ The certainty that results when governing rules are similar can have a beneficial impact on all parties.²²⁵ Differences in interpretation will be fewer, and mandatory terms used by contracting parties in different nations will be used consistently.²²⁶ More importantly, transaction costs involved in conducting transnational business will decrease, as there will be less need to obtain foreign legal advice to ensure complete comprehension of every contractual transaction.²²⁷ Furthermore, the existence of a common legislative framework will ensure that both parties will enter into transactions with a similar understanding.²²⁸

Some argue that harmonization is not necessarily beneficial for business.²²⁹ They fear that a harmonized contract law will result in the loss of a legal culture, which is important and specific to each nation.²³⁰ Furthermore, they argue that it is unnecessary, considering that the parties have the option to select a choice of law clause or the CISG to govern.²³¹ European Community ("EC") legislation is already partially harmonized, in the form of directives, and opponents argue that

222. *Id.* at 104.

223. *Id.* at 111.

224. *See infra* text accompanying notes 249-60.

225. *See infra* text accompanying notes 249-60

226. *See generally* Dominik Kallweit, *Towards a European Contract law: For a Prosperous Future of International Trade*, 35 VICT. U. WELLINGTON L. REV. 269, 275-77 (2004).

227. *Id.* at 227.

228. *Id.*

229. *See infra* Part Vb.

230. *See infra* Part Vbi.

231. *See infra* Part Vbii.

this legislation provides enough protection for consumers without a complete overhaul of national contract legislation.²³²

Harmonization of contract laws is so important that the EU is considering adopting supranational legislation to govern contractual relations in Europe.²³³ The introduction of a Common Frame of Reference (“CFR”) could possibly increase the likelihood of a successful common European market. Because Estonia has already harmonized laws governing contract formation with other European models, the adoption of a CFR may not be a difficult transition.²³⁴

A. Benefits of a Harmonized Contract Law

Prospects for membership in the EU provided the incentives necessary for struggling Eastern European nations to reform existing legislation.²³⁵ Competition with larger foreign markets and political pressure from other European nations can be a powerful motivation for small countries, such as Estonia, to conform to Western legal systems.²³⁶ The unification of Europe initially developed in pursuit of establishing a common market.²³⁷ Furthermore, increased globalization and modern technology have heightened the need for cooperative methods of transacting business throughout the world.²³⁸

By harmonizing contract principles with those encompassed by other member states, the legislative reforms introduced by the *Law of Obligations Act* and the *Courts Act* enable business transactions between Estonia and other member states to function more smoothly by providing clear rules and ensuring consequences for failure to uphold obligations.²³⁹ Harmonization of contract laws enables Estonia to align legal foundations governing concepts, general principles, and adjudicative methods with the rest of Europe to eventually create a common

232. See *infra* Part Vbii.

233. COMMISSION OF THE EUROPEAN COMMUNITIES, A MORE COHERENT EUROPEAN CONTRACT LAW, AN ACTION PLAN 4 (2003) [hereinafter ACTION PLAN], available at http://europa.eu.int/comm/consumers/cons_int/safe_shop/fair_bus_pract/cont_law/actionplan_en.htm.

234. The Principles of European Contract Law were used as a model for the Estonian Civil Code and will likely be used as a model for a Common Frame of Reference. See Lando, *supra* note 71, at 383.

235. See Appelquist, *supra* note 8, at 80 (stating that the use of foreign legal systems in Estonia were implemented both voluntarily and by inducement from multilateral organizations, such as the EU and NATO).

236. See Kull, *supra* note 13, at 32.

237. See Kallweit, *supra* note 226, at 269-70.

238. See Lando, *supra* note 71, at 379 (proposing that the increased use of electronic communication has increased world trade); see also Vivian Grosswald Curran, *Re-Membering in the International World*, 34 HOFSTRA L. REV. 93, 101 (stating that contacts are multiplying because of the EU and modern increase of communication).

239. See COMMISSION OF THE EUROPEAN COMMUNITIES, JOINT RESPONSE OF THE COMMISSION ON EUROPEAN CONTRACT LAW AND THE STUDY GROUP ON A EUROPEAN CIVIL CODE v (2001) [hereinafter JOINT RESPONSE], available at http://www.sgecc.net/media/download/stellungnahme_kommission_5_final1.pdf (stating that costs encountered by businesses can be eliminated by harmonization of private law in Europe).

legal culture.²⁴⁰ Although legal diversity does not hinder international business cooperation in itself, differences in substantive law governing many aspects of transactional business can.²⁴¹ To achieve optimum efficiency, unified rules that govern mandatory and standard provisions are essential.²⁴²

1. Mandatory Rules

Differences among the laws governing mandatory rules of the respective contracting parties may result in the disadvantage of one of the parties.²⁴³ Differences regarding contract formation, content, validity, interpretation, performance, the precise ending of an obligation, and the presence of unfair conditions all pose significant obstacles to reaching fair and legally binding contracts.²⁴⁴ In practice, the differences among the contract laws governing mandatory provisions may not always be clear on their face, and therefore, are not appropriately negotiated to give parties an opportunity to bypass potential obstacles during business transactions.²⁴⁵

The establishment of uniform rules with regard to contract regulation would eliminate market barriers and therefore encourage further economic integration.²⁴⁶ Differences in contract legislation tend to affect small- and medium-sized business enterprises more so than large enterprises because the former often lack the resources necessary to afford competent legal advice and do not have sufficient bargaining power to impose legal requirements on the other party.²⁴⁷

2. Default Rules

The process of drafting and reviewing contracts is often expensive and can increase transaction costs.²⁴⁸ Difficulties arise when determining which terms are

240. See Lopez-Rodriguez, *supra* note 194, at 1206 (stating that the key to determining how legal rules are understood and applied is dependent on legal culture).

241. See Kallweit, *supra* note 226, at 275-77 (presenting a case study example on how a disadvantaged transaction creates an obstacle to cross-border trade in the communities); see also Lando, *supra* note 71, at 379 (proposing that many parties do not focus enough attention on the governing laws of the parties with whom they contract).

242. Ugo Mattei, *Efficiency and Equal Protection in the New European Contract Law: Mandatory, Default and Enforcement Rules*, 39 VA. J. INT'L L. 537, 543 (1999).

243. See JOINT RESPONSE, *supra* note 239, at 6 (stating that costs encountered by businesses can be eliminated by harmonization of private law in Europe); see also Kallweit, *supra* note 226, at 275-77 (providing examples of differences among European codes, where differences in the most basic elements of contract formation may result in substantial disadvantage to one party if that party is unclear of specific requirements).

244. *Id.* at 275-77.

245. ACTION PLAN, *supra* note 233, at 10.

246. Kallweit, *supra* note 226, at 274.

247. See *id.* at 275; see also ACTION PLAN, *supra* note 233, at 10.

248. See Mattei, *supra* note 242, at 543 (explaining that many resources are spent on the specifics of legal reform instead of other areas of government).

mandatory and those that are standard default rules.²⁴⁹ When default rules differ depending on the national laws of each contracting party, transaction costs increase.²⁵⁰ Contract terms may have to be drafted more than once to satisfy the different requirements of each party's national law governing those provisions.²⁵¹ To do so effectively, contracting parties will be forced to expend significant resource to determine their respective rights under any applicable foreign law.²⁵² Failure to do so may result in one party entering into a contractual relationship with another without a complete understanding of their legal rights and obligations.²⁵³

These concerns are particularly troublesome for small- and medium-sized enterprises that may not have the financial resources available; therefore, these enterprises will be disadvantaged the most.²⁵⁴ This disadvantage may discourage parties from entering into cross-border economic transactions.²⁵⁵ The mere possibility of legal uncertainty may be sufficiently troublesome to discourage parties from transacting with foreign parties.²⁵⁶ The lack of affordable legal advice allows for the possibility that parties will trade without full knowledge of their rights or be discouraged because of legal uncertainty.²⁵⁷ The cost of negotiating around certain standard terms may be too great to warrant certain transactions.²⁵⁸ Consequently, even terms that are not legally mandatory may become mandatory because parties cannot afford to negotiate around them.²⁵⁹

3. Enforcement Rules

In addition to achieving uniformity with regard to mandatory rules and default provisions, the harmonization of contract law can facilitate the enforcement of contracts.²⁶⁰ A strong contract law may provide the incentives necessary to encourage parties to perform under the contract.²⁶¹ Judicial systems may not provide the best mechanism for contract enforcement due to substantial delay and expense.²⁶² In terms of enforcement, contracting with nations that have

249. *Id.* at 544.

250. Kallweit, *supra* note 226, at 281.

251. *Id.* at 282.

252. JOINT RESPONSE, *supra* note 239, at 6.

253. *Id.*

254. ACTION PLAN, *supra* note 233, at 10.

255. *Id.*

256. JOINT RESPONSE, *supra* note 239, at 6 (stating that "apparent differences can be as damaging to confidence as real ones").

257. *Id.* at 9 (explaining this is especially so in older legal systems where the codified law cannot be adequately understood without full comprehension of how the law has been interpreted by judges).

258. ACTION PLAN, *supra* note 233, at 10.

259. *Id.* at 11.

260. Mattei, *supra* note 242, at 565.

261. *Id.* at 567.

262. *Id.*

different standards can lead to injustice.²⁶³ The lower legal standards of some laws will offer an advantage to local business and provide an incentive for others to relocate to nations with lower standards.²⁶⁴ By harmonizing contract laws, nations no longer have an incentive to seek out a forum with lenient standards, as the laws will be the same.

B. Arguments against Harmonized Contract Law

Many scholars oppose harmonization for fear that the transposition of laws is often ineffective.²⁶⁵ It is believed that certain ways cannot be completely abolished by simply enacting new laws.²⁶⁶ Additionally, legal harmonization may eliminate certain elements that are important to a nation's own legal culture.²⁶⁷ Furthermore, opponents argue that harmonization is unnecessary because contracting parties are able to choose the applicable law or apply CISG rules, which would enable nations to keep their national legal culture intact while facilitating transnational contracting.²⁶⁸ Lastly, opponents claim that since contract laws are already somewhat harmonized by implementing EC directives, any further harmonization is unnecessary.²⁶⁹

1. The Loss of a Legal Culture

Opponents of a harmonized contract law favor legal diversity. They argue that a unified approach to legal reform will eliminate a national legal culture²⁷⁰ and inhibit competition among international economic players.²⁷¹ Many contracting parties may elect to trade with another party, depending on which parties' national law may prove to be the most advantageous to them.²⁷²

Additionally, many argue that despite a harmonized legal text, interpretations may vary, and therefore, uncertainty exists despite efforts to encourage foreseeability by unifying textual differences.²⁷³ However, cases that have interpreted CISG provisions demonstrate that many courts will interpret

263. *Id.*

264. *Id.*

265. Erin Orucu, *Law as Transposition*, 51 ICLQ 205, 205 (2002) (explaining that "transplanted institution continues to live on in its old habitat").

266. *Id.*

267. P.G. Monateri, *The Weak Law: Contaminations and Legal Cultures*, 13 TRANSANT'L L. & CONTEMP. PROBS. 575, 576 (2003).

268. *See infra* text accompanying notes 276-288.

269. *See infra* text accompanying notes 289-299.

270. French opponents to a unified European Civil Code argue that the national civil codes reflect each state's culture. *See* Curran, *supra* note 238, at 110.

271. Kallweit, *supra* note 227, at 282.

272. *See id.* at 271-75 (providing a brief summary of certain discrepancies among member states regarding basic contractual transactions).

273. *Id.* at 286.

principles uniformly.²⁷⁴ Concerns that interpretations will be muddled by national legislatures could be resolved by including a list of defined terms to be used by courts in contract interpretation.

2. Alternative Solutions

Opponents of a harmonized contract law rely on choice of law clauses²⁷⁵ and international conventions²⁷⁶ as a basis for suggesting that nations may retain their own civil codes, yet manage to ameliorate any differences that may arise from transnational contracts by choosing which law will apply to any given transaction. EC Directives already provide a minimum level of harmonization with regard to certain areas that need to be addressed.²⁷⁷ Additionally, many believe that competition among market participants will result in the self-regulation of contract provisions because parties themselves will want to make transactions run as smoothly as possible and therefore willingly conform to each other's law.²⁷⁸ Given the cumbersome and expensive nature of creating new legislation,²⁷⁹ proponents of this theory suggest that self-regulatory measures will respond to problems created by differences in contract laws more rapidly.²⁸⁰

Choice of law clauses do not remedy problems related to different mandatory terms since these terms govern regardless of the choice of law.²⁸¹ This is especially problematic with the increasing use of e-commerce.²⁸² Additionally, choice of law clauses are not always possible.²⁸³ The determination of the preferred law involves considerable expense and may depend on whether one party has sufficient bargaining power to demand a particular law they choose to govern the transaction.²⁸⁴ Furthermore, choice of law clauses regarding contractual transactions have no bearing on different laws regarding the transfer of property, which is often different among member states.²⁸⁵

274. Lando, *supra* note 71, at 387.

275. ACTION PLAN, *supra* note 233, at 10.

276. Such as the CISG. See Hugh Beale, *The Development of European Private Law and the European Commission's Action Plan on Contract Law*, X JURIDICA INTERNATIONAL 4, 7 (2005) (stating that although the CISG may be a solution for parties who want to specify a certain set of rules, the CISG only applies to the sale of goods and has not been ratified by some countries). *But see* Kallweit, *supra* note 226, at 279 (stating that "most commercial contracts contain a clause excluding application of the CISG").

277. See *supra* text accompanying notes 181-190.

278. Kallweit, *supra* note 226, at 278.

279. See *id.* at 290-91 (suggesting that the fear is that the creation of a European Code is so burdensome that compromises are inevitable therefore resulting in lower-quality legislation).

280. *Id.* at 278.

281. ACTION PLAN, *supra* note 233, at 10.

282. *Id.*

283. *Id.*

284. *Id.*

285. *Id.* at 12.

3. EC Directives

Current contract law legislation in the EC is enacted in the form of a directive.²⁸⁶ These directives provide the minimum standards that member states are required to adopt into their respective national legislation.²⁸⁷ Minimum harmonization allows member states to adopt higher domestic standards and therefore, despite a consistent base in certain areas of contract laws, each national law may vary in application.²⁸⁸ Many argue that because there is already some level of harmonization, further harmonization is unnecessary.²⁸⁹

However, many of the directives have not been sufficiently defined, which leaves considerable discretion to national legislators in implementing these directives.²⁹⁰ Even when terms are defined, there is not enough consistency among all the directives so that the same definition is used throughout interpretation of all directives.²⁹¹ Furthermore, a growing number of directives have caused legislation in the field of contract law to become too specific and fragmented, resulting in an incoherent system of rules to be followed by member states.²⁹² Although in certain situations these directives may be good examples of comparative legal study that work towards a successful common market,²⁹³ other directives have been criticized for not being created so that the interests of all member states are adequately represented.²⁹⁴

C. The Need for Further Harmonization

Although most European contract laws are relatively similar, the expanding EU has now become large enough that legal diversity relating to national contract

286. Peter Schlechtriem, *EC Directives, Common Principles, and Law Reforms*, 75 TUL. L. REV. 1177, 1178 (2001).

287. Thomas Mollers, *European Directives on Civil Law*, 18 TUL. EURO. CIV. LF 1, 16 (2003).

288. Minimum harmonization may provide little incentive for heightened standards as this may result in "reverse discrimination" of national products. See Mel Kenny, *Globalization, Interlegality and Europeanized Contract Law*, 21 PENN ST. INT'L L. REV. 569, 575 (2003); see also ACTION PLAN, *supra* note 233, at 7 (stating that two legislative approaches to the same directive may lead to inconsistencies).

289. Kallweit, *supra* note 226, at 270.

290. See ACTION PLAN, *supra* note 233, at 8.

291. *Id.*

292. See Curran, *supra* note 238, at 106; see also Kallweit, *supra* note 226, at 280; ACTION PLAN, *supra* note 233, at 7 (explaining that differences in the interpretation of withdrawal periods in the Directives on Doorstep Selling, Timeshare, Distance Selling, and Distance Selling of Financial Services is one example of how minimum requirements can result in divergent rules regarding the EC directives).

293. See Schlechtriem, *supra* note 287, at 1179 (offering the Products Liability Directive of 1985 as an example of good comparative legislation).

294. In comparison, those who drafted the Principles of European Contract Law (PECL) were mainly scholars, and therefore, did not represent particular governments. See Lando, *supra* note 71, at 380; see also Schlechtriem, *supra* note 287, at 1180 (explaining that the German view on the consumer sales directive resulted because of heavy German representation by those who drafted the directive).

laws is noticeably problematic.²⁹⁵ The importance of harmonized legislation is so great that the EU is in the process of determining whether to begin legislative reform on an international level.²⁹⁶ If the EU does take legislative action with regard to contract legislation, the current law governing contracts in Estonia provides an excellent basis for a smooth transition into an integrated European contract law.²⁹⁷ Because the *Law of Obligations Act* was developed by comparing model codes²⁹⁸ and other European civil codes,²⁹⁹ the imposition of further changes in the field of contract law may not be dramatic enough to further complicate any current legislative changes relating to contract law in Estonia. The reformed *Law of Obligations Act* will provide the necessary groundwork for a successful transition to a greater European Civil Code.³⁰⁰

A CFR will be used to set forth common principles and define terminology that is necessary to further consistency in contractual negotiations in Europe.³⁰¹ A CFR will eliminate differences in national contract laws, and could be used as a model for national legislatures to alter current provisions regarding contractual relations.³⁰² The use of standard terms in contractual relations will lower costs that are involved in negotiating specific contract terms.³⁰³ By providing these standard terms, a CFR will provide the best solution to current problems relating to divergent definitions and currently fragmented EU directives, which need to be simplified.³⁰⁴ As there has already been considerable research in this area, it will be only necessary to begin new research where it has been discovered that something was inadequately covered.³⁰⁵

Most agree that the current body of EC legislation regarding contract law needs to be improved.³⁰⁶ At the very least, the current legislation regarding contract law needs to be adjusted to remedy the current discrepancies among basic contracts principles.³⁰⁷ Uniform definitions of essential terms must be created and gaps in current legislation need to be filled.³⁰⁸ Consistent terminology

295. Kallweit, *supra* note 226, at 271.

296. ACTION PLAN, *supra* note 233, at 4.

297. See Kull, *supra* note 13, at 32 (stating that the success of transformation depends on how effectively the existing legal system can be reformed).

298. Such as CISG, PECL, and UNIDROIT Principles. See Kull, *supra* note 187, ¶ 5.

299. Varul, *supra* note 9, at 108.

300. A European Civil Code would ensure an overarching system that provides legal consequences for contractual relationships. This would also lessen the burden on nation states that are currently incorporating the growing number of EU directives in a piecemeal fashion pursuant to EU requirements. See Curran, *supra* note 238, at 115.

301. ACTION PLAN, *supra* note 233, at 16.

302. *Id.*

303. *Id.* at 21.

304. *Id.* at 16-17.

305. *Id.* at 18.

306. Kallweit, *supra* note 226, at 280.

307. *Id.*

308. *Id.*

throughout Europe would ensure that terms are defined consistently, and once used by all member states, it would reduce the need for foreign legal advice.³⁰⁹ Furthermore, it is not enough that the legislation be codified uniformly; issues of uniform application by judges may require implementing a different system of adjudication in Europe.³¹⁰ Procedure must be harmonized to accommodate problems associated with different interpretations among national courts that may hinder proper enforcement of contractual obligations among parties.³¹¹

VI. CONCLUSION

The precise ingredients necessary for a successful transition to a market economy is still an elusive concept. Economic success is not guaranteed by simply enacting new legislation.³¹² Attracting foreign investment is a central element to fostering economic growth.³¹³ Considering the results of the *Doing Business* and *Economic Freedom Index*, evidence suggests that Estonia is indeed headed in the right direction.³¹⁴

While there is certainly no exact reason for these high rankings, Estonia has reformed core legislation underlying private law by enacting new legislation governing contract formation and restructuring their judicial system. The importance of reforming contract law, the judicial system, and the educational methodology has facilitated Estonia's integration into Europe. By harmonizing legal principles with those of other European nations, business transactions between Estonia and other European entities will suffer from fewer complications, as compared to other nations who have not implemented reforms.³¹⁵ As transacting business will become less complicated, the result may be an increase of international transactions that is required to boost the Estonian economy. Nations that continue to suffer economically, despite reform efforts, should follow the Estonian example of comparative study and legal harmonization to successfully integrate with the rest of Europe.

Estonia's focus on reforming legal rules governing private law is important because it is those rules "whose initial function is to facilitate and to underpin the choice made by people largely unaware of its existence."³¹⁶ Codified rules alone

309. ACTION PLAN, *supra* note 233, at 23.

310. Kallweit, *supra* note 226, at 294.

311. *Id.*

312. Russia is ranked seventy-nine and Kazakhstan is ranked eighty-six. See WORLD BANK, *supra* note 10, at 91.

313. Timothy Frye, *Keeping Shop: The Value of the Rule of Law in Warsaw and Moscow*, in ASSESSING THE VALUE OF LAW IN TRANSITION ECONOMIES 229, 232 (Peter Murrell ed., University of Michigan 2001).

314. WORLD BANK, *supra* note 10, at 91.

315. See *supra* Part Va.

316. Bernard Rudden, *Civil Law, Civil Society and The Russian Constitution*, L.Q.R. 110 (JAN) 56, 59 (1994).

are not enough.³¹⁷ A legal system must be viewed as a whole, and not simply as a collection of individualized statutes that do not correspond to each other.³¹⁸ To be truly effective, legal standards need to be adopted into society as a legal norm that is incorporated into everyday business practice.³¹⁹

Freely-negotiated contracts are the building blocks behind every business transaction in international commerce.³²⁰ Without well-constructed laws governing the formation of contracts,³²¹ business transactions will suffer because there will not be any common understanding from the beginning of each business relationship.³²² To effectively conduct business, a basic understanding of elementary principles relating to business transactions is necessary.³²³ If contracting parties do not have a similar comprehension of basic business transactions, there will be difficulties in interpretation³²⁴ and performance.³²⁵

Estonia reformed legislation governing contract formation because the previous Soviet system was not sufficiently adaptable for business cooperation with EU nations.³²⁶ As commercial relations are becoming increasingly

317. Cynthia Clement & Peter Murrell, *Assessing the Value of Law in Transition Economies: An Introduction*, in *ASSESSING THE VALUE OF LAW IN TRANSITION ECONOMIES* 1, 11 (Peter Murrell ed., University of Michigan 2001) (stating that written law cannot explain litigation behavior of Russian enterprises).

318. See Kalvis Torgens & Amy Bushaw, *Some Comparative Aspects of Contract Law and Common Law Systems*, 12 INT'L LEGAL PERSP. 37, 71 (2002) (discussing the difficulties of transposing written text from one language to another).

319. See Orucu, *supra* note 265, at 221 (stating that internalization of norms and standards by the recipient of a legal transplant system is crucial for development); see also Robert D. Cooter, *The Theory of Market Modernization of Law*, 16 INT'L REV. L. & ECON. 141, 142-43 (1996) (explaining that if economic law is poorly adapted to the economy, expectations, conflict, and cooperation are difficult and disputes consume resources).

320. See Danielle Mazzini, *Stable International Contracts in Emerging Markets: An Endangered Species?*, 15 B.U. INT'L L.J. 343, 344 (1997).

321. See Kathryn Hendley, Peter Murrell & Randi Ryterman, *Law Works in Russia: The Role of Law in Interenterprise Transactions*, in *ASSESSING THE VALUE OF LAW IN TRANSITION ECONOMIES* 56, 87 (Peter Murrell ed., University of Michigan 2001) (explaining that a clear and enforceable contract will reduce transaction costs for both parties).

322. See Francis S.L. Wang & Laura W. Young, *Prescriptions for Iraq, Predictions for Russia and Performance for China: China's Market Economy—A Historical Perspective*, 18 TRANSNAT'L LAW. 11, 11 (2004) (describing economist Hernando De Soto's perspective that the key ingredient for a market economy is trust); see also Norbert Horn, *Uniformity and Diversity in the Law of International Commercial Contracts*, in 2 THE TRANSNATIONAL LAW OF INTERNATIONAL COMMERCIAL TRANSACTIONS (Norbert Horn, Cline M. Schmitthoff & Richard M. Buxbaum eds., Kluwer Law and Taxation 1982) (stating that clarity, stability, and uniformity in contracts are required for international commerce to function).

323. See Hannu Honka, *Harmonization of Contract Law Through International Trade: A Nordic Perspective*, 11 TUL. EURO. CIV. LF 111, 117-18 (1996) (explaining how parties may be discouraged from entering into intraregional trade because the law governing the transaction will be unfamiliar to at least one of the parties, which therefore makes the outcome of litigation unpredictable).

324. See Kull, *supra* note 48, at 119 (stating that the goal of European integration is a common civil law that would eliminate discrepancies between legal systems).

325. See Lopez-Rodriguez, *supra* note 194, at 1196 (stating that some scholars argue that the existence of different contract laws may be regarded as a nontariff barrier to trade).

326. See Varul, *supra* note 9, at 104 n.1 (stating that economic principles, such as state planning principles as the basis for Soviet civil law, conflicted with the market economy 'freedom of contract' as basis

international, the need for basic understanding among contracting parties is essential to furthering harmony among international business entities.³²⁷ Even the mere perception of legal environments can have an effect on economic growth.³²⁸ Furthermore, merely transposing another nation's laws into national legislation can have drastic consequences if the laws are not adapted to take into account other societal pressures.³²⁹

Judicial reform was absolutely necessary in Estonia because to be effective, laws need to be enforceable in a court of law.³³⁰ Economic players usually make very calculated decisions whether to resolve commercial disputes in courts of law or whether to resort to alternative means to find solutions to business disputes.³³¹ One problem in Soviet civil law was the inability of courts to effectively enforce many of the laws already in force.³³² Many judges emerging from decades under Communist rule were not able to easily adapt to the impartiality that is required to effectively adjudicate in a market economy structure.³³³ Furthermore, the judicial systems of Eastern Europe were wrought with corruption, incompetence, and budget deficiencies.³³⁴ Consequently, the introduction of new legislation also required extending new legal perspectives to both the judiciary and lawyers working within the system.³³⁵

for civil law); see also Glenn P. Hendrix, *The Experience of Foreign Litigations in Russia's Commercial Courts*, in *ASSESSING THE VALUE OF LAW IN TRANSITION ECONOMIES* 94, 94 (Peter Murrell ed., University of Michigan 2001) (stating that to attract foreign investment, Russia must provide mechanisms for a fair and just resolution of disputes).

327. See Torgens & Bushaw, *supra* note 319, at 39-40; see also Friedrich Blase, *A Uniform Law of Contracts—Why and How?* 8 COLUM. J. EUR. L. 487, 490 (2002) (suggesting that although the unification of European contract law will not lead to an economic boom by itself, it will send a signal and may hold the key to a truly unified Europe).

328. See Lee, *supra* note 4, at 134-35 (stating that the use of complete contracts and formal enforcement methods is associated with a positive view of the legal environment, which is important in encouraging financial transactions that sustain economic growth).

329. See Orucu, *supra* note 265, at 205 (suggesting that certain scholars disapprove of the phenomenon of 'legal transplants' and that some say that legal reform should be from within because a transplanted institution will continue to live on old habits). But see Varul, *supra* note 9, at 109 (stating that Estonia's goal in developing a new private law was not to start from scratch but to follow rules that had been tried in the West and proven effective).

330. See Minxin Pei, *Does Legal Reform Protect Economic Transactions? Commercial Disputes in China*, in *ACCESSING THE VALUE OF LAW IN TRANSITION ECONOMIES* 180, 190 (Peter Murrell ed., University of Michigan 2001); see also Claude D. Rohwer, *Enforcing New Commercial Rights in Emerging Nations*, 15 TRANSNAT'L LAW. 3, 8-9 (2002) (discussing the impact of judicial enforcement and how stories of problematic enforcement impacts the course of conduct in the legal and business communities).

331. Pei, *supra* note 331, at 184.

332. See Byrne, *supra* note 30, at 449 (providing the example of how banks may not lend money because no laws assured a right to collect debts).

333. See Kuhn, *supra* note 132, at 531 (explaining how judges emerging from communism were used to authoritarian traditions, centrally planned economies and were insufficiently educated according to Western standards); see also Byrne, *supra* note 30, at 454-55 (stating that Estonians had a very low opinion of their judges and thus wanted to draft laws so as to leave judges with only ministerial application).

334. Radon, *supra* note 25, at 380.

335. *Id.*

To remedy this problem, Estonia reformed the judicial system, which included increasing the levels of transparency³³⁶ and making the judicial system more accountable³³⁷ and less susceptible to corruption.³³⁸ Additionally, reforms were necessary to make the judicial branch independent and not easily influenced by the executive branch.³³⁹

Achieving long-term success in transition economies also requires an effective implementation of new rules into common legal practice. Education is one of the most important factors for successful reform.³⁴⁰ Attorneys from former Soviet states were not accustomed to transacting business with the same level of legal expertise as other parts of Europe.³⁴¹

Reforms that began in the 1990s continue to improve the quality of Estonian legal education.³⁴² By employing new faculty, publishing more textbooks, and incorporating EU law into the curriculum, Estonian law schools have enabled newly-reformed laws to become realized in practice.³⁴³ Furthermore, by participating in programs to educate young lawyers with Western legal theory, such as RIGA, the likelihood of success is greater.³⁴⁴

336. Estonica, Judicial System: General Principles of Judicial Proceedings and the Structure of the Judicial System, www.estonica.org/eng/lugu.html (last visited Mar. 27, 2006) (stating that court sessions are made public (or in camera if needed to protect a party) and court judgments are also made public).

337. See JUDICIAL INDEPENDENCE, *supra* note 16, at 154 (stating that the credibility of the judiciary was in question as evidenced by a speech given by the state president on January 14, 2000).

338. See Raja Kali, *Business Networks in Transition Economies: Norms, Contracts, and Legal Institutions*, in ASSESSING THE VALUE OF LAW IN TRANSITION ECONOMIES 211, 211 (Peter Murrell ed., University of Michigan 2001) (stating that there is a network of informal exchanges that plays an important role in the business activity of emerging economies); see also The Estonia Page, Society, Judicial Reform in Estonia, www.esis.ee/inst/2000/einst/index.htm (last visited Mar. 27, 2006) (suggesting that an independent judiciary is guaranteed by the constitution (as indicated by lifetime appointments of judges) and by the rules governing legal procedures).

339. See *Estonia's Supreme Court Says Lifting of Rent Ceilings Legitimate*, THE BALTIC NEWS SERVICE, December 2, 2004 (reporting that the Estonian Supreme Court has ruled against the president's proposal to declare a law limiting rent ceilings as unconstitutional because the *Law of Obligations Act* regulating housing increases must be taken into account). But see John C. Reitz, *Export of the Rule of Law*, 13 TRANSNAT'L L. & CONTEMP. PROBS. 429, 439 (2003) (discouraging transition economies from establishing a constitutional court initially because doing so may inhibit promotion of the rule of law if a court is able to invalidate new legislation).

340. See Claude Rohwer, *Progress and Problems in Vietnam's Development of Commercial Law*, 15 BERKELEY J. INT'L L. 275, 278 (1997) (stating that the educational curriculum in law schools in the Soviet Union and German Democratic Republic were not designed to acquaint students with issues such as the formation of business organizations or appropriate governmental regulation of private enterprise; thus, when a country prepares itself for a market economy, extra effort is required to acquaint themselves with these issues).

341. See Byrne *supra* note 30, at 454 (stating that lawyers trained under the Soviet system lacked the knowledge and skill necessary for legal work in a market economy).

342. University of Tartu Faculty of Law, General Information, Development Plan, www.iuridicum.ee (last visited Mar. 27, 2006).

343. See *supra* Part V.

344. See Reich & Freiman, *supra* note 217, at 101 (describing the new Riga Graduate School of Law, which was designed to provide law graduates from all three Baltic countries with an in-depth understanding of private law for use in their native country but also to learn to work in an international environment).

These reforms have ensured the success of Estonia in the EU. Even though Estonia is a small country, its modern legal framework governing business activity will promote business development and ensure the success of the new market-oriented economic structure. Nations still in transition should look to Estonia for guidance in how to effectively encourage beneficial legislative reform.