

Umsögn um frumvarp til laga um breytingu á lögum um vexti og verðtryggingu, lögum um aðgerðir í þágu einstaklinga og fyrirtækja vegna banka- og gjaldeyrishrunsins og lögum um umboðsmann skuldara, með síðari breytingum. (Þingskjal 225 – 206. mál).

Sendandi: M. Elvira Méndez Pinedo. Kt. 181266-2529

The undersigned sends these comments to the Althingi in her private capacity, as a consumer and private person personally concerned by the problem of illegal *gengistryggt* loans and the adjustment of mortgage contracts in Icelandic law following the financial crisis and the jurisprudence of the Supreme Court of Justice in 2010. This document must be read and interpreted as a personal opinion with legal arguments based in European (consumer) law.

These comments refer to one of the main aspects of the proposed legislative act, the declaration on the partial illegality of the loans in Icelandic krónas (ISK) linked to foreign currencies (*gengistryggt*) as prohibited by Act 38/2001 and several of its provisions with regards to the adjustment of the mortgage credit contracts. It is her opinion that, while this objective of the proposal does not contradict directly European law and the obligations of Iceland under the EEA Agreement; several provisions breach the most fundamental and mandatory principles of European (consumer) law. All the arguments in support of this conclusion will be explained in detail from a European perspective.

#### **1. European consumer law: obligatory application for consumer disputes and fully applicability in Iceland.**

Most of European consumer law adopted by the European Union (EU) has been also incorporated into the EEA Agreement and belongs to the EEA legal order and the Icelandic domestic system. As the Icelandic Administration summarized in its reply to the European Commission during 2010 on the applicability of EU/EEA consumer law in Iceland in the context of negotiations for accession:<sup>1</sup>

“EU legislation in the field of consumer protection has been incorporated into the EEA Agreement and EU directives on consumer protection have been transposed into Icelandic legislation. Accordingly, consumer protection legislation in Iceland is mainly in line with minimum protection as stipulated within the aforementioned directives. [...] Consumer Protection is recognized as a specific policy in Iceland. “

While preparing a legislative act intended to help consumers indebted with home mortgages (foreign mortgages or illegal loans in ISK linked to foreign currencies); the legal principles of European consumer law should be respected (Annex XIX EEA Agreement).

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<sup>1</sup> Information available at the website <http://www.mfa.is/>

European consumer law contains many provisions of mandatory nature. This means they belong to the economic public order and cannot be waived by mutual consent of private parties. Another important consequence of this mandatory nature is that EEA Member States can only improve the minimum standard of consumer protection as it is not a ceiling, but they can never lower it.

The general principles of European consumer law protect the legal and economic interests of consumers entering mortgage contracts. They are applicable to these contracts and clauses. Most of the principles applicable have been harmonised by Directive 93/13/EC on unfair commercial clauses and Directive 2005/29/EC on unfair commercial practices. Recommendation 2001/93/EC on pre-contractual information to be given to consumers by lenders offering home loans is also applicable although non obligatory.<sup>2</sup>

More specifically, Directive 93/13/EC declares unfair clauses not individually negotiated by the consumer null and void. Unfair clauses are those that affect negatively consumers. Any change of contracts is prohibited if it is prejudicial or detrimental for the consumer who is the weakest party. As European/Icelandic consumer law is mandatory (*ófrávikjanleg*), a consumer contract cannot be substituted with new terms and clauses in a way that breaches the general principles of European consumer law incorporated by Iceland.

The executive, legislative and judicial branches of the State have the obligation under the EEA legal order to protect the legal and economic interests of the consumers. The first obligation is to follow the rule of law and understand the different scope of applicability of business/commercial law, contract law and consumer law.

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<sup>2</sup> Directive of the Council 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts (OJ No L 95, 21.4.1993, p.29).

Directive 2005/29/EC of the European Parliament and of the Council of 11 May 2005 concerning unfair business-to-consumer commercial practices in the internal market and amending Council Directive 84/450/EEC, Directives 97/7/EC, 98/27/EC and 2002/65/EC of the European Parliament and of the Council and Regulation (EC) No 2006/2004 of the European Parliament and of the Council ('Unfair Commercial Practices Directive') (OJ L 149, 11.6.2005, p. 22).

Directive 2006/114/EC of the European Parliament and of the Council of 12 December 2006 concerning misleading and comparative advertising (codified version) (OJ L 376, 27.12.2006, p. 21).

Directive 2008/48 on credit agreements for consumers and repealing Council Directive 87/102, published in Official Journal L133/66 on 22.05. 2008. Corrigendum to Directive 2008/48 published in Official Journal L207/14 on 11.09.2009.

European Commission. *Opinion on Iceland's application for membership of the European Union*, Doc. COM(2010) 62 from 24.2.2010.

European Commission, Proposal for an EC directive on consumer rights. Doc. COM (2008) 614 from 8.10.2008.

Recommendation of the Commission 2001/193/EC of 1 March 2001 on pre-contractual information to be given to consumers by lenders offering home loans (OJ L 69, 10.3.2001, p. 25).

Consumer law cannot be pre-empted or substituted by contract law as if there was full equality of the parties. When regulating contracts drafted by financial institutions where consumers are parties, consumer law cannot be set aside and pre-empted (substituted) by contract law or, even worst, by business law.

While business law is designed for professional actors who may limit their responsibility through legal persons or societies (business to business), contract law is generally applicable when there is full equality of the parties (private person to private person). When one party is a professional or a financial institution and the other party is a consumer, it is consumer law that applies (business to consumers). Only to the extent that consumer law did not provide a specific solution to the case, general provisions of contract law would be applicable. It is common knowledge the "lex specialis derogat lex generalis" in this case the lex specialis (consumer law) applies with precedence over the lex generalis (contract law). At any case, commercial law can never be applied to agreements entered by consumers with financial institutions. And, even in the circumstances that general contract law had to be applied to a relationship between a consumer and a financial institution, it would have to be applied in such a way that it would not affect in a negative way the economic position and legal interests of the consumers.

The first observation is thus of general nature but is a very serious issue. The legislative proposal would introduce by statute several provisions which are unfair for the consumers. The grounds for declaring a term to be unfair in European law is the imbalance which the term creates between the professional and the consumer (a term is considered to be unfair because of its effects). For this reason, there is indeed a contradiction between the goal of the legislation and its development in several provisions.

How is it possible that a legislation intended to protect consumers approaches this subject exclusively through contract law (as if financial institutions and consumers were in equal and comparable situations) and introduces unfair provisions against consumers which are prohibited by European law?

The Conclusions of the Advocate General of the Court of Justice of the European Union of 16 December 1999 explains how some principles of consumer law are of mandatory nature.<sup>3</sup>

According to the Advocate General the Directive on unfair contract clauses "means that the Directive's provisions can be characterized as "imperative" rules of public economic order which cannot but be reflected in the powers vested in the national court". The Advocate General also stresses that "it is in the public interest that terms harmful to consumers be unenforceable" and that "the ex officio involvement of the court is not only extremely effective with a view to suppression but also seems likely

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<sup>3</sup> ECJ, joint cases C-240/98 to C-244/98 *Océano Grupo Editorial, S.A. and Salvat Editores, S.A. v Rocío Murciano Quintero et al.* ECR [1999].

to genuinely dissuade firms from including unfair terms in consumer contracts". The same Directive contemplates sanctions to provide effectiveness to the prohibition of unfair contract clauses, sanctions that all EU/EEA Member States must adopt.

Furthermore, as it is reflected on the case of the Court of Justice of the European Union *Océano*<sup>4</sup>, the Court notes that the use of terms which lead to a significant imbalance in the contractual relations between the parties undermines not only the interests of the consenting party but also the legal and economic order as a whole.<sup>5</sup> The Court acknowledges therefore that consumer law has a different nature than commercial, business or financial law and that this different nature, biased towards the weakest parties, is important both for the market and from a social point of view.<sup>6</sup>

Thus, by legislating on consumer affairs from the perspective of business and contract law, by changing in a retroactive way several provisions of the existing legal framework introducing unfair clauses to the detriment of the weakest parties in the contracts, and by ignoring European/Icelandic consumer legislation that states clearly that unfair clauses are illegal, null and void; it is the opinion of the undersigned that the legislative proposal breaches the EEA Agreement (Annex XIX- Consumer Protection).

## **2. Legal consequences of the partial nullity of the consumer mortgage contracts (distinction between *ex tunc* and *ex nunc* effects).**

The legislative proposal follows the doctrine established by the Supreme Court on car loans with similar illegal price-indexation clauses (*gengistrygging*). Following the rulings of the Supreme Court of Justice on *gengistryggð* car loans from June and September 2010, the District Court of Reykjavík in a ruling of 28 September 2010 followed the same approach -in a case concerning house mortgages –and decided the nullity of the clause which links the ISK with foreign with *ex tunc* effects. However, by substituting the interest to be paid with the *óverðtryggt* interest decided by the Central Bank of Iceland, the judge worsened the position of the debtor in such a way regarding past payments that it cannot simply be ignored from a consumer law perspective. The application of the doctrine of the Supreme Court on car loans to house mortgages produces dramatic financial consequences extremely prejudicial for consumers who acted in good faith (due to the difference of interest due regarding past payments). The same judge, in another ruling from 10 November 2010 has now

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<sup>4</sup> ECJ, Joint cases C-240/98 to C-244/98, *Océano Grupo Editorial, S.A. and Salvat Editores, S.A. v Rocio Murciano Quintero et al*] [2000] ECR I-04941.

<sup>5</sup> Advocate-General Saggio emphasised this point in his Opinion of 16 December 1999 [ECJ, Joint cases C-240/98 to C-244/98, *Océano Grupo Editorial al.*] [2000] ECR I-04941.

<sup>6</sup> On the importance of consumer law for social justice see in the bibliography the research published by Prof. Micklitz from the European University Institute.

requested an advisory opinion from the EFTA Court on the compatibility of this doctrine with the provisions of European consumer law.

A fundamental distinction in law exists between legal effects *ex tunc* or *ex nunc* following the partial or total nullity of a contract. General European contract law establishes that illegal contracts or illegal clauses can be declared null and void with effects *ex tunc* (retroactive or from the beginning) or with effects *ex nunc* (prospective or for the future).

*Ex tunc* is a term derived from Latin which means "from the outset". It can be contrasted with the other term *ex nunc*, which means "from now on". Thus in contract law, the total or partial nullity of contract can lead to it either being null and *void ex nunc*, i.e. from then on, or *ex tunc*, in which case it is treated as though it had never come into existence.

While it is true in European law that any court judgment that finds a term to be unfair must provide that the judgment take effect from the time of conclusion of the contract (*ex tunc*); it is also true that the court should be *ex officio* entitled to rule differently on the fairness/unfairness of the remaining contractual clauses (such as interest of a mortgage) and the general balance of the contract (rights and obligations between parties). At any event, the unfair clause should not be substituted with an even worse provision thanks to the ruling of the court or to the new clause imposed by the strongest party. The same applies to the legislator. In the case of partial illegality of one clause of the contract, the judge or the legislator should not impose other unfair contractual clauses upon consumers because that violates the goal and spirit of the European consumer legislation.

In the light of the above, while the illegal contract is declared null and void from the start (*ex tunc*), both the legislator and the judge should look and evaluate the consequences of the nullity of the clause for the consumer so that unjust enrichment, usury or other abuses do not prejudice the consumers as it would happen if the strongest party took advantage of the nullity declared.

The consequences of applying the doctrine established by the Supreme Court on car loans to house mortgages substituting the interest agreed by the parties by the interest of the Central Bank with effects *ex tunc* is the following. In spite of having paid all installments regularly in good faith, the consumers will soon find that the amounts that they in good faith are not sufficient (they have grown in a geometrical progression due to the high interest rates decided by the Central Bank during the period) and they have an outstanding astronomical debt towards the bank.

Legal effects of the ruling of the District Court of Reykjavík of 28 september 2010 and of the legislative proposal for the past (*ex tunc*)

Two charts below show the effects of the application for the past payments of the doctrine of the Supreme Court. These figures were not disputed by the parties (Frjálsi

and consumers) before the judge who ruled on the 28 September 2010. Another line has been added to show the even more shocking numbers that the consumer will have to pay (four times the original amount planned) if the legislative proposal is approved.



It has to be remembered, in the first place, that the *gengistryggt* loans offered by the banks were illegal from the beginning. It was the bank the party that drafted the contracts, not the consumers. The total figures claimed by the banks and linked to the foreign currencies have been therefore illegal for all the duration of the contract and

have no legal basis at all. The claim that the legislative proposal gives a discount for consumers with illegal loans in ISK linked to foreign currencies is falsified.

In the second place, it is important to note that, if the consumer had had the total amount of the debt in savings being able to reimburse all the amount in full at the initial moment or at the current moment and canceling the debt; the problem would not even exist. The consumer borrowed capital in order to finance a house for an average period of 20-30 years. What is essential for the consumer is not only the total amount of the debt, but the monthly payments, as they are tied to his/her present capacity of payment and connected to his/her income. Any change in the monthly payments stresses the financial capacity of the consumers to a great extent.

How is then possible that a proposal for legislative act presented to the Althingi deteriorates the position of the consumer for the past payments done in good faith and rewards the bank for breaching the law? To simply defend the view that this proposal will help consumers is to misunderstand in a very serious way the most essential and fundamental principles of European law, consumer protection and fundamental rights.

Legal effects of the ruling of the District Court of Reykjavík of 28 september 2010 and of the legislative proposal for the future (*ex nunc*)

As for the future (effects *ex nunc*) the legal effects of the ruling of the 28 September 2010 and the legislative proposal are extremely uncertain. Any illegal loan in ISK linked to the foreign currencies is converted automatically into an Icelandic mortgage with imprecise interest rates linked to the inflation and gives the bank the power to revise the conditions, terms and interest after 5 years (unless consumers can convince the financial institutions of a better contract and/or better terms).

As the situation is currently in Iceland, the undersigned has serious doubts concerning the legality of an imprecise interest rate which is impossible to predict in advance and which is calculated in such a way that might be strongly prejudicial for consumers economic interests in the future.

The decision imposed by judicial ruling or by legislative proposal to reimburse the debt according to the general interest rates fixed by the Central Bank of Iceland (bank interest of approximate X% (X) plus inflation/consumer price index of the future (Y) is expressed in an indeterminate equation ( $X + Y = ?$ )). The interest rate is in fact an interest impossible to calculate or predict in advance.

This provokes the following consequences that are very dubious in European consumer law:

- it is impossible to determine the future interest of the mortgage as, at least one component of the equation (inflation), is always unpredictable.
- Not even the Central Bank of Iceland has been able to predict the inflation with accuracy during the past decade.

- The history of the Icelandic króna shows that it has suffered historical record devaluations in the last century in the Western countries.
- The monetary and financial authorities have also proved incapable to control the inflation of the country in accordance to the predictions of the Central Bank and monetary policy announced.

The lack of certainty and predictability of the final interest rate on the most important financial obligations assumed by consumers during their entire life is very dubious in the light of the general principles of European consumer law on credit. It is a general principle of European consumer law that consumers must not assume the risks and consequences of calculating future indexes such as inflation (which falls on specialized financial and State institutions). Price-indexation clauses are prohibited unless the method of calculation is clearly known in advance. Consumers should know very clearly what are the financial obligations they assume beforehand. For this reason, it could be also argued that the legal effects deployed by the ruling of 28 September 2010 and the legislative proposal for the future might constitute a breach of Iceland of its European obligations under the EEA Agreement regarding European consumer law.

Nonwithstanding the evolution of a future European consumer credit law, general principles of European (consumer) law that have to be fully respected are the following:

- unfair contractual clauses are illegal, null and void in European law
- unfair commercial practices offering unfair contractual clauses are illegal
- there is a general duty for financial institutions to trade fairly, also applicable for home mortgages.
- good faith is essential and mandatory for the strongest party of the transaction: the businesses.
- in the cases of home mortgages consumers must know in advance their financial obligations and should have all the information necessary to determine their best economic interest.
- price indexation clauses are in principle prohibited.
- price indexation clauses are only allowed if two conditions are met: 1) they must be legal and 2) the method of calculation must be previously determined in advance.
- national legislators must apply and enforce European consumer law which is of mandatory nature and non-disposable.



- national judges must interpret national law as far as possible in the light of European (consumer) law.

To conclude this section, it can be said that while the nullity of the illegal clause of the contract (*gengistrygging*) must take effects for the past (*ex tunc*); the same *ex tunc* effects should not apply to the interest to be paid by the consumers to the financial institutions as this condemns consumers to pay astronomic figures to the banks for past obligations (for payments never overdue) in spite of their good faith. It is a principle of consumer law that any change of contract must not be prejudicial to the weakest party. Interests due for this period could be even qualified as “usury” as they show no relation whatsoever with the initial plan, the terms of the contract agreed and the financial capacity of consumers. We will come back later to the concept of “usury”.

Regarding other effects of the partial nullity of the *gengistrygging* clause, two solutions seem feasible in the perspective of European consumer law.

Interest for the past: no *ex tunc* effects. The original interest agreed by the parties is left in force, payments done in good faith by consumers are respected.

For the future: *ex nunc* effects. The original interest agreed by the parties is respected, or, alternatively, another reasonable interest is recommended which the consumers must know in advance or can calculate on the basis of precise and accurate information. The unpredictability and imprecision of the “verðtrygging” in Iceland might be contrary to European consumer law.

### **3. Retroactive legislation. Clash with the principles of legality and legal certainty and the right of property protected by the European Convention of Human Rights.**

In the third place, it has to be noted that -contrary to the principle of legality and legal certainty which are essential in a State where the rule of law prevails- this legislative proposal will take effect retroactively deteriorating the rights of consumers in contracts signed in the past with these negative consequences:

- It will allow “gengistrygging” for business ignoring the fundamental prohibition of the former Act 38/2001 and making it look perfectly legal and normal, thus exempting the previous illegality of the *gengistrygging* and creating confusion and legal uncertainty in the general public. Why is this necessary if real foreign currency loans (*erlend lán*) are allowed?
- It will declare a necessary interconnected illegality between the illegal *gengistryggt* clause and the legal interest originally agreed contrary to the general principles of contract law which were in force at the time of signing and which recognized the autonomy for the parties in this regard. All in detriment of the consumers.

- It will make the consumer partially responsible for the illegal drafting of the contracts by making him/her as the weakest party share the financial consequences of the illegality in spite of his/her acting in good faith and lack of specialized knowledge of financial services and credit mortgage contract law.
- It will impose upon consumers in favor of the financial institutions a new interest never contemplated in the original contract with legal effects *ex tunc* (interest decided of the Central Bank of Iceland )
- It will create a totally new contractual obligation for consumers to pay interest on interest (compound interest) due to the difference between the original interest agreed and the one set by the Central Bank. This compound interest or this charging of unreasonable or relatively high rates of interest – is technically known as “anatocism” – and, when applied to house mortgages, could be even qualified as usury (unjust enrichment) which is prohibited ie. by Spanish law and by European consumer law.

Anatocism, a term used in civil law, is a known form of usury which consists in taking interest on interest, or receiving compound interest (usury comes from Medieval Latin *usura*, "interest", or from Latin *usura*, "interest"). Usury originally meant the charging of interest on loans, this included charging a fee for the use of money which is prohibited in some societies. In places where interest became acceptable, usury is an interest above the rate allowed by law or, under an equity perspective, the charging of unreasonable or relatively high rates of interest which provoke unjust enrichment of the creditor. Both anatocism and usury are forbidden in the Spanish Civil Code where courts have considered contracts for compounding interest illegal and within the statute of usury. European consumer law equally opposes unjust enrichment on the basis of claims of interest of interest (anatocism and usury).

- It will automatically convert a *gengistryggt* loan into *verðtryggt* loan unless the consumer can convince the financial institution of the merits of any other solution in his favor (such as keeping it as a foreign loan permitted by law). This is an oxymoron or impossible contradiction per se. How are consumers supposed to convince the bank to keep the original contract or to sign a new contract in their best interests when such a change of circumstances (financial crisis) has occurred? For two years the whole situation has not been resolved by the legislator and all kind of uncertainties have to adjudicated now by judges. The decision of 10 November 2010 issued by Héraðsdómur Reykjavíkur requesting a advisory opinion from the EFTA Court shows the difficulties of this task. At any case, the final choice of what contract is in its best interest should be for the consumer, not for the financial institution.
- It will leave total freedom for the financial institution to decide the terms of the contracts and conditions of payment after 5 years with the legal uncertainty this provokes for consumer in an environment where it has been predicted that credit is going to be very expensive (because of the approval of new international Basil III rules for banks which increases their active liquidity obligations).

- Furthermore, retroactive legislation deteriorating previous existing consumer rights without due compensation goes against the principle of legality and might give way to State liability. The principle of legality means that claims have to be adjudicated and assessed in relation with the legal framework in force at the time of signing the contract.
- Last but not least, the legislative proposal interferes with some important cases now pending before the Supreme Court and with a request from an advisory opinion of the EFTA Court on this issue. For the sake of legal certainty we should eradicate first all uncertainties regarding this problematic rather than introducing newly created unfair clauses by legislation. Judicial decisions from the Supreme Court have general effects erga omnes.

For all these reasons, these retroactive provisions of the legislative proposal deteriorate and affect in a negative way the position of consumers who contracted in good faith mortgage loans in ISK linked to foreign currencies. The legislative proposal seems to ignore mandatory provisions of European consumer law – both for the past and for the future - provisions that cannot be ignored by ruling or legislating exclusively on the basis of contract law. In fact, the legislative proposal expropriates previous economic and legal rights that consumers had. This is contrary to European consumer law fully applicable in Iceland and to the due protection of property/economic rights recognized by the European Convention of Human Rights that consumers do also enjoy.

Iceland's membership in the EEA and the incorporation of the European Convention on Human Rights into Icelandic law (Lög um mannréttindasáttmála Evrópu 1994 nr. 62, Article 1 Protocol 1 –protection of property) entails that the question of the legality of retroactive legislation nowadays must be seen from a European perspective. For reasons of legal certainty and legal security, European law protects against retroactive legislation if it is detrimental to an individual legal subject or if it breaches fundamental rights such as the right to property. This principle is general in European law, it is not limited to criminal or tax law, and it is especially important in consumer law. The normal consequence of a breach of the principle of legal certainty and illicit expropriation of property rights is a due compensation for those who have suffered loss.

It has to be reminded that retroactive legislation affecting fundamental individual rights (right of property) is prohibited in European law unless due compensation is provided for the loss.<sup>7</sup> For reasons of legal certainty and legal security, European law protects against retroactive legislation. According to Bernitz, a professor of the University of Stockholm of international reputation, European law establishes a strict view regarding the permissibility of retroactive lawmaking and assumes that this

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<sup>7</sup> “Retroactive Legislation in a European Perspective – On the Importance of General Principles of Law” Article by Ulf Bernitz, Stockholm Institute for Scandinavian Law 1957-2009, pp. 44-58.

cannot be permitted if it is detrimental to an individual legal subject. In this view, this principle is general and lacks the primary limitation to criminal and tax law that characterizes, among others, Swedish law.

Bernitz has noted that in practice, this has been already indicated in the *Wachauf*<sup>8</sup> case from the ECJ. In that case it examined the question whether it was allowed, according to Community/Union legal certainty principles, to deprive, without compensation, a leasee of his earlier right to payment for refraining from milk production. The Court of Justice of the European Union pronounced:

“...Community rules which, upon expiry of the lease, had the effect of depriving the leasee, without compensation, of the fruits of his labour and of his investments in the tenanted holding would be incompatible with the requirements of the protection of fundamental rights in the Community legal order. Since those requirements are also binding on the Member States when they implement Community rules, the Member States must, as far as possible, apply those rules in accordance with requirements.”<sup>9</sup>

Thus, Bernitz points that the general principle that substantive legal rules and measures which detrimentally affect the legal position of individuals and business enterprises may not have a retroactive effect is a general principle of European law. For this reason, Bernitz argues that a lawmaker should observe greater care in deciding which general exceptions to the principle can be accepted at the national level in extreme circumstances. At any case, any restriction of fundamental rights must pass a test of proportionality under European law. All measures affecting fundamental rights must be justified by the general interest, be legitimate and constitute the only appropriate means to achieve the goal pursued.<sup>10</sup>

The same would be applicable by analogy to the EEA legal order as the EEA Agreement is also based on similar principles of European law (principle of homogeneity and respect for fundamental rights) and similar substantive provisions exist regarding consumer law. To deteriorate the economic rights of the consumers by a retroactive statute could amount to an expropriation of their property rights with no justification under European law.

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<sup>8</sup> Case 5/88, *Hubert Wachauf v. the German Federal Republic*, (1989) ECR 2609. One can also mention the cases 205-215/82, *Deutsche Milchkontor GmbH v. the German Federal Republic*, (1983) ECR 2633.

<sup>9</sup> The subject was further developed by Advocate General Francis Jacobs' statement in the case (p. 22). He drew the conclusion: "Member States must be subject to the same constraints, in any event in the relation to the principle of respect for fundamental rights, as the Community legislator."

<sup>10</sup> Craig and De Búrca, *EU Law. Text, Cases and materials*. Oxford University Press, 2007.

#### **4. Obligations for Icelandic authorities under the EEA Agreement to apply and enforce European consumer law and protect fundamental rights.**

The protection of consumers must also be guaranteed in the EEA legal order.<sup>11</sup> Iceland is obliged to apply and enforce the general principles of European consumer law as well as fundamental rights. This obligation extends to all branches of the State (legislative, executive and judicial powers).

Both Parliament and Government must comply with the provisions of the EEA Agreement and the European Convention of Human Rights.

More specifically, under EEA law, national judges are obliged to interpret national law as far as possible in the light of European law.

No matter what the legal approach is taken to solve consumer disputes - legislative or judicial approach; the principles of European consumer law – both for the past and for the future- are of mandatory nature and cannot be ignored by converting them into general contract law issues where equality of the parties is the norm.

It is the opinion of the undersigned that a legislative act and/or judicial decision ignoring the European mandatory provisions of consumer law and deteriorating the protection of consumers in a retroactive manner with regards to contracts signed under previous legislation could also result in a breach of Icelandic obligations under the EEA Agreement triggering State liability under common principles of the EU and EEA legal orders.<sup>12</sup>

#### **5. Judicial review of legislation contrary to the Constitution and the European Convention of Human Rights**

Together with the State liability for breach of European law that might be requested under the EEA Agreement for breach of European consumer law and fundamental rights in the case of retroactive legislation; it is also very important that the legislator does not trespass the limits of their legislative powers because this might end in a constitutional review of the legislation in the light of Icelandic constitution.

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<sup>11</sup> In the ruling from the EFTA Court, Case E-4/09 from 27.1.2010, the Court declares:

“According to Recital 8 of the preamble to the Directive [93/13/EC], one of the key objectives of the Directive is to enhance protection for consumers concluding insurance contracts via insurance intermediaries. This means, inter alia, that it must be possible for consumers to make an informed decision prior to the conclusion of an initial insurance contract or upon its amendment or renewal, and thereby to protect their interests in case of a conflict with the intermediary.”

<sup>12</sup> For the EU pillar and judicial infringements see the most recent jurisprudence of the Court of Justice of the European Union in the cases *Köbler*, *Traghetti del Mediterraneo* and, more recently, *Commission v. Spain*.

As Hjörtur Torfason has written and summarized:<sup>13</sup>

“Over the years since then, the [Supreme] Court has frequently been required to consider the constitutionality of laws of the *Althingi*, to an increasing degree and over an increasingly wide field, covering both civil and political rights and social and economic rights. And in several cases, involving matters such as the freedom of expression and assembly, the protection of private property and the legitimacy of taxation, the right to work and freedom of enterprise, the retroactive and other effects of economic measures and the right to pension and social sustenance, the Court has decided that the statutory provisions in issue were to be overruled. To make a brief comparison, the issues at stake were not necessarily as dramatic as the legitimacy of the death penalty (which was abolished by law within the 19th century), but many of them were concerned with matters of high general importance in the society and regulatory measures of serious economic consequence.”

## Conclusions

1. European consumer law protects the economic and legal interests of the consumers and declares that unfair clauses prejudicial for consumers and not individually negotiated are illegal, null and void. This mandate is of obligatory application for consumer disputes and fully applicability in Iceland. Exemptions regarding house mortgage credit must be explicit and interpreted strictly in order not to frustrate the protective ambit of European consumer law.
2. Consumer contracts cannot be changed to the detriment of the consumers with the introduction of unfair clauses. The legal consequences of the partial nullity of the consumer mortgage contracts should be differentiated (*ex tunc* and *ex nunc* effects). While the *ex tunc* nullity of the illegal clause is the norm, the application of the interest of the Central Bank *ex tunc* raises deep questions of legality in the European legal order as it has dramatic consequences for the payments done in the past by consumers in good faith and results in overdue interest and claims on interest of the interest.
3. The retroactive character of several provisions of the proposed legislation regarding contracts signed under a previous legal order is in tension with the principles of legality and legal certainty and the right of property protected by the European Convention of Human Rights.

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<sup>13</sup> Hjörtur Torfason Former Justice of the Supreme Court Venice Commission Member (Iceland). Article “Influential Constitutional Justice: Some Icelandic Perspectives”, *World Conference on Constitutional Justice, Cape Town 23-24 January 2009*.

4. All Icelandic authorities under the EEA Agreement are obliged to apply and enforce European consumer law and protect fundamental rights. European rules on consumer protection are mandatory and cannot be waived. The standard of consumer protection given by European legislation is a minimum that can only be ameliorated by EU/EEA Member States legislators. While the consequences of the nullity of illegal price-indexation clauses belong to the sphere of national law and fall mainly on national courts, these must interpret domestic legislation as far as possible in the light of European consumer law.

5. A judicial review of legislation contrary to the Icelandic Constitution and the European Convention of Human Rights should not be excluded in regards of several provisions of the legislative proposal.

6. In short, several provisions of the legislative proposal deteriorate “de iure” the legal protection and the economic interests of the consumers in a retroactive manner and unduly affect existing mortgage contracts entered into with good faith by consumers. By acting so, the legislative power would be expropriating “de facto” consumers property rights recognized by previous legislation without due compensation. If adopted, it is the opinion of the undersigned that this legislation would breach the most fundamental principles of European (consumer) law under the EEA Agreement. Strong claims of State liability for breach of EEA law as well as for breach of fundamental rights (property rights of consumers) protected under the European Convention of Human Rights would inevitably follow.

#### **Annexes**

- EU/EEA consumer law incorporated into Iceland \_ Annex XIX of the EEA Agreement on consumer protection.

- An article drafted by the undersigned on the mandatory general principles of European law concerning the protection of consumers with mortgages linked to foreign currencies in Iceland.

This article contains the main principles of European consumer credit law applicable to this problematic. It has been independently reviewed in Iceland by two experts and it has been approved for legal publication by two specialists in the field to guarantee that the content would be neutral and not biased. It was presented in a Conference organized by the University of Iceland called *Þjóðarspejillinn* on the 29<sup>th</sup> October 2010 and it has been published by the University of Iceland - Law Faculty.





*ANNEX XIX***CONSUMER PROTECTION**

List provided for in Article 72

**INTRODUCTION**

When the acts referred to in this Annex contain notions or refer to procedures which are specific to the Community legal order, such as:

- preambles,
- the addressees of the Community acts,
- references to territories or languages of the EC,
- references to rights and obligations of EC Member States, their public entities, undertakings or individuals in relation to each other, and
- references to information and notification procedures,

Protocol 1 on horizontal adaptations shall apply, unless otherwise provided for in this Annex.

**SECTORAL ADAPTATIONS**

For the purposes of this Annex and notwithstanding the provisions of Protocol 1, the term "Member State(s)" contained in the acts referred to shall be understood to include, in addition to its meaning in the relevant EC acts, Iceland, Liechtenstein, Norway, [ ]<sup>{1}</sup> [ ]<sup>{2}</sup>.

**ACTS REFERRED TO**1.<sup>{3}</sup>

1a.<sup>{4}</sup> **398 L 0006**: Directive 98/6/EC of the European Parliament and of the Council of 16 February 1998 on consumer protection in the indication of the prices of products offered to consumers (OJ L 80, 18.3.1998, p. 27).

2.<sup>{5}</sup> **32006 L 0114**: Directive 2006/114/EC of the European Parliament and of the Council of 12 December 2006 concerning misleading and comparative advertising (codified version) (OJ L 376, 27.12.2006, p. 21).

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<sup>{1}</sup> Words "and Switzerland" deleted by the Adjusting Protocol.

<sup>{2}</sup> Words "Austria, Finland" and "Sweden" deleted by Decision No 43/2005 (OJ No L 198, 28.7.2005, p.45 and EEA Supplement No 38, 28.7.2005, p. 26), e.i.f. 12.3.2005.

<sup>{3}</sup> Text of point 1 deleted by Decision No 113/98 (OJ No L 277, 28.10.1999, p. 50 and EEA Supplement No 46, 28.10.1999, p. 164), e.i.f. 28.11.1998.

<sup>{4}</sup> Point inserted by Decision No 113/98 (OJ No L 277, 28.10.1999, p. 50 and EEA Supplement No 46, 28.10.1999, p. 164), e.i.f. 28.11.1998.

<sup>{5}</sup> Point 2 (Council Directive 84/450/EEC) replaced by Decision No 34/2010 (OJ No L 143, 10.6.2010, p. 29 and EEA Supplement No 30, 10.6.2010, p. 37), e.i.f. 13.3.2010.

3. **385 L 0577**: Council Directive 85/577/EEC of 20 December 1985 to protect the consumer in respect of contracts negotiated away from business premises (OJ No L 372, 31.12.1985, p. 31).
- 3a.<sup>{6}</sup> **397 L 0007**: Directive 97/7/EC of the European Parliament and of the Council of 20 May 1997 on the protection of consumers in respect of distance contracts (OJ No L 144, 4.6.1997, p. 19), as amended by:
- <sup>{7}</sup> **32002 L 0065**: Directive 2002/65/EC of the European Parliament and of the Council of 23 September 2002 (OJ L 271, 9.10.2002, p. 16),
- <sup>{8}</sup> **32005 L 0029**: Directive 2005/29/EC of the European Parliament and of the Council of 11 May 2005 (OJ L 149, 11.6.2005, p. 22),
- <sup>{9}</sup> **32007 L 0064**: Directive 2007/64/EC of the European Parliament and of the Council of 13 November 2007 (OJ L 319, 5.12.2007, p. 1).
- 4.<sup>{10}</sup> [ ]
5. **387 L 0357**: Council Directive 87/357/EEC of 25 June 1987 on the approximation of the laws of the Member States concerning products which, appearing to be other than they are, endanger the health or safety of consumers (OJ No L 192, 11.7.1987, p. 49).
- The provisions of the Directive shall, for the purposes of the present Agreement, be read with the following adaptation:
- in Article 4(2), the reference to Decision 84/133/EEC shall be read as a reference to Decision 89/45/EEC.
- 6.<sup>{11}</sup> [ ]
7. **390 L 0314**: Council Directive 90/314/EEC of 13 June 1990 on package travel, package holidays and package tours (OJ No L 158, 23.6.1990, p. 59).
- 7a.<sup>{12}</sup> **393 L 0013**: Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts (OJ No L 95, 21.4.1993, p.29).
- 7b.<sup>{13}</sup> **32008 L 0122**: Directive 2008/122/EC of the European Parliament and of the Council of 14 January 2009 on the protection of consumers in respect of certain aspects of timeshare, long-term holiday product, resale and exchange contracts (OJ L 33, 3.2.2009, p. 10).
- 7c.<sup>{14}</sup> **397 L 0005**: Directive 97/5/EC of the European Parliament and of the Council<sup>(1)</sup> of 27 January 1997 on cross-border credit transfers (OJ No L 43, 14.2.1997, p. 25).

<sup>{6}</sup> Point inserted by Decision No 15/98 (OJ No L 272, 8.10.1998, p. 22 and EEA Supplement No 42, 8.10.1998, p. 99), e.i.f. 1.7.2000.

<sup>{7}</sup> Indent and words “, as amended by:” above, added by Decision No 47/2003 (OJ No L 193, 31.7.2003, p. 18 and EEA Supplement No 39, 31.7.2003, p. 12), e.i.f. 1.5.2004.

<sup>{8}</sup> Indent added by Decision No 93/2006 (OJ No L 289, 19.10.2006, p. 34 and EEA Supplement No 52, 19.10.2006, p. 27), e.i.f. pending.

<sup>{9}</sup> Indent added by Decision No 114/2008 (OJ No L [to be published]), e.i.f. pending.

<sup>{10}</sup> This point, including the indents, introduced by Decision No 122/98 (OJ No L 297, 18.11.1999, p. 56 and EEA Supplement No 50, 18.11.1999, p. 97), e.i.f. 19.12.1998, replaces former point 4, subsequently the text of Point 4 deleted by Decision No 16/2009 (OJ No L 73, 19.3.2009, p. 53 and EEA Supplement No 16, 19.3.2009, p. 24) with effect from 12 May 2010, e.i.f. pending.

<sup>{11}</sup> Text of point 6 deleted by Decision No 113/98 (OJ No L 277, 28.10.1999, p. 50 and EEA Supplement No 46, 28.10.1999, p. 164), e.i.f. 28.11.1998.

<sup>{12}</sup> Point inserted by Decision No 7/94.

<sup>{13}</sup> Point inserted by Decision No 18/95 (OJ No L 83, 13.4.1995, p. 49 and EEA Supplement No 13, 13.4.1995, p. 34), e.i.f. 1.7.1997 and text subsequently replaced by Decision No 86/2009 ( OJ No L 277, 22.10.2009, p. 38 and EEA Supplement No 56, 22.10.2009, p. 16), e.i.f. pending.

<sup>{14}</sup> Point inserted by Decision No 1/98 (OJ No L 272, 8.10.1998, p. 1 and EEA Supplement No 42, 8.10.1998, p. 1), e.i.f. 1.2.2000, to be deleted with effect from 1.11.2009 by Decision No 114/2008 (OJ No L [to be published] and EEA Supplement No [to be published]), e.i.f. pending.

(1) Listed here for purposes of information only. For application, see Annex IX.

7d.<sup>{15}</sup> **32009 L 0022**: Directive 2009/22/EC of the European Parliament and of the Council of 23 April 2009 on injunctions for the protection of consumers' interests (OJ L 110, 1.5.2009, p. 30).

7e.<sup>{16}</sup> **399 L 0044**: Directive 1999/44/EC of the European Parliament and of the Council of 25 May 1999 on certain aspects of the sale of consumer goods and associated guarantees (OJ L 171, 7.7.1999, p. 12).

The provisions of the Directive shall, for the purposes of the present Agreement, be read with the following adaptations:

- (a) in Articles 6(4) and 8(2) the word "Treaty" shall read "Agreement on the European Economic Area";
- (b) in Article 6(4) the words ", Icelandic and Norwegian" shall be added at the end of the paragraph.

7f.<sup>{17}</sup> **32004 R 2006**: Regulation (EC) No 2006/2004 of the European Parliament and of the Council of 27 October 2004 on cooperation between national authorities responsible for the enforcement of consumer protection laws (the Regulation on consumer protection cooperation) (OJ L 364, 9.12.2004, p. 1), as amended by:

-<sup>{18}</sup> **32005 L 0029**: Directive 2005/29/EC of the European Parliament and of the Council of 11 May 2005 (OJ L 149, 11.6.2005, p. 22).

7fa.<sup>{19}</sup> **32007 D 0076**: Commission Decision 2007/76/EC of 22 December 2006 implementing Regulation (EC) No 2006/2004 of the European Parliament and of the Council on cooperation between national authorities responsible for the enforcement of consumer protection laws as regards mutual assistance (OJ L 32, 6.2.2007, p. 192), as amended by:

-<sup>{20}</sup> **32008 D 0282**: Commission Decision 2008/282/EC of 17 March 2008 (OJ L 89, 1.4.2008, p. 26).

7g.<sup>{21}</sup> **32005 L 0029**: Directive 2005/29/EC of the European Parliament and of the Council of 11 May 2005 concerning unfair business-to-consumer commercial practices in the internal market and amending Council Directive 84/450/EEC, Directives 97/7/EC, 98/27/EC and 2002/65/EC of the European Parliament and of the Council and Regulation (EC) No 2006/2004 of the European Parliament and of the Council ('Unfair Commercial Practices Directive') (OJ L 149, 11.6.2005, p. 22).

7h.<sup>{22}</sup> **32008 L 0048**: Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on credit agreements for consumers and repealing Council Directive 87/102/EEC (OJ L 133, 22.5.2008, p. 66).

## ACTS OF WHICH THE CONTRACTING PARTIES SHALL TAKE NOTE

The Contracting Parties take note of the content of the following acts:

<sup>{15}</sup> Point (Directive 98/27/EC) inserted by Decision No 121/1999 (OJ NO L 325, 21.12.2000, p. 38 and EEA Supplement No 60, 21.12.2000, p. 443), e.i.f. 1.7.2000 and subsequently replaced by Decision No 35/2010 (OJ No L 143, 10.6.2010, p. 30 and EEA Supplement No 30, 10.6.2010, p. 38), e.i.f. pending

<sup>{16}</sup> Point inserted by Decision No 12/2000 (OJ No L 52, 22.2.2001, p. 37 and EEA Supplement No 9, 22.2.2001, p. 4), e.i.f. 1.9.2000.

<sup>{17}</sup> Point inserted by Decision No 92/2006 (OJ No L 289, 19.10.2006, p. 33 and EEA Supplement No 52, 19.10.2006, p. 26), e.i.f. 1.6.2007.

<sup>{18}</sup> Indent and words "as amended by:" above, added by Decision No 93/2006 (OJ No L 289, 19.10.2006, p. 34 and EEA Supplement No 52, 19.10.2006, p. 27), e.i.f. pending.

<sup>{19}</sup> Point inserted by Decision No 88/2008 (OJ No L 280, 23.10.2008, p. 25 and EEA Supplement No 64, 23.10.2008, p. 18), e.i.f. 5.7.2007.

<sup>{20}</sup> Indent and words "as amended by:" above, added by Decision No 88/2008 (OJ No L 280, 23.10.2008, p. 25 and EEA Supplement No 64, 23.10.2008, p. 18), e.i.f. 5.7.2008.

<sup>{21}</sup> Point inserted by Decision No 93/2006 (OJ No L 289, 19.10.2006, p. 34 and EEA Supplement No 52, 19.10.2006, p. 27), e.i.f. pending.

<sup>{22}</sup> Point inserted by Decision No 16/2009 (OJ No L 73, 19.3.2009, p. 53 and EEA Supplement No 16, 19.3.2009, p. 24), e.i.f. pending.

8. **388 X 0590**: Commission Recommendation 88/590/EEC of 17 November 1988 concerning payment systems and in particular the relationship between cardholder and card issuer (OJ No L 317, 24.11.1988, p. 55).
9. **388 Y 0611(01)**: Council Resolution 88/C 153/01 of 7 June 1988 on consumer protection in the indication of the prices of foodstuffs and non-food products (OJ No C 153, 11.6.1988, p. 1).
- 10.<sup>{23}</sup> **392 X 0295**: Commission Recommendation 92/295/EEC of 7 April 1992 on codes of practice for the protection of consumers in respect of contracts negotiated at a distance (distance selling) (OJ No L 156, 10.6.1992, p. 21).
- 11.<sup>{24}</sup> **393 Y 0420(01)**: Council Resolution 93/C 110/01 of 5 April 1993 on future action on the labelling of products in the interest of the consumer (OJ No C 110, 20.4.1993, p. 1).
- 12.<sup>{25}</sup> **379 Y 0630(01)**: Council Resolution of 19 June 1979 on the indication of the prices of foodstuffs and non-food household products prepacked in pre-established quantities (OJ No C 163, 30.6.1979, p. 1).
- 13.<sup>{26}</sup> **486 Y 0723(07)**: Council Resolution and the Ministers for Education meeting within the Council of 9 July 1986 on consumer education in primary and secondary schools (OJ No C 184, 23.7.1986, p. 21).
- 14.<sup>{27}</sup> **387 Y 0107(01)**: Council Resolution of 15 December 1986 on the integration of consumer policy in the other common policies (OJ No C 3, 7.1.1987, p. 1).
- 15.<sup>{28}</sup> **387 Y 0704(03)**: Council Resolution of 25 June 1987 on consumer safety (OJ No C 176, 4.7.1987, p. 3).
- 16.<sup>{29}</sup> **387 Y 0704(02)**: Council Resolution of 25 June 1987 on consumer redress (OJ No C 176, 4.7.1987, p. 2).
- 17.<sup>{30}</sup> **388 X 0041**: Commission Recommendation 88/41/EEC of 10 December 1987 on the involvement and improvement of consumer participation in standardization (OJ No L 23, 28.1.1988, p. 26).
- 18.<sup>{31}</sup> **398 X 0257**: Commission Recommendation 98/257/EC of 30 March 1998 on the principles applicable to the bodies responsible for out-of-court settlement of consumer disputes (OJ L 115, 17.4.1998, p. 31).
- 19.<sup>{32}</sup> **32001 H 0310**: Commission Recommendation 2001/310/EC of 4 April 2001 on the principles for out-of-court bodies involved in the consensual resolution of consumer disputes (OJ L 109, 19.4.2001, p. 56).
- 20.<sup>{33}</sup> **32001 H 0193**: Commission Recommendation 2001/193/EC of 1 March 2001 on pre-contractual information to be given to consumers by lenders offering home loans (OJ L 69, 10.3.2001, p. 25).

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<sup>{23}</sup> Point inserted by Decision No 7/94.

<sup>{24}</sup> Point inserted by Decision No 7/94.

<sup>{25}</sup> Point inserted by Decision No 7/94.

<sup>{26}</sup> Point inserted by Decision No 7/94.

<sup>{27}</sup> Point inserted by Decision No 7/94.

<sup>{28}</sup> Point inserted by Decision No 7/94.

<sup>{29}</sup> Point inserted by Decision No 7/94.

<sup>{30}</sup> Point inserted by Decision No 7/94.

<sup>{31}</sup> Point inserted by Decision No 13/2000 (OJ No L 103, 12.4.2001, p. 26 and EEA Supplement No 20, 12.4.2001, p. 146), e.i.f. 29.1.2000.

<sup>{32}</sup> Point inserted by Decision No 160/2001 (OJ No L 65, 7.3.2002, p. 40 and EEA Supplement No 13, 7.3.2002, p.23), e.i.f. 19.01.2002.

<sup>{33}</sup> Point inserted by Decision No 84/2003 (OJ No L 257, 9.10.2003, p. 41 and EEA Supplement No 51, 9.10.2003, p. 24), e.i.f. 21.6.2003.





# Overview of European consumer credit law:

## Protection of consumers with foreign currency mortgages in the aftermath of the Icelandic crisis

M. Elvira Méndez-Pinedo\*

### 1. Introduction

The impact of the recent financial crisis in Iceland has brought into light the need for a better protection of consumer's economic and legal interests in the field of financial services, house mortgages and unfair contractual terms. Price indexation clauses are specially regulated in European law which establishes strict conditions for their legality. Most usual clauses offered to consumers by the banks and financial institutions operating in the the Icelandic financial services market were clauses linking the principal amount to the price inflation index (*verðtryggt lán*) or linking the payments of both principal and montly installments to foreign currencies (*gengistryggt lán*).<sup>1</sup> Both fall under the Icelandic law on interest and price indexation (*Lög um vexti og verðtryggingu nr. 38/2001*). This article will focus mainly on Icelandic house mortgages denominated in krónas but linked to foreign currencies –price indexed- contracted by consumers in the period 2004-2008.

Icelandic law allowed mortgages denominated in foreign currencies but prohibited mortgages in Icelandic krónas (ISK) linked to the fluctuation of foreign currencies.<sup>2</sup> After the financial crisis in October 2008 and the collapse of the ISK króna, consumers with this kind of contracts have seen their debt doubled. Many consumers have taken cases before the courts presenting their deep concerns about the total/partial nullity of the mortgage contracts signed in light of the Act nr. 38/2001. The national judges have been asked to review the legality of some contracts and to decide for the consequences of illegality if necessary. Presently there are many cases waiting to be adjudicated at local level (district courts). The Supreme Court ruled on the 16<sup>th</sup> June 2010 that car loans contracted in ISK and linked to foreign currencies were illegal as there was never exchange of foreign currency between lender and borrower (cases no. 92/2010 and 153/2010). In another ruling of 16th September 2010 in the case nr. 471/2010 the Supreme Court decided that the Central Bank's non-indexed interest rates were to replace foreign currency indexation and the interest rates that were originally agreed upon in the case of car loans. The Supreme Court confirmed the ruling of a lower court and provided a solution more beneficial for the consumer at that case. At the time of writing a essential question still remains pending: the scope and

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\* The author is Professor of European Law at the University of Iceland. The author would like to disclose a personal interest on the subject of foreign currency mortgages as she contracted a "gengistryggt lán" (loan in ISK linked to foreign currencies) with one financial institution in Iceland. At the time of writing, a case was adjudicated by the District Court of Reykjavík on 28.9.2010 which ruled under Act no. 38/2001 that the principal amount was due in ISK with the general interest of the Central Bank (effects ex tunc). An appeal is pending before the Supreme Court

<sup>1</sup> Mortgages can be denominated in a foreign currency (foreign currency loans or *erlend lán*) or denominated in a national currency but indexed to a foreign currency (*gengistryggt*). In this study we refer mostly to the *gengistryggt lán*. Mortgages can also be contracted with foreign institutions as opposed to domestic institutions although this was never the case in Iceland.

<sup>2</sup> All banks and financial institutions offered nevertheless these loans to the consumers and the banks specially advertised them by focusing on their lower interest rates. Risks associated to the devaluation of the national currency were minimised if not set aside or simply ignored by lenders and borrowers. In general, consumers were not duly informed of risk as pre-contractual information on this point was not given. No code of conduct regarding responsible borrowing and lending existed either. Consumers of course did not know that Icelandic law prohibited other price-indexing clauses different than *verðtrygging*. The main reasons why consumers turned to these loans were the lower interest rates and to avoid the automatic price indexation clauses that Icelandic loans carry.

terms of this jurisprudence on car loans for house loans. Put it another way, the legal effects of the Supreme Courts's ruling on car loans for similar foreign currency indexed house loans and the consequences of the partial nullity of the contracts regarding the payment of principal and interest rates.

The main research questions that this paper will tackle are the following ones: Do consumers in Iceland who signed this kind of house credit mortgages enjoy protection in European law? What are the obligations concerning the application and interpretation of (European) consumer law for the Icelandic judges?

Civil law, real property law and procedural law in general belong to the realm of EU Member State laws, but – even without pleading for an Europeanization of this field- it is useful to look at at some contract problems in the context of European consumer law – both in the interest of national law and European private law. For this reason, the final aim of this contribution is to describe the status quo of the European consumer credit law concerning the protection of consumers in the field of house mortgages and assess the legality of price indexation clauses such as foreign currency indexes as well as its relevance for the protection of Icelandic consumers with home mortgages linked to foreign currencies. Further research will have to be done regarding other kind of price indexation clauses currently used for home loans (*verðtrygging*) in Iceland under the light of European consumer law. This topic is left outside the scope of this research.<sup>3</sup>

This study is divided into two parts where we explore 1) the European Union consumer law *acquis* and strategy as well as the current policy on mortgage credit law and 2) the relevance of European consumer credit law in the EEA legal order and in Iceland. While studying concepts such as unfair contractual clauses and practices and other general principles of consumer law applicable in general, we will discover how the EU is in search for a modern, clear and un-fragmented policy/European Consumer Code protecting consumer's economic and legal interests in these circumstances. Last but not least, reference is done to the relevance of this EU *acquis* to the EEA legal order and the protection of consumers in the Icelandic cases pending before the courts. For constraints of space, this study does not cover European contractual law although readers are advised to refer to the Principles of European Contract Law upon which a Common Frame of Reference for future harmonisation has been drafted (which might be the basis for a future European Civil Code) as general contract law is also applicable to consumer problems in the absence of specific legislation adopted.<sup>4</sup>

Methodology chosen for this task is standard in the field of European law. Legal method relies in a combination of study of principles provided by legislation (as in civil law) and case-law (as in common law) and is comparative in approach with a European perspective. The scope is determined mostly by European legislation and case-law from the Court of Justice of the European Union (ECJ). Both "hard law" (proper EU legislative measures) and "soft law" (recommendations and/or policy initiatives) (such as the EU Consumer Compendium or EU Recommendations) are taken into account. The approach will show how the complex problem of consumer protection in the field of house mortgage credits requires a

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<sup>3</sup> The standard price indexation clause used in Iceland for home mortgages (*verðtrygging*) allowed by Act Nr. 38/2001 might fall for the time being outside the direct scope of Consumer Credit Directive 2008/48/EC incorporated to the EEA legal but is highly questionable in the light of general principles of European consumer law. Reasons for questioning this practice under EU law: 1) for consumer credit other than home mortgages, consumers must know in advance the annual percentage rate of charge (the total cost of the credit to the consumer, expressed as an annual percentage of the total amount of credit); 2) price indexation clauses must be individually negotiated and not prejudicial to consumers in order to be lawful and 3) financial risks associated to such price indexation clauses cannot be properly assessed by an average consumer in advance (economic history of real inflation in Iceland proves irrelevance of Central Bank's predictions and failure of inflation-control policy).

<sup>4</sup> On the status and development of European contract law (Principles of European Contract Law, Draft of a Common Frame of Reference and Project of a European Civil Code) see for further reference: Beale, H., "European Contract Law: the Common Frame of Reference and Beyond", in Twigg-Flesner (ed.), *The Cambridge Companion to European Union Private Law*, Cambridge University Press, 2010, pp. 116-130; Grundmann, S. And Mazeaud, D. (eds), *General Clauses and Standards in European Contract Law* Private law in Context Series. Comparative law, EC law and Contract Law Codification, Kluwer Law International, 2006; Lando, O and Beale, H. (eds), *The Principles of European Contract Law Parts I and II*, The Hague 2000; Lando, O., Clive, E., Prüm, A. and Zimmermann, R. (eds). *The Principles of European Contract Law Part III*, The Hague 2003; Lando, O., "The European Principles in an Integrated World", *European Review of Contract Law* 2005, Volume 1, Issue 1, p. 18ff.



combination of different legal techniques and fields and the coordination of a plurality of lawmaking levels and judicial actors in order to be effective. The study is mostly descriptive but incorporates some empirical data (ie: judgments from the ECJ).

## 2. European consumer law acquis and strategy: In search of a modern, clear and un-fragmented policy/European Consumer Code protecting consumers economic and legal interests.

As the European Commission describes, the *acquis communautaire*<sup>5</sup> on consumer protection is limited to certain issues where EU law has proved essential for the internal market but it does not cover all issues regulated by national consumer law. European law does not substitute national law but interacts with domestic legal orders. In fact, it covers so far essential cross-border issues such as the safety of consumer goods as well as the protection of the economic interests of consumers in a number of specific sectors harmonised by a number of adopted Directives. EU Member States transpose the EU dynamic *acquis* into national law and are obliged to put in place independent administrative structures which allow effective market surveillance and enforcement. Appropriate judicial and out-of-court dispute resolution mechanisms, consumer information and education, and a role for consumer organisations are to be ensured as well in this European consumer framework.<sup>6</sup>

### 2.1 European consumer law acquis on consumer rights, unfair contractual terms and commercial practices.

General principles of EU law in the field of contractual law and consumer law related to price-indexation clauses are established in two European Directives: the Directive 93/13/EEC on unfair contractual terms which states that these terms must be declared non-enforceable against consumers and the Directive 2005/29/EC on unfair commercial practices which inaugurates a general European duty for business to trade fairly and not to mislead consumers. Both have been incorporated to the EEA Agreement and they will be covered infra.

A general principle set by these Directives is that under EU legislation any contractual clause that creates a significant imbalance in the parties' rights and obligations, to the detriment of the consumer is forbidden per se. Another general principle is that businesses have the obligation to trade fairly, avoiding unfair and misleading commercial practices.

Unfortunately, for the time being, the scope of EU law on good faith and unfair dealing is not general. The protection of the consumers is therefore partially achieved. The consumer *acquis* on contract law does not include yet a general duty to deal fairly or to act in good faith for all contracts on all cases. This is a principle that hopefully will be inaugurated when the European legislation is revised with a horizontal approach.

In the next section we will see that this general duty to deal fairly and act in good faith is in force concerning two cases: unfair contractual terms non-individually negotiated and unfair commercial practices. EU law clearly establishes in the two Directives that unfair contractual clauses non-negotiated individually (usually referred as "standard clauses") do not bound the consumers and that there is general duty to trade fairly when engaging in commercial practices addressed to consumers (marketing, advertising, etc).

In another section infra we will see how the judicial review done by the ECJ on unfair commercial clauses and practices primarily applies a test of unfairness and determines the legal consequences of unfair contractual terms favouring the protection of consumers. However, the ECJ has also reminded that, at the

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<sup>5</sup> This term is used in EU law to refer to the total body of EU law accumulated thus far. It means all law which has been acquired or adopted within the Community (both legislation and case-law from the Court of Justice of the EU).

<sup>6</sup> European Commission, Doc. SEC (2010) 153 and Doc. COM (2010) 62 from 24 February 2010. See also Annex XIX to the EEA Agreement which lists all EU acts incorporated to the EEA legal order as it stood on 1 May 2010. *De lege ferenda*, since the EU is reforming this field and Iceland has started negotiating accession to the EU in 2010 some changes will be expected concerning new legislation falling outside the EEA or not yet incorporated such as the new *acquis*.

end, it is for the national courts to decide on the legality of the clauses taking into account the context of national legislation. Special mention will be made on the Case *Turnmer* on foreign mortgages and free movement of capital in the internal market.<sup>7</sup>

European legislation is dynamic so that general EU consumer law is currently under reform. There is a process of legislative review of the Consumer acquis and a new proposal for a Directive on consumer rights (2008) which is now pending for adoption. However, in the field of consumer protection specifically related to financial services, mortgage credits on immovable property and indexation clauses, there is no specific acquis as the European institutions are still working on a separate legislation and policy. The new Consumer Credit Directive 2008/48/EC excludes from its scope credit agreements secured by mortgages on immovable property. At present there is consultation work under way to deal with mortgage credit at European level, following the Recommendation 2001/93/EC that has been incorporated into the EEA legal order.<sup>8</sup> In the absence of an specific aquis, the general EU consumer law remains applicable.

### 2.1.1 *Applicability of the Directive 93/13/EC on unfair contractual terms (under revision). Focus on price indexation clauses.*

In the first place, it must be said that European consumer law offers a good general protection in particular with the Directive on unfair contractual terms which is currently under revision.<sup>9</sup> This legislation already generates far-reaching protection, though generally unintended, for consumers doing real estate transactions and contracting mortgages to that regard. Such conclusion is supported by the ECJ case *Heininger*<sup>10</sup>, dealing with the consumer's right to withdraw from a real estate investment arrangement entered into on credit.

Directive 93/13/EEC has harmonised national provisions on unfair terms in consumer contracts at European level. A contractual term not individually negotiated (particularly in the context of a pre-formulated standard contract) shall be regarded as unfair if, contrary to good faith, it causes a significant imbalance in the parties' rights and obligations, to the detriment of the consumer. This principle is applicable to all kind of contracts. There has been some discussions in academic literature as to whether real property contracts were to be included or not. Final conclusion is given by the Consumer Law Compendium. The principle is also applicable to contracts on land and property such as credit mortgages for the acquisition of property.<sup>11</sup>

However, with the exception of the ECJ *Freiburger Kommunalbauten*<sup>12</sup> case, this question does not appear to have become a matter of discussion in praxis. In this case the ECJ ruled that it is for the national

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<sup>7</sup> ECJ, Case *Manfred Turnmer and Peter Mayer* C-222/97. European Court Reports (from now on ECR) [1999] p. I-01661.

<sup>8</sup> Commission Recommendation 2001/193/EC of 1 March 2001 on pre-contractual information to be given to consumers by lenders offering home loans (OJ L 69, 10.3.2001, p. 25).

<sup>9</sup> Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts. OJ L 095, 21/04/1993 pp. 29-34.

<sup>10</sup> ECJ, Case *Heininger* C-481/99 [2001] ECR I-9945. The litigation turned on the question of whether real estate credit transactions, which were expressly excluded from the Consumer Credit Directive 87/102/EEC, could nevertheless be subsumed under the doorstep directive if the credit transaction was entered into or prepared in a 'doorstep situation'. At the time the litigation came before German courts, it was accepted legal that neither the Consumer Credit nor the Doorstep Directive applied to real estate credit transactions and that therefore the implementing German legislation was in conformity with European law. Therefore, the banks had not informed the consumer of an eventual right of cancellation, as required by Directive 85/577/EEC, because in their opinion no such right existed anyhow. In the *Heininger* case, proceedings brought before the ECJ by a reference from the highest German civil court, the *Bundesgerichtshof* (BGH), the ECJ found, to the surprise of most legal observers, to the opposite. The ECJ ruled that Directive 85/577/EEC is also applicable to real estate credit transactions because it is not expressly exempted, and such exemptions must be interpreted strictly in order not to frustrate the protective ambit of the directive.

<sup>11</sup> See paper from Remien, O, Real Property Law and European Private Law - A Sketch of an Unsurveyed Territory and Consumer Law Compendium on Directive 93/13/EC. This document mentions the judgment from a UK Court which reasoned that to exclude contracts relating to land from the scope of "goods and services" would go against the grain of the aim and purpose of the Directive, which is to provide a high level of protection. See for further reference the CA judgment of 24 February 2004 - *Khatun & Others v Newham LBC* [2004] EWCA Civ 55.

<sup>12</sup> Case C-237/02 *Freiburger Kommunalbauten GmbH Baugesellschaft & Co. KG v Ludger Hofstetter et Ulrike Hofstetter* [2004] ECRI-3403.

court to decide whether a contractual term satisfies or not the requirements for it to be regarded as unfair under the European Directive.<sup>13</sup>

The scope of the Directive 93/13/EC encompasses terms laying down, for instance, the manner of calculation and the procedures for altering the price of services and goods subject to a contract between a consumer and a professional.<sup>14</sup> Although the Directive prohibits in Annex 1 terms allowing the final price to be determined in the future, it allows however for an exception in Annex 2 Subparagraph (I). Price-indexation clauses are accepted on two conditions. First, they must be lawful or not prohibited by law and secondly, the method by which prices vary must be explicitly described in the contract. Consumers must therefore know in advance how the future price for the contract will be determined and calculated. Changes in the price must be predictable.

In order to assess the fairness of contractual terms, it is essential to take into account the approach adopted by the Consumer Law Compendium<sup>15</sup>. A term is considered to be unfair because of its effects on the economic interests of the consumer. While assessing the fairness of contractual terms, regard has to be paid not only to the circumstances prevailing at the time of conclusion of the contract (as the Directive provides as a minimum), but also to conditions following conclusion of the contract (change of circumstances).

The ECJ in its case law on this Directive primarily applies the "abuse theory". According to the ECJ in the cases *Océano Grupo Editorial*<sup>16</sup> and *Mostaza Claro v Milerium*,<sup>17</sup> the system of protection introduced by Directive 93/13 is designed from a consumers' perspective:

"is based on the idea that the consumer is in a weak position vis-à-vis the seller or supplier, as regards both his bargaining power and his level of knowledge. This leads to the consumer agreeing to terms drawn up in advance by the seller or supplier without being able to influence the content of the terms."

Furthermore, as it is reflected on the ECJ case *Océano* referred supra, the Court notes that the use of terms which lead to a significant imbalance in the contractual relations between the parties undermines not only the interests of the consenting party but also the legal and economic order as a whole.<sup>18</sup> The Court acknowledges therefore that consumer law has a different nature than commercial, business or financial law and that this different nature, biased towards the weakest parties, is important both for the market and from a social point of view.<sup>19</sup>

In another case *Cofidis*,<sup>20</sup> the ECJ extended the competence of judges to review consumer law even further and stated that the protection of the consumers precludes any national provision which prohibits the national court, on expiry of a limitation period, from finding that a term of the contract is unfair. In contrast to the *Océano* case, the dicta of the ECJ is related not only to the issue of whether the national court can review its jurisdiction "on its own motion", but on the nullity of clauses generally. It is therefore

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<sup>13</sup> Poncibò, C., "Some Thoughts On The Methodological Approach To EC Consumer Law Reform", *Loyola Consumer Law Review*, 2009, Vol. 21, Issue 3, pp. 353-371, on p. 358.

<sup>14</sup> EFTA Surveillance Authority, Report on the Application of Council Directive 93/13/EEC of 5 April 1993 on Unfair Terms in Consumer Contracts. Document No: 01-9395-D, on pages 5 and 12.

<sup>15</sup> The EC Consumer Law Compendium is a study prepared for the European Commission by an international research group where the transposition of 8 important consumer directives into the national laws of 27 Member States is analysed. The findings of this study reveal the substantial differences between the various national implementing measures as a result of utilising minimum harmonisation clauses and regulatory options. [http://ec.europa.eu/consumers/rights/docs/consumer\\_law\\_compendium\\_comparative\\_analysis\\_en\\_final.pdf](http://ec.europa.eu/consumers/rights/docs/consumer_law_compendium_comparative_analysis_en_final.pdf)

<sup>16</sup> ECJ, Joint cases C-240/98 to C-244/98, *Océano Grupo Editorial, S.A. and Salvat Editores, S.A. v Rocío Murciano Quintero et al.* [2000] ECR I-04941

<sup>17</sup> See as well ECJ judgment of 26 October 2006, C-168/05 - *Elisa María Mostaza Claro v Centro Móvil Milenium SL* [2006] ECR I-10421, para. (25).

<sup>18</sup> Advocate-General Saggio emphasised this point in his Opinion of 16 December 1999 [ECJ, Joint cases C-240/98 to C-244/98, *Océano Grupo Editorial al.*] [2000] ECR I-04941.

<sup>19</sup> On the importance of consumer law for social justice see in the bibliography the research published by Prof. Micklitz from the European University Institute.

<sup>20</sup> ECJ judgment of 21 November 2002, C-473/00 - *Cofidis v Fredout*, [2002] ECR I-10875.

to be assumed that, according to the view of the ECJ, national courts must have the power to review the fairness of a clause on their own initiative generally (and not only when jurisdiction clauses or disputes arise). This has been reaffirmed in a recent case *Pannon GSM Zrt. v. Erzsébet Sustikéné Györfi* where the ECJ rules that national courts are required to examine, of their own motion, the unfairness of a term contained in a contract concluded between a consumer and a seller or supplier.<sup>21</sup> Under EU law, national judges also have the competence to do judicial review of national legislation in order to determine whether it complies or not with the European provisions. In case the domestic legislation does not respect with EU law, national judges have to duty to set it aside or not to apply it.<sup>22</sup>

The concept of absolute nullity of the unfair clause is established clearly by EU law. The whole contract remains binding on both parties, so long as this is possible without the offending clause according to the purpose and legal nature of the contract. The nullity is thus a rule limited to the unreasonable term.<sup>23</sup>

To conclude this section, it can be said that as the EU acquis stands today, unfair terms in consumer contracts not individually negotiated are unlawful (are to be declared null and void). Price-indexation clauses must be, first, legal and, secondly, they must also determine explicitly the method of calculation for future payments. This provision applies to all contracts according to the case-law of the ECJ. Member States can decide on a higher level of protection regarding financial services and house mortgages as this Directive sets only a minimum threshold of harmonisation.<sup>24</sup> While the minimum protection must be guaranteed by all EU Member States, a higher protection can be afforded at national level. According to the EU Treaties, judges, governments and national legislators can never lower the standard of protection that EU law affords consumers. The diversity of national law is only allowed to the extent that it ameliorates the minimum European protection.

This Directive is in force but is currently under revision. A new proposal for a Directive on Consumer Rights has been presented by the European Commission.<sup>25</sup> It is still unclear whether this new proposal will include in its scope credit mortgage on immovable property or not. The European Commission is working on a separate policy on consumer mortgage credit following its Recommendation 2001/93/ EC that will be examined infra.

#### 2.1.2 *Applicability of the Directive 2005/29/EC on unfair commercial terms.*

Together with the Directive 93/13/EC on unfair contractual terms, another Directive is essential as it deals with the marketing, advertising and selling practices. Directive 2005/29/EC has simplified existing EU legislation concerning unfair commercial practices which are now prohibited under Article 5 of this Directive.<sup>26</sup> Unfair commercial practices can be of different sorts (misleading and aggressive practices, 'sharp practices', such as pressure selling, misleading marketing and unfair advertising, and practices which use coercion as a means of selling). All these practices are prohibited, irrespective of the place of purchase or sale. This Directive, furthermore, states clearly the concept of a "duty to trade fairly" for businesses.<sup>27</sup>

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<sup>21</sup> In this case the ECJ recalls, first, that the protection which the Directive confers on consumers extends to cases in which a consumer who has concluded with a seller or supplier a contract containing an unfair term fails to raise the unfairness of the term, whether because he is unaware of his rights or because he is deterred from enforcing them on account of the costs which judicial proceedings would involve. See ECJ, Judgment of the Court of Justice of 4 June 2009 in Case C-243/08 *Pannon GSM Zrt. v. Erzsébet Sustikéné Györfi*, [2009] ECR not yet reported.

<sup>22</sup> ECJ, case *Simmmenthal* 106/77 [1978] ECR 629.

<sup>23</sup> Consumer Law Compendium, on p. 406.

[http://ec.europa.eu/consumers/rights/docs/consumer\\_law\\_compendium\\_comparative\\_analysis\\_en\\_final.pdf](http://ec.europa.eu/consumers/rights/docs/consumer_law_compendium_comparative_analysis_en_final.pdf)

<sup>24</sup> Most important case-law from the ECJ regarding this Directive: Case C 243/08 *Pannon GSM Zrt. v Erzsébet Sustikéné Györfi* [2009] ECR nyr, Case C-168/05 *Elisa María Mostaza Claro v Centro Móvil Milenium SL* [2006] ECR I-10421; Case C-302/04 *Ynos left v János Varga* [2006] ECR I-371; Case C-237/02 *Freiburger Kommunalbauten GmbH Baugesellschaft & Co KG v Ludger Hofstetter et Ulrike Hofstetter* [2004] ECR I-3403 ; and Case C-473/00 *Océano Grupo/ Cefidis SA v Jean-Louis Frotout* [2002] ECR I-10875.

<sup>25</sup> European Commission, Proposal for an EC directive on consumer rights. Doc. COM (2008) 614 from 8.10.2008.

<sup>26</sup> Directive 2005/29/EC of the European Parliament and of The Council of 11 May 2005 concerning unfair business-to-consumer commercial practices in the internal market. OJ L 149 from 11.6.2005.

<sup>27</sup> Article 4 expressly prohibits Member States from maintaining or adopting more restrictive national measures, even where such measures are designed to ensure a higher level of consumer protection if these rules interfere with the internal market: freedom to provide services and/or free movement of goods but only for reasons falling within the field approximated by this Directive.

Like it was the case before, this legislation has imposed a duty to trade fairly with a horizontal approach. Still it has to be remembered that it does not apply to the substance of the contracts. Being the complement of Directive 93/13/EC, it applies to advertising, promotions, marketing, webpages, etc. When these commercial practices are unfair or reflect unfair or abusive substantive clauses, they are deemed unlawful. It is important to remember that unfair commercial practices point to the existence of bad faith with regards to the professional offering the services or goods.

Regarding the scope of the Directive, some explanation must be done. In Article 3.2. it is established that this Directive is without prejudice to contract law and, in particular, to the rules on the validity, formation or effect of a contract. In Article 3.9. it reads that, in relation to 'financial services, as defined in Directive 2002/65/EC and immovable property, Member States may impose requirements which are more restrictive or prescriptive than this Directive offering better consumer protection.

This is an important clarification in its scope. Article 4 contains a general rule on "maximum harmonisation" which has been unusual so far in consumer law. It expressly provides that Member States may not adopt stricter rules than those provided for in the Directive, even in order to achieve a higher level of consumer protection. There are now uniform rules on those unfair business-to-consumer commercial practices which have been harmonised as the ECJ has declared in the cases *VTB-VAB* and *Galatea* and other recent jurisprudence.<sup>28</sup> This is done to prevent national legal obstacles (regulations of commercial practices) to the functioning of the European internal market.

However, regarding financial services and immovable property, an exception to the general rule established by Article 4 is done. We therefore return to the normal standard of EU consumer law of "minimum harmonisation". In the field of financial services and immovable property, Member States can go further than the uniform provisions established in the Directive and can offer a higher level of consumer protection regarding unfair commercial practices.<sup>29</sup>

What must be clear under EU law is that if a unfair contractual term is null and void under Directive 93/13/EC, commercial institutions should not be allowed to use unfair commercial practices (advertising, promotions and marketing) to lure consumers into signing these contracts. It is also clear that in the relation to financial services and immovable property Member States can increase consumer protection but can never decrease it.

To conclude this section, it can be said that this Directive has a general nature. As it has not harmonised specifically at European level commercial practices on credit mortgages, these can be regulated with a higher strict standard in national law. For the time being, consumers can rely on the uniform rules and general principles of the Directive and then refer to more specific national provisions for further specific protection. The EU legal framework and the national consumer law must peacefully coexist. The Commission has also announced its decision to develop a horizontal initiative on unfair commercial practices in the field of retail financial services including mortgage credit.<sup>30</sup> As it is the case in national law, the EU Treaties establish that future EU legislation can only improve the level of protection afforded to consumers, EU law does not allow European institutions and/or Member States to lower the current standards.

### *2.1.3 Applicability of Recommendation 2001/93/EC on pre-contractual information to be given to consumers by lenders offering home loans.*

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Article 5 of the Directive prohibits in general unfair commercial practices and provides a definition. Article 6 of the Directive describes misleading actions. Article 7 incorporates misleading omissions which are prohibited.

<sup>28</sup> ECJ, Judgment of the Court (First Chamber) of 23 April 2009, *VTB-VAB NV v Total Belgium NV* and *Galatea BVBA v Sanoma Magazines Belgium NV*. Joined cases G-261/07 and G-299/07. ECR [2009] not yet reported. See also Judgment of the Court (First Chamber) of 14 January 2010. *Zentrale zur Bekämpfung unlauteren Wettbewerbs eV v Plus Warenhandels-gesellschaft mbH*. Case G-304/08. ECR [2010] not yet reported and Judgment of the Court (Third Chamber) of 11 March 2010. *Telekomunikacja Polska SA w Warszawie v Prezes Urzędu Komunikacji Elektronicznej* Case G-522/08. ECR [2010] not yet reported.

<sup>29</sup> Micklitz, H-W., "Unfair commercial practices and misleading advertising", in Micklitz, H-M., Reich, N. and Rott, P., *Understanding EU Consumer Law*, Intersentia, 2009, pp. 61-117, on p. 78.

<sup>30</sup> European Commission. White Paper on the Integration of EU Mortgage Credit Markets. Doc COM (2007) 807 final.

In the field of financial services and home loans, a non-binding instrument has been already adopted at European level which is the Recommendation 2001/193/EC on pre-contractual information to be given to consumers by lenders offering home loans (Code of Conduct) and the use of the European Standardised Information Sheet (ESIS).<sup>31</sup> It aims to ensure that consumers obtain transparent and comparable information on housing loans.

This recommendation covers pre-contractual consumer information for domestic and cross-border home loans. According to the recommendation, the lender should supply to the consumer in the course of the pre-contractual phase with general information set out in Annex I and personalised information to be presented in a European Standardised Information Sheet as set out in Annex II. In addition, the lender should supply to the consumer information on the identification of the competent body to which the consumer can refer in the event of difficulties in relation to the application of the Code on pre-contractual information for home loans. Member States and lenders offering home loans in the Community are invited to comply with this recommendation.

This Code of Conduct and Information Sheets appear to have been implemented with varying degrees of success across EU Member States, yet without solving the overall problem of a lack of a common legal framework.<sup>32</sup> For this reason, the European Parliament has called for greater harmonisation of provisions on pre-contractual information, which are necessary to enable borrowers to take informed decisions on potential mortgage contracts. The Parliament has insisted that such pre-contractual information must be accurate and comprehensible to allow an informed choice, and that it should give the consumer as comprehensible and global a picture as possible in the light of the available information on which the mortgage contract is based.

In short, the European Parliament considers the Code of Conduct and the Information Sheets to be important yet insufficient instruments for the protecting the economic interests of citizens contracting home loans, specially those citizens who find themselves in cross-border situations.<sup>33</sup>

*2.1.4 Review of the Consumer acquis. Proposal for a Directive on consumer rights (2008). Discussions on the applicability to mortgage credit.*

As explained above, the existing consumer protection legislation is, in general, based on minimum harmonisation and allows Member States to introduce more stringent legislation. This approach has not been totally successful so far. For this reason, the European Commission launched a public consultation on the revision of the consumer acquis in 2007 by adopting a Green Paper<sup>34</sup> for discussion. Following that consultation, the European Commission proposed a new horizontal Directive on consumer rights which advances the consolidated acquis and reforms several Directives<sup>35</sup> and is developing other initiatives in the general field of consumer protection, such as the EU Consumer Compendium.<sup>36</sup>

At the moment the proposal for a Directive on Consumer Rights from 2008 is awaiting Parliament decision in a first reading.<sup>37</sup> Within the Council, a large number of EU Member States think that there are specific areas which should not be covered by some or all parts of the directive, such as contracts on

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<sup>31</sup> Commission Recommendation 2001/193/EC of 1 March 2001 on pre-contractual information to be given to consumers by lenders offering home loans (OJ L 69, 10.3.2001, p. 25).

<sup>32</sup> European Parliament resolution on mortgage credit in the EU (2006/2102(INI)) OJ C 314E, 21.12.2006, p.136–142, on p. 138.

<sup>33</sup> Ibidem on p. 139.

<sup>34</sup> European Commission, Green paper on the Review of the Consumer Acquis. Doc. COM (2006) 744 final. OJ C 61 15.3.2007.

<sup>35</sup> European Commission, Proposal for an EC directive on consumer rights. Doc COM (2008) 614. The proposal aims to revise four existing directives on consumer contracts (the cornerstones of EU legislation in the field: Dir. 85/577/EEC on contracts negotiated away from business premises, Dir. 93/13/EEC on unfair terms in consumer contracts, Dir. 97/7/EC on distance contracts, Dir. 1999/44/EC on consumer sales and guarantees) merging them into a single horizontal instrument based on full-harmonisation (i.e. Member States cannot maintain or adopt provisions diverging from those laid down in the Directive), which regulates the common aspects in a systematic fashion, simplifying and updating the existing rules, removing inconsistencies and closing gaps.

<sup>36</sup> European Union. Consumer Law Compendium. Doc. available at

[http://ec.europa.eu/consumers/rights/docs/consumer\\_law\\_compendium\\_comparative\\_analysis\\_en\\_final.pdf](http://ec.europa.eu/consumers/rights/docs/consumer_law_compendium_comparative_analysis_en_final.pdf).

<sup>37</sup> European Parliament. Draft Report by the Committee on Internal Market and Consumer Protection. Doc PE442.789 from 20.05.2010.

immovable property and financial services because they need a separate policy. Clarification is also deemed necessary in order to determine the scope of the directive, the coherence with other EU legislation and the interaction with the general contract law of the Member States and even with European contract law.<sup>38</sup>

EU Consumer law is therefore evolving and under continuous reform. In the future, the minimum harmonization approach (i.e. Member States may maintain or adopt stricter consumer protection rules) adopted in the previous EU legislation in the field will be abandoned in order to avoid fragmentation in the level of consumer protection in the Member States. A new general horizontal approach aiming for a full protection of consumers has been inaugurated and this is an approach that hopefully will cover all existing gaps.<sup>39</sup> What is still unclear for the time being is the substance of the future corpus of European law applicable to consumers in the field of financial services and, more specifically, how mortgage credits will be considered in the EU legal order from a consumer perspective. While the new policy is determined and new legislation drafted, the Recommendation 2001/93 on pre-contractual information to be given to consumers by lenders offering home loans is applicable. And, of course, general EU consumer law as well as national consumer legislation remain in force.

## 2.2. European consumer law *non-acquis* on financial services and mortgage credits on immovable property

As explained in the previous section, notwithstanding the general EU consumer *acquis*, it must be said that - in the field of consumer protection specifically related to financial services, mortgage credits on immovable property and indexation clauses- there is no specific *acquis* legally binding. In fact, the European institutions are still working on a separate legislation and policy to complement the Recommendation from 2001. This policy will be mentioned *infra*.

While there is general agreement that mortgage credits need urgent attention both at European and national level,<sup>40</sup> the EU has so far guaranteed a limited and minimum standard of consumer protection specifically in this field. In fact, the only real European specific initiative is the European Standard Information Sheet (ESIS), a standardised information sheet which aims to improve the presentation of precontractual information to consumers. Unfortunately, it is not mandatory and this weakens its applicability.

At the time of writing, EU general consumer law is nevertheless applicable to the specific field of consumer credit unless stated otherwise. More worrisome is the fact, as EU legislation seems to be evolving, that an entire new exemption has been created for credit agreements which are secured either by a mortgage or by other comparable security or right related to immovable property by the new Directive 2008/48/EC to be examined *infra*. This could be a problem if the European Union did not adopt in a parallel way a separate legislation for this field. This is a critic seriously put forward by the leading specialists in the field of consumer law.<sup>41</sup>

### 2.2.1 *Non applicability of the new Consumer Credit Directive 2008/48/EC: exclusion of credit agreements secured by mortgages on immovable property.*

The new Directive 2008/48/EC updates existing EU rules on consumer credit,<sup>42</sup> by recasting the existing Directives on consumer credit 87/102, 90/88 and 98/8. It concerns credit agreements for loans of between €200 and €75,000 but does not apply to a number of credit agreements secured by immovable property, forms of overdraft facility, private credit agreements and those between employer and employee.

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<sup>38</sup> Council of the European Union, Press Release 2982nd Council meeting, Brussels 3-4 December 2009.

<sup>39</sup> For a commentary on the proposal see Poncibò, C, "Some Thoughts On The Methodological Approach To EC Consumer Law Reform", *Loyola Consumer Law Review*, 2009, Vol. 21, Issue 3, pp. 353-371; and Whitaker, S, "Unfair Contract Terms and Consumer Guarantees: the Proposal for a Directive on Consumer Rights and the Significance of 'Full Harmonisation'", *European Review of Contract Law*, 2009, Volume 5, Issue 3, pp. 223-247.

<sup>40</sup> European Parliament. Report on Mortgage Credit in the EU from 19.10.2006. OJ C 314E, 21.12.2006, p. 136-142.

<sup>41</sup> Micklitz, H-M, Reich, N and Rott, P, *Understanding EU Consumer Law*, Intersentia, 2009, p. 189.

<sup>42</sup> Directive 2008/48 on credit agreements for consumers and repealing Council Directive 87/102, OJ L133/66 from 22.05. 2008. Corrigendum to Directive 2008/48 OJ L207/14 from 11.09.2009.

It aims to ensure that consumers are provided with enough information prior to and on conclusion of the contract to allow them to make informed decisions and it allows a consumer 14 days to withdraw from the credit agreement without having to give reasons. It also limits compensation consumers must pay to banks in the event of early repayment.

Why does the new Consumer Credit Directive 2008/48/EC exclude from its scope credit agreements secured by mortgages on immovable property? The Commission has insisted that these types of credit agreements are so different from normal credit contracts that they should be regulated in a separate legal instrument. Furthermore, all specialists agree that they touch upon difficult questions of contract and property law which need very careful consideration. We will therefore have to follow the work announced by the EU institutions very closely. While a policy is adopted, general EU consumer law and the Recommendation 2001/93/EC (Code of Conduct and Information Sheets) are still applicable. Specific comments on some questions related to contract law are offered infra.

### 2.2.2 *Jurisprudence from the ECJ. Comment on the Case Trummer and Mayer on foreign mortgages and free movement of capital in the internal market.*

Although there is a rich jurisprudence from the ECJ on Directives 93/13/EC on unfair contractual terms and Directive 2005/29/EC on unfair commercial practices, there is only one case so far where the Court of Justice has ruled on foreign mortgages in the context of European Law. In the case *Trummer and Mayer*<sup>43</sup> the Court declared that an obligation to have recourse to the national currency for the purposes of creating a mortgage could be a restriction on the movement of capital.<sup>44</sup> The ECJ ruled that mortgages can be, but do not have necessarily to be, considered as capital movements falling under EU law. In order for the European law of the internal market to apply there must be a community or European cross-border dimension to the capital or payment movement.<sup>45</sup>

What is interesting in this case *Trummer and Mayer* are the statements from Advocate General La Pergola where he defines the competence of Member States in this area, elaborating on the nature of the mortgage, the necessary link between the financial obligation, the lien/property secured, the inherent risks of this kind of mortgages for consumers and indicating that the final test under EU law to justify or not national legislation on foreign mortgages will be one of proportionality:

[... ] the mortgage is one of the most classical ways of guaranteeing an obligation. If the distinguishing mark of a mortgage is considered to be its accessory nature, its fate will be inextricably linked with that of the obligation it guarantees. Let us pause to consider this notion. Precisely because the accessory follows the principal, the mortgage must, for the purposes of the present case, be considered strictly in relation to the transaction for the existence (or effectiveness) of which it is an essential precondition. At this juncture, however, it is necessary to consider whether overriding factors such as those mentioned in Article 73d of the Treaty may nevertheless justify the maintenance of legislation such as the Austrian law at issue in the present dispute.

This calls for a number of remarks. It has been pointed out in this context that the national legislature needs to safeguard mandatory requirements, such as certainty as to the value of the lien. Reference has also been made to the difficulty for lower-ranking mortgage creditors in ascertaining the precise value of their own lien when the higher-ranking mortgage is registered in a foreign currency, both because of the difficulty of establishing the exact value of the currency in which the higher-ranking mortgage has been created and because of the risk of variation in the exchange rate between the currency of registration and the currency which is legal tender in the country in question.

Admittedly, there is the other aspect to the question, which relates to the difficulty of establishing the value of the foreign currency or to the extreme volatility of its value in relation to the national currency, on the assumption that the latter, by contrast, displays a degree of stability. The

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<sup>43</sup> ECJ. Case *Marfried Trummer and Peter Mayer* C-222/97. ECR [1999] p. I-01661.

<sup>44</sup> Akkermans, Bram, *Property Law and the Internal Market* in Sief van Erp, Bram Akkermans (eds.), *CFR and Property Law*, forthcoming. Available at SSRN: <http://ssrn.com/abstract=1436496>

<sup>45</sup> A resident in Germany sold to a resident in Austria a share in the ownership of a property situated in Austria, the purchase price was agreed by the parties in German marks which were later replaced by the euro. They agreed that a mortgage should be created to secure payment of the purchase price but an application for registration of the mortgage in the Austrian land register was refused on the ground that the debt was denominated in a foreign currency. The EJC ruled that Austrian rules were liable to dissuade the parties concerned from denominating a debt in the currency of another EU State, thereby depriving them of a right of free movement of capital and payments.



considerations involved here are far from negligible. Moreover, Article 73b treats the currencies of all countries, whether Community Member States or not, as equivalent for the purposes of the free movement of capital. In addition, Article 73d contains a reservation which permits Member States 'to take measures which are justified on grounds of public policy or public security'. In order to safeguard the overriding requirements to which Article 73d refers, the national legislature is therefore authorised to introduce measures which restrict the free movement of capital. Let me be more specific. The justifying criterion that comes to mind in this regard is that of proportionality. In view of the requirements of public policy or public security on which they may have been based, the measures adopted by the Austrian legislature should be considered compatible with the Treaty only if they are reasonable and proportionate to the objective pursued.

As it is usual in the case-law of the Court of Justice, at the end a balance was found between the freedom of the parties regarding movement of capital and the public interest to be protected. The balancing instrument was the principle of proportionality. While the EJC recognised the right of a Member State to require a mortgage to be expressed in the national currency for several reasons (public policy, creditor protection and ensuring transparency of the system) the ECJ held that – in the concrete case – the principle of proportionality had not been respected and the restriction was not duly justified. Parties were forced to express their security right in terms of the national Austrian currency and this had deprived them of an element of the free movement of capital. The provision of Austrian law was declared contrary to EU law as the ECJ found no valid grounds for a justification of such restriction in the circumstances of the case.<sup>46</sup>

According to Akkermans and Bram, this judgement could have meant some progress in the creation of the single market in financial services and mortgage credit, an important segment of the EU financial market that had fallen outside EU harmonisation.<sup>47</sup> Although this has not yet happened, it was on the basis of free movement of capital together with this judgment, that it became possible for example to secure a mortgage over a property situated in Iceland and raise a loan in another EU currency such as the Euro, Sterling Pound or Danish Kronor or even in non-EU currencies (as the free movement of capital and payments is the only internal market freedom that also applies to third countries). This is so because the principle of homogeneity between EU and EEA law legal orders is an essential pillar of the European legal order.<sup>48</sup> This explains the legislative choice of the Icelandic Parliament. According to Icelandic law,<sup>49</sup> it is possible to contract a home loan in a foreign currency secured by a property in Iceland and pay monthly instalments in that currency. What is prohibited is to contract a home loan denominated in Icelandic krónas (where no real exchange of foreign currency takes place between lender and borrower) and link the payment of both the capital and the interest to the fluctuations of foreign currencies as the Supreme Court has ruled in June and September 2010.

### *2.2.3 Work under way to deal with mortgage credit at European level – current trends.*

As we have seen, in spite of the importance of the problems raised there is not yet any European specific legislation or practice dealing specifically with consumer problems linked to mortgage credit such as foreign mortgages, foreign currency mortgages and/or mortgages linked to foreign currencies. The protection of consumers in the field of financial services (credit and mortgages) still falls primarily under

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<sup>46</sup> Advocate General La Pergola in his opinion on the case *Trummer and Mayer* recognises the risks associated to foreign currency mortgages admitting a general regulatory scope for the EU Member States which might prohibit them and derogate from the free movement of capital. But, in that regard, the principle of proportionality must be applied on a case by case basis. Opinion delivered on 6 October 1998. ECJ. Case *Marfred Trummer and Peter Mayer* C-222/97. [1999] ECR p. I-01661.

<sup>47</sup> See Sideek Mohamed, "A Critical Assessment of the ECJ Judgement in *Trummer and Mayer*", (1999) 14 JIBFL 396. According to this author, attempts to develop a single market in mortgage services reached a legislative deadlock due to the lack of political enthusiasm in the Council to adopt any meaningful legal measures for its liberalisation. The European Commission for example proposed unsuccessfully a directive on the freedom of establishment and the free supply of services in the field of mortgage credit. See Doc. COM/1984/730/FINAL on the right of establishment and freedom to provide services. OJ C/1985/42/4. On this draft directive, see for further reference Marco Radice, "A Proposal For An EC Directive Concerning The Liberalization of Mortgage Credit In Line With The Second Banking Directive", (1994) 1 LIEI 155.

<sup>48</sup> M. Elvira Méndez-Pinedo, *EC and EEA Law*, Europa Law Publishing, 2009.

<sup>49</sup> Act no. 38/2001.

general EU consumer law and under general and specific national laws. As a result, protection of consumers is fragmented and sometimes unclear both at European and national level.<sup>50</sup>

There is work under way to advance the integration of mortgage credit markets and law at European level. Mention must be made of the Green Paper on Mortgage Credit on the EU<sup>51</sup> and the White Paper on the integration of EU Mortgage Credit Markets.<sup>52</sup> In parallel to the Commission initiatives we also find the Report on the Green Paper on Mortgage Credit done by the European Parliament.<sup>53</sup>

To understand why progress is slow, it is useful to remember some statements done by the Forum of discussion on financial services and protection of consumers, where several issues have been discussed.<sup>54</sup> This forum pointed out that "traditional" consumer protection law might be understood as a relatively coherent set of rules, which is often put together in a national consumer code or systematically integrated in national civil codes but the same cannot be said with regard to consumer credit law. In financial services, consumer protection rules are scattered over a large number of laws and regulations which makes it a difficult and complex area.<sup>55</sup>

[...]The financial services area is characterised by its high complexity and ever changing legislation. Financial products are very difficult to understand for non specialised lawyers and all the more so for most consumers. The situation is made worse by the banks not informing consumers properly on the characteristics of the services they buy. Financial services are usually outside the education and training of young lawyers. Expertise is needed and must be built up. This requires cooperation between lawyers and economists. Such expertise is a scarce commodity in the consumer movement – and even more so in the case of the smaller Member States. Financial services are *per se* international and cross-border and so are the consumer problems they give rise to. Financial service providers are often operating on a world-wide basis – as the recent worldwide financial crisis has highlighted. Local consumer problems therefore can bear an inherent transnational dimension.

The European Commission declared that in its White Paper on Mortgage Credit its intentions to study the potential integration of the EU mortgage market and the benefits for European consumers.<sup>56</sup> According to the Commission, the notions of pre-contractual information and independent legal advice are essential without forgetting the principles of responsible lending and borrowing. This seems to be the policy currently being considered at European level.

Academic literature in EU law is almost non-existent concerning the treatment of foreign (currency) mortgages from a European perspective as only general studies on consumer credit and mortgage law have been published so far. Volante<sup>57</sup> has evaluated the issues addressed by the Commission in its Green Paper as well as the problems involved in any regulation of mortgage agreements and suggested that consumer protection with regard to these contracts should be focused on a test of the fairness of their

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<sup>50</sup> Ása Ólafsdóttir and Eiríkur Jónsson, *Staða neyðindamála á Íslandi*, Skýrsla Lagastofnunar HÍ, Apríl 2008, 141-240.

<sup>51</sup> European Commission. Green Paper Mortgage Credit in the EU. Doc COM (2005) final.

<sup>52</sup> European Commission. White Paper on the Integration of EU Mortgage Credit Markets. Doc. COM (2007) 807 final.

<sup>53</sup> European Parliament. Report on Mortgage Credit in the EU (2006/2102(INI)). OJ C 314E , 21.12.2006, p. 136-142.

<sup>54</sup> Document available at [http://www.clef-project.eu/media/d\\_CLEFguidelinesonfinancialservices\\_final\\_96344.pdf](http://www.clef-project.eu/media/d_CLEFguidelinesonfinancialservices_final_96344.pdf)

<sup>55</sup> The Association EUROFI has reminded all actors about the importance of the European harmonisation in the field of financial services. According to EUROFI group: "Certain characteristics of retail financial services explain why consumer protection is a strong issue for these products: The "products" and services are intangible, and their features, quality and performance can be complex or difficult to understand for consumers. Consumers buy certain of these products relatively rarely, thus making it difficult to learn from experience (ex: mortgages, long term savings...). The effect or benefit of the 'product may not be apparent for many years in certain cases (e.g. a life assurance policy or pension) and is not easily predictable. Consumers should be prevented from going into over-indebtedness." See Eurofi group. Consumer protection. Document available at [http://www.eurofi.net/pdf/Consumer\\_protection\\_en.pdf](http://www.eurofi.net/pdf/Consumer_protection_en.pdf)

<sup>56</sup> European Commission. White Paper on Mortgage Credit. Doc. COM (2007) 807 final p. 4.

<sup>57</sup> Volante, Raffaele, "Mortgage credit contracts and the Green Paper on Mortgage Credit – Controls on Transparency and Fairness", *European Review of Contract Law* 2007, Volume 3, Issue 2, pp. 150-178.

terms, which could be based on the balance of risks the terms create between the parties. Volante has also pointed out some dangers relating to the opening up of the markets which need to be carefully assessed.<sup>58</sup>

In view of the complexities of the area, all EU legislative institutions agree that a European approach is needed but a stronger coordination must be done of consumer and contract law issues.<sup>59</sup> While the Commission's White Paper on the integration of EU mortgage credit markets considered the need for further assessment of policy options to increase market transparency and to ensure that consumers have a greater level of certainty as regards the recovery value of their mortgage investment; the Commission also announced in 2008 that it would first examine how to improve the quality of information provided to consumers in the field of mortgage credit and it would then study other aspects related to it such as responsible lending and borrowing. The Commission has recently indicated that it will not take any decision on the introduction of legislative measures until it has carried out further consultation and impact assessment,<sup>60</sup> as the European Parliament had requested in its Report on Mortgage Credit in the EU.<sup>61</sup> Last but not least, the financial crisis may have a potential impact on EU policy as the Commission has recently declared that it is considering introducing penalties on foreign currency loans due to the higher risk they pose to consumers.<sup>62</sup>

### 3. Are general principles of European consumer and contractual law applicable to financial services and house mortgages in the EEA and Iceland?

The EEA Agreement with its annex IXI incorporates almost all the EU consumer law *acquis* into the EEA legal order. Following the proper adoption of domestic legislation, this EU/EEA consumer *acquis* becomes fully applicable in Iceland. The Preamble of the EEA Agreement states that Contracting Parties are "DETERMINED to promote the interests of consumers and to strengthen their position in the market place, aiming at a high level of consumer protection;". Annex XIX EEA Agreement specifically

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<sup>58</sup> *Ibidem*. See the abstract: "Through the 2005 Green Paper on Mortgage Credit the European Commission opened a broad debate about which aspects of secured lending should be subject to uniform regulation throughout the European Union in order to increase the availability for consumers of one Member State of credit offered by lenders of a different Member State, thus achieving a fully integrated Internal Market in this important sector. The opening of national markets might, however, let more unscrupulous lenders issue credit on unfair conditions, in order to get more assets to use for securitization; this financial technique radically changed the US mortgage sector in recent decades and it is of increasing importance in Europe too."

<sup>59</sup> See European Parliament, DG for Internal Policies. Policy Department C. Citizens' Rights and Constitutional Affairs, "A comparison between the provisions of the draft Common Frame of Reference and the European Commission's proposal for a Consumer Rights Directive". Study. Doc PE 419.608.

<sup>60</sup> Council Conclusions of 14 May 2008 on Commission White Paper from 18 December 2007 support Commission intention to assess benefits and costs of different policy options. The European Commission is currently examining quality of information in mortgage credit in Europe and there is a Commission staff working document from 16 December 2008 and a Commission study on Equity Release Schemes in the EU from 18 March 2009. Feedback on the role and regulation of non-credit institutions in EU mortgage markets was given on 30 March 2009. A Commission working paper on best practices is expected in 2010. On 30 November 2009 the Commission published the results of the consultation on responsible lending and borrowing. Commission's services are currently considering whether a package of combined measures can be presented covering both mortgages and responsible lending. Information stated in Report of the UK Law Societies, Joint Brussels Office, *EU Legislation on Consumer Protection*, March 2010. For official information from the European Commission and the latest news on mortgage credit policy at European level see [http://ec.europa.eu/internal\\_market/finances-retail/credit/mortgage\\_en.htm](http://ec.europa.eu/internal_market/finances-retail/credit/mortgage_en.htm)

<sup>61</sup> European Parliament resolution on mortgage credit in the EU from 21.12.2006. OJ C 314E, 21.12.2006, p. 136-142.

<sup>62</sup> Tait, N. And Cienski, J., "EU eyes foreign currency loan penalties", article in *Financial Times* 3.09.2009. The Commission wants to introduce "specific and penal" capital requirements on lenders to prevent the granting of excessive loans to private households when these are denominated in a currency other than that of the borrower's income. Foreign exchange loans have also been a problem in Poland, Hungary, Romania and the Baltic states. See also Groendal, B., "E. Europe banks, regulators head for FX loan fight", article in *Reuters* 28.09.2009, who reports that European Central Bank governing council member Ewald Nowotny called for tighter restrictions on foreign currency lending in eastern Europe, saying it had no place in credit for ordinary consumers.

incorporates a number of EC legislative acts on Consumer Protection and is updated regularly by decisions of the EEA Joint Committee.<sup>63</sup>

As the Icelandic Administration has summarised in its reply to the European Commission on the applicability of EU/EEA consumer law in Iceland:<sup>64</sup>

“EU legislation in the field of consumer protection has been incorporated into the EEA Agreement and EU directives on consumer protection have been transposed into Icelandic legislation. Accordingly, consumer protection legislation in Iceland is mainly in line with minimum protection as stipulated within the aforementioned directives. [...] Consumer Protection is recognised as a specific policy in Iceland. “

Together with the EEA Agreement, we must note that the two EU Directives on unfair contractual terms<sup>65</sup> and commercial practices<sup>66</sup> have been incorporated to the EEA legal order by Decisions of the EEA Joint Committee. The European Recommendation 2001/93/EC (Code of Conduct and pre-contractual information) is also part of the EEA legal order as well as the European Consumer Credit Directive 2008/48/EC (non applicable to house mortgage credit).<sup>67</sup> Substantive law examined supra applicable to consumer relations seems to be identical in EU and EEA law. In both legal orders, regarding the protection of consumers in the field of mortgage credit and immovable property the current European legislation allows EU/EEA Member States to allow a higher degree of protection for consumers. There is a diversity of legal regimes in Europe concerning the degree and scope of consumer protection outside the minimum set by the Directives.

Some important general principles of European consumer and contractual law which are part of the EU *acquis* are applicable to the current problems being discussed in Iceland regarding the protection of consumers who contracted both foreign currency mortgages (legal) and Icelandic mortgages linked to foreign currency currencies (illegal). The principles of European consumer law explained supra belong to the EEA legal order and have been incorporated to Icelandic law.<sup>68</sup>

There is no specific jurisprudence from the EFTA Court especially relevant to the problem explored in this study but the EFTA Court has already ruled that the protection of the consumers is an integral part of the EEA Agreement.<sup>69</sup> The EFTA Court has declared that it will interpret the internal market legislation in the context of a high consumer protection. As it is the case in EU law, the principle of proportionality is a key issue in determining whether national legislation based on consumer protection breaches or not the EEA internal market legislation. A case-by-case study approach has to be followed as the EFTA Court has ruled.

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<sup>63</sup> Annex XIX of the EEA Agreement as of 1.5.2010 available at <http://www.efta.int/content/legal-texts/eea/annexes/annex19.pdf>

<sup>64</sup> Information available at the website <http://www.mfa.is/>

<sup>65</sup> Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts (OJ No L 95, 21.4.1993, p.29). EEA Joint Committee Decision No. 7/94, OJ [1994] No. L 160, p. 1. Decision available [http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:21994D0628\(01\):EN:HTML](http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:21994D0628(01):EN:HTML)

<sup>66</sup> Directive 2005/29/EC of the European Parliament and of the Council of 11 May 2005 (OJ L 149, 11.6.2005, p. 22). Decision of the EEA Joint Committee No 93/2006 of 7 July 2006 amending Annex IX (Financial services) and Annex XIX (Consumer protection) to the EEA Agreement, OJ [2006] No. L 289, p. 34. Decision available <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2006:289:0034:0035:EN:PDF>

<sup>67</sup> Decision of the EEA Joint Committee No 84/2003 (OJ No L 257, 9.10.2003, p. 41) and Decision of the EEA Joint Committee No 16/2009 (OJ No L 73, 19.3.2009, p. 54).

<sup>68</sup> On Icelandic consumer law see Ása Ólafsdóttir and Eiríkur Jónsson, *Staða neytendamála á Íslandi*, Skýrsla Lagastofnunar HÍ, Apríl 2008, 141-240 and *Neytendaréttur*, Codex, Reykjavík, 2009.

<sup>69</sup> In Case E-1/05 EFTA Surveillance Authority v Norway (Case E-1/05 EFTA Surveillance Authority v the Kingdom of Norway, 2005 EFTA Court Report, 234) the Court had to assess the question of whether a requirement in Norwegian law to the effect that costs which accrue when life assurance contracts are entered into have to be charged and paid no later than the date when the first premium payment is due, was in conformity with Article 33 of Directive 2002/83/EC.

### 3.1 Application of Directive 93/13/EC in Iceland

Directive 93/13/EC is a part of the EEA Agreement. According to the Icelandic Government, Iceland has transposed Directive 93/12/EC with amendments made to Act No 7/1936, on Contracts, Agency and Void Legal Instruments.<sup>70</sup> The legislation is therefore fully transposed into Icelandic law.<sup>71</sup>

### 3.2 Application of Directive 2005/29/EC in Iceland

Directive 2005/29/EC on unfair commercial practices is a part of the EEA Agreement. Iceland has transposed Directive 2005/29/EC with Act No 57/2005, as amended, on Surveillance of Business Practices and Marketing. The legislation is therefore fully transposed into Icelandic law.<sup>72</sup>

### 3.3 Application of Recommendation 2001/193/EC in Iceland

Regarding the pre-contractual information to be given to consumers by lenders offering home loans, the Commission Recommendation 2001/193/EC has also been incorporated into the EEA Agreement. As Iceland has declared to the European Commission, the Ministry of Trade and Commerce (later the Ministry of Business Affairs and now Ministry of Economic Affairs) introduced these principles to the relevant parties when this Act was incorporated in the EEA Agreement.<sup>73</sup>

### 3.4 The role of national judges in the interpretation of credit law related to house mortgages: financial law vs. consumer law?

As the body of general European consumer law is fully applicable in Iceland, one may ask what are the obligations for national judges when applying and interpreting consumer law. National judges must interpret national law as far as possible in the light of EEA law.<sup>74</sup> Their role is essential as the doctrine has already signalled the special context of European contract law where there is a shifting of power from legislators to judges and from a central European level to the national level.<sup>75</sup> In this context, the first reference for Icelandic judges dealing with foreign currency mortgages and/or mortgages linked to foreign currencies should be EU/EEA consumer law which is a strong component of the European legal order and a fundamental policy in the internal market. European consumer law has been incorporated to Iceland. General consumer law cannot therefore be ignored while solving mortgage credit disputes. A misunderstanding must be avoided. The fact that there is no specific European legislation means that the topic or policy remains at national level, not that consumers do not deserve legal protection of their economic interests when contracting house mortgages. The mandate given by European law to protect

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<sup>70</sup> A Report from the EFTA Surveillance Authority on the application of the Directive 93/13/EEC in the EFTA countries described the implementation of Directive 93/13/EEC in the Icelandic, Norwegian and Liechtenstein legal orders as it was in 2001. EFTA Surveillance Authority. Report adopted on 6.12.2001 available at <http://www.eftasurv.int/information/reportsdocuments/otherreports/dbafile5726.pdf>

<sup>71</sup> *Log um samningsgerð, umboð og ogilda löggæringa (Samningalög) nr. 7/1936 breytt með lögum nr. 11/1986 og nr. 14/1995* (Law on Making of Contracts, Agency or Mandate and Void Agreements (Contracts Law) No. 7/1936 as amended by Law No. 11/1986 and No. 14/1995). See <http://eng.efnahagsraduneyti.is/laws-and-regulations//nr/2972>

Note that this is a translation of the original Act that does not include the latest amendments adopted by Act 98/2009 that took effect on 1 January 2010.

<sup>72</sup> We must also take note that Directive 2006/114/EEC on misleading and comparative advertising is a part of the EEA Agreement. Iceland has transposed Directive 2006/114/EEC with Act No 57/2005 on Surveillance of Business Practices and Marketing, with subsequent amendments. The legislation is therefore also fully transposed into Icelandic law.

<sup>73</sup> Reply to the questionnaire sent by Iceland to the European Commission available at the website [http://evropa.utanrikisraduneyti.is/media/esb\\_svor/28%20-%20Consumer%20and%20Health%20Protection/Chapter%2028%20-%20final.pdf](http://evropa.utanrikisraduneyti.is/media/esb_svor/28%20-%20Consumer%20and%20Health%20Protection/Chapter%2028%20-%20final.pdf)

<sup>74</sup> It is principle both in EEA law and in Icelandic law that national courts must interpret national law as far as possible in the light of EEA law. See EFTA Court, Case E-1/07 *Criminal proceedings against A*, 2007 EFTA Court Report, 245 and M. Elvira Méndez-Pinedo, *EC and EEA Law: A comparative study of the effectiveness of European law*, Europa Law Publishing, 2009. See also Hæstiréttur Íslands. Icelandic Supreme Court judgment in case Nr. 169/1998 *Fagín ehf. gegn byggingarnefnd Borgarhótsledda íslerska nálinu Reykjavíkurborg og Mosfellsbæ* of 18 November 1999.

<sup>75</sup> Judge Edward, D., "The EC Contract Law Context", in Grundmann, S. And Mazeaud, D. (eds), *General Clauses and Standards in European Contract Law*, Kluwer Law International, 2006, pp. 77-84.

consumers in the internal market – while ensuring a minimum harmonisation for certain issues - applies both to legislative and judicial powers. While this article focuses on the principles of European law applicable to the solution of disputes currently waiting before the national courts it is obvious that the role of the national legislators is also essential for the amelioration of consumer protection law in Europe.

When disputes arise between banks/financial institutions and consumers, it is consumer law that applies neither financial nor commercial law. According to EU and EEA law, consumers are expected to behave normally and have a standard knowledge of the financial services. Detailed consumer protection and diverse set of legislative instruments have been developed in EU countries in the field of financial services as a certain degree of caution is necessary and a strong consumer protection is advisable. The minimum protection afforded by the European legal order can never be ignored; this would be a violation of the EEA Agreement. Notwithstanding the different national provisions of contract law in the EU/EEA Member States in the lack of harmonisation at European level; consumer law and contract law should be applied complementarily. EU-EEA/Icelandic consumer law must deploy all its effects for all cases pending before the courts.

Jurisprudence from the ECJ and the EFTA Court is not directly related to the Icelandic cases of foreign currency mortgages but their case-law confirms that the protection of consumers is essential in the internal market and that that Member States can adopt more protective measures of consumers based on public policy considerations as consumer protection is an essential pillar of economic law and society. In the presence of business-to-consumers transactions, consumer law cannot be pre-empted by financial or business law. While the principle of minimum harmonisation remains the general rule in EU-EEA law, Iceland could even decide to protect consumers with a higher standard. The principle of proportionality is essential to determine how far the national legislation can go to regulate mortgage markets and how consumers are to be protected when contracting house loans.

#### 4. Conclusions

We can therefore reply to the research questions asked at the beginning of this study in the following way. The protection of consumers with foreign currency mortgages/ mortgages linked to foreign currencies in the aftermath of the financial crisis is assured in general by principles harmonised at European level but is properly articulated specifically at a national level. Both general principles and specific national provisions are important and must complement each other.

Consumers in Iceland enjoy protection given by general European consumer law. General principles of European consumer and financial services law are applicable to these contracts and clauses and have been harmonised by Directive 93/13/EC on unfair commercial terms and Directive 2005/29/EC on unfair commercial practices. Recommendation 2001/93/EC on pre-contractual information to be given to consumers by lenders offering home loans is also applicable although non obligatory. This *acquis communautaire* is fully applicable in Iceland.

It is difficult to assess at this stage whether a specific body of European consumer credit law will be specifically adopted in the short-term to deal with financial services and mortgage credits on immovable property in view of the complexities of the area. While a European approach is discussed at EU level, general principles of EU/EEA consumer law and national consumer law remain fully in force and cannot be excluded. Exemptions regarding house mortgage credit must be explicit and interpreted strictly in order not to frustrate the protective ambit of EU consumer law.

National judges have an essential role in the application and interpretation of both European and national consumer law. The consequences of the nullity of illegal price-indexation clauses belong to the sphere of national law and fall mainly on national courts. European rules on consumer protection are mandatory and cannot be waived. The standard of consumer protection given by European legislation is a minimum than can only be ameliorated by EU/EEA Member States. National courts must interpret domestic legislation as far as possible in the light of European law.

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