



Spanish Mortgage Foreclosure and Unfair Terms in Banking Contracts

Yolanda De Lucchi López-Tapia

Associate Professor in Procedural Law at the University of Málaga

Abstract: Mortgage foreclosure in Spain has been in the spotlight of all legal practitioners since the economic crisis began. At the time many debtors found themselves to have severe difficulties in meeting the payments of their debt which was secured by a mortgage and, from this resulted in losing their homes, the privileges of these proceedings set forth within the Spanish Civil Procedure Act began to arise. As a consequence of this, many courts started to refer questions for preliminary rulings to the Court of Justice of the European Union, in order to examine the compatibility of them with European standards. Due to many rulings of the European Court, Spanish legislation has been modified accordingly. We have arrived to a point where social awareness has imposed and the consumer's protection has been increased. The aim of this paper is to show the way this change has been generated.

Keywords: mortgage foreclosure, enforcement, unfair terms, dation in payment, preliminary rulings, fresh start.

Summary: I.- Introduction.- II.- Mortgage enforcement proceedings in Spain: recurrent problems related with consumers.- a) Dation in payment.- b) Unfair terms. III.- The CJEU rulings in the subject and their changes in legislation.- IV.- The current situation in the mortgage market.



I. Introduction.-

The western economic crisis has particularly affected our country, thus leading to a rise in enforcement proceedings, notably mortgage enforcement proceedings. The causes for this explosion of mortgage defaults and subsequent foreclosures can be described as the combination of heavy household indebtedness levels secured by mortgages and a rising of unemployment rate as well as a decrease in household revenues¹. As we are told, the situation is tending to change slowly, and so the figures show.

Spanish mortgage foreclosure has been always a quick way, different from the “general” enforcement proceedings, for the creditor to enforce the debt secured by the mortgage. In these proceedings, the debtor has very little chance to object it, either because the price for the auction is set in the deed, with no possibility to a new appraisal if the value changes, or because there are no possibilities for him to claim the staying of the proceedings nor to allege other causes of objection. For these and other reasons, these type of proceedings have been questioned of unconstitutionality before the Constitutional Court, but this Court has always ruled the legality of them.

At the moment when the crisis hit strongly the consumers, social movements and civil platforms were born claiming for a solution for the people losing their homes², because of their inability to pay the installments of the debt, and the banks filing “inevitably” enforcement claims. Fortunately, all legal operators started to realize that mortgage foreclosure in Spain was a privileged procedural instrument which affected consumer’s rights and did not comply with European Law. Specifically, two different problems broke into the scene:

-The situation when a debtor, after the repossession of his home, found himself in a position that the price of the mortgaged asset was insufficient to cover the whole debt, so he still had to pay back the outstanding amount to the bank.

¹ GÓMEZ POMAR, F. and LYCZKOWSKA, K. “Spanish Courts, the Court of Justice of the European Union, and Consumer Law. A theoretical model of their interaction” *Indret* 4/2014, pág. 5.

² PAH is the most famous in Spain.



-The numerous unfair terms the mortgage contracts incorporate and the helplessness of the debtor to void them with effect in mortgage foreclosure.

This being so, Spanish courts have been very active in referring questions for preliminary rulings to the Court of Justice of the European Union (CJEU) related with the compatibility of Spanish procedural rules with European Law, basically with Council Directive 93/13/EEC of 5 April 1993 of unfair terms in consumer contracts.

At the same time, a consequence of different CJEU rulings provoked the government to enact legislation in order to protect the consumer in this field. Though, the protection has been being enacted very gradually and always almost after a “*slap on the wrists*” from the CJEU³.

Although these different provisions have changed the scenario in mortgage foreclosure in Spain, yet we have a way to go. The CJUE insists in that one remaining aspect of Spanish mortgage proceedings does not comply Directive 93/13 but Spanish government refuses to modify the rules of procedure in that direction.

II. Mortgage enforcement proceedings in Spain: recurrent problems related with consumers.-

As mentioned previously, in case of a default in payment, creditors with their credits guaranteed by a mortgage can bring action to demand its payment through special proceedings –different from the normal enforcement proceedings- regulated in articles 681 to 698 of Civil Procedure Act. As their security is documented in a public deed, the creditor is exempted from going to a declaratory trial in first instance to obtain an enforcement title⁴.

The use of these special proceedings means that enforcement shall be directed against the mortgaged assets, laying aside other debtor’s assets. In other words, the proceedings shall

³ The different provisions enacted are as follows: RD-Ley 8/2011, 1st July, RD-Ley 6/2012, 9th March, Rd 27/12, 15th November, Ley 8/2013, 26th June, Ley 10/2014 26th June, Rd-Ley 11/2014, RD 1/2015 27th February.

⁴ Creditors can also bring action through a normal enforcement proceeding, a declaratory proceeding or extrajudicial proceedings to be followed before a Notary Public. The election implies different types of protection for the mortgagee or the mortgagor. For the advantages and disadvantages of all of them, see RUIZ-RICO RUIZ, J.M and DE LUCCHI LÓPEZ-TAPIA, Y. “*Ejecución de préstamos hipotecarios y protección de consumidores. Análisis y propuestas para una adecuada conciliación de los intereses en juego*”. Madrid, 2013, págs. 21 to 44.



be focused only on the repossession of the mortgaged asset. If the debt is not covered fully with the proceeds obtained with the sale or awarding of the mortgaged asset, the mortgagee will continue to enforce the debt through general enforcement proceedings. This situation was very common before the latest reforms were enacted, because the price for the award of the asset by the bank –in cases such as there was no bidders, which occurs very often- was really low (50% of the price set in the public deed). Moreover, the mortgagee also enjoys the speediness of the proceedings, and also the lack of grounds to challenge a foreclosure from the mortgagor perspective.

It is required to bring action in these proceedings that the mortgage deed shall include the price at which the mortgage property is valued (based on an official appraisal). This might serve as a rate in the auction. It is also required an address of the debtor for notifications and summons that shall be included in that deed.

The proceeding shall begin with an enforcement claim that must be made against the debtor. It can also be made, if applicable, against the non debtor party which has taken on the mortgage or against the third party which owns the assets mortgaged.

A certificate of ownership from the Registry shall be claimed, together with a statement that the mortgage in favour of the mortgagee subsists and has not been cancelled. If the registration certificate shows that the person in favour of the last registration of ownership was made and has not been requested to pay in any notary or judicial form, this person shall be notified of the existence of the procedure so that he may intervene in the proceedings.

The mortgagor has very little grounds to challenge foreclosure in case the enforcement claim has been correctly filed, mainly the payment of the debt and, after Law 1/2013 the inclusion of some unfair terms in the contract.

Once the above has been complied with, and at the request of any of the parties at the proceeding, the property or asset mortgaged shall be auctioned. In order to attend the auction, bidders must deposit the 5% of the auction price (it was 30% before Royal Decree 8/2011 and



20% before Law 1/2013). The enforcing party may only bid when there are other bidders and will not be required to make a deposit. These are the possible scenarios in the auction:

Bid equal to or higher than 70% of the price for which the asset is auctioned: the Court Clerk shall, by order issued on the same or the following day, award the foreclosed asset to the highest bidder.

Bid higher than 70% of the appraisal value with payment in instalments: if only bids in excess of 70% of the appraisal value are made, but offering to pay in instalments with sufficient bank or mortgage guarantees of the deferred price, the agreed bids shall be notified to the enforcement creditor who, within the next twenty days, may request the adjudication of the real property at 70 percent of the start value. If the enforcement creditor does not make use of this right, the final bid shall be approved in favour of the most favourable of the said bids, with the conditions of payment and guarantees offered in the latter.

Bid lower than 70% of the appraisal value: the enforcement creditor may, within a time limit of ten days, present a third party improving the bid by offering an amount in excess of 70 percent of the appraisal value or that, albeit lower than the said amount, proves to be sufficient for the complete satisfaction of the right of the enforcement creditor.

Awarding of the asset by the mortgagee. If, upon expiry of the said time limit, the enforcement debtor has failed to present a third party paying an excess of 70 percent of the appraisal value or that, albeit lower than the said amount, proves to be sufficient for the complete satisfaction of the right of the enforcement creditor, the mortgagee may, within the time limit of five days, seek the awarding of the property at 70% of the aforementioned value or for the amount owed to him for all items, but it must be provided that such amount does not exceed sixty per cent of its appraisal value and of the highest bid.

Bid higher than 50% of the appraisal value. If the mortgagee does not make use of this faculty, the final bid shall be approved in favour of the highest bid provided that the amount offered by the latter is higher than 50 percent of the appraisal value or, if lower, covers at least



the amount for which the enforcement was dispatched, including the provision for interests and costs.

Bid lower than 50% of the appraisal value: if the best bid does not meet the above requirements, the parties may allege whether or not the award is admissible and the Court Clerk will resolve on the basis of a series of circumstances, mainly the attitude of the foreclosed debtor regarding its obligations under the agreement.

No bidders: if there are no bidders to the auction the mortgagee may request the award of the asset. Depending on the consideration of the immovable asset as primary residence or not, the awarding price would be different. If it is, the award would be for an amount equal to 70% of the appraisal value (it was 50% before Royale Decree 8/2011 and 60% before Law 1/2013) or 60% if the amount owed is lower than that. If it is not, then the awarding value would be for an amount equal than 50% of the appraisal value.

When the secured creditor fails to use this faculty within a time limit of 20 days, the Court Clerk will order the lifting of the attachment over the asset at the request of the foreclosed debtor.

This brief outlook of the mortgage proceedings in Spain lead us to highlight where the difficulties were in order to comply European Consumer Law and over all, to protect consumers from the devastating effects of the economic crisis.

a) **Dation in payment.**

"Dation En Paiement" (derived from French) means giving in lieu of payment. It is an act by which a debtor gives a movable or immovable asset or property to the creditor, instead of paying a debt he or she owes in money. The creditor is generally willing to receive it, in payment of a sum which is due. It is similar to cession of assets, as well known as "datio pro solvendo", established in section 1175 Civil Code. Under the dation in payment the credit is paid and discharged fully by giving the property or asset to the creditor, who becomes the new owner of the property, whereas the cession of assets does not discharge the debt until the



creditor sells and gets the full amount for the debt. This means that the creditor does not become the owner of the property and will only get a profit through a sale, the debt will then be considered cancelled. The Spanish jurisprudence states that although dation in payment is not expressly regulated under civil law, rules of purchase and sale must be applied⁵.

Under the provisions set in Article 140 of the Mortgage Act, the parties can agree that the guaranteed obligation is subject only to the mortgaged properties. In the event of the default of payments, the obligation of the debtor and the action of the creditor will be limited to the amount of the mortgaged properties and will not refer to the rest of the estate of the debtor. Agreeing this type of mortgage contract means higher interest rates and more difficulties in getting the loan, as a result of the limited liability. Furthermore, it is a voluntary agreement between creditor and debtor.

This type of contract is wrongfully called dation in payment. On the contrary, what society demands as dation in payment is the total cancelation of the remaining debt after mortgage foreclosure, so the creditor cannot prosecute other debtor's assets.

The situation works as follows: If there is no such agreement of limited liability, normal conditions shall apply. Those conditions are basically set in article 1911 of the Civil Code which sets forth the debtor's universal liability for the performance of his obligations with all present and future property. In connection with this provision, article 579 of the Civil Procedure Act sets forth that, if the proceeds from auctioned mortgaged are insufficient to cover the debt, the enforcement creditor may seek the enforcement of the remaining amount against whomever it may be appropriate –the guarantor-, and the enforcement action shall proceed in accordance with the normal rules that apply to any enforcement action. So, once the special mortgage proceedings have ended, and the amount obtained in the auctioning of the asset or the price for which the creditor has awarded the asset is below the amount owed, the creditor shall continue the enforcement proceedings, bringing action towards the rest of the debtor's assets.

⁵ "<http://www.legaltoday.com/blogs/civil/legal-english-blog/dation-en-paiement-or-datio-pro-solutio#n2>.



Having said so, dation in payment involve the breakage of the principle of universal debtor's liability and cannot be a general rule in our enforcement proceedings. It is certainly true to say that this has not been an immovable principle and could have been moderated by the legislator, but certain conditions will have to apply.

As we stated in our introduction, dation in payment is a general demand that social groups have been claiming just right from the starting point of the crisis, where lots of people were evicted from their homes and they still had a remaining debt to the bank. They claimed for the changing of the law to set dation in payment as a general rule. The courts also started to move towards the consideration of dation in payment within our regulations before all the legal reforms where enacted, which was a bit forced.

In December 2010 and February 2011, the Court of Appeal in Navarra issued two different and opposite rulings. The first one, in which the BBVA bank was obliged to accept the solution of dation in payment to cancel the debt and the second one ruled just the opposite. The Court of Appeal's first judgment considered that by giving a house to the bank, its value was enough to cover the debt, and discharged it, moreover, if the bank granted the loan was because the house had a higher value than the credit. On the other hand, the second judgment was totally different and stated that, even if the value of the property was then 70.000€ lower than when it was firstly valued, the court challenged what the previous court issued and stated that, applying a principle of Spanish Civil Code, the debtor will have to pay all the debts with current or future assets and that judges should be independent and fulfill the law accordingly. After those judgments, most of the court started to issue rulings trying to interpret the law according with the consumer's interest, but forcing the statutory law.

A situation of legal uncertainty was being generated, because depending on the court the mortgage foreclosure had been filed, you would have had the luck of seeing your debt cancelled as a consequence of court interpretations of article 579 of the Civil Procedure Act.

So, preliminary rules in this sense were asked to the CJUE, which ruled that dation in payment is a decision which internal legislative body of each country has to enact. In this context, Spanish government has been aware of the situation and important changes have



been made in Spanish legislation towards that end. Indeed, many recent laws have provided a case-by-case dation in payment –always with the bank consent- and also, the staying of the eviction of their homes of families in risk of social exclusion –meeting specific requirements that successively have been amplified- for up to four years.

b) Unfair terms

The second issue brought here that initially affected mortgage foreclosure proceedings was the one related with unfair terms in mortgage contracts with banks and the possibility of the debtor to challenge the unfairness of them.

Following rulings of the CJUE⁶, the concept of *unfair term* within Article 3(1) and (3), and Annex I, of Directive 93/13 is 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.

In order to determine whether this imbalance arises “contrary to the requirement of good faith”, courts must assess whether the seller or supplier is dealing fairly and equitably with the consumer, and can reasonably assume that they would have agreed to such a term. Lastly, the unfairness of a contractual term should be assessed by taking into account all the circumstances in which the contract was concluded, and the nature of the goods or services for which it was.

In relation with mortgage contracts, unfair terms would be the inclusion of acceleration clauses in long-term contracts that allows the bank to call in the totality of the loan after a single failure to meet a due payment of principal or interest; a high default interest rate of automatically applicable to sums not paid when due; the clause on unilateral quantification of the unpaid debt stipulates that the bank may immediately quantify that amount in order to initiate mortgage enforcement proceedings; and what we called ground clause -a minimum

⁶ Aziz case. Judgment 14th March 2013 (C-415/11)



interest rate that banks and other financial institutions applied to the loans so the client would pay a minimum monthly amount even if the *Euribor* rate would fall below this limit⁷.

At the beginning of the situation that caused this stir in the legal world, neither in the general enforcement proceeding nor the mortgage proceedings, the debtor could contest the enforcement alleging the inclusion of an unfair term in his contract. There was not a procedural way for the court to deem such unfairness, although many courts had been doing so.

Having stated that initial impossibility –it has already been amended in our legislation, as we will see afterwards-, the only solution for the debtor to challenge such unfairness was bringing the action to declaratory proceedings which is a long process. Moreover, the interrelation between the declaratory proceedings and the enforcement proceedings could be disastrous; if a debtor want to challenge the unfairness of a term, which leads into the illegality of the entire enforcement proceeding, he would have to file a claim into a declaratory proceeding. During those declaratory proceeding, the mortgage enforcement proceedings will continue because it is absolutely forbidden the staying of the proceeding for that specific cause. Indeed, article 698 of the Civil Procedure Act provides that *“any claim that the debtor, a third-party holder or any other interested party may bring which is not included under the preceding articles, including any concerning the nullity of title or on the expiry, certainty, extinction or amount of the debt, shall be dealt with in the relevant trial without ever having the effect of staying or hindering the proceedings set forth in this chapter”*.

This meant that, when the court issue a ruling stating the unfairness of the term which leads into the illegality of the enforcement, the enforcement proceedings would have already

⁷ The so-called ground clause is still causing a legal debate in Spain. The Supreme Court ruled the unfairness of it when its consequences had not been carefully explained to customers and they did not know or clearly understood the effects it would have in their monthly payments. In this ruling the banks or financial institutions were forced to withdraw the “ground clause” from the conditions of the mortgage loan and the loans title deeds. This directly affected at least 400,000 contracts from BBVA bank, 90,000 contracts in the case of Novagalicia Bank and 100,000 in the Cajamar entity. But he Supreme Court ruled that the banks shall refund the amounts illegally charged from the date of the ruling and not from when the contract was signed. We are now awaiting for a new ruling from that court to clarify the situation. Vid. DE TORRES PEREA, J.M. *Nulidad de la cláusula suelo por falta de transparencia fundada en una insuficiente información del cliente bancario. En especial, sobre la idoneidad de su impugnación mediante el ejercicio de la acción de cesación*. Revista jurídica valenciana, Nº. 2, 2014, págs. 23-62.



finished and the asset sold to the best bidder. The only way to grant relief to the debtor would be a compensation on the price of the asset. This solution is way too far from the right to effective protection of the court (due process) guaranteed in Article 24.1 of the Spanish Constitution.

The situation provoked different referrals to the CJEU for preliminary rulings in the matter of deeming unfair terms in mortgage proceedings, most of them are analyzed in next section.

II. The CJEU rulings in the subject and its consequent changes in Spanish legislation.

As the situation was precarious, with many homeowners losing their homes, a number of cases regarding the compliance of Spanish law on mortgage enforcement with EU consumer law started to make its way through preliminary reference proceedings before the CJEU⁸. A point that draws the attention is the interaction between national and supranational judiciaries in this field, in which the principle of effectiveness functions as leverage for 'upgrading' national laws to EU standards. As a consequence of this, Spanish legislation has been amended to meet those EU standards.

a) Calderón case: Judgment 14th June 2012 (C-618/10)

One of the first rulings coincident with the economic situation was this case. Although the dispute is not about a mortgage contract, the ruling was interesting if we compared it with one of the latest of the CJEU.

⁸ Hans-W. Micklitz, Norbert Reich, "The Court and Sleeping Beauty: The revival of the Unfair Contract Terms Directive (UCTD)" 51 *Common Market Law Review*, 20014.Issue 3, pp. 771–808. *The paper gives an overview of the increased litigation leading to innovative case law of the CJEU concerning the scope and effects of the Unfair Contract Terms Directive (Directive 93/13/EEC) on consumer contracts, in particular financial services and services in the general economic interest. The originally limited impact of the Directive on Member State contract law and procedure has been substantially extended - as a metaphor, one may even say that a "Sleeping Beauty has been kissed awake" by the Court.*



Mr Calderón Camino entered into a loan agreement for the sum of EUR 30 000 with Banesto in order to purchase a vehicle. The nominal interest rate was 7.950%, the APR (Annual Percentage Rate of Charge) 8.890% and the rate of interest on late payments 29%. In September 2008, reimbursement of 7 monthly repayments had not yet been made. Thus, Banesto submitted, before the Court of First Instance, No 2 of Sabadell, in accordance with Spanish law, an application for an order for payment in the amount of EUR 29 381.95, corresponding to the unpaid monthly repayments plus contractual interest and costs. The Court of First Instance held of its own motion that the term relating to interest for late payment was automatically void, on the ground that it was unfair. It also fixed that rate at 19%, referring to the statutory rate of interest and to the rates of interest for late payment included in national budget laws from 1990 to 2008, and ordered Banesto to recalculate the amount of interest for the period at issue in the dispute before it.

Banesto appealed against that order to the Audiencia Provincial de Barcelona, who found, that the Spanish legislation on the protection of the interests of consumers and users does not empower the courts before which an application for order for payment has been brought to hold, of their own motion and *in limine litis*, that unfair contract terms are void, so they referred the preliminary ruling to the CJEU, referring also the question whether the court that finds that an unfair term in a contract concluded between a seller or supplier and a consumer is void, can modify that contract by revising the content of that term instead of merely setting aside its application to the consumer.

The answers of the CJEU for the questions referred to above are as follows:

-Firstly, the CJEU ruled that Directive 93/13 had to be interpreted as precluding legislation of a member state which did not allow the court before an application for an order of payment has been brought to assess of its own motion, in limine litis or at any other stage of the proceedings, if a term shall be considered unfair.

-Secondly, the Court insisted on the necessity to remove an unfair clause within the meaning of Article 3 of Directive 93/13. If a national court deems the unfairness of a term, the legislation that allows the court to modify the contract by revising the content of that term



does not comply within the Directive 93/13. The idea would be to invalidate the term and not moderate it. The reason behind the ruling of the court is that if it was open to a national court to revise the content of unfair terms, that power would seriously undermine the dissuasive effect for sellers or suppliers of straightforward non-applications with regards to the consumer of those unfair terms, because those sellers or suppliers would still be tempted to use such terms in the knowledge that, even if they were declared invalid, the contract could nevertheless be adjusted, to the extent necessary, by the national court in such a way as to safeguard the interest of those sellers or suppliers. An exception to this case-law is made where the invalidity of the unfair term would require the court to annul the contract in its entirety, thereby exposing the consumer to disadvantageous consequences.

b) Aziz case: Judgment 14th March 2013 (C-415/11)

The most famous ruling of the CJEU in the matter of unfair terms and mortgages is the Aziz case which attracted the media and caused a great stir. This case is directed related with mortgage contracts.

The court judgment is originated from a preliminary ruling handed down by the Commercial Court nº 3 of Barcelona, as a result of the mortgage foreclosure procedure between Aziz and *La Caixa* Bank.

Mr. Aziz concluded with Catalunyaacaixa, before a notary, a loan agreement secured by a mortgage. The immovable property subject to the mortgage was Mr Aziz's family home. The principal sum lent by Catalunyaacaixa was EUR 138 000. It was to be reimbursed in 396 monthly instalments. That loan agreement entered into with Catalunyaacaixa provided for annual default, interest of 18.75%, automatically applicable to sums not paid when due, without the need for any notice. In addition, clause 6a of that agreement conferred on Catalunyaacaixa the right to call in the totality of the loan on expiry of a stipulated time-limit where the debtor failed to fulfil his obligation to pay any part of the principal or of the interest on the loan. Finally, clause 15 of that agreement, concerning the agreement on determination of the amount due, stipulated not



only that CatalunyaCaixa had the right to bring enforcement proceedings to reclaim any debt but also, for the purposes of those proceedings, that it could immediately quantify the amount due by submitting an appropriate certificate indicating that amount. Mr Aziz paid his monthly instalments regularly from July 2007 until May 2008 but stopped payments with effect from June 2008. Having called in vain upon Mr Aziz to pay, CatalunyaCaixa instituted enforcement proceedings against him before the Court of First Instance No 5 de Martorell, seeking recovery of the sums owed. Since Mr Aziz failed to appear, that court ordered enforcement. Mr Aziz was then sent an order for payment but he neither complied with it nor objected to it. Accordingly, a judicial auction of the immovable property was arranged, but no bid was made. Therefore, in accordance with the provisions of the Code of Civil Procedure, the Court of First Instance No 5 of Martorell consented to the awarding of that property at 50% of its value. Mr Aziz had however applied to the Commercial Court No 3 de Barcelona for a declaration seeking the annulment of clause 15 of the mortgage loan agreement, on the ground that it was unfair and, accordingly, of the enforcement proceedings. In that context, the Juzgado de lo Mercantil No 3 de Barcelona expressed doubts concerning the conformity of Spanish law with the legal framework established by the directive.

The questions referred were related to; firstly, determine if the restricted grounds of objection of the Spanish mortgage proceedings, as seen before in Section II, consisted of a clear limitation of consumer protection in the terms of Directive 93/13; and secondly, the national court asked about several terms included in Aziz's mortgage contract and how can they be understood in terms of disproportion as in Directive 93/13 set forth.

The court recalls two important principles of implementation of European Law in order to rule the case; the principle of equivalence -legislation may not be any less favourable than that governing similar situations subject to domestic law- and principle of effectiveness – legislation must not make it in practice impossible or excessively difficult to exercise the rights conferred on consumers by EU law-.

In the absence of harmonization of the national mechanisms for enforcement, the grounds of opposition allowed in mortgage enforcement proceedings and the powers conferred



on the court hearing the declaratory proceedings are a matter for the national legal order of each Member State. However, taking into account those two principles, the answer to the alluded case are that Spanish legislation listed the grounds, which were very limited, upon which a debtor might object to mortgage enforcement proceedings. Those grounds did not include the existence of an unfair term in the mortgage loan agreement.

Moreover, the Court considered that the Spanish procedural system impairs the effectiveness of the protection which the directive seeks to achieve. That is so in all cases where enforcement is carried out in respect of the property before the court hearing the declaratory proceedings declares the contractual term on which the mortgage is based unfair and, accordingly, annuls the enforcement proceedings. Since the court hearing the declaratory proceedings is precluded from staying the enforcement proceedings, that declaration of invalidity allows the consumer to obtain only subsequent protection of a purely compensatory nature. That compensation is thus incomplete and insufficient, and would not constitute either an adequate or effective means of preventing the continued use of those terms. That applies all the more strongly where, as in this case, the mortgaged property is the family home of the consumer whose rights have been infringed, since that means of consumer protection is limited to payment of damages and interest and does not make it possible to prevent the definitive and irreversible loss of the home. It would thus be sufficient for sellers or suppliers to initiate mortgage enforcement proceedings in order to deprive consumers of the protection intended by the directive.

The Court therefore holds that the Spanish legislation does not comply with the principle of effectiveness, as it makes it impossible or excessively difficult, in mortgage enforcement proceedings initiated by sellers or suppliers against consumer defendants, to apply the protection which the directive confers on those consumers.

Following Aziz's rulings, Spanish legislation in mortgage proceedings was amended in *Law 1/2013 14th of May, laying down measures for the strengthening of the protection of mortgagors, the restructuring of debt and social rent*. The provisions of the law changed substantially the situation, so much in procedural law as well as in substantive law.



The main amendments were as follows:

Amendments to the mortgage market

-Limitation of default interest on mortgages created on primary residences to three times the statutory interest rate.

-Acceleration of payment clause must be applicable only within three months of default of payment or on a number of installments equivalent to three monthly payments.

Amendments to the enforcement proceedings

-The law grants judges the power to deem, at their own initiative or at the request of the interested party, the existence of unfair terms in the enforceable title. Article 552.1 of the Civil Procedure Act has been amended, to authorize Judges to be able to warn the parties if they discern that some of the clauses of the enforceable nonjudicial ownership instrument might be unfair, granting them a five-day hearing.

-The mortgagor also can object the enforcement alleging unfair terms in the enforceable title. New grounds for opposition in nonjudicial foreclosure processes have been included in article 557.1 of the Civil Procedure Act, one of which is if the instrument contains unfair clauses. In cases where one or more clauses are found to be unfair, the court will rule that the foreclosure is unjustified, or it will carry out the foreclosure without applying those unfair clauses, as appropriate (article 561.1 of the Civil Procedure Act). The same provision has been included in mortgage proceedings, where the mortgagor can object the unfairness of a clause, but the grounds are more restrictive in this type of proceedings, because the unfairness can only be objected if the contractual term constitutes the grounds for enforcement or has determined the amount due.



Judicial auction

-The auction will be announced, not only by edict, but also on a judicial and electronic auctions portal belonging to the Ministry of Justice (article 668 of the Civil Procedure Act).

The period within which the price at which the property is awarded must be deposited has been extended to 40 days (article 670.1 of the Civil Procedure Act)

- The starting price at auction set out in the mortgage deed cannot be lower than 75% of the appraisal value –in mortgage proceedings where the auction price is set in the deed-

-It possible to remit part of the outstanding debt in the monetary foreclosure proceeding following the foreclosure of a mortgage on a principal residence;

-Reduction by up to 2% of the debt if permission to inspect the mortgaged property is granted. During the 20-day auction announcement period, anyone interested in the auction may ask the court for permission to inspect the mortgaged property, in which case the court will ask the owner of the property for permission and the mortgage debt could be reduced by up to 2% of the repossession value (article 691.2 of the Civil Procedure Act).

-The amount secured by the guarantee needed to take part in the auction from decreases from 20% to 5% of the appraisal value (article 674 Civil Procedure Act)

- The percentage at which the property (primary residence) will be awarded if there are no bidders at auction increases to 70% of the starting price;

-The period afforded to the successful bidder to deposit the price at which the property is awarded extends from 20 to 40 days;

Monetary foreclosure following foreclosure of a mortgage on a primary residence (Art. 579 Civil Procedure Act)

If the proceeds from auctioned mortgaged assets are insufficient to cover the debt, the enforcement creditor may seek the enforcement of the remaining amount against whomever it may be appropriate, and the enforcement action shall proceed in accordance with the normal



rules that apply to any enforcement. As aforementioned, this is the provision that do not cover what we have defined as dation in payment. However, Law 1/2013 has amended that article and now two cases are set out in which the foreclosed borrower may be released: where 65% of the borrower's outstanding debt at the time of approval of the bid is paid off, in 5 years, plus, exclusively, the statutory interest accrued until the time of payment; or where 80% is paid off in 10 years. Also, to allow the debtor to benefit from a future increase in value of the foreclosed property, the debt may be reduced by 50% of the gain obtained on a sale made within 10 years of the repossession.

As can be noticed, there is no amendment in full to this article, which would have meant the entry in force of a general dation in payment, which is not the solution to the mortgage market, as we mentioned before.

One of the points the CJEU ruled in Aziz's case was the opposition of Spanish legislation to the Directive 93/13 in the grounds of potential staying of the mortgage proceedings while declaratory proceedings are being heard to determine the unfairness of a term. Since article 698 of Civil Procedure Act does not permit this staying, the Court concluded that Council Directive precludes Spanish legislation insofar as it does not allow the court before which declaratory proceedings have been brought, which does have jurisdiction to assess whether such a term is unfair, to grant interim relief, including, in particular, the staying of those enforcement proceedings, where the grant of such relief is necessary to guarantee the full effectiveness of its final decision.

However, Spanish legislation has not been amended in this sense. It is true that with the changes already made by Law 1/2013 the unfairness can be deemed in the enforcement proceedings and it will be not necessary to seek protection under a declaratory proceeding.

c) Case Sánchez/Chacón: Judgment 30 April 2014 (c-280-13)

The dispute in this case is about the possibility of dation in payment within spanish legislation:



The debtors concluded a loan contract with the Caja de Ahorros y Monte de Piedad de Baleares for EUR 91 560. In order to secure that loan they mortgaged the dwelling in which they lived. The parties included in the mortgage deed a specific term providing that, in the event of any auction which might be held, with reference to the value of the dwelling would be EUR 149 242.80. According to Barclays, the parties to the contract also agreed to the unlimited personal liability of the debtors, without limiting that liability to the value of the mortgaged property. Barclays was substituted to the contractual position of the lender. Barclays and the debtors agreed by an act of the same date to an increase in the capital lent to EUR 153.049,08. The estimation of the value of the property mortgaged and the term relating to the liability of the debtors was not changed. As regards the points which were not expressly set out in the new act, the provisions of the original mortgage loan contract were to apply. Having ceased the debtors to pay the monthly loan instalments Barclays brought an action before the Court of First Instance, Palma de Mallorca, seeking the enforcement of the whole debt against the debtors. The property was auctioned, but no bidders were present, so the property was awarded to Barclays, in accordance with the wording of Article 671 of the Civil Procedure Act in force at that time, that is, 50% of the estimated value which the parties had entered in the .mortgage deed.

Barclays requested an order for enforcement for the outstanding debt, which was granted. Within the statutory period prescribed for that purpose, the debtors lodged an objection to that order. They claim that the debt must be deemed to have been cleared and repaid in full because of the value estimated in the deed. They also rely on the abuse of rights and unjust enrichment by Barclays.

The questions referred a preliminary ruling in this case can be resumed in two points:

The first matter concerns whether Directive 93/13 precludes on mortgage regulation which, although it provides that the mortgagee may request an increase of the security where the valuation of a mortgaged property decreases by 20%, does not provide, in the context of mortgage enforcement proceedings, that the debtor may request, following a valuation involving the parties concerned, revision of the sum at which the property was valued, at least



for the purposes stipulated in Article 671 of the Civil Procedure Act, where that valuation has increased by an equal or higher percentage during the period between the creation of the mortgage and the enforcement thereof.

As previously mentioned in the second section of this paper, Spanish procedural rules on mortgage enforcement provide that the creditor seeking enforcement may be awarded the mortgaged property at 50% at the time of the judgment (now 70% for primary residence) of the sum at which the property was valued, which entails an unjustified penalty for the debtor equivalent to 50% (30% in case of primary residence) of that valuation. The referring court asked whether Directive 93/13 is precluding such dispositions.

The second question settled for a preliminary ruling was whether Directive 93/13 could be interpreted as meaning that there is an abuse of rights and unjust enrichment where, after being awarded the mortgaged property at 50% (now 70% for primary residence) of the sum at which the property was valued, the creditor applies for enforcement in respect of the outstanding amount in order to make up the total amount of the debt, despite the fact that the sum at which the property awarded was valued and/or the actual value of the property awarded is higher than the total amount owed, even though such action is permitted under national procedural law.

The answer of the CJEU was completely different from the case *Aziz*, because in this case, the national court did not invoke any contractual term that could be classified as unfair. On the contrary, it did invoke national Spanish provisions, which are laws or regulations that were not set out in the contract at issue in the main proceedings. Such provisions do not fall within the scope of that directive which aims to prohibit unfair terms in contracts concluded with consumers.

This means that, in relation with the prior section, an eventual request for installment of payment into Spanish legislation on the grounds of incompatibility to European consumer law is not applicable.



d) Case Sanchez Morcillo: Judgment 17 July 2014 (C-169-14)

The case of *Sánchez Morcillo and Abril García v Banco Bilbao* once more concerned the weak position of consumers under Spanish law regarding the enforcement of mortgage contracts by banks. The home owners found themselves in the position where the contract allowed the bank to claim payment of the entire amount of the mortgage loan upon the failure to pay a certain number of monthly instalments.

In this case, the CJEU again came to the conclusion that the Spanish rules on enforcement of mortgages do not live up to the standards of the Unfair Terms Directive. This time, moreover, the Court explicitly grounded its assessment on Article 47 of the EU Charter of Fundamental Rights, which safeguards the right to an effective remedy and a fair trial in accordance with the principle of equality of arms.

Indeed, the question arising in this case is a direct consequence of the reform of Article 695 of the Civil Procedure Act following the *Aziz* judgment, as we will see in next paragraph. Procedure stipulated that in such cases appeals might only be brought against a judicial order staying the proceedings or displaying an unfair contract term. This effectively offered the bank a possibility to immediately appeal against the substance of a home owners objection to enforcement, whereas the party against whom enforcement was sought (the owner of the house) might not appeal if his or her objection is dismissed. In other words, Article 695(4) allowed the bank to appeal against the staying of proceedings, whereas the debtors did not have similar possibilities. The national judge in the present case doubted whether this is in line with the consumer protection offered under the Unfair Terms Directive, read in combination with Article 47 of the EU Charter, as aforementioned.

The CJEU ruled that this different treatment to the mortgagee and the mortgagor violated the principle of equality of procedural defense mechanisms available to the parties involved in mortgage enforcement proceedings.



This ruling soon provoked changes in Spanish legislation. Indeed, by RD Law 11/2014 5th September, about urgent measures in Insolvency Law, article 695.4 was modified entitling the debtor to seek appeal in case of dismissal of his objection.

And once more, the CJEU insisted that Spanish system of mortgage enforcement does neither offer adequate nor effective protection (in the sense of Article 7 of the Unfair Terms Directive) to home owners, insofar as it still does not effectively prevent unjustified evictions. A judge in enforcement proceedings may assess the unfairness of contract terms, but this assessment is not mandatory and bound by time restrictions. Furthermore, in case a judge in parallel declaratory proceedings eventually establishes that the terms of the mortgage contract were unfair, the consumer can only claim monetary compensation, because of the prohibition of the staying of the proceedings for this reason (art. 695 Civil Procedure Act).

e) Case: Unicaja v. various (Joined cases): Judgment 21 January 2015.

The last CJEU's ruling in this scenario is the one issued a couple of months ago. The questions referred for preliminary ruling were again about the judicial assessment of general terms and conditions applying to Spanish mortgage contracts. Soon after Law 1/2013 entered into force, many courts started to refer preliminary rulings to the CJEU about the following issue:

Known that Spanish legislation, for the sake of Law 1/2013, allows a judge to assess whether a term is unfair or not in any enforcement proceeding, the next step is asking the European court if, in order to ensure the protection of consumers and users in accordance with the principles of equivalence and effectiveness, must a national court, when it finds there to be an unfair default-interest clause in mortgage loans, declare the clause void and not binding or, on the contrary, must it moderate the interest clause, referring the matter back to the party seeking enforcement, or to the lender, for adjustment of the interest. This issue was already referred to preliminary ruling in Calderón case and the European Court ruled that unfair terms should not be moderate.



In this case, the question has necessarily to do with the Second Transitional Provision of Law 1/2013⁹ which requires a moderation of default interest for loans or credit for the purchase of a principal residence and guaranteed by mortgages on the dwelling at issue. Accordingly, it is laid down that in proceedings for enforcement or extra-judicial sale commenced and not concluded by the time of the entry into force of that law, that is, on 15 May 2013, and in proceedings in which the sum in respect of which an enforcement order or order for extrajudicial sale is sought has already been fixed, that amount must be adjusted by applying default interest at a rate at most equal to three times the statutory rate, if the rate of default interest under the mortgage contract is higher than that rate.

Linking those two ideas, the referral court asked if the Second Transitional Provision of Law No 1/2013 implicitly imposes upon the court the obligation to moderate a default-interest clause that could be considered to be unfair, adjusting the interest stipulated and maintaining in force a stipulation which was unfair, instead of declaring the clause to be void and not binding upon the consumer.

The answer of the European court was an eclectic one. It divides between unfair default interest term (in the light of Directive 93/13) and non unfair default interest term. When assessing the unfairness of a default interest rate, even if it is under the ceiling set by Law 1/2013 –three times the statutory rate-, the consequence is the annulment of the term, without moderating it.

On the contrary, when the national court is faced with a contractual term relating to default interest at a rate higher than that provided by Law 1/2013 but not considered unfair, the court shall moderate the term.

⁹ *“The limitation of default interest on mortgages on habitual dwellings, provided for in Article 3(2), shall apply to mortgages created after the entry into force of this Law. Likewise, that limitation shall apply to default interest, provided for in mortgage loans secured on habitual dwellings and created before the entry into force of the Law, which falls due subsequently, and to any interest which, having accrued and fallen due by that date, has not been paid. In proceedings for enforcement or extra-judicial sale commenced and not concluded by the time of the entry into force of this Law, and in proceedings in which the sum in respect of which an enforcement order or order for extrajudicial sale is sought has already been fixed, the Judicial Officer [Secretario judicial] or the notary shall allow the party seeking enforcement a period of 10 days in order to recalculate that sum in accordance with the preceding paragraph”.*



III. The current situation in the mortgage market

After so many reforms in the recent years, the current situation has obviously improved. Moreover, the latest reform which affects directly mortgagors with difficulties in paying back their debt is the Royale –Decree 1/2015 27 th of February, of the mechanism of second chance, reduction of the financial charge and other social measures. Among other measures, the one to highlight here is the regulation of what is called *fresh start*¹⁰. It follows the American system of a second chance or ‘fresh start’, which businesses in Spain have been demanding for a long time.

A fresh start means a discharge of debts granted to debtors in specific circumstances, so a natural person will have, despite an economic breakdown, the opportunity to restart his life, without having to carry out debts that will never be able to satisfy.

According to this law, a debtor can, within an insolvency proceeding, cancel once and for all any debts that could not be satisfied with their property and assets that are present. The scope of this fresh start is restricted, however, because it will only be available to certain types of debtors; it does not apply for public law claims and requires the debtor to satisfy certain classes of claims in full.

This means that, in the context of a debt secured by a mortgage in which the debtor is unable to meet the payments, he could initiate an insolvency procedure and within it, once the secured asset has been sold or awarded to the creditor and the proceeds from auctioned mortgaged or pledged assets are insufficient to cover the debt, the mortgagor could claim a discharge of the remaining amount of debt, understanding that he meets the requirements set forth in the Insolvency Act.

The introduction of this second chance implies, together with the possibility of dation in payment, as we mentioned before, a rupture of the traditional principle in Spanish Civil Law of unlimited personal liability of the debtor set forth in Article 1911 Civil Code, according to which, the debtor is liable for the performance of his obligations with all present and future property.

¹⁰ Although it had been implemented for the first time, not fully, in Law 14/2013, 28th September, to support entrepreneurs and their internationalization.



With this second chance, the debtor will be no longer liable for the debts with future assets. It is not technically a dation in payment, because certain requirements have to be met, but in overall means a relief for debtors overwhelmed by bad economics decisions or bad personal situations –such as divorce-. Moreover, the discharge can also be denied or revoked by the court based on certain misconduct of debtors, including fraudulent actions or failure of a debtor to disclose all assets during a bankruptcy case. In this sense, one of the Government’s main worries about bankruptcy and fresh start is the high level of fraud often linked to it, which makes it harder for those honest business failures to get help. The new legislation comes with stringent checks to ensure that no fraud will have taken place.

As a recall of the situation, we are being witnesses of very important changes in the traditional’s view of the mortgage market. The tendency is to move towards a more social perspective of it, restructuring the initial imbalance of the previous situation.

On the other side of the coin is the impact on the economy the new system will have; in other words, would it mean that the regulation of the fresh start will discourage banks? Would it mean they will restrict the range of potential debtors by requiring more guarantees or increasing interests? Or, on the contrary, the new regulation will potentiate wealth and prosperity by promoting new businesses? Time will tell.