

**IN THE COURT OF JUSTICE  
OF THE EUROPEAN UNION  
JOINED CASES C-307/15 AND C-308/15**

**PALACIOS MARTINEZ AND OTHERS**

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**WRITTEN OBSERVATIONS OF THE UNITED KINGDOM**

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Submitted by

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**28 October 2015**

## Introduction

1. By orders dated 15 June 2015 in the joined cases, the *Audiencia Provincial de Alicante* (España) (“the Referring Court”) sought a preliminary ruling from the Court of Justice on eight questions (seven of which are common to both cases) concerning Articles 6(1) of Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts (“the Directive”).
2. The questions arose in the context of proceedings concerning a general contractual condition relating to the application of a minimum interest rate (“floor clause”) in a mortgage loan.
3. These are the Written Observations of the United Kingdom submitted pursuant to Article 23 of the Protocol on the Statute of the Court of Justice.

## Factual background

4. A judgment of the *Tribunal Supremo* (Supreme Court) of 9 May 2013 held that clauses restricting the minimum interest rate applicable to mortgage loans granted to consumers were unfair on the grounds of lack of transparency. The *Tribunal Supremo* applied a temporal limitation such that its judgment did not have retroactive effect.
5. The Applicants sought declarations that floor clauses in their mortgage agreements were unfair and reimbursement of payments made pursuant to those agreements.
6. In Case C-307/15, the court of first instance held that the proceedings were devoid of purpose, the floor clauses concerned having already been declared unfair in the judgment of the *Tribunal Supremo* dated 9 May 2013.
7. In Case C-308/15, the court of first instance declared the floor clause null and void and ordered a full repayment of the sums paid previously under the mortgage agreement by the claimants.

8. Having heard appeals from these judgments, the Referring Court made the Order for Reference.

### **The First Question**

9. By the first question, the Referring Court asks whether it is compatible with Article 6(1) of the Directive for a national court to limit the temporal effect of its judgment on an unfair contract term such that the applicant's claim for restitution derived from that judgment cannot have retroactive effect. For the avoidance of doubt, this question should not read as querying the right of the Court of Justice to limit the temporal effects of its judgments in this area. It is unnecessary, for the purposes of the proceedings before the Referring Court, to answer such a question.
10. In the United Kingdom's submission the first question should be answered in the affirmative because such limits, properly applied, are:
  - (1) consistent in principle with the Directive's objectives; and
  - (2) (being remedial) left by Article 6(1) of the Directive to the procedural autonomy of the Member States.
11. As regards the first of these reasons, it is necessary to consider in detail the objectives of the Directive and their relationship with an order limiting the temporal effect of a finding that a contract is unfair and not binding under Article 6(1) of the Directive. Temporal limits on national judgments applying EU law are unlikely to be permitted where they conflict with the objectives of the EU law instrument in question (Case C-41/11 *Inter-Environnement Wallonie ASBL* ECLI:EU:C:2012:103).
  - (a) *The consistency between the Directive's objectives and temporal limits on national judgments applying Article 6(1) of the Directive*
12. The Directive recognises that the consumer is in a weak position vis-à-vis the trader as regards both his bargaining power and his level of knowledge; the consumer normally agrees to terms prepared in advance by the trader without being able to influence the content of those terms (Case C-453/10 *Pereničová and Vladislav Perenič*, EU:C:2012:144, §27).

13. In providing that unfair terms shall not be binding on the consumer “*as provided for under their national law*”, Article 6(1) of the Directive aims to replace the formal balance, which the contract establishes between the rights and obligations of the parties, with an effective balance which re-establishes equality between them (*Pereničová and Vladislav Perenič*, §28).
14. A national court which finds that terms of a contract are unfair is required by Article 6(1) of the Directive to apply all the necessary consequences under national law so that the consumer is not bound by those terms (*Pereničová and Vladislav Perenič*, §30). The objective is to restore the balance between the parties while in principle preserving the validity of the contract as a whole (*Pereničová and Vladislav Perenič*, §31).
15. These consequences under national law must have dissuasive effect. The content of the unfair terms may be revised but not in such a way as to safeguard the interests of sellers or suppliers (*Banco Español de Crédito* EU:C:2012:349, §69). A national court may, however, delete an unfair term and substitute for it a supplementary provision of national law where invalidity would otherwise lead to unfavourable consequences for the consumer (*Kásler* EU:C:2014:282; *Unicaja Banco, SA* EU:C:2015:21, §33).
16. The dissuasive effect of the requirement that unfair terms are non-binding on consumers is not undermined by temporal limits on judgments applying Article 6(1) of the Directive. First, unfair terms will still be non-binding on consumers in the future, so sellers and suppliers will moderate their conduct and will not be tempted to continue to use such terms. Second, in order to ensure that the effectiveness of the Directive is not undermined, such temporal limits must be applied in exceptional circumstances only. National supreme courts should follow the approach of the Court of Justice in applying such limits to its own rulings.
17. According to the Court of Justice, two essential criteria must normally be fulfilled before such a limitation can be imposed, namely that those concerned should have acted in good faith (see paragraphs 34 - 43 below) and that there should be a risk of serious difficulties (see paragraphs 44 - 50 below) if the limitation is not imposed. The Court of Justice has taken that step where there was a risk of serious economic repercussions owing in particular to the large number of legal relationships entered into in good faith on the basis of rules considered to be validly in force and where it appeared that individuals and national authorities had been led to adopt practices

incompatible with EU legislation by reason of objective, significant uncertainty regarding the implications of provisions of EU law (*Schulz and Egbringhoff* EU:C:2014:2317, §§57-58 and *Balazs and Casa Județeană de Pensii Cluj* §§50-51).

18. In *RWE Vertrieb AG*, EU:C:2013:180 the CJEU considered a request for temporal limitation of its judgment concerning unfair terms in consumer contracts. Although the CJEU did not consider the essential criteria for the grant of temporal limitation to be satisfied in the circumstances of that case, it did not find that the grant of temporal limitation would be incompatible with Article 6(1) of the Directive as a matter of principle.
19. Similarly, in *Schulz and Egbringhoff*, at §62 the CJEU declined a request for temporal limitation because the risk of serious difficulties had not been established. Again, the CJEU did not express any reservations as to the compatibility of temporal limitation with the Directive on principle.
20. The Court of Justice has recognised in an analogous case that national courts may exceptionally impose temporal limits on the effects of judgments applying EU law where that is necessary to protect legal certainty. In Case C-40/08 *Asturcom* ECLI:EU:C:2009:615, the Court of Justice held that a national judgment finding a clause to be unfair under the Directive did not require a past judgment to be re-opened, despite that judgment involving an incorrect interpretation of EU law to the detriment of a party in that case (§§37-38).
21. The obligation to avoid further harm to consumers (*Kásler*) may support the imposition of a temporal limitation, where the absence of such a limit would lead to the widespread failure of firms and the withdrawal of firms from the relevant market (to the ultimate detriment of consumers).
22. The fact that the mortgage loan agreement before the Referring Court may relate to the Applicants' rights of access to housing under Article 7 of the Charter of Fundamental Rights does not preclude in principle temporal limitations on a finding that an unfair term is non-binding. Such rights may be limited, subject to the principle of proportionality, where necessary, genuinely to meet objectives of general interest or the need to protect the rights of others. In deciding whether to impose temporal limits, the national court (in common with the Court of Justice) weighs such rights in the balance where appropriate.

23. The Court of Justice has limited the temporal effects of its judgments even in cases where the fundamental EU law rights of individuals had been breached (*Barber* ECLI:EU:C:1990:209). In those cases the effect of the temporal limitation was to deny to past victims of that breach the fruits of the judgment of the Court of Justice. The Court of Justice imposed such a limitation on those rights because it was necessary in the general interest.
  24. Since temporal limitation of the Court of Justice's own judgments is in principle compatible with EU law, it follows that temporal limitation of national courts' judgments (on similar grounds) must equally be in principle compatible with EU law.
  25. If the Court of Justice were to conclude otherwise, it would be necessary (in order to obtain a temporal limit in a national judgment) to obtain it by way of a ruling under Article 267 TFEU since the domestic court could not do it directly. Even if this were possible (and such an objective would not normally of itself justify a reference under Article 267 TFEU) this result would be anomalous and inefficient.
- (b) *Temporal limits are remedies which Article 6(1) of the Directive leaves to the procedural autonomy of the Member States*
26. As regards the second reason above, Article 6(1) of the Directive is not concerned with the particular remedies available under national law e.g. whether or not a temporal limit prevents a claim for restitution having retroactive effect. Articles 6(1) and 7(1) of the Directive are concerned to ensure that an unfair term ceases to be binding and that the continued use of such term is prevented.
  27. In fact, Article 6(1) of the Directive leaves the national court free to apply such "consequences" as are necessary and appropriate to restore the balance between the parties. A temporal limit on the effect of the national court's judgment might be necessary and appropriate for that purpose.
  28. The Directive does not require for this purpose that any particular restitutionary or damages remedy is available to consumers still less that any such remedy must be permitted retroactive effects.

29. In the absence of harmonisation, national rules governing domestic proceedings concerning unfair terms in consumer contracts are a matter for the national legal order of the Member State concerned, provided that they are no less favourable than those governing similar domestic actions (the principle of equivalence) and do not make it in practice impossible or excessively difficult to exercise the rights conferred on consumers by EU law (*Banco Popular Español SA* EU:C:2013:759, §45).
30. The principle of equivalence is a matter which the Spanish government is best placed to address.
31. Temporal limitation is clearly compatible with the principle of effectiveness, since it does not hinder the enforcement of EU rights. It is well established that, pursuant to the principle of legal certainty, the Court of Justice has the power exceptionally to grant temporal limitation of its own judgments where justice requires (see, for example, *Skov and Bilka* EU:C:2006:6).
32. It is significant that, where the EU legislature has legislated for consumer remedies for breach of the Directive (Directive 98/27/EC on injunctions for the protection of consumers' interests), those remedies have been prospective only. Neither Directive 98/27/EC nor any EU measure provides for retrospective redress for breaches of the Directive.
33. For all these reasons, the United Kingdom submits that the answer to the first question is that it is compatible with Article 6(1) of the Directive for a national court exceptionally to grant temporal limitation of its judgment on an unfair contract term such that any restitutionary claim based on that judgment does not have retroactive effect.

#### **The second to fourth questions**

34. By the second to fourth questions the Referring Court asks for guidance as to the meaning of "good faith" in the context of determining whether to impose temporal limitations on judgments finding unfair terms to be non-binding under Article 6(1) of the Directive.

35. It is necessary first to distinguish between the concept of “good faith” within the meaning of Article 3(1) of the Directive and the “good faith” of the parties in considering whether to impose temporal limits on a judgment as a matter of EU law.
36. Under Article 3(1), a term is unfair if “*contrary to the requirement of good faith*” it causes a significant imbalance in the parties’ rights and obligations under the contract to the detriment of the consumer. In that sense, a lack of “good faith” indicates that the trader has exploited unduly the consumer’s weak position as regards both his bargaining power and his level of knowledge. The Court of Justice has, in that context, grouped “good faith” with “balance and transparency” (*Kásler* §40).
37. It is likely that the requirement of “good faith” in Article 3(1) of the Directive is an autonomous concept of EU law. This is because it is part of the legal test specified expressly in EU legislation, which does not refer to any concept in national law.
38. By contrast (and by reference to the third question), in considering whether to impose temporal limits on its judgments, the Court of Justice refers to the parties’ “good faith” in the sense of the reasonableness of their past reliance on an interpretation of EU law which the Court has decided to reject: see Case C-57/93 *Vroege* [1994] ECR I-4567 §23. This may be demonstrated by *inter alia* a lack of, or uncertain, guidance from the Court of Justice (*Vroege* at §24) or the Commission, (*Schulz and Egbringhoff* §58; *Santander Asset Management SGIC* EU:C:2012:286, §60) or the parties’ reasonable diligence as to the correct legal position (Case C-372/98 *R v MAFF ex p. JH Cooke & Sons* [2000] ECR I-8699 §§42-46).
39. In this context, “good faith” is not treated by the Court of Justice as an autonomous concept of EU law. The expression is used by the Court to describe a situation of objective fact, which the Court has considered indispensable before temporal limits may be imposed. It is unnecessary to treat “good faith” in this context as an autonomous concept of EU law. It is simply part of the factual examination which the Court has ruled is necessary in order properly to vindicate the general EU law principle of legal certainty.
40. In these joined cases the contracts in dispute were made in 2001 and 2006, respectively. This was before the judgements of the Court of Justice in *Invitel*, EU:C:2012:242 and *RWE Vertrieb AG*. On the basis of the law as understood at the



time that the contracts were made, sellers understood that terms which complied with paragraph (2)(b) of the Annex to the Directive were generally considered less likely to be unfair under Article 3(1) of the Directive and that the degree of importance placed by the Court of Justice on the transparency of terms was not anticipated. In the circumstances, sellers were entitled to consider that compliance with detailed regulatory requirements for mortgage contracts was sufficient for the purposes of a general obligation of transparency. The Commission had never suggested otherwise to the Member States.

41. The *Invitel* and *RWE Vertrieb AG* judgements were the first in this particular area covered by the Directive. It is reasonable to contend that these judgments upheld an interpretation that was not commonly held previously.
42. For these reasons, the United Kingdom submits that the answer to the second to fourth questions is that “good faith” in the context of imposing temporal limits on judgments is not an autonomous concept of EU law. It refers to a situation of fact, namely whether the parties in question could in the past reasonably have relied on the interpretation which the Court has rejected in its judgment.
43. Specifically by reference to the fourth question, prior to the judgments of the Court of Justice in *Invitel* and *RWE Vertrieb AG*, sellers understood that terms which complied with paragraph (2)(b) were generally considered less likely to be unfair under Article 3(1) of the Directive and that the degree of importance placed by the Court of Justice on the transparency of terms was not anticipated. Specifically, the United Kingdom understands from the Order for Reference §5 that the judgment of the *Tribunal Supremo* radically extended the previous understanding of what the Directive required as a matter of Spanish law.

#### **The fifth to seventh questions**

44. By the fifth to seventh questions the Referring Court asks for guidance regarding the criterion of “serious difficulties” in the context of determining whether to impose temporal limitations on judgments finding unfair terms to be non-binding under Article 6(1) of the Directive. The Referring Court asks in particular if difficulties to sellers alone are relevant or whether it may also take into account the fact that a temporal limitation would prevent consumers recovering all of the sums paid under the “floor clause” identified as unfair.

45. In this context, “serious difficulties” (like “good faith”) is not treated by the Court of Justice as an autonomous concept of EU law. The expression is used by the Court to describe a situation of objective fact which the Court has considered indispensable before temporal limits may be imposed. It is unnecessary to treat “serious difficulties” in this context as an autonomous concept of EU law. It is simply part of the factual examination (along with the reasonableness of the parties’ past reliance), which the Court has ruled is necessary in order properly to vindicate the general EU law principle of legal certainty.
46. Since the Court has stressed consistently that temporal limitations should be imposed on an exceptional basis only (since such limitations run contrary to the general principle that the Court’s rulings apply *ex tunc*), the concept of “serious difficulties” should be interpreted restrictively. Such difficulties should normally be very serious and arise at a macro-economic level.
47. The Court examines the impact on all interests, public and private of applying its judgment *ex tunc* (Case C-333/07 *Societe Regis Networks*). The Court has held that financial loss to a Member State in question is normally insufficient (*Balazs and Casa Județeană de Pensii Cluj*). There must be a substantial and wide-ranging disruption (e.g. affecting thousands of contractual relationships) before “serious difficulties” may be demonstrated (*Barber* and Case 43/75 *Defrenne*). It appears from the Order for Reference that there were such “serious difficulties” in this case.
48. Accordingly, as regards the seventh question, the difficulties which would be experienced by a particular trader or consumer, however severe, are normally insufficient.
49. The seventh question raises, however, a question of principle: in considering the question of “serious difficulties”, may the national court take into account the risk of harm to consumers whose rights might be prejudiced by the temporal limit? The United Kingdom submits that the national court may take such matters into account where relevant and sufficiently serious for the reasons set out above. For example, where the temporal limit may restrict the rights of consumers under Article 7 of the Charter, it may be appropriate to take the risk of prejudicing such rights into account in undertaking the necessary proportionality analysis.

50. For these reasons, the United Kingdom submits that the answer to the fifth to seventh questions is that “serious difficulties” in the context of imposing temporal limits on judgments is not an autonomous concept of EU law. It refers to a situation of fact, namely whether the judgment would have such gravely onerous or disruptive consequences for past transactions that the Court would be compelled to depart from the normal principles regarding the temporal effect of its ruling.

### **The eighth question**

51. By the eighth question, the Referring Court asks if a temporal limitation in a judgment entered in favour of a consumers’ association under Article 6(1) of the Directive should be automatically extended to a claim raising the same issues but brought by an individual.
52. The United Kingdom submits that, for the reasons set out above, it is inevitable that any temporal limitation of a judgment would also be applicable to all other judgements raising the same issues. The fact that proceedings are brought by individuals as opposed to consumers’ associations is irrelevant to the considerations of good faith and serious difficulties which the Court must address in deciding whether a temporal limit is imposed.

### **Joinder with Case C-154/15 *Gutierrez Naranjo***

53. The United Kingdom respectfully requests that the Court join these proceedings with those in Case C-154/15 *Gutierrez Naranjo* under Article 54 of the Rules of Procedure of the Court. There is a very substantial overlap in subject matter between the two cases, particularly in relation to the first question in the instant proceedings.

### **Conclusion**

54. In conclusion, the United Kingdom submits that the Court should answer the questions of the referring court as follows:

*“1. It is compatible with Article 6(1) of Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts for a national court to grant temporal limitation of its judgment on an unfair contract term such that any restitutionary claim based on that judgment does not have retroactive effect.*

2. *“Good faith” in the context of imposing temporal limits on judgments is not an autonomous concept of EU law.*

3. *“Good faith” refers to a situation of objective fact, namely whether the parties in question could in the past reasonably have relied on the interpretation which the Court has rejected in its judgment. This may be demonstrated by inter alia a lack of, or uncertain, guidance from the Court of Justice or the Commission or the parties’ reasonable diligence as to the correct legal position.*

4. *In considering the question of “good faith” in the context of imposing temporal limits on a Court ruling under Article 6(1) of the Directive, it is irrelevant that the actions of a seller have been the cause of a lack of transparency making the term unfair. This lack of transparency relates to the question of “good faith” in a different context, namely Article 3(1) of the Directive.*

5. *“Serious difficulties” in the context of imposing temporal limits on judgments is not an autonomous concept of EU law.*

6. *“Serious difficulties” refers to a situation of objective fact, namely whether the judgment would have such gravely onerous or disruptive consequences for past transactions that the Court would be compelled to depart from the normal principles regarding the temporal effect of its ruling. The concept is to be applied strictly and normally covers macro-economic difficulties only.*

7. *Subject to the answer to question 6 above, in assessing the risk of serious difficulties it may be appropriate to take into account the loss caused to consumers if the temporal limit in question were to be imposed.*

8. *Any temporal limitation of a judgment would also be applicable to all other judgements raising the same issues”.*

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**Date: 28 October 2015**