CONSUMER LOANS: EARLY TERMINATION CLAUSES AFTER THE MOST RECENT DEVELOPMENTS

On 26 March 2019, the European Court of Justice issued the long-expected judgment regarding early termination clauses in Spanish mortgage-secured loans. This, together with the recent publication of the Real Estate Financing Act, opens up a whole new dimension of one of the great *hot topics* of the Spanish foreclosure market.

Key issues

- The ECJ judgment, expected as a final solution, defers the final decision to the Spanish Supreme Court, opening new lines for debate.
- The new Real Estate Financing Act only serves as a solution for loans that have not yet been accelerated.
- Financial institutions and NPL acquirers will have to wait until there is greater visibility on how to unblock the current situation.

The problem arising around early termination clauses included in Spanish mortgage-secured loans

The Spanish Supreme Court and the European Court of Justice (*ECJ*) have confirmed that early termination clauses that list *"any breach"* as a termination event are unfair and, therefore, null and void.

Clauses with this wording were standard in all loan deeds formalised with consumers in Spain, at least up to 2013, when a legal amendment moved some financial entities to modify the existing templates, adapting them to the new regulations, which establish that there must be a minimum of three (3) unpaid monthly repayment amounts (or equivalent) due in order for the lender to be allowed to accelerate a mortgage-secured loan in full.

Looking back to the origin of the problem

In July 2011, a Commercial Court of Barcelona dragged these early termination clauses into the spotlight by referring a question on its unfairness to the ECJ, seeking a preliminary ruling.

On 14 March 2013, the ECJ ruled that, in order to analyse if an early termination clause is unfair, the national court should consider:

- if the right to terminate the loan is based on the breach of an **essential obligation**, and
- whether the breach of the essential obligation is **sufficiently serious**, considering the circumstances of the case.

Additionally, the ECJ confirmed that any clause that places a consumer in a less-favourable position than the consumer's national regulations will be considered unfair.

Considering the ECJ's position, on 2 May 2013, Barcelona Commercial Court No. 3 confirmed that this standard clause (widespread among Spanish consumer loans) was unfair.

As time went by, the problem acquired a new, broader dimension

From the time of this first precedent, the issue evolved over the years.

At the beginning, minor courts in Spain (first instance courts and courts of appeal) declared the unfairness of this sort of early termination clause. However, despite the declaration of nullity, the widely-held position amongst these courts was that the enforcement could continue if the bank respected the minimum established in the law since 2013 (the three (3) unpaid monthly repayment amounts due) to accelerate.

Despite the Supreme Court's initial confirmation in December 2015 of the possibility to continue with enforcement, things worsened for lenders after the issue of certain precedents by the ECJ confirming (contrary to the position sustained by the Spanish Supreme Court) that national courts should not apply clauses declared unfair and are not permitted to integrate the contract with national legislation if this harms the interests of the consumer.

The controversy between the ECJ and the Spanish Supreme Court resulted in a division between minor courts around two positions:

- the ones that strictly followed the criteria of the ECJ and systematically dismissed all enforcements commenced on the basis of this sort of clause.
- the ones that, following the criteria of the Spanish Supreme Court, permitted the continuance of the enforcement if the breach of payment obligations by the consumer was sufficiently serious (complying at least with the 3 repayment defaults criterion).

Intervention by the Supreme Court to put an end to the controversy and the overall halt of foreclosures in Spain

In February 2017, the Spanish Supreme Court asked the ECJ to issue a preliminary ruling which definitively clarified whether the presence of this sort of unfair clause in the deed formalising a consumer loan should impede the initiation or continuation of the foreclosure.

In view of this, courts (at a local and provincial level) suspended those foreclosures where the unfairness of the early termination clause was included in the object of the dispute (almost all court actions).

This resulted in an overall halt of the foreclosures and enforcement procedures against consumers in Spain, with the consequent concern for financial institutions and NPL purchasers.

A wide audience has been expecting this decision as a potential final solution for an issue affecting thousands of foreclosure procedures.

The decision of the ECJ on the question referred by the Spanish Supreme Court

On 26 March 2019, the ECJ rendered its decision on the question referred to it for a preliminary ruling.

The ECJ judgment confirms the unfairness of this sort of clause that includes any breach as a termination event and prohibits the use of the "blue pencil rule" to delete those sections of the clause that may be considered null in order to seek partial validity thereof.

However, the ECJ opens the door to applying the rule of the three (3) unpaid monthly repayment amounts to terminate the affected agreements, if the declaration of unfairness entails an invalidity of the entire mortgage loan. On

the contrary (i.e. if the mortgage loan can survive without this clause), the ECJ instructs the Spanish Supreme Court to not integrate the contract, forbidding access to the mortgage foreclosure process (unless the consumer gives its approval).

The rationale behind the ECJ's decision is to avoid forcing the lenders to abide by a general enforcement against the consumer, which is allegedly less protective of them, since it is would encompass the consumers' entire estate.

However, the ECJ has not realised that, by rejecting the integration of the contract after the declaration of unfairness, all cases will end up in general enforcement actions.

The ECJ defers the final decision on this issue to the Spanish Supreme Court. Now, the Supreme Court must to decide: i) whether the abusiveness of an early termination clause triggers the nullity of the loan agreement as a whole, and ii) if the contract remains valid without the early termination clause, whether lenders would be forced to search for alternatives which finally lead to general enforcement actions, instead of mortgage foreclosures (more protective of consumers).

Therefore, market agents interested in this issue (mainly financial institutions and acquirers of NPL portfolios) will have to continue to wait for a final solution that gives them a clearer idea as to how to unblock enforcements against consumers in Spain.

The recently published Act on Real Estate Credit Contracts serves as a solution for loans that have not yet been accelerated

In addition, it should be noted that the Real Estate Financing Act (*Ley Reguladora de los Contratos de Crédito Inmobiliario*) was approved by the Spanish Parliament on 21 February 2019. It was published in Spain's Official State Gazette on 16 March 2019 and it will enter into force on 16 June 2019.

This Act offers a solution for mortgage-secured loans and loans for the acquisition of real estate (in both cases, when the collateral or the asset is a residential property) that have not been accelerated before its entry into force (even if they were formalised before).

For those cases, lenders will be able to fully accelerate the loans, if: (i) during the first half of the loan's term, there are twelve (12) defaults on monthly repayments due (or 3% of the total amount loaned); or (ii) during the second half of the loan's term, there are fifteen (15) defaults on monthly repayments due (or 7% of the total amount loaned).

These new criteria will apply, unless (i) the lender has decided to accelerate the loan before the entry into force of the new Act (regardless of whether or not it has decided to commence legal proceedings); and (ii) the consumer alleges that the current wording is more beneficial.

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