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Court of Justice of the EU to consider whether sale of consumer debt portfolio contravenes unfair contract terms rules

*Banco Santander SA v. Demba & Bonet
Cortés v. Banco de Sabadell SA
Cases C-96/16 and C-94/17*

Article by David Bowden

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Executive speed read summary

In 2017 consumer debt portfolios with a value of around £35billion were traded in the UK alone. The value of the market in the EU is €100billion. However there are now question marks about whether the trading in the underlying consumer loan agreements contravenes the EU rules on unfair contract terms or not. On 10 January 2018 the Court of Justice of the European Union in Luxembourg will hear arguments in 2 separate cases that have been referred to it from Spain. The first case (*Cortés*) has been referred by Spain's highest court. It has asked the 5th chamber of the CJEU to rule as to whether a default rate of interest of 2% above the annual ordinary interest rate is unfair or not. If such a rate is judged unfair, the court is asked whether no interest is due or whether a lender can recover statutory interest instead. However all eyes are on the other case which has zoomed straight up from a 1st instance court in Barcelona to Europe's highest court. In *Demba & Bonet* there is an all-out attack on the validity of debt sales. There the CJEU is asked whether the business practice of assigning or buying debts without offering the consumer the opportunity to extinguish his debt first contravenes the EU's unfair contract rules or not. The CJEU is also asked whether the business practice of buying a consumer's debt for a negligible price without his consent or knowledge is compatible with the Unfair Contract Terms Directive. After the hearing an opinion will be prepared by one of the court's Advocate Generals. This will be published in due course. At a later date the 5th Chamber will issue its judgment saying whether it agrees with this opinion or not. These cases will then be sent back to Spain. A ruling from the CJEU is final and there is no appeal. An adverse ruling on these unfair contract terms issues could have severe consequences for the UK's debt sale market.

Banco Santander SA v. Mahamdou Demba & Mercedes Godoy Bonet
Case C-96/16

Rafael Ramon Exocbedo Cortés v. Banco de Sabadell SA
Case C-94/17 10 January 2018

Court of Justice of the European Union, 5th Chamber (Judges José Luís da Cruz Vilaça, Egils Levits, Anthony Borg Barthet, Maria Berger and François Biltgen)

How big is the market for debt sales in the EU?

According to a report published by KPMG in February 2016 there had been debt sales in 2015 of more than €100billion by value. Of this market, 37% of this was in the UK alone.

Where do these cases come from?

Both of these cases come from Spain but from opposite ends of the court spectrum. *Demba & Bonet* has been referred from a 1st instance court in Barcelona (broadly equivalent to an English county court). *Cortés* has been referred from the Spanish Supreme Court (of equivalent level to the UK Supreme Court).

What is the hearing on 10 January 2018?

The 2 cases have been ordered to be heard together. Both lenders have submitted their written arguments as have both sets of consumers. The European Commission and the Spanish Government has also put in their written arguments. Each party will have an opportunity to address the court for around 30 minutes or so. At the end of oral submissions, judges will ask questions to the advocates.

What will happen after the hearing?

If the case is straightforward, then the 5th Chamber may decide to proceed straight to judgment. If this is the case a written judgment will be prepared to be handed down at a later date. What is more likely to happen is that one of the court's Advocate-Generals will be tasked with preparing a written opinion which will be handed down in open court at a later date. After the delivery of this opinion, the 5th chamber will deliberate, decide whether they agree with their Advocate General and then prepare a judgement they are all agreed on. This is usually a watered down version of the AG's opinion. What we have seen recently is that neither an Advocate General nor the court wanting to answer referred questions individually. Often a combined answer is given or a decision is taken that it is unnecessary to answer some questions. The 5th chamber judgment will be handed down in open court at a later date. It is likely that this process will be completed by the end of 2018.

What are the referred questions in *Demba & Bonet*?

There are 4 questions. In plain English these are as follows:

- Does the business practice of assigning or buying debts without offering the consumer the opportunity to extinguish the debt (by paying the price, interest, expenses and costs of the proceedings to the assignee) comply with these provisions of EU law:

- Article 38 of the Charter of Fundamental Rights of the EU,
- Article 2C of the Lisbon Treaty, and
- Articles 4(2), 12 and 169(1) of the Treaty on the Functioning of the EU?
- Is the business practice of buying a consumer's debt for a negligible price without his consent or knowledge compatible with the principles laid down in the Unfair Contract Terms Directive (UTCD) **93/13/EEC** particularly Articles 3(1) and 7(1)?
- For the purpose of safeguarding the protection of consumers, is it in accordance with the UTCD, to establish as an unequivocal criterion that in unsecured consumer loan agreements, a non-negotiated term which sets a default interest rate that exceeds by more than 2% the basic contract rate of interest is unfair?
- Is it in accordance with the UTCD that ordinary interest will continue to accrue until the debt has been paid in full?

What are the referred questions in Cortés?

There are 2 questions (with a 3rd question only arising if the 2nd question is answered 'No'). In plain English these are as follows:

- Do Articles 3 and 4 of the UTCD prevent a judicial interpretation that declares that a term in a loan agreement setting a rate of default interest that exceeds by more than 2% the annual ordinary interest rate fixed in the agreement constitutes disproportionately high compensation on the a late paying consumer and is it therefore unfair?
- Do Articles 3, 4(1), 6(1) and 7(1) of the UTCD prevent a judicial interpretation which (when a term in a loan agreement that sets the rate of default interest is declared unfair) identifies as the 'unfairness' the fact that that rate exceeds the ordinary interest rate, on the grounds that it constitutes '*disproportionately high compensation*' and establishes in consequence that that additional charge must cease to apply, so that only ordinary interest continues to accrue until the loan has been repaid?
- If the answer to this is 2nd question is 'no', must a declaration that a term setting a rate of default interest is void have other effects in order to be compatible with the UTCD? For example, the total elimination of both ordinary and default interest when the borrower fails make the loan repayments on time? Or can statutory interest be charged instead?

What is the UK Government doing to protect the interests of the UK economy?

As is the practice of the CJEU, details of all new cases lodged with it from any EU member state are sent to the UK Government. However, the UK rarely seems to intervene to make written submissions when a case from another member state could have damaging consequences for the UK or its economy. The UK has become even more apathetic since the Brexit vote. Similarly, there is often a delay in translating documents into English as the working language of the CJEU is French. Many of the consumer law cases have come from Spain and some of the judgements are only available in Spanish and French.

What does the EU unfair contract terms directive say that is relevant?

These are the provisions of the UTCD that are referred to in the referred questions.

- **'Article 3** 1. A contractual term which has not been *individually negotiated shall be regarded as unfair if, contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations arising under the contract, to the detriment of the consumer.*
2. *A term shall always be regarded as not individually negotiated where it has been drafted in advance and the consumer has therefore not been able to influence the substance of the term, particularly in the context of a pre-formulated standard contract. The fact that certain aspects of a term or one specific term have been individually negotiated shall not exclude the application of this Article to the rest of a contract if an overall assessment of the contract indicates that it is nevertheless a pre-formulated standard contract. Where any seller or supplier claims that a standard term has been individually negotiated, the burden of proof in this respect shall be incumbent on him.*
3. *The Annex shall contain an indicative and non-exhaustive list of the terms which may be regarded as unfair.*
- **Article 4** 1. *Without prejudice to Article 7, the unfairness of a contractual term shall be assessed, taking into account the nature of the goods or services for which the contract was concluded and by referring, at the time of conclusion of the contract, to all the circumstances attending the conclusion of the contract and to all the other terms of the contract or of another contract on which it is dependent.*
2. *Assessment of the unfair nature of the terms shall relate neither to the definition of the main subject matter of the contract nor to the adequacy of the price and remuneration, on the one hand, as against the services or goods supplied in exchange, on the other, in so far as these terms are in plain intelligible language.*
- **Article 6** 1. *Member States shall lay down that unfair terms used in a contract concluded with a consumer by a seller or supplier shall, as provided for under their national law, not be binding on the consumer and that the contract shall continue to bind the parties upon those terms if it is capable of continuing in existence without the unfair terms.*

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- **Article 7** 1. Member States shall ensure that, in the interests of consumers and of competitors, adequate and effective means exist to prevent the continued use of unfair terms in contracts concluded with consumers by sellers or suppliers.
- **Annex** Terms Referred to in Article 3(3)
1. Terms which have the object or effect of:....
(e) requiring any consumer who fails to fulfil his obligation to pay a disproportionately high sum in compensation'

What else has the CJEU ruled recently in consumer finance or mortgage contracts?

In 2016-17 we saw these 4 rulings amongst others:

- **Ruxandra Paula Andriciu v. Banca Românească SA C-186/16**
Article 4(2) of the UTCD had to be interpreted as meaning that the requirement that a contractual term had to be drafted in 'plain intelligible language' required for loan agreements that financial institutions provide borrowers with sufficient information to enable them to take prudent and well-informed decisions. Article 3(1) of the UCTD had to be interpreted as meaning that the assessment of the unfairness of a contractual term had to be made by reference to the time of conclusion of the contract taking account all of the circumstances which could have been known to the supplier at that time and which were such as to affect the future performance of that contract.
- **Banco Santander SA v. Cristobalina Sánchez López C-598/15**
Articles 6(1) and 7(1) of the UTCD did not apply to extra judicial proceedings brought by a successful bidder in an auction of real property following enforcement of a mortgage granted over that property by a consumer to a creditor acting in the course of trade. It is within the course of a mortgage enforcement procedure that a court seised could have carried out a review of the potential unfairness of terms stipulated in the mortgage loan agreement. However the consumer had not availed herself of the legal remedies provided at the appropriate time.
- **Finanmadrid EFC SA v. Zambrano, Zapata and Merino Case C-49/14**
Where a court order for payment proceedings had been closed without it being possible for there to be a check as to whether there were unfair terms in the underlying contract concluded between a supplier and a consumer, the consumer could be faced with an enforcement order without having had the benefit, at anytime during the court proceedings, of a guarantee that such an assessment would be made. Such a procedural arrangement was liable to undermine the effectiveness of the protection intended by the UTCD.
- **Ernst Radlinger & Helena Radlingerová v. Finway AS Case C 377/14**
National courts must apply the provisions of the UTCD by virtue of their office (even where a consumer does not raise issues under them) because a consumer is in a weak position as regards his bargaining power and level of knowledge. The phrase '*effective means*' under Article 7(1) of the UTCD must include provisions in national law enabling consumers to be guaranteed effective judicial protection by (a) making it possible for them to bring legal proceedings in relation to the disputed loan agreement in insolvency proceedings, (b) under reasonable procedural conditions, and (c) not subject to particular time limits or costs which make it excessively difficult or impossible for consumers to exercise their UTCD rights. The UTCD must be interpreted as meaning that in order to assess whether the amount of compensation required to be paid by a consumer who does not fulfil his obligations is '*disproportionately high*' it is necessary to evaluate the cumulative effect of all the penalty clauses in the disputed contract. This is so regardless of whether a creditor actually insists on enforcing them. If necessary national courts must under article 6(1) of the UTCD establish all the consequences of a finding that certain terms are unfair and then exclude all terms found to be unfair (rather than merely some of them) in order to ensure that the consumer is not bound by them

What will happen after the CJEU has given its judgement?

The cases will be sent back to the Spanish courts for them to apply its ruling. The CJEU does not rule on costs in the proceedings. From *Demba & Bonet* there may also be further appeals through the Spanish court system.

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