

Banking - Estonia

Supreme Court Clarifies Consequences of Consumer Credit Contract Breach

March 13 2009

Facts Supreme Court Decision

In a recent decision the Supreme Court analyzed the legal consequences of a breach of a consumer credit contract.⁽¹⁾ The decision focused mainly on the enforceability of various types of legal claim (including late payment interest, contractual penalty, compensation of expenses and other damages) that a lender can submit against a consumer⁽²⁾ in the event of default on a consumer credit contract.

The decision is significant for consumer credit market practices and consumer protection in Estonia, particularly for the future interpretation of consumer credit contracts concluded with unreasonable and unfair conditions (including consumer credits with unreasonably high interest rates or other unreasonable conditions or financial obligations).

Facts

The lender (as credit institution) and the borrower (as consumer) concluded a consumer credit contract.⁽³⁾ The credit contract was classified as a contract with standard terms⁽⁴⁾ by the lender. The borrower defaulted on the repayments and the lender subsequently terminated the contract and filed a claim to the court.

Among other claims, the lender demanded the following payments from the borrower:

- loan interest (with a rate of approximately 25% per annum);
- late payment interest (with a rate of approximately 33% per annum); and
- an additional contractual penalty for the contract breach.

In addition, the lender demanded compensation for expenses incurred in the course of collecting the debt and related to the loss of profit in connection with the loss of a future opportunity to receive interest from the non-repaid loan principal amount.

Supreme Court Decision

Regarding the late payment interest the Supreme Court stated that if in the consumer credit contract the lender and borrower have agreed upon a loan interest rate (in this case 25% per annum) that is higher than the statutory late payment interest rate fixed by the Law of Obligations Act (9.5% per annum),⁽⁵⁾ the lender may demand late payment interest at least equal to the interest rate agreed in the credit contract and shall not be limited by the statutory late payment interest rate. Due to a misleading interpretation of the wordings of Sections 415(1) and 113(1) of the Law of Obligations Act, it has previously been held that with a consumer credit contract the lender may not charge late payment interest that is higher than the statutory late payment interest. According to the decision, the late payment interest can be higher, but pursuant to the law it is always limited by the maximum interest rate agreed in the contract. In this case the lender was not permitted to demand late payment interest of 33% per annum; the court limited this to 25% per annum.

However, according to the law, the consumer may also apply for a reduction in the contractual late payment interest if the applied rate is unreasonably high. In the present judgment the court concluded that late payment interest rate of 25% per annum was not unreasonably high.

In relation to possible compensation for damages, the court held that the lender could not claim compensation for damages related to the possible loss of a future opportunity

Author

Priit Pahapill



to receive interest from the non-repaid loan principal amount. Instead, according to the law, the lender was entitled to receive late payment interest from the borrower until the full loan principal was repaid. Such late payment interest can be agreed individually in the credit contract; otherwise, the statutory late payment interest fixed by law will apply.

The court also stated that according to the law, a standard term allowing the lender to demand compensation for expenses related to written notices according to its own price list was unreasonable and, under such circumstances, void. A lender may claim compensation only for actual and reasonable expenses incurred in the collection of the debt and not according to a unilateral price list. This new interpretation is useful from the perspective of consumer protection, as it has become customary practice for consumer credit providers in Estonia to charge an additional fee for reminder, warning and termination notices that often significantly exceeds the actual cost level of such notices.

In addition, the court concluded that a complementary contractual penalty agreed upon in the consumer credit contract in case of default and early termination of the contract was not in accordance with the law and was therefore void. The mandatory provisions of Estonian law concerning consumer credit contracts do not entitle the lender to a contractual penalty; under such contracts, the lender may claim only late payment interest, compensation for damages and compensation for expenses incurred in collection of the debt. Furthermore, if such contractual penalty is agreed upon in a non-consumer credit contract with standard terms, such a term may also be deemed unreasonable and therefore void.

For further information on this topic please contact [Priit Pahapill](#) at [Luiga Mody Hää](#) Borenius by telephone (+372 665 1888) or by fax (+372 665 1899) or by email (priit.pahapill@lmh.ee).

Endnotes

- (1) Supreme Court judgment, January 14 2009, Civil Case 3-2-1-120-08 (see www.nc.ee/?id=11&tekst=RK/3-2-1-120-08 for text of judgment in Estonian).
- (2) According to the Law of Obligations Act, a 'consumer' is a natural person who performs a transaction which is unrelated to his or her independent economic or professional activity.
- (3) Pursuant to Estonian law, a consumer credit contract is a credit contract by which a creditor, in the course of its economic or professional activities, grants or undertakes to grant credit or a loan to a consumer.
- (4) According to the Law of Obligations Act, a condition of a contract which is drafted in advance for use in standard contracts or which the parties have not negotiated individually for some other reason, and which the party supplying the term uses with regard to the other party which is therefore unable to influence the content of the term, is deemed to be a standard term. It is presumed that standard terms have not been negotiated individually in advance.
- (5) The statutory late payment interest rate is defined by the Law of Obligations Act as the interest rate applicable to the main refinancing operations of the European Central Bank before January 1 or July 1 of each year and published by the Bank of Estonia in an official publication (currently 2.5% per annum), plus a fixed margin of 7% per annum.

The materials contained on this website are for general information purposes only and are subject to the [disclaimer](#).

ILO is a premium online legal update service for major companies and law firms worldwide. In-house corporate counsel and other users of legal services, as well as law firm partners, qualify for a free subscription. Register at www.iloinfo.com.