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No Plan B for Traders Using Unfair Terms

Court of Justice Excludes Application of Default Rules Replacing an Unfair Term - Case Note on Dexia Nederland (Joint Cases C-229/19 and 289/19) -

I. Introduction

The recent ruling of the Court of Justice of the EU (ECJ) in *Dexia Nederland*[1] concerns a new act in a financial drama that has absorbed victims, the financial world and Dutch legal practice for already two decades. In the late 1990 s and the early 2000 s, banks (and sometimes insurance companies) sold complex financial products (share leasing contracts) to consumers and grossly overcharged them without the consumers understanding the products they were buying. These contracts were often linked to a mortgage, annuity or pension, or were incorporated into single-premium policies or savings plans. Where many consumers simply thought they were investing on the stock market, in reality they borrowed money from the bank, which kept that money, and invested it in shares. Under these share leasing contracts, the dividend paid to the bank was paid to the consumer, but the consumer had to pay the bank a monthly sum corresponding to the interest on the principal amount borrowed and, in some cases, to the repayment of part of the principal amount borrowed to the bank. At the end of the duration of the share leasing contracts the bank sold the consumer's shares and the proceeds were paid to the consumer after deduction of (the remainder of) the principal amount borrowed and any remaining monthly instalments.

This scheme operated well in the early days, when the stock market was booming and shares kept becoming more valuable. As a result, the higher sales prices of the stocks easily covered the interest and the repayment of the loans. However, after the financial crisis of the late 2000 s, the opposite became true, due to falling share prices. In fact, many consumers not only lost their whole investment but often were left with a residual debt to the bank. This was particularly true of share leasing contracts that were terminated prematurely due to the consumer's delay in paying the monthly instalments.

Over the course of years, Dexia, a Belgian company, had purchased several of the banks that had offered these share leasing contracts, and thus had become the creditor of these consumers and therefore the party collecting these debts in thousands and thousands of legal proceedings. From their side, in particular after continuing attention in the media, consumers challenged the validity of these contracts and of some of the clauses in the bank's standard terms and conditions. Given the sheer number of these cases, courts set up specialized chambers to deal with these claims. In addition, consumers participated in several mass claim procedures. Some of these led to collective settlements, which were then declared binding for all consumers concerned that did not opt out of the settlements. Several cases went up to the Dutch Supreme Court, the *Hoge Raad*, and led to ground breaking case law. As the appellate courts of Amsterdam and The Hague thought the Dutch Supreme Court had misunderstood or not applied the case law of the ECJ, they referred questions to the ECJ for preliminary reference.

The cases that were to be decided by the appellate courts revolved around two clauses in (now) Dexia's terms and conditions. Under Article 6 of the 'Special Conditions' of the share leasing contract, Dexia was entitled to terminate the contract and any other share leasing contracts with the same consumer in the event of payment arrears. In such case Dexia could sell the shares and claim the cash value of (the remainder of) the principal amount(s) borrowed in its (their) entirety, with set-off of the proceeds of the shares. Pursuant to Article 15 of these Special Conditions, the cash value of the principal amount was calculated in accordance with the provisions of Article 7A:1576 e (2) of the Dutch Civil Code (the regulation on early repayment by the consumer in the event of a sale by instalments).

Both cases concerned share leasing contracts that had been terminated prematurely by Dexia due to arrears in the payment of the monthly instalments owed to it. Both courts noted that in its *Tijhuis/Dexia* judgment,[2] the Dutch Supreme Court had deemed Article 6 of the Special Conditions to be unfair because the clause did not take into account that, in the event of early repayment of the principal amount borrowed, the bank could immediately lend out the amount again at the interest rate applicable at that time. Thus, Article 6 of the Special Conditions deviated to the detriment of the consumer from the otherwise applicable default rules on the amount of damages banks could claim from consumers (Articles 6:277 and 74 of the Dutch Civil Code). The disadvantage caused could be very significant, depending on the amount of the interest and the time at which the termination of the contract would take place. Article 15 of the Special Conditions only limited that disadvantage to a limited extent. This meant, according to the Supreme Court, that Article 6 of the Special Conditions could lead to a disproportionately high penalty.

The Supreme Court furthermore ruled that for the assessment whether the clause is unfair under the Dutch transposition of Article 3 (1) of the Unfair Contract Terms Directive (UCTD)[3] in Article 6:233 (a) of the Dutch Civil Code, it is not relevant whether the obligations arising from the contract in the case at hand reasonably impose an unacceptably heavy financial burden on the consumer. Finally, in its judgment – which was rendered in answers to questions referred to the Supreme Court for preliminary ruling by the Amsterdam Court of

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1 CJEU 27 January 2021, joint cases C-229/19 and 289/19, *Dexia Nederland*, ECLI:EU:C:2021:68.

2 Hoge Raad 21 April 2017, ECLI:NL:HR:2017:773 (*Tijhuis/Dexia*).

3 Directive 1993/13/EEC, *OJ* 1993, L 95/29.

Appeal – the Supreme Court pointed out that after the annulment of Article 6 of the Special Conditions, Dexia could still claim damages on the basis of Article 6:277 of the Dutch Civil Code.

The Amsterdam Court of Appeal indicated that in *Tijhuis/Dexia,* the Supreme Court had based its judgment that Article 6 of the Special Conditions was unfair on an abstract test: the mere *possibility* of a disadvantage to the consumer was sufficient, according to the Supreme Court, to classify the term as unfair within the meaning of the UCTD. The Amsterdam Court of Appeal, in its preliminary question to the ECJ, raised the issue of whether the Supreme Court had wrongly failed to take into account the fact that, at the time the contract was concluded, it was uncertain whether premature termination of the contract would benefit the bank. Furthermore, the Court of Appeal wondered what consequences it should draw from the annulment of Articles 6 and 15 of the Special Conditions. In this respect, the Court of Appeal considered that the share leasing contract concluded by the consumer continues to exist even after these clauses are annulled. However, in the case that had to be decided by the Court of Appeal, application of Article 6:277 of the Dutch Civil Code would be even more unfavorable for the consumer than application of Articles 6 and 15 of the Special Conditions would have been. In the case at the Court of Appeal in The Hague, the applicability of Article 6:277 of the Dutch Civil Code was also at issue. The preliminary questions thus raised two different issues: how should the assessment of whether a term is unfair be carried out, and what are the legal consequences if a term indeed is found to be unfair?

II. Assessment of Unfair Terms

As regards the substantive assessment, the Court of Justice held that whether a term, to the detriment of the consumer, causes a significant imbalance in the contractual relationship must be determined, in particular, by making a comparison with the otherwise applicable default law.[4] In so doing, it is not sufficient to have regard only to the magnitude of the costs resulting from the term, as the significant imbalance between the parties' rights and obligations under the contract may result from the mere restriction of the consumer's rights or from the imposition on the consumer of an additional obligation that does not follow from the otherwise applicable default rule.[5] In line with its settled case-law the Court held that the actual effect of a term must be explained in the contract in such a way that the consumer is able to assess, on the basis of clear and comprehensible criteria, which economic consequences for him follow from that term.[6] In order to assess the unfairness of a term, the court must take into account all the circumstances of the case which the seller or supplier could have known at the time of conclusion of the contract and which are liable to have an effect on the subsequent performance of the contract. In this respect, the ECJ considered that a term may disturb the contractual balance between the parties' rights and obligations, even if the disturbance only becomes apparent during performance of the contract.[7] The ECJ deduced from this that it is necessary to examine whether the terms, as from the date of conclusion of the contract, represented that imbalance, even if the imbalance may arise only in certain circumstances and even if the terms might, in other circumstances, benefit the consumer.[8] However, this also means that if the substantive assessment leads to a finding that the term is unfair because it could, in certain cases, lead to a significant imbalance in the contractual relationship, the term must be invalidated even if, in the specific case, the term would not lead to a significant imbalance.[9] The conclusion is therefore that the Supreme Court was justified in considering that the mere possibility of a detriment to the consumer was sufficient for the term to be regarded as unfair within the meaning of the UCTD.

The rulings of the Court of Justice contained in paras. 53, 55 and 57 have potentially far-reaching consequences for legal practice. For example, an exemption clause in terms and conditions that excludes liability will have to be annulled if the term is found to be unfair, even if the term would not have an unfair effect in the actual case at hand. For instance, if the seller or supplier had excluded all liability, the exemption clause will undoubtedly be considered unfair and therefore invalidated. This will also be the case if it is established that in this case there is only a minor breach of contract and the seller or supplier cannot be blamed for the breach. For example, imagine that the seller merely delivered goods purchased from a supplier without being able to check them for conformity, and that under the applicable national law that would be enough to award damages to the consumer. It may be that the inclusion of an exemption clause excluding liability (only) in such cases would be considered to be fair, e.g. because of the absence of personal blame and the existence of disproportionality between the extent of the possible damage that arises in the event of a lack of conformity and the relatively limited price of the goods. Conversely, the consumer may benefit from a clause that sometimes turns out to be unreasonable, but that in the concrete case is actually favorable. This may be the case, for example, with penalty clauses which fix the damage caused by the consumer's breach of contract, such as Article 6 of the Special Conditions of Dexia in the present case. In that case, the term could be annulled, if necessary *ex officio*, in cases that are unfavorable to the consumer. On the other hand, the consumer may oppose the annulment of the term if it turns out that the fixed compensation is in fact lower than the actual loss (.[10]

III. Consequences of Unfairness

The second part of the judgment concerns the interpretation of Article 6 UCTD. This article provides that an unfair term 'does not bind the consumer'. However, the exact meaning of this provision has long been unclear. In the case-law of the Court of Justice two, interrelated, lines may be distinguished. The first of these pertain to the national court's obligation to determine, if necessary, of its own motion that a term is unfair.[11] In later cases, the ECJ clarified that in order to ensure the full effect of the UCTD, the national court may be required to demand the trader to hand over the underlying contract and the terms and conditions in order for the court to determine whether or not the claim is based on an unfair term, if these documents have not been made available to the court.[12]

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4 Para. 48 of the judgment, with reference to previous case-law.
5 Para. 49.
6 Para. 50.
7 Para. 53
8 Para. 55.
9 Para. 57.
10 See already CJEU 4 June 2009, case C-243/08, *Pannon*, ECLI:EU:C:2009:350, recently confirmed in CJEU 29 April 2021, case C-19/20, *Bank BPH*, ECLI:EU:C:2021:341.
11 See, inter alia, CJEU 4 June 2009, case C-243/08, *Pannon*, ECLI:EU:C:2009:350.
12 See CJEU 7 November 2019, joint cases C-419/18 and 483/18, *Profi Credit Polska II*, ECLI:EU:C:2019:930; CJEU 11 March 2020, C-511/17, *Lintner*, ECLI:EU:C:2020:188.

The second line is potentially even more far-reaching. In numerous judgments the Court of Justice has made it clear that it follows from Article 6 UCTD that the sanction for a term being deemed unfair must be effective and dissuasive for sellers and suppliers. If a national court were to nonetheless draw any consequences from an unfair term, the long-term objective of the UCTD – to have no more unfair terms in consumer contracts – could be jeopardized. In this respect, the ECJ stated that traders must not be tempted to continue to use unfair terms in the knowledge that if a term would be declared invalid, the national court could substitute that term and the contract could nevertheless be enforced. For this reason, the ECJ ruled, among other things, that the national court may neither modify the term,[13] nor uphold it by mitigating its effects.[14] In later case law, the Court has gone even further: in *Dziubak*[15] the Court made it clear that the national court may not replace the unfair term with obligations arising from open standards such as reasonableness and fairness or good faith either.

This does not mean that the seller or supplier is always left empty-handed: in *Banco Santander/Demba and Godoy Bonet*,[16] the ECJ ruled that Article 6 UCTD does not preclude the replacement of an unfair contractual interest rate for late payment with the agreed contractual interest rate for the principal amount. However, the ECJ did not address the question of whether the national court may replace an unfair term with a national provision of supplementary law. The ECJ appears to have done so in *Unicaja Banco*, where it stated that the national court may only replace an unfair term by a national provision of default law if that would restore the contractual balance between the parties and if the nullity of the unfair term would otherwise oblige the court to invalidate the contract in its entirety.[17] This would seem to imply that the gap left by the invalidity of the term may not be filled by the application of default rules. This is the case even if, in the case at hand, application of the default rule would be worse for the consumer than application of the unfair term would have been. However, as the national court is required to inform the consumer of the legal consequences that striking the unfair term may have for the consumer,[18] and as the consumer may waive the protection offered by the Directive after having been informed of these consequences,[19] the consumer can 'protect himself' from such detrimental effect.

Nevertheless, one could argue that the *Unicaja Banco*-case only forbids the national court to *replace* the unfair term by a default rule, but that it does not preclude a national court from applying a default rule that applies 'automatically', by operation of law, in the absence of a contrary contractual agreement. It seems that the Dutch Supreme Court thought so in *Tijhuis/Dexia*, which was decided in 2017, i.e. more than two years after *Unicaja Banco*, as the Dutch Supreme Court was of the opinion that Article 6 UCTD did not stand in the way of the application of Article 6:277 of the Dutch Civil Code once the unfair terms in Dexia's terms and conditions were set aside. And there seem to be good arguments in allowing the application of such default rules on damages, as the absence of such a possibility would be tantamount to giving the consumer *carte blanche* for non-performance, as such conduct could not be sanctioned otherwise. That would seems to be not just harsh, but disproportionate. The question thus arises whether the sanction of invalidity of the unfair terms should not only be effective and dissuasive, but also proportionate? Or should the judgment of the Supreme Court be considered to be contrary to the *Unicaja Banco* judgment of the ECJ? Exactly this question was referred for preliminary ruling to the Court of Justice by the Court of Appeal of The Hague.

In a relatively short part of the *Dexia Nederland*-judgment discussed here (a mere 7 paragraphs are dedicated to this part, whereas 21 paragraphs concern the first part), the Court of Justice puts an end to this ambiguity. First of all, the ECJ repeats its above-mentioned case law,[20] emphasizing that if the national court had the power to revise the content of the term, the long-term objective of the UCTD would be jeopardized. According to the ECJ, such a power would help to eliminate the deterrent effect on traders of the fact that these unfair terms are simply not applied vis-à-vis the consumer, because traders would still be inclined to include such terms in their terms and conditions in the knowledge that, even if they were declared invalid, the contract could still be supplemented by default rules and their interests would therefore be served after all. Moreover, since, as the Court of Appeal of Amsterdam had indicated, the share leasing contracts can continue to exist without the unfair term, it is not necessary for the default rules to be applied to prevent the contract from being void in its entirety.[21] Therefore, the Court of Justice finds that '*it is apparent from the case-law cited in paragraphs 62 to 64 of this judgment that, in a situation such as that in Case C-289/19, in accordance with Article 6(1) of Directive 93/13, the national court does not have the power to replace the unfair term with a supplementary provision of national law*'.[22]

The Court of Justice's conclusion is clear: replacement of the term by the applicable default rules is not allowed unless invalidity of the term would lead to the contract being void in its entirety. This is obviously not the case when a penalty clause is invalidated. This conclusion is far-reaching: if the trader tries to get the most out of the contract in his terms and conditions, but goes too far in doing so, he will be left empty-handed. Not only the primary claim based on the terms and conditions will be rejected, but also a subsidiary claim based on default rules. In other words, the Dutch Supreme Court was wrong in *Tijhuis/Dexia* in suggesting that the invalidity of the unfair penalty clause did not stand in the way of a claim for damages after termination of the contract based on Article 6:277 of the Dutch Civil Code. Instead, such claim must also be rejected.

There are only a few ways out for the trader making use of terms and conditions. The first of these is the simplest: (the lawyer of) the trader could simply refrain from invoking the penalty clause in the terms and conditions and instead base its primary claim on the applicable default law. Such a claim is likely to be allowed if the unfair term is not part of the dispute between the parties. As the national court cannot be expected to scrutinize the trader's terms and conditions with-

13 CJEU 14 June 2012, case C-618/10, *Banco Español de Crédito*, ECLI:EU:C:2012:349.
14 CJEU 30 May 2013, case C-488/11, *Asbeek Brusse*, ECLI:EU:C:2013:341.
15 CJEU 3 October 2019, case C-260/18, *Dziubak*, ECLI:EU:C:2019:819.
16 CJEU 7 August 2018, joint cases C-96/16 and C-94/17, *Banco Santander/Demba and Godoy Bonet*, ECLI:EU:C:2018:643.
17 CJEU 21 January 2015, joint cases C-482/13, C-484/13, C-485/13 and C-487/13, *Unicaja Banco*, ECLI:EU:C:2015:21, para. 33.
18 CJEU 29 April 2021, case C-19/20, *Bank BPH*, ECLI:EU:C:2021:341, para. 97.
19 CJEU 9 July 2020, case C-452/18, *Ibercaja Banco*, ECLI:EU:C:2020:536, para. 25; CJEU 29 April 2021, case C-19/20, *Bank BPH*, ECLI:EU:C:2021:341, para. 46.
20 Paras. 62-64.
21 Para. 65.
22 Para. 66.

out having a reason to do so on the basis of the claims made in front of it, the court will not see a reason to look at the terms and conditions without having an incentive to do so. However, if (the lawyer of) the consumer would point to the existence of the penalty clause in the terms and conditions, this would be different as then that penalty clause is part of the dispute that must be decided by the national court. In such case, the national court would be required to review the penalty clause. If it is then found that the term is unfair, the national court must attach '*toutes les conséquences du caractère abusif de ladite clause*', the ECJ held.[23] I must admit that there is a problem here. Where the consumer does not actively look for a potentially unfair term in the trader's terms and conditions, the court will not come to the consumer's assistance and will award the trader's claim. But where the consumer has a lawyer scrutinizing the trader's terms and conditions and indeed finds a potentially unfair term, the court will test that term, and may subsequently reject the trader's claim if the consumer's lawyer was right. This could create a distinction between consumers who have the money to ask a lawyer to do so, and consumers who do not have such possibilities. Whereas the former group of consumers would be protected against the claim based on the applicable default law as they will have discovered the unfair penalty clause and pointed the court's attention to that clause, the second group of consumers would not be protected. In practice, this would mean that 'richer' consumers would be protected, and 'poorer' consumers would be left out in the cold. On the other hand, it does not seem right either to allow traders using unfair terms to benefit from equal treatment amongst consumers by denying justice to the 'richer' consumers for the mere fact that 'poorer' consumers would also not be protected.

The second possibility, already mentioned, is the possibility of reverting to the contractual interest rate if the contractual late payment clause is deemed unfair. However, this option is only available for credit agreements (regardless of whether these are consumer credit or mortgage credit). Finally, in *Kanyeba*,[24] the ECJ did consider a claim based on an extra-contractual basis to be admissible, because the UCTD only relates to contract law. Therefore, if the consumer's breach of contract also constitutes an (independent) tort towards the trader, damages may be claimed on that basis. In other cases, the trader may be allowed to invoke another remedy for the consumer's non-performance, e. g. termination or specific performance if damages are not available due to an unfair penalty clause. But there do not seem to be many other options.

IV. Conclusion

The sanction that the Court of Justice attaches to finding that a term is unfair is therefore far-reaching. This does not need to be to the advantage of the consumer: given the severity of the sanction, a court may hesitate to find a term unfair. This may be true in one of two cases – that may in fact coincide. In the first scenario, the national court might simply not find the term unfair if that term could but need not have a significantly disturbing effect on the contractual balance between the parties' rights and obligations. In this case, the national court could find that the term causes an imbalance between the parties' rights and obligations, but that the effect is not considered to be significant (enough) to consider the term as a whole to be unfair. In the second scenario, when in doubt, the court could find the term not to be unfair if national contract law leaves the possibility open to not apply a contractual term in a specific case if its application *in that case* would be contrary to good faith and fair dealing. That would give the court the possibility for a tailor-made solution and also leave open the possibility to apply the applicable default rule that the Court of Justice tries to exclude. This may lead to *Einzelfallgerechtigkeit*, but significantly reduces legal certainty *and* the deterrent effect that the Court of Justice seeks to retain. Therefore, the Court of Justice's strictness when determining the meaning of Article 6 UCTD may be counter-productive for consumer protection.

Leaving this aside for now, *Dexia Nederland* sends a clear message to corporate lawyers and lawyers who draft terms and conditions for traders intended to be used in consumer contracts. These lawyers should ask themselves whether it is really necessary for a party who concludes contracts with consumers to use terms and conditions in the first place. Is that really necessary or can general (or specific) contract law regulate the contract sufficiently? And if terms and conditions are needed as such, is this particular clause really necessary? Certainly for those subjects for which supplementary law contains a provision, a contractual rule deviating from that provision to the detriment of the consumer will be vulnerable. Is the trader's interest served properly if their lawyer suggests to regulate a certain subject in the terms and conditions? After all, what has not been agreed upon cannot be invalidated – and the trader's interest may thus be better served by simply relying on general contract law. And to take the lesson a little further: does a lawyer who introduces unfair terms in a trader's terms and conditions not engage in professional liability for doing so? After all, the sanction for using unfair terms in such a case results in actual damage for the trader, such as, in the case of *Dexia Nederland*, the impossibility of claiming compensation for the consumer's non-performance. And since *Dexia Nederland*, such a result is the fully foreseeable consequence of a clause that goes too far – which implies that in a claim from the trader against his (former) lawyer, the requirement of causality clearly is met… ■

23 CJEU 11 June 2015, case C-602/13, *Banco Bilbao Vizcaya Argentaria*, ECLI:EU:C:2015: 397, paras. 47-51 and 54 (this decision was published only in French and Spanish).

24 CJEU 7 November 2019, joint cases C-349/18 to C-351/18, *Kanyeba*, ECLI:EU:C:2019:936).