Lögfræðistofa Reykjavíkur

Reykjavík, 21 April 2023

TO THE PRESIDENT AND MEMBERS OF THE EFTA COURT

WRITTEN OBSERVATIONS

submitted pursuant to Article 90 of the Rules of Procedure of the EFTA Court by

Elva Dögg Sverrisdóttir and Ólafur Viggó Sigurðsson

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in

CASE E-1/23

Elva Dögg Sverrisdóttir and Ólafur Viggó Sigurðsson

v

Íslandsbanki hf.

in which the District Court of Reykjanes (Héraðsdómur Reykjaness) requests the EFTA Court to give an advisory opinion pursuant to Article 34 of the Agreement between the EFTA states on the Establishment of a Surveillance Authority and a Court of Justice concerning the interpretation and application of Directive 2014/17/EU, in particular, Article 24 of the Directive, and as appropriate, Article 10(2)(f) of Directive 2008/48/EC.

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INTRODUCTION

1. By an application dated 1 February 2023, the District Court of Reykjanes (Héraðsdómur Reykjaness) requested the EFTA Court (hereinafter "the Court") to give an advisory opinion pursuant to Article 34 of the Agreement between the EFTA states on the Establishment of a Surveillance Authority and a Court of Justice. The District Court had concluded that interpretation of Directive 2014/17 was paramount for the resolution of the case *Elva Dögg Sverrisdóttir v Íslandsbanki hf.* and therefore referred the following question to the Court:

> *Is it compatible with Directive 2014/17/EU, (see, in particular, Article 24 thereof) and, as appropriate, Article 10(2)(f) of Directive 2008/48/EC (cf. recital 19 of Directive 2014/17/EU), that the terms of a consumer property mortgage with variable interest state that adjustments of the borrowing rate will take account of factors including operating costs and other unforeseen costs?*

LEGAL CONTEXT

EEA Law

2. In the Preamble to the Agreement of the European Economic Area the contracting parties state their determination to "*...promote the interests of consumers and to strengthen their position in the market place, aiming at a high level of consumer protection.*"

3. Recital 67 of Directive 2014/17 states:

> *It is important to ensure that sufficient transparency exists to provide clarity for consumers on the nature of the commitments made in the interests of preserving financial stability and on where there is flexibility during the term of the credit agreement. Consumers should be provided with information concerning the borrowing rate during the contractual relationship as well as at the pre-contractual stage. Member States should be able to maintain or introduce restrictions or prohibitions on unilateral changes to the borrowing rate by the creditor.*

4. Article 17 (6) of Directive 2014/17 states:

Where the credit agreement allows for variations in the borrowing rate, Member States shall ensure that the consumer is informed of the possible impacts of variations on the amounts payable and on the APRC at least by means of the ESIS.

5. Article 24 of Directive 2014/17 states:

   Where the credit agreement is a variable rate credit, Member States shall ensure that: (a) any indexes or reference rates used to calculate the borrowing rate are clear, accessible, objective, and verifiable by the parties to the credit agreement and the competent authorities.

6. Annex II of Directive 2014/17, Part B, provides instructions to complete the European Standardized Information Sheet (ESIS). Section 3(6), "Main features of the loan," states:

   This section shall explain whether the borrowing rate is fixed or variable and, where applicable, the periods during which it will remain fixed; the frequency of subsequent revisions and the existence of limits to the borrowing rate variability, such as caps or floors. The formula used to revise the borrowing rate and its different components (e.g. reference rate, interest rate spread) shall be explained. The creditor shall indicate, e.g. by means of a web address, where further information on the indices or rates used in the formula can be found, e.g. Euribor or central bank reference rate.

7. Recital 19 of Directive 2014/17 states:

   For reasons of legal certainty, the Union legal framework in the area of credit agreements relating to residential immovable property should be consistent with and complementary to other Union acts, particularly in the areas of consumer protection and prudential supervision. Certain essential definitions including the definition of 'consumer', and 'durable medium', as well as key concepts used in standard information to designate the financial characteristics of the credit, including 'total amount payable by the consumer' and 'borrowing rate' should be in line with those set out in Directive 2008/48/EC so that the same terminology refers to the same type of facts irrespective of whether the credit is a consumer credit or a credit relating to residential immovable property. Member States should therefore ensure, in the transposition of this Directive, that there is consistency of application and interpretation in relation to those essential definitions and key concepts.

8. Article 5 (1)(f) of Directive 48/2008/EC sets out the pre-contractual information the creditor is obliged to provide the consumer with regarding variable interest rates:

   The information in question shall specify:

   ...

   (f) the borrowing rate, the conditions governing the application of the borrowing rate and, where available, any index or reference rate applicable to the initial borrowing rate, as well as the periods, conditions, and procedure for changing the borrowing rate; if different borrowing rates apply in different circumstances, the abovementioned information on all the applicable rates

9. Article 10 (2)(f) of Directive 48/2008/EC, on information to be included in credit agreements, states:

   The credit agreement shall specify in a clear and concise manner:

   ...

   (f) the borrowing rate, the conditions governing the application of that rate and, where available, any index or reference rate applicable to the initial borrowing rate, as well as the periods, conditions and, if different borrowing rates apply in different circumstances, the abovementioned information in respect of all the applicable rates procedures for changing the borrowing rate and, if different borrowing rates apply in different circumstances, the abovementioned information in respect of all the applicable rates

10. Recitals 20 and 24 of Directive 93/13/EEC on unfair terms in consumer contracts state:

    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 favorable to the consumer should prevail

    ...

    Whereas 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

11. Article 3(1) of Directive 93/13/EEC states:

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.

12. Article 4 of Directive 93/13/EEC states:

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 supplies in exchange, on the other, in so far as these terms are in plain intelligible language.

13. Article 5 of Directive 93/13/EEC states:

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.

14. The Annex to Directive 93/13/EEC, which contains an indicative list of the terms which may be regarded unfair, is worded as follows:

Terms which have the object or effect of:

...

(i) irrevocably binding the consumer to terms with which he had no real opportunity of becoming acquainted before the conclusion of the contract;

(j) enabling the seller or supplier to alter the terms of the contract unilaterally without a valid reason which is specified in the contract;

...

(l) 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;
(m) giving the seller or supplier the right to determine whether the goods or services supplied are in conformity with the contract, or giving him the exclusive right to interpret any term of the contract;

National Law[1]

15. Article 34 of Act no. 118/2016 on Consumer Property Mortgage states:

If a property mortgage agreement contains a provision stating that reference values, indexes or reference index rates are to be used for determining variable interest rates, the creditor may only use reference values, indexes or reference rates that are clear, accessible, objective and verifiable, both by parties to the agreement and by the Consumer Agency (Neytendastofa).

If a decision on the adjustment of the interest rate is not based on a reference value, indexes, or a reference interest rate, then the mortgage agreement shall state the conditions and procedure for adjustment of the interest rate.

16. Annex I of Regulation no. 270/2017 on Consumer Property Mortgages contains a standardized information sheet for creditors to provide to consumers. Part B of Annex I sets out instructions to creditors on how to complete the information sheet, and states in segment 3(6) (Main features of the loan):

This section shall explain whether the borrowing rate is fixed or variable and, where applicable, the periods during which it will remain fixed; the frequency of subsequent revisions and the existence of limits to the borrowing rate variability, such as caps or floors. The formula used to revise the borrowing rate and its different components (e.g. reference rate, interest

[1] Translated from Icelandic to English

rate spread) shall be explained. The creditor shall indicate, e.g. by means of a web address, where further information on the indices or rates used in the formula can be found, e.g. Euribor-interests or central bank reference rate.

17. Article 7 (4) of the Consumer Lending Act no. 33/2013 states:

f. the borrowing rate, the conditions for its application and, if appropriate, any index or reference interest rate applicable to the initial borrowing rate, as well as the periods, conditions, and procedures for changing the borrowing rate and, if different borrowing rates apply in different circumstances, the abovementioned information shall be provided on all of them.

18. Article 12 (2) of the Consumer Lending Act no. 33/2013 states:

A loan agreement shall set out in clear and concise manner:

...

f. the borrowing rate, conditions governing its application, and if appropriate, index or reference rate that can affect the initial borrowing rate, as well as the periods, conditions, and procedures for changing the borrowing rate and, if different borrowing rates apply in different circumstances, the abovementioned information in respect of all the applicable rates...

19. Article 36 (b) of the Act no. 7/1936 on contracts, agency, and void legal instruments states:

Written contracts offered by a business operator to consumers shall be phrased in plain and intelligible language.

20. Article 36 (c) (2) of the Act no. 7/1936 on contracts, agency, and void legal instruments states:

A contract is unfair if it is contrary to good business practices and materially distorts 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, in full or in part, or amended, the contract shall, at the request of the consumer, remain valid in other respects without change if it can be performed without the term

FACTS

21. The plaintiffs of this case, Elva Dögg Sverrisdóttir and Ólafur Viggó Sigurðsson, live with their three children in Mosfellsbær, Iceland. Ólafur is a fisherman, and Elva Dögg has a degree in cosmetology but is currently a student in landscape architecture. Neither of the plaintiffs has any professional experience or education in finance or banking.

22. In 2021, they concluded a mortgage loan agreement with Íslandsbanki, a leading commercial bank in Iceland, for the purpose of financing the acquisition of their family home in Mosfellsbær. The loan disputed in this case (hereinafter the "Loan"), originally amounted to ISK 57,610,000. The mortgage loan agreement is dated January 21st, 2021 (hereinafter "the Agreement") and is still outstanding. The term of the loan is 40 years, and it is to be repaid in 480 monthly installments.

23. The terms of the Loan stipulate that the interest rate is variable. At the signing date of the Agreement, this interest rate was an annual rate of 3.4%. The bank has increased the interest rate several times. When the plaintiffs filed this lawsuit against Íslandsbanki in December 2021 the applicable rate was 3.95% and according to Íslandsbanki's most recent interest rate decision applicable to the Loan the rate will be 9.25% from 30 April 2023.

24. Clauses 1-2 in the Agreement describe how the variable interest rate functions (my translation):

    1. *The loan shall be repaid with equal installments of interest and principal, but as the interest is variable under clause 2, the lender reserves the right to re-calculate the loan following any interest rate change and/or change of terms in line with changed conditions and then installments shall be based on the interest rate that is applicable on the day that the recalculation refers to. Adjustments to the interest rate can lead to an increase or decrease in any installment and therefore affect the total repayment of the loan.*[2] *(see the original Icelandic text in footnote 2)*

[2] Skuldin endurgreiðist með jöfnum greiðslum vaxta og afborgana, jafngreiðslulán, en þar sem vextir eru breytilegir sbr. 2. tl. áskilur lánveitandi sér rétt til að endurreikna lánið við hverja vaxtabreytingu og/eða skilmálabreytingu

2. ***Variable non-indexed property mortgage interest*** *shall be paid on this loan as determined at any given time and published in the interest rate chart of Íslandsbanki hf. The interests of Íslandsbanki hf. on this loan and any adjustment thereof shall take account, amongst other things, of changes to the financing costs (terms of loans) of the bank, operating costs, public levies and/or other unforeseen costs, the key rate of the Central Bank of Iceland, changes in the consumer price index, etc. Decisions on adjustments are taken by a professional committee acting on behalf of the management of the bank. The committee considers primarily the development of the cost factors mentioned above and assesses whether changes regarding these factors present a reason to change the borrowing rate. The proportional weight of each factor mentioned above varies and is determined, among other things, by decisions taken by the government and market conditions at any given time. When the rate is adjusted all the factors are assessed together and/or each on its own. If any of these factors has changed when the borrowing rate is revised, whether a fixed rate loan or variable, it can result in an adjustment to the rate, either an increase or a decrease.*[3] *(see the original Icelandic text in footnote 3)*

25. Before the Agreement was concluded, the plaintiffs signed the standard information sheet (based on the ESIS) provided by the defendant. The information sheet neither provides further information concerning the factors that determine the adjustments to the borrowing rate nor on the method used to calculate or determine the rate. The information sheet only reiterates the terms of the Agreement.

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miðað við breyttar forsendur og miðast þá afborganir við vexti eins og þeir eru á þeim degi sem endurútreikningurinn miðast við. Vaxtabreytingar geta leitt til hækkunar eða lækkunar hverrar greiðslu og hafa þ.a.l. áhrif á heildarendurgreiðslu lánsins.

[3] Af höfuðstól skuldar þessarar eins og hann er á hverjum tíma ber að greiða **breytilega óverðtryggða húsnæðisvexti** eins og þeir eru ákveðnir á hverjum tíma og birtir í vaxtatöflu af Íslandsbanka hf. Vextir Íslandsbanka hf. á láni þessu og breytingar á þeim taka meðal annars mið af breytingum á fjármögnunarkostnaði (lánskjörum) bankans, rekstrarkostnaði, opinberum álögum og/eða öðrum ófyrirséðum kostnaði, stýrivöxtum Seplabanka Íslands, breytingum á vísitölu neysluverðs o.s.frv. Ákvarðanir um breytingar á vöxtum eru teknar af fagnefnd innan bankans í umboði yfirstjórnar. Nefndin skoðar einkum þróun á þeim kostnaðarþáttum sem að framan eru taldir og metur hvort breytingar á þeim gefi tilefni til breytinga á útlánsvöxtum. Hlutfall framangreindra þátta í ákvörðun um breytingar á vöxtum er breytilegt og ræðst meðal annars af ákvörðunum opinberra aðila og markaðsaðstæðum hverju sinni. Við vaxtabreytingar eru allir þessir þættir metnir saman og/eða hver um sig. Hafi orðið breyting á einhverjum þessara þátta þegar vaxtaendurskoðun lán fer fram, hvort sem um er að ræða lán með föstum eða breytilegum vöxtum, getur það leitt til þess að vöxtum verði breytt, hvort sem er til hækkunar eða lækkunar.

26. In the spring of 2021, the Consumers' Association of Iceland ("NS") started a public campaign to highlight how leading Icelandic commercial banks adjust variable rates in consumer loans. NS pointed out that standardized terms in loan agreements, offered to consumers, lack necessary transparency and that these terms provide banks with an opportunity to manipulate rates to their benefit at the cost of ordinary consumers.

27. The NS published a study that showed that leading commercial banks in Iceland had between 2019 and 2021 significantly increased the margin/spread on their loans. The interest rates of Íslandsbanki developed in this manner during the same period. In January 2019 the rate of variable non-indexed mortgage loans (the same type as disputed in this case) determined by the defendant was 6%, whereas the key rate of the Central bank was 4.5%, representing a margin of 1.5%. In January 2021 the rate of variable non-indexed mortgage loans (the same type as disputed in this case) determined by the defendant was 3.4%, whereas the key rate of the Central bank was 0.75%, representing a margin of 2.65%. In a relatively short period, the bank had increased the margin/spread by 76.7%, measured against the key rate of the Central Bank.

28. The development of the variable interest rate on Íslandsbanki's consumer property loans during the last decade is illustrated in Image 1 (Source: Neytendasamtökin – The Icelandic Consumer Association).

[Image 1 is on the next page]

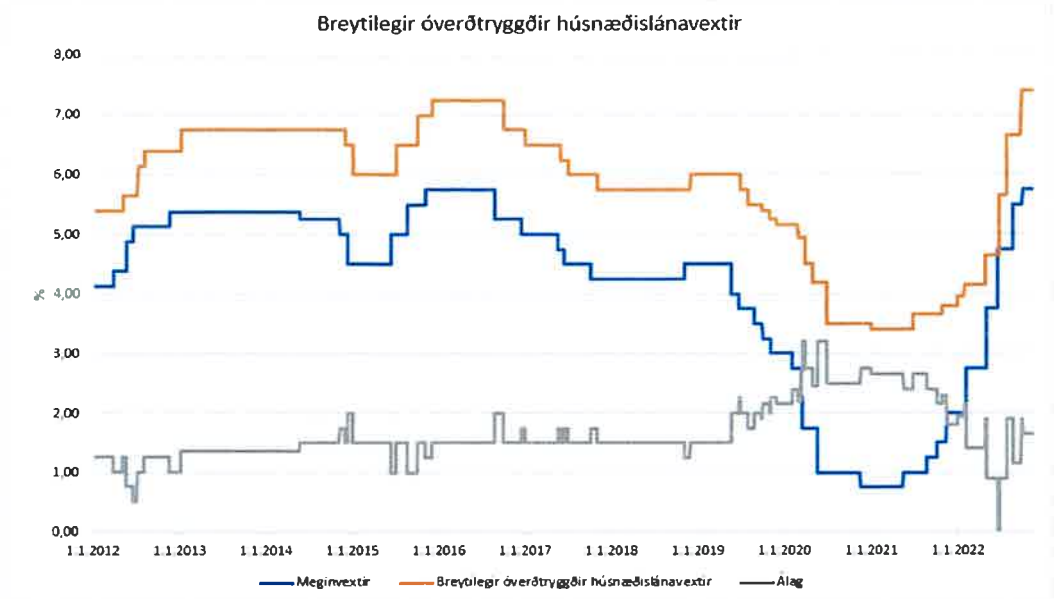

Image 1. Interest rate trends from 1 January 2012 to 1 December 2022. Central Bank of Iceland, key interest rate (blue), Íslandsbanki, variable non-indexed rate (orange), and the difference between the two (grey).

29. The blue line in Image 1 shows the development of the key interest rate of the Central Bank of Iceland, from 2012 through November 2022. The orange line shows the development of the interest rate determined by Íslandsbanki for variable rate credits of the same type as the Loan, during the same period. Furthermore, the graph illustrates that the interest rate determined by Íslandsbanki follows the Central Bank's key rate consistently from 2012 till 2019, and the spread on the base rate was therefore relatively constant until 2019. Finally, the graph demonstrates how Íslandsbanki increased its margin, or spread, from 2019, thus denying consumers the gains from favorable interest rate conditions. The margin decreases slightly in 2021-2022, but then seems to start following the sharp increase in the key rate of the Central Bank. The margin is still considerably higher than during the period 2012 to mid-2019. The plaintiffs note that in 2022, the margin drops in short periods following steep increases in the key rate announced by the Central Bank, but the key rate increased from 2% in January 2022 up to 6% in November. The main reason for these drops is a time lag resulting from the obligation of the defendant to provide consumers with at least one-month notice before an increase in the borrowing rate takes effect.

30. Shortly before the plaintiffs signed the Agreement, the Consumer Appeals Committee (Icelandic: Áfrýjunarnefnd neytendamála), a government agency, had ruled in case no. 11/2019 that Íslandsbanki had not fulfilled the requirements of Article 7 (4) (f) and Article 12 (2) (f) of the Consumer Lending Act no. 33/2013 with respect to information concerning adjustments to the borrowing rate in its standardized consumer mortgage loan agreement. The ruling included the following arguments in paragraph 63[4]: "*Both the standard information sheet and the loan agreement state that interest can take account of "and/or other unforeseen costs." The appellant does not explain what can be considered unforeseen costs in this context, how likely it is that such costs can affect adjustments nor the weight this factor can have on decisions made by the appellant. It must be concluded that it is hardly possible for a general consumer to comprehend under what circumstances the borrowing rate may change on account of reference to unforeseen costs, as the information is presented in the information sheet of the appellant in this case. Furthermore, the list of factors cited by the appellant is obviously not exhaustive, as it begins with the words "among other things" and ends with "etcetera."*[5]

31. The ruling of the Consumer Appeal Committee deals with a variable rate contract term which is identical to the term disputed in this case. Despite this ruling, the defendant has continued to use the same term in its standardized documentation for variable consumer credit. The bank has contested the ruling before courts of law, the District Court in Reykjavík has ruled in favor of the bank, but the Consumer Agency appealed to Landsréttur (an appellate court). According to information received by the plaintiffs in this case, Landsréttur is now considering a motion to seek an advisory opinion of the EFTA Court.

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[4] https://neytendastofa.is/library/Files/Neytendarettarsvid/urskurdir/%c3%9arskur%c3%b0ur2019-11.pdf

[5] "Hvoru tveggja í stöðluðu eyðublaði kæranda og lánssamningum var þannig vísað til þess að vextir gætu tekið breytinga sem tækju mið af „og/eða öðrum ófyrirséðum kostnaði". Ekki var í upplýsingagjöf kæranda útskýrt hvað gæti talist vera ófyrirséður kostnaður í þessum skilningi, hversu líklegt væri að slíkur kostnaður gæti haft áhrif á ákvörðun vaxta eða hvaða vægi hann gæti haft við ákvarðanatöku kæranda. Verður að leggja til grundvallar að hinum almenna neytenda hafi verið illmögulegt að átta sig á því hvaða aðstæður vextir kunna að breytast á grundvelli tilvísunar kæranda til ófyrirséðs kostnaðar eins og upplýsingagjöf bankans var háttað í því eyðublaði kæranda sem liggur til grundvallar í málinu. Þá var upptalning kæranda á þeim breytum sem áhrif gætu haft til hækkunar eða lækkunar á vöxtum kæranda augsýnilega ekki tæmandi, enda hófst hún á orðunum „meðal annars" og endaði á „o.s.frv." Í ljósi þessa verður að líta svo á að kærandi uppfylli ekki upplýsingaskyldu sína á grundvelli f. liðar 4. mgr. 7. gr. og f. liðar 1. mgr. 12. gr. laga nr. 33/2013. Með vísan til þessa verður hin kærða ákvörðun staðfest að því er varðar brot kæranda gegn þessum lagaákvæðum."

32. Consequently, the disputed contract term is now being challenged in two separate court cases in Iceland on behalf of consumers. However, it should be noted that the findings of the Consumer Agency and the Consumer Appeals Committee, only relate to the legality of the term and connected information provided by the defendant, but not the consequences under private law for the contractual relationship between the bank and individual consumers, for example concerning restitution of advantages obtained by the bank through an illegal contract term.

33. The plaintiffs, after they had reviewed arguments and evidence presented by NS, including reference to the findings of the Consumer Agency, believed that the term in the Agreement governing adjustments of the borrowing rate was unfair, and provided the bank with a wide discretion to manipulate the rate to their disadvantage. The evidence showed in their opinion that the bank did not adjust the borrowing rate based on clear, consistent, and objective benchmarks. From their perspective, the contract term provides no foreseeability as to how the bank will in the future determine the rate.

34. The plaintiffs initiated the lawsuit, which was filed in December 2021, against Íslandsbanki, to prevent the bank from adjusting the interest rate in an arbitrary manner and to seek restitution of payments unfairly and illegally obtained by the bank. The plaintiffs argue that the term setting out how the bank is unilaterally allowed to change the rate is illegal and void and maintain that the bank is therefore not allowed to increase the borrowing rate applicable to the Loan on the basis of the term. In addition, the plaintiffs claim repayment of interest paid due to illegal adjustments to the rate by the bank.

35. The plaintiffs base their case on legal requirements stemming from EEA law, the Council Directive 93/13/EEC on unfair terms in consumer contracts (hereinafter "Directive 93/13"), Directive 2014/17/EU on credit agreements for consumers relating to residential property (hereinafter "Directive 2014/17"), and Directive 2008/48/EC on credit agreements for consumers (hereinafter "Directive 2008/48").

LEGAL ANALYSIS

General – the essence of the dispute

36. The disputed contract term, see paragraph 24, refers to 8 factors or elements that may prompt adjustments to the borrowing rate of the Loan:
    a. "Amongst other things"
    b. Financing costs (terms of loans) of Íslandsbanki
    c. Operating costs
    d. Public levies
    e. Other unforeseen costs
    f. The key rate of the Central Bank of Iceland
    g. Changes in the consumer price index
    h. "etc."

37. The term also allegedly describes a method or procedure by which the bank determines or calculates adjustments to the rate. According to clause 2 of the Agreement, adjustments to the rate are determined by the following method or procedure:
    a. A professional committee considers primarily the cost factors mentioned in the Agreement.
    b. The committee assesses whether changes regarding these factors present a reason to change the borrowing rate.
    c. The proportional weight of each factor mentioned above varies and is determined, among other things, by decisions taken by the government and market conditions at any given time.
    d. When the rate is adjusted all the factors are assessed together and/or each on its own.

38. The plaintiffs argue that the terms described above, setting out the conditions and procedure for adjustments of the borrowing rate, do not clarify in any meaningful manner how the defendant adjusts the rate. Firstly, the term refers to factors that are vague and general and open-ended (see further following paragraphs 39-40). Secondly, the method by which these

open-ended factors are used to adjust the rate is varying, or ever-changing, subject only to an unrestricted and unexplained assessment by an internal committee (see further paragraphs 41-43).

39. With regards to the ambiguity of the factors referred to in the Agreement, the plaintiffs want to firstly point out that the contract term does not provide a full description of the factors or elements that affect the interest rate. The terms state that factors, not articulated or mentioned in the Agreement, can affect adjustments to the rate (see the phrases "*amongst other things*" and "*etc.*", paragraph 24).

40. Secondly, the reference factors that the Agreement sets out are extremely vague and general. This applies in particular to the term "*other unforeseen costs*", which obviously does not provide the consumer with any clear guidance on what kind of events or circumstances might affect the rate, or how they might affect the rate. At best it is a disguised signal or statement to the effect that the bank reserves the right to shift to the consumer the burden of any misfortunates in the business operations of the bank. The text "*the financing costs (terms of loans) of the bank"* does not present any specific benchmark but seems to refer to the interest rates of the bank's debt in general (loans in particular[6]). Furthermore, the factor "*operating costs*" is not a precise definition of a specific benchmark, does not explain how operating costs are measured or how such costs may affect the rate, but seems to indicate that any increase in costs experienced by the bank may provide a reason to increase the rate.

41. No actual method or formula to calculate the rate is set out or explained, which leaves wide discretion for the bank to unilaterally change the rate, to the detriment of the plaintiffs. The procedure, described in the Agreement, effectively gives an internal committee an unrestricted mandate to alter and modify the method as it sees fit on each occasion.

42. More specifically, the committee "*considers primarily*" factors mentioned in the term, which clearly implies the committee will assess other undefined factors as well. The committee is to

[6] The meaning of the word "lánskjör", used in the Icelandic text, usually refers to the interest rate and other payment terms of a loan. The provision seems to exclude deposits as a benchmark.

assess whether changes that have occurred in respect of the *"factors present a reason to change"* the rate, which effectively means that the committee decides on each occasion whether the bank adheres to the benchmarks defined in the Agreement. *"The proportional weight of each factor"* varies according to the term, which enables the committee to pick and choose which factors apply to each interest rate adjustment and how they apply.

43. Finally, the Agreement states that "*when the rate is adjusted all the factors are assessed together and/or each on its own.*" In the opinion of the plaintiffs this wording is perplexing, even incomprehensible, particularly for an ordinary consumer. It seems to indicate three methods of assessment that the bank uses to adjust the rate: 1) all factors assessed together, 2) each factor assessed on its own, and 3) all factors assessed together and each on its own. It is not explained how the factors are assessed, the difference between each method is unclear and the consequences of utilizing each of the methods are not determined. In fact, this provision does not provide an ordinary consumer with any useful information on how the bank actually adjusts the borrowing rate. However, the quoted sentence highlights that it is obviously the intension of the defendant to formulate the contract terms in a way which gives the defendant unrestricted power to choose the reference factors at will, and how they are utilized, on each occasion.

44. The plaintiffs maintain in their case against Íslandsbanki that the disputed term, and connected documentation, fail to fulfill transparency requirements set out in Article 34 of the Act no. 118/2016 on Consumer Property Mortgage and Articles 36 (b) and 36 (c) of the Act no. 7/1936 on contracts, agency, and void legal instruments. The plaintiffs argue that it follows from these provisions of Icelandic Law that a bank needs, in order to fulfill transparency requirements in a mortgage loan agreement, to (i) specify in the agreement (or connected documentation) comprehensively relevant factors that can affect decisions to adjust the interest rate, (ii) define with precision each factor or reference that can impact the rate, (iii) use only clear, objective, accessible and verifiable reference rates, and (iv) explain the functionality of the method or formula used to calculate or determine any adjustment to the rate.

45. In its written objections to the District Court of Reykjavík, Íslandsbanki presents a different view with respect to the transparency obligations stemming from the national law referred to in paragraph 44. The defendant maintains in a nutshell that 1) the bank has no obligation to mention all relevant factors used to adjust the borrowing rate in the credit agreement or the connected information sheet or define precisely how they are used to adjust the rate, 2) reference to general terms like "*operation costs*" and "*unforeseen costs*" provide sufficient clarity for the consumer, and 3) the obligation to use only clear, objective, accessible and verifiable factors (reference rates) does not apply because the bank adjusts the rate on the basis of an internal decision by the bank which it takes with reference to factors that only the bank can verify.[7]

46. In the case before the District Court, the plaintiffs have formally requested the defendant to demonstrate how the bank adjusts the borrowing rate. The plaintiffs' request refers in particular to three adjustments made by the bank, which the bank had instigated before the lawsuit was filed in December 2021: 1) on 1 June 2021 the bank increased the borrowing rate from 3.4% to 3.65%, 2) on 7 November 2021 the bank increased the borrowing rate from 3.65% to 3.8%, and 3) on 1 December 2021 the bank increased the borrowing rate from 3.8% to 3.95%. The plaintiffs requested the bank to provide "*information concerning the preconditions, calculation and method used to adjust the interest rate*"[8] in these instances.

47. The defendant has ignored the requests set forth by the plaintiffs. In fact, the bank has not provided to the plaintiffs, in addition to the terms of the Agreement, any information regarding the preconditions, calculations or method used to determine the rate in general or with respect to the specific instances referred to in the preceding paragraph.

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[7] The following is stated in Íslandsbanki´s written memorandum to the District Court, page 8-9: "Af 35. gr. er ljóst að munur er gerður á því varðandi upplýsingagjöf til lántaka um vaxtabreytingar hvort breytingar miðast við viðmiðunargengi, vísitölur eða viðmiðunarvexti sem unnt er að sannreyna eða hvort að breytingin miðast við viðmiðunargengi, vísitölur eða viðmiðunarvexti eða hvort breytingin miðast við ákvörðun lánveitanda." Then the defendant states: "Mótmælt er málsástæðum stefnenda um að lánaskilmálar verði ekki bundnir viðmiðum sem lánveitandi getur einn sannreynt.".

[8] The request was so worded in Icelandic: "Stefnendur skora á stefnda að leggja fram...: ...b) upplýsingar um forsendur, útreikning og aðferð við vaxtabreytingar stefnda, sbr. tilkynningar stefnda á dskj. 7-9."

The question posed to the EFTA Court

48. In its request for an advisory opinion, the District Court states that the case at hand concerns whether the terms of a mortgage deed regarding the calculation of variable interest rates are compatible with Articles 12 and 34 of the Consumer Property Act no. 118/2016 and Article 36 c. of the Act no. 7/1936 on Contracts, Mandates and Invalid Legal Instruments, and that these provisions are to be interpreted in accordance with Directive 2014/17, Directive 2008/48 and Directive 93/13. Moreover, the referring court highlighted the importance for the case of clarifying the interplay between these Directives as regards the term "*reference rate*" and the terms "*conditions and procedure*".

49. However, in the question posed to the Court, the District Court limits its request to only two factors referred to in the Agreement, i.e. "*operating costs*" and "*other unforeseen costs*". Although these open-ended factors are certainly particularly problematic, they should neither be reviewed in isolation from the structure of the contract terms, nor the other applicable factors identified in the Agreement. The relevant provisions of the directives mentioned above do not only set out requirements that apply to individual factors utilized to adjust the borrowing rate of a consumer loan, but also the procedure and methods used to calculate the rate, which necessitates an analysis of the relationship between the factors (for example the relative weight or impact of the factors) and the particularities of the mechanism used to adjust the rate.

50. Consequently, a meaningful guidance to the referring court not only needs to answer the question directly posed by the referring court, but also provide holistic guidance with reference to all elements of interpretation of EEA law which may be of assistance in adjudicating in the case.

Requirements stemming from Art. 24 of Directive 2014/17

51. Directive 2014/17 was transposed into Icelandic Law with Act no. 118/2016, that came into force on the 1st of April 2017. Accordingly, the Directive had already been implemented into Icelandic Law when the EEA Joint Committee decided on 8 May 2019 to incorporate it into the EEA Agreement by Decision no. 125/2019. The Decision was subject to constitutional

requirements, but these requirements had no relevance in the case of Iceland which had already implemented the Directive. All the events relevant for the case at hand occurred long after the Directive had been implemented in accordance with the EEA Agreement.

52. The plaintiffs point out that Iceland had, following the Decision of the EEA Joint Committee, a duty under Article 104 of the EEA Agreement to take necessary steps to ensure implementation and application of the Decision. The plaintiffs also note that, according to Article 103(2) of the EEA Agreement, if upon the expiry of a period of six months after the decision of the EEA Joint Committee a notification lifting constitutional requirements has not taken place, the decision of the EEA Joint Committee shall be applied provisionally pending the fulfilment of the constitutional requirement.

53. Article 24 of Directive 2014/17 has particular relevance for the case at hand, and the question from the District Court is focused on its interpretation and application. In its briefing of the case to the Court, the referring court discusses the necessity to interpret terms in the Article, including the concept "*reference rate*".

54. The concept "*reference rate*" is not defined in Directive 2014/17. The plaintiffs submit that the concept should be interpreted in line with the literal meaning of the words used in the Directive. A rate is commonly understood as a measure or a quantity of something, and a reference rate in this context is therefore a measure or quantity identified as a source of information. The plaintiffs argue that factors mentioned in the Agreement, that may affect adjustments to interest rate of the Loan, constitute "*reference rates*" within the meaning of Article 24 of Directive 2014/17.

55. The key rate of the Central Bank of Iceland is undoubtedly a reference rate within the meaning of Article 24. The term "*financing costs (terms of loans) of Íslandsbanki*"also refers to interest rates applicable to debt owed by the bank to its lenders. The words "*public levies*" seem to refer to taxes and fees charged by the government, which also may be regarded as reference rates within the meaning of Article 24, for example a tax rate. "*Changes in the consumer price*

index" is also a factor referred to by the defendant that falls clearly within the scope of Article 24, which not only applies to reference rates but also indices.

56. The terms "*operating costs*", "*other unforeseen costs*", "*etc.*" and "*among other things*" are so vague and open-ended that it is difficult to classify them with respect to Article 24. However, as the disputed contract term refers to factors that fall within the scope of Article 24, the whole term needs to be reviewed and analyzed on the basis of Article 24.

57. Article 24 of Directive 2014/17 stipulates that a lender must only use reference rates and indices that are clear, accessible, objective, and verifiable. The criterion of Article 24 applies, by necessity, both to the substance, or the qualities, of a reference rate and the utilization thereof. If a lender combines the application of a reference rate with subjective benchmarks, only verifiable by the lender, the lender can no longer be considered to use an objective and verifiable reference rate to adjust the borrowing rate. Any other interpretation of Article 24 would render it meaningless.

58. Consequently, the plaintiffs maintain that the disputed contract terms fail to fulfill the standard set in Article 24. The defendant combines, in the disputed term, potentially clear and objective reference rates, with factors that are subjective, unclear, inaccessible, and unverifiable. The utilization of these different factors is variable and ever-changing and subject to the discretion of the defendant on each occasion. While the defendant purports to use reference rates and indices within the meaning of Article 24, the bank is effectively not using a verifiable benchmark.

59. Furthermore, the plaintiffs argue that the some of the reference rates of the Agreement are not accurately specified, and therefore, it is unclear which rates are used to calculate or determine adjustments of the interest rate of the Loan. Consequently, information regarding the reference rates is not accessible to the consumer. As the rates in the Agreement lack specificity, the terms leave wide discretion to Íslandsbanki, to pick and choose applicable benchmark rates for each adjustment to the interest rate of the Loan. This ambiguity makes it impossible for the consumer to verify that Íslandsbanki has adjusted the rate in accordance with the Agreement.

60. The defendant argues in the bank´s written memorandum to the District Court of Reykjavík, that the abovementioned requirements set out in Article 24 of Directive 2014/17 do not apply to the method used by the bank to determine adjustments to the interest rate. The defendant maintains that the terms of the Agreement that govern the variability of the interest rate, are not connected to, or based on any reference rate. This interpretation of Article 24 entails that it would be optional for creditors whether to use clear and verifiable reference rates for variable rates and adjustments thereof.

61. A rational consumer will expect that the variable interest rate will follow the movements of recognized market benchmarks. The consumer knows that there is a risk of increased rates, but also a promise of an upside if market rates decrease. However, in the absence of transparent benchmarks, the general consumer is in a difficult position to assess the integrity of adjustments made by a professional lender. The well-known story of the infamous LIBOR Scandal illustrates the risk facing consumers of being manipulated when lending rates are adjusted in an unclear and ambiguous process.

62. EEA rules on how financial institutions determine variable rates have at least twofold urgent purpose: to enable comparison between different choices available for consumers and to prevent manipulation.

63. Transparent, clear, and intelligible information and terms governing variable rates enable consumers to compare and reflect on the characteristics of different credit products. Clear information enables the consumer to make rational choices and is important for the functioning of an effective market. Directive 2014/17 states this objective in various provisions (see for example recitals 40, 44, and 66, and Article 14).

64. Moreover, recital 67 of Directive 2014/17 discusses the importance of sufficient transparency to provide clarity for consumers and states that the directive aims to enable regulation to maintain or introduce restrictions or prohibitions on unilateral changes to the borrowing rate by the creditor.

65. The interpretation of Article 24 of Directive 2014/17 should not compromise the attainment of these objectives of the directive. To achieve "*a high level of consumer protection*", one of the aims of the EEA Agreement, terms relating to variable interest rates need to clarify how the interest is adjusted, what factors come into play, and how the lender utilizes these factors to calculate or determine adjustments and their magnitude.

66. If, on the other hand, Article 24 of Directive 2014/17 is interpreted to give creditors the ability to "opt out" by defining very broad and open-ended guidelines for adjustments instead of reference to a concrete objective benchmark, the creditor is provided with great leeway to maneuver and manipulate the interest rate to the detriment of a consumer.

67. Annex II of Directive 2014/17, Part 2 (6) also provides meaningful guidance for the interpretation of Article 24 of the directive. Creditors are instructed to set out "*The formula used to revise the borrowing rate and its different components (e.g. reference rate, interest rate spread) shall be explained. The creditor shall indicate, e.g. by means of a web address, where further information on the indices or rates used in the formula can be found.*" This obviously requires creditors to define clear and concrete references or factors that affect the determination of the interest rate adjustment and, on that basis, specify or explain the functionality of the method or the formula used to determine the adjustments to the rate.

Requirements stemming from Article 10(2)(f) of Directive 2008/48

68. Article 10 (2) of Directive 2008/48 stipulates that certain information and terms need to be specified in a credit agreement "*in a clear and concise manner.*" Item (f) in particular, states that a credit agreement needs to specify "*conditions and procedures for changing the borrowing rate,*" as well as any index or reference rate applicable to the initial rate.

69. The use of the concept "*conditions*" in the text of the directive refers to things, circumstances, or events that are prerequisite to any adjustments of the rate. To ensure full transparency, these conditions need to be stipulated in the text of a credit agreement in a clear and concise manner.

70. Case C-66/19 (*Kreissparkasse Saarlouis*) of the Court of Justice of the European Union (CJEU) provides guidance on the interpretation of the term "*conditions*" in Article 10(2) of Directive 2008/48/EC where the CJEU states that *"knowledge and good understanding, on the part of the consumer, of the information that must be mandatorily included in the credit agreement, in accordance with Article 10(2) of Directive 2008/48, are necessary for the proper performance of the agreement and in particular the exercise of the rights of the consumer ..."* (see paragraph 45 of the judgment). Moreover, the case clarifies that the credit contract needs to inform the consumer of the substance of the contractual obligations, referred to in Article 10(2). This entails, for instance, that Article 10(2) must be interpreted as precluding a credit agreement from making general reference to conditions (such as "amongst other things") that are not clearly articulated in the text of the agreement.[9]

71. The concept "*procedure*" refers to a particular method for performing a task. In the German language version of Directive 2008/48, the phrase "*Die Art und Weise*"[10] is used in article 10(2)(f) to describe the same, underlining even more strongly that a description or formulation of the steps that need to be taken to determine how the rate is adjusted, needs to be articulated in the text of the credit agreement.

72. In joined cases C-33/20 (*UK v Volkswagen Bank GmbH*), C-155/20 (*RT, SV, BC v Volkswagen Bank GmbH, Skoda Bank)* and C-187/20 (*JL, DT v BMW Bank GmbH, Volkswagen Bank GmbH)*, the CJEU also set out meaningful guidelines for the interpretation of the requirements stemming from Article 10 of Directive 2008/14. The CJEU was, inter alia, requested to interpret the meaning of the provisions of Article 10(2)(l) that stipulate that a credit agreement shall specify the arrangements for adjustments to the interest rate payable in the case of late payments.

73. In its ruling in C-33/20, C-155/20 and C-187/20 (in paragraphs 94 and 95), CJEU sets out a firm criterion to evaluate whether a credit agreement specifies in a clear and concise manner the arrangements for adjustment of the applicable penalty interest rate. The CJEU explains:

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[9] See also case C-42/15 (Home Credit Slovakia).

[10] „...bedingungen und die Art und Weise der Anpassung des Sollzinssatzes.."

Article 10(2)(l) of Directive 2008/48 is to be interpreted as meaning that a credit agreement must state, in the form of a specific percentage, the rate of late-payment interest applicable at the time of conclusion of that agreement and must explain the specific arrangements for adjusting the rate of late-payment interest. Where the parties to the credit agreement concerned have agreed that the rate of late-payment interest is to change in step with a change in the base rate set by the central bank of a Member State and published in an easy-to-access official journal, a reference in that agreement to that base rate is sufficient, ***provided that the method of calculating the rate of late-payment interest relative to the base rate is set out in the credit agreement. In that regard, two conditions must be met. In the first place, that method of calculation must be set out in a way which is readily understood by an average consumer who does not have specialist knowledge in the financial field and must enable him or her to calculate the rate of late-payment interest based on the information provided in the credit agreement.*** *In the second place, the frequency with which the base rate may be varied, which is determined by national provisions, must also be set out in the credit agreement concerned.* [My emphasis]

74. The plaintiffs argue in support for their case that the same or a similar standard applies with respect to Article 10(2)(f) and consequently, a credit agreement must specify in a clear and concise manner the method of calculation used to adjust the interest rate of a variable interest rate in a way that is readily understood by average consumers and enables them to verify that the interest rate has indeed been adjusted in line with their agreement with the creditor.

75. The English version does not use the same words in Article 10(2)(f) and Article 10(2)(l) to describe the obligation to specify in a credit agreement how interest rates are adjusted. Whereas the term *procedures* is applied in item (f), the word *arrangements* is used in item (l). The same applies to the Icelandic version, where the term "*málsmeðferð*" is used in item (f) and the term "*fyrirkomulag*" is used in item (l). However, there is neither a logical nor a linguistic reason to confer completely different meanings to these words. In this context the words have similar meaning and purpose. In fact, some versions of the Directive use the same words in both instances, for example the Spanish version that states in item (f) that a credit agreement must specify "*procedimientos de variación del tipo deudor*", and item (l) refers to "*los*

procedimientos para su ajuste". In the German version items (f) and (l) both include the phrase "*Die Art und Weise*" to describe what needs to be explained regarding the potential adjustment of interest rates in a credit agreement.

76. In accordance with Recital 19 of Directive 2014/17 that key concepts should be in line with those set out in Directive 2008/48/EC, these guidelines were applied in the transposition of Directive 2008/14 into Icelandic Law, to ensure consistency of application and interpretation. This included requirements relating to adjustments to a variable interest rate, set out in Article 34 of Act no. 118/2016 on Consumer Property Mortgage, which states the following: "*If a decision on the adjustment of the interest rate is not based on a reference value, indexes, or a reference interest rate, then the mortgage agreement shall state the conditions and procedure for adjustment of the interest rate.*"

77. The terminology "*conditions and procedure for adjustment of the interest rate*" is clearly derived from article 10(2)(f) of Directive 2008/48, and sets the very basic, minimal, requirement as to how a variable borrowing rate is presented in a credit agreement. In a credit agreement the conditions that need to be fulfilled to allow for adjustments to the interest rate shall be specified, and moreover, the procedure applied to determine adjustments has to be described in a "*clear and concise*" manner.

78. Neither Directive 2014/17 nor Directive 2008/48 mandate the use of reference values or indices, so the rationale for an adjustment may be linked to other kind of factors. For example, a term in a credit agreement may prescribe a change in the interest rate if certain events occur or when a defined period has lapsed. However, in every instance, the credit agreement needs to clarify, in a clear and concise manner, the conditions and procedure applicable for the adjustment of the rate.

79. If the creditor utilizes reference rates or indices as benchmarks, further requirements come into play. Then the credit agreement not only has to define the conditions and procedure but needs also to define and use reference values that are accessible, objective, and verifiable. This

requirement aims to secure both clarity on commitments undertaken by the consumer and substantive integrity of the benchmark used by the creditor.

Parallel application with Directive 93/13

80. The CJEU has applied transparency requirements stemming from sectorial legislation, such as Directive 2014/17, and Directive 93/13 in a complimentary fashion. The CJEU ruling in C-92/11 *(RWE Vertrieb)* is a case in point. Point 2 of the operative part of the judgment states:

    Articles 3 and 5 of Directive 93/13 in conjunction with Article 3(3) of Directive 2003/55/EC... concerning common rules for the internal market in natural gas... must be interpreted as meaning that, in order to assess whether a standard contractual term by which a supply undertaking reserves the right to vary the charge for the supply of gas complies with the requirements of good faith, balance and transparency laid down by those directives, it is of fundamental importance:

    — *whether the contract sets out in transparent fashion the reason for and method of the variation of those charges, so that the consumer can foresee, on the basis of clear, intelligible criteria, the alterations that may be made to those charges.*

81. In joined cases C-33/20 (*UK v Volkswagen Bank GmbH*), C-155/20 (*RT, SV, BC v Volkswagen Bank GmbH, Skoda Bank)* and C-187/20 (*JL, DT v BMW Bank GmbH, Volkswagen Bank GmbH,* the CJEU bases its arguments partly on a precedence that concerns interpretation of Directive 93/13 (see paragraph 94 of the judgment). The CJEU refers to case C-125/18, *Gómez del Moral Guash*, by analogy, and underlines thereby the parallel application of the Consumer Credit Directive and Directive 93/13.

82. The CJEU's judgment in case C-125/18, *Gómez del Moral Guash v Bankia SA,* sets out guidelines regarding the interpretation of Directive 93/13, in particular Articles 4(2) and 5, with a view to complying with the transparency requirement of a contractual term setting a variable rate under a mortgage loan agreement.[11] These guidelines are in essence identical to

[11] Point 2 of the operative part: *"Directive 93/13, in particular Article 4(2) and Article 5 thereof, must be interpreted as meaning that, with a view to complying with the transparency requirement of a contractual term setting a variable*

the requirements set out by the CJEU in *UK v Volkswagen Bank GmbH,* which deals with transparency requirements stemming from Article 10(2)(l) of Directive 2008/48. In each case, the CJEU emphasizes that the term must be readily understood by an average consumer; the term must define a clear benchmark or criteria; and the specific functioning of the method used to determine or calculate the rate must be explained. The CJEU highlights the importance of the predictability of the contract terms and clarifies that the terms must enable consumers to assess and foresee the economic consequences of their obligations.

83. The guidelines set out in the CJEU's judgment in the *Gómez del Moral Guash* case are the product of a long line of cases dealing with transparency requirements stemming from Directive 93/13 in respect of contract terms that enable a seller or a supplier to change the contract price or payments which consumers must make under a contract. The CJEU has summarized the standard to be expected from sellers and suppliers in a number of cases concerning various subject matters. The CJEU has applied these standards, for instance, to the functioning of the currency conversion mechanisms applying to mortgage loans indexed to foreign currency (see case C-26/13 *Árpád Kásler and Hajnalka Káslerné Rábai,* paragraphs 73-73 and C-186/16 *Ruxandra Paula Andriciuc and Others*, paragraphs 49-51). Also, in relation to energy supply agreements, (see C-92/11 *RWE Vertrieb AG*). There are, moreover, a number of cases which deal with terms that enable a creditor to adjust the interest rate of a credit agreement, see for example cases C-143/13 (*Matei*), C-348/14 (*Bucara*), and C-269/19 (*Banca B. SA*).

84. The EFTA Court has also, for instance in case E-25/13 (*Gunnar V. Engilbertsson v Íslandsbanki hf.*), stressed the importance of the quality and the clarity of information presented to a consumer in a credit agreement in relation to terms that allow the creditor to unilaterally

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interest rate under a mortgage loan agreement, that term not only must be formally and grammatically intelligible but also enable an average consumer, who is reasonably well-informed and reasonably observant and circumspect, to be in a position to understand the specific functioning of the method used for calculating that rate and thus evaluate, on the basis of clear, intelligible criteria, the potentially significant economic consequences of such a term on his or her financial obligations. Information that is particularly relevant for the purposes of the assessment to be carried out by the national court in that regard include (i) the fact that essential information relating to the calculation of that rate is easily accessible to anyone intending to take out a mortgage loan, on account of the publication of the method used for calculating that rate, and (ii) the provision of data relating to past fluctuations of the index on the basis of which that rate is calculated."

change the amount of payments to be made by the consumer (see for example paragraphs 97-99). The Court referred to the transparency requirements stemming from Articles 3(3) and 5 of Directive 93/13, and their impact on the assessment on whether a term is "*unfair*".

85. In case E-25/13, the EFTA Court in this context also referred to the judgment of CJEU in the joined cases C-359/11 and C-400/11 (*Schulz and Egbringhoff*). In its judgment of *Schulz and Egbringhoff,* the CJEU emphasizes that to ensure a high level of consumer protection, a supplier or seller must provide to the consumer information regarding the reasons and preconditions of any adjustment to the price to be paid by the consumer, in a way that enables the consumer to verify and challenge adjustments to the price (see paragraphs 45-47).

86. The interpretation of the transparency obligations stemming from Article 10(2)(f) of Directive 2008/48 needs to take appropriate account of this case law of the CJEU and the Court. Consequently, the "*conditions and procedures for changing that rate*" must be interpreted to mean that a creditor is obliged to draft a standard term, that enables him to unilaterally adjust the interest rate, in a way that is readily understood by an average consumer and clearly defines all the parameters any adjustment can be based on, explains the specific functionality of the method used to adjust the rate, and provides predictability for the consumer in respect of his/her obligations.

An obligation to assess the unfairness of the term

87. The plaintiffs note that the question posed by the District Court does not directly address issues arising from the provisions of Directive 93/13. However, the District Court states in its request to the Court, dated 1 February 2023, that the dispute in this case concerns whether the terms of a mortgage deed regarding the calculation of variable interest rates are, inter alia, compatible with Article 36 c of Act no. 7/1936, on Contracts, Mandates and Invalid Legal Instruments, which is to be interpreted in accordance with Council Directive 93/13/EEC (see page 7 of the request for advisory opinion from the District Court, second paragraph).

88. The plaintiffs argue that the disputed terms cannot be considered to be drafted in "*plain, intelligible language*" within the meaning of Article 5 of Directive 93/13. As discussed in these

Written Observation, the term does not achieve the standard set by the CJEU in numerous cases with regards to the substantive transparency requirements stemming from Directive 93/13. Moreover, the plaintiffs hold that the disputed term is not even formally and grammatically intelligible (see paragraphs 39-43 herein).

89. Consequently, in accordance with Article 4(2) of Directive 93/13, the referring court is obliged to assess the fairness of the term. The transparency requirements discussed in the preceding chapter are of fundamental importance for this assessment (see for example case C-92/11 *RWE Vertrieb*, paragraph 49). Moreover, it is also of particular relevance for this assessment that the defendant has not provided the plaintiffs with essential information required under Directives 2014/17 and 2008/48 (see case C-348/14 *Bucara*, for example the operative part of the judgement).

90. Furthermore, the plaintiffs argue that the disputed term has the effect to enable the defendant to alter the terms of the Agreement without a valid reason which is specified in the Agreement (e.g. "*other unforeseen costs*", "*amongst other things*", "*etc.*"), and that the ambiguous and imprecise wording of the term in effect give the defendant exclusive right to interpret the disputed term (as the defendant reserves the right to decide on each occasion which factors are used to adjust the rate and how the factors are used). These are circumstances described in the items (j) and (m) of the Annex to Directive 93/13, and following Article 3(3) of the Directive, this indicates that the term is unfair within the meaning of the Directive.

91. According to a settled case law of CJEU (see for example case C-243/08 *Pannon GSM*), the referring court is required to assess whether the shortcomings of the disputed term cause a significant imbalance, contrary to the requirements of good faith, in the parties' rights and obligations arising under the contract, to the detriment of the consumer, as stated in Article 3(1) of the Directive. The indicative list in the Annex of the Directive is an essential element of the assessment.

92. Recital 16 of the Directive states that the assessment of the unfair character of a term needs to consider whether the seller or supplier has dealt fairly and equitably with the consumer and taken his/her legitimate interests into account. For this purpose, the CJEU has emphasized that

a national court needs, in order to assess the fairness of a term, to consider whether the seller or supplier, dealing fairly and equitably with the consumer, could reasonably assume that the consumer would have agreed to the term in individual negotiations (see Case C-415/11 *Aziz*, paragraphs 68-69 and C-186/16 *Ruxandra Paula Andriciuc and Others*, paragraphs 52-58).

93. The unequal sharing of financial risk inherent in the disputed term is of particular relevance with respect to this assessment. The CJEU has highlighted this aspect in its case law (see C-186/16 *Ruxandra Paula Andriciuc and Others*, paragraph 55 and joined cases C-229/19 and C-289/19 *Dexia Nederland BV,* paragraphs 58-60). In the case at hand, the defendant has drafted a term that provides it with the unilateral right to choose the factors that can justify changes to the contract price, and the method by which the price is adjusted. In addition, the defendant reserves the right to adjust the price with reference to its operating costs and any unforeseen costs, which means that the consumer not only bears the market risk, but also idiosyncratic risk associated only with the financial well-being of the defendant.

94. The plaintiffs argue that the defendant, dealing fairly and equitably with the plaintiffs, could not assume that the plaintiffs, or ordinary consumers in general, would in individual negotiations have agreed to 1) allow the defendant to choose the factors that determine the level of the interest rate, 2) allow the defendant to choose, without particular restrictions, the weight of each factor or the method of calculation, 3) allow the defendant to increase, without any defined limit, the interest rate to recoup financial losses or costs suffered by the defendant. The term causes significant imbalance between the parties, contrary to good faith, and is therefore unfair.

CONCLUSION

Accordingly, the plaintiffs respectfully request that the Court should answer the question referred as follows:

95. Article 24 of Directive 2014/17 must be interpreted to apply to any rate or value utilized, according to the terms of a credit agreement, as a benchmark to determine variable interest rates. Consequently, the reference in a mortgage credit agreement to "*operating costs*" and "*other unforeseen costs*" as benchmarks for the determination of a variable interest rate must satisfy the requirements of Article 24. As the terms do not stipulate clear, accessible, objective, and verifiable reference rates or indexes, the terms are in principle not compatible with Article 24.

96. Article 10(2)(f) of Directive 2008/48 must be interpreted as meaning that, with a view to complying with the transparency requirement of a contractual term setting a variable interest rate under a mortgage loan agreement, a credit agreement must:
    - state, in a clear and concise manner, all relevant conditions or factors that may affect the interest rate, and
    - enable an average consumer, who does not have specialist knowledge in the financial field, to understand the specific functioning of the method used for determining the rate and thus evaluate, based on clear, intelligible criteria, the potentially significant economic consequences of such a term on his or her financial obligations.

    As the terms "*operating costs*" and "*other unforeseen costs*" can neither be considered to be clear and concise nor criteria that enables an average consumer to evaluate the financial consequences of his/her obligations, the terms are in principle not compatible with Article 10(2)(f).

97. A contractual term in a mortgage loan agreement, which provides the lender unilateral right to vary the borrowing rate, and neither sets out in transparent fashion the reasons for nor the method of variation, so that the consumer can foresee, on the basis of clear, intelligible criteria,

the alterations that may be made to the borrowing rate, is not drafted in plain, intelligible language within the meaning of Article 5 of Directive 93/13/EEC.

98. If a contractual term is not drafted in plain, intelligible language, the provisions of Directive 93/13/EEC require a national court to examine the unfairness of the term. To establish whether a term creates significant imbalance, contrary to good faith, within in the meaning of Article 3(1), the national court must ascertain that a term, having regard to the interaction with the other terms that form part of the contract, does not result in very unequal sharing of the risks borne by the parties to the contract. While it is for the national court to determine the facts of the case before it, in principle a contractual term, setting a variable interest rate under a mortgage loan agreement, which allows a lender to unilaterally adjust, without a defined limit or other restrictions, the rate on account of factors such as "*among other things*", "*operating costs*" and "*other unforeseen costs*" can significantly impair the legal situation of the consumer and create unequal and unfair allocation of the risk inherent in, or related to, a variable credit.

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