STUDIES AND COMMENTS

Iceland, the EFTA Court and the indexation of credit to inflation: operating in nature ex-post but need to calculate and disclose ex-ante. A law of contradiction?

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Abstract

Indexation of credit to inflation (ex-post) is a unique legal practice in Iceland based on valorism theory on money vs. nominalism. Two rulings issued in 2014 by the EFTA Court try to clarify the legality and fairness of this particular price-variation clause under the European Economic Area consumer credit acquis. The study summarizes the rulings and analyses critically the interpretation provided by the court. It argues that the judgements defy the logic of non-contradiction since indexation of credit proves to be an impossible oxymoron under EU/EEA law. The results are confusing. On one hand, cost of credit and usury practices tend to fall outside the scope of European harmonisation (provided disclosure obligation of cost of credit and transparency ex-ante are respected). A fairness control is thus dependent on national and case circumstances to be assessed by domestic courts. On the other hand, European rules also impose with no derogations that the cost of indexation of credit to inflation is disclosed in a transparent way and calculated ex-ante. The paradox is there. Since indexation of credit operates ex-post on the basis of real inflation, it is impossible to disclose ex-ante in a transparent way. The findings of the study help to understand the situation of impasse in Iceland. Without a clear interpretation from the EFTA Court, the saga has continued at national level and will probably head for a second round of assessment at European level.

Keywords: *EFTA Court; Iceland; indexation of credit; fairness; information and transparency; consumer protection.*

JEL Classification: K33, K41

1. Introduction

The EFTA Court issued in 2014 two important judgments in the field of European consumer protection and credit which are probably difficult to understand in Europe since they deal with a specific Icelandic problem. The cases *Engilbertsson/Íslandsbanki*[2] and *Gunnarsson/Landsbanki*[3] refer to the

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[2] Case C-25/13 *Gunnar V. Engilbertsson and Íslandsbanki hf.* [2014] EFTA Court Reports, not yet reported (nyr.). Judgment of the EFTA Court of 28 August 2014.

[3] Case C-27/13 *Sævar Jón Gunnarsson and Landsbankinn hf*. [2014] EFTA Court Reports nyr. Judgment of the EFTA Court of 24 November 2014.

compatibility of inflation-indexed secured and unsecured loans (consumer credit and/or mortgage credit) with European Economic Area (EEA) law.

Indexation of credit is a novel issue in European law although it is related to price-variation clauses in consumer law. This indexation to real inflation ex-post (after the signature of credit contract) is a unique practice found in Iceland but also known in other countries of Latin America[4]. In the field of credit and financial services, Iceland is an exception to the general theory of debt adopted in Europe based on nominalism[5]. All EEA countries have adopted a nominalistic approach to credit and debt. When an obligation/debt keeps its nominal value, inflation erodes slowly the real value of debt (since it keeps its original nominated or face value while the salaries tend to follow inflation). In a context of inflation, nominalism and time help debtors and damages creditors. When creditors are financial professional institutions and debtors are consumers, nominalism and inflation tend to compensate the original imbalance of power and asymmetry of information and education that exists between contracting parties.

In Iceland the opposite occurs since credit is constructed on the basis of valorism theory. Inflation benefits creditors because the principal of the debt is directly linked/indexed to the general inflation index and thus keeps its real value or purchasing power over time. Indexation is thus a practice which operates ex-post, a sort of semi-automatic price-variation clause embedded in the contract which deploys its effect during the whole life of the credit and updates the principal, the interest and other charges on a regular basis. Indexation clauses seem to be standard terms; they are not individually negotiated (indexation of credit has been a "take it or leave it" situation for consumers). In practice, the loan agreement is articulated through a bond (financial instrument) that the consumer issues to the bank promising future payments and pledging guarantees. Empirical research done by consumer associations has proved that the method of calculation of cost of credit is never explicitly disclosed to consumers ex-ante, usually there is only a general referral to indexation to the consumer price index ("CPI") in the contract.

The financial sector has traditionally argued that there this indexation is not a choice but a necessity in Iceland due to the historic inflation[6] and a micro-

[4] Ásgeir Jónsson, Sigurður Jóhannesson, Valdimar Árman, Brice Benaben and Stefania Perrucci, *"Nauðsyn eða val? Verðtrygging, vextir og verðbolga*" ("Necessity or choice? Indexation, interest and inflation"), Report for the Association of Financial institutions SFF (Reykjavík, 2012) available on internet at <http://sff.is/sites/default/files/naudsyn_eda_val-verdtrygging_vextir_og_ verdbolga.pdf> (consulted last time in July 1, 2016). See Chapter 7 "Inflation Indexation and Housing Finance", at 171- 196 which presents a good summary of the problem in English with a history of indexation to indexation in Latin America for comparison purposes and final policy suggestions for Iceland. As the report shows, Chile has a similar system of indexing loans to the consumer price index (using a different currency called Unidad de Fomento UF).

[5] On the different theories of debt (nominalism vs. valorism) see Mann, *The legal aspect of money* (OUP, 1938 and 1992) and Kessler, "Book Review: Money in the Law" 40 *Columbia Law Review* 175 (1940) available on internet at <http://digitalcommons.law.yale.edu/fss_papers/2713> (consulted last time in July 1, 2016).

[6] Jónsson and others, op. cit. supra note 4.

currency. Consumer associations, on the contrary, have consistently argued to the legislative, executive and judicial powers that credit indexation is extremely prejudicial not only for consumers but also for the economy since it fuels, in fact, inflation[7].

The core of the disputes is whether indexation practices allowed by Icelandic legislation -as they have been implemented in Iceland during 2001-2013 comply with the requirements of European consumer credit law. From an academic perspective, the key question is whether loan indexation can pass or not the European legality and fairness tests that EEA consumer (credit) law requires.

The European legal framework for assessment is given by the EEA Agreement[8], the Annex XIX incorporating EU consumer legislation to the EEA legal order[9] and, in particular, the following secondary law: Directive 87/102/EEC on consumer credit[10] in force in Iceland at the time (from now on "1987 Consumer Credit Directive"), Directive 93/13 on unfair terms in consumer contracts[11] (from now on "1993 Unfair Terms Directive") and Directive 2005/29 on unfair commercial practices[12] (from now on "2005 Unfair Commercial Practices Directive").

The relevance of the interpretation could not be greater. The current judicial review on the legality and fairness of indexation of credit under EEA consumer law by the EFTA Court affects thousands of loan contracts and the majority of families in Iceland as well as the public sector (Housing Financing

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7 Mallet has argued that indexation of loans to the consumer price index (CPI) has failed to address the economic problem and consequences of the hyperinflation and has directly contributed to increase the inflation rate through creation of secondary monetary supply. She summarizes it as a "positive feedback loop within the banking system's monetary regulation". Mallet, "An Examination of the effect on the Icelandic Banking System of Verðtryggð Lán (Indexed-Linked Loans)", (2013) IIIM TECH REPORT IIIMTR 2013-01-001 (Icelandic Institute for Intelligent Machines), available at <www.iiim.is> (consulted last time in July 1, 2016).

8 The EEA Agreement extending the internal market to Iceland, Norway and Lichtenstein entered into force on 1 January 1994, see O.J. 1994 L 1, p. 3. It has never been formally amended since the update of all subsequent and relevant legislation is done through the inclusion of new EU/EEA acts into the annexes of the Agreement. There is a paralell Aagreement between the EFTA States on the establishment of a Surveillance Authority and a Court of Justice (ESA/EFTA Court Agreement) O.J. 1994 L 344, p. 3.

9 EU legislation on consumer protection is regularly incorporated to the Annex XIX of the EEA Agreement by the relevant decisions of the EFTA Joint Committee. Once incorporated to the EEA legal order, the Icelandic Parliament adopts it as national domestic law. The new database EEA-Lex allows to search all EU acts that have been incorporated into the EEA Agreement or are under consideration for future incorporation

10 Council Directive 87/102/EEC of 22 December 1986 for the approximation of the laws, regulations and administrative provisions of the Member States concerning consumer credit. O.J. 1987 L42, p. 48.

11 Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts. O.J. L 095, p. XX.

12 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. O.J. L 149, p. 29.

Fund)[13].

This study focuses on the advisory opinions given by the EFTA Court in 2014. The judgments are extremely important for society since the problems relating to indexation of credit in Iceland have been one the most important economic issues discussed in the country in the aftermath of the financial crisis during 2013 and 2014. During the economic crisis the working population feels insecure about their future as many people have been affected by the wage cuts, and uncertainty still remains concerning the retention of the work place. New risk groups whose incomes have undergone a significant decrease during the crisis, join those risk groups already in a crisis situation (the disabled, pensioners, in particular single pensioners, the long-term unemployed, single-parent families and families with many children, the homeless, ex-convicts). The population becomes increasingly more convinced that they can rely only on themselves or informal contacts and the state and policies implemented by the government cannot be trusted[14]. In fact, the promise to write-off/restructure the principal of household indexed-debt and to put an end to indexation brought to power the political party of the current Prime Minister in 2013 (coalition of Progressive Party with Independent Party). A national plan of household debt-relief (called "leiðrétting") was approved in 2014 and executed in 2015 where the principal of indexed mortgage loans was reduced taking into consideration the inflation after the crisis[15]. At the time being, the Parliament still has to discuss the promise to put an end to indexation of consumer/mortgage credit from 2016 onwards[16].

2. The facts and the questions referred

The case *Engilbertsson /Íslandsbanki*[17] refers to secured credit (guaranteed by mortgage lien on property). This individual took out three loans in 2005 and 2007 from *Íslandsbanki* in order to buy property in Reykjavík. As it is usual in Iceland, the loan contracts were framed as securities-backed bonds issued by the

[13] Empirical research done by consumer association *Samtök heimilanna* (SHH) (the Homes association) shows that, unfortunately, there are too many loan contracts in force (both secured and non-secured credit) where the information given on total cost of credit and the amount of the principal due are inaccurate and do not correspond with the factual payments that consumers are requested to pay on a regular basis.

[14] Signe Dobelniece, Tana Lace, *Global economic crisis in Latvia: social policy and individuals' responses*, 'Filosofija-Sociologija', 2012. Vol. 23, issue 2, p. 115.

[15] Information on the houseld debt relief programme executed in Iceland in 2014-2015 can be found in English at the website <http://eng.forsaetisraduneyti.is/debt-relief/> (consulted last time in July 1, 2016).

[16] Written reply of Prime Minister to MP Sigríður Ingibjörg Ingadóttir of 23 February 2015 available at http://www.althingi.is/thingstorf/thingmalalistar-eftir-thingum/ferill/?ltg=144&mnr=485 (consulted last time in July 1, 2016).

[17] EFTA Court, case C-25/13 *Gunnar V. Engilbertsson and Íslandsbanki hf.* [2014] EFTA Court Reports, not yet reported (nyr.). Judgment of the EFTA Court of 28 August 2014.

bank[18]. The loans disputed were linked to the Icelandic consumer price index (CPI) and the contract also included a provision on the review of the interest rates. The debtor stopped complying with financial obligations mid-2009 and enforcement actions were started for the execution of the bond resulting in an partial attachment on the Reykjavík real state property securing the loans. The dispute made it to the courts where the individual argued, inter alia, that the indexation practice/clause was an unfair contract term contrary to EEA law.

The second case *Gunnarsson/Landsbanki*[19] refers instead to non-secured credit (with personal guarantee). The individual took out a loan from *Landsbanki*nn. The bond /financial contract disputed contained standardised contractual terms prepared by the financial institution. One of them stated that the loan was linked to the consumer price index (CPI), with both indexation adjustments and a variable interest rate. The individual also signed a document annexed to the bond/contract with a descriptive list of future scheduled repayments of the loan. The announced cost of credit and calculations of interest rate and indexation cost were based on a 0% rate of inflation. This hypothesis did not correspond to the actual rate of inflation at the time nor with the inflation predicted by monetary authorities. The real inflation that Iceland experience later turned out to be considerably higher. As a result, the nominal cost of credit and the repayment of financial obligations turned out to be much higher than those announced and signed in the repayment schedule plan. The individual brought the case to the courts and argued, inter alia, that the indexation violated both EEA law and the national implementing legislation (on double grounds, unfair term and breach of information).

In both cases the banks rejected the claims on the basis of the legality of indexation of credit under Icelandic law and the fact that the loans complied prima facie with all legal requirements. Confronted with these arguments, the Reykjavík District Court requested the EFTA Court an assessment of the credit indexation practice allowed by Icelandic legislation with European consumer contract law. The EFTA Court delivered advisory opinions on the fairness and legality of indexation under the 1993 Unfair Terms Directive in the first case (*Engilbertsson /Íslandsbanki*); and under both the 1987 Consumer Credit Directive and 1993 Unfair Terms Directive in the second case (*Gunnarsson/Landsbanki*). It also replied to a question regarding the mandatory nature of the sanction prescribed by the European legislator for unfair terms (non-binding) in the EEA legal framework, a question already replied by the ECJ.

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[18] Arnar Kristinsson, "Framkvæmd verðtryggingar á skuldbindingum almennra fjárfesta og neytenda", (2012) Masters´ thesis under supervision of M. Elvira Mendez-Pinedo (University of Bifröst, Iceland).

[19] EFTA Court, case C-27/13 *Sævar Jón Gunnarsson and Landsbankinn hf*. [2014] EFTA Court Reports nyr. Judgment of the EFTA Court of 24 November 2014.

3. The EFTA Court´s advisory opinions

In the first case *Engilbertsson /Íslandsbanki*[20], the EFTA Court rules that indexation of mortgage loans is not generally prohibited as long as the practice respects the provisions set by the 1993 Unfair Terms Directive (as interpreted by the Court of Justice of the EU). While a general interpretation on consumer credit law concepts is given, most of the questions are sent back for final assessment to the national court. The Court does not provide guidance, on this occasion, on the interpretation of 1987 Consumer Credit Directive.

In a preliminary manner, the Court deals with the applicability of the Directive to the case (para. 79). The Court decides that it is for the national court to ascertain whether contractual terms on loan indexation such as the ones at issue, reflect mandatory statutory or regulatory provisions and, consequently, are exempted from the scope of the Directive (Article 1(2)). The limited scope is justified on the legitimate assumption that the national legislature has excluded unfair terms in consumer contracts – in substance- since the mandatory rules are supposed to strike a fair balance between the rights and obligations of the parties. The Court adds that, from the perspective of the consumer, it is therefore of particular importance that EEA States actually ensure that balance in all cases.

It is therefore for the national court to decide whether the 1993 Unfair Terms Directive is applicable to the case. If the reply was to be affirmative, the Court also states that that the question whether the indexation terms at issue are unfair, is a matter also to be assessed by the national court in the light of European consumer credit law and due interpretation of the concept of "unfair term".

Regarding the set of questions, the Court finds, in the first place, that the 1993 Unfair Terms Directive does not categorically prohibit a price-indexation clause in a mortgage loan agreement, such as the one challenged. In this sense, the Directive (Articles 3,4 and 5) only lays down general principles for the assessment of whether a particular contractual term is unfair. The final assessment is for the national court taking account of all circumstances of the case (para. 86).

In this regard, however, it notes that Article 3(3) of the Directive read together with point 2(d) of the Annex to the Directive, explicitly provides that price-indexation clauses do not, in and of themselves, amount to terms that may be regarded as unfair, where these clauses are lawful and the method by which prices vary is explicitly described (para. 97). However, on the other hand, it adds that clarity and quality of information are essential for the final assessment by the judge (para. 98).

The Directive does not limit the discretion of a EEA State to regulate a reference/base index but the method of calculation of price changes must be explicitly described in the contract (para. 110). Whether the indexation of the challenged bond to the base index was individually negotiated or not is a question to be finally determined by the national court (para. 121-122) although the Court

[20] Case C-25/13 supra note 1.

points that it looks like indexation was a standard term non individually negotiated and falling under the scope of the Directive (para. 125-126).

From a consumer´s perspective the most crucial part of the ruling refers to the requirement of an explicit and comprehensive description of the method of calculating price-changes in the contract (para. 140-146). While the national court must assess this taking into account its precise wording and all other relevant data circumstances as well as national legislation; the Court sets a clear rule. The financial institution is required to respect the obligation of information disclosure of all credit information ex-ante, pointing that it is of crucial importance for a consumer to obtain adequate information on a contract's terms and consequences before concluding it.

The Court adds that it is particularly the case if the parties agree on a price variation clause that leads automatically to adjustments of the principal of the debt, such as the indexation (para. 141). And the Court clearly rules in para. 142 that the contract must set in a transparent fashion a description of the indexation mechanism of the loan so that the consumer can foresee, on the basis of clear, intelligible criteria, the alterations that may occur to the principal of the loan. This obligation is not found to be satisfied by a mere reference in the contract to a national legislative act (para. 143). In this regard, the Court reasons that such a description must enable the consumer to make an informed choice before signing the contract (para. 144). It is on the basis of that information that the consumer decides to be bound or not by the terms previously drawn up by the seller or supplier (para. 144). It follows that the payment schedule must be disclosed as provisional and not definitive since financial obligations will change with price indexation (para. 145).

The Court also clarifies obligations for the national court. It finds that Article 6(1) of the Directive must be interpreted as meaning that, where a national court considers that a given term is unfair within the meaning of the Directive, that court must ensure that such a clause is not binding on the consumer provided that the contract is capable of continuing in existence without the unfair term, in so far as, in accordance with the rules of domestic law, such continuity of the contract is legally possible (para. 147).

In the second case C-27/13 *Gunnarsson/Landsbanki*[21], the EFTA Court answers a set of new and similar questions referred by the Reykjavík District Court concerning the interpretation of 1987 Consumer Credit Directive and the 1993 Unfair Terms Directive in relation with the indexation of a loan agreement. While the first directive is found to be applicable to the case (para. 61), the application of the second directive is for the national court to decide taking into account that indexation terms may reflect or not mandatory or regulatory provisions excluded from the scope of the Directive (para. 63). In this regards the Court refers to para. 66 to 79 of first case *Engilbertsson*.

[21] Case C-27/13 supra note 2.

The most important finding of the Court in this second case refers to the core question of calculation of the total cost of credit, the reference to inflation in the contract (para. 86-96) and its compatibility with EEA consumer credit law. The Court finds that the term "total cost of the credit" in the 1987 Consumer Credit Directive comprises all the cost that the consumer is liable to pay under the credit agreement, including both interest charges and any other charges resulting from the price indexation of the principal. In para. 92 it rules that an estimation or hypothesis of 0% rate of inflation indicated in a loan agreement, at a time when the actual rate of inflation was considerably higher, did not correctly represent the charges resulting from the price indexation and thus the total cost of credit for consumer.

Having said this, it rules that it is for the national court to assess, taking account of all the circumstances of the case, the legal consequences and the remedies for such incorrect information, provided that the level of protection established by the 1987 Consumer Credit Directive, as interpreted by the Court, is not thereby compromised (para. 96). Furthermore, the Court notes that a failure by a credit institution to provide the consumer with full information regarding the total cost of credit and annual percentage rate of charge specified in the Consumer Credit Directive may also qualify as an unfair business-to-consumer commercial practice under the 2005 Unfair Commercial Practices Directive. Once more, this will be an issue to be taken into account by the national court for the final assesment of the case at hand.

The five questions concerning the interpretation of the 1993 Unfair Terms Directive are in substance identical to the questions examined in case *Engilbertsson*. The Court finds that there is no reason to make a distinction between a mortgage credit, as in Engilbertsson, and a consumer credit loan, as in the present case (para. 97). Icelandic law, in fact, provides equal protection to both categories of consumers by extending the scope of the 1987 Consumer Credit Directive to mortgage credit, an issue dealt in case *Engilbertsson* where the Court rules that provisions borrowed from EEA law should be interpreted uniformly (para. 53-56).

4. The legal context

A short explanation on the legal context applicable to the disputes is necessary for the sake of clarity and understanding. Icelandic law deals with consumer protection under Act No 179/2000 amending Act No 121/1994 ("the Consumer Credit Act" now superseded by new Act No. 33/2013) and Act No 7/1936 ("the Contracts Act").

In the first place it is important to note that Act No. 121/1994 on Consumer Credit was in force at the time. This Act transposed the 1987 Consumer Credit Directive. The most recent Directive 2008/48/EU on consumer credit[22] (from now

[22] 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. O.J. 2008 L 133, p. 66.

on "2008 Consumer Credit Directive") was incorporated by the Icelandic Parliament by the most recent Act No 33/2013 on Consumer Credit but only entered into force on 1 November 2013. The EFTA Court rules on the basis of the legislation in force at the time (principle of legality obliges) and therefore the 2008 Directive on Consumer Credit is left aside.

In the second place, it must be added that the national legal framework reflects EEA consumer credit law but also encompasses some acts on interest and indexation. Indexation of savings and credit was first regulated in Iceland by Act No 13/1979 on Economic Policy. Chapter VI of Act No. 38/2001 on Interest and Indexation sets out the mandatory provisions currently in force in relation to all indexed savings and loans. Price indexation is allowed if it is based on the consumer price index ("CPI") as calculated by Statistics Iceland in accordance with legislation applicable to the index (Act No. 12/1995 on the CPI) and published monthly in the Legal Gazette. Furthermore, rules of the Central Bank No 492/2001 on Price Indexation of Savings and Loans require a minimum period of five years for the indexation of the principal of a loan (Art. 4.1 para.). Last but not least, Act No 14/1995 amending Act No 7/1936 on contracts, agency and void legal instruments has incorporated the 1993 Unfair Terms Directive adding four new articles to its Article 36.

In the third place, it must be remembered that while European law has not directly harmonised cost of credit *per se* and does not affect national contract law in general terms, it has nevertheless regulated this question in an indirect way. The European legislator has set obligations to calculate and disclose cost of credit in a certain transparent way through the 1987 and 2008 Consumer Credit Directives. European law has also introduced a general ban on abusive clauses for contracts and commercial practices through 1993 Unfair Terms Directive and 2005 Unfair Commercial Practices Directive. Consumer protection in the field of credit is articulated in the EU acquis through the following paradigm and framework: information disclosure legality requirements + fairness test[23].

In particular, European consumer credit directives provide for a set of information to be given to consumers in good time and in a comprehensible way before the credit contract agreement is concluded. The methodology to disclose ex-ante the cost of credit to consumers has been harmonized so that EU/EEA Member States have no margin for appreciation in this regard. In order to improve the comparability of different offers from financial services providers and to make the information clearer and better understandable, the pre-contractual information needs to be supplied in a standardised form (Standard European Consumer Credit Information). What is more important, consumer credit cost must be calculated through the Annual Percentage Rate of Charge (APRC), a single unique figure based on a common formula. Where a credit agreement allows for the variation of interest rates and this increases the cost of credit, a notice of a variation must be

[23] Mendez-Pinedo, "The Cost Of Credit In Iceland Under European Judicial Review: May Legality And Transparency Justify Unfairness?", 2 (2014) *Europarättslig Tidskrift* (ERT), 303-329.

provided to the consumer before the change takes effect. These provisions are similar in the 1987 and 2008 Consumer Credit Directives.

4.1 Indexation of credit to inflation. A unique practice and problem in Iceland that needed judicial interpretation

One of the core questions dealt by the EFTA Court is to determine whether indexation of credit to CPI (on the basis of valorism theory) can constitute or not a derogation from the European framework of consumer credit law (based on nominalism). The 1987 and 2008 Consumer Credit Directives do not regulate this sort of practice although a mention is done of price-variation clauses in the 1993 Unfair Terms Directive.

The question is a fresh novel one in the European legal order that had been impossible to resolve at national level during the incorporation of 2008 Consumer Credit Directive to the domestic legal order.[24] At the end, the Icelandic legislator adopted the Act No. 33/2013 on Consumer Credit and opted to allow indexation of credit provided it was done within the framework of Act No 38/2001 on interest and indexation and under the conditions set by 2008 Consumer Credit Directive (indexation must be transparent, calculated through APRC rules, and disclosed ex-ante). However, the legislative and executive powers acknowledged that the competence to clarify the legality and fairness of indexation of credit under EEA law was a difficult question of interpretation to be left to the national courts (and

[24] The Icelandic legislator tried to clarify this issue during 2013 without initial success. In order to help the legislator to reach a conclusion, a set of questions was sent by the author to the European Commission, EFTA Surveillance Authority (ESA) and the European Parliament with a view to assess the legality of indexation of credit. These institutions disagreed at the time on whether or not price-indexation (which increases de facto the cost of money as the principal is indexed to inflation ex-post) fell into the scope of harmonization as "cost of credit" or not. The Commission held that, no matter its denomination or construction, Article 3 of the 2008 Consumer Credit Directive was applicable. Consumers must pay the amount of credit given and the total cost of credit announced. In this construction, indexation would be cost of credit so it has to be calculated under the formula of annual effective rate of charge (APRC). The ESA, on the contrary, argued that price-indexation might not be cost of credit per se but some additional charge for money currently falling outside the scope of European harmonization. At any case, both institutions agreed that transparency and clarity of language for consumers were key factors. European disclosure information obligations concerning future indexation effects on the contract could not be set aside as consumers needed to assess ex ante their capacity to take on financial obligations. Letters from the European Commission to the author of 12.2.2013 and from the ESA to the author of 20.3.2013 can be requested to the author. The European Commission also replied in similar terms to SHH (The Homes Association of Iceland) in a letter of 15.2.2013. The replies only provide incidental comments on the fairness test as this is a question for judicial interpretation However, the European Commission stated very clearly that -when indexation was non transparent- it did not escape control of abuse under 1993 Unfair Terms Directive applicable to mortgage contracts. In its reply from 20.3.2013, on the other hand, the ESA acknowledged that transparency could not justify abusive or unfair terms.

eventually on the EFTA Court)[25].

4.2 EEA law. A parallel sui generis legal order constructed on homogeneity, reciprocity and effectiveness

European Economic Area (EEA) law is based on the EEA Agreement which entered into force on 1 January 1994 and brings together the 28 EU Member States and the three EEA EFTA States — Iceland, Liechtenstein and Norway — together under a unique and sui generis legal order with the internal market as a center of gravity[26]. The Agreement guarantees equal rights and obligations for citizens and economic operators in the EU/EEA[27].

There is a common substantive law (four freedoms and other policies) but there is a distinct institutional framework constructed around a two pillar system (EU – EFTA). This construction is explained by the political compromise agreed at the time and the impossibility to agree on a transfer of competences to a supranational organization[28]. The legal autonomy of EFTA countries was preserved at the prize of a lack of participation in the EU formal legislative procedure.

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[25] The relevant Committee of the Icelandic Parliament (*Efnahags- og viðskiptanefnd*) or Economic and Business Comittee) considered this question during October 2012 to February 2013. The author forwarded to the Parliament the replies from the European institutions and was called to a meeting to discuss this issue. Following this preliminary assessment, as well as research and legal opinions sent to the Parliament during the legislative process by the author and other parties, the doubts persisted. No institution nor individual could determine with final authority whether this solution was compatible with EEA consumer/credit law. Both the Economic and Business Comittee from the Parliament and the Committee on Consumer Protection on Financial Markets (nominated by the Prime Minister) expressed their concerns about the potential illegality of the indexation practice (as it had been traditionally constructed) under European law. See *Forsætisráðuneytið* (Prime Minister Office), *Neytendavernd á fjármálamarkaði* (Consumer protection in financial markets) (Reykjavík, 2013) at 7 and 61-62. Report available in Icelandic at <http://www.forsaetisraduneyti.is/media/Skyrslur/neytendavernd-a-fjarmalamarkadi.pdf> (consulted last time in July 1, 2016). All documents referring to the legislative adoption of Act No 33/2013 on Consumer Credit can be accessed (in Icelandic) at http://www.althingi.is/thingstorf/thingmalalistar-eftir-thingum/ferill/?ltg=141&mnr=220 (consulted last time in July 1, 2016).

[26] Substantive law falling under the scope of the EEA Agreement is basically similar as all relevant EU legislation covering the four freedoms in the internal market — the free movement of goods, services, persons and capital — is incorporated to the EEA legal order and is therefore applied throughout the 31 EEA States. In addition, the Agreement covers cooperation in other important areas such as research and development, education, social policy, the environment, consumer protection, tourism and culture, collectively known as "flanking and horizontal" policies. Since the crisis in 2008 Iceland benefits from a derogation on free movement of capital.

[27] The main general reference books for EEA law in English are as follows: Norberg, Hökborg, Johansson, Eliasson and Dedichen *The European Economic Area EEA Law. A Commentary on the EEA Agreement* (Kluwer, 1993); Blanchet, Piipponen, and Westman-Clément, The Agreement on the EEA. A guide to the free movement of goods and competition rules. Foreword by Jacques Delors (Oxford : Clarendon Press, 1994); and Stefán Már Stefánsson, The EEA Agreement and Its Adoption Into Icelandic Law (Scandinavian University Press,1997).

[28] The institutional framework is a two pillar construction based on the EU institutions, on one side, and EFTA institutions on the other, joining forces and becoming unique EEA institutions.

Judicial review and general surveillance/supervision are also organised on the basis of two pillars.[29]

Special mention also must be made of the issue of the legal effect of EEA law since the compromise to secure equal or comparable rights has to be assured, on the EFTA/EEA pillar, on the basis of international and/or domestic law. While EEA law is certainly a non-supranational legal order, it cannot be affirmed either that it is not unlike the EU in a certain way. Article 3 of EEA Treaty is binding regarding outcomes and/or effects in practice and establishes the duty of loyal cooperation[30]. The principle of the supremacy/primacy of EU becomes thus a "quasi-primacy" of EEA law expressed through Article 7 and Protocol 35 of the EEA Agreement. Two essential features of EU law cannot be extended automatically to EEA law, i.e. direct effect and direct applicability. Last but not least, the doctrine of State liability for infringements of EEA law derives directly from the EEA Agreement and was introduced by the jurisprudence of the EFTA Court (case *Erla María* adopting the same outcome of the ECJ *Francovich* doctrine[31]). The nature of EEA law is therefore a delicate issue that must be treated with caution.

Legislative and judicial homogeneity[32] are the main foundation of this European legal system strongly complemented by the principle of reciprocity between contracting parties. Together with common substantive rules, a similar application and interpretation of rules throughout the EEA is needed. The principles of homogeneity and reciprocity form a trio with the general doctrine of effectiveness of more recent appearance. In fact, the need to secure authority and effect to this European corpus –while respecting the national legal autonomy- has provided the EFTA Court with a strong argument to search for doctrines that can hold together this unique legal construction and fill up the gaps and silences of the EEA Agreement lacking in supranational character[33]. The effectiveness doctrine is

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[29] There is another agreement that provides for the establishment of the EFTA Surveillance Authority (with a role similar to the Commission but without any legislative/political power) and a Court of Justice with exclusive jurisdiction for the resolution of EEA disputes, the EFTA Court. See EFTA Court, *The EEA and the EFTA Court: Decentred Integration* (Hart Publishing, 2015).

[30] Article 3 EEA reads: The Contracting Parties shall take all appropiate measures, whether general or particular, to ensure fulfilment of the obligations arising out this Agreement. The shall abstain from any measure which could jeopardize the attainment of the objectives of this Agreement. Moreover, the shall facilitate cooperation within the framework of this Agreement.

[31] EFTA Court, case E-9/97, *Erla María Sveinbjörnsdóttir v. the Government of Iceland* [1998] EFTA Court Rep. 95 later confirmed in case E-4/01 *Karlsson* [2002] EFTA Court Rep. 240, para 32. See originally ECJ, Joined Cases C-6/90 and C-9/90 *Francovich* [1991] ECR I-5357.

[32] On the concept and scope of the judicial homogeneity, see Baudenbacher, "The EFTA Court and the ECJ – Coming in parts but winning together" in *The Court of Justice and the Construction of Europe: Analysis and Perspectives on Sixty years of Case Law* (TCM Springer/Asser Press, 2013),at 183. See also Frediksen, "One market, two courts: Legal pluralism vs. homogeneity in the European Economic Area", 79 *Nordic Journal of International Law* (2010), 481.

[33] Mendez-Pinedo, *The effectiveness of European law. A comparative study between EC and EEA law* (Europa Law Publishing, 2009) and Mendez-Pinedo and Hannesson, *The authority of European law. Exploring primacy of EU law and effect of EEA law from European and Icelandic perspectives*, (Law Institute, University of Iceland, 2012).

therefore of paramount importance to this legal order and is referred to quite often by the EFTA Court[34].

If it could be summarised in one sentence, one might say that the EEA guarantees one single internal market with two legal orders and a two-pillar system for the adoption/incorporation of EU legislation, supervision and judicial review (EU on one side and EFTA on the other side). Ideally, both legal orders function and coexist together peacefully for the benefit of private individuals and economic operators who are given comparable rights. In spite of its legal complexity, the general view since 1994 was that this scheme worked in practice surprisingly well. [35] However the tensions between national legal autonomy and obligations to provide similar effects to supranational legislation have always been there[36]. Some recent authors now refer openly to the need to critical revision of the EEA Agreement[37]. The even more acute democratic deficit of the legislative process/es designed 20 years ago is so far the most important flaw of the EEA legal system from a political perspective.[38] In spite of this critique what is for sure, in fact, is that the case-law of the EFTA Court provides occasionally the field of European law with novel and extremely relevant questions and judgements of a high moral authority[39].

5. Comment and analysis

5.1 Judicial review in the area of credit/mortgage law. The path set by the ECJ

In this context of judicial review, it is very important to remember some essential points already decided by the ECJ[40]. Taking into account the extensive case-law on credit/mortage law, what follows is a selection of most relevant points for the assessment of indexation of credit in Iceland under EEA law and the core issue of cost of credit.

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[34] See Dóra Guðmundsdóttir, case note on Case E-3/11 *Sigmarsson*, 49 CML Rev (2012), 2019 and more recently Burke and Hannesson, case note on Case E-26/13 *Gunnarsson*, 52 CML Rev (2015), 1119-1120.

[35] See Almestad, 'The Squaring of the Circle – The internal market and the EEA', in Johansson, Wahl and Bernitz, *Liber Amicorum in Honour of Sven Norberg* (Bruylant: Bruxelles, 2006)1-10, at 10.

[36] See in particular Graver, "Mission impossible: Supranationality and national legal autonomy in the EEA AGreement", 7 *European Foreign Affairs Review* (2000) 73-90, at 73.

[37] Franklin and Fredriksen, "Of Pragmatism and Principles: The EEA Agreement 20 Years On", 52 *Common Market Law Review* [2015] 629-684.

[38] See Müller-Graff and Mestad, *The rising complexity of European law* (BWV Verlag, 2014) at 135 for a critical analysis of the EEA Agreement from Norway.

[39] See Skúli Magnusson, "On the authority of advisory opinions", 3 *Europarättslig Tidskrift* (2010), 532-534.

[40] On the case-law of the ECJ see Schilling, "Inequality of bargaining power versus market for lemons: Legal paradigm change and the Court of Justice's jurisprudence on Directive 93/13 on unfair contract terms". 3 *European Law Review* (2008), 336-358.

5.1.1 On the review of unfairness and core terms excluded (price control)

European consumer law protects consumers through a double approach based on information/transparency and general fairness[41]. It protects consumers by ensuring market transparency (information paradigm). Judicial review on cost of credit is nevertheless eliptical since core terms on price do not fall in principle under EU harmonization. The European legislator has not regulated the core issue of cost of money, that is to say the interest rates and other charges that creditors may claim to provide capital to debtors through a private contract. Here we find a situation of national diversity with countries such as Italy and France capping interest rates and controlling usury by legislation and countries such as Spain, UK and Germany relying on the judicial control taking into account the context of the financial credit market[42]. The ECJ has respected in principle this parcel of national autonomy so that the substntive review of unfair terms (provided transparency is respected) is for national courts according to main rules of private law. While direct price control is excluded from a fairness review under 1993 Unfair Terms Directive as a core term, the Court has offered some guidance concerning the interpretation of European consumer credit law in relation to transparency. In this regard it can be said that there is a judicial review which frames indirectly the cost of credit but it consists mostly on a legality test under 1987 and 2008 Consumer Credit Directives and a transparency test under the 1993 Unfair Terms Directive.

The 1993 Directive provides for a double control over the fairness: a formal verification of unfairness (requirement of transparency) and a substantive test in the light of a general clause. Regarding transparency, the disclosure ex-ante of all essential financial information on credit seems to be a strong requirement both in law and in case-law. Article 5 requires that terms must always be drafted in plain, intelligible language. Consumers need to be informed of their future rights and obligations and be able to compare offers in the whole internal market. The failure to mention the real cost of credit ex-ante is found to be a breach of both 1993 Unfair Term and 1987 Consumer Credit Directives and this failure triggers sanctions under national law (*Pohotovost v. Korčkovská*[43]). On the other hand, the European substantive fairness test, however, is a general one. The Court has ruled

[41] Mendez-Pinedo, "The Cost Of Credit In Iceland Under European Judicial Review: May Legality And Transparency Justify Unfairness?", 2 (2014) *Europarättslig Tidskrift* (ERT), 313-315 on cost of credit and fairness review.

[42] Reifner, Udo and Schröder, Michael, Usury Laws: *A Legal and Economic Evaluation of Interest Rate Restrictions in the European Union* (BoD – Books on Demand, 2012). See also the Opinion of the European Social and Economic Committee on consumer protection and appropiate treatment of over-indebtedness to prevent social exclusion, INT/726, Brussels 29 April 2014, pp. 9-10.

[43] ECJ, case C-76/10 *Pohotovost' s.r.o. v Iveta Korčkovská* [2010] ECR I-11557.

that a clause is unfair "if it is not beneficial for consumers" (*Océano*[44]), providing thus a very open concept following the steps of the European legislator. The fairness test also extends to marketing, advertising or other business practices. Prohibition of unfair commercial practices is also applicable to public law bodies charged with a task of public interest since the protection of consumers prevails (and *BKK Mobil Oil*[45]).

Core terms relating to the main subject matter of the contract and/or the adequacy of the price and the remuneration provided are excluded by Article 4(2) of the 1993 Unfair Terms Directive. However, this rule has two qualifications. Assessment of substantial fairness is nevertheless allowed when they are not drafted in plain intelligible language[46]. Secondly, where the terms are unclear as to their meaning, the interpretation most favourable to consumer will prevail (the *contra proferentem* rule).[47]

The Court has ruled that "it is for the referring court to determine, having regard to the nature, general scheme and the stipulations of the loan agreement, and its legal and factual context, whether the term concerned constitutes an essential element of the debtor's obligations, consisting in the repayment of the amount made available by the lender" (*Kásler and Káslerné Rábai*[48] and *Matei*[49]). However, it has also added that this exclusion from substantive review is conditional to the drafting of core terms in plain intelligible language and must be strictly interpreted (*Kásler and Káslerné Rábai*[50]).

The Court searches a balance between the cost of credit and the general requirement of fairness. It has ruled that the exemption for core terms does not stretch without limit either regarding "price" and/or "remuneration". In principle, the exclusion provided under Article 4 (2) of the Directive is limited in scope and "concerns only the adequacy of the price or remuneration as against the services or goods supplied in exchange, that exclusion being explained by the fact that no legal scale or criterion exists that can provide a framework for, and guide, such a review" (*Kásler and Káslerné Rábai*[51] *and Matei*[52]).

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44 ECJ, joined cases Océano Grupo Editorial SA v Roció Murciano Quintero (C-240/98) and Salvat Edit*ores SA v José M. Sánchez Alcón Prades* (C-241/98), *José Luis Copano Badillo* (C-242/98), *Mohammed Berroane* (C-243/98) and *Emilio Viñas Feliú* (C-244/98) [2000] ECR I-4941.

45 ECJ, case C-59/12 *BKK Mobil Oil* [2013] nyr. Judgment of 3 October 2013, para 41.

46 Article 4(2) of the Directive; ECJ, Case C-484/08 *Caja de Ahorros y Monte de Piedad de Madrid v Asociación de Usuarios de Servicios Bancarios (Ausbanc)* [2010] ECR I-04785.

47 Article 5.This rule can only apply to terms whose meaning is unclear and can be interpreted in several different ways.

48 ECJ, case C-26/13 *Kásler and Káslerné Rábai* [2014] ECR nyr. Judgment of 30 April 2014, para. 49 to 51.

49 ECJ, case C-143/13 *Matei v. SC Volksbank România SA* [2015] nyr. Judgment of 26 February 2015, para. 54.

50 ECJ, case C-26/13 *Kásler and Káslerné Rábai* [2014] ECR nyr. Judgment of 30 April 2014, para. 42.

51 ECJ, case C-26/13 *Kásler and Káslerné Rábai* [2014] ECR nyr. Judgment of 30 April 2014, para. 54-55.

52 ECJ, case C-143/13 *Matei v. SC Volksbank România SA* [2015] nyr. Judgment of 26 February 2015, para. 55.

The requirement of transparency of contractual terms under the 1993 Unfair Terms Directive cannot be reduced merely to their being formally and grammatically intelligible. It is of fundamental importance, for the purpose of complying with the requirement of transparency, to determine whether the loan agreement sets out transparently the reasons for and the particularities of the mechanism for altering the interest rate and the relationship between that mechanism and the other terms relating to the lender's remuneration, so that the consumer can foresee, on the basis of clear, intelligible criteria, the economic consequences for him which derive from it (*Matei*[53]and *Kásler and Káslerné Rábai*[54]).

Last but not least the Court has finally clarified that there is not equivalence between the transparent and clear core terms excluded from fairness review and the total cost of credit to be disclosed to consumers ex-ante. It has ruled that the exact scope of 'main subject-matter' and 'price' within the meaning of Article 4(2) of 1993 Unfair Terms Directive (exempted from fairness review) cannot be determined by the concept of 'the total cost of the credit to the consumer' within the meaning of Article 3(g) of 2008 Consumer Credit Directive as article refers to disclosure information duties and is very broadly defined (*Matei* [55]). In a nutshell, while transparency and information are to be interpreted broadly, exemptions from fairness review are to be interpreted narrowly. The Court keeps therefore open the possibility in the future to rule on certain issues connected to the potential unfairness of some cost of credit clauses/terms.

This is a difficult balance between fairness and transparency. On one hand, the fairness test required by 1993 European Directive and interpreted by the ECJ has substantive limits justified by the legal diversity within EU Member States on core terms reflecting cost of credit. The ruling in case *Barclays*[56] shows what a fairness test/control cannot do for debtors affected by clear but unfair national rules or lack of rules on interest. On the other hand, the margin of appreciation for national judges, the national credit markets and context and the legal autonomy is recognized as long as the European framework on information under the 1987 and 2008 Consumer Credit Directive is respected (protection by information ex-ante of total cost of credit).

5.1.2 On legality and ex-ante transparent disclosure of cost of credit

While a general fairness test is weak, the legality test under the 1987 Consumer Credit Directive has allowed the European Court to reach further into

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[53] ECJ, case C-143/13 *Matei v. SC Volksbank România SA* [2015] nyr. Judgment of 26 February 2015, para 73-74.

[54] ECJ, case C-26/13 *Kásler and Káslerné Rábai* [2014] ECR nyr. Judgment of 30 April 2014, para. 69 and 71, para. 73).

[55] ECJ, case C-143/13 *Matei v. SC Volksbank România SA* [2015] ECR nyr. Judgment of 26 February 2015, para. 47.

[56] ECJ, case C-280/13 *Barclays Bank SA v Sara Sánchez García* [2015] ECR nyr. Judgment of 30 April 2015.

this field and provide more extensive consumer protection. The formal review of cost of credit is the result of an extensive European harmonisation on legal obligations of disclosure of future financial obligations. The first case *Pohotovost*[57] refers to the failure to mention the cost of credit (APRC or annual percentage rate of charge) in a consumer credit contract. A breach of European Directives is found. While the post-contractual regime, sanctions and legal actions still fall under national laws and there is a judicial discretion in this regard, the Court allows a national court to declare that the failure to mention the APR in a consumer credit contract means that the credit granted is deemed to be interest-free and free of charge. In the following case *Perenicova and Perenic v SOS*[58], the ECJ acknowledges the powers of the national judge to declare the total nullity of contract affected by unfair terms not properly disclosed. The Court resolves on the basis of both 1993 Consumer Credit Directive and 2005 Unfair Practices Directive[59].

Furthermore, in the case *Volksbank România SA*[60], the Court has clarified the full harmonisation character of the recent 2008 Consumer Credit Directive in relation with other questions of national consumer law. The issues of total cost disclosure and method of calculating cost of credit ex-ante fall inside the scope of the European maximum harmonization. EU/EEA Member States can only deviate on two cumulative conditions: if the problem falls outside the scope of the fully harmonised provisions of the Directive (i.e.: sanctions for infringement of informational duty provisions) and if the national legislation is intended to increase consumer protection.

5.1.3 On price-variation clauses

There is already a line of jurisprudence on this problem. In the first place, the Court has confirmed that price variation clauses are not prohibited by EU law in principle provided they are legal, on one hand; and transparent, clear and disclosed in plain intelligible language ex-ante, on the other. The case law of the Court reflects the drafting of point 2 (d) Annex to the 1993 Unfair Terms Directive.

In the second place, it has already clarified that reference to mandatory legislation does not guarantee an escape from the fairness test under the 1993

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[57] ECJ, case C-76/10 *Pohotovost'* [2010] ECR I-11557, para. 44. The Court rules that the Directive, by excluding them from its scope, regulates the "position" of national contractual rules and also puts them beyond the reach of general principles (of EU consumer law?), following the prevalence of *lex specialis*.

[58] ECJ, case C-453/10 *Pereničová and Perenič v SOS* [2012] ECR nyr. Judgment of 15 March 2012.

[59] It declares that "a commercial practice which consists in indicating in a credit agreement an annual percentage rate of charge lower than the real rate must be regarded as 'misleading' within the meaning of Article 6(1) of Directive 2005/29/EC [...] in so far as it causes or is likely to cause the average consumer to take a transactional decision that he would not have taken otherwise". The most important conclusion is that the national judge may decide that an unfair commercial practice is an indication of an unfair contract term (para. 43).

[60] ECJ, case 602/10 *Volksbank România SA SC* [2012] ECR nyr. Judgment of 12 July 2012, para. 22 (1).

Unfair Terms Directive as unilateral variations of prices and charges must still comply with good faith, balance and transparency (*RWE*[61]*)*. In the same line of argumentation, it has held that additional fees, other risk charges ex-post are not considered core terms excluded from the scope of European law fairness test. Terms relating to a mechanism for amending the prices of the services provided to the consumer (additional fees) are not excluded by Article 4(2) of 1993 Unfair Terms Directive (*Invitel*[62]). Terms including a 'risk charge' charged by the lender and authorising it, under certain conditions, to unilaterally alter the interest rate are not either exempted from fairness control (*Matei*[63]). Fairness and transparency go hand in hand in the case of price variations. In this regard, the Court has ruled that it is of fundamental importance that, in addition to having an effective right to terminate the contract, the consumer should be able to foresee, on the basis of clear, intelligible criteria what changes the supplier may make in exercise of the power of variation (*Invitel*[64] and later on *RWE*[65]).

In the third place, a case of price indexation is now pending before the ECJ. The Court will have to decide whether this this practice constitutes a modification or simple execution of a long time contract. In the case *Verein für Konsumenteninformation*[66], the Advocate General Cruz Villalón has already interpreted that a price indexation clause should not be seen as allowing a contractual modification- and thus should not be accompanied by the possibility for the consumer to terminate the contract if the said clause complies with requirements of foreseeability, transparency and legal certainty (para. 37) such as

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61 ECJ, case C-92/11 *RWE Vertrieb AG v Verbraucherzentrale Nordrhein-Westfalen eV* [2013] ECR nyr. Judgment of 21 March 2013.

62 ECJ, case C-472/10 *Invitel* [2012] ECR nyr. Judgment of 26 April 2012, para. 23.

63 ECJ, case C-143/13 *Matei v. SC Volksbank România SA* [2015] nyr. Judgment of 26 February 2015, para 78.

64 ECJ, case C-472/10 *Invitel* [2012] ECR nyr. Judgment of 26 April 2012, para. 23.

65 ECJ, in case 92/11 *RWE [2013]* ECR nyr. Judgment of 21 March 2013: "46. With respect to a standard term such as that at issue in the main proceedings which allows the supply undertaking to vary unilaterally the charge for the gas supply, it must be observed that .... the legislature recognized, in the context of contracts of indeterminate length such as contracts for the supply of gas, the existence of a legitimate interest of the supply undertaking in being able to alter the charge for its service." "47. A standard term which allows such a unilateral adjustment [of price] must, however, meet the requirements of good faith, balance and transparency laid down by those Directives" […] "49. ... the contract (must) set out in transparent fashion the reason for and method of the variation of the charges for the service to be provided, so that the consumer can foresee, on the basis of clear, intelligible criteria, the alterations that may be made to those charges..."[…] "53. Those strict requirements as to the information to be given to the consumer, both at the stage of the conclusion of a supply contract and during the performance of the contract, as regards the right of the supplier unilaterally to alter the terms of the contract, correspond to a balancing of the interests of the two parties. To the supplier's legitimate interest in guarding against a change of circumstances there corresponds the consumer's equally legitimate interest, first, in knowing and thus being able to foresee the consequences which such a change might in future have for him and, secondly, in having the data available in such a case to allow him to react most appropriately to his new situation ".

66 ECJ, case C-326/14 *Verein für Konsumenteninformation* pending. Opinion Advocate General Cruz Villalón of 9 July 2015.

to ensure that that it does not *in concreto* modify the contract, but rather uphold the original balance (para. 41). This requirement entails that the index used should be determined by a third, independent party on the basis of objective criteria (para. 42). As for the final assessment of compatibility with EU law of price-variation clauses, it is for national judges to decide whether a specific term fulfils the conditions above (para. 40 and 45). At the time of writing, it remains to be seen whether the ECJ follows the opinion of AG Cruz Villalón with a similar legal reasoning or whether it deviates from it.

5.1.4 On the consequences of unfairness, duties of national judges and procedural law

Judges have positive duties under European law towards individuals. National courts have the power to ascertain the unfairness of a standard term on their own motion, even if neither party demands it (*Océano*[67]). National law may not limit this power of the judge which stems directly from EU law (*Cofidis*[68]). The principle of effectiveness requires that the application of the protection which the 1993 Unfair Terms Directive seeks to confer on consumers is not impossible or excessively difficult in national judicial /mortgage enforcement proceedings (*Aziz*[69] and *Banco Popular Español* and *Banco de Valencia*[70]). The sanction for unfair terms under European law must be nullity *ex tunc* (*Garabito*)[71] as courts must declare the terms wholly unbinding. Judges may not weaken the dissuasive effect of the European rules by rewriting unfair terms (*Banco Español de Crédito*[72]). There is no national autonomy in this regard, if the terms or clauses are found unfair, invalidity may leed to the recalculation of past undue payments (*RWE*[73]).

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[67] ECJ, joined cases *Océano Grupo Editorial SA v Roció Murciano Quintero* (C-240/98) and *Salvat Editores SA v José M. Sánchez Alcón Prades* (C-241/98), *José Luis Copano Badillo* (C-242/98), *Mohammed Berroane* (C-243/98) and *Emilio Viñas Feliú* (C-244/98) [2000] ECR I-04941.

[68] ECJ, case C-473/00 *Cofidis* [2002] ECR I-10875. On the questions *ex officio* unfairness vs *audi alteram partem*, see also ECJ, case C-472/11 *Banif Plus Bank* [2013] ECR nyr. Judgment of 21 February 2013.

[69] ECJ, case C-415/11 *Aziz v. Catalunyacaixa*, [2013] ECR nyr. Judgment of 14 March 2013, see para. 63.

[70] ECJ, joined cases *Banco Popular Español SA v Maria Teodolinda Rivas Quichimbo and Wilmar Edgar Cun Pérez* (C-537/12) and *Banco de Valencia SA v Joaquín Valldeperas Tortosa and María Ángeles Miret Jaume* (C-116/13) [2013] ECR nyr. Judgment of 14 Nov. 2013.

[71] ECJ, case C- 488/11 *Asbeek Brusse and da Man Garabito v Jahani BV* [2013] ECR nyr. Judgment of 30 May 2013.

[72] ECJ, case C-618/10 *Banco Español de Crédito SA v Joaquín Calderón Camino* [2012] ECR nyr. Judgment of 14 June 2012.

[73] The case *RWE* gives way to a recalculation to all past bills in Germany, although the statute of limitation limited the claim to three years. ECJ, in case 92/11 *RWE [2013]* ECR nyr. Judgment of 21 March 2013.

5.1.5 A Court searching to strike the right balance between European consumer protection rules and national circumstances justifying diverse cost of credit

The review of the case-law already given by the ECJ lead to the following provisional conclusions. As stated above, the legality test on transparency and disclosure information duties is very strict. Consumers/debtors are strongly protected against lack of information, lack of clarity and lack of transparency. There is also a strong protection of their procedural rights at national level. On the other hand, the general fairness test is vague and even weak. There is no direct substantive control of fairness, for the time being, regarding core terms when they are transparent duly disclosed ex-ante. When transparency and information ex-ante are respected, the general theory of unfairness results in a concept left open for the interpretation of national courts. National autonomy is preserved for most important issues not directly covered by Directives: cost of credit, usury, over-indebtedness. Core (national) unfairness is still possible under EU consumer/credit law and shows the limits of European harmonization. There is not a right to fair credit cost, only a right to clarity. For the time being, arguments that the ECJ has used to challenge national procedural laws and increase consumer credit/mortgage rights (ie. *Aziz*[74] in Spain) are absent when the question revolves around the core issue of cost of credit allowed by national legislation (ie. *Barclays*[75]*)*. In spite of that limitation, the Court tries its best to offer as much protection to consumers as possible under the current framework.

5.2 Judicial review by the EFTA Court. Could the Court have ruled differently?

In this context, it is important to reflect on the conclusions reached by the EFTA Court on the indexation of credit in Iceland from both a fairness and legality perspectives in order to reply to a set of questions: 1) taking into account EU/EEA law... was a different outcome possible? 2) do the legal reasoning and questions asked and/or answered follow the jurisprudence of the ECJ? and 3) how far are consumers/debtors protected in the EEA legal order?

5.2.1 On core (national) unfairness and mandatory rules exempted from European control (case Engilbertsson /Íslandsbanki)

In this first case *Engilbertsson /Íslandsbanki*[76] the EFTA Court, on the one hand, acknowledges the framework created by EU/EEA law on consumer and eventually mortgage credit; but, on the other hand, it shows respect for national

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[74] ECJ, case C-415/11 *Aziz v. Catalunyacaixa*, [2013] ECR nyr. Judgment of 14 March 2013, see para. 63.

[75] ECJ, case C-280/13 *Barclays Bank SA v Sara Sánchez García* [2015] ECR nyr. Judgment of 30 April 2015.

[76] Case C-25/13 *Gunnar V. Engilbertsson and Íslandsbanki hf.* [2014] EFTA Court Reports, not yet reported (nyr.). Judgment of the EFTA Court of 28 August 2014.

rules that might fall outside of the scope of EU/EEA law harmonization. The goal of the Court is to strike a balance between the most effective protection of European consumer rights and the national autonomy still allowed in some parcels of consumer and mortgage credit, such as cost of money or other issues falling under Member States´ area of competences.

The logic and assessment is two-folded and articulated around the information and fairness paradigms. Lets look first to information disclosure. Here the Court tries to reach a Salomonic conclusion. While it rules that price-indexation of credit, per se, is not prohibited; it establishes that EEA law requests a general high standard of clarity and quality of information (para. 97-98). It does so by referring specifically to the Opinion of Advocate General Wahl in cases *Schulz and Egbringhoff*[77]) and requiring an explicit description of the method of calculation of price changes so that consumers can see alterations to the principal of the loan (para. 142). However, the final assessment on legality of disclosure of information is left for national courts, based on the circumstances of the specific case (para. 141-146).

We learn other things from the opinion. It seems to be clear for the Court that opaque changes of cost of credit done carried out by creditors unilaterally ex-post are illegal in EU/EEA law (although it is not directly said), that price-indexation clauses tend to be standard terms (not individually negotiated) and that sanction for unfair terms is mandatory invalidity under the 1993 Unfair Terms Directive. However, on the information disclosure test, the Court offers just a general conclusion but leaves too many questions aside: how this extensive information obligation should be fulfilled in the contract by creditors? what standard and model is needed to disclose the method of calculation and the cost formulas? The Court does not refer to the requirements set by the 1987 Consumer Credit Directive (obligation to disclose the total amount and cost of credit ex-ante and strict rules on annual percentage rate of charge or APRC). It simply sets it aside saying on the grounds that there is another case pending and that a second or even third question for interpretation can always be requested if necessary by the national judge. Needless to say, this fragmentation of European consumer credit law is not very convincing. The exclusion of the most important Directive regulating extensively the requirements of disclosure of cost of credit ex-ante (in force until 1 November 2013 in Iceland) is not justified on the sake of judicial interpretation.

However, the most important conclusions of the opinion for Icelandic consumers are those referring to the (national) unfairness alleged and the exclusion of mandatory rules from European control. Here the Court leaves the two core questions to the national courts that will have to rule whether price indexation practices are 1) protected as national mandatory/regulatory law and excluded from European harmonisation and 2) unfair or not in view of context and circumstances (para. 67).

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[77] ECJ, Opinion of Advocate General of 8 May 2014 in joined cases C-359/11 and C-400/11 *Schulz and Egbringho*ff [2014] ECR nyr, point 53.

The legal reasoning followed by the Court reflects the arguments of the parties in the dispute. It looks at the European framework of fairness constructed by the 1993 Unfair Terms Directive in order to determine that the scope of European harmonization does not reach core (national) unfairness and mandatory domestic rules on credit (presumption of national parliaments protecting consumer rights). On the basis of this argument it concludes that these issues are to be assessed at national level by domestic courts. The national autonomy is preserved and the margin of discretion that national judges have in this regard to be exercised taking into account a legal, economic and political context as well as case circumstances. In a nutshell, it is for Icelandic courts to decide whether indexation of credit is exempted from control under 1993 Unfair Terms Directive as mandatory law and, if not exempted, whether indexation is unfair taking into account the credit market in Iceland. The assessment will be done on the basis of national law.

The EFTA Court in this ruling does not seem to think that European law limits indirectly or elliptically the cost of credit. A parallel is therefore evident between this case and case *Barclays*[78] from the ECJ which is only mentioned by the EFTA Court concerning the competences of national judges for assessing fairness (para. 162).

Can the cost of credit in Iceland better controlled at national level? In this sense, it is important to remember that the Iceland legislator decided that to expand the scope the Directive (Article 4.2) and offer better protection concerning "core terms" (main object of a credit contract). Icelandic Act No. 7/1936 allows the judges to assess the relationship between the price and the service or goods in order to determine the unfair nature of clearly worded contractual terms[79]. As in other European countries, the cost of credit in Iceland is not therefore a "core term" excluded from national judicial control on fairness. The EFTA Court does not mention this issue so a guidance to national courts on this point is missing. A better explanation of the case *RWE*[80] and a reference to case *Kásler and Káslerné Rábai*[81] on "core terms" would have been very useful in this regard.

Trusting national judges to assess domestic fairness/unfairness of cost of credit seems, in principle, like a good conclusion taking into account that this is what the European legislator chose to do. But some questions remain open and unanswered: what happens if the national legislation fails to offer adequate protection to consumers against exorbitant cost of credit? Or if mandatory provisions are simply unfair in a new economic context? Or if national judges avoid to assess cost of credit in spite of their competence to do so under domestic

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[78] ECJ, case C-280/13 *Barclays Bank SA v Sara Sánchez García* [2015] ECR nyr. Judgment of 30 April 2015.

[79] *Forsætisráðuneytið* (Prime Minister Office), *Neytendavernd á fjármálamarkaði* (Consumer protection in financial markets) (Reykjavík, 2013) p. 55.

[80] ECJ, case C-92/11 *RWE Vertrieb AG v Verbraucherzentrale Nordrhein-Westfalen eV* [2013] ECR nyr. Judgment of 21 March 2013.

[81] ECJ, case C-26/13 *Kásler and Káslerné Rábai* [2014] ECR nyr, Judgment of 30 April 2014, para. 49 to 51.

law? Can European consumer credit law come to the rescue if the assumptions laid by European law are not complied with? These are difficult questions which reveal the limits of the European legal framework regarding substantive control of fairness.

Could the EFTA Court have ruled differently? Yes, here is a possible line of reasoning that might have been plausible to bring (national) unfairness and mandatory rules under the scope of EU/EEA law in some circumstances. In this sense, it can be argued that the European fairness test should also apply to both private and public practices anchored in domestic legislation in those cases when protection of consumers is not properly guaranteed at national level (ie. when cost of credit is not duly disclosed ex-ante according to European rules). Lack of consumer protection against unfair terms has allowed the ECJ to declare Spanish mortgage execution procedural law incompatible with the 1993 Unfair Terms Directive on three occasions, two of them after legislation was reformed (*Aziz*[82], *Sánchez Morcillo y Abril García v BANCO BILBAO*[83] and *BBVA SA v. Gabarro*[84]).

The main argument here is that the reference in the 1993 Unfair Terms Directive to mandatory provisions is essentially constructed on the assumption that the national legislator will adopt fair general measures intended to secure the economic interests of consumers. It is implicit for the European legislator that such measures will only improve but not deprive the persons affected of the rights secured by European legislation. This is consistent with the obligation for Member States to ensure that unfair terms are not included in the contracts. When the assumption no longer holds and is falsified by reality, the derogation for abusive terms anchored in national legislation should no longer exist.

A second important argument is that the ECJ has already established that the lack of European control and judicial review on "core terms" allowed by the 1993 Unfair Terms Directive only apply as long as cost of credit is perfectly transparent, clear, intelligible and disclosed ex-ante (*Kásler and Káslerné Rábai*[85]). Since indexation of credit in Iceland operates ex-post and is opaque, it qualifies as an unfair clause that national legislation cannot save alone.

This interpretation is supported by the fact that 2005 Unfair Commercial Practices Directive does not exclude mandatory law from its scope. It only allows an amelioration of consumer rights but not deterioration at national level[86].

The Court could have very well chosen that paid and said that –by allowing the use of unfair terms or abusive clauses in loan contracts (because of its opacity)–

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[82] ECJ, case C-415/11 Mohamed Aziz v. Catalunyacaixa [2013] ECR nyr. Judgment of 14 March 2013.

[83] ECJ, case C-169/14 *Sánchez Morcillo y Abril García v Banco Bilbao* [2014] ECR nyr. Judgment of 17 July 2014.

[84] ECJ, case C-8/14 *BBVA SA v. Gabarro* [2015] ECR nyr. Judgment of 29 October 2015.

[85] ECJ, case C-26/13 *Kásler and Káslerné Rábai* [2014] ECR nyr, Judgment of 30 April 2014, para. 42.

[86] Art. 3.9 states: "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 in the field which it approximates."

Icelandic legislation showed a deep misunderstanding of the main corpus of European consumer (credit) law impairing the core protection sought by the 1987 Consumer Credit Directive, the 1993 Unfair Terms Directive and 2005 Unfair Commercial Practices Directive. In this sense, at the end of the day what would count is the necessary protection of economic interests of consumers who are weaker and more vulnerable than credit institutions in the area of financial services and who need all information on cost of credit ex-ante, not the umbrella provided by domestic legislation.

The EFTA Court could have ruled in the following way.

European fairness test should also refer to unfair terms/commercial practices anchored in domestic legislation in some circumstances (particularly in cases where there is a violation of APCR rules under the 1987 Consumer Credit Directive, later Directive 2008/48/EU). The scope and limits of the exemption of fairness control for mandatory provisions of national law are not absolute but relative (conditional to the effective protection of consumers and to the requirement of transparency). The presumption of compatibility of national legislation with European consumer law may be subject to judicial review, both at national and European level. When substantial abuse of economic consumer rights are at stake, when national legislation allows opaque practices (unfair terms or abusive clauses) with are so disproportionate in favour of creditors, such rules impair the core protection sought by general principles of European law. In these conditions, the effectiveness of European consumer law and the rights of individual consumers must prevail. The presumption of compatibility with European consumer law would be set aside and the national legislation could be subject to judicial review, both at national and European level. In short, there is no guaranteed immunity from fairness control in those circumstances in so far as domestic legislation pursues objectives related to consumer protection already harmonized at EU/EEA level (calculation and disclosure of cost of credit & transparency ex-ante) and fails to secure a fair balance between rights and obligations of debtors and creditors.

The silence of the EFTA Court on core issues and, specially, on how cost of credit in EU/EEA Member States is or not affected by the European legal framework reveals other important things. In the first place, it shows how the Court has not really understood the triple cost of credit that an indexed loan really carries and the structure of credit contracts. The Court does not mention that financial institutions are, in fact, charging in two ways (interest and price-indexation) for the same concept (loss of monetary value of principal withdrawn by debtor over time). In the second place, the Court does not differentiate either between the CPI-indexation (regulated by public law) and the extra negative amortization cost of loans (formulas originating in public/private banking business practices). In the third place, it shows how the EFTA Court avoids to take taking a position on ever anything that might come close to a minimum substantive control of fairness (examining things like e.g. potential extortionate cost of credit, commercial practices and business models based on misleading information likely to distort the

economic behaviour of the average consumer, significant imbalance and inequality of contracting parties versus inflation knowledge and influence of credit/debt on the monetary mass etc). In the fourth place, transparency seems to be constructed/used as a potential defence against unfairness (at least relating to cost of credit). This is surprising since lack of transparency in EU law constitutes an autonomous and sufficient criterion of unfairness (vis à vis the "unfair imbalance" general clause) as the ECJ has already explained in case *RWE*[87] (para. 62-63) which was adopted after *Invitel*[88].

Out of all arguments missed, what is really worrisome is to observe how the EFTA Court does not seem to understand how indexed credit in combination with a negative amortization scheme really works. It notes rightly one of the main differences with variable interest rates (the initial principal borrowed is indexed and updated every month) but that is not all. A real example of an indexed loan between a bank and a consumer illustrate the cost of credit in Iceland and the technique used. In the most common contract, indexation is embedded and coupled with a so called annuity system (negative amortisation). This structure leads to an extreme form of anatocism which the EFTA Court did not seem grasp correctly.

In general, in Iceland consumers are paying the cost of credit in a three-fold scheme: through ex-ante disclosed interest rates, through indexation payments non-disclosed and calculated ex post (principal due is regularly updated although the debtor does not draw any more capital) and through additional interest calculated regularly both on principal and interest due but postponed (as all unpaid principal and interest in a negative amortisation scheme are consolidated regularly into the principal with a "snow ball" effect as it is the case with the so-called "revolving credit"). Through the magic of indexation (of principal and interest) and negative amortization in a never-ending process, debtors see debt grow exponentially as they only reimburse a minimum part of the financial obligations. The triple cost of credit leads to compound interest (interest on interest) of astronomic nature and, inevitably, to perpetual state of debt[89].

The argument that Icelandic legislator has opted for a different approach to credit does not hold alone. Coming back to the different nominalism/valorism theories, a clarification must be made. While Icelandic choice for valorism may be

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[87] ECJ, case C-92/11 *RWE Vertrieb AG v Verbraucherzentrale Nordrhein-Westfalen eV* [2013] ECR nyr. Judgment of 21 March 2013.

[88] ECJ, case C-472/10 *Nemzeti Fogyasztóvédelmi Hatóság v Invitel Távközlési Zrt* [2012] ECR nyr. Judgment of the Court of 26 April 2012.

[89] *Forsætisráðuneytið* (Prime Ministers´Office), Report of Expert group on the elimination of inflation-indexation in new loans, 23 January 2014 available on internet at <http://www.forsaetisraduneyti.is/afnam-verdtryggingar/> (consulted last time in July 1, 2016). This report acknowledges both the problem and the difficulty of eliminating indexation of credit in Iceland. The dissenting opinion of expert Vilhjálmur Birgisson proposes to prohibit indexation of all new consumer credit in Iceland since 1 July 2014 onwards and to restrict interest rates and indexation on existing indexed loans on the basis of the current situation of oligopoly and extortionate interest rates that the financial sector practices. A summary of his separate opinion in English is available on internet at <http://www.forsaetisraduneyti.is/media/frettir2/seralit-vilhjalms-afnam-vaxtatr-ensk-thyding.pdf> (consulted last time in July 1, 2016).

justifiable in principle, this does not mean than the practice of indexation -as it is implemented in Iceland- is automatically fair. This is so because financial institutions charge for the cost of money both from a nominalistic perspective (interest) and from a valoristic perspective (CPI-indexation) adding to it a third dimension (negative amortization). Had the EFTA Court understood it properly, it could have maybe offered some clarification on whether or not it is fair, from a European law perspective, to charge credit/mortgage consumers for the same concept using both theories of valorism and nominalism or put it more simply, "having the cake and eating it", all this taking into account the opacity of the different business formulas used for the calculation ex-post of this triple cost.

To conclude this section, one may say that the EFTA Court missed the opportunity in this ruling to lead the European discussions and elaborate some guiding principles regarding core (national) unfairness, transparency and mandatory rules exempted from European control in relation with debt/consumer credit. As it was the case before before the ECJ (*Barclays*[90] in Spain) the courts put national unfairness out of reach of general principles of European law. The problem is that, unlike the case in Spain where moratory interest was transparent and disclosed ex ante and had not been capped by domestic law (until recently), indexation of credit to inflation in Iceland is opaque and complex, relies only partially on public law and cannot –by definition- be disclosed ex ante.

5.2.2 On legality and ex-ante disclosure of cost of credit (case Gunnarsson/Landsbanki)

It is really in the second case *Gunnarsson/Landsbanki*[91] that the EFTA Court really nails the issue finding a breach of European legality (violation of disclosure information duties based on protection-by-information paradigm) and finding that, according to the 1987 Consumer Credit Directive, it is not possible to calculate and disclose a cost of credit with 0% inflation ex-ante but charge a higher figure ex-post on the basis of real inflation.

The Court finds that European law does not provide justification for the practices developed by the financial institutions in Iceland in the last decades where cost of inflation for borrowers was neglected and set aside or left as 0% ex-ante while indexation clauses embedded into the contracts meant a different cost of credit ex-post. Traditionally both public and private banks have offered loans where the principal due by the borrower and the real total cost of credit were indeterminate and unclear. The Court confirms that this should not be possible under the constraints of European consumer credit law. It is simply not acceptable to disclose to consumers ratios of 0% inflation and 0% cost of indexation and then charge for additional cost and compound interest both on the principal and the

[90] ECJ, case C-280/13 *Barclays Bank SA v Sara Sánchez García* [2014] ECR nyr. Judgment of 30 April 2014.

[91] EFTA Court. Case C-27/13 *Sævar Jón Gunnarsson and Landsbankinn hf* [2014] EFTA Court Reports, nyr. Judgment of the EFTA Court of 24 November 2014.

interest due later on (calculated on the basis of the monthly CPI index). A credit agreement allowing for the regular increase ex-post of the principal of the loan and total cost of credit through opaque and non-disclosed price-indexation method should be illegal as the European Directives assume that the principal of the loan remains stable with some limited exceptions (in any case when as here, the consumer does not withdraw more capital). When consumers are not duly informed of the effects of indexation on their loans, the information and transparency paradigm on which the 1987 Consumer Credit Directive is based (as well as the 2008 Directive) fail completely.

With its ruling, the Court confirms that the nature of the variation of the total cost of credit is such that it cannot be argued that it is incidental or equivalent to other charges falling out of the scope of the Directive. Indexation is cost of credit and, as such, it must be disclosed ex-ante mandatorily and in compliance with the European form, APCR rules and method of calculation. Even if inflation cannot be predicted accurately in advance, the plan of payments must be realistic and based on past history/present inflation predictions. Transparency and disclosure of information ex-ante are essential for the legality assessment of credit contracts. Consumers must know the total cost of the loan so that they can commit responsibly to their future financial obligations and compare between offers of different providers of financial services competing between them. That is the goal of European consumer legislation in the internal market.

The legality test does not exclude the fairness control required by European legislation and left to the discretion of national courts (prohibition of abusive contractual clauses and abusive commercial practices) a question explained in the first case *Engilbertsson /Íslandsbanki*[92]to which the EFTA Court refers.

5.2.3 A Court opting for a weak fairness assessment and a strong legality/disclosure of cost of credit ex-ante

We can now reply to the questions asked before regarding the EFTA Court´s advisory opinions. Taking into account EU/EEA law and the case-law of the ECJ and the lack of deep understanding on how indexation works in practice ... a different outcome was probably not possible. We end up with a weak (European) fairness assessment but strong information disclosure requirements. A conclusion where transparency ex ante pre-empts fairness. The legal reasoning and questions asked and/or answered by the EFTA Court do not exactly mirror the questions already clarified by the ECJ since this is a new problem in European consumer law. To the question "how far are consumers/debtors protected in the EEA legal order against indexation of credit practices" we may reply the following. Very well protected for breach of information cases but unfortunately not that well regarding abusive cost of credit. This is due to legal diversity allowed by both EU/EEA law

[92] Case C-25/13 *Gunnar V. Engilbertsson and Íslandsbanki hf.* [2014] EFTA Court Reports, nyr. Judgment of the EFTA Court of 28 August 2014.

and the doctrine of a unique right to clarity that seems to come instead of a European right to fairness.

As the ECJ, the EFTA Court requires a strong legality test guaranteeing protection against lack of information and lack of clarity and transparency while yielding the final fairness test to the national courts with general concepts left for further interpretation. There is no revolutionary approach concerning procedural rights which are not part of the main case. National autonomy is preserved for indexation of credit which is, on the other hand, required to be transparent and disclosed ex-ante. Consumers get therefore no direct protection in European law against core national unfairness (since the Court does not say that there is an opaque calculation of cost of credit ex-post and thus an unfair term non-legally binding). The limits of EEA law are similar to limits of EU law regarding cost of credit, usury and over-indebtedness .... provided that general disclosure obligations and transparency are complied ex-ante. And these are probably the only questions that may yield the balance one way or another at national level.

Only difference is that ECJ tries harder to conceptualize and analyse the problems, stretching European consumer law to afford as much protection as possible, providing good solid legal reasoning and understanding most core issues while the EFTA Court relies too much on arguments set by the parties, misses some structural problems and sends most important questions of interpretation back to the national court. By doing that it misses the opportunity to interpret and clarify this important problem of credit indexation ex-post and the clash between nominalism and valorism theories. On the other hand, the advisory opinions illustrate how difficult is to walk on the edge of a knife.

6. Conclusions

The cases prove that the EFTA Court dares to do a judicial review of the legality and fairness of credit indexation in Iceland in the light of EEA law that legislative and executive powers in Iceland had not been able to resolve. In this sense, the rulings are very much appreciated by both specialists, financial sector, consumer associations and society in general since the clarification of some issues is essential for the sake of legal certainty.

The interpretation provided, however, defies the logic of non-contradiction. The Court concludes, on one hand, that EEA law does not reach into the realm of national core unfairness and yields the final assessment task to the national courts as the 1993 Unfair Terms Directive requires (*Engilbertsson /Íslandsbanki*); while, on the other hand, requires under the 1993 Directive a general duty of transparency (*Engilbertsson /Íslandsbanki*) and a strict and high standard of disclosure ex-ante on total cost of credit (inflation-cost inclusive) under the 1987 Consumer Credit Directive (*Gunnarsson/Landsbanki*).

At the end, the legal reasoning and conclusions of the Court in the two cases try to solve the impossible oxymoron that indexation of credit in Iceland brings to EU/EEA law. Indexation, cost of credit and usury practices tend to fall

outside the scope of European harmonisation (provided disclosure obligation of cost of credit and transparency ex-ante are respected). A fairness control is dependent on national and case circumstances to be assessed by domestic courts. On the other hand, European rules impose with no derogations that the total cost of credut is disclosed and calculated ex-ante (the cost of indexation of credit to inflation is therefore included and not excluded).

The problem lies in the fact that it is not possible to square a circle with this technique as the cost of indexation of credit to inflation is impossible to disclose in advance and to explain in a transparent way. It is opaque and relies not only on CPI but also on secret business formulas. While it is feasible to formulate a Salomonic approach in theory, it is not possible to block the inherent contradiction or oxymoron in practice. The solution and attempt to clarify EEA law by the Court is nevertheless useful as it reveals the paradox. For this reason, it is suggested in the title that the EFTA Court might have created in this regard a sort of "law of contradiction". If we look at the ruling from the EFTA Court from the fairness angle, indexation is not prohibited per se in theory – provided is transparent- and the assessment is for national judges. If we look at it from the information disclosure obligations ex-ante, indexation is extensively regulated by European law and thus impossible in practice. Lack of transparency is a ground of unfairness per se. The law of contradiction is confusing for the general public: are consumers 'economic rights protected or not under EEA rules in Iceland? We do not know yet since the paradox is an oxymoron and the saga continues at national level.

What is most disappointing, however, is that the EFTA rulings do not seem to grasp and understand the scope, rationale and technique behind the cost of money/debt. The indexation of credit is not only based on the CPI but on the very old historical principles of anatocism and compounding[93] structured in formulas not disclosed to consumers. The triple cost of credit (interest rates, indexation cost and negative amortization schemes) leads to an exponential increase of debt without parallel in Europe. While the calculation of CPI index is public and transparent, the formulas used by financial institutions are secret and opaque. Valorism (indexation) is cumulative to nominalism (interest). The EFTA Court seems to misunderstand the assumptions, hypothesis and techniques used for the calculations of total cost of credit.

Could the EFTA Court have ruled in a different way? It is difficult to say. On one hand, it is possible to argue in the affirmative. While it is true that the cost of credit, the fight against usury practices that lead to over-indebtedness have been left in principle to national regulation due to the differences in consumer credit markets and legal diversity; the case-law of ECJ has brought the issue under a minimum common framework of European consumer protection principles. Member States ´attitudes towards the regulation of cost of credit vary, some introduce interest rate restrictions in order to prevent consumer insolvency

[93] Reifner, Schröder, *Usury Laws: A Legal and Economic Evaluation of Interest Rate Restrictions in the European Union*, Instituts für Finanzdienstleistungen e.V. (iff), BoD – Books on Demand, 2012, pages 109-11.

problems. Others prefer not to regulate and/or introduce a cap on credit justifying this lack of intervention on the need to assure access to credit for people with moderate means. The concept of usury, although not mentioned directly by EU/EEA Directives, is an underlying theme. It could have been inspired by consumer protection aims stating that any regulatory choice should respect the purpose of European consumer credit law which is to ensure that the market works well, that it promotes social welfare of people by means of appropriate and adequately priced credit agreements. In this context, transparency, information ex-ante and fairness constitute a limit on the national regulation and its margin of appreciation/ discretion/ choices. If the Courts take into account not only the EU/EEA acquis but also the general ethos of consumer protection in the area of credit and the vulnerability of consumers versus financial institutions, European law would control the cost of credit in an elliptical way at least.

On the other hand, it is possible to argue in the negative and recognise that the limits of EEA law are identical to EU law when confronted to national core unfairness on cost of credit embedded/allowed by domestic legislation as long as transparency is respected. The case Barklays in Spain shows the scope and limits of European harmonization on abusive cost of credit. In this line of reasoning, European law would only a general frame but it would offer neither protection nor a theory on credit fairness allowing for 31 (28 + 3) different national regimes to deal with cost of credit and/or extortionate or usurary practices leading to over-indebtedness, provided that clear information ex-ante is given.

One thing is nevertheless clear. The question "is indexation of credit ex-post such as practiced in Iceland a loophole open for circumvention of the European rules on consumer credit?" is still pending. The EFTA Court has already said that, as long as indexation of inflation ex-post is legal, transparent and duly calculated and disclosed ex-ante there will be no European fairness review. This is an oxymoron and the litigation has continued at national level. The most recent ruling of the Supreme Court of Iceland of 26 November 2015 (case nr. 243/2015) recognises the paradox (indexation to inflation is legal under Icelandic law even if that law breaches EU/EEA consumer credit law – the classic problem of lack of effect of European law in a dualist country). Consumers´ association will surely complain to the EFTA Surveillance Authority but we may be very well waiting for Godot. The indexation of credit to inflation ex-post in Iceland seem, at least for now, the perfect example of a law of contradiction where statements and propositions can be true and false, and reality is possible and impossible simultaneously.

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11. ECJ, case C-472/11 *Banif Plus Bank* [2013] ECR nyr. Judgment of 21 February 2013.
12. ECJ, case C-415/11 *Aziz v. Catalunyacaixa*, [2013] ECR nyr. Judgment of 14 March 2013.
13. ECJ, case C- 488/11 *Asbeek Brusse and da Man Garabito v Jahani BV* [2013] ECR nyr. Judgment of 30 May 2013.
14. ECJ, case C-59/12 *BKK Mobil Oil* [2013] nyr. Judgment of 3 October 2013.
15. ECJ, joined cases *Banco Popular Español SA v Maria Teodolinda Rivas Quichimbo and Wilmar Edgar Cun Pérez* (C-537/12) and *Banco de Valencia SA v Joaquín Valldeperas Tortosa and María Ángeles Miret Jaume* (C-116/13) [2013] ECR nyr. Judgment of 14 Nov. 2013.
16. ECJ, case C-26/13 *Kásler and Káslerné Rábai* [2014] ECR nyr. Judgment of 30 April 2014.
17. ECJ, case C-143/13 *Matei v. SC Volksbank România SA* [2015] nyr. Judgment of 26 February 2015.
18. ECJ, case C-280/13 *Barclays Bank SA v Sara Sánchez García* [2015] ECR nyr. Judgment of 30 April 2015.

19. ECJ, case C-8/14 *BBVA SA v. Gabarro* [2015] ECR nyr. Judgment of 29 October 2015.
20. ECJ, joined cases C-359/11 and C-400/11 *Schulz and Egbringho*ff. Opinion of Advocate General of 8 May 2014 [2014] ECR nyr.
21. ECJ, case C-326/14 *Verein für Konsumenteninformation* pending. Opinion Advocate General Cruz Villalón of 9 July 2015.