



JUDGMENT OF THE COURT

28 August 2014*

*(Article 34 SCA – Appeal against a request for an Advisory Opinion –
Indexation of mortgage loans – Directive 87/102/EEC – Directive 93/13/EEC – Principles
of effectiveness and equivalence)*

In Case E-25/13,

REQUEST to the Court under Article 34 of the Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice from Reykjavík District Court (*Héraðsdómur Reykjavíkur*), in the case between

Gunnar V. Engilbertsson

and

Íslandsbanki hf.

concerning the interpretation of Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts,

THE COURT,

composed of: Carl Baudenbacher, President and Judge-Rapporteur, Per Christiansen and Páll Hreinsson, Judges,

Registrar: Gunnar Selvik,

having considered the written observations submitted on behalf of:

- Gunnar V. Engilbertsson (hereinafter “the Plaintiff”), represented by Einar Páll Tamimi, Attorney at Law, assisted by Guðrún Inga Torfadóttir, Attorney at Law;
- Íslandsbanki hf. (hereinafter “the Defendant”), represented by Áslaug Árnadóttir, District Court Attorney, and Jóhannes Karl Sveinsson, Supreme Court Attorney, acting as legal counsel;

* Language of the request: Icelandic.

- the Icelandic Government, represented by Anna Katrín Vilhjálmsdóttir, First Secretary, Ministry for Foreign Affairs, acting as Agent, Eiríkur Áki Eggertsson, Legal Officer, Ministry of Finance and Economic Affairs, acting as Co-agent, Andri Árnason, Supreme Court Attorney as Lead Counsel, and Stefán Andrew Svensson, Supreme Court Attorney as Co-Counsel;
- the EFTA Surveillance Authority (hereinafter “ESA”), represented by Xavier Lewis, Director, Markus Schneider, Deputy Director, and Auður Ýr Steinarsdóttir, Officer, Department of Legal & Executive Affairs, acting as Agents; and
- the European Commission (hereinafter “the Commission”), represented by Michel Van Beek and Nicola Yerrell, Members of the Legal Service, acting as Agents,

having regard to the Report for the Hearing,

having heard oral argument of the Plaintiff, represented by Einar Páll Tamimi; the Defendant, represented by Áslaug Árnadóttir; the Government of Iceland, represented by Stefán Andrew Svensson; ESA, represented by Markus Schneider; and the Commission, represented by Nicola Yerrell, at the hearing on 9 April 2014,

gives the following

Judgment

I Legal background

EEA law

1 Article 3 EEA reads:

The Contracting Parties shall take all appropriate measures, whether general or particular, to ensure fulfilment of the obligations arising out of this Agreement.

They shall abstain from any measure which could jeopardize the attainment of the objectives of this Agreement.

Moreover, they shall facilitate cooperation within the framework of this Agreement.

2 Article 7 EEA reads:

Acts referred to or contained in the Annexes to this Agreement or in decisions of the EEA Joint Committee shall be binding upon the

Contracting Parties and be, or be made, part of their internal legal order as follows:

(a) an act corresponding to an EEC regulation shall as such be made part of the internal legal order of the Contracting Parties;

(b) an act corresponding to an EEC directive shall leave to the authorities of the Contracting Parties the choice of form and method of implementation.

Directive 93/13/EEC

- 3 Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts (OJ 1993 L 95, p. 29) (hereinafter “the Directive”) was incorporated into Annex XIX to the EEA Agreement at point 7a.
- 4 Recitals 6, 13, 20 and 24 in the preamble to the Directive read:

Whereas, in order to facilitate the establishment of the internal market and to safeguard the citizen in his role as consumer when acquiring goods and services under contracts which are governed by the laws of Member States other than his own, it is essential to remove unfair terms from those contracts;

[...]

Whereas the statutory or regulatory provisions of the Member States which directly or indirectly determine the terms of consumer contracts are presumed not to contain unfair terms; whereas, therefore, it does not appear to be necessary to subject the terms which reflect mandatory statutory or regulatory provisions and the principles or provisions of international conventions to which the Member States or the Community are party; whereas in that respect the wording ‘mandatory statutory or regulatory provisions’ in Article 1(2) also covers rules which, according to the law, shall apply between the contracting parties provided that no other arrangements have been established;

[...]

Whereas contracts should be drafted in plain, intelligible language, the consumer should actually be given an opportunity to examine all the terms and, if in doubt, the interpretation most favourable to the consumer should prevail;

[...]

Whereas the courts or administrative authorities of the Member States must have at their disposal adequate and effective means of preventing the continued application of unfair terms in consumer contracts,

5 Article 1 of the Directive reads:

1. The purpose of this Directive is to approximate the laws, regulations and administrative provisions of the Member States relating to unfair terms in contracts concluded between a seller or supplier and a consumer.

2. The contractual terms which reflect mandatory statutory or regulatory provisions and the provisions or principles of international conventions to which the Member States or the Community are party, particularly in the transport area, shall not be subject to the provisions of this Directive.

6 Article 2 of the Directive reads:

For the purposes of this Directive:

(a) ‘unfair terms’ means the contractual terms defined in Article 3;

(b) ‘consumer’ means any natural person who, in contracts covered by this Directive, is acting for purposes which are outside his trade, business or profession;

(c) ‘seller or supplier’ means any natural or legal person who, in contracts covered by this Directive, is acting for purposes relating to his trade, business or profession, whether publicly owned or privately owned.

7 Article 3 of the Directive reads:

1. A contractual term which has not been individually negotiated shall be regarded as unfair if, contrary to the requirement of good faith, it causes a significant imbalance in the parties’ rights and obligations arising under the contract, to the detriment of the consumer.

2. A term shall always be regarded as not individually negotiated where it has been drafted in advance and the consumer has therefore not been able to influence the substance of the term, particularly in the context of a pre-formulated standard contract.

The fact that certain aspects of a term or one specific term have been individually negotiated shall not exclude the application of this Article to the rest of a contract if an overall assessment of the contract indicates that it is nevertheless a pre-formulated standard contract.

Where any seller or supplier claims that a standard term has been individually negotiated, the burden of proof in this respect shall be incumbent on him.

3. The Annex shall contain an indicative and non-exhaustive list of the terms which may be regarded as unfair.

8 Article 4 of the Directive reads:

1. Without prejudice to Article 7, the unfairness of a contractual term shall be assessed, taking into account the nature of the goods or services for which the contract was concluded and by referring, at the time of conclusion of the contract, to all the circumstances attending the conclusion of the contract and to all the other terms of the contract or of another contract on which it is dependent.

2. Assessment of the unfair nature of the terms shall relate neither to the definition of the main subject matter of the contract nor to the adequacy of the price and remuneration, on the one hand, as against the services or goods supplied in exchange, on the other, in so far as these terms are in plain intelligible language.

9 Article 5 of the Directive reads:

In the case of contracts where all or certain terms offered to the consumer are in writing, these terms must always be drafted in plain, intelligible language. Where there is doubt about the meaning of a term, the interpretation most favourable to the consumer shall prevail. This rule on interpretation shall not apply in the context of the procedures laid down in Article 7(2).

10 Article 6 of the Directive reads:

1. Member States shall lay down that unfair terms used in a contract concluded with a consumer by a seller or supplier shall, as provided for under their national law, not be binding on the consumer and that the contract shall continue to bind the parties upon those terms if it is capable of continuing in existence without the unfair terms.

2. Member States shall take the necessary measures to ensure that the consumer does not lose the protection granted by this Directive by virtue of the choice of the law of a non-Member country as the law applicable to the contract if the latter has a close connection with the territory of the Member States.

11 The Annex to the Directive reads:

Terms referred to in Article 3(3)

1. Terms which have the object or effect of:

...

(1) providing for the price of goods to be determined at the time of delivery or allowing a seller of goods or supplier of services to increase their price without in both cases giving the consumer the corresponding right to cancel

the contract if the final price is too high in relation to the price agreed when the contract was concluded;

...

2. Scope of subparagraphs (g), (j) and (l)

...

(c) Subparagraphs (g), (j) and (l) do not apply to:

- transactions in transferable securities, financial instruments and other products or services where the price is linked to fluctuations in a stock exchange quotation or index or a financial market rate that the seller or supplier does not control;

-...

(d) Subparagraph (l) is without hindrance to price-indexation clauses, where lawful, provided that the method by which prices vary is explicitly described.

National law

Act No 7/1936

- 12 In Iceland, the Directive has been transposed by Act No 14/1995 amending Act No 7/1936 on Contracts, Agency and Void Legal Instruments by adding four new articles, Articles 36a to 36d, to the latter Act and by amending Article 36.
- 13 The first paragraph of Article 36 states that a contract may be set aside, in full or in part, or amended, if it would be considered unfair or contrary to good business practice to invoke it, subject, however, to Article 36c. It states also that the same applies to other legal instruments.
- 14 Pursuant to the second paragraph of Article 36, consideration is to be given to the substance of the contract, the position of the parties, the circumstances when the contract was made and subsequent circumstances in any assessment made under paragraph 1 of that Article.
- 15 Pursuant to the first paragraph of Article 36a, Articles 36a to 36d apply to contracts, including contract terms that have not been individually negotiated, provided that the contracts form part of the activities of one of the business activities of one of the parties, the business operator, but do not form part of the activities of the other party, the consumer. Moreover, reference is made to Article 36d.
- 16 Article 36b requires written contracts offered by a business operator to be phrased in plain and intelligible language. In the event of any doubts concerning

the meaning of a contract referred to in paragraph 1 of Article 36a, the contract shall be construed in the consumer's favour.

- 17 According to Article 36c, Article 36 shall apply to contracts specified in the first paragraph of Article 36a, but with the changes resulting from the second and third paragraphs of Article 36c.
- 18 Pursuant to the second paragraph of Article 36c, in assessing whether a contract is unfair, account should be had to the factors and circumstances referred to in paragraph 2 of Article 36, including the terms of other linked contracts. However, no attention is to be given to circumstances that arose subsequently, to the disadvantage of the consumer.
- 19 The third paragraph of Article 36c states that a contract is to be considered unfair if it is contrary to good business practices and substantially disturbs the balance between the rights and obligations of the contracting parties to the disadvantage of the consumer. If a term of this kind is set aside, either in full or in part, or amended, the contract shall, at the consumer's request, remain valid in other respects without change if it can be performed without the term.

Act No 38/2001

- 20 Indexation of savings and credit was first generally permitted in Iceland by Act No 13/1979 on Economic Policy, and provisions on the matter have existed in Icelandic legislation ever since. Chapter VI of Act No 38/2001 on Interest and Indexation sets out the provisions in respect of indexation that are currently in force. Except to the extent permitted by Article 2 of the Act, the provisions of that chapter are mandatory in relation to all indexed savings and loans.
- 21 Pursuant to Article 13, the provisions of Chapter VI shall apply to obligations concerning savings and credits in Icelandic krónur where the debtor promises to pay money and it has been agreed or stipulated that the payments are to be price-indexed. It also states that the price indexation referred to in the Chapter shall mean changes in line with a domestic price index and that authorisation for price indexation shall be as provided for in Article 14 of this Act unless otherwise provided for by law.
- 22 Pursuant to the first paragraph of Article 14, savings and loans may be price-indexed in accordance with Article 13 if the basis of the price indexation is the consumer price index ("CPI") as calculated by Statistics Iceland in accordance with legislation applicable to the index and published monthly in the Legal Gazette. An index that is calculated and published in a specific month shall apply to the indexation of savings and loans from the first day of the second month thereafter. The second paragraph of Article 14 states that a loan agreement may be based on a share price index, domestic or foreign, or a set of such indices which do not measure changes in general price levels.

- 23 The first paragraph of Article 15 states that the Central Bank may, subject to the approval of the Minister of Business Affairs, decide on a minimum maturity for indexed deposits and loans. The Bank may also, subject to the approval of the Minister, decide that the interest rates on indexed deposits and loans should be fixed during the period of the loan. Pursuant to the second paragraph of that article, the Central Bank shall adopt further rules on the indexation of savings and loans.

Rules of the Central Bank No 492/2001

- 24 On the basis of Article 15 of Act No 38/2001, Rules No 492/2001 on Price Indexation of Savings and Loans were adopted by the Central Bank.
- 25 Article 1 states that domestic price indexation of savings and loans shall be based on the CPI as announced monthly by Statistics Iceland, cf. the provisions of Chapter VI of Act No 38/2001, unless otherwise stipulated by law.
- 26 Pursuant to the first paragraph of Article 4, provisions for indexing the principal of a loan against the CPI are only permitted if the loan is for a minimum term of five years. The second paragraph of that article provides that the principal changes in proportion to changes in the CPI from the base index to the first due date, and then in proportion to changes in the index between due dates. The principal of a loan shall change on each due date before interest and instalments are calculated. The base index shall be the index that is in effect when the loan is furnished, unless otherwise determined by an agreement or the nature of the case.
- 27 The third paragraph of Article 4 states that all the due dates of a loan shall be on the same day of the month, so that the interval between them is counted in whole months. If the due date of a loan is on a different day of the month from that on which the loan is furnished, a daily interest rate with special indexation shall be calculated for the purpose of adjustment for deviations within the month of the loan (to a maximum of 29 days). On disbursement of a loan, the borrower pays daily interest if the due date is later in the month than the granting of the loan, while the lender shall pay if the due date is earlier. The fourth paragraph of that article provides that in financial instruments, listed on a regulated market, cf. Act No 110/2007 on Stock Exchanges, - it may be stipulated that, on the day of the deposit of the loan and on the date of the payment of instalments and interest, the price indexation within a month shall be based on a daily linear change in the consumer price index, i.e. between its value on the first day of the month and its value on the first day of the month thereafter. Finally, the fifth paragraph of that article provides that receipts shall state in detail the calculation of payments and accrued indexation.
- 28 Pursuant to Article 5, however, loan agreements may be indexed against a domestic or foreign equity index, or a basket of such indices which do not measure changes in the general level of prices. The provisions of Article 4 paragraph 1 apply to the term of lending, and the technicalities of the debt

documents are subject to the provisions of Article 4, paragraphs 2, 3 and 5 as applicable.

Act No 12/1995

- 29 Act No 12/1995 on the CPI contains provisions concerning the methods used when the CPI is calculated. It provides that Statistics Iceland shall calculate and publish the index on a monthly basis. The index is to be compiled on a base determined by Statistics Iceland according to the results of the household budget survey. As far as possible, the index shall reflect average prices in Iceland. A special Advisory Committee on the CPI has the purpose of advising Statistics Iceland regarding the CPI and of monitoring its monthly calculations, cf. paragraph 2 of Article 1 of Act No 12/1995.

Act No 121/1994

- 30 At the time the bond in question was issued (see paragraph 33 below), Act No 121/1994 on Consumer Credit was in force. The Act transposed Directive 87/102/EEC into Icelandic law and was replaced by Act No 33/2013 on 1 November 2013, which implements Directive 2008/48/EC. The earlier Directive laid down information disclosure requirements regarding consumer credits. Pursuant to Article 2(3) of that directive, the provisions of Article 4 and of Articles 6 to 12 shall not apply to credit agreements or agreements promising to grant credit, secured by mortgage on immovable property, insofar as these are not already excluded from the Directive under Article 2(1)(a). However, the Icelandic legislature decided to apply the provisions of Directive 87/102/EEC to mortgage credit agreements through Act No 179/2000, amending Act No 121/1994.
- 31 Article 12 of the Act deals with credit agreements containing clauses allowing indexation or variations in the rate of interest and the amount or level of other charges contained in the annual percentage rate of charge, but unquantifiable at the time when it is calculated. In these cases, the annual percentage rate of charge shall be calculated on the assumption that the price level, interest rate and other charges will remain unchanged until the end of the credit agreement. Moreover, it is stated therein that it shall be assumed when calculating the annual percentage rate of charge that: (i) if the agreement does not specify a credit limit, the amount of credit granted shall not exceed ISK 150 000; (ii) if no fixed maturity is specified, and one cannot be deduced from the terms of the agreement, the maturity shall be deemed to be one year; and (iii) where the agreement provides for more than one repayment date, the repayments shall be made at the earliest time provided for in the agreement.

II Facts and procedure

- 32 By letter of 5 November 2013, registered at the Court on 12 November 2013, Reykjavík District Court requested an Advisory Opinion in a case pending before it between Gunnar V. Engilbertsson and Íslandsbanki hf.

- 33 In 2005 and 2007, the Plaintiff took out three loans in the form of securities-backed bonds in order to buy property in Reykjavík. The last bond was issued on 2 May 2007. Its header stated that it is “linked to the consumer price index with a provision on the review of the interest rate”. It also defined the issuer, the overall loan period, the number of instalments and their timing, the date of the first instalment, and the date from which interest was to be calculated, as well as the bank account for repayment. In a special text box it was stated that the “index base” was 267.1 points.
- 34 According to Article 1 of the bond, “[t]he principal of the debt shall be revised in proportion to changes in the consumer price index from the index base as recorded above until the first due date, and thereafter in proportion to changes in the index between subsequent due dates”. It also made provision for the consequential revision of the principal of the debt, which “shall be revised on each due date before the interest and the instalment to be paid are calculated”, as well as the subsequent instalments, which were to be “calculated in such a way that on each due date the indexation adjustment is added to the principal of the debt, the result then being divided by the number of due dates then remaining, including the due date at the time”.
- 35 The bond was accompanied by a repayment schedule signed by both parties on the same day as the bond was issued. It set out 180 due dates of the bond, with information about the individual instalments broken down into repayment of principal, interest and costs. The payment schedule contained a clause noting that it was based on the “index currently valid” (as well as current interest rates and bank tariffs), and that this could “change in accordance with the provisions of the loan agreement”. The schedule stated further that “[i]f the principal of the loan is subject to review and/or the loan period is not fixed, the schedule is based, purely as an example, on particular sums and a loan period of one year” and that it formed part of the attached loan agreement. Moreover, the borrower confirmed that he/she had received and examined the schedule. Finally, the bond contained a provision authorising the calling-in of the entire debt in the event of a default in the payment of the instalments, as well as the possibility of an attachment to secure payment without any previous court orders, as provided for in the Enforcement Measures Act No 90/1989.
- 36 The relevant loan application – also dated 2 May 2007 – noted that it was an accompanying document to the bond, and that the security for the loan was the Plaintiff’s property in Reykjavík.
- 37 From around mid-2009, the Plaintiff made no further payments. At the Defendant’s request and based on the enforcement provisions set out in the bond, the Reykjavík District Commissioner made an attachment of the Plaintiff’s share in his Reykjavík property that served as security for the loan. The Plaintiff raised objections to this and argued that the indexation provisions in the bond were unlawful and contrary to Article 36 and Articles 36a to 36c of Act No 7/1936. The District Commissioner rejected the Plaintiff’s objections. As a consequence,

the Plaintiff referred the matter to Reykjavík District Court, arguing that the enforcement action should be discontinued.

- 38 In these proceedings, the Plaintiff argued that the indexation provision had not been individually negotiated and that it was an unfair contract term contrary to Article 3(1) of the Directive. On the basis of Article 3 EEA and Article 6(1) of the Directive, in his view, the corresponding national provision had to be interpreted as requiring the unfair contract term to be set aside. Moreover, Article 36 of Act No 7/1936 could not be considered a sufficient basis to set aside the term. That provision allows for a contract term to be set aside but does not require such.
- 39 In addition, the Plaintiff argued that the indexation mechanism had not been fully explained in the bond and that he therefore did not understand the financial risks and consequences of high inflation. In his view, the payment schedule did not give a realistic picture of how the principal of the debt and the instalment payments would develop during the loan period.
- 40 The Defendant disagreed. It argued that price indexation was permitted by law and that the loan complied with all relevant requirements. In any event, it was not possible to set aside a provision of the bond relating to price indexation without interfering with its other provisions. The Defendant also submitted that the Directive had been correctly implemented into the national legal system since, pursuant to Article 7 EEA, the Icelandic legislature has the choice of form and method with regard to the implementation of directives. Consequently, in its view, the outcome in this case depended on the interpretation of Act No 7/1936, since directives have no direct legal effect.
- 41 As regards the Annex of the Directive, the Defendant contends that it has not been implemented. However, there was no obligation to implement the list in the Annex since it is only indicative and non-exhaustive.
- 42 According to the Defendant, it was clearly stated in the bond that the principal of the debt was to change in line with changes in the CPI, in accordance with national law, from an index base which was also set out in a clear manner in the document.
- 43 On 4 July 2013, Reykjavík District Court granted the Plaintiff's request to obtain an Advisory Opinion from the Court in relation to the first question he presented, but not as regards the second. The Defendant challenged that decision, bringing an appeal before the Supreme Court of Iceland. On hearing that appeal, the Supreme Court decided that the questions set out below should be referred to the Court.
- 44 Having regard to the letter from the Supreme Court of Iceland of 8 October 2013 and its judgment of 8 October 2013 in Supreme Court Case No 489/2013, Reykjavík District Court posed the following questions:

1. *Is it compatible with the provisions of Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts if the legislation in a State which is a party to the EEA Agreement permits contracts between consumers and suppliers for loans to finance real estate purchases to contain provisions stating that the instalment repayments are to be linked to a predetermined index?*
2. *If the answer to the first question is that the index-linking of repayments of loans taken to finance real-estate purchases is compatible with the provisions of Directive 93/13/EEC, then the second question is: Does the Directive limit the discretion of the EEA State in question to determine, whether through legislation or by means of administrative regulations, the factors that may cause changes in the predetermined index and the methods by which these changes are to be measured?*
3. *If the answer to the second question is that Directive 93/13/EEC does not restrict the discretion of the Member State referred to in that question, then the third question is: is a contractual term regarded as having been individually negotiated within the meaning of Article 3(1) of the Directive when (a) it is stated in the bond which the consumer signs when taking out the loan that his obligation is index-linked and the base index to be used when calculating price-changes is specified in the bond, (b) the bond is accompanied by a payment schedule showing estimated and itemised payments to be made on the due dates of the loan, and it is stated in the schedule that these estimates may change in accordance with the indexation provision of the bond, and (c) both the consumer and the lender sign the payment schedule at the same time as the consumer signs the bond?*
4. *Is the method of calculation of price changes in contracts for loans to finance real estate purchases regarded as having been explicitly explained to the consumer within the meaning of point 2(d) of the Annex to Directive 93/13/EEC when the circumstances are as described in the third question?*
5. *Does a State that is party to the EEA Agreement have the option, when adopting Article 6(1) of Directive 93/13/EEC, of either prescribing in domestic legislation that unfair contract terms within the meaning of Article 6(1) of the Directive may be declared non-binding on the consumer or prescribing in domestic legislation that such terms shall be non-binding on the consumer at any time?*

45 By letter of 1 April 2014, the Court asked the parties whether, in order to answer the questions referred by Reykjavík District Court in the case at hand, it is of relevance, and if so to what extent, that the Icelandic legislature decided to apply the provisions of Directive 87/102/EEC to mortgage credit agreements through Act No 179/2000, amending Act No 121/1994, as the Defendant contended in its written submissions.

- 46 Reference is made to the Report for the Hearing for a fuller account of the legal framework, the facts, the procedure and the written observations submitted to the Court, which are mentioned or discussed hereinafter only insofar as is necessary for the reasoning of the Court.

III The scope of the national court's request

- 47 The Plaintiff submits that the questions referred by Reykjavík District Court do not fully cover the issues that court intended to refer before the Supreme Court rendered its ruling. As a consequence, the Plaintiff suggests that the Court should render an Advisory Opinion on those matters as well as on the questions that have been referred by the District Court.
- 48 The Court recalls that it is solely for the national court before which the dispute has been brought, and which must assume responsibility for the subsequent judicial decision, to determine in the light of the particular circumstances of the case both the need for an Advisory Opinion in order to enable it to deliver judgment and the relevance of the questions which it submits to the Court (see Case E-13/11 *Granville Establishment v Volker Anhalt, Melanie Anhalt and Jasmin Barbaro, née Anhalt* [2012] EFTA Ct. Rep. 400, paragraph 18).
- 49 Even if in practice the decision to submit a reference will often be made on an application by one or both parties in the national proceedings, the cooperation between the Court and the national court is completely independent of any initiative by the parties (see Case E-18/11 *Irish Bank Resolution Corporation Ltd v Kaupping hf* (“*Irish Bank*”) [2012] EFTA Ct. Rep. 592, paragraphs 55 and 56). The questions referred to the Court by a national court enjoy a presumption of relevance. The same presumption applies in relation to reasoned decisions of national courts as regards the content and scope of the questions referred (see Case E-10/12 *Yngvi Harðarson v Askar Capital hf.* [2013] EFTA Ct. Rep. 204, paragraphs 38 and 41, and case law cited).
- 50 Contrary to the situation in *Irish Bank*, it appears from the request in the present case that the competent national court decided to refer the set of questions as they stood following the decision of the Supreme Court.
- 51 The Court will therefore answer the questions as formulated by the District Court in its request of 5 November 2013.

IV Answers of the Court

Applicability of 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

- 52 In order to provide a useful answer to the national court, the Court may extract from all the factors provided by the former and, in particular, from the statement of grounds in the order for reference, the elements of EEA law requiring an interpretation having regard to the subject-matter of the dispute. It may also

restrict its analysis to the provisions of EEA law and provide an interpretation of them which will be of use to the national court, which has the task of interpreting the provisions of national law and determining their compatibility with EEA law (see *Yngvi Harðarson*, cited above, paragraph 39, and case law cited).

- 53 In the present case, it appears from the observations received that the Icelandic legislature decided to apply the provisions of 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, as incorporated in the EEA Agreement at point 7h of Annex XIX to the EEA Agreement, also to internal situations, in the sense that, through Act No 179/2000, amending Act No 121/1994, it applied Directive 87/102/EEC also to mortgage credit agreements.
- 54 It is settled case law that where domestic legislation, in regulating purely internal situations, adopts the same or similar solutions as those adopted in EEA law in order to avoid any distortion of competition, it is in the interest of the EEA to forestall future differences of interpretation. Provisions or concepts taken from EEA law should thus be interpreted uniformly, irrespective of the circumstances in which they apply (see Case E-17/11 *Aresbank S.A v Landsbankinn hf., the Financial Supervisory Authority and Iceland* [2012] EFTA Ct. Rep. 916, paragraph 45, and case law cited).
- 55 However, in the case at hand, having regard to the subject-matter of the dispute, it is unclear whether, and if so to what extent, Directive 87/102/EEC concerning consumer credit and/or its relationship with Directive 93/13/EEC requires an interpretation.
- 56 Consequently, the Court will limit its answers to an analysis of the provisions of Directive 93/13/EEC and will not provide guidance on the interpretation of Directive 87/102/EEC. It is the task of the referring court to assess whether it considers that sufficient guidance is given by the Advisory Opinion or whether it appears to it that a further request to the Court is required (see Case E-2/12 INT *HOB-vín ehf.* [2013] EFTA Ct. Rep. 816, paragraph 14).

Applicability of Directive 93/13/EEC

- 57 Both in their written observations and at the hearing, the Defendant, Iceland, and ESA have questioned whether the contractual terms at issue fall within the scope of the Directive. They observe that, pursuant to Article 1(2) of the Directive, contractual terms, when they reflect mandatory statutory or regulatory provisions in national legislation, shall not be subject to the provisions of the Directive.
- 58 This issue has not been addressed in the questions referred to the Court. However, it is for the Court to provide the national court with all those elements for the interpretation of EEA law that may be of assistance in adjudicating on the case pending before it. Consequently, the Court must address, as a preliminary point, whether the contractual terms on indexation of repayment instalments of

mortgage loans such as those at issue in this case must be considered mandatory pursuant to Article 1(2) of the Directive.

Observations submitted to the Court

- 59 The Defendant and ESA argue that, when national legislation has set out rules that directly or indirectly determine the terms of consumer contracts, consumers are not prone to suffer due to a weaker bargaining position and do not need the same protection since the playing field has been levelled. Hence, the Directive states in Article 1(2) that contractual terms reflecting mandatory statutory or regulatory provisions of national law are not subject to the provisions of the Directive.
- 60 The Defendant claims that the indexation at issue is based upon rules that must be considered mandatory. Indexation of mortgage loans is not obligatory, but constitutes a well-established and common means of addressing the inflation risk. If the parties agree that the loan shall be indexed, the indexation has to comply with Articles 13 and 14 of Act No 38/2001. Moreover, the calculation of the CPI, upon which the indexation must be based, is to be carried out by Statistics Iceland in accordance with the rules set out in Act No 12/1995. In the Defendant's view, the indexation terms contested in the case at hand satisfy the relevant rules established in Acts No 38/2001 and No 12/1995.
- 61 The Government of Iceland submits that the wording "mandatory or regulatory provisions" in Article 1(2) of the Directive extends not only to non-derogable laws which apply to contractual provisions, but also covers derogable default contractual provisions.
- 62 ESA contends that contractual terms are excluded from the scope of the Directive according to Article 1(2) if they reflect provisions of national legislation governing a certain category of contracts. ESA argues that this applies to the terms at issue. The indexation clauses and the calculation of the underlying CPI are largely covered by detailed provisions of national law. These statutory rules are not to be considered mandatory in the sense that consumers are obliged to enter into indexed loan agreements. However, if private parties choose to do so, the terms of indexation laid down in national law are mandatory. Thus, the terms of bonds and payment schedules such as those at issue are determined, at least indirectly, on the basis of the provisions specified.
- 63 The Plaintiff, on the other hand, argues that the Directive applies to the mortgage loan instrument in question. It does not follow from the preamble to the Directive or from case law that the instrument at issue is excluded from the scope of the Directive. The exclusion specified in Article 1(2) of the Directive does not apply to the disputed indexation arrangement. The mortgage loan instrument linking the borrower's obligations to a CPI does not reflect a mandatory statutory or regulatory provision within the meaning of that Article. Moreover, even if the exemption under Article 1(2) of the Directive were to apply *prima facie*, its application would be excluded in practice since the consumer has to be informed

about mandatory statutory or regulatory provisions and, as regards the CPI Act No 12/1995, the Defendant did not do so.

- 64 In the Commission's view, it follows from recital 13 in the preamble to the Directive that Article 1(2) of the Directive is intended to cover contractual terms determined by provisions of national law or default terms that are deemed to apply when the parties make no other specific arrangements. The rationale behind Article 1(2) of the Directive is that it may legitimately be supposed that the national legislature already struck an appropriate balance between the rights and obligations of the parties to certain types of contract.
- 65 The Commission submits further that in Icelandic law price indexation is governed by the terms of Act No 38/2001, which, pursuant to Article 14, permits savings and loans to be price-indexed if the basis for that indexation is the CPI calculated by Statistics Iceland. In this way, the Icelandic legislature has weighed up the various interests of the parties to loan agreements and provided for the possibility of price-indexing, under certain strictly defined conditions. However, the inclusion of a price-indexation clause appears to remain purely a possibility. It is authorised by national law, but is not compulsory, and does not apply as a default rule in the absence of any specific contractual arrangement on this point. It follows, therefore, that it cannot be a mandatory provision within the meaning of Article 1(2) of the Directive. Such a conclusion is reinforced by the general consideration that derogations from EEA consumer protection law must be interpreted strictly.

Findings of the Court

- 66 The jurisdiction of the Court extends to the interpretation of the Directive, the Annex thereto, and the criteria which the national court should apply when examining the unfairness of a contractual term in the light of the provisions of the Directive.
- 67 Thus, the question whether contractual provisions on indexation such as those at issue reflect mandatory statutory or regulatory provisions and are therefore exempted from the scope the Directive pursuant to Article 1(2) is to be ascertained by the national court (compare Case C-488/11 *Asbeek Brusse and de Man Garabito*, judgment of 30 May 2013, published electronically, paragraph 33). The Court must limit itself to providing the referring court with guidance which the latter must take into account in order to assess whether Article 1(2) of the Directive applies in situations such as that in the case at hand.
- 68 According to recital 13 in the preamble to the Directive, the exclusion contained in Article 1(2) extends to terms which reflect provisions of national law that apply between the parties to the contract independently of their choice or provisions that apply by default in the absence of other arrangements established by the parties.

- 69 Not only contractual terms which reflect provisions of national legislation that govern the category of contract at issue are exempted, but also other contracts to which that legislation applies pursuant to a provision of national law (compare Case C-92/11 *RWE Vertrieb*, judgment of 21 March 2013, published electronically, paragraphs 26 and 27).
- 70 This exemption is based on the legitimate assumption that the national legislature has, in substance, excluded unfair terms in consumer contracts since the mandatory rules strike a fair balance between the rights and obligations of the parties. From the perspective of the consumer, it is therefore of particular importance that EEA States actually ensure that balance. If power is delegated, it must be assessed in each individual case whether that balance has in fact been struck.
- 71 In the present case, it was agreed that the mortgage loan was to be linked to the CPI with a provision on the review of the interest rate subject to further requirements, as set out in paragraphs 33 to 35 above.
- 72 The Court notes that Icelandic law provides for a possibility to index certain loans on the basis of the CPI. The index is calculated by Statistics Iceland. Statistics Iceland is a professionally-independent institution under the aegis of the Icelandic Prime Minister. The index is subject to certain requirements. These requirements and the calculation of the underlying CPI are set out in Act No 38/2001, Act 12/1995 and Rules No 492/2001 on Price Indexation of Savings and Loans as published by the Central Bank of Iceland. The Central Bank's rules are subject to the approval of the Minister of Finance and Economic Affairs, cf. Article 15 of Act No 38/2001.
- 73 However, indexation does not appear mandatory in the sense that a mortgage loan must be indexed. All the same, it is plain from the case-file that indexation is a widespread practice in Iceland. Furthermore, indexation does not apply as a default rule in the absence of any specific contractual arrangement on this point between the parties.
- 74 At the same time, if the parties agree to index a loan in accordance with one of the possibilities provided under Icelandic law, it appears that they are bound to a substantial extent by the scheme set out in regulatory and statutory provisions of national law. That seems to be the case if the parties agree to index the loan on the basis of the CPI as set out in paragraph 33 to 35.
- 75 To the extent that the contractual terms at issue reflect the regulatory scheme provided under Icelandic law for the indexation of loans based on the CPI, it would be artificial to draw a distinction between terms that, pursuant to national law, must be included in a category of contract, such as mortgage loans, and clauses whose inclusion in the category of contract is optional but whose substance is mandatory. In neither case does the inequality of bargaining power influence the content of the terms to the detriment of the consumer. Moreover, to the extent that the parties have to apply contractual terms which reflect a scheme

set out in regulatory and statutory provisions of national law, these rules are equally imposed on the supplier and consumer.

- 76 Therefore, the exclusion of mandatory rules applies also to contractual terms that are optional but if chosen by the parties their substance is not left to the parties to negotiate. The legitimate assumption that unfair contractual terms are excluded applies therefore also in a case of that kind, as it does in cases where parties have no choice, or have not made a choice.
- 77 It therefore follows from Article 1(2) of the Directive as well as from the premise underlying the system of protection introduced by the Directive that such contractual terms must also be considered mandatory and thus exempted from the application of the Directive. This conclusion is not altered by the general consideration that derogations from EEA consumer protection law must be interpreted strictly.
- 78 Since the exclusion provided for in Article 1(2) of the Directive is only applicable insofar as the contractual terms reflect mandatory provisions it must be assessed whether and to what extent the regulatory scheme is exhaustive and that the seller or supplier therefore has no right to unilaterally set out certain aspects in terms and conditions at a contractual level. By contrast, rules of a regulatory scheme which enable the contractual parties to individually negotiate certain aspects are not to be considered mandatory. Moreover, even if the terms of a contract are found to reflect mandatory provisions, the supplier of a loan may be required to provide the customer with certain information as regards those provisions (compare, to that effect, Case C-472/10 *Invitel*, judgment of 26 April 2012, published electronically, paragraph 29). This issue is addressed in paragraph 143 of this judgment.
- 79 It is for the national court to ascertain whether contractual terms on the indexation of the repayment instalments of mortgage loans, such as those at issue in the present case, are to be considered as reflecting mandatory regulatory or statutory provisions pursuant to Article 1(2) of the Directive.

Substance of the first question

Observations submitted to the Court

- 80 As regards the substance of the first question, the Plaintiff submits that it is compatible with Directive 93/13/EEC for the legislation in a EEA State to permit repayment instalments to be linked to a predetermined index in contracts between consumers and suppliers for loans to finance real estate purchases, insofar as the reasons for or method of variation are explicitly and comprehensively described in the debt instrument. However, in his view, the information given in the present case does not enable the Plaintiff as a consumer to read from the terms of the contract, prior to or at the time he enters into it, the extent of the obligations he is undertaking. No guidance is given as to what to expect in terms of payment obligations during the contract period as a result of the indexation. For that to be

the case, everything of importance would have to be written into the contract in a clear and unambiguous fashion.

- 81 In the event that the Directive applies in the case at hand, the Defendant submits that the Annex to the Directive contains a list of the terms that may be regarded as unfair. However, this list is not exhaustive and it has not been regarded as binding. As can be seen from paragraph 1(l) of the Annex, indexation in itself is not to be considered unfair. Moreover, that provision does not apply to the indexation term at issue since it is not subject to any arbitrary decision-making. Moreover, as can be seen from points 2(c) and (d) of the Annex, the use of price-indexation clauses is to be considered fair, provided that they are in accordance with the law and that the method by which prices vary is explicitly described.
- 82 Taking the same premise as the Defendant, ESA argues that the Directive does not establish a general prohibition on financial services providers using price-indexation clauses in consumer mortgage contracts. On the contrary, point 2(d) of the Annex to the Directive provides expressly 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. The emphasis is thus placed on the clarity and quality of the information concerning the price indexation which the seller or supplier provided to the consumer at the time when the contract was concluded.
- 83 ESA contends that the two conditions of point 2(d) of the Annex to the Directive are fulfilled. First, Chapter VI of Act No 38/2001 and Rules No 492/2001 expressly permit the index-linking of loans provided that the basis of the indexation is the official CPI. Second, it follows from the information given by the national court that an explicit description of the price-index mechanism was provided in the contract. The bond and the accompanying payment schedule contain provisions specifically explaining that the principal of the debt will be revised on each due date before the interest and the instalment payable are calculated, in proportion to changes in the CPI.
- 84 The Commission submits that Articles 3 and 4 of the Directive lay down general principles for the assessment of whether a particular contractual term is unfair, but do not as such preclude a price-indexation clause. This is further illustrated by the terms of Article 3(3) of the Directive read together with the Annex. Not only does this confirm that the list of terms set out in paragraph 1 of the Annex is purely indicative. Paragraph 1(l), read together with point 2(d), goes on to provide express confirmation that a price-indexation clause may be permitted, subject only to the condition that, in order to be considered fair, it should explicitly describe the method by which prices vary.

Findings of the Court

- 85 To cover the situation that, having regard to the considerations set out in paragraphs 71 to 79 of this judgment, the national court finds the Directive applicable to the contractual terms linking the mortgage loan to the CPI, the

Court will, in order to give as useful a reply as possible, also examine the issues raised by the subsequent questions of the referring court.

- 86 By its first question, the national court asks, in essence, whether the Directive generally prohibits contractual terms on the indexation of mortgage loans in contracts between a supplier and a consumer.
- 87 Taken together, Articles 3, 4 and 5 of the Directive lay down general principles for assessing whether a particular contractual term is unfair. Pursuant to the Directive, an unfair contractual term is a term which has not been individually negotiated and which, contrary to the requirement of good faith, causes a significant imbalance in the parties' contractual rights and obligations, to the detriment of the consumer.
- 88 In referring to the concept of good faith and in view of a significant imbalance between the rights and obligations of the parties, Article 3 of the Directive merely defines in a general way the factors that render unfair a contractual term (compare, to that effect, Case C-478/99 *Commission v Sweden* [2002] ECR I-4147, paragraph 17).
- 89 The Annex to which Article 3(3) of the Directive refers contains an indicative and non-exhaustive list of terms which may be regarded as unfair. A term appearing in the list need not necessarily be considered unfair and, conversely, a term that does not appear in the list may none the less be regarded as unfair (compare Case C-243/08 *Pannon GSM* [2009] ECR I-4713, paragraphs 37 and 38). If the content of the Annex does not suffice in itself to establish automatically the unfair nature of a contested term, it is nevertheless an essential element on which the competent court may base its assessment as to the unfair nature of that term.
- 90 Moreover, Article 5 of the Directive imposes an obligation on the seller or supplier to draft terms in plain, intelligible language. The 20th recital in the preamble to Directive specifies that the consumer must actually be given an opportunity to examine all the terms of the contract.
- 91 The jurisdiction of the Court extends to the interpretation of the concept of an "unfair term" used in Article 3(1) of the Directive and in the Annex thereto and to the criteria which the national court should apply when examining a contractual term in the light of the provisions of the Directive. It is for that court to determine, in the light of those criteria, whether a particular contractual term is actually unfair in the circumstances of the case.
- 92 As to the question whether a particular term in a contract is, or is not, unfair, Article 4(1) of the Directive provides that the answer should be reached taking into account the nature of the goods or services for which the contract was concluded and by referring, at the time of conclusion of the contract, to all the circumstances surrounding the conclusion of the contract. In the context of the present case, the national court must also take into consideration that under an

indexed loan, the interest rate is normally lower than it would have been under a non-indexed loan.

- 93 Consequences of the term under the law applicable to the contract must also be taken into account. This requires that consideration be given to the relevant national law (compare Case C-226/12 *Constructora Principado*, judgment of 16 January 2014, published electronically, paragraph 24), comprising a comparative analysis between the legal situation of the consumer under the contract and the legal situation provided for by the national law in force. To that end, an assessment should also be carried out of the legal situation of that consumer having regard to the means at his disposal, under national legislation, to prevent continued use of unfair terms (compare Case C-415/11 *Aziz*, judgment of 14 March 2013, published electronically, paragraph 68).
- 94 With regard to the circumstances in which such an imbalance arises “contrary to the requirement of good faith”, the national court must assess for those purposes whether the seller or supplier, dealing fairly and equitably with the consumer, could reasonably assume that the consumer would have agreed to such a term in individual contract negotiations.
- 95 However, pursuant to Article 4(2) of the Directive, the assessment of the unfair nature of the terms shall relate neither to the definition of the main subject matter of the contract nor to the adequacy of the price and remuneration, on the one hand, as against the services or goods supplied in exchange, on the other, in so far as these terms are in plain intelligible language.
- 96 In the present case, that exclusion does not apply since a term relating to a mechanism for amending the prices of the services provided to the consumer is not encompassed by Article 4 of the Directive (compare *Invitel*, cited above, paragraph 29).
- 97 In light of the considerations set out above, the Directive does not categorically prohibit a price-indexation clause in a mortgage loan agreement, such as the one at issue, as Articles 3 and 4 of the Directive are limited to laying down general principles for the assessment of whether a particular contractual term is unfair and 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.
- 98 At the same time, it follows from the relevant provisions of the Annex and Articles 3(3) and 5 of the Directive that the clarity and quality of the information about the price indexation which the seller or supplier provided the consumer with at the time when the contract was concluded is particularly relevant for the assessment (compare, to that effect, the Opinion of Advocate General Wahl of 8 May 2014 in Joined Cases C-359/11 and C-400/11 *Schulz and Egbrinshoff*, published electronically, point 53). Whether the conditions of clarity and quality of information are fulfilled is a matter to be assessed by the national court.

- 99 The answer to the first question must therefore be that Directive 93/13/EEC does not generally prohibit contractual terms on the indexation of mortgage loans in contracts between a supplier and a consumer. It is for the referring court to assess whether the term at issue is unfair. The assessment must take into account the Court’s guidance on the interpretation of the concept of “unfair term”.

The second question

- 100 By its second question, the referring court asks, in essence, whether, on the basis that, under the Directive, the indexation of mortgage loans is not generally prohibited, the Directive limits the discretion of an EEA State to determine, through legislation or by means of administrative regulations, the factors that may cause changes in a pre-determined index, such as the CPI, as well as the methods for measuring those changes.

Observations submitted to the Court

- 101 The Plaintiff submits that the Directive does not limit the discretion of an EEA State to determine, whether through legislation or by means of administrative regulations, the factors that may cause changes in the predetermined index and the methods by which these changes are to be measured, insofar as these factors are capable of comprehension by an average consumer if explicitly described in a contract and supporting a high degree of certainty regarding the contractual obligations of the consumer.
- 102 The Defendant argues that it follows from Article 1(1) of the Directive that the Directive is intended to regulate unfair terms in contracts only. It does not influence the power of an EEA State to regulate the indexing of loans, and in particular when such indexation is an integral part of the domestic economy, i.e. in relation to savings and preservation of the purchasing power of savers.
- 103 The Government of Iceland submits that the Directive does not impose any limits on an EEA State determining by national legislation the factors that may cause changes in a predetermined index such as the CPI or the methods by which these changes are to be measured since the terms at issue do not fall within the scope of the Directive. Moreover, the national law referred to in the question of Reykjavík District Court, i.e. the operation of the index, does not relate to contractual terms *per se* and is therefore, in any event, not covered or limited by the Directive.
- 104 Second, and notwithstanding the above, the Icelandic Government submits that, since the national law of the EEA State will be a benchmark in the national court’s assessment of whether contractual terms are considered fair, changes to the index as a result of factors and methodology prescribed by national law cannot in and of themselves give rise to a finding that contractual terms referencing that index are unfair. National law cannot be limited by the Directive in practice. And, even if the Directive could limit that discretion, the Government fails to see how this could cause changes in the manner in which Statistics

Iceland compiles the CPI, since the index is compiled independently by that body and in accordance with European standards.

- 105 In the event that the Directive is applicable, ESA contends that point 2(d) of the Annex requires only that the method of calculation for the price indexation must be explicitly described in the contract, given that price-indexation clauses are lawful under national rules. There are no rules specifying the factors that may or may not be used when the amendments to a predetermined index are calculated.
- 106 According to ESA, the Directive is not intended to fetter the powers of national authorities to regulate contract terms. The national authorities are therefore free to regulate which factors may cause changes in the predetermined index and the methods by which these changes are to be measured. The fact that Article 1(2) of the Directive expressly excludes mandatory statutory or regulatory provisions from its scope further strengthens the conclusion that the Directive is not intended to address the powers of national authorities to regulate terms in consumer contracts.
- 107 In the Commission's view, the question should be answered in the negative since the Directive is silent in that regard. In particular, point 2(d) of the Annex lays down no specific conditions or criteria for the choice of factors to be taken into account, or the method of calculation.

Findings of the Court

- 108 The Court notes at the outset that the discretion of an EEA State to determine, whether through legislation or by means of administrative regulations, the factors that may cause changes in a pre-determined index, such as the CPI, as well as the methods for measuring those changes is not limited in itself.
- 109 Only a contractual term permitting the indexation of mortgage loan can be assessed under the Directive. If that term is not considered to reflect a mandatory provision under Article 1(2) of the Directive, it must fulfil the conditions set out in the Directive in order not to be considered unfair, in particular those laid down in point 2(d) of the Annex, according to which the method of calculation for the price indexation has to be explicitly described in the contract, given that price-indexation clauses are lawful for the category of contract at issue under national law.
- 110 Consequently, the answer to the second question must be that the Directive does not limit the discretion of an EEA State to determine, whether through legislation or by means of administrative regulations, the factors that may cause changes in a pre-determined index, such as the Icelandic consumer price index, as well as the methods for measuring those changes, provided they are explicitly described in the contract.

The third question

- 111 By its third question, the referring court asks, in essence, whether a contractual term must be regarded as having been individually negotiated within the meaning of Article 3(1) of the Directive when
- (a) it is stated in the bond which the consumer signs when taking out the loan that his obligation is index-linked and the base index to be used when calculating price-changes is specified in the bond;
 - (b) the bond is accompanied by a payment schedule showing estimated and itemised payments to be made on the due dates of the loan, and it is stated in the schedule that these estimates may change in accordance with the indexation provision of the bond; and
 - (c) both the consumer and the lender sign the payment schedule at the same time as the consumer signs the bond.

Observations submitted to the Court

- 112 The Defendant reiterates that in its view the indexation term at issue falls outside the scope of the Directive. The Court's jurisdiction is to give answers that concern the EEA Agreement, its Protocols and Annexes.
- 113 The Defendant argues that the information given to the Plaintiff at the time the bond was issued was in accordance with both Articles 6 and 12(1) of Act No 121/1994. Further, the term concerning price indexation was individually negotiated, as the Plaintiff had other options and could have negotiated, *inter alia*, for a non-indexed loan.
- 114 The Icelandic Government submits that a contractual term that reflects national law applicable to such contracts falls outside the scope of the Directive. On the other hand, contractual terms that do not reflect the provisions of Articles 13 and 14 of Act No 38/2001 will, as a matter of national law, be void – unless they are to the advantage of the borrower. Accordingly, a contractual indexation term either reflects national law and falls outside the Directive's scope, or it does not reflect national law and is void as a matter of Icelandic law. On this basis, the Government of Iceland argues that the question is hypothetical and therefore inadmissible, since, in light of the answers to the previous questions, the answer to this question cannot have any effect on the determination of the national court in the case before it.
- 115 Without prejudice to that objection, and to the extent that the Court declares the question admissible, the Icelandic Government submits that, pursuant to Article 3(2) of the Directive, it is for the national court to assess whether the indexation clause has been individually negotiated.
- 116 ESA too argues that it is for the national court to assess whether the contractual terms at issue have been individually negotiated within the meaning of Article

3(2) of the Directive. The Court can provide guidance on when contractual terms may be considered to have been individually negotiated.

- 117 On the basis that the Directive is applicable, ESA submits that it remains unclear whether the question of individual negotiation is relevant in the main proceedings. ESA makes reference to the findings in its 2001 Report on the Application of Directive 93/13/EEC. According to that report, Iceland has opened the unfairness review of consumer contracts available under Article 36 of Act No 7/1936 to any term in a consumer contract including those that have been individually negotiated. This higher level of protection is explicitly permitted pursuant to Article 8 of the Directive. In any event, ESA submits, there are no indications in the request of the national court to suggest that the terms have been individually negotiated.
- 118 As regards condition (a), ESA argues that no contracting parties could have individually negotiated the base index or the calculation of it, since that is regulated by national law. As regards condition (b), ESA submits that the fact that the bond was accompanied by a payment schedule itemising estimated payments to be made on the agreed due dates does not change the outcome of the assessment. The schedule expressly states that the prospective payments are only estimates, which may change in accordance with the indexation provision of the bond. Moreover, the information given is in accordance with the relevant national legislation, i.e. Act No 38/2001 and Rules No 492/2001. As regards condition (c), ESA argues that the fact that both parties have signed the payment schedule does not alter the assessment. The substance of the payment schedule cannot be negotiated, as it is based on projections of future payments of the bond that depend on the CPI as calculated each month.
- 119 The Commission submits that it is a matter for the national court, taking all circumstances into account, to assess whether the price indexation clause should be regarded as having been individually negotiated. In that assessment, the rule specified in Article 3(2) of the Directive is of particular importance. The information provided in the request from Reykjavík District Court suggests *prima facie* that the price-indexation clause was both a standard term used by the bank and part of a pre-drafted document. Further, the Commission continues, were the bank to contend nevertheless that such a term was individually negotiated, it would need to prove this in accordance with the third subparagraph of Article 3(2).

Findings of the Court

- 120 It appears from the case-file that, under Article 4 of the Central Bank's Rules No 492/2001, the parties to a contract can determine the base index by agreement. Nevertheless, it is not clear from the case-file whether this includes a possibility for a bank to impose on a borrower within the meaning of the Directive a certain base index unilaterally and, if so, whether that indeed happened in the circumstances at issue in the main proceedings.

- 121 In that regard the Court recalls that it is for the national court to assess, taking into account all the circumstances, whether the contractual terms at issue in a given case before it have been individually negotiated (compare *Constructora Principado*, cited above, paragraph 19). The Court must limit itself to providing the referring court with guidance as to when contractual terms may be considered to have been individually negotiated.
- 122 In making that appraisal, Article 3(2) of the Directive establishes that a term must be regarded as not having been individually negotiated where it has been drafted in advance and the consumer has not been able to influence its substance, particularly in the context of a pre-formulated standard contract. The fact that certain aspects of a term or one specific term have been individually negotiated shall not exclude the application of the Directive to the rest of a contract if an overall assessment of the contract indicates that it is nevertheless a pre-formulated standard contract. Finally, the third subparagraph of Article 3(2) establishes that where a seller or supplier claims that a standard term has been individually negotiated, the burden of proof shall be incumbent on that party.
- 123 As follows from Article 8, the Directive provides for minimum harmonisation. Therefore, it is for the national court to assess whether the relevant Icelandic legislation provides for a greater level of protection. In particular, it must assess whether the unfairness review of consumer contracts available under Article 36 et seq. of Act No 7/1936 has been extended to terms that have been individually negotiated.
- 124 As for the question itself, first, the simple mention in the bond that the obligation is index-linked and specification of the base index to be used when calculating price-changes does not entail that the contractual term has to be regarded as having been individually negotiated. Second, the fact that the bond was accompanied by a payment schedule itemising estimated payments to be made on the agreed due dates must be assessed in the same way. The schedule expressly states that it only provides estimates, which may change in accordance with the indexation provision of the bond. Third, the fact that both parties have signed the payment schedule cannot alter the assessment under Article 3(2). More specifically, the substance of the payment schedule cannot be negotiated, as it is based on projections of future payments under the bond that depend on the CPI as calculated each month.
- 125 Consequently, there is nothing in the request of the national court to suggest that the bond at issue in the main proceedings was individually negotiated. Were the Defendant to claim otherwise, it would be incumbent on that party to prove this in accordance with the third subparagraph of Article 3(2) of the Directive. On the contrary, the information provided in the request tends to suggest that the price-indexation clause was both a standard term used by the bank and part of a pre-drafted document.

- 126 In light of the above, the answer to the third question must be that it is for the competent national court to establish whether a particular contract term has been negotiated individually within the meaning of Article 3 of Directive 93/13/EEC.

The fourth question

- 127 By its fourth question, the referring court seeks to establish, in essence, whether, under the circumstances described in the third question, the method of calculation of price changes in contracts for loans to finance real estate purchases must be regarded as having been explicitly described to the consumer within the meaning of point 2(d) of the Annex to the Directive.

Observations submitted to the Court

- 128 The Plaintiff submits that the indexation is generally lawful, although the method by which prices vary, e.g. the underlying criteria for the calculation of the index, is far from being explicitly described. What is laid down in the bond is the principle of the loan being linked to the CPI. The bond also explains in some detail how the principal shall be revised to reflect changes in the consumer price index. However, this information does not enable the Plaintiff as a consumer to read from the terms of the contract, prior to or at the time he enters into it, the extent of the obligations he is undertaking. No guidance is given as to what to expect in terms of payment obligations during the contract period as a result of the indexation. For that to be the case, everything of importance would have had to be written into the contract in a clear and unambiguous fashion.
- 129 On the basis that the Directive is applicable, the Defendant submits that, at the time the bond was issued, it was prescribed as a matter of national law which information had to be given to consumers regarding the terms in consumer credit agreements, including indexation clauses in mortgage loans, and it indeed complied with these rules, i.e. Articles 6 and 12 of Act No 121/1994.
- 130 To the extent that the Court regards the question as admissible, the Icelandic Government submits that point 2(d) of the Annex to the Directive, which is to be considered a limitation of paragraph 1(l) of the Annex, is not relevant to the issue before the national court. Indexation of a loan principal does not represent a change in the price of goods or services over the duration of the contract. Rather, it is intended to ensure that the principal of the loan remains consistent over the loan's repayment period and is not reduced by inflation. Moreover, Icelandic law only permits loans to be indexed to the publicly maintained CPI. Therefore, lenders cannot unilaterally change the amount owed by borrowers.
- 131 Should the Court hold that point 2(d) of the Annex applies to the indexation terms at issue, the Icelandic Government submits that the information provided could be regarded as an explicit description of the method by which prices may vary, in particular since information about the consumer price index itself is publicly available. In that respect, the Government adds that a reference was made to the base index on the date the loan was taken out and a payment

schedule with an illustrative example of estimated payments based on a given set of presumptions was provided. However, it is not possible to determine in the abstract whether or not a hypothetical document explicitly describes the method by which prices may vary. Accordingly, it is for the national court having regard to the actual document, all the circumstances of the case, and the knowledge of the parties to determine this matter.

- 132 As a preliminary point and in the event that the Directive is applicable, ESA notes that the Icelandic version of the relevant provision of the Annex differs from the English version. The latter uses the term “explicitly described” and not “explicitly explained” (in Icelandic: “útskýrð rækilega”). Other language versions are: FR: “explicitement décrit”; DE: “ausdrücklich beschrieben”; IT: “esplicitamente descritte”; ES: “se describa explícitamente”; DA: “udførligt beskrevet”; and SV: “beskrivs tydligt”.
- 133 In that regard, ESA submits that the term must be interpreted in line with the above-mentioned language versions of the Directive, in other words that the method by which prices vary must be explicitly described.
- 134 ESA submits further that it is for the national court to assess whether the price-indexation clause has been explicitly described in the relevant documents within the meaning of point 2(d) of the Annex to the Directive. Article 5 of the Directive must be taken into account when making that assessment and that the fairness or unfairness of a commercial practice must be assessed against the “average consumer”, who must be “reasonably well-informed and reasonably observant and circumspect”, taking into account social, cultural and linguistic factors.
- 135 ESA argues that the circumstances described in the request suggest that the methods of calculating price changes in contracts for loans for the financing of real estate purchases have been explained to the consumer in a sufficiently clear manner. In particular, it appears to reflect the method of calculation explicitly described in Chapter VI of Act No 38/2001 and Rules No 492/2001. Overall, the information given about the revision of the principal of the debt and the calculation of the instalments in the bond and the accompanying payment schedule is sufficient for the purposes of the Directive.
- 136 The Commission submits that the description of the method by which prices vary, as also required by point 2(d) of the Annex to the Directive, is a crucial element of the case at hand. It allows the consumer to make an informed choice before signing the contract. Relevant factors will include those set out in points (a) and (b) of the third question, taken together with the precise drafting of the clause as a whole, as well as all other relevant circumstances, including the extent to which the clause complies with the national provisions on price indexation.
- 137 The Commission adds that, where interest payments under a loan are indexed, it is clear that the payment schedule cannot, by its very nature, predict the exact instalments to be paid in the future. However, an explicit and clear statement to

the effect that those instalments might change in accordance with a defined index, as well as a specific reference to the price index method used, normally satisfies the transparency requirements mentioned above.

Findings of the Court

- 138 In the event that the Directive is applicable, it must be noted that the Icelandic language version of point 2(d) of the Annex to the Directive differs materially from the other versions of the provision including the English, Norwegian, German, French, Danish, Swedish, Italian and Spanish language versions. The latter versions use the term “explicitly described”, and not “explicitly explained” (in Icelandic: “útskýrð rækilega”).
- 139 In the case of discrepancy between different language versions, the version which reflects the purpose and the general scheme of the rules provided for as well as the general principles of EEA law must be deemed to express the meaning of an EEA law provision (compare *Irish Bank*, cited above, paragraphs 84 to 99). Consequently, point 2(d) of the Annex to the Directive requires an “explicit description” and not an “explicit explanation” of the method by which prices vary.
- 140 As regards the question referred by the national court, the jurisdiction of the Court extends to the interpretation of the concept of an “unfair term” used in Article 3(1) of the Directive and in the Annex thereto, bearing in mind that it is for that court to determine, in the light of those criteria, whether a particular contractual term is actually unfair in the circumstances of the case, including the question whether the method of calculation of price changes in contracts for loans to finance real estate purchases has been explicitly described.
- 141 It is of crucial importance for a consumer to obtain adequate information on a contract’s terms and consequences before concluding it. This is particularly the case if the parties agree on a price indexation that leads automatically to adjustments of the principal of the debt, such as the CPI indexation at issue. 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.
- 142 Accordingly, it is of fundamental importance for that purpose, first, whether the contract sets out in a transparent fashion a description of the indexation mechanism of a 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 (compare, to that effect, *Invitel*, cited above, paragraphs 24, 26 and 28).
- 143 It is clear that the obligation to make the consumer aware of the method of the variation of the instalments is not satisfied by the mere reference, in the contract, to a legislative or regulatory act determining the rights and obligations of the parties. It is essential that the consumer is informed by the seller or supplier of the content of the provisions concerned (compare, to that effect, *Invitel*, cited above, paragraph 29).

- 144 In the present case it must be examined whether the price indexation clause contained an explicit and comprehensible description of the “method by which prices vary”, as required by point 2(d) of the Annex to the Directive. Such a description must allow the consumer to make an informed choice before signing the contract. As the Commission has submitted, the relevant factors will include those set out in points (a) and (b) of the third question, taken together with the precise drafting of the clause as a whole, as well as all other relevant circumstances.
- 145 Where instalment payments under a loan are indexed, a payment schedule will by its very nature contain predictions concerning future instalments. Such predictions may only exceptionally and by chance correspond to an actual instalment to be paid. Therefore, the contract must contain an explicit and clear statement to the effect that those instalments might change in accordance with a defined index, as well as a specific description and reference to the price index method used.
- 146 The answer to the fourth question must therefore be that it is for the national court to establish whether a contract term relating to the indexation of repayment instalments of a loan to finance real estate purchases must be regarded as having been explicitly and comprehensibly described to the consumer. Such an assessment must take into account the precise wording of the relevant contract terms and all other relevant circumstances, including the circumstances set out in points (a) and (b) of the third question posed by the national court, as well as the national legislation on price indexation.

The fifth question

- 147 In order to provide an interpretation of EEA law as useful as possible to the referring court, it is necessary to construe the fifth question as asking, in essence, which obligations follow from Article 6(1) of the Directive where a national court finds, pursuant to the Directive, that a given term is unfair.

Observations submitted to the Court

- 148 The Plaintiff submits that, pursuant to Article 6(1) of the Directive and the case law concerning the function of that provision, EEA States are obliged to introduce into national law provisions to the effect that unfair contract terms pursuant to Article 3(1) of the Directive shall not be binding on the consumer. EEA States have no discretion concerning the obligation to release a consumer from the binding effect of an unfair contract term.
- 149 The Plaintiff also contends that, pursuant to Article 6(1) of the Directive, a contract that contains an unfair term shall continue to bind the parties if it is capable of continuing in existence without the unfair term. In the present case, it is clear that this is possible. The loan will simply become a normal, non-indexed consumer mortgage loan agreement.

- 150 ESA submits that the question is only of a hypothetical nature in a case such as the present, since it is obvious from the information provided in the request that the Icelandic legislature has already made its choices on the implementation of Article 6(1) of the Directive. It argues, however, that the Court is competent to reformulate the question if it considers it appropriate to advise the national court on the obligation that follows from Article 6(1) of the Directive where a national court finds that a given term is unfair within the meaning of the Directive.
- 151 As regards the duty of national courts to interpret national law in conformity with EEA law, ESA recalls that Article 3 EEA requires the EEA States to take all measures necessary to guarantee the application and effectiveness of EEA law. ESA notes further in that respect that it is settled case law that a national court seised with a case to which the Directive applies has to carry out, of its own motion, an assessment of the fairness of the contractual terms.
- 152 On that basis, ESA submits that Article 6(1) of the Directive requires that, where a national court considers that a given term before it is unfair within the meaning of that Directive, that court must (i) make a finding accordingly, and (ii) draw the necessary consequences, that is to say, ensure that such a clause is not binding on the consumer and to decide whether “the contract is capable of continuing in existence without the unfair terms”, and in that case (only) the contract “shall continue to bind the parties”.
- 153 ESA contends finally that Article 4(1) of the Directive sets out that, in assessing whether a given term is unfair within the meaning of the Directive, the relevant point in time is when the agreement at issue is concluded. In other words, a term that is fair at that time cannot, under the Directive, be considered to become unfair at a later stage of the contract’s term. Nor can an unfair term become fair due to lapse of time or changes that take place subsequent to the conclusion of the contract.
- 154 On the question whether national law is obliged to make an unfair term non-binding on the consumer, the Commission observes that Article 6(1) of the Directive plainly states that unfair terms in a contract “shall not” be binding on the consumer.
- 155 The Defendant and the Icelandic Government agree that Article 6 of the Directive requires EEA States to take the necessary measures to ensure that unfair terms used in a contract concluded with a consumer by a seller or supplier are not binding on the consumer. However, EEA States have the choice of form and method of implementation under Article 7 EEA, which corresponds to the principle of national procedural autonomy, as limited by the principles of equivalence and effectiveness. Accordingly, the Icelandic Government argues that it is sufficient for a State to provide the national courts with the power to annul unfair contractual terms as long as they are obliged to exercise that power with respect to terms they find unfair pursuant to the Directive.

- 156 As regards the situation under Icelandic law, the Icelandic Government submits, with reference to Articles 36a and 36c of Act No 7/1936, that Article 36 of that Act relates both to contractual terms that may be unfair pursuant to the Directive and to terms that may be invalid or unfair purely as a matter of national law. Pursuant to Article 3 of Act No 2/1993, Icelandic courts are obliged to interpret national law in line with Iceland’s obligations stemming from the EEA Agreement. In accordance with those obligations, national courts, acting within the constitutional scope of that power, must annul contractual terms where they find that a contractual term is unfair within the meaning and scope of the provisions implementing the Directive.
- 157 The Icelandic Government argues that the end-result for the consumer is thereby effectively the same whether national law explicitly requires national courts to annul unfair contractual terms or simply gives them the power to do so.

Findings of the Court

- 158 Given the nature and significance of the public interest which constitutes the basis of the protection guaranteed to consumers, who are in a weak position vis-à-vis sellers or suppliers, the Directive requires EEA States, as is apparent from Article 7(1), read in conjunction with recital 24 in the preamble thereto, to provide for adequate and effective means “to prevent the continued use of unfair terms in contracts concluded with consumers by sellers or suppliers”.
- 159 Article 3 of the EEA Agreement requires the EEA States to take all measures necessary to guarantee the application and effectiveness of EEA law. It is inherent in the objectives of the EEA Agreement that national courts are bound, as far as possible, to interpret national law in conformity with EEA law. Consequently, they must, as far as possible, apply the methods of interpretation recognised by national law in order to achieve the result sought by the relevant rule of EEA law (see Case E-6/13 *Metacom AG v Rechtsanwälte Zipper & Kollegen* [2013] EFTA Ct. Rep. 856, paragraph 69 and case law cited).
- 160 It is necessary to refer both to the wording of Article 6(1) of the Directive and to the objectives and overall scheme of that provision to examine the consequences of a finding that a contractual term is unfair (compare, to that effect, Case C-482/07 *AHP Manufacturing* [2009] ECR I-7295, paragraph 27, and Case C-125/10 *Merck Sharp & Dohme Corp.* [2011] ECR I-12987, paragraph 29).
- 161 According to the wording of Article 6(1) of the Directive, the EEA States are granted a certain degree of autonomy with respect to the definition of the legal arrangements applicable to unfair terms. Nevertheless they are expressly required to provide that those terms “shall [...] not be binding on the consumer and that the contract shall continue to bind the parties upon those terms if it is capable of continuing in existence without the unfair terms”.
- 162 As follows from settled case law, the national court is required, where it has available to it the legal and factual elements necessary for that task, to assess of

its own motion whether a contractual term falling within the scope of the Directive is unfair, compensating in this way for the imbalance which exists between the consumer and the seller or supplier (compare C-280/13 *Barclays Bank*, judgment of 30 April 2014, reported electronically, paragraph 34; *Aziz*, cited above, paragraph 46 and case law cited).

- 163 In that regard, it is for the referring court to ascertain what the national rules applicable to the dispute before it are and to do whatever lies within its jurisdiction, taking the whole body of domestic law into consideration and applying the interpretative methods recognised by domestic law, with a view to ensuring that Article 6(1) of the Directive is fully effective and achieving an outcome consistent with the objective pursued by it (see, to that effect, Case C-282/10 *Dominguez*, judgment of 24 January 2012, published electronically, paragraph 27, and case law cited, and Case C-618/10 *Banco Español de Crédito*, judgment of 14 July 2012, published electronically, paragraph 58).
- 164 It follows from Article 6(1) of the Directive that national courts are required only to exclude the application of an unfair contractual term such that it does not produce binding effects with regard to the consumer, without also being authorised to revise the term's content. In principle, the contract must continue in existence (compare, to that effect, Case C-26/13 *Kásler and Káslerné Rábai*, judgment of 30 April 2014, published electronically, paragraphs 80 to 84) without any amendment other than that resulting from the deletion of the unfair terms, in so far as, in accordance with the rules of domestic law, such continuity of the contract is legally possible.
- 165 In the light of the foregoing, the answer to the fifth question must be 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.

V Costs

- 166 The costs incurred by the Icelandic Government, ESA and the Commission, which have submitted observations to the Court, are not recoverable. Since these proceedings are a step in the proceedings pending before Héraðsdómur Reykjavíkur, any decision on costs for the parties to those proceedings is a matter for that court.

On those grounds,

THE COURT

in answer to the questions referred to it by Reykjavík District Court hereby gives the following Advisory Opinion, on the basis and to the extent that contractual terms on the indexation of repayment instalments of mortgage loans, such as those at issue in the main proceedings, are not considered to reflect mandatory regulatory or statutory provisions in accordance with Article 1(2) of Directive 93/13/EEC:

- 1. Directive 93/13/EEC does not generally prohibit contractual terms on the indexation of mortgage loans in contracts between a supplier and a consumer. It is for the referring court to assess whether the term at issue is unfair. The assessment must take into account the Court’s interpretation of the concept of “unfair term”.**
- 2. Directive 93/13/EEC does not limit the discretion of an EEA State to determine, whether through legislation or by means of administrative regulation, the factors that may cause changes in a pre-determined index, such as the Icelandic consumer price index, as well as the methods for measuring those changes, provided they are explicitly described in the contract.**
- 3. It is for the competent national court to establish whether a particular contract term has been negotiated individually within the meaning of Article 3 of Directive 93/13/EEC.**
- 4. It is for the competent national court to establish whether a contract term relating to the indexation of repayment instalments of a loan to finance real estate purchases must be regarded as having been explicitly and comprehensibly described to the consumer. Such an assessment must take into account the precise wording of the relevant contract terms and all other relevant circumstances, including the circumstances set out in points (a) and (b) of the third question posed by the national court, as well as the national legislation on price indexation.**

- 5. Article 6(1) of Directive 93/13/EEC 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.**

Carl Baudenbacher

Per Christiansen

Páll Hreinsson

Delivered in open court in Luxembourg on 28 August 2014.

Philipp Speitler
Acting Registrar

Carl Baudenbacher
President