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**EUROPEAN, HUNGARIAN AND SERBIAN MODELS OF
FAIRNESS IN CONSUMER CONTRACTS AND THEIR
APPLICATION TO CONSUMER CREDIT**

PhD Thesis

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ABBREVIATIONS INDEX

- APR: annual percentage rate of charge
- APR HuDecree: (Hungarian) Government Decree 83/2010 on Calculation of the APR
- CCD: (EU) Directive 2008/48/EC on Credit Agreements to for Consumers
- CJEU: (EU) Court of Justice of the European Union
- DCFR: (EU) Draft Common Frame of Reference
- FCA: (UK) Financial Conduct Authority
- FSA: (UK) Financial Services Authority
- HuCC: (Hungarian) Act IV of 1959 on the Civil Code
- HuCCA: (Hungarian) Act CLXII of 2009 on Credit Agreements for Consumers
- HuCFR: (Hungarian) Commissioner for Fundamental Rights
- HuCFRA: (Hungarian) Act CXI of 2011 on the Commissioner for Fundamental Rights
- HuCIFEA: (Hungarian) Act CXII of 1996 on Credit Institutions and Financial Enterprises
- HuCode: (Hungarian) Code of Conduct on Principles of Fair Conduct of Financial Institutions
Engaged in Retail Lending of 2010
- HuCPA: Act CLV of 1997 on Consumer Protection
- HuFAB: (Hungarian) Financial Arbitration Boards
- HuFSA: (Hungarian) Financial Supervisory Authority
- HuNB: (Hungarian) Central Bank
- HuNBA: (Hungarian) Act CXXXIX of 2013 on the Hungarian National Bank
- HuSC: (Hungarian) Supreme Court
- HuUCT Decree: (Hungarian) Government Decree 18/1999 on Unfair Contract Terms
- ID: (EU) Directive 98/27/EC on Injunctions
- nHuCC: (Hungarian) Act V of 2013 on the Civil Code (new Civil Code)
- OFT: (UK) Office of Fair Trading
- pCESL: (EU) Proposal for a Regulation on a Common European Sales Law
- SECCI: Standard European Consumer Credit Information
- SrbADR Decision: (Serbian) Decision on Complaint Handling by Banks and Financial Leasing
Providers and the Activities of SrbNB upon Notification of User Complaints of 2011
- SrbCode: (Serbian) Code of Banking Practice of 2007
- SrbCPA: (Serbian) Consumer Protection Act of 2010
- SrbCPEFSU: (Serbian) Centre for Protection and Education of Financial Services Users

SrbDIA: (Serbian) Act on Default Interest of 2012

SrbFSUPA: (Serbian) Financial Services Users Protection Act of 2011

SrbLOA: (Serbian) Law of Obligations Act of 1978

SrbNB: (Serbian) National Bank

SrbSC: (Serbian) Supreme Court

TFEU: (EU) Treaty on the Functioning of the European Union

UCPD: (EU) Directive 2005/29/EC on Unfair Commercial Practices

UCTD: (EU) Directive 1993/13/EC on Unfair Contract Terms

UK Law Commission: (UK) Law Commission for England and Wales and the Scottish Law Commission

UM HuDecree: (Hungarian) Decree 275/2010 on Conditions of Unilateral Modification of Contractual Interest

CHAPTER I

INTRODUCTION

Gábor and Tünde just got married. They decided to immediately buy their own home. However, as most young couples, in the lack of sufficient capital, they had to take a loan. The house needed to be furnished and required small renovations for which the couple took further loans. Not far away, in another country, Zoran and Jelena got married, and having had similar circumstances, also took a number of loans to start their life together. After a while, Gábor noticed instalments are considerably higher than they initially anticipated. Thus Gábor and Tünde realized they did not understand how the price of the loan will be calculated. At the same time Zoran and Jelena received a letter from their bank in which they were being notified on the increase of their interest rate this being allowed for by the standard terms of the contract. In the meantime, Tünde lost her job that significantly decreased the income of their household. Jelena got ill and treatments triggered significant expenses. Gábor and Tünde still struggle with payments, but Tibor and Jelena already defaulted. The default greatly increased their monthly payments. Being in trouble, the couples start reading their contracts. After consulting with lawyer friends they discovered that some terms in their contracts are probably unfair. However, the reality is that it is far from simple to decide what rules apply to the above situations and how they might be applied. The law is contained in a complex mix of European Union (hereinafter: EU) and national rules, both of which contain quite specific and more general principles, and both of which have things to say about the fairness of the content of terms and about the way they are presented to consumers. It is often not clear how these rules should apply to particular kinds of terms, and what influence real life problems and changed circumstances can have. To complicate matters further, the regimes expect a certain degree of enforcement of the rules to take place, yet this is often a matter that depends on available resources, political will and national traditions. The thesis tries to unfold this complex map of rules, reveal the state of consumer protection against unfair terms in consumer credit contracts and suggest improvements for the future.

The objective of the thesis is to analyze the issue of unfair terms in consumer credit contracts in EU in general, and in the two selected jurisdictions, in Hungary and in Serbia in particular. Although consumer credits are nominated contracts and there is an

increasing body of consumer credit specific regulation, the question of unfair terms remained under the general regime of the unfair contract terms regulation. Therefore, the foundation of the thesis is the *Directive 1993/13/EC on Unfair Terms in Consumer Contracts* (hereinafter: UCTD)¹ and its implementing acts, *Act IV of 1959 on the Civil Code of the Republic of Hungary* (hereinafter: HuCC) in Hungary, and the *Consumer Protection Act of 2010* (hereinafter: SrbCPA)² in Serbia. However, as the unfair contract terms regulation cannot be analyzed in a “vacuum”, the thesis explores the relation between these “new” consumer protection rules and the “old” or “traditional” contract law institutions; and the relation between the general regime of unfair contract terms and the specific regime of consumer credit. Regarding the “new/old” issue, the thesis especially analyzes the principle of good faith, and the traditional contract law institutions of *laesio enormis*, *usury*, *clausula rebus sic stantibus* and *force majeure*, and the “traditional” regulation of standard terms; and the limits of these tools, i.e. the need for the new rules. Regarding the “general/specific” issue, the thesis primarily relies on the *Directive 2008/48/EC on Consumer Credit* (hereinafter: CCD)³ in EU, on *Act CLXII of 2009 on Credit Agreements for Consumers* (hereinafter: HuCCA) and the *Act CXII of 1996 on Credit Institutions and Financial Enterprises* (hereinafter: HuCIFEA) in Hungary, and the *Financial Services Users Protection Act of 2011* (hereinafter: SrbFSUPA)⁴ in Serbia. The key is to understand how these specific rules operate together with the general unfair terms rules to provide protection.

As the UCTD contains a combination of rules that set standards of fairness and rules on enforcement of these standards⁵ the European, Hungarian and Serbian “models of fairness” referred to in the thesis reflect these two components. Therefore, on the one hand, the thesis tackles the question of when contract terms are (un)fair. This analysis evolves around the notions of substantive and procedural fairness. “*Substantive fairness*” relates to fairness of the substance of the terms, fairness in the distribution of contractual rights and obligations between the parties. “*Procedural fairness*” means fairness in the process leading up to contract conclusion, primarily the consumers’ real

¹ Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts, OJ L 95, 21.4.1993.

² Official Gazette of the Republic of Serbia No. 73/2010.

³ Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on credit agreements for consumers and repealing Council Directive 87/102/EEC, OJ L 133, 22.5.2008.

⁴ Official Gazette of the Republic of Serbia No. 36/2011.

⁵ Hans-Wolfgang Micklitz, *Reforming European Unfair Terms Legislation in Consumer Contracts*, 6(4) *European Review of Contract Law* 347-383, 2010, 347-383, p. 348.

opportunity to understand the terms of the contract.⁶ On the other hand, the thesis tackles the available enforcement mechanisms searching for those that provide for genuinely effective preventive enforcement.

Although the UCTD was subject to considerable academic attention in the international arena, in Hungary and in Serbia the regulation of unfair contract terms and the implementation of the UCTD was not studied in great detail or in a comprehensive and critical way. Therefore, remedying this gap, the thesis provides a comprehensive analysis of this issue, and thereby contributes to legal science in Hungary and in Serbia. Given the fact that the thesis is written in the English language, it potentially has a wider impact on EU legal science in general as the research principally relies on materials written in Hungarian and Serbian languages thereby making their achievements available in English. Moreover, even though the UCTD represents one of the first steps in the creation of *consumer acquis*, and therefore was explored by leading academics from different angles and taking into account different aspects, the issue of unfair contract terms in relation to contracts of consumer credit has so far not been subject to any comprehensive and publicly available research. This is the main contribution of the present research to the legal science in EU in general and in Hungary and Serbia in particular.

Hungary and Serbia have been chosen as specific jurisdictions for a number of reasons. First, the issue of unfair contract terms in consumer credit contracts was not subject to comprehensive academic analysis. This is especially true for Serbia, where the concept of fairness was just recently introduced by the SrbCPA. Second, the comparison is unique, and it has not been done before. Third, a comparative analysis is possible, because the two legal systems show plenty of similarities and a sufficient degree of differences. Both Hungary and Serbia belongs to civil law families; their contract laws show similar influences.⁷ Both countries were socialist states that underwent significant changes after the change of regime, the most important being the influence of EU law and policy. Fourth, the selected jurisdictions can learn from each other. Hungary can learn from Serbia, Serbia has a very modern approach to the regulation of unfair terms, while Hungary opted for adopting the test in the UCTD that was created in different times. Due to its slower social and economic development, Serbia can learn from

⁶ Chris Willett, *Fairness in Consumer Contracts: The Case of Unfair Terms*, Ashgate, Aldershot, 2007, p. 2.

⁷ Earlier Roman law and later the great early European codifications, the French Civil Code of 1804, the Austrian Civil Code of 1811, and the German Civil Code of 1900.

Hungary in enforcement of consumer credit. Serbia and Hungary can learn from each other in regulation of consumer credit. Fifth, the application of considerably different unfair terms regimes together with somewhat different consumer credit regimes gives a comparative perspective of what solutions provide for a higher level of protection. Finally, in both jurisdictions, consumer credit is a large problem, especially the Swiss franc denominated loans.

The thesis addresses the problem of Swiss franc denominated loans, and tries to find solutions; however, the thesis is not a case study of these loans. It aims to give a more general and lasting contribution to legal science and practice in how the general regime of unfair contract terms applies to consumer credit contracts. It explores a wider range of issues than those specific to foreign currency denominated loans.

The question of unfair terms in consumer credit contracts is very topical in the selected jurisdictions, it is a dynamic area of research, and these dynamics posed the greatest challenge to the thesis, i.e. the challenge of how to deal with changed circumstances and changed regulation. The Swiss franc denominated loan scandal triggered significant legal and institutional changes. These changes were constant during the research and are still ongoing. For example in Hungary courts at the moment tackle Swiss franc denominated consumer loan cases,⁸ and in Serbia there is not yet court practice on the test of fairness. For this reason it is important to say that the research is completed in June 2013, with later changes added concluding with 23 November 2013.

Independently and parallel to changes in consumer credit regulation general civil law reform efforts took place in selected jurisdictions. The most significant is the adoption of the *Act V of 2013 on Civil Code* (hereinafter: nHuCC) in Hungary. Since it was adopted towards the end of the research, and thinking of the faith of the *Act CXX of 2009 on the Civil Code*, that failed to enter into force in the very last moment, the decision was made, to primarily rely on the law in force, that is, on the HuCC. However, the thesis indicates the solutions of the nHuCC focusing on what has changed in the nHuCC when issues are discussed and devotes a special and independent analysis to the regime of unfair terms in the nHuCC. Overall, the nHuCC adopted the regime of the HuCC without significant changes. Therefore, the analysis of the HuCC is almost entirely applicable to the nHuCC.

⁸ See All hell breaks loose on foreign currency loan disputes- The stake is enormous, at Portfolio: http://www.portfolio.hu/users/elofizetes_info.php?t=cikk&i=190424 (13 November 2013).

Consumer credit is chosen as a specific context for analysing the concept of fairness because it raises important consumer protection issues. Consumer credits are usually long term contracts, involve substantial funds of consumers and potentially have very significant social and economic consequence for consumers and their families. Consumer credit contracts are particularly likely to cause unfairness as they are complex contracts containing highly specific legal and economic language, and are drafted unilaterally by the creditor. Contracts are long and comprehensive (standard form contracts with addition of standard terms and conditions) and most of potential situations that might arise in conclusion and performance of the contract are covered by the contract. Therefore, when there is a problem the source of it is often not a default rule or a legal gap, but the fairness of a term that is in the contract.

There is a great variety in types of consumer credit. Taking the terminology of the CCD, the most general division of consumer credits is on trade credits and loan credits.⁹ Loan credits are based on the loan of money, while trade credits are deferred payment based transactions. The thesis deals only with loan credits. Therefore, when referring to credit, the thesis means loan credit. This is because trade credits are usually interest free loans, and the creditors' interest in deferred payment is in spreading its web of customers, or providing goods and services on higher prices than other retailers. Trade credits are not always even classified as consumer credits.¹⁰ Additionally, traders as trade credit providers fall under a different regulatory and supervisory regime than financial institutions as loan credit providers. The analysis of the thesis is not applicable to some loan credits that trigger a different fairness regime like free of charge or zero interest rate credits, credits given at discounted interest by employers to their employees, or state subsidized credits. Loan credits are provided by financial institutions, primarily banks. Banks dominate the consumer credit market throughout EU.¹¹ As Tajti points out, Hungary is a bank-based system where the world of finance and credit is dominated by domestic and foreign universal banks. As a result, the world of finance is looked through the "banking-prism", although there are non-bank institutions that provide credit for

⁹ This division is also accepted by academia. Goode differentiates three types of credits: loan credit, sale or trade credit and finance lease. Roy Goode, *Commercial Law*, Penguin, London, 2004, p. 579.

¹⁰ E.g. English courts always regarded price deferment as something different from loans. Tibor Tajti, *Comparative secured transactions law*, Akadémia kiadó, Budapest, 2002, p. 65.

¹¹ Gloria M. Soto, Study on the calculation of the annual percentage rate of charge for consumer credit agreements, Report submitted to DG SANCO, 2009 (hereinafter: APR Study), p. 94 at DG SANCO: http://ec.europa.eu/consumers/rights/docs/study_APR_en.pdf (28 June 2013).

consumers.¹² Finally, although financial lease is not a credit contract *stricto sensu* credit and finance lease are often used as alternatives by consumers in searching for financing options.¹³ Finance lease companies, like banks, fall under strict regulatory and supervisory regime. Therefore, the thesis primarily analyzes loan credits provided by banks, and where applicable, financial lease companies. The thesis uses the terminology credit or consumer credit for loan credit and creditor or financial institution for banks and finance lease companies.

Consumer credit is an interaction between law and economy, and raises important social, behavioural and policy questions. The thesis focuses on the legal side of consumer credit. However, consumer credit raises various legal questions to tackle various forms of unfairness. Reifner and Clerc-Renaud identified the following: “[c]onsumers do not understand the terms and conditions of their loan agreement, e.g., what happens in the event of delinquency or default; in case of credit in foreign currency (...) or the impact of non-capped variable rates (...); they pay a high price; they take on too much debt; they are exposed to loan officers who ask for a “gift” to complete the loan process, to recommend a larger loan, or to expedite loan approval; they are subject to intimidation, abuse, or humiliation by collection staff/agents.”¹⁴ Hence, before the contract is concluded, credit can be subject to unfair marketing (or selling practices), and involve an unfair process of granting the credit.¹⁵ The contract itself can contain unfair terms. Credit can be secured with unfair securities.¹⁶ After default, the fairness of debt collection practices¹⁷ and fair debt enforcement arises.¹⁸ Finally, the fairness of credit

¹² Tibor Tajti, Hungary, 303-338 In: *Regulating Unfair Banking Practices in Europe: The Case of Personal Suretyships*, Stephen Weatherill, Aurelia Colombi Ciacchi (eds.), Oxford University Press, Oxford, 2010, p. 304.

¹³ Nelli Varga, Consumer credit law, 191-200 In: *Hungarian consumer protection law – with European reflections*, Veronika Szikora (ed.), Fogyasztóvédők Magyarországi Egyesülete, Debrecen, 2010, p. 199.

¹⁴ Udo Reifner, Sebastien Clerc-Renaud, *Financial Supervision in the EU: A Consumer perspective*, Report submitted to BEUC by Institut für Finanzdienstleistungen e.V., 2011, p. 15 (hereinafter: *Financial supervision report*) at BEUC: <http://www.beuc.org/custom/2011-00396-01-E.pdf> (28 June 2013).

¹⁵ Approving the credit application is a long process (up to 30 days) when both the creditors and consumers have significant documentary obligations. Erzsébet Gál, *Banks, banking transactions*, Miskolci Egyetemi kiadó, Miskolc, 2009, p. 117.

¹⁶ Suretyships, or accumulation of security devices. Tajti 2010, p. 321-328.

¹⁷ EU countries generally lack adequate laws on fair debt collection practices. Tibor Tajti, *Testing the equivalence of the new comprehensive Australian Personal Properties Securities Act, its segmented European equivalents and the draft common frame of reference*, 24(1) *Bond Law Review* 85-147, 2012, p. 134-135 at <http://epublications.bond.edu.au/cgi/viewcontent.cgi?article=1428&context=blr> (27 June 2013).

¹⁸ Self-help repossession of securities or the closest equivalents in EU are private collection agencies. Tajti 2012, p. 132-133.

reporting can also be questioned.¹⁹ The thesis focuses on the contract of credit, and on one aspect of fairness, on fairness of the terms of the contract.

The thesis analyzes consumer credit from the point of view of consumer protection. It sees consumer credit as part of consumer (protection) law. It is not easy to define what consumer law is. Consumer law could be understood as “all laws and regulations affecting consumption and the structuring of consumer markets,”²⁰ or as “a body of law protecting consumers.”²¹ “[C]onsumer law is not simply a plugging of a few gaps in the market system. Consumer law raises issues that are central; to the determination of how our society views the citizen (...) At stake are elements of the correction of market failures and, additionally, the achievement of fairness to consumers (*inter alia*) as the economically weaker parties. Consumer protection law has a wide range of forms and objectives.”²² The rules of consumer law belong to more areas of law, stretching through public and private law, including the traditional branches of civil law, commercial law, administrative law, and criminal law, containing both substantive and procedural norms;²³ and “modern” areas of law like competition law. Consumer law is a special area of law that does not fit into “classical” branches of law.²⁴ According to Cafaggi, the differentiation of public and private in consumer law is outdated.²⁵ Hence, as Sándor rightly asserts, consumer law should be regarded as a new, special field of law “intersectorial” in its nature that rests on existing branches.²⁶

Consumer law and policy is part of the “regulatory state”. The regulatory state broadly means the state’s involvement in the regulation creation, monitoring and enforcement of market transactions. For example, rather than leaving to contracting parties to determine the terms of their relationship (traditional freedom of contract) and to enforce these terms *ex post*, the state steps in, setting standards for contracting

¹⁹ Primarily data confidentiality and privacy issues see: Federico Ferretti, *The Law and Consumer Credit Information in the European Community, The Regulation of Credit Information Systems*, Rutledge, Cavendish, London, New York, 2008.

²⁰ Iain Ramsay, *Consumer Law and Policy: Texts and Materials on Regulating Consumer Markets*, Hart Publishing, Oxford and Portland, Oregon, 2012, p. 1.

²¹ Hans-Wolfgang Micklitz, Jules Stuyck, Evelyne Therryn (eds.), *Cases, Materials and Texts on Consumer Law*, Hart Publishing, Oxford and Portland, Oregon, 2010, p. 1.

²² Geraint Howells, Stephen Weatherill, *Consumer protection law*, Ashgate, Aldershot, 2005, p. 7-8.

²³ Judit Fazekas, *The development of consumer protection law 113-150* In: *The history of development of civilistics*, Péter Miskolczi Bodnár (ed.), Miskolc, 2006, p. 114.

²⁴ István Sándor, *The regulation of consumer protection in Hungary*, 1 *Studia Iuridica Caroliensia* 193-208, 2006, p. 201; See also Fazekas 2006, p. 114.

²⁵ Fabrizio Cafaggi, *The great transformation. Administrative and Judicial Enforcement in Consumer Protection: a remedial perspective*, 21 *Loyola Consumer Law Review* 496- 539, 2008-2009, p. 498.

²⁶ Sándor 2006, p. 202; *Cf* Fazekas 2006, p. 114.

behaviour, enforcing these standards, helping individuals to seek redress, and protecting citizens from poverty.

Beyond this general overview, it is not easy to define what regulation is. Selznick's seminal definition of regulation as "the sustained and focused control exercised by a public authority over activities valued by the community"²⁷ is today seen as "problematic".²⁸ Instead Baldwin and others suggest a broader understanding of regulation: 1) as a specific set of commands, where regulation involves a promulgation of a binding set of rules; 2) as deliberate state influence, where regulation covers all state action that are designed to influence business or social behaviour; 3) as all forms of social and economic influence, where all mechanisms affecting behaviour are deemed regulatory, including regulation created by non-state entities.²⁹ Therefore, regulation can have various meanings, starting from mandatory statutory rules to customs and practices. However, as consumer law is characterised by mandatory rules,³⁰ when talking about regulation, the thesis means mandatory rules, taking various forms,³¹ whether enforced via private or administrative law means.

Consumer law and policy become part of the regulatory state after the emergence of "consumer society" and the creation of consumer markets. It very soon became clear that consumer markets have to be regulated in order to address apparent imbalance of power between producers and consumers. The rationale for regulatory intervention has generally been the correction of market failures, especially information asymmetries.³² But state intervention in consumer credit is also increasingly justified by reasons of social justice.³³ After the initial steps following the end of the Second World War, the transformation of the ideas about the role of the state and market in Western Europe took

²⁷ Peter Selznick, *Focusing Organisational Research and Regulation*, In: *Regulatory Policy and the Social Sciences*, R. Noll (ed.), Berkeley, California, 1985, p. 363 in: Robert Baldwin, Martin Cave, Martin Lodge, *Introduction: Regulation- the field and development agenda 3-16* In: *The Oxford Handbook of Regulation*, Robert Baldwin, Martin Cave, Martin Lodge (eds.), Oxford University Press, Oxford, 2010, p. 12.

²⁸ *Ibid.*

²⁹ Robert Baldwin, Martin Cave, Martin Lodge, *Understanding Regulation: Theory, Strategy and Practice*, Oxford University Press, Oxford, 2013, p. 3.

³⁰ Micklitz et al. 2010, p. 2.

³¹ Regulation can be pervasive and partial, direct and indirect, enacted by different levels of government. Jeffrey L. Harrison, Thomas D. Morgan, Paul R. Verkuil, *Regulation and Deregulation*, West Publishing, 1997, p.3.

³² See e.g.: Micklitz et al 2010, p. 2-3. See for rationales in general: Baldwin et al 2013, p. 16-23.

³³ Udo Reifner, *Renting a Slave: European Contract Law in the Credit Society*, 325-341 In: Thomas Wilhelmsson, Elina Paunio, Annika Pohjolainen (eds.), *Private Law and the Many Cultures of Europe*, Kluwer Law International, Alphen aan den Rijn, 2007, p. 326.

place from the 1970's.³⁴ Regulation increased after the Maastricht Treaty in 1992 when consumer protection became a separate policy area and an important factor in the creation and well functioning of the internal market.³⁵ Socialist states of Eastern Europe largely “caught up” with this “Western” movement only after shift to market economy, Hungary in the 1990's and Serbia in effect in the 2000's.³⁶

Regulation is connected to the changing perception on the role of regulatory state in the society. Therefore, it is not static or permanent, but a cycle of regulation and deregulation is a dynamic process.³⁷ However, in the past thirty years the paradoxes of regulatory dynamics came to light. On the one hand, there have been continued critiques over excessive regulation and bureaucratisation; on the other hand, demands and efforts for deregulation showed regulation is indeed necessary,³⁸ and as a paradox, deregulation is often achieved by regulation.³⁹ Consequently, the modern policy dynamics focuses on the quality and direction of regulation, the agenda is “better regulation”⁴⁰ or “good regulation”.⁴¹

Consumer law is characterised by increasing regulatory intervention, especially in consumer credit. Consumer credit has multiple economic benefits for one national economy, but it also carries a great deal of danger, including systemic risk and sovereign debt, and the state is interested to intervene. To a certain extent the thesis tackles the questions of why and how to regulate unfair terms in general and consumer credit in particular. The thesis also points to shifts in aims and tools of regulatory intervention. However, the focus of the thesis is on the contract of credit. Nevertheless, regulation comes into play in two significant aspects. One is to the extent of which regulation is in place to limit the parties' contractual freedom to ensure contractual fairness. The other is the role of regulatory authorities in preventive enforcement of unfair contract terms.

³⁴ See the general lines of development and the example of UK in: Ramsay 2012, p. 2-6.

³⁵ For a recent overview of EU consumer law and policy development see: Christian Twigg-Flesner, Comment: the future of EU consumer law – the end of harmonization?, 6-20 In: European Consumer Protection: Theory and Practice, James Devenney, Mel Kenny (eds.), Cambridge University Press, Cambridge, 2012, p. 7.

³⁶ The corner stone of the “modern” regulatory state is the control of businesses by administrative agencies as opposed to other methods of control like state ownership. Michael Moran, Understanding the Regulatory State, 32(2) British Journal of Political Science 391-413, 2002, p. 392.

³⁷ Harisson et al. 1997, p. 3.

³⁸ Baldwin et al. 2010, p. 6-7.

³⁹ Contemporary critiques suggest regulation is a major barrier to competitiveness and economic growth, but regulation is used to easy competitive barriers and boost competition, regulation is used to “deregulate”. See: Baldwin et al 2010, p. 6-7; also: Harrison et al. 1997, p. 18.

⁴⁰ Baldwin et al. 2010, p. 6.

⁴¹ Baldwin et al. assert “good regulation” depends on five criteria: the legislative mandate, accountability, due process, expertise and efficiency. Baldwin et al. 2013, p. 26-34.

The key research question the thesis aims to answer is if a high level of protection is achieved. More particularly, to what extent the UCTD sets a high level of protection; how this has been received and improved in Hungary and in Serbia; what impact the UCTD and its implementation has on the particular problems of unfairness of the terms of credit contracts; what tools of preventive enforcement are available against unfair terms; and if there is the potential in the future for a higher level of protection.

A “high level of protection” means fairness or fair contract terms. Fairness depends on the presence of, and relation between, substantive and procedural fairness. A high level of protection also depends on which contract terms can be assessed for their fairness, if some terms are exempted from this scrutiny. Also, relevant is the question as to when contract terms can be evaluated for their fairness, if changed circumstances after the conclusion of the contract can be taken into account. Finally, a high level of protection depends on the effectiveness of preventive enforcement mechanisms and availability of ultra-preventive mechanisms for eliminating unfair terms.

The research methods used in the thesis are the methods of legal analysis and comparative methods. The thesis relies on the writings of legal scholars, research reports, legislation and the case law. Since the UCTD is one of the first EU legislative acts in the area of consumer protection, it was subject to considerable academic attention. The thesis summarizes the arguments, and selects the most important writings, without an attempt to cover everything written. This would be impossible given the quantity. However, in contrast to the large volume of academic writing on the UCTD in general, the opposite is true in relation to unfair terms in consumer credit, and in relation to both the general and the credit rules in Hungary and (especially) Serbia. Therefore, in the rest of the analysis the thesis principally relies on research reports, the legislation and the available case law.

The thesis is primarily comparative in its nature. Comparative research and comparative law is very important. From its many benefits, Zweigert and Kötz identify the following as the most vital: it is an aid of the legislator, a tool of construction, a contributor to the systemic unification of the law, and an essential tool in developing the common private law of Europe.⁴² The thesis compares the models of fairness in consumer credit in the EU, Hungary and Serbia. In its analysis the thesis is primarily a *micro-comparison* of specific legal provisions (the provisions of the UCTD, the HuCC

⁴² Konrad Zweigert, Hein Kötz, Introduction to comparative law, Clarendon Press, Oxford, 1998, p. 16.

and the SrbCPA) and specific legal institutions in Hungary and in Serbia (the traditional contract law institutions). However, the final aim of the thesis, the comparison of the models of fairness, is achieved by *macro-comparison*, comparing the effects of the tests of fairness and their enforcement.⁴³

The analysis of the thesis is divided into eight chapters.

Chapter I contains the introduction to the research. It sets the problem of unfair contract terms in consumer credit, identifies the objectives, methods, scope and limits of the research and the areas of scientific contribution.

Chapter II analyzes the regime of unfair contract terms in Europe. It is a general chapter and does not focus on any specific contract. It analyzes the regime of unfair contract terms under the UCTD. To a certain extent the thesis deals with all the provisions therein, but focuses the analysis on the basic concept of unfairness, on the role of transparency, and on the limits of the test of fairness i.e. terms exempted from the test and the time when the test is applied. It particularly tackles the question what substantive and procedural fairness mean and what the relation between these two types of fairness is. It relies on the most important writings of legal scholars and research studies. Besides analyzing the provisions of the UCTD this Chapter tackles broader theoretical questions related to the regulation of unfair terms. The key question it aims to answer is whether the UCTD sets a high level of protection for consumers.

Chapter III analyzes the regime of unfair contract terms in Hungary. It is a general Chapter and does not focus on any specific contract. It principally focuses the analysis on the basic concept of unfairness, on the role of transparency, and on the limits of the test of fairness. It aims to see how the UCTD was implemented into the national legal system of Hungary, i.e. how the UCTD fits into the existing system of contract law and how some particularly disputed issues of the UCTD are addressed in Hungary. It particularly focuses on how substantive and procedural fairness is perceived in Hungary, and what the relation between them is. In its analysis this Chapter uses the writings of legal scholars, the legislation and the case law. It answers the key question if the Hungarian implementation achieves the protection intended by the UCTD, and where the level of protection provided by the UCTD is not so high, provides its own, higher level of protection.

⁴³ Micro-comparison deals with specific legal institutions and problems. In contrast, macro-comparison compares the “spirit and style” of different legal systems. Research is done in the handling of legal materials, procedures for resolving disputes and the role of those engaged in law, and answers on the question, how effective they actually are. Zweiger&Kötz 1998, p. 4-5.

Chapter IV analyzes the regime of unfair contract terms in Serbia. It is a general Chapter and does not focus on any specific contract. It principally focuses on the basic concept of unfairness, on the role of transparency, and on the limits of the test of fairness. It aims to see how the UCTD was implemented into the national legal system of Serbia, i.e. how it fits into the existing contract law system and how some particularly disputed issues of the UCTD are addressed in Serbia. As the UCTD was implemented only recently, there is no case-law and very little academic writing on the issue. Therefore, only assumptions can be made on the perception of procedural and substantive fairness and their relation, based on the previous analysis applied to newly enacted legal provision. This Chapter aims to answer the key question if the Serbian implementation achieves the protection intended by the UCTD, and where the level of protection provided by the UCTD is not so high, provides its own, higher level of protection.

Chapter V deals with the regime of unfair contract terms in credit contracts. In its analysis this Chapter builds on the research results of previous Chapters, and relies on analyzing academic writings, research projects, legislation, and the case law. It aims to see how the concepts of substantive and procedural fairness apply to consumer credit, in EU in general, and in Hungary and in Serbia in particular. In this Chapter the general concepts are analyzed together with the sector specific regulation. The focus is on how the substantive fairness of core and ancillary terms is determined in consumer credit, what the role of transparency or procedural fairness is, and the consequences of the limits in application of the test of fairness. This Chapter also tackles broader theoretical questions on the regulation of consumer credit. The key question it aims to answer is if a high level of protection is achieved in consumer credit contracts. To what extent this high level of protection is achieved in EU, and where the level of protection is not so high, a higher level is provided in Hungary and in Serbia.

Chapter VI analyzes the regime of preventive enforcement of unfair contract terms. As enforcement mechanisms in financial services are different from generally available mechanisms, it deals with enforcement of credit contracts in EU in general, and in Hungary and Serbia in particular. The key question this Chapter answers is if there are specifically designed and operated preventive enforcement mechanisms as to make for genuinely effective preventive control and set a high level of protection in EU, Hungary, and Serbia.

Chapter VII briefly considers the future of unfair contract terms regimes in EU, Hungary and Serbia. It is a general Chapter without focus on any specific contract. It briefly outlines the contract law reform initiatives in EU, Hungary and Serbia and analyzes the proposed tests of fairness, in particular the basic concept of unfairness, the role of transparency and the limits of the test of fairness. The key question this Chapter aims to answer is if the new solutions would provide for a higher level of protection than the present level is in EU, Hungary and Serbia.

Chapter VIII contains conclusions of the research. It presents the models of fairness in EU, Hungary, and Serbia, compares their level of protection and provides suggestions for improvements of these models in the future.

CHAPTER II

THE REGIME OF UNFAIR CONTRACT TERMS IN THE EUROPEAN UNION

This Chapter analyzes the regime of unfair contract terms in Europe. It is a general Chapter and does not focus on any specific contract. It analyzes the regime of unfair contract terms under the UCTD, and in particular focuses on the basic concept of unfairness, on the role of transparency, and on the limits of the test of fairness. Besides analyzing the provisions of the UCTD it tackles broader theoretical questions on the regulation of unfair terms. The key question this Chapter aims to answer is if the UCTD sets a high level of protection.

II.1. Regulation of unfair contract terms in Europe: a brief overview

The need for European regulation of unfair contract terms was raised at the very beginning of the European integration. First efforts date back to the 1970's⁴⁴ shortly after consumer protection policy was recognized as an autonomous policy area of the European Community (hereinafter: EC). However, at the same time, Member States started to adopt their own legislation of unfair contract terms, which slowed down the process of adopting a European legal act.⁴⁵ In 1984 the EC Commission finally published a consultation,⁴⁶ suggesting the following options for regulation: 1) lay down a general principle that contract terms must not be unfair; 2) provide for a black list of clauses that are detrimental to the interest of consumers and provide penalties for their use; 3) negotiate the drafting of contract terms between the representatives of consumers and the industry; 4) introduce specific checks on unfair contract terms; 5) provide prior authorization of standard contract terms; and 6) allow public authorities to draw up standard contracts or standard contract terms.⁴⁷ Finally, in 1990, the EC Commission released the first proposal for a *Directive on Unfair Terms in Consumer Contracts*.⁴⁸ It

⁴⁴ Paolisa Nebbia, *Unfair Contract Terms in European Law: A Study in Comparative and EC Law*, Hart Publishing, Oxford, Portland, Oregon, 2007, p.7.

⁴⁵ *Ibid.*

⁴⁶ Commission Communication to the Council: "Unfair terms in contracts concluded with consumers", COM (84) 55 final, 14 February 1984. Bulletin of the European Communities, Supplement 1/84 (hereinafter: Commission Communication of 1984), p.7-9.

⁴⁷ Commission Communication of 1984, p. 7-8

⁴⁸ Proposal for a Council Directive on Unfair Terms in Consumer Contracts COM (1990) 322 final [1990] OJ C 234.

caused lengthy debates in the Parliament and in the Council, and resulted in an amended proposal in 1992.⁴⁹ The final text was adopted on 3 April 1993 that was due to be implemented by 31 December 1994.

As the “first intrusion of Community law into the heartland of national contract law thinking,”⁵⁰ the UCTD was characterized as “a milestone in consumer policy.”⁵¹ This “intrusion” was necessary in order to create the internal market of the EC. The UCTD was adopted based on “the internal market clause” (Art. 95(3) ECT, now Art. 114 TFEU) in order to facilitate the establishment of the internal market (Rec. 1 UCTD), and ease the regulatory diversity of unfair contract terms between Member States (Rec. 2 UCTD). The idea behind the UCTD was that having different regulation of unfair contract terms distorts competition, and this undermines the achievements of the internal market. The UCTD intended to create a “level playing field”, i.e. a set of rules that are common to all Member State.⁵²

The second rationale stemming from the first was the raising of consumer’s confidence in cross-border transactions (Rec. 5&6 UCTD). The characteristic of the approach is that it sees consumers not just as passive beneficiaries of the internal (or single) market, but as active market players.⁵³ The logic is that if consumers are confident in cross-border purchases of goods and services, this will enhance competition, which in turn leads to better choice and lower prices for consumers. According to this reasoning statutory measures are needed to generate consumer confidence, and provide for a more integrated and competitive market.⁵⁴

Finally, the third rationale was the requirement of achieving a high level of consumer protection.⁵⁵ What a high level of protection means is a practical question but as Stuyck points out a “high level” of protection does not necessarily mean the “highest” level of consumer welfare.⁵⁶ The thesis focuses on this third rationale, attempting to more

⁴⁹ Amended Proposal for a Council Directive on Unfair Terms in Consumer Contracts, COM (1992) 66, final SYN 285 (hereinafter: Amended proposal of UCTD 1992).

⁵⁰ Stephen Weatherill, *EU Consumer Law and Policy*, Edward Elgar, 2005, p.115.

⁵¹ Report on the Implementation of Council Directive 93/13/EEC of 5 April 1993 on Unfair Terms in Consumer Contracts, COM (2000) 248 final, 27 April 2000 (hereinafter: UCTD Implementation Report), p. 5.

⁵² Willett 2007, p. 87.

⁵³ Willett 2007, p. 88.

⁵⁴ Willett 2007, p. 89.

⁵⁵ This was set as an aim both by “internal market clause” and by the “consumer protection clause” in the ECT (Art. 153 ECT, now Art. 169 TFEU).

⁵⁶ Jules Stuyck, *European Consumer Law After the Treaty of Amsterdam: Consumer Policy In or Beyond the Internal Market?*, 37 *Common Market Law Review* 367-400, 2000, p. 392.

closely determine what a high level of protection means, and aiming to see if the UCTD sets a high level of protection.

The UCTD contains “a unique combination of substantive rules on fairness and procedural rules for eliminating unfair terms from the market.”⁵⁷ It is a short legislative act, and at the first sight appears to contain simple and clear provisions. However, deeper analysis points to a lot of uncertainties and possibilities for different interpretation. In this Chapter the thesis primarily focuses on the basic concept of unfairness, on the role of transparency, and on the limits of the test of fairness. Rules for eliminating unfair terms from the market will be discussed in Chapter VI.

II.2. The basic concept of unfairness in the UCTD

The basic concept of unfairness, or when a contract term is unfair, is set out by test of fairness is laid down in Art. 3(1) UCTD that reads:

“A contractual term which have not been individually negotiated shall be regarded as unfair if, contrary to the requirement of good faith, it causes significant imbalance in the parties’ rights and obligations arising under the contract, to the detriment of the consumer.”

At first reading it can be noticed that the core of the test of fairness consists of two general clauses: “good faith” and “significant imbalance.” However, it is not clear if they are to be understood cumulatively, alternatively or in the sense that any clause which generates a significant imbalance is always contrary to the principle of good faith.

In understanding the basic concept of unfairness the concepts of “substantive” and “procedural” fairness are very important. “*Substantive fairness*” relates to fairness of the contract terms themselves, fairness in their substance.⁵⁸ One way to analyze substantive fairness is that a contract term is unfair if it deviates from the default rules and from reasonable expectations of the consumer.⁵⁹ “*Procedural fairness*” means fairness in the process leading up to the agreement.⁶⁰ It is connected to fair and open dealing, and is in place to prevent unfair surprise and lack of choice.⁶¹ The assessment of procedural fairness includes an evaluation as to whether a consumer had a reasonable

⁵⁷ Micklitz 2010, p. 348.

⁵⁸ Willett 2007, p. 2.

⁵⁹ Willett 2007, p. 49.

⁶⁰ Willett 2007, p.2.

⁶¹ Roger Brownsword, Geraint Howells, Thomas Wilhelmsson, *Between Market and Welfare: Some Reflections on Article 3 of the EC Directive on Unfair Terms in Consumer Contracts*, 25-60 In: Chris Willett (ed.) *Aspects of Fairness in Contract*, Blackstone, London, 1996, p. 33, 40.

opportunity to get acquainted with the contract term, if the term was presented in plain and intelligible language, if the consumer understood the term, if the consumer was able to influence it, and if the consumer had a choice between different alternative terms.⁶² Procedural fairness is different from the *culpa in contrahendo*.⁶³ Therefore, questions that emerge are: what “type” of fairness the UCTD is concerned with, and what the relationship between the two “types” of fairness is.

II.2.1. The concept of good faith

Good faith as a contract law principle of an eternal value originates from *bona fides* of Roman law.⁶⁴ It is not easy to determine what good faith means. First, good faith can have a subjective dimension (clear conscious) and objective dimension (standard of fair dealing).⁶⁵ Although the dual perception of this principle is not without a doubt, the contemporary contract law of continental legal systems understands good faith as an objective principle, as good faith and honesty, like *Treu und Glauben* in German private law.⁶⁶ On the other hand, the content of objective good faith can also depend on the stage of the contract in which it comes into play. First, there is a purely pre-contractual stage where the duty of good faith relates to the breaking off negotiations. Second, the issue might arise where a contract has been concluded but the fairness of the terms is questionable. Third, good faith may be used for interpretative and gap filling purposes of statutory law. Fourth, good faith might be used to analyse fair dealing in performance of the contract and solving the problem of changed circumstances after the contract is

⁶² Nebbia 2007, p. 149.

⁶³ Though it is sometimes seen as a liability for breaking off negotiations, it involves a much broader concept including “not giving adequate information”. Still, *culpa in contrahendo* is primarily in place to be invoked by a party who suffered damages as a consequence of the other negotiating parties. It provides a fault based liability for breaching the obligation of pre-contractual good faith, and an opportunity for the honest party to claim damages. Hugh Beale, Denis Tallon, Ludovic Bernardeau, Robert Williams, Cases, materials and texts on Contract Law, Hart publishing, Oxford, Portland, Oregon, 2002, p. 237-240.

⁶⁴ On the emergence of this principle in Roman law see: Magdolna Szűcs, Fides and bona fides in the process of creation of Roman common law (*ius gentium*), 46(2) Zbornik radova Pravnog fakulteta u Novom Sadu, 2012, 157-176. See also: Magdolna Szűcs, Eternal values of Roman Law, 43(3-4) Zbornik radova Pravnog fakulteta u Splitu 383-401, 2006, p. 393-397; András Földi, The principle of good faith, the history of institution from Roman law until today, Publicationes Instituti Iuris Romani Budapestinensis, Budapest, 2001, p. 29.

⁶⁵ Allan E. Fransworth, Good Faith Performance and Commercial Reasonableness under the Uniform Commercial Code, 30 University of Chicago Law Review 666-679, 1962-1963, p. 671 et seq.

⁶⁶ Cf András Földi, Newer remarks on the dualism of bona fides, 44 Acta Facultatis Politico-Iuridicae Universitatis Scientiarum Budapestinensis de Rolando Eötvös Nominatae 123-143, 2007, p. 124-125. The concept was inserted into the UCTD because of its importance in continental legal systems, especially Germany, and because Portugal already used good faith alone as a criterion for assessing fairness. Mario Teneiro, The Community Directive on Unfair Terms and National Legal Systems, 3(2) European Review of Private Law, 273-284, 1995, p. 274.

concluded. Finally, the fairness of the remedies set down by the law for breach of contract may be analysed from the aspects of good faith.⁶⁷ The thesis analyzes one of the above aspects of good faith, fairness of the terms of the contract.

Having in mind the meaning of substantive and procedural fairness, it is important to determine the types of fairness the UCTD accommodates within the principle of good faith. According to Rec. 16 UCTD the principle criteria for determining the unfairness of a term is the “overall evaluation of the different interests involved” that could imply procedural and substantive fairness. However, while making the assessment of good faith “particular regard shall be had” to different circumstances in relation to the contract conclusion (e.g. strength of bargaining positions). This arguably implies procedural fairness. The provision goes further that the requirement of good faith *may be satisfied* when the business deals “fairly and equitably” with the consumer, and takes into account its “legitimate interests”, which plausibly refers to (building on the significant imbalance/detriment question) unfairness in substance.⁶⁸ Hence, Rec. 16 UCTD suggests, the principle of good faith in the UCTD is to be understood as being concerned with both procedural and substantive fairness. However, it can also be understood as aiming only towards substantive or towards procedural fairness.

II.2.2. Significant imbalance in the parties’ rights and obligations

Besides good faith, the other general clause in the test of fairness is the “significant imbalance”. Placing it into the context of substantive and procedural fairness, this general clause without a doubt goes into the substance of contract terms and aims towards substantive fairness.⁶⁹

It is evident that significant imbalance involves a lack of symmetry in the parties’ rights and obligations.⁷⁰ However, in order to determine what the exact meaning is and which are the limits of the concept, one has to look at a general setting of consumer contracts. In consumer contracts consumers are acting outside their trade or profession, while businesses are acting within their trade or profession. Hence, there is always a

⁶⁷ See for summary: Willett 2007, p. 1-2.

⁶⁸ Chris Willett, The functions of transparency in regulating contract terms: UK and Australian approaches, 60(2) *International and Comparative Law Quarterly* 355-385, 2011, p. 364.

⁶⁹ See e.g. Hugh Collins, Good Faith in European Contract Law, 14 *Oxford Journal of Legal Studies* 229-254, 1994, p. 249.

⁷⁰ Nebbia 2007, p. 150.

“natural imbalance” between a consumer and a business, stemming from asymmetry in information, knowledge and other circumstances surrounding the conclusion of the contract. Businesses in most cases have more information on the product or service they sell and better understanding of the relevant market. Because of these factors in addition to the fact that they are primarily aimed at achieving profits, businesses are in a better bargaining position. If they manage to sell on a fairly reasonable price they are at gain. Consumers are different. They are guided by aims, wishes and needs, often have no real choice in whether to conclude a contract or not, and are not solely guided by the price. Even if a consumer is well informed and educated, the business will still be in an advantage, it will have something the consumer desires or needs.

However, the above “natural imbalance” has to be distinguished from “contractual imbalance”, i.e. imbalance in the parties’ contractual rights and obligations. “Natural imbalance”, not necessarily, but most likely will lead to “contractual imbalance.”⁷¹ Businesses will strive to safeguard their interests, and this “naturally” stronger legal and economic position will be reflected in the contract. This is especially possible because, as a rule, contracts are drafted by the business for standardized use. It is not the purpose or effect of standard terms to establish fair balance between the parties. On the contrary, they are designed to reinforce the economic and legal position of the party who drew them up and uses them.⁷² Hence, the UCTD is aimed at curing the “contractual imbalance” by removing the unfair term from the contract.

Since both natural and often contractual imbalance is a characteristic of all contracts, the UCTD requires that the imbalance is significant, i.e. really serious or exceptional.⁷³ Yet what is “significant” in practice is to be determined on case by case basis. Scott and Black are of the opinion, that as long as the balance is not trivial it satisfies the test of fairness.⁷⁴

The UCTD insists the imbalance has to be to the detriment of the consumer. These words probably have no operative effect but are simply words of description,⁷⁵ as probably there are not many contract terms that cause a “significant imbalance” and are at the same time not to the detriment of the consumer.⁷⁶ The point of the use of the word

⁷¹ Colin Scott, Julia Black, *Cranston’s Consumers and the Law*, Butterworths, London, Edinburgh, Dublin, 2000, p. 94.

⁷² Commission Communication of 1984, pt. 14.

⁷³ Scott & Black 2000, p. 94.

⁷⁴ *Ibid.*

⁷⁵ Brownsword et al. 1996, p. 46.

⁷⁶ Scott & Black 2000, p. 95.

detriment is probably to underline the detriment has to be to the consumer rather than the business.

To conclude, under the UCTD the contract term will be substantively unfair if the contractual imbalance in the parties' rights and obligations is significant and it is to the detriment of the consumer.

II.2.3. The relation between “good faith” and “significant imbalance”

Besides difficulties in determining what the two general clauses mean, the further question is what is their relationship?

Brownsword and others point at least on four different possibilities of interpretation: 1) a term is unfair if it causes i) a significant imbalance ii) to the detriment of the consumer. In this interpretation the significant imbalance defines good faith, and therefore good faith is not a separate requirement; 2) a contract term is unfair if it causes i) a significant imbalance, ii) to the detriment of the consumer; iii) it is contrary to the requirement of good faith. The requirement of good faith is an independent, procedural condition. 3) a contract term is unfair if it causes i) a significant imbalance, ii) to the detriment of the consumer; iii) it is contrary to the requirement of good faith. The requirement of good faith is an independent, substantive condition. 4) a contract term is unfair if it causes i) a significant imbalance, ii) to the detriment of the consumer; iii) it is contrary to the requirement of good faith. The requirement of good faith is an independent, substantive and procedural condition.⁷⁷

The correct answer to the above question is that there is no good answer. As the UCTD is a result of a compromise between Member State with different contract law traditions (the largest difference being between the common law and continental legal traditions in terms of good faith), the clause leaves room for interpretation. For example one key issue whether the two criteria are completely separate or whether the “significant imbalance” is part of the general criteria of good faith, national courts approach differently. Italian courts are inclined to assimilate good faith into significant imbalance. A common formula used in decision making is that a term is unfair because it creates a significant imbalance in the parties' rights and obligations and which is sufficient to render the term unfair.⁷⁸ On the contrary, in the first case on the interpretation of the test of fairness in the United Kingdom (hereinafter: UK), in *First*

⁷⁷ Brownsword et al. 1996, p. 31-32.

⁷⁸ Nebbia 2007, p. 151.

*National Bank v. Director General of Fair Trading*⁷⁹ (hereinafter: First National Bank) the House of Lords took the view that a term is unfair if there is a significant imbalance in the parties' rights and obligations and a violation of good faith, these being connected but separate requirements.”⁸⁰

The consensus is also absent among academics. There is a view that good faith is not an independent criterion. Consequently, significant imbalance automatically triggers the violation of good faith.⁸¹ This view relies on the key reason for good faith being part of the test that is to reflect those national traditions that were tied to the good faith concept. In this regard good faith can be viewed simply as a label that “explains” to these national traditions what is meant by the significant imbalance.⁸² Nevertheless, as Willett points out, this standpoint is difficult to uphold, as shown above. Rec. 16 UCTD contains explicit and separate guidelines on good faith.⁸³ It follows that the violation of good faith is at least to some extent an independent requirement (whether independent from significant imbalance or, with the same practical result, playing some independent role in determining when an imbalance is “significant”).⁸⁴

The issue on the relation between the two general clauses also raises the question of the relationship between procedural and substantive fairness. One general clause, the “significant imbalance” relates to substantive fairness, but the other general clause, “good faith,” can have both procedural and substantive aspects (if the above interpretation is accepted). As both general clauses aim toward substantive fairness, it could be inferred that the UCTD is primarily concerned with substantive fairness, i.e. the contract term should be in the first place fair in its substance. However, this is not the only reading of the test.

If significant imbalance is the only requirement of fairness (good faith being part of it) it is fairly clear, the contract term has to be unfair in its substance in order to be declared unfair, and the issue of relation between procedural and substantive fairness will not arise. But, if these are separate requirements, Willett point on two important questions. Can the lack of procedural fairness make a term unfair where, otherwise, there would be no sufficient unfairness in substance? Can substantive unfairness be

⁷⁹ *First National Bank v. Director General of Fair Trading*, 25 October 2001, [2001] UKHL 52.

⁸⁰ Paras. 1307-8, 1313 *First National Bank*. For details see: Willett 2007, p. 176-216.

⁸¹ Teneiro 1995, p. 273, 279.

⁸² Willett 2011, p. 363.

⁸³ Willett 2011, p. 364.

⁸⁴ *Ibid.*

legitimized by procedural fairness?⁸⁵ The issue of the relation between procedural and substantive fairness will be further discussed below. Nevertheless, at this point it can be concluded, the UCTD leaves open many questions. Certainly the highest level of protection is provided if both procedural and substantive fairness is ensured. If a choice has to be made between procedural and substantive fairness, substantive fairness seems to provide for a higher level of protection.

II.2.4. The role of the CJEU in interpreting the test of fairness

The first case on the test of fairness was *Oceano Editorial Group* (hereinafter: Oceano). Here the CJEU established that clauses that are “manifestly” unfair i.e. serve solely to the benefit of the seller and contains no benefit in return for the consumer, like jurisdiction clauses, are unfair.⁸⁶ However, apart from ruling on manifestly unfair terms the role of the CJEU in interpreting the test of fairness underwent an “evolution,” starting from a blunt refusal to rule on fairness to willingness to give some guidance to national courts.

In the landmark case of *Freiburger Kommunalbauten v. Hofstetter* (hereinafter: Freiburger) the CJEU pointed out that Art. 3(1) UCTD merely defines in a general way the factors that render a contract term unfair but whether a particular term is unfair should be decided by the applicable national law. Accordingly, the CJEU may interpret general criteria used to define the concept of unfair terms, but it should not rule on the application of these general criteria to a particular term, which must be considered in the light of particular circumstances of a particular case.⁸⁷ As Advocate General Greehold specified the EU legislator did not intend to bring the final decision of the question of fairness into the scope of EU law.⁸⁸

⁸⁵ Willett 2011, p. 365.

⁸⁶ Para. 21 Joined cases C-240/98 and C-244/98 *Oceano Grupo Editorial SA v. Rocío Murciano Quintero and Salvat Editores SA v. José M. Sánchez Alcón Pradès ea*, 27 June 2000, ECR [2000] p. I-4941. See also para. 41-42 C-243/08 *Pannon GSM Zrt. v Erzsébet Sustikné Gyórfi*, 4 June 2009 ECR [2009] I-04713.

⁸⁷ Para. 21, 22 Case C-237/02 *Freiburger Kommunalbauten GmbH Baugesellschaft & Co. KG v Ludger Hofstetter and Ulrike Hofstetter*, 1 April 2004, ECR [2004] p. I-3412. C- 137/08, *Pénzügyi Lízing Zrt. v Ferenc Schneider*, 9 November 2010, ECR [2010] p. I-10847; C- 76/10 *Pohotovost' s.r.o. v Iveta Korčkovská*, 16 November 2010, ECR [2010] p. I-11557; C-453/10 *Jana Pereničová and Vladislav Perenič v SOS financ spol. s r. o.*, 15 March 2012 ECR [2012] I-0000 (not reported).

⁸⁸ Para. 71 Opinion of Advocate General Greehold in C-237/02 of 23 September 2003, ECR [2003] p. I-3405.

In *Pénzügyi Lízing Zrt. v Ferenc Schneider*⁸⁹ (hereinafter: Pénzügyi Lízing) Advocate General Trstenjak pointed out the CJEU is competent to interpret and the national courts to apply EU law. Consequently, the CJEU is not empowered to apply the rules of EU law to individual cases. The CJEU does, however, retain the right to provide the national court with *guidance* on the interpretation of EU law. This guidance is only a general guidance, i.e. laying down “general criteria” for the application of the test of fairness.⁹⁰ In *Caja de Ahorros v Association de Usuarious*⁹¹ (hereinafter: Caja de Ahorros) Advocate General Trstenjak clarified what she means by “general guidance”, i.e. “... the Court could ... indicate the criteria allowing it to distinguish between the various possibilities in individual sets of facts”.⁹²

Within its “guidance giving” role in *Jana Perenicova, Vladislav Perenic v SOS finance spol* (hereinafter: Perenicova) role the CJEU first underlined one contract term cannot be estimated in an isolated manner from the rest of the contract.⁹³ More importantly, in *Nemzeti Fogyasztóvédelmi Hatóság v Invitel Távközlési Zrt* (hereinafter: Invitel) the CJEU emphasized the fairness of the terms in the contract should be determined in the light of the entire contract and compared with *default rules* of the applicable national law.⁹⁴ As deviation from default rules is not mentioned in the UCTD as one of the circumstances that should be looked at in determining fairness (Art. 4(1) UCTD) the CJEU here did a major step forward and pointed on one concrete but still general criterion that the national courts should relay on in determining the fairness of contract terms.

The most important CJEU case in giving guidance on the test of fairness so far was *Aziz v Catalunyaacaixa*⁹⁵ (hereinafter: Aziz). In this case the CJEU for the first time give some reference to the relationship between the two general clauses. Namely, the CJEU ruled that in determining if a term causes “significant imbalance” departure from

⁸⁹ C- 137/08, Pénzügyi Lízing Zrt. v Ferenc Schneider, 9 November 2010, ECR [2010] p. I-10847.

⁹⁰ Para. 88-99 Opinion of Advocate General Trstenjak in C- 137/08 of 6 July 2010, ECR [2010] p. I-10847.

⁹¹ Case C-484/08 Caja de Ahorros y Monte de Piedad de Madrid v Asociación de Usuarios de Servicios Bancarios (Ausbanc), 3 June 2010, ECR [2010] I-4785.

⁹² Para. 70 Opinion of Advocate General Trstenjak in C-484/08 of 29 October 2009, ECR [2010] p. I-04785.

⁹³ Para. 44 C-453/10 Jana Pereničová and Vladislav Perenič v SOS financ spol. s r. o., 15 March 2012 ECR [2012] I-0000 (not reported); also Para. 41 C-472/11 Banif Plus Bank Zrt v Csaba Csipai, Viktoria Csipai, 21 February 2013 ECR [2013] I-0000 (not reported).

⁹⁴ Para. 30 Case C-472/10 Nemzeti Fogyasztóvédelmi Hatóság v Invitel Távközlési Zrt, 26 April 2012, ECR [2012] p. I-0000 (not reported).

⁹⁵ C-415/11, Mohamed Aziz v Caixa d’Estalvis de Catalunya, Tarragona i Manresa (Catalunyacaixa), 11 March 2013, [ECR] I-00000 (not reported).

default rules will not automatically make the contract term unfair. In order to assess if significant imbalance arises “contrary to the requirement of good faith”, it must be determined, having regard to Rec. 16 UCTD, whether the business “dealing fairly and equitably with the consumer, could reasonably assume that the consumer would have agreed to such a term in individual contract negotiations.”⁹⁶ Here the CJEU seems to confirm that good faith is at least to some extent a separate requirement playing some independent role in determining when an imbalance is “significant.” What the CJEU does not answer is if good faith within the test of fairness is concerned with both procedural and substantive fairness. Using good faith to determine significant imbalance suggests the CJEU gave a more substantive meaning to good faith. As Advocate General Kokott specified, if significant imbalance is contrary to good faith, it is “unjustified.”⁹⁷ However, the fact that the CJEU failed to expressly comment on procedural aspects of good faith can lead to two opposing conclusions. One is that by specifically mentioning the phrase “dealing fairly and equitably” and the process of contract conclusion, the CJEU impliedly included procedural fairness into the scope of good faith. The other is, failing to expressly point to procedural aspects of good faith, bringing the principle only in connection with significant imbalance, the CJEU sees good faith as a principle contributing only to enquiries into substantive fairness.⁹⁸ Hence, this case failed to give a long waited answer on whether the test of fairness should be given a more substantive or a more procedural meaning.⁹⁹

There is no doubt national courts will continue making references.¹⁰⁰ Hopefully the CJEU will continue being more and more instructive in giving general guidance, especially to answer if the test of fairness should be given a more substantive or a more procedural meaning. For now it seems, the CJEU is more inclined towards giving substantive meaning to the test of fairness in Art. 3(1) UCTD.

⁹⁶ Para. 69 Aziz.

⁹⁷ Para. 74 Opinion of Advocate General Kokott in C-415/11 of 8 November 2012, ECR [2013] p. I-00000 (not reported).

⁹⁸ Fairness of Contract Terms in European and Serbian Law, 186-201, In: Strengthening Consumer Protection in Serbia-Liber Amicorum Svetislav Taboroši, Thierry Bourgoignie, Tatjana Jovanić (eds.), Faculty of Law University of Belgrade, Belgrade, 2013, p. 192-193.

⁹⁹ This expectation was expressly raised by Reich. Norbert Reich, Protection of Consumers’ Economic Interest by EC Consumer Law – Some Follow-up Remarks, 28 Sydney Law Review 37- 62, 2006, p. 48.

¹⁰⁰ C-226/12 Constructora Principado, S.A. v José Ignacio Menéndez Álvarez, Reference for preliminary ruling of 14 May 2012.

II.2.5. Circumstances to be taken into account in determining fairness

In interpreting the test of fairness in Art. 3(1) UCTD the circumstances laid down in Art. 4(1) UCTD should be taken into account. These are the nature of the goods and services for which the contract was concluded, and at the time of contract conclusion a) all the circumstances attending the conclusion of the contract; b) all other terms of the contract, c) all other terms of another contract on which it is dependent.

Some terms will be unfair *per se*, others only if looked at in connection with other provisions of the contract. As result, for example it might be that one term would be considered unfair if taken isolated, but if the contract contains an equally disadvantageous provision burdening the business, based on Art. 4(1) UCTD the term will most probably not be considered unfair as the contractual balance in the rights and obligations of the parties would be maintained. There will be no significant imbalance in the parties' rights and obligations when there is a countervailing benefit to a consumer. The favourable term might represent a "fair price" for the term that is detrimental to the consumer.¹⁰¹

Art. 4(1) UCTD also makes possible that some aspects which might not be part of the test itself, can be brought into the test. In *Perenicova* the CJEU was asked if the advertising of lower APR in consumer credit than the real rate was an unfair commercial practice under the *Directive 2005/29/EC on Unfair Commercial Practices* (hereinafter: UCPD),¹⁰² what relation will it have to Art. 4(1) UCTD. The CJEU was of the opinion that Art. 4(1) UCTD is very wide and expressly includes "all the circumstances" of contract conclusion. If a commercial practice is unfair this could be one element among others on which the competent court can base its assessment of fairness. However, the CJEU emphasized that that element is not such as to establish automatically and on its own the unfairness of a contract term.¹⁰³ Therefore, commercial communication prior the conclusion of the contract, which falls outside the scope of the UCTD, might be taken into account within Art. 4(1) UCTD, and thereby have an indirect effect on the fairness of a contract term.

Overall, Art. 4(1) UCTD provides for a high level of protection. Nevertheless, it carries a hidden danger that businesses couple substantively unfair terms with terms that

¹⁰¹ Willett 2007, p. 51.

¹⁰² Directive 2005/29/EC of the European Parliament and of the Council of 11 May 2005 concerning unfair business-to-consumer commercial practices in the internal market, OJ L 149, 11.6.2005.

¹⁰³ Para. 44 *Perenicova*.

confer rights on consumers like a right of withdrawal, which consumers will rarely, if ever, use in practice. This result is especially likely in consumer credit contracts.¹⁰⁴

II.2.6. Terms on the indicative list

Besides the general test of fairness comprised of general clauses the UCTD contains an indicative and non-exhaustive list of contract terms that are to be regarded substantively unfair. The terms in the UCTD Annex can be grouped in the following categories: exemption clauses;¹⁰⁵ terms giving the business a right to vary or terminate performance under the contract;¹⁰⁶ terms imposing liability on the consumer or allowing the price to be varied;¹⁰⁷ and terms that give a certain right to the business but not give similar rights to the consumer under like circumstances.¹⁰⁸ Two terms will be discussed further in Chapter V.¹⁰⁹

The formulation “indicative” in addition to “non-exhaustive” raises the question of the legal nature of the terms on the list. In *Commission v. Sweden*¹¹⁰ the CJEU clarified that the list is not binding, that a term on the list need not necessarily be considered unfair and, a term that does not appear in the list may none the less be regarded unfair.¹¹¹ It further clarified, that the list serves only as an *aid* to interpret the test of fairness in Art. 3(1) UCTD, and circumstances surrounding the conclusion of the contract in Art. 4(1) UCTD. The list did not in itself intended to create rights and obligations for individuals.¹¹² It is only of indicative and illustrative value, and a “source of information”.¹¹³ This means, the degree as to which the list is binding is even less than the “grey list” as no presumption of unfairness is involved.¹¹⁴

The existence of the indicative list provides for a certain degree of protection, giving examples of substantive unfairness, but its reach remains uncertain. A higher level of protection would be ensured if the UCTD clarifies the “status” of the examples.

¹⁰⁴ See for more: V.6.2.5.

¹⁰⁵ Paras. 1(a),(b) (n) and (q) UCTD Annex.

¹⁰⁶ Paras. 1(g), (j) and (k) UCTD Annex.

¹⁰⁷ Paras. 1(c), (e), (h) and (l) UCTD Annex.

¹⁰⁸ Paras. 1(d), (f) and (o) UCTD Annex.

¹⁰⁹ See: variation clauses (V.6.2.1.); default interest (V.6.2.2.)

¹¹⁰ C-478/99 *Commission of the European Communities v Kingdom of Sweden*, 7 May 2002, ECR [2002] p. I-414.

¹¹¹ Para. 20 *Commission v Sweden*.

¹¹² Para. 13 *Commission v Sweden*.

¹¹³ Para. 22 *Commission v Sweden*.

¹¹⁴ Willett 2007, p. 172.

II.2.7. Intermediary conclusions

The basic concept of unfairness is laid down in the test of fairness in Art. 3(1) UCTD. This provision incorporates two general clauses, “good faith” and “significant imbalance”. In determining what unfairness means two concepts are crucial, the concepts of substantive and procedural fairness. Substantive fairness means fairness in the substance of the terms. Procedural fairness means fairness in the process that leads to the conclusion of the contract. In order to determine the meaning and reach of the test of fairness the thesis aimed to determine in the light of procedural and substantive fairness what the two general clauses mean, and what their relation is. It concluded, the UCTD is not clear if the good faith is to be understood as aiming towards procedural and/or substantive fairness. The analysis of Rec. 16 UCTD suggests it is concerned with both procedural and substantive fairness. But this is not the only possible interpenetration. The other general clause, “significant imbalance” without a doubt points towards substantive fairness. Besides this general clause the UCTD also contains examples of terms that may be substantively unfair in the UCTD Annex. Substantive unfairness may be indicated by departing from default rules of the applicable law, however, in determining the fairness of one term the entire contract and all the circumstances surrounding the conclusion of the contract should be taken into account under Art. 4(1) UCTD.

One of the controversial questions of the basic concept of unfairness is what the relation between the two general clauses is within the test of fairness. Since both general clause point towards substantive fairness, it may be inferred, that the test of fairness primarily aims towards substantive fairness. This is the more protective reading that provides for a high level of protection and it seems to be confirmed by the CJEU. However, it is not the only way the test can be interpreted.

Hence, it seems that the test of fairness intends to achieve a high level of protection, and primarily provide for substantive fairness, but it is uncertain if its language achieves the set aim. The level of protection the UCTD provides is undetermined.

II.3. The role of transparency in the UCTD

The meaning of procedural fairness is concretized by the principle of transparency laid down in Art. 5 UCTD:

“In the case of contracts where all or certain terms offered to the consumer are in writing, these terms must always be drafted in plain, intelligible language. Where there is doubt about the meaning of a term, the interpretation most favourable to the consumer shall prevail.”

When talking about the role of transparency, the first question is what transparency means, the second, can transparency or procedural fairness legitimise substantive unfairness, and the third, can the breach of transparency rules alone make the contract term unfair. In determining the meaning of transparency it is also important to establish the benchmark consumer to whom the communication is directed.

II.3.1. The meaning of transparency

Willett summarizes “terms are transparent when they are available at the point of contract; there is a reasonable opportunity to become acquainted with them; they are in clear, jargon free language and decent sized print; the sentences, paragraphs and overall contract are well structured; and appropriate prominence is given to particularly important terms”.¹¹⁵

The core component of transparency is information. Information is among consumer’s basic rights. It was for the first time proclaimed by the *United Nation’s General Assembly Resolution No. 39/248 of 1985*,¹¹⁶ and later confirmed by the CJEU.¹¹⁷ The Treaty of Amsterdam recognized transparency as a subjective right that is now incorporated into Art. 169 TFEU. The “information paradigm” therefore gradually became a general legal principle of EU contract law, and became one of the most important aspects of consumer protection.¹¹⁸

The ultimate purpose of information is to allow consumers to assess their contractual position based on the information at their disposal¹¹⁹ and to make an

¹¹⁵ Willett 2011, p. 357.

¹¹⁶ UN: http://www.un.org/ga/search/view_doc.asp?symbol=A/RES/39/248&Lang=E&Area=RESOLUTION (20 June 2013).

¹¹⁷ C-326/88 GB-INNO-BM v Confédération du commerce luxembourgeois, 7 March 1990, ECR [1990] p. I-667.

¹¹⁸ Micklitz et al. 2009, p. 17.

¹¹⁹ Micklitz et al. 2009, p. 137.

informed decision.¹²⁰ The right to information includes the right to be informed on the (voluntarily) included terms in the contract, and the right of disclosure of the consumers' legal rights.¹²¹ Terms voluntarily included are usually those which repeat the default rules of the law. However, if a particular term in some way deviates from default rules, the consumer's right for information will not be fulfilled by including the term into the contract but only if a clear indication is given as to the way in which the term alters the consumers' position relative to the default position. This is especially important as terms deviating from default rules to the detriment of the consumer are the terms that are potentially unfair in substance.¹²²

Willett asserts that transparency has to ensure for consumers a *real chance to understand* the content of the terms.¹²³ Since understanding depends on a number of additional factors like education and intelligence,¹²⁴ transparency means terms should be formulated and explained in such matter that provide an *opportunity* for understanding of particular terms, and to allow the overall estimation of a contractual position of the consumer (regardless whether actual understanding is achieved). In this sense sometimes general presentation of the terms might not be enough, but businesses have to take additional steps, and specifically draw the attention of the particular consumer to a particular term, and even to explain the meaning of the terms. A real chance for understanding is more easily achieved if a distinction is made between consumers e.g. according to their education and intelligence.¹²⁵

Hence, the meaning of transparency is "multi levelled". On the first "level" it means including information into the contract, on the second "level," drawing the attention of the consumer to particular information, and on the third "level," providing additional explanations to the particular consumer in order to create a chance for his full understanding. The question is to what extent the UCTD achieves these meanings?

¹²⁰ Christian Twigg-Flesner, Reiner Schulze, Protection rational choice: information and the right of withdrawal, 130-157 In: Handbook of Research on International Consumer Law, Geraint Howells, Ian Ramsay, Thomas Wilhelmsson (eds.), Edward Elgar, Cheltenham, Northampton, 2010, p. 130.

¹²¹ Willett 2011, p. 176. It should be noted, "information" and "disclosure" are often used interchangeably in literature, but while information relates to voluntarily included information, a duty to disclose information implies that a person on whom the duty is placed has information which it would rather not reveal because it provides advantage for him. Ruth Stefton-Green, General Introduction, In: Ruth Stefton-Green (ed.), Mistake, Fraud and Duties to Inform, Cambridge University Press, Cambridge, 2004, p. 2.

¹²² Willett 2011, p. 177.

¹²³ Willett 2011, p. 384.

¹²⁴ Experience shows that information is more utilized by "affluent, well-educated, middle-class consumers." Geraint Howells, The Potential and Limits of Consumer Empowerment by Information, 32(3) Journal of Law and Society 349-370, 2005, p. 356.

¹²⁵ Cf Fejös 2013, p. 198.

At first reading it seems Art. 5 UCTD relates to the language of the contract, to the way contract terms are formulated. Plain certainly refers to contract terms drafted with no ambiguities, misunderstandings or doubts in the content of the terms.¹²⁶ Intelligibility primarily relates to legibility. It can also refer to the quality of the information incorporated into the contract.¹²⁷ Hence, both requirements are in essence formal: “clear” refers to external presentation, “intelligible” to comprehensibility.¹²⁸ However, if Art. 5 UCTD is read together with Art. 3(1) UCTD, where transparency is connected to procedural fairness as part of the general requirement of good faith and the test of fairness, this would mean more than clear and comprehensible language. Talking about the function of transparency, the EU Commission seems to confirm this position. First, by reading Art. 5 UCTD together with Rec. 20 UCTD, according to which, the consumer should have “actually be given an opportunity to examine all the terms” of the contract, transparency is seen as a way of vetting contractual terms at the time of contract conclusion.¹²⁹ Terms that are not transparent, will not even become part of the contract. Second, reading together Art. 5 UCTD and Art. 3(1) UCTD the principle of transparency relates to the control of the content of the contract.¹³⁰ The EU Commission further emphasizes transparency also means consumers should be able to obtain the necessary pre-contractual information to make an informed decision.¹³¹ The CJEU seems to largely confirm the EU Commission’s interpretation. Going above plain and intelligible language the CJEU interpreted Art. 5 UCTD in connection with Rec. 20 UCTD as relating to pre-contractual information on the terms of the contract and on the consequences of concluding the contract.¹³² Therefore, although the final reach of transparency remains undetermined, both the EU Commission and the CJEU seem to be inclined towards giving a wider meaning to transparency than plain and intelligible

¹²⁶ Hans Schulte-Nölke, Christian Twigg-Flesner, Martin Ebers (eds.), *EC Consumer Law Compendium – Comparative Analysis*, February 2008 (hereinafter: *Consumer Law Compendium*) p. 412 at DG SANCO: http://ec.europa.eu/consumers/rights/cons_acquis_en.htm#com (22 November 2012); *Cf* Micklitz et al. 2009, p. 136.

¹²⁷ Micklitz et al. 2009, p. 136.

¹²⁸ *The Directive on Unfair Terms, five years later - Evaluation and future perspectives*, Conference organized by the European Commission, 1-3 July 1999. Proceedings from Workshop No. 4: Obligations of Clarity and Favourable Interpretation to the Consumer (hereinafter: *Workshop No. 4 UCTD Conference*) p. 158 at DG SANCO: http://ec.europa.eu/consumers/cons_int/safe_shop/unf_cont_terms/event29_02.pdf (10 December 2011).

¹²⁹ UCTD Implementation Report, p. 17.

¹³⁰ *Ibid.*

¹³¹ *Ibid.*

¹³² Para. 44 C-92/11, *RWE Vertrieb AG v Verbraucherzentrale Nordrhein-Westfalen e.V.*, 21 March 2013, [ECR] I-00000 (not reported). See also C-144/99 *Commission of the European Communities v Kingdom of Netherlands*, 10 May 2001 [2001] ECR 2001 p. I-3541.

language, a meaning that includes pre-contractual information aiming to enable the consumer to reach an informed decision. However, any wider meaning and a higher level of protection can only be achieved by interpretation. Therefore, the immediate protection Art. 5 UCTD provides is a relatively low protection as it unambiguously refers only to the language and presentation of contract terms.

II.3.1.1. The benchmark consumer

The UCTD does not define the benchmark consumer against whom the meaning of transparency is measured.¹³³ The landmark decisions that established the standard of a consumer in EU consumer law in general is *Gut Springenheide*.¹³⁴ In this case, in a choice between a “casual consumer” and an “informed average consumer”¹³⁵ the CJEU opted for the latter, and ruled that the national court must take into account the presumed expectations the advertisement raises “*in an average consumer who is reasonably well-informed and reasonably observant and circumspect.*”¹³⁶ The average, well informed and circumspect consumer standard means, that the level of information and observation capabilities of a particular consumer are measured compared to an objective standard of the average consumer. This standard was further developed by the CJEU.¹³⁷ Overall, the case law of the CJEU is based on a relatively strong belief in an average consumer as an active and critical information seeker,¹³⁸ equipped with freedom of choice and decision. Therefore, it is no longer seen as a passive market participant, a “*homo economicus passivus*” but is rather a reasonably well informed and circumspect individual.¹³⁹

The standard developed by the CJEU is criticized from different angles. First, as Hondius asserts, the impetus for harmonizing consumer law has usually been to protect

¹³³ It is important to point out that the benchmark consumer is also important in determining substantive fairness; however, the thesis will relate it to transparency as this is how the benchmark is developed and in literature discussed.

¹³⁴ C-210/96 *Gut Springenheide GmbH and Rudolf Tusky v Oberkreisdirektor des Kreises Steinfurt - Amt für Lebensmittelüberwachung* 16 July 1998, [ECR] p. I-04657.

¹³⁵ Para. 15 *Gut Springenheide*.

¹³⁶ Para. 37 *Gut Springenheide*.

¹³⁷ e.g. Case C-303/97 *Verbraucherschutzverein v Sektkellerei Kessler GmbH*, ECR [1999] p. I-513; C-220/98 *Estée Lauder Cosmetics GmbH & Co. OHG v Lancaster Group GmbH*, 13 January 2000, [ECR] 2000 p. I-00117.

¹³⁸ Geraint Howells, Thomas Wilhelmsson, *EC Consumer Law*, Aldershot, Dartmouth, 1996, p. 274.

¹³⁹ Micklitz et al. 2009, p. 45. The CJEU seems to depart from this standard in case of “manifestly unfair” terms when the CJEU is especially “sensitive” towards consumers. See: Jules Stuyck, *The Notion of The Empowered and Informed Consumer in Consumer Policy and How to Protect the Vulnerable Under Such Regime*, 167-186 In: *Yearbook of Consumer Law*, Geraint Howells, Annette Nordhausen, Deborah Parry, Christian Twigg-Flesner (eds.), 2007, p. 175-176.

the weaker party in contracting, where the legislature had in mind a “weak person, hardly able to read a contract, and in need of information about every conceivable item.” The CJEU completely departed from this approach.¹⁴⁰ Second, without even raising the difficulty of determining the “average”,¹⁴¹ the average standard leaves vulnerable consumers open for exploitation. *Gut Springenheide* does not answer the question how to determine the average, absolutely or relatively, i.e. compared to a particular group of consumers. In the absence of additional clarifications, a contract term satisfies the requirements of transparency if the information is understood by a person of average intelligence, regardless of intellectual capabilities of a particular consumer. There are however other legislative options. The UCPD for example, adopted much later than the UCTD, implements the standard developed in *Gut Springenheide*¹⁴² but is also familiar with the notion of a vulnerable consumer¹⁴³ In case of vulnerable consumers, the “vulnerable consumer” standard replaces the “average consumer” standard.¹⁴⁴ For a high level of protection this differentiation should be extended to the UCTD.¹⁴⁵ Third, the case law of the CJEU developed in relation to marketing practices and the UCPD, and was seen as a barrier to trade in the internal market.¹⁴⁶ However, the question of average is something different in commercial practices than in contract terms. Contracts are more complex than advertisements, and in order to understand the terms of the contract the consumer has to engaged in targeted and deeper information seeking and be educated

¹⁴⁰ Ewoud Hondius, The Notion of Consumer: European Union versus Member States, 28 Sydney Law Review 89-98, 2006, p. 94.

¹⁴¹ Wilhelmsson questions if average exists, as people are different by their individual characteristics but also by belonging to different Member States. Thomas Wilhelmsson, Consumer Images in East and West, 53-65 In: *Rechtseinheit der Rechtsvielfalt in Europa?*, Hans-Wolfgang Micklitz (ed.), Nomos, Baden-Baden, 1996; Thomas Wilhelmsson, The Average European Consumer: a Legal Fiction? 243-265, In: *Private Law and Many Cultures of Europe*, Thomas Wilhelmsson, Elina Paunio, Annika Pohjolainen (eds.), Kulwer Law International, Alphen aan den Rijn, 2007, p. 252-254.

¹⁴² Art. 5(2) UCPD referring to an average consumer to whom the commercial practice is directed or who the addressee it, or to an average member of the group if the communication is directed towards a group.

¹⁴³ Art. 5(3) UCPD makes an exception from the average standard in favour of a clearly identifiable group of consumers who are particularly vulnerable because of their “mental or physical infirmity, age or credulity.” See for analysis: Stephen Weatherill, Who is the ‘Average Consumer’, 115-138 In: *The Regulation of Unfair Commercial Practices under EC Directive 2005/29: New Rules and New Techniques*, Stephen Weatherill, Ulf Bernitz (eds.), Hart Publishing, Oxford, Portland, Oregon, 2007, p. 133-138.

¹⁴⁴ Christian Twigg-Flesner, Deborah Parry, Geraint Howells, Anette Northausen, An Analysis of the Application and the Scope of the Unfair Commercial Practices Directive, An independent report for the Department of Trade and Industry, 2005, p. 24-27 at DTI: <http://www.dti.gov.uk/files/file32095.pdf> (7 November 2011).

¹⁴⁵ See e.g. Simon Whittaker, Language or Languages of Consumer Contracts?, 8 Cambridge Yearbook of European Legal Studies 229-257, 2005-2006, p. 244.

¹⁴⁶ See Willett 2007, p. 113-115.

and intelligent enough to understand to be able to compare the offers on the market and make an informed decision.¹⁴⁷

Therefore, it can be concluded, the standard of average, well informed and circumspect consumer sets a low level of protection. For a high level of protection, special sensitivity towards vulnerable consumers seems necessary.

II.3.1.2. The wider meaning of transparency

Besides the above meanings of transparency academics also identify a wider meaning of the principle. According to Willett, first, it may be viewed as a basic *social right* that consumers should be placed in a position that they have real chance of understanding what they are agreeing to, as a right to have chance to exercise informed consent, regardless whether the opportunity is realistic or not. Second, transparency can be viewed as being important in furthering market discipline. Even if the average consumer cannot take advantage of transparency there may some consumers that can. This so-called “active margin” of consumers is able to discipline the market, as will be discussed below. Finally, transparency can be viewed as independently important in helping consumers to protect their interests *ex post* by potentially enhancing their access to justice,¹⁴⁸ or giving them time for reflection after the contract is concluded.¹⁴⁹ Micklitz points out that transparency of contract terms are linked to market transparency, transparency in competition, which allow consumers to compare offers on the market.¹⁵⁰ The importance of this latter meaning of transparency will be further analyzed in Chapter V.¹⁵¹

II.3.2. Transparency and substantive (un)fairness

The second issue related to transparency is whether it can legitimize substantive unfairness. If the answer is yes, this means, substantively unfair terms are considered fair just because they are communicated in a transparent, i.e. procedurally fair, manner. This

¹⁴⁷ Cf Ibid.

¹⁴⁸ Willett 2011, p. 376-377.

¹⁴⁹ Chris Willett, Martin Morgan-Taylor, Recognizing the limits of transparency of EU consumer law, 143-163, In: European Consumer Protection: Theory and Practice, James Devenney, Mel Kenny (eds.), Cambridge University Press, Cambridge, 2012, p. 147.

¹⁵⁰ Micklitz et al. 2009, p. 138.

¹⁵¹ See especially V.7.

would leave the door wide open for businesses to include substantively unfair terms into consumer contracts, especially among standard terms and conditions.

Therefore, transparency or procedural fairness alone is not a tool that provides for a high level of protection. First, consumers often choose not to read the contract.¹⁵² Second, even if they read the contract they cannot process the information adequately to make an informed decision.¹⁵³ Third, as behavioural economics showed, consumers are not rational decision makers but are in fact irrational and biased.¹⁵⁴ It is rightly advocated nowadays that concept of fairness should be interpreted in the light of the most recent findings of behavioural economics.¹⁵⁵ The research of behavioural economics showed that consumers are not rational in making decisions, and information as a regulatory tool has limited reach. Namely, the economic analyses of law traditionally focused on rational choice theory. This theory assumed that information makes possible for a rational consumer to make an informed decision. Accordingly, regulation focused on remedying information asymmetries and provide for information disclosure.¹⁵⁶ The UCTD relies on the rational choice theory and transparency should empower the consumer to make an informed decision and a rational choice. However, if consumers are not rational, than even if presented with a right amount and quality of information at the right time they will still not be able to make a rational decision. For example in case of credit contract, consumers often are aware of the consequences of

¹⁵² Omri Ben-Shahar, The Myth of the ‘Opportunity to Read’ in Contract Law, 5(1) European Review of Contract Law 1-69, 2009, p. 7-9; for possible reasons for not reading the contract see also: Willett 2011, p. 359.

¹⁵³ Stefan Grundmann, Information, Party Autonomy and Economic Agents in European Contract Law, 39 Common Market Law Review 269-293, 2002, p. 269-270; Howells 2005, p. 350.

¹⁵⁴ Faure Michael G., Luth Hanneke A., Behavioural Economics in Unfair Contract Terms, Cautions and Considerations, 34 Journal of Consumer Policy 337-358, 2011, p. 337, 343-345, 348-349.

¹⁵⁵ Commission Guidance on the Implementation/Application of Directive 2005/29/EC on Unfair Commercial Practices, SEC (2009) 1666, p. 32; Franziska Rischkowsky, Thomas Döring, Consumer Policy in a Market Economy: Considerations from the Perspective of the Economics of Information as well as Behavioural Economics, 31 Journal of Consumer Policy 281-314, 2008; Aristides N. Hatzis, An Offer You Cannot Negotiate: Some Thoughts on the Economics of Standard Form Consumer Contracts, 43-56, In: Standard Contract terms in Europe: A Basis for and a Challenge to European Contract Law, Hugh Collins (ed.), Kluwer Law International, Alphen aan den Rijn, 2008, p. 44 et seq.; In some Member States like the UK the findings of behavioural economics recently gained attention of the legislator. See The Law Commission for England and Wales and The Scottish Law Commission, Unfair terms in consumer contracts: a new approach?, A Joint Issue Paper, 2012 (hereinafter: 2012 UK Law Commission) p. 26 at the Law Commission: http://lawcommission.justice.gov.uk/docs/unfair_terms_in_consumer_contracts_issues.pdf (29 June 2013).

¹⁵⁶ Iain Ramsay, Framework for Regulation of the Consumer Marketplace, 8 Journal of Consumer Policy 353-372, 1985, p. 359; Hans-Wolfgang Micklitz, Some reflections on Cassis de Dijon and the control of unfair contract terms in consumer contracts, 19-42 In: Standard Contract terms in Europe: A Basis for and a Challenge to European Contract Law, Hugh Collins (ed.), Kluwer Law International, Alphen aan den Rijn, 2008, p. 21.

default but irrationally believe that they will not default.¹⁵⁷ Hence, consumers should be empowered by more protective rules aiming to provide substantive fairness than by transparency and procedural fairness. Information and procedural fairness does not provide for a high level of protection. Procedural fairness should not be capable of legitimizing substantive unfairness.

It is not clear how the UCTD solved the issue. The more protective reading of the test of fairness seemingly confirmed by the CJEU in *Aziz* is that it primarily intends to regulate substantive unfairness, which consequently, cannot be legitimized by procedural fairness. But this is not the only reading of the UCTD. If violation of good faith is a separate requirement under UCTD, then it might be argued that, if there is transparency, there is good faith, and therefore no unfairness, no matter the degree of substantive unfairness.¹⁵⁸ In other words, the principle of good faith and significant imbalance are two separate requirements there is always a danger that substantive unfairness is able to be justified by procedural fairness. This would be the task of the CJEU to settle the relationship between the general clauses and provide a high level of protection.

II.3.3. Transparency as independent basis of unfairness

The third issue connected to transparency is if transparency and procedural fairness alone is capable of making a contract term unfair.

The UCTD failed to provide an explicit sanction for breach of transparency. According to the EU Commission, the intention of the UCTD is to maintain the contract with the help of the *contra proferentem* rule, i.e. the interpretation most favourable for the consumer.¹⁵⁹ However, this approach fails to take into account that there might be no such interpretation, or that there are terms that are drafted in plain language but are still not understandable.¹⁶⁰ This leads Nebbia to conclude that the rule is no weapon against terms that are drafted in a plain and intelligible language, or a weak weapon against terms that are able to provide for more meanings none of which is to the advantage of

¹⁵⁷ For some common behavioural biases see: Michael G. Faure, Hanneke A. Luth, Behavioural Economics in Unfair Contract Terms, Cautions and Considerations, 34 *Journal of Consumer Policy* 337-358, 2011, p. 344-345.

¹⁵⁸ Willett 2011, 372.

¹⁵⁹ UCTD Implementation Report, p. 19.

¹⁶⁰ Consumer Law Compendium, p. 415.

the consumer.¹⁶¹ However, taking the wider meaning of transparency, a contract term that is not communicated in a transparent manner will not become part of the contract (Art. 5 UCTD read with Rec. 20 UCTD), or it will make the term unfair and therefore null and void (Art. 5 UCTD read together with Art. 3(1) UCTD). This is however subject to interpretation, and the only explicit sanction is the *contra proferentem* interpretation.

Willett is of the opinion transparency should be provided on its own right, and a non-transparent term sanctioned as an unfair term. Consumers should know what they are agreeing to and transparent terms are important not just in pre-contractual stage but also in realizing the rights of consumers to access justice post-contractually.¹⁶² Therefore, for a high level of protection transparency or procedural fairness should be alone able to make the contract term unfair. At the moment, the level of protection provided by the UCTD in this respect is low.

II.3.4. Intermediary conclusions

The thesis pointed out transparency may have “multi levelled” meaning. It can mean clear language, decent size print, etc. but also a real opportunity of a consumer to understand the terms of the contract. As understanding depends on other factors like education and intelligence, transparency can also mean drawing the attention of a particular consumer to a particular term, or even providing additional explanations. Transparency is regulated in Art. 5 UCTD. The language of the provision at first sight suggests the principle of transparency relates only to plain and simple language of written terms, however, a wider analysis, Art. 5 UCTD, connected to other provisions of the UCTD (Rec. 20 UCTD and Art. 3(1) UCTD), reveals that transparency can mean more. Therefore, the precise meaning of transparency remains unclear, as its wider meaning can only be achieved by interpretation. Additionally, the meaning of transparency is to be measured against a standard of the average, well informed and circumspect consumer the standard of which leaves open the door for the abuse of vulnerable consumers.

In the system of the UCTD it is not clear if transparency and procedural fairness can legitimize substantive unfairness, i.e. if a business is able to include substantively unfair terms after presenting them to the consumer in a procedurally fair manner. The

¹⁶¹ Nebbia 2007, p.142.

¹⁶² Willett 2011, p. 385.

thesis pointed out that consumers often fail to read or understand the contract but even more likely consumers are just not able to make a rational choice. As a result, information, and procedural fairness should not be allowed to legitimize substantive unfairness.

Finally, transparency has no independent sanction. Under the UCTD the contract term cannot be removed from the contract solely for being procedurally unfair. In this regard the thesis pointed out a separate sanction is necessary for a high level of protection.

Overall, the regulation of transparency in the UCTD leaves unanswered what transparency means, and what the relation between procedural and substantive fairness is and for this reason, it provides for a low level of protection. Not providing transparency as an independent basis of fairness also results in a low level of protection.

II.4. Limits of the test of a fairness

The test of fairness in the UCTD has a number of limitations. The most important are the exemption of certain terms from the test: “mandatory rules”, the “core terms” and the “individually negotiated terms” exemptions, and time when the test is to be applied.

II.4.1. The “mandatory rules” exemption

Terms that reflect mandatory statutory or regulatory provisions and the provisions or principles of international conventions are exempted from the scope of the UCTD (Art. 1(2) UCTD). The problem of this provision is what mandatory statutory and regulatory provisions means. Rec. 13 explains that this exemption also “covers rules which, according to the law, shall apply between the contracting parties provided that no other arrangements have been established.” This arguably implies dispositive rules, or default rules. Although it can be assumed that mandatory rules and even default rules are substantively fair, however, this is not necessarily the case. Mandatory rules may favour other interests and produce unfair results for consumers. Hence the scope of mandatory rules exemption seems very wide. It becomes even wider if one tries to think of what “regulatory provisions” can mean.¹⁶³

¹⁶³ See especially for mandatory statutory rules IV.5.1. and for the context of credit V.6.1.5.

II.4.2. The “core terms” exemption

Art. 4(2) UCTD provides the “core terms” exemption.¹⁶⁴ This exemption is a result of a compromise. It was added as an amendment by the EU Council during the legislative process and it corresponded to legal provisions already in force in some Member State like Germany.¹⁶⁵

Willett identifies several rationales for the exclusion of core terms. First, a possible argument is that core terms are subject to market discipline and therefore are more likely to be fair than ancillary terms.¹⁶⁶ Second, since core terms go into the heart of the bargain they are most probably subject to (at least some) negotiation and therefore true consent is more likely than over ancillary terms. Core terms are likely to be known and understood by consumers as they will be always affected by the price and main subject matter of the contract. Finally, the third possible explanation is that it would be too much of an intrusion into the freedom of contract if these terms would be subject to the fairness test.¹⁶⁷ Advocate General Trstenjak in case *Caja de Ahorros*, the only case so far involving Art. 4(2) UCTD, identified like reasons. She pointed out that the provision was suppose to limit the restriction of intervention of the UCTD into the contractual relations of the parties, exempt core terms from the judicial scrutiny and the test of fairness, and leave the fairness of these terms to the market.¹⁶⁸

Although the insertion of the exemption may be justified, its imprecise formulation can cause a lot of uncertainties in practice. Art. 4(2) UCTD reads:

“Assessment of the unfair nature of the terms shall relate neither to the definition of the main subject matter of the contract nor to the adequacy of the price and remuneration, on the one hand, as against the services or goods supplies in exchange, on the other, in so far as these terms are in plain intelligible language.”

It can be seen that there are two exemptions. One is the main subject matter of the contract. The other is the relation between the price and the service or goods supplied in exchange. First, it is questionable what the main subject matter of the contract is. Second, the problem is whether the exception relates to all price terms or just to the price

¹⁶⁴ The thesis calls Art. 4(2) UCTD exemption the “core” term exemption, even though it is uncertain whether the exemption relates only to core terms or what core terms are. The “core term” label is justified by reasons of clarity of the arguments, as it could be only replaced by long description of the provision, or referred to in numerical terms which start to be complicated when the thesis turns to national provisions.

¹⁶⁵ Para. 64 Advocate General Trstenjak *Caja de Ahorros*.

¹⁶⁶ Willett 2007, p. 246.

¹⁶⁷ Willett 2007, p. 96.

¹⁶⁸ Paras. 39-40 Advocate General Trstenjak *Caja de Ahorros*.

that is given in exchange for goods or services that are the main subject matter of the contract. Third, the exemptions are linked to transparency.

Often it will be difficult to determine what the main subject matter of the contract is. According to Beale¹⁶⁹ the “main subject matter” clause cannot be the one that governs the manner and time in which claims must be made (procedural clauses). Further, it cannot be a term that comes into play when the consumer defaults. The main subject matter clause must only be a clause that “define[s] the parties’ rights and obligations in the due performance of the contract.”¹⁷⁰ But Beale further asserts that it is important how the term is presented to the consumer. Since the classification of the contract term as the main subject matter will depend on, partially, how it is presented, the test will be in fact whether the clause permits performance different from what the consumer reasonably expected.¹⁷¹ Hence, any deviation from what the consumer would reasonably expect should be clearly stated.¹⁷² The 2012 UK Law Commission suggested two guides. One is how the term is presented. Prominent terms are likely to be considered the “main” terms, while small print terms are “incidental” or ancillary. Another guide is whether the term is on the grey list. Terms of the grey list are ancillary.¹⁷³ Hence, the test of determining what the main subject matter is twofold. On the one hand the term must be related to the definition of the parties’ rights and obligations in due performance of the contract; on the other, it has to be presented in a way that a consumer reasonably expects the terms is very important in the contract.

The “price/quality ratio” exception is more problematic. The problem with this exception is whether it relates to all price terms or just the price paid for the goods or services that are equivalent to the “main subject matter” of the contract. For example in airline contracts, is the baggage fee within the ticket price and thereby a core term, or is it a separate charge and an ancillary term? It would provide for a higher level of protection, and would be more inferred from the logic of the exception in Art. 4(2) UCTD that only the price in relation to the main contractual obligation is exempted

¹⁶⁹ Hugh Beale, *Unfair Terms in Contracts: Proposals for Reform in the UK*, 27 *Journal of Consumer Policy* 289–316, 2004.

¹⁷⁰ Court of Appeal and the House of Lords agreed with the argument advanced by the Director-General of Fair Trading in *First National Bank*, see especially paras. 12, 34 and 43.

¹⁷¹ Beale 2004, p. 298.

¹⁷² The Directive on Unfair Terms, five years later - Evaluation and future perspectives, Conference organized by the European Commission, 1-3 July 1999. Proceedings from Workshop No. 1: Non-negotiated Terms in Consumer Contracts (hereinafter: Workshop No. 1 UCTD Conference), p. 94 at DG SANCO: http://ec.europa.eu/consumers/cons_int/safe_shop/unf_cont_terms/event29_02.pdf (10 December 2011).

¹⁷³ 2012 UK Law Commission, p. 104.

while all other charges fall within the test. Whittaker confirms this interpretation, and points out that not the “price” is exempted but the “adequacy of the price.”¹⁷⁴ The “ratio.”¹⁷⁵ The EU Commission underlined “terms laying down the manner of calculation and the procedures for altering the price remain entirely subject to the Directive.”¹⁷⁶ Consequently, price variation clauses and clauses relating to the method of price calculation, referred to in the indicative list, are subject to the test. It seems that as far as the term is on the indicative list there is no disagreement that the term is ancillary and therefore its fairness can be assessed. Since the logic of the core terms exemption is that a core term is likely to be known and understood by consumers, and additionally be subject to market discipline, only its exemption is justified. Consumers are much less likely to take into account terms that into play on the occurrence of certain circumstances and therefore they should be subjected to the test of fairness. However, this is not the only interpretation of core terms. In *Office of Fair Trading v Abbey National* (hereinafter: *Abbey National*)¹⁷⁷ the UK Supreme Court was of the opinion that overdraft charges are the price and therefore exempted from the test.

Importantly, core terms are exempted from the test only if they are transparent. This is because, as Advocate General Trstenjak points out, Art. 4(2) UCTD reflects the tension between “the parties’ freedom to arrange their own affairs and the need for statutory intervention in favour of consumer protection”.¹⁷⁸ For this reason the test of fairness is limited within the scope of the UCTD.¹⁷⁹ But the limitation works only as long as terms are presented in a transparent manner. Once transparency is breached, the “veil” is lifted, and the term can be assessed for its fairness. Hence, transparency is a fundamental requirement for core terms to escape review. This is logical because the main point of exempting core terms that these are the terms that consumers will focus at and consequently these terms will be subject to competitive pressure. Without transparency this is not possible. Nevertheless, transparency raises further questions in addition to the already uncertain scope of Art. 4(2) UCTD, as it was shown above, the meaning of transparency under the UCTD is not clear. Nevertheless, Art. 4(2) UCTD is the only place where the relation between procedural and substantive fairness is clearly

¹⁷⁴ Simon Whittaker, *Judicial Interventionism and Consumer Contracts*, 117 *Law Quarterly Review* 215-220, p. 219.

¹⁷⁵ Workshop No. 1 UCTD Conference, p. 96.

¹⁷⁶ UCTD Implementation Report, p. 15.

¹⁷⁷ *Office of Fair Trading v Abbey National Plc.* [2009] UKSC 6, [2010] 1 AC 696.

¹⁷⁸ Para. 64 Advocate General Trstenjak *Caja de Ahorros*.

¹⁷⁹ Para. 74 Advocate General Trstenjak *Caja de Ahorros*.

determined. Here procedural fairness gets primacy over substantive fairness, and allows potentially substantively unfair terms to remain in the contract.

Unfortunately, there is no guidance of the CJEU how to interpret Art. 4(2) UCTD. The only case that involved the provision was *Caja de Ahorros*, but the CJEU was not asked to determine the scope of Art. 4(2) UCTD. Recently, several Romanian courts asked a more direct on the exemption of certain price terms.¹⁸⁰ The CJEU's standpoint is very important, and perhaps these express references will change the way in which the UCTD is to be applied. Nevertheless, for the time being, there is no useful CJEU guidance on core terms exemption, and the narrower the exemption is interpreted the higher the protection of the UCTD is.¹⁸¹

II.4.3. The “individually negotiated terms” exemption

The applicability of the UCTD is limited only to those terms that were not individually negotiated between the parties.¹⁸² The indirect exclusion of individually negotiated terms was one of the most controversial issues in the drafting the UCTD. It was included into the final draft of the UCTD on the pressure of a very influential article of Brander and Ulmer. They argued that the inclusion of individually negotiated terms into the scope of the UCTD would “represent a drastic restriction of the autonomy of the individual”.¹⁸³

Following the exemption in Art. 3(1) UCTD, Art. 3(2) UCTD attempts to clarify when a term is not individually negotiated. It says:

“A term shall always be regarded as not individually negotiated where it has been drafted in advance and the consumer has therefore not been able to influence the substance of the term, particularly in the context of a pre-formulated standard contract.”

The provision sets two cumulative conditions: 1) the term has to be drafted in advance; and 2) the consumer did not have a chance to influence its content. The further formulation,

¹⁸⁰ C-236/12 *Comisariatul Județean pentru Protecția Consumatorilor Argeș v SC Volksbank România SA, SC Volksbank România SA — Sucursala Pitești, Alin Iulian Matei, Petruța Florentina Matei*, Reference for a preliminary ruling on 4 May 2012; C-123/12 *SC Volksbank România S.A. v Comisariatul Județean pentru Protecția Consumatorilor Giurgiu*, Reference for a preliminary ruling on 6 March 2012; C-108/12 *SC Volksbank România SA v Ionuț-Florin Zglimbea, Liana-Ramona Zglimbea*, Reference for a preliminary ruling on 29 February 2012.

¹⁸¹ See more on price terms exemption: V.6.1.1.3.

¹⁸² This exclusion was not present in the 1990 and 1992 drafts of the UCTD.

¹⁸³ Hans Erich Brander, Peter Ulmer, *The Community Directive on Unfair Terms in Consumer Contracts: Some Critical Remarks on the Proposal Submitted by the EC Commission*, 28 *Common Market Law Review* 647-662, 1991, p. 652.

”particularly” likely to appear in standard contracts raises some doubts as to whether the provision suggests there is a higher degree of probability that the term is individually not negotiated when it is in standard contract or that a term in standard contract is always regarded as individually non-negotiated *per se*. Consequently, there are doubts as to whether the UCTD aims to control only standard terms or more broadly, all contract terms that were not individually negotiated.¹⁸⁴

In order to fully understand the issue, it is useful to briefly point out the differences between standard terms, standard contracts and standard terms and conditions. *Standard terms* are contract terms prepared in advance by one contracting party which content the other was not able to influence. Standard terms are part of standard (form) contracts or standard terms and conditions. In *standard form contracts*, the free blank spaces which the parties fill in are referred to “special conditions” while the printed terms are the “general conditions” of the contract.¹⁸⁵ Normally, the free blank spaces are left open for the core terms of the contracts, which are supposed to be negotiated between the parties. In consumer transactions, the negotiated character of these terms is questionable. Beale points out that without full understanding negotiation is meaningless even if the consumer was offered a choice.¹⁸⁶ Standard form contracts in consumer context are not subject to any negotiation but are imposed on the consumer on a “take it or leave it” basis by the business.¹⁸⁷ These are contracts of adhesion, where negotiation is outright excluded. The only choice the consumer has is to accept the entire contract or refuse it.¹⁸⁸ *Standard terms and conditions*¹⁸⁹ are a set of pre-formulated clauses prepared in advance by one contracting party, and imposed on the consumer at the time of contract conclusion. They are different from standard contracts. Standard contracts contain a small portion out of the total range of possible future legal problems. Standard terms and conditions tend to be longer and govern most of the legal problems that may arise in the parties’ contractual relation. They are “all-inclusive” and often

¹⁸⁴ Micklitz et al. 2009, p. 139.

¹⁸⁵ Report of the Secretary-General: general conditions of sale and standard contracts (A/CN.9/98). VI Yearbook of the United Nations Commission on International Trade Law 114-118, 1975 (hereinafter: UNCITRAL general conditions and standard contracts), p. 115 at UNCITRAL: <http://www.uncitral.org/pdf/english/yearbooks/yb-1975-e/vol6-p114-118-e.pdf> (22 November 2011).

¹⁸⁶ Beale 2004, p. 293.

¹⁸⁷ Antonio Boggiano, *International Standard Contracts: The Price of Fairness*, Graha, Trotman, Martinus Nijhoff, Dordrecht, Boston, London, 1991, p. 95-99.

¹⁸⁸ Contracts of adhesion are different from standard contracts. In standard contracts the possibility to negotiate is not outright excluded; but in contracts of adhesion, negotiation is excluded by their definition. Miroslav Milosavljević, *Law of commercial contracts*, Prometej, Novi Sad, 2009, p. 26-27.

¹⁸⁹ Also called: general terms and conditions, general conditions, terms and conditions.

have a form of small brochures.¹⁹⁰ Complex contracts like consumer credit contain both standard form contracts and standard terms and conditions.

Having a look at the legislative history of the UCTD, one can see that it was adopted primarily because of the differences in standard terms among Member State. However, already the first proposal on the UCTD aimed to vest control on unfair terms as such.¹⁹¹ Art. 3(1) UCTD mentions individually not negotiated terms; Art. 3(2) UCTD specifies that these terms will be particularly those that are in standard contracts, i.e. standard terms. Nevertheless, in the absence of any specific limitation the interpretation of Art. 3(1) UCTD would lead to a conclusion that the UCTD indeed relates to all individually not negotiated terms, whether they are part of a standard contract, standard terms and conditions or are just not negotiated but are drawn up for the contract at hand and are not designed for a repeated use.¹⁹² Importantly, the lack of negotiation seems to be presumed,¹⁹³ and if a dispute arises over the negotiated character of a term Art. 3(2)(3) UCTD places the burden of proof on the business.

II.4.4. Time of assessing fairness

Though the UCTD does not deal specifically with the question, Art. 4(1) UCTD stipulates that in assessing fairness regard is to be paid to the circumstances prevailing *at the time of conclusion of the contract*. Following the wording of Art. 4(1) UCTD changes in the circumstances that occur after the contract is concluded shall not play a role. The same conclusion is confirmed by looking at the drafting process of the UCTD.¹⁹⁴ The UCTD is not flexible to accommodate the principle of “*social force majeure*”.

The principle of “*social force majeure*” was introduced as an aid to deal with changed circumstances by the legislator of Nordic countries and was reinforced by their

¹⁹⁰ UNCITRAL: general conditions and standard contracts, p. 115.

¹⁹¹ Proposal for UCTD 1990.

¹⁹² Cf Nebbia 2007, p. 118; Cf Micklitz et al. 2009, p. 129. Micklitz even goes further and argues the UCTD provides control for all contract terms that are unfair, and that the differentiation between individually negotiated and pre-formulated terms becomes less relevant. Micklitz et al 2009, p. 139-140.

¹⁹³ Cf Micklitz 2009, p. 139.

¹⁹⁴ The original proposal of Art. 3(1) UCTD contained a second criterion of unfairness that did not become part of the test. It said that a term is unfair if “it causes a performance to be significantly different from what the consumer could legitimately expect”. This provision was to point out that the requirements of good faith is not restricted to the point of contract conclusion. Thomas Wilhelmsson, Social Contract Law and European Integration, Dartmouth, Aldershot, Brookfield, Singapore, Sydney, 1995, p. 149.

enforcement authorities.¹⁹⁵ *Social force majeure* means “social obstacles to performance” obstacles to perform the contract due to changed circumstances like unemployment or illness, which are although not completely unforeseeable, are not attributable to the consumer’s fault. For *social force majeure*, the following cumulative conditions have to be satisfied: 1) the consumer is affected by some special occurrence affecting its family life, health, employment or anything else; 2) there is a causal connection between the occurrence of a special event and the consumers payment difficulties (problems in performance of the contract); 3) the consumer could not foresee the occurrence of the event; 4) the occurrence of the event cannot be attributed to the consumer’s fault.¹⁹⁶ The result may be different. The application of the principle will sometime lead to mitigation of the contract, other times the contract will be rescinded or avoided.¹⁹⁷

Although the concept was developed primarily in the context of financial services and overindebtedness, according to Wilhelmsson the concept might lead in the future to a more open-ended interpretation of the test of fairness, allowing an additional reassessment of the fairness of the contract term at a later point, during performance of the contract, taking into account social values and general consumer welfare.¹⁹⁸

II.4.5. Intermediary conclusions

The test of fairness in the UCTD is limited in several ways. The UCTD foresaw exemptions in favour of mandatory rules, core terms and individually negotiated terms. The thesis showed that the scope of exemptions is not completely determined. Even the scope of the mandatory rules exemption can be questioned. The individually negotiated terms exemption leaves outside its scope the “specially negotiated” terms. It may be uncertain what the “main subject matter is” but the most controversial and practically the most important question is if the core terms exemption relates to all price terms or just the “adequacy of the price”. The existence of exemptions in general, but the price term exemption in particular, significantly lowers the level of protection the UCTD provides.

¹⁹⁵ Thomas Wilhelmsson, 'Social Force Majeure': A New Concept in Nordic Consumer Law, 13 Journal of Consumer Policy 1-14, 1990, p. 3-7.

¹⁹⁶ Wilhelmsson 1990, p.7-8.

¹⁹⁷ Ibid.

¹⁹⁸ This is already the case in Nordic Countries. Thomas Wilhelmsson, Control of Unfair Contract Terms and Social Value: EC and Nordic Approaches, 16(3-4) Journal of Consumer Policy 435-453, 1993, p. 450.

Additionally, the application of the test of fairness is limited in time to the moment of contract conclusion. This means changed circumstances after the contract is concluded cannot be taken into account in assessing fairness. This limit likewise makes the level of protection of the UCTD low.

II.5. The consequence of unfair terms: remedial control

Besides the test of fairness, the UCTD contains rules on what happens with unfair terms in the contract and how to prevent their continued use. Art. 6 UCTD provides for remedial control, remedy available for the consumer after the contract is concluded; Art. 7 UCTD stipulates preventive control, forbidding the future use of unfair terms and comes into play between drafting and conclusion of the contract.¹⁹⁹ In the following lines the thesis briefly explains the control laid down in Art. 6 UCTD (remedial control); while the control in Art. 7 UCTD (preventive control) is subject to a separate and more detailed analysis in Chapter VI.

Art. 6(1) UCTD requires Member State to provide that unfair terms are not binding on the consumer but that the remainder of the contract continues to be valid, if such partial validity is possible. Partial voidity, a nullity of a contract clause is generally possible if the contract is able to continue its existence without the unfair term. However, since the assessment of fairness relates only to ancillary terms of the contract (core terms are exempted under Art. 4(2) UCTD), the contract will most likely be able to keep its existence without the unfair term. Exceptionally, if core terms are not transparent, and therefore are allowed to be assessed for fairness, the unfairness of a core term will most likely render the entire contract void. Therefore, the remedy in Art. 6 UCTD seeks to ensure for consumers is the elimination of the unfair terms from the contract, their annulment.

The EU Commission clarified consumers not only have a right to raise the issue of unfairness during a court procedure, but they must also be free to refuse to honour their obligations under unfair terms before a court adjudicated on the matter at hand.²⁰⁰ However, if the court eventually finds that the term was fair, the business in dispute is

¹⁹⁹ The terminology is taken from The Directive on Unfair Terms, five years later - Evaluation and future perspectives, Clearing of the Market: the Mechanism for Controlling Unfair Terms, Conference organized by the European Commission, 1-3 July 1999. Proceedings from Workshop No. 5 (Workshop No. 5 UCTD Conference), p. 189-190 at DG SANCO: http://ec.europa.eu/consumers/cons_int/safe_shop/unf_cont_terms/event29_02.pdf (10 December 2012)

²⁰⁰ UCTD Implementation Report, p. 19.

entitled to claim damages based on breach of contract. Further, the judgement declaring the term unfair must be effective as of the time of contract conclusion (*ex tunc*).²⁰¹

The first case in which the CJEU addressed the legal consequences of unfairness is *Océano*, where it held, that national courts should rule on unfairness *ex officio*.²⁰² It later confirmed that the national court has not only a power but an *obligation* to declare the term null and void on its own motion.²⁰³ The power of courts is subject to no limitation period,²⁰⁴ to the stage (e.g. annulment of arbitration award)²⁰⁵ or type of the process (not only litigation).²⁰⁶ However, the national court has only a power to eliminate the term from the contract but no power to modify the unfair contract term,²⁰⁷ and cannot annul the entire contract if the conditions for partial nullity are fulfilled even if that would be more advantageous for the consumer.²⁰⁸

Although the CJEU is very generous in interpreting Art. 6(1) UCTD to give as much protection to consumers as possible, the real power in terms of providing fairness for consumers, and a high level of protection lies in Art. 7 UCTD. The importance and the models of preventive control will be discussed in Chapter VI.

II.6. Freedom of contract and the regulation of standard terms

The principle of freedom of contract (autonomy of will, party autonomy) is one of the basic principles of contract law, a fundamental standard of private law in general,²⁰⁹ and is known to all Member State.²¹⁰ Freedom of contract consists of several distinct freedoms. It means the “freedom to enter into a contract, the freedom to select a contractual partner, the freedom of content in respect of the type of performance, quantity, price and conditions; the freedom of form, extending the possibility to conclude binding contracts through mere consensus; and the freedom of amendment,

²⁰¹ Ibid.

²⁰² Para. 22 *Océano*.

²⁰³ Para. 32 *Pannon*.

²⁰⁴ Para. 38 C 472/00 *Cofidis SA v Jean-Louis Fredout*, 21 November 2002, [ECR] 2002 p. I-10875.

²⁰⁵ Para. 39 C-168/05 *Elisa Maria Mostanza Claro v Centrol Movil Milenium*, 26 October 2006, ECR [2006] p. I-10421; Para 52, 59 Case C-40/08, 6 October 2009, *Asturcom Telecomunicaciones SL v Cristina Rodríguez Nogueira* ECR [2009] p. I-09579.

²⁰⁶ Para. 55 Case C-618/10 *Banco Español de Crédito SA v Joaquín Calderón Camino*, 14 June 2012, not reported.

²⁰⁷ Para. 65, 73 *Camino*.

²⁰⁸ Para 24 *Perenicova*.

²⁰⁹ On the history see: Jelena Vilus, *General terms of standard contracts*, *Savremena administracija*, Belgrade, 1976, p. 59-65.

²¹⁰ Commission Communication of 1984, p. 7-9.

embodying a right of the contracting parties, over the duration of the contract, to agree as to how its provisions will be arranged.”²¹¹

Ideally, freedom of contract is exercised without any limits, and the equality of bargaining power between the contracting partners enables the conclusion of a contract that represents a compromise of opposing interests arrived at after negotiations on all points. Then it can be said that parties are in symmetrical and horizontal positions, even though complete equality in bargaining power will rarely exist. A certain difference in power due to the parties’ “natural” inequality might exist, but this difference is legally irrelevant.²¹²

State intervention in form of regulation is justified for public policy reasons, one of which is the protection of a weaker party.²¹³ The question of weaker party arises in asymmetric contract, in contracts where the bargaining position of the parties is hindered.²¹⁴ In tackling the question who a weaker party is, Gellén concludes that a weaker party in asymmetric contracts is a party that is in the weaker bargaining position, and because of that he is unable to represent his interests in process of contract conclusion in the same way as the other contracting party does being in a superior bargaining position.²¹⁵ She continues that who a weaker party is will sometimes be determined by the mere fact of complexity of contractual relations (e.g. in case of standard terms and conditions), other times the subjective characteristics of the weaker party will be taken into account (e.g. usury contracts), and sometimes that mere fact of belonging to a certain group, regardless of subjective characteristics or complexity of the transaction. This is the case with consumers in consumer contracts.²¹⁶ However, she concludes that state intervention for the protection of weaker party should be limited to minimum, and carefully thought of in the light of the theory of private law.²¹⁷ Therefore, consumers are considered weaker parties in contracts, and are entitled for increased protection by regulation.

²¹¹ Jürgen Basedow, Freedom of Contract in the European Union, 16(6) *European Review of Private Law* 901-923, 2008, p. 922.

²¹² Klára Gellén, Protection of weaker party in asymmetrical contractual relations, In: 1(1) *FORVM Acta Juridica et Política, Acta Universitatis Segediensis* 243-254, 2011 p. 244-245.

²¹³ Gellén 2011, p. 244.

²¹⁴ *Ibid.*

²¹⁵ Gellén 2011, p. 246-247.

²¹⁶ Gellén 2011, p. 246. Gellén underlines that the expression “weaker party” in consumer context may not be the most adequate, as consumers are considered as such regardless of their actual subjective characteristics. She is of the opinion that what the practical implication of the intended protection is, protection against the stronger party in the contract (against its potential abuse of power). Gellén 2011, p. 248.

²¹⁷ Gellén 2011, p. 254.

Regulation is especially justified in standard contracts. Standard contracts carry an increased danger of being unfair, because the terms are pre-formulated by the business and because standard contracts are as rule contracts of adhesion, where the consumer accedes to an already prepared text.²¹⁸ The dangerous nature of “standardized mass contracts” was raised by Kessler already in the 1940’s, long before the beginning of consumer movement.²¹⁹ Later in the 1970’s Slawson pointed out standard contracts are undemocratic but represent commercial reality; consequently, most consumer contracts, if not all, are concluded on standard terms of the business.²²⁰ Hence, freedom of contract is in practice a blind acceptance of the terms and conditions offered by the business.²²¹ As a result, contract concluded with the use of standard terms no longer provide for fair and equitable result. The contract will always favour the party that drafted its terms.

The justification of standard terms regulation is put forward by two theories. The theory of transaction or information costs believes the use of standard terms decreases transactions costs, and therefore is overall beneficial for the society. Lower transaction costs enable the drafting party to spread out the cost of drafting, which gives him an opportunity to invest more in making of standard terms. But the more one invests, the more expensive it becomes for the other contracting party to obtain the necessary information for conducting negotiation on the terms in question. Consequently, the party using pre-formulated terms is much better informed about the content of standard terms. This theory is directly linked with information asymmetries.²²² The second theory, the theory of abuse is based on the notion that unfair terms are often used and abused by businesses against weaker parties. Due to (economic, social, psychological and intellectual) superiority of the business, the consumer has no choice but to accept the contract terms. The main idea behind this theory is to protect consumers, and only at a second instance, to eliminate standard terms. Accordingly, the review of validity should encounter the imbalance in power and knowledge between the contracting parties.²²³

²¹⁸ See e.g. Kessler 1943, p. 631-632.

²¹⁹ Friedrich Kessler, *Contracts of Adhesion: Some Thoughts about Freedom of Contract*, 43 *Columbia Law Review* 629-640, 1943, p. 631-632.

²²⁰ David W. Slawson, *Standard Form Contracts and Democratic Control of Lawmaking Power*, 84(3) *Harvard Law Review* 529-566, 1971, p. 529.

²²¹ Vilus 1976, p. 71.

²²² *Consumer Law Compendium*, p. 352; also: Hugh Beale, *Legislative Control of Fairness: The Directive on Unfair Term in Consumer Contracts*, 231-262 In: Jack Beatson, Daniel Friedmann (eds.), *Good Faith and Fault in Contract*, Oxford University Press, Oxford, 1995, p. 232-233.

²²³ *Consumer Law Compendium*, p. 352; Kessler 1943, p. 631-632.

Both theories point on market failures as reasons intervening and regulating standard terms. Market failures can be corrected by market solutions i.e. by raising the level of information of consumers, and protecting competition, or by direct state intervention in form of regulation. Increased competition is directly related to consumer choice, choice in selecting contracting parties that will offer fairer contract terms. The greater the competition is the fairer the terms of the contract are, and competition appears as a means to achieve fair and balanced terms.²²⁴ According to Trebilcock, the consequences of imperfect information are not so severe provided there is an “active margin” of informed, sophisticated and aggressive consumers. These consumers understand the standard terms on the offer, and either negotiates over unfavourable terms or switch to other business, and thereby discipline the entire market, the benefit of which may be used by more marginal consumers.²²⁵ Therefore, competition and information are interrelated, and they both provide for better balanced and fairer contract terms. This leads to a conclusion, that direct intervention into contract law should be exceptional. However, the situation is different when it comes to standard terms.

Hartlief criticizes the (over) protection, i.e. paternalism of consumers advocating the re-establishment of freedom of contract, and the remedy of market failures by market solutions, i.e. by the tools of competition and consumer protection. However, even he admits that intervention against the abuse of standard terms may be justified.²²⁶ According to Trebilcock under certain circumstances like complex transactions, or less competitors on the market intervention may be justified.²²⁷ Wilhelmsson even points out that when it comes to standard terms the links between consumer protection and competition may lead to paradoxical results. Horizontal cooperation between businesses in drawing up standard terms, whether in the form of formal agreements or just recommendations might improve consumer decision making in terms of better comparison of standardized information, but the same cooperation might infringe the rules of competition law, which exactly forbid cooperation.²²⁸ The theory of transaction costs, since it focuses on information asymmetries, primarily suggests the use of market

²²⁴ Thomas Wilhelmsson, Cooperation and Competition Regarding Standard Form Terms in Consumer Contracts, 49 *European Business Law Review* 49-72, 2006, p. 49.

²²⁵ Michael J. Trebilcock, *The Limits of the Freedom of Contract*, Harvard University Press, Cambridge, London, 1997, p. 120.

²²⁶ Ton Hartlief, Freedom and Protection in Contemporary Contract Law, 27 *Journal of Consumer Policy* 253–267, 2004, p. 256 et seq.

²²⁷ Trebilcock 1997, p. 120.

²²⁸ Wilhelmsson 2006, p. 52.

tools for correcting market failures. State intervention in this regard should be limited to laying down mandatory rules that will oblige the business to inform the consumer. The abuse theory on the other hand, focuses on the protection of consumers, inclines towards protectionist approach, and protection may be given by increased state intervention that increases competition but also provides protection against the abuse of standard terms.

The question is, towards which theory the UCTD is more inclined? The question may be justified when the scope of the UCTD is not clear, like in case of non-negotiated but non-standard terms. The information theory would most probably exclude these terms from the scope of the UCTD saying that consumers are informed about them; while the abuse theory would extend the UCTD's protection. An even more important question is the relation between procedural and substantive fairness, the problem pointed out earlier in this Chapter. Namely, if the UCTD is based on the information asymmetries theory this means that consumers are empowered by information, and if the vague requirements of transparency are respected but substantively unfair terms are included into the contract, in case of conflict, procedural fairness may legitimize substantive unfairness. It was said that the UCTD is based on the mixture of the two theories,²²⁹ which practically makes its regulatory strategy unclear.²³⁰ It will be therefore the task of a judge handling the case at hand to decide whether to be more or less protective towards consumers. It seems the CJEU is more found of the abuse theory.²³¹

The research of behavioural economics definitely points towards a more protective approach in regulating standard terms and favouring the abuse theory. Namely, as it was pointed out earlier, the information paradigm of EU consumer policy is strongly based on rational choice theory.²³² It rests on the presumption that information makes possible for a rational consumer to make an informed choice. Accordingly, earlier regulation focused on remedying information asymmetries and provide for information disclosure.²³³ The achievements of information economics were challenged by behavioural economics that pointed out consumers are not rational but are

²²⁹ Rec. 9 UCTD refers both to the need to protect consumers against the abuse of power (as in France), in particular against the unfair exclusion of essential rights in one-sided standard contracts (as in Germany). Consumer Law Compendium, p. 352.

²³⁰ Brawnsword et al. 1996, p. 56.

²³¹ Para. 25 *Oceano*, Para. 25 *Claro*; Cf Para 38 Advocate General Trstenjak *Caja de Ahorros*.

²³² Micklitz 2008, p. 21.

²³³ Imperfect information was a fundamental rationale of consumer protection measures. Iain Ramsay, Framework for Regulation of the Consumer Marketplace, 8 *Journal of Consumer Policy* 353-372, 1985, p. 359.

in fact irrational and biased.²³⁴ Consequently, disclosure obligations do not guarantee that consumers make rational decisions.²³⁵ There is a need for a more interventionist approach in standard form contracts. The questions that remains is which tools to use and how far regulation should go.²³⁶

II.7. Instead of conclusion: the overall regulatory objective of the UCTD - freedom or fairness?

According to Willett, the freedom oriented approach tends to maximise the self interests of the parties, both in relation to the process leading up to the conclusion of the contract (procedural freedom), and in terms of the substance of contract terms (substantive freedom). The fairness oriented approach seeks to balance the parties' interests, and in particular aims to protect the substantive (substantive fairness) and procedural (procedural fairness) interests of the consumer.²³⁷ In other words, the freedom approach allows the parties to exercise their contractual freedom, while the fairness approach limits this freedom to protect consumers against the inclusion of unfair terms into their contracts.

One of the aims the UCTD strives at is a high level of protection. What is a “high level of protection” is an abstract question, but in the context of the present research, it means fair contract terms. Hence, a high level of protection can only be achieved by relying on the fairness approach. The question is, does the UCTD provides for a limited fairness approach (substantive or procedural fairness), or is rather inclined towards a full fairness approach (procedural and substantive fairness)?

It is not completely clear if Art. 3(1) UCTD includes both procedural and substantive fairness, and what their relation is. One general clause, the “significant imbalance” without a doubt aims to ensure substantive fairness. But “good faith” allows for the inclusion of both substantive and procedural fairness. Therefore, a wide interpretation of the basic concept of unfairness includes both substantive and procedural fairness. In a narrower interpretation it most likely points to only substantive fairness (which interpretation seems to be confirmed by the CJEU), or in an extreme

²³⁴ For common behavioural biases see: Faure&Luth 2011, p. 344-345.

²³⁵ Faure&Luth 2011, p. 337.

²³⁶ Faure&Luth suggest as remedy the use of ultra-preventive mechanisms instead of information disclosure. Faure&Luth 2011, p. 352-354.

²³⁷ Willett 2007, p.4

interpretation, only to procedural fairness. Hence, although the intention of the UCTD was probably to provide in the first place substantive fairness, i.e. a high level of protection entails at least some level of substantive fairness, it is uncertain if the language of Art. 3(1) UCTD achieves this aim.

Procedural fairness is further inferred from Art. 5 UCTD that provides for transparency, however, it is disputable what the reach of this provision is. First, it is unclear what the meaning of transparency is. The literary reading points to the language used in written contracts, but placing Art. 5 UCTD in context with Art. 3(1) UCTD and Rec. 20 UCTD transparency seems to mean a genuine chance to understand the terms communicated. The reach of the provision becomes even less clear as understanding is measured towards a reasonably well informed and average consumer, without guidance on how to determine the average and without having special sensitivity towards vulnerable consumers. Second, the relationship between procedural and substantive fairness is not clear. The only place where this relationship is settled is Art. 4(2) UCTD i.e. the core terms exemption, where procedural fairness gets primacy over substantive fairness. Nevertheless, this is an exemption, and should be interpreted restrictively. A more protective reading of the UCTD (primarily Arts. 3(1) and 5 UCTD), and a reading that provides a high level of protection, is that the principle aim of the UCTD was to provide for substantive fairness of contract terms and procedural fairness cannot justify substantive unfairness. This is because information as a regulatory tool has its limits, businesses could communicate substantively unfair terms in a transparent manner, and thereby escape the test of fairness. Nevertheless, the preferred reading is not the only reading. Third, a higher level of protection is provided if procedural unfairness alone is able to make the term unfair, but this function of transparency is not explicitly provided by the UCTD.

The test of fairness is subject to a number of exceptions. Individually negotiated, and mandatory rules are exempted at all times, and core terms if they are transparent. However, in practice it will be often difficult to decide whether a term falls under a particular exemption. The exemptions in general, but the core terms exemption in special lowers the level of protection the UCTD provides.

The test of fairness is not flexible. It is to be applied at the moment of contract conclusion under Art. 4(1) UCTD, and any changed circumstances cannot be taken into account. Hence, the concept of *social force majeure* cannot be included into the scope of the UCTD. This limit significantly lowers the level of protection the UCTD provides.

The UCTD is a result of a compromise between the different contract law traditions and opposing interests of Member States, and as a consequence it has many gaps and faults. Although within the objective of achieving a high level of protection the UCTD probably intended towards the full fairness approach (substantive and procedural fairness) this aim is not followed up. At many instances the UCTD provides only for a limited fairness approach (procedural or substantive fairness) and leaves room for freedom approach.

For a high level of protection and the achievement of the full fairness approach the UCTD should be changed to settle some of its disputes issues. The relationship between procedural and substantive fairness should be settled in a way that primacy of substantive fairness is ensured at all times. Procedural fairness should not be capable of justifying substantive fairness. Nevertheless, procedural unfairness alone should be sufficient to make the contract term unfair. The meaning of procedural fairness should be clarified and the benchmark consumer regulated in a way to show sensitivity towards vulnerable consumers. The test of fairness should not have exemptions. Alternatively, if the exemptions are maintained, they should be clarified in a way to include as little as possible. The test of fairness should be flexible, and applicable at a later point, during performance in order to accommodate changed circumstances. Therefore, for a high level of protection further regulatory intervention is necessary.

CHAPTER III

THE REGIME OF UNFAIR CONTRACT TERMS IN HUNGARY

This Chapter analyzes the regime of unfair contract terms in Hungary. It particularly focuses on the basic concept of unfairness, on the role of transparency, and on the limits of the test of fairness. It aims to see how the UCTD was implemented into the national legal system of Hungary, and to answer the key question whether the Hungarian implementation achieves the protection intended by the UCTD, and where the level of protection provided by the UCTD is not so high, provides its own, higher level of protection.

III. 1. Development of consumer protection law and policy: a brief overview

This sections aims to briefly highlight the main lines of development of consumer law and policy in Hungary and to point on the major changes that are important for the subject matter of the thesis. As consumer law and policy is an area that is under constant development, especially in consumer credit, the thesis will indicate more specific changes at places where the discussion takes place. Bellow, besides the general stapes of development, the thesis also briefly shows the regulation of unfair contract terms before the implementation of the UCTD, and the process of the UCTD's implementation.

Until the 1990's, when the economy shifted from planned to market economy, consumer protection in contemporary meaning, did not exist.²³⁸ In the "economy of shortage" the focus of the state was to provide goods for the basic needs and what was offered was subject to intensive price fixing. Therefore, there was no opportunity to make free and rational choices. Protection to the weaker party in the transaction was provided by traditional civil law institutions principally in the HuCC.²³⁹

The first important step towards consumer protection was the *Act LXXXVI of 1990 on the Prohibition of unfair Market Practices* that was followed by the establishment of the *Hungarian Competition Authority* in 1990, and the *General*

²³⁸ Judit Fazekas, Consumer protection law, Novotni Kiadó a Magánjog Fejlesztéséért, Miskolc, 2003, p. 31.

²³⁹ For more see: Béla Kemenes, The Hungarian Civil Law and the Protection of Consumers, 22(4) Acta Juridica et Politica 3-39, 1975. For a brief overview: Gellén 2011, p. 246.

Inspectorate for Consumer Protection (“Fogyasztóvédelmi Főfelügyelőség”) as a government agency for consumer protection in 1991.²⁴⁰

The creation of a modern system of consumer protection consisting a developed legal regulation and institutional structure started after Hungary signed the *Europe Agreement* in 1991. In bringing in line its laws with the requirements of *consumer acquis*, Hungary generally opted for the partial method of harmonization. This meant amendments to HuCC and other primary laws and the adoption of a large number of secondary legislation, mostly government decrees. In the period of 1991-2004, a total of almost 50 pieces of new or amended legislation were adopted.²⁴¹ One of the most important statutes was the *Act CLV of 1997 on Consumer Protection* (hereinafter: HuCPA), that introduced a number of new contract law rules among which were the rules on consumer credit.²⁴² It also established the *Consumer Arbitration Boards* (“Békéltető Testület”) as an alternative dispute resolution (hereinafter: ADR) body specially designed for solving consumer to business disputes.

After becoming an EU Member State the Government focused on strengthening the governmental institutional framework and the non-governmental sector.²⁴³ From 2006 the principal government organ is the *Ministry of Social Affairs and Labour*.²⁴⁴ In 2007, the *National Consumer Protection Authority* (“Nemzeti Fogyasztóvédelmi Hatóság”) replaced the existing consumer protection agency, having the widest competence for consumer protection save for financial services.²⁴⁵ In 2010, the single supervisory and regulatory authority, the *Financial Supervisory Authority* (“Pénzügyi Szervezetek Állami Felügyelete”, hereinafter: HuFSA), established in 2000, gained significant competences in consumer protection, including enforcement.

Recognizing that strong consumer protection is the basis of a well-working economy, the *Constitution of the Republic of Hungary of 2011 (Art. M)*, among its general principles, declared the support for fair competition and the protection of

²⁴⁰ At that time consumer protection organizations already existed. The National Council of Consumers was established in 1982 that later transferred into the National Association for Consumer Protection (“Országos Fogyasztóvédelmi Egyesület”).

²⁴¹ Judit Fazekas, Gabriella Sós, 10 years of consumer protection harmonization – II. part, 48(6) *Külgazdaság* 77-89, 2004, p. 77.

²⁴² For details: Judit Fazekas, *Consumer protection law*, Complex, Budapest, 2007, p. 43.

²⁴³ New Hungary development program between the European Commission and Hungary 2007-2013. National Development Agency at: http://www.nfu.hu/uj_magyarország_fejlesztési_terv_2 (12 December 2012).

²⁴⁴ Act LV of 2006 on the Listing of the Ministries of the Republic of Hungary.

²⁴⁵ Arts. 1&7 of Government Decree 225/2007 on National Consumer Protection Authority and Government Decree on the amendments of government decrees in line with establishment of the National Consumer Protection Authority.

consumers' rights. Currently, the Government strategy is to strengthen the institutional framework of consumer protection, and to improve the enforcement of consumer rights, especially collective and preventive enforcement.²⁴⁶ From the latest developments the most notable are the adopted the nHuCC, and the integration of the HuFSA into the *Hungarian National Bank* ("Magyar Nemzeti Bank", hereinafter: HuNB).

It seems the Hungarian consumer protection law and policy underwent an evolution rather than revolution.²⁴⁷ The legal and institutional framework developed gradually, and was changed over time. Second, more importantly, the policy went in a direction of separating consumer protection in the area of financial services from other areas. Finally, consumer protection becomes increasingly important, and the focus shifted from providing substantive rights to improving their enforcement.

III.1.1. The control of unfair terms before implementation of consumer acquis

At the time of its adoption the HuCC did not contain any provision on unfair contract terms. Although the *Decree Law 11 of 1960 on the entering into force and enforcement of the HuCC* empowered the Government to determine the contract terms presumed to be unfair in consumer contracts, the predecessor of regulating unfair terms was only the *Act IV of 1977 on the amendments to the HuCC* that inserted Art. 209.²⁴⁸ Art. 209 HuCC introduced two new legal categories. The notion of standard terms ("általános szerződési feltétel") and one-sided unjustified advantage ("indokolatlan egyoldalú előny"), failing to determine their meaning.²⁴⁹ According to the *Explanatory memorandum to Act IV of 1977* what is considered to be a one-sided advantage is left to the court to determine. However, it clarifies, the institution of one-sided unjustified advantage is different from the existing civil law institutions of *laesio enormis* and usury, as it can be a valid ground for annulment even if the contract term results in a lower level of infringement than the above two existing institutions.²⁵⁰ Regarding

²⁴⁶ IV Mind-Term Consumer Policy Strategy for the period of 2011-2014.

²⁴⁷ For details see: Judit Fazekas, Past, present and future of consumer protection in light of the Consumer protection act 13-35 In: Consumer protection codex, Közgazdasági és jogi könyvkiadó, Budapest, 1998, p. 15-35; Fazekas 2006, p. 128-149; Anita Németh, Introduction to consumer protection, 13-35 In: Contract law – consumer protection, hvgorac, Budapest, 2000, p. 25-34.

²⁴⁸ The HuCC in this initial phase of regulation was not familiar with the notion of fairness. The HuCC refers to fairness only after implementing the UCTD in 1997.

²⁴⁹ Judit Fazekas, The new European directive on unfair contract terms and the Hungarian law, 47(11) Magyar jog 660-668, 1995, p. 664.

²⁵⁰ Pt. 4 Explanatory Memorandum to Act IV of 1977.

standard terms, Art. 209 HuCC was completed with Opinion 37 of the Economic Council of Supreme Court (hereinafter: Opinion 37 HuSC), where it developed special benchmarks for the incorporation of standard terms into the contract. Standard terms can become part of the contract only if the non-drafting party knew or had an opportunity to get familiar with their content and later explicitly or impliedly accepted them. In determining whether there was an acceptance the courts have to look at the generally accepted customs in the given legal branch. The opinion also introduced the *contra proferentem* rule of interpretation. The problem with the opinion was, that it was not a source of law, and its application depended on the judge handling the instant case.²⁵¹

Art. 209 HuCC also contained provisions on enforcement. Standing to sue was given to the injured party under the rules of relative nullity (Art. 209(3) HuCC); and also to state or other social entity, the judgement having *erga omnes* effect (Art. 209(1) HuCC).²⁵² Hence, the HuCC at this early stage provided for a possibility of collective actions.²⁵³

Besides the HuCC, *Act LXXXVI of 1990 on the Prohibition of Unfair Market Practices* dealt with contract terms providing unfair advantage from a competition law point of view, within the context of prohibiting the abuse of dominant position. Art. 20 banned clauses that result in unilateral and unjustified advantage.²⁵⁴

III.2. The implementation of the UCTD

The UCTD was transposed by *Act CXLIX of 1997 on Amendments to the HuCC* that considerably reformed the unfair contract terms regulation. For the first time the HuCC was familiar with the notion of unfair contract terms (Art. 209/B HuCC). The provision went further than the UCTD and listed examples when the term will cause significant imbalance in the parties' rights and obligations to the detriment of the consumer (Art. 209/B(2) HuCC), i.e. if it departs from the default rule of the law, or if it is incompatible with the object or the aim of the contract (Art. 209/B(2) HuCC). Moreover, based on the Opinion No. 37 HuSC the rules on incorporation of standard terms got inserted into Art. 205 HuCC; and the *contra proferentem* rule in Art. 207 HuCC. Finally, it defined standard terms and conditions (Art. 209/C HuCC), and

²⁵¹ Fazekas 1995, p. 665.

²⁵² The *erga omnes* effect was not unanimously accepted. See László Németh, Standard terms and conditions and lessons from disputes on annulment of unfair contract terms, 16(11) *Gazdaság és Jog* 15-23, 2008, p. 18.

²⁵³ Fazekas 1995, p. 665.

²⁵⁴ See for more: Fazekas 1995, p. 666.

extended the scope of the HuCC to all consumer contracts allowing (only in consumer contracts) to challenge even non standard unfair terms (Art. 209/A HuCC). The drawback of the implementation was that the new provision provided only for relative nullity (Art. 209(1)&(2) HuCC) the judgement having *inter partes* (Art. 209(3) HuCC) as opposed to the earlier *erga omnes* effect. Relative nullity also meant courts lacked *ex officio* powers to review contract terms.²⁵⁵ Finally, the *Government Decree 18/1999 on Unfair Terms in Consumer Contracts* was adopted (hereinafter: HuUCT Decree), containing the “black” and the “grey” list of unfair contract terms.

Academics were not satisfied with the initial implementation of the UCTD.²⁵⁶ The HuCC departed from the UCTD in two significant aspects. It provided protection to all persons, legal and natural, and instead of absolute nullity (null and void) provided for relative nullity (voidable). To make the situation even more confusing, the HuUCT Decree provided for relative nullity of “grey” listed terms and for absolute nullity of “black” listed terms. Therefore, the HuCC was in conflict with Art. 6(1) UCTD but the HuUCT Decree was in conflict with the HuCC. Despite critics, changes were initiated by *Ynos Kft v János Varga*²⁵⁷ where the national court in effect asked the CJEU if Art. 209(1) HuCC is compatible with Art. 6(1) UCTD.²⁵⁸ This case raised the potentially serious faults in implementation, and initiated further amendments to the HuCC.

Due to the above mistakes in implementation and the need to accommodate the case law of the CJEU²⁵⁹ the HuCC was amended with *Act III of 2006 on Amendments to the HuCC*. These amendments kept the rules on the incorporation of standard terms and conditions (Art. 205/B HuCC), on the definition of standard terms (Art. 205/A(1) HuCC) and the rule on shifting the burden of proof (Art. 205/A(2) HuCC). Art. 209 HuCC was considerably changed, now titled: “*Unfairness of contract terms.*” Individually negotiated terms become exempted from the test.²⁶⁰ The principle of good faith instead of “honesty” now it reads “good faith and honesty” (Art. 209/B HuCC).

²⁵⁵ BH 2002.105.

²⁵⁶ E.g. Lajos Vékás, Suggestion for correction of the regulation of standard contract terms in the Civil Code, 55(12) *Jogtudományi Közlöny* 485-492, 2000; László Kovács, Difficulties in Harmonizing Civil Law, 57(7) *Magyar Jog* 425-433, 2005.

²⁵⁷ C-302/04 *Ynos Kft. v János Varga*, 10 January 2006, ECR [2006] p. I-00371.

²⁵⁸ Even though the questions referred on their face related to the interpretation of the UCTD, in fact the questions were if the Art. 209(1) and Art. 239 HuCC were compatible with the UCTD. Lajos Vékás, *The Challenge of §209 of the Civil Code in front of the European Court of Justice*, 4(6) *Európai Jog* 8-11, 2004, p. 9.

²⁵⁹ Judit Fazekas, Development of Hungarian Consumer Protection Law, 331-348, In: *The Transformation of the Hungarian Legal Order 1985-2005*, András Jakab, Péter Takáts, Allan F. Tatham (eds.), Kluwer Law International, 2007, ft. 73&74 (Fazekas 2007a).

²⁶⁰ For reasons see: Sec. II Pt. 4 Explanatory Memorandum to Act III of 2006.

Referral to transparency in the new Art. 209(4) HuCC was completely abolished. Art. 209(5) HuCC inserted the mandatory rule exception (without connecting the provision to transparency).²⁶¹ The most important, positive change was the correct implementation of Art. 6(1) UCTD. Voidability is kept as a general rule (Art. 209/A(1) HuCC), but a special regime of nullity is introduced for consumer contracts (Art. 209/A(2)HuCC). Nullity can be invoked only in the interest of a consumer.²⁶² In individual actions the judgement has *inter partes* effect, but the legal consequence of public interest action (*actio populi*) in Art. 209/B(1) HuCC is wider, influencing all contracts concluded with the annulled contract term (*quasi erga omnes* effect). The 2006 amendments also changed the system of control of unfair terms, introducing preventive control mechanism into Art. 209/B(2) HuCC. The HuUCT Decree was also amended in 2006.²⁶³ Now the HuUCT Decree only lists the “black” or “grey” listed terms without attribution of any legal consequence.

The 2006 amendments brought significant changes. However, as a result of the reform, the principle of transparency from Art. 5 UCTD and Art. 4(2) UCTD was completely exempted from the scope of the HuCC. This required the final amendment of Art. 209(4) HuCC and Art. 209(5) HuCC, by *Act XXXI of 2009*.²⁶⁴

It can be concluded that the transposition of the UCTD was a gradual process. In the following, the thesis focuses on the current regime of unfair terms in Hungary. In particular, on the basic concept of unfairness, on the role of transparency and on the limits of the test of fairness. This Chapter also indicates the changes the nHuCC will introduce, but the nHuCC will be subject of a somewhat more detailed discussion in Chapter VII.

III. 3. The basic concept of unfairness in Hungary

The basic concept of unfairness or the test of fairness is laid down in Art. 209(1) HuCC that reads:

„A standard contract term, or an individually non-negotiated contract term in consumer contracts, shall be regarded unfair if, contrary to the requirement of good faith, unilaterally and without justification causes a significant imbalance in the parties’ rights

²⁶¹ For reasons see: Comments to Art. 5 Act III of 2006 in Explanatory Memorandum to Act III of 2006.

²⁶² In Hungary legal doctrine this type of nullity, when the nullity can be invoked only in the favour of one contracting party, is called relative or one sided nullity. Vékás 2004 p. 8-11, Fazekas 2007a, p. 339

²⁶³ Government Decree 2/2006 on amendments of government decrees for consumer protection harmonization.

²⁶⁴ Act XXXI. of 2009 on Amendments to the Civil Code, and the Decree No. 11 of 1960 on Entering Into Force of the Civil Code and on Modifications of Other Related Acts.

and obligations arising under the contract, to the detriment of the contracting party that did not draft the term.”²⁶⁵

At first sight it can be noticed that the Hungarian legislator did not make substantial changes to the test of fairness in Art. 3(1) UCTD. Therefore, the same questions arise as regarding the UCTD, i.e. what the relation is between “good faith” and “significant imbalance” and if the test of fairness deals with both substantive and procedural fairness.

III.3.1. The principle of good faith

As Hungary belongs to the family of continental legal systems, good faith is an overarching principle of its contract law, and the entire HuCC. The “principle of good faith and honesty” (“jóhiszeműség és tisztesség elve”)²⁶⁶ is incorporated into Art. 4(1) HuCC, according to which, in exercising their civil law rights and obligations the parties must act in accordance with the principle of good faith and mutually cooperate. The formulation of Art. 4(1) HuCC resulted in departure of academia into two streams. One group of authors argues the provision incorporates one general clause, the mutual cooperation being part of good faith.²⁶⁷ The other group is of the opinion the provision sets two requirements, i.e. the principle of good faith and the obligation to mutually cooperate.²⁶⁸ The thesis is inclined towards the first opinion, and accepts the standpoints of the authors discussed below.

Vékás follows the first opinion, and states that private autonomy in contractual relations gets its final shape with the principle of good faith which obliges the parties to act in accordance with ethics, respecting the other contractual party and mutually cooperate.²⁶⁹ Földi emphasizes that it is one general clause, the obligation to mutually

²⁶⁵ Reading together Art. 6:102 nHuCC (unfair contract terms) and Art. 6:103 nHuCC (unfair contract terms in consumer contracts) it can be noticed the test of fairness remains unchanged in the nHuCC.

²⁶⁶ Alternatively, as translated by Fazekas, “good faith and fairness.” Fazekas 2007a p. 339. The thesis further refers to the principle of good faith in line with the terminology of the UCTD.

²⁶⁷ Lajos Vékás, Commentary on Art. 4 HuCC In: Commentary on the Civil Code, Vol. 1, KJK-kerszöv, Budapest, 2004, p. 34; Földi 2001, p. 92-94.

²⁶⁸ See Commentary on Art. 4(1) in Commentary on Art. 4(1) in Commentary on HuCC, CompLex Library (CompLex Jogtár) (hereinafter: Commentary on HuCC); Petrik is even of the opinion that there are three separate criteria: good faith, honesty and mutual cooperation. Civil Law, Commentary for practice, Ferenc Petrik (ed.), Budapest, 1997, p. 16. For critics see: Földi 2001, p. 93; Bíró asserts the general principle of mutual corporation in Art. 4(1) HuCC leads to development of special contract law principles like the principle of contractual autonomy, the principle of contracts with mutual rights and obligations, *pacta sunt servanda* and *clausula rebus sic stantibus*. György Bíró, Common rules of the law of obligations and law of contracts, Novotni Alapítvány a Magánjog Fejlesztéséért, Miskolc, 2000, p. 229-230.

²⁶⁹ Vékás, Commentary on Art. 4, 2004, p. 34.

cooperate being the main content of the principle of good faith.²⁷⁰ Regarding the content of mutual cooperation, Vékás is of the opinion that it means paying attention, being considerate of the other party. This in the first place means communication between the parties, the obligation to inform when information obligation is not laid down explicitly by the law.²⁷¹ According to Földi, in one notable decision, the Supreme Court did not consider the obligation to inform part of the performance, but rather as a base for correct and ethical contractual relations.²⁷² The principle of good faith and the obligation for mutual cooperation cannot work in practice without a certain level of trust. The principle of good faith is thereby closely linked to mutual trust between the parties.²⁷³

Further, it is important to emphasize that the principle of good faith is an objective principle, as a standard of honest and conscious behaviour, as opposed to subjective good faith, a belief that a certain behaviour does not infringe others rights, generally accepted in property law.²⁷⁴ Although the dual perception of this principle is not without a doubt, this differentiation is important for understanding the principle of good faith as an objective standard of behaviour.²⁷⁵ Under the influence of objective conception of *bona fides* this principle is accepted in the HuCC as the principle of good faith and honesty (“*jóhiszeműség és tisztesség elve*”). Good faith and honesty together mean the objective good faith, like *Treu und Glauben* in German private law.²⁷⁶ The Supreme Court confirmed the good faith is an objective contractual category, as is based on generally accepted ethical behaviour in contractual relations.²⁷⁷

Finally, Vékás notices that the principle of good faith overlaps with the separately incorporated principle, principle of acting in accordance with what is reasonably expected under the circumstances incorporated within the same provision (Art. 4(4) HuCC).²⁷⁸ Other limits of the principle can be found in the principle of party autonomy and legally protected business interests.²⁷⁹

²⁷⁰ Földi 2001, p. 106.

²⁷¹ Vékás, Commentary on Art. 4, 2004, p. 36.

²⁷² BH 1996.364 analysed in Földi 2001, p. 94.

²⁷³ Földi 2001, p. 106.

²⁷⁴ Vékás, Commentary on Art. 4, 2004, p. 35.

²⁷⁵ Földi 2007, p. 143.

²⁷⁶ The requirement of good faith and honesty (“*jóhiszeműség és tisztesség követelménye*”) was incorporated into the HuCC by the Act XIV of 1991, and it was accepted as terminus technicus by the Act III of 2006. Földi 2007, p. 124.

²⁷⁷ Pt. 3 Opinion 2/2011 of the Civil Chamber of the HuSC on certain questions regarding the nullity of consumer contracts (hereinafter: Opinion 2/2011 HuSC). Földi 2001, p.105-106. Confirmed by BDT 2007.1550.

²⁷⁸ Vékás criticizes the existence of the two largely overlapping general principles, and advocates the principle of good faith should be kept on the level of a general clause, and the obligation to act in

Placing the above discussion in the context of procedural and substantive fairness, it can be concluded that both authors seem to be inclined towards interpreting the principle of good faith as procedural fairness, as information and communication obligations of the parties. However, as the authors emphasize good faith is an ethical behaviour in general in accordance with what would any party reasonably expect under the contract this could arguably imply both procedural and substantive fairness. Additionally, as it will be shown below, the principle of good faith is actually given a substantive meaning within the test of fairness. It should also be noted that Art. 1:3 nHuCC separates the principle of good faith from a duty to mutually cooperate, that arguably point even more towards undoubtedly giving the principle both the meaning of procedural and substantive fairness.

III.3.2. Significant imbalance in the parties' rights and obligations

Kiss and Sándor identify two criteria for a contract term to cause a significant imbalance: it has to deviate from a default provision of the applicable law; and it must not be compatible with the object or aim of the contract.²⁸⁰ The Supreme Court confirmed that in deciding whether a contract term is unfair, courts have to take into account the default rules because these rules are in place to provide for a contractual balance. Therefore, deviation from default rules is an indication of unfairness. It continued that if the contractual rights and obligations of the parties are determined in a way to endanger the contractual aim to be achieved, this was also an indication of unfairness (Pt. 3 Opinion 2/2011 HuSC).

Takáts advocated long before the implementation of the UCTD that in order to decide whether the balance is hindered the entire contract; all the provisions of the contract should be taken into account, their relation with each other and with other contracts between the parties. What should be strived at is the contractual balance between the parties' rights and obligations. This requirement is today expressly laid down in Art. 209(2) HuCC.²⁸¹

accordance with reasonable expectation incorporated into specific provisions. Vékás, Commentary on Art. 4, 2004, p. 35; Földi disagrees. Földi 2001, p. 103. In the nHuCC the principles are separated. The principle of good faith is incorporated into Art. 1:3 nHuCC, and the principle of acting according to reasonable expectations in Art.1:4 nHuCC.

²⁷⁹ Vékás, Commentary on Art. 4, 2004, p. 36-37,

²⁸⁰ Gábor Kiss, István Sándor, Nullity of contracts, Hvgorac, Budapest, 2008, p. 147

²⁸¹ Péter Takáts, Standard contracts, Akadémia Kiadó, Budapest, 1987, p. 136-141.

Therefore, it seems that a contract term causes significant imbalance if it deviates from default rule of the law, if this deviation is contrary to the aim or object of the contract, and if there are no other favourable terms in the contract that would “cure” the contractual imbalance. However, the problem is when there are no default rules, or when these default rules are not precise, like in case of the price. The thesis now turns to the institutions of *laesio enormis* and *usury* to see if these institutions clarify what significant imbalance means.

If there is gross disparity in the contractual rights and obligations of the parties (“feltúnó értéklülönbség”) at the moment of contract conclusion, without an intention to make a gift, the damaged party can avoid the contract (Art. 201(2) HuCC). Interpreting this provision, the Supreme Court developed three cumulative conditions for a successful challenge²⁸²: 1) the difference in the value of contractual rights and obligations of the parties raising up to or above the level sufficient to determine obviously gross disparity; 2) the obviously gross disparity has to exist at the moment of contract conclusion; 3) the claim based on this ground is only possible if the injured party did not intend to make a gift.²⁸³

Since the HuCC is silent on what gross disparity is, it is left for the courts to give guidance. According to the Supreme Court courts should primarily look at the difference in the market value of the contractual obligations. However, the gross disparity in the market value will not in itself be a sufficient for annulment, but courts have to take into account the content of the entire contract, its relation with other contracts between the parties, the process of contract conclusion, especially the method of price valuation,²⁸⁴ and any special interests the parties had in concluding the contract leading to agree on a higher than market value price (affectionate price).²⁸⁵ Therefore, an isolated comparison of the two core obligations of the parties will normally not be sufficient.

Laesio enormis, as a rule for determining just price, originates from Roman law *laesio ultra dimidium* in Codex Justinianus. However, in Roman law, it was not a general contract law rule, but had a narrow application. The institution empowered the seller to rescind the contract and ask for restitution if the purchase price of a land did not

²⁸² Opinion 267 of the Civil Committee of the HuSC on determining gross disparity and rules for determining the counter obligation in Commentary on Art. 201 HuCC in Commentary on HuCC.

²⁸³ Commentary on Art. 202(2) in Commentary on HuCC confirmed by BH 2004.149.

²⁸⁴ In a contract for work, the price of the work is determined based on the value of the result of the work, and not the hours of work invested (EBH 2002. 643). In case of a sale of security, the final price should be taken into account, and the daily price related to the accrued interest not (EBH 2003. 870).

²⁸⁵ E.g. the price is reached at an auction. BH 2002.146.

reach the value of the land (*iustum rei pretium*). The buyer however had an option to maintain the contract by offering to supplement the purchase price equal to the real value of the land, the just price (*iusto pretio*).²⁸⁶ In the Middle Ages (starting from glossators, XI. Century) the requirement for just price was not questioned.²⁸⁷ The only problem was how to determine it.²⁸⁸ In deciding how much to tolerate in difference in the value between the parties contractual rights and obligations, the glossators accepted the Roman law rule of *laesio ultra dimidium* (laesio above half), the rule they called *laesio enormis*.²⁸⁹ During the Middle Ages *laesio enormis* was heavily debated. For example it was questioned when can the buyer rely on the rule. One view was that the buyer can rescind the contract if he paid more than double the price. However, as this entirely mathematical method could result in unjust results, a more acceptable solution for glossators and commentators was that the buyer can rescind the contract if he paid a full price and a half price.²⁹⁰ Nevertheless, the rule of laesio above half was not always respected. The strict mathematical formula was subject to harsh critiques.²⁹¹ Searching for more flexible options, legislators took other parameters as measures of *laesio enormis* (e.g. 2/3, 5/12). An even more flexible approach emerged in theory that a just price is between the highest and lowest market price.²⁹² Consequently, *laesio enormis* can determine by either applying a mathematical formula or a legal standard. The mathematical formula makes the method transparent, but it lacks flexibility and it difficult to apply on long term contracts. A legal standard may not be as certain and transparent as the mathematical formula but is flexible and allows the court to take into account all the circumstances of a particular case.²⁹³ Manyhárd points out that it is unusual in modern contracts to follow the Roman law and take into account only the mathematical value of the contractual rights and obligations of the parties.²⁹⁴ Consequently, the Hungarian legislator left the institution flexible, opting for legal standard. Having a look at court practice, Menyhárd asserts, under a disparity of 25% the

²⁸⁶ See for more: Magdolna Szűcs, Just price (*iustum pretium*) and its application throughout the history, (120) *Zbornik Matice srpske za društvene nauke* 212-218, 2006, p. 199-225.

²⁸⁷ Reinhard Zimmermann, *The Law of Obligations: Roman Foundations of the Civilian Tradition*, Oxford University Press, Oxford, 1996, p. 266.

²⁸⁸ See: Atilla Menyhárd, *Immoral contracts*, Gondolat, Budapest, 2004, p. 56-62.

²⁸⁹ Zimmermann 1996, p. 259.

²⁹⁰ Zimmermann 1996, p. 263.

²⁹¹ Zimmermann 1996, p. 267.

²⁹² See for details: Zimmermann 1996, p. 264-267.

²⁹³ József Szalma, *Law of Obligations – general part, main principles, contracts and delicts*, Faculty of Law, Novi Sad, 2009, p. 370-372.

²⁹⁴ Menyhárd 2004, ft. 643.

courts generally do not invalidate the contract; from a difference of 30% the disparity is treated usually striking; in exceptional cases the disparity is striking only above 50% difference.²⁹⁵

The contract can be annulled only if the injured party did not intend to make a gift. This is an exception from the rule that inner reservations, i.e. motives or intention of the parties do not play a role in contract validity (Art. 207(4) HuCC). Courts extended the interpretation of an intention to make a gift to an intention to agree on the disparity.²⁹⁶ Hence, even if there is a disparity, the contract can only be annulled if the damaged party did not intend to agree to the disparity. The problem further is that consent to deviate from the contractual balance does not have to be given explicitly, but implied conduct is sufficient.²⁹⁷ In BH 2011.343 the court ruled that if the injured party knew or must have known the disparity at the moment of contract conclusion, it will be assumed the injured party accepted the difference in value, and is thereby not entitled to avoid the contract.

Finally, the objective gross disparity presumes the existence of a subjective element.²⁹⁸ The presumption is rebuttable, according to the general rules on the burden of proof.²⁹⁹ Hence, the consumer has to prove that he did not agree to the deviation from the contractual balance. The nHuCC adopted the wording of *laesio enormis* from Art. 201(2) HuCC but extended it with a subjective element. The institution is not applicable if the consumer was supposed to be aware of the gross disparity at the time of contract conclusion, or if he accepted the associated risk (Art. 6:79 nHuCC).

Turning now to usury contracts, if at the moment of contract conclusion, one contracting party abuses the other parties' situation and gains a manifestly disproportionate advantage ("feltűnően aránytalan előny") the contract will be usury (Art. 202 HuCC).³⁰⁰ Therefore, in order for one contract to be usury an objective, i.e. manifestly disproportionate advantage and a subjective, intention to abuse the other contracting parties' situation, have to be satisfied cumulatively.³⁰¹ Tajti asserts, case law points to three necessary elements: 1) unusually disproportionate benefits for one of the

²⁹⁵ Attila Menyhárd, Excessive benefit and unfair advantage in contracts, 37 Zbornik radova Pravnog fakulteta Univerziteta u Novom Sadu 299-314, 2003, ft 24. See also BH 1999.176 where the court found the 28% percent interest rate is not extortionate. See also Petrik 1997, p. 24.

²⁹⁶ Menyhárd 2003, p. 308; Cf BH 2011.343.

²⁹⁷ Commentary on Art. 201(1) HuCC in Commentary on HuCC.

²⁹⁸ Menyhárd 2004, ft. 645.

²⁹⁹ Commentary on Art. 201(1) HuCC in Commentary on HuCC.

³⁰⁰ Art. 6:79 nHuCC incorporates the institution with the exact wording.

³⁰¹ BDT 2003. 891.

contracting parties (the objective element); 2) significantly weaker bargaining position of one of the parties (the subjective element); and 3) earning of the disproportionate benefits by exploiting the weaker contracting party (the causal element).³⁰²

Regarding the objective element, similarly to the institution of *laesio enormis*, the legislator left a degree of flexibility. Since the HuCC uses a different language in the two provisions, *laesio enormis* means *gross disparity* while usury means *manifestly disproportionate advantage*, the difference leads to a conclusion that the two provisions have different regimes. In other words, the threshold of inequality is not the same. Manifestly disproportionate advantage could mean a significant advantage of any type, and should not be necessarily connected to the balance between the main contractual rights and obligations of the parties, like *laesio enormis*.³⁰³ Manifestly disproportionate advantage basically requires a comparison between the two contractual obligations in relation to what is accepted as a commercial practice and trade custom.³⁰⁴ However, in practice courts equal the objective element with the standard applied in *laesio enormis* relying on guidance given by the Supreme Court.³⁰⁵ Therefore, the difference in the objective element between the two institutions remains theoretical.³⁰⁶ Practice made usury contracts a special case of *laesio enormis*, to which a significant subjective element is added.³⁰⁷ The consequences of the narrower interpretation of the objective element could be softened if courts take into account all the circumstances of the case, and all the provisions of the contract, especially those that relate to the allocation of risk between the parties. This approach is especially justified in complex contracts.³⁰⁸ It is also important to point out that the injury does not actually have to happen in practice. It is sufficient if the contractual balance is hindered without having to produce consequences in practice.³⁰⁹

³⁰² Tajti 2010, p. 319.

³⁰³ Edit Vízkeleti, Practical problems of establishing usury, Jogi Fórum Publikáció 1-12, 2012, p. 3 at Jogi Fórum:

[http://www.jogiforum.hu/files/publikaciok/vizkeleti_edit_az_uzsora_megallapitasanak_gyakorlati_prob_emailjogi_forum\].pdf](http://www.jogiforum.hu/files/publikaciok/vizkeleti_edit_az_uzsora_megallapitasanak_gyakorlati_prob_emailjogi_forum].pdf) (29 June 2013). Cf Manyárd 2004, p. 234.

³⁰⁴ Kiss&Sándor 2008, p. 119.

³⁰⁵ Opinion 267 HuSC in Vízkeleti 2012, p. 2; also BDT2003. 891.

³⁰⁶ Manyárd 2003, p. 304.

³⁰⁷ Manyárd 2003, p. 309.

³⁰⁸ Manyárd 2004, p. 235-236.

³⁰⁹ Manyárd 2004, p. 236.

The other crucial element of usury contracts is subjective, the abuse the grave situation of the other contracting party, more accurately, the *intention to abuse*.³¹⁰ Here too, the legislator left wide direction to courts.³¹¹ Based on the case law, it can be determined, grave situation means any situation that “forces” the contracting party to accept the terms of the contract he would otherwise not accept. It may be financial hardship, but also any problem connected to family or health.³¹² The financial hardship does not have to go as far as resulting in inability to provide for essential needs of the household.³¹³ The subjective element pre-supposes knowledge of the grave material situation and the conclusion of the contract in lieu of this information.³¹⁴ Since knowledge is very difficult to prove, courts tend to focus on the grave situation of the party, as it is easier to determine and prove.³¹⁵ The requirement for grave situation will not exist if the injured party agreed to a disproportionately high interest rate in order to invest in a very lucrative business that later does not realize.³¹⁶

The concept of significant imbalance was introduced in 1977, with the initial incorporation of the regulation of standard contract terms. Formulated as *one-sided unjustified advantage*, it represented a completely new legal category.³¹⁷ Since there was no court practice neither theoretical base for determining what the content of the legal category was, according to Pt. 4 *Explanatory Memorandum to Act IV of 1977* what is considered to be a one-sided advantage is left to the court to determine. However, it clarifies, that one-sided unjustified advantage is different from the existing civil law institutions of *laesio enormis* or *usury contracts* as it can be a valid ground for

³¹⁰ Commentary on Art. 202 HuCC in Commentary on HuCC. If the intention of the creditor is not to abuse the situation of the debtor, but to realize its rights, the contract will not be usury. BDT2011. 2484. If a bank grants a credit to in anticipation of the business that the loan will save its operations, but the anticipation does not realize, the subjective element lacks, and the contract will not be usury. BDT 2008.1832. Cf. BH 1998.275.

³¹¹ István Sándor, Nullity of option to purchase agreements, 91-113 In: XV. Polgári Jogot Oktatók Országos Találkozásának Konferencia-kötete, Novotni Alapítvány, Miskolc, 2010, p. 100. See this paper for case law on usurious securities: p. 101-104.

³¹² Court of Appeal of Győr Pf. I. 20.025/2005/22. in Gellén 2012, p. 251.

³¹³ County Court of Kaposvár Bf. I. 501/1971. in Vízkeleti 2012, p. 17.

³¹⁴ Pf.IV.21.580/1996 in Vízkeleti 2012, p. 7.

³¹⁵ Klára Gellén, Contract concluded with the abuse of the others' situation from the Civil Law Codification proposal until today, XV. Polgári Jogot Oktatók Országos Találkozásának Konferencia-kötete. Miskolc, Novotni Alapítvány, 2010, p. 6; Gellén 2012, p. 251. For exemption see: BH 1998.275.

³¹⁶ Commentary on Art. 202 HuCC in Commentary on HuCC. For example in BH 1999.176 the Supreme Court found that a purchase of a kettle was not an economic duress but a rational business decision and therefore the subjective element of usury was not fulfilled. The claimant was supposed to know the profitability of farming, and the potential risks such investment carries, and had to take responsibility for the risk taken.

³¹⁷ The terminology “egyoldalú indokolatlan előny” or one-sided unjustified advantage is kept in the present version of the HuCC. However, for the aim of consistency with the UCTD, the terminological construction of “significant imbalance in the parties’ rights and obligations” is used in the thesis.

annulment even if the term results in a lower level of infringement. Based on the above analysis, other significant difference between significant imbalance and the two traditional institutions is in the subjective element. In the test of fairness, the fairness of a contract term is not influenced by the intention of the business. Moreover, as ruled in BDT 2011.2502, the business does not even have to be aware that the term it incorporated into the contract is unfair, its previous business practice and whether the unfair term was actually used are also irrelevant. The mere possibility of a contract term to place the consumer in a disadvantaged position, taken objectively, is sufficient.

Therefore, it seems that significant imbalance exists when a contract term taken objectively deviates from default rule of the law, and if this deviation is contrary to the aim or object of the contract, and when there are no other terms in the contract that would re-establish this imbalance. When the default rules are not precise significant imbalance seem to be less than gross disparity in (the market value of) the parties' rights and obligations.

III.3.3. The relation between good faith and significant imbalance

Besides Art. 4(1) HuCC, good faith is specially mentioned in Art. 209(1) HuCC. This special insertion is interpreted as meaning that the HuCC in this particular context aimed to clarify what good faith means, and states that a contract term is contrary to the principle of good faith, if it causes a significant imbalance in the parties' rights and obligations, unilaterally and without justification.³¹⁸ Therefore, the content of the principle of good faith is the significant imbalance in the parties' rights and obligations. This is one of the cases when the HuCC aims to establish a balance in the contractual rights and obligations of the parties. If the contractual balance, provided by default rules of the HuCC, is significantly hindered, the legislator will intervene, and allow the contract term to be annulled for being unfair.³¹⁹

This standpoint was confirmed by the Municipal Court of Szeged in 1999, according to which, good faith as a general clause in Art. 209(1) HuCC has two components. On the one hand, the contracting party that drafted the term infringed the requirements of good faith (subjective side);³²⁰ on the other hand, because the

³¹⁸ Commentary on Art. 209(1) HuCC in Commentary on HuCC.

³¹⁹ Ibid.

³²⁰ It must be noticed, the court refers to good faith, as a subjective element, the feeling of acting fairly and honestly, whereas the principle of good faith in Art. 209 is objective. Later, the Appellate Court of Szeged

requirement of good faith is not respected the contractual term places the other contracting party in a significantly disadvantaged position, which consequently hinders the balance in the contractual rights and obligations of the parties, and an imbalance occurs (objective side). The court goes further and clarifies that the imbalance does not exist between the right of one party and the obligation of the other, the essence of imbalance is not in the difference in price, in the value of the parties obligations, but it is connected to a contractual balance, a balance between the contractual rights and obligations of the parties.³²¹ Therefore, according to the court, the essence of good faith is to provide for a contractual balance, and once the principle of good faith is not respected in drafting the terms of the contract, the balance will be hindered.

Therefore, it seems the prevailing standpoint in Hungary is that the requirement of good faith and significant imbalance is one, objective criteria, the good faith being defined by significant imbalance.³²² This means, that for the more possible interpretations of the UCTD Hungary opted for the option where good faith is not an independent criterion within the test of fairness; but good faith and significant imbalance are one, integrated criteria. Consequently, significant imbalance will also automatically trigger the violation of good faith, or in other words, it is sufficient to show the term causes significant imbalance in the parties' rights and obligations for it to be considered unfair.

Placing the general clauses of good faith and significant imbalance in the context of procedural and substantive fairness, the test of fairness includes only substantive fairness. This interpretation provides for a high level of protection as it eliminates the possibility of justifying substantive unfairness with a procedural fairness. Additionally, as said above, the principle of good faith as an overarching principle of Hungarian contract law can have a procedural meaning. Therefore, even though the test of fairness points to purely substantive criteria, procedural fairness is taken into account as a general principle of contract law. Consequently, a contract term that does not cause significant imbalance and therefore cannot be annulled for being substantively unfair, can be eliminated from the contract for lacking procedural fairness, and therefore being

modified this reasoning, and clarified, that the principle of good faith is not subjective, but objective within the meaning of Art. 209 HuCC (BDT 2007.339).

³²¹ Szegedi Városi Bíróság P. 23 454/1999/25. See also Commentary on Art. 209(2) HuCC in Commentary on HuCC.

³²² Fazekas 2007a, p. 339.

contrary to good faith under general rules of contract, under the general rules of contract law.

Therefore, the Hungarian solution provides for a high level of protection.

III.3.4. Circumstances to be taken into account in determining fairness

Art. 209(2) HuCC, implementing Art. 4(1) UCTD, clarifies the circumstances that should be taken into account in assessing fairness. These are: 1) the nature of the contractual obligation; 2) all the circumstances that existed at the time of contract conclusion; 3) all the other terms of the contract or with other contracts between the parties.

If a contractual balance is hindered in one term, it might be re-established by another. The importance of looking at the entire contract and all contracts and their relation,³²³ was confirmed by courts on several occasions. For example in an agency contract for the sale of immovable the exclusivity clause is fair, if the parties have individually negotiated it, with paying due attention to details and limits of the clause.³²⁴ In an insurance contract, the insurer, in a separate clause deviating from standard terms and conditions, undertakes a greater degree of risk than stipulated in standard terms and conditions, the insurer is allowed to determine the conditions for taking additional risk.³²⁵ Since fairness should be determined based on the particular circumstances of a particular case,³²⁶ save for the terms on the “black” and “grey” list in the HuUCT Decree, it is impossible to determine whether a contract term is unfair just by having a look at one contract term.³²⁷ Hence, by copying out Art. 4(1) UCTD, Art. 209(2) HuCC adopted its level of protection and potential dangers the provision carries.

III.3.5. The “black” and “grey” list of unfair contract terms

Based on Art. 209 (3) HuCC the list of unfair contract terms from the UCTD Annex, was implemented into the HuUCT Decree. The HuUCT Decree abolishes the uncertainties surrounding the nature of the indicative list in the UCTD, and provides for a combination of “black” list i.e. contract terms regarded unfair under all circumstances (Art. 1 HuUCT Decree); and “grey” list i.e. contract terms regarded unfair until the

³²³ Commentary on Art. 209(2) HuCC in Commentary on HuCC.

³²⁴ BDT 2008. 1775.

³²⁵ BDT2006. 1327.

³²⁶ BH 2009.323. See also BH 2008.21.

³²⁷ Commentary on Art. 209(2) HuCC in Commentary on HuCC.

opposite is proven (Art. 2 HuUCT Decree). Terms on the black list are e.g.: terms that unilaterally empower the business to interpret the terms of the contract (Art. 1(1) HuUCT Decree); terms that authorize the business to unilaterally determine if the performance was according to the contract (Art. 1(2) HuUCT Decree); terms that require performance from the consumer even if the business fails to perform (Art. 1(3) HuUCT Decree). Therefore, black listing certain terms the HuUCTD provides for a higher level of protection than the UCTD.³²⁸ Two terms on the grey list will be discussed further in Chapter V.³²⁹

III.3.6. Intermediary conclusions

In Hungary, under the test of fairness the principle of good faith and the principle of significant imbalance are one integrated criterion, good faith being part of significant imbalance. Therefore, the test of fairness imposes substantive requirements, under which the terms of the contract must be substantively fair. However, good faith as an overarching principle of Hungarian contract law can also mean procedural fairness, and therefore procedural aspects of fairness can be taken into account within good faith as a general principle. Hence, by understanding the test of fairness primarily as aiming towards substantive fairness the HuCC provides for a higher level of protection than the UCTD.

III.4. The role of transparency in Hungary

The implementation of the principle of transparency is one of the controversial issues of the HuCC. The provision gained its final shape with the latest amendments in 2009. Now Art. 5 UCTD is transposed into Art. 209(4) HuCC that provides:

“A standard term or individually not negotiated term in consumer contracts will be regarded unfair in itself, if it is not plain and intelligible.”

Following the same lines as in Chapter II, this section aims to answer what transparency means; can the breach of transparency alone make the contract term unfair, and can transparency or procedural fairness legitimise substantive unfairness.

Regarding the meaning of transparency, Art. 209(4) HuCC adopted the unclear “plain and intelligible” language.” Reading together Art. 209(4) HuCC with Art.

³²⁸ The black and grey lists are an integral part of the nHuCC and are placed in Art. 6:104 nHuCC. There are no changes in the two selected clauses.

³²⁹ See: variation clauses (V.6.2.1.); default interest (V.6.2.2.).

205/B(1) HuCC under which transparency is a vetting rule, the meaning of transparency becomes clearer. It seems here the HuCC clarifies transparency means more than just a plain and understandable language, but the business have to make sure the consumer had a real opportunity to get familiar with the content of standard terms. Moreover, if the standard term departs from usually contractual practice, or the other terms of the contract the business have to specially alert the consumer, draw the consumer's attention onto those terms (Art. 205/B(2) HuCC). It also seems the HuCC clarifies that under certain circumstances transparency relates to a duty to inform, and even a duty to provide additional explanations. In this regard, the HuCC is more precise than the UCTD, and expressly incorporates the different functions and scope of the principle of transparency, and therefore provides for a higher level of protection. Overall, it means a consumers' genuine opportunity to understand the terms of the contract. At this point it should be pointed out that Art. 6:103(2) nHuCC instead of the "clear and understandable language" uses the word "unambiguous" which arguably immediately implies a consumer's real chance for understanding the terms of the contract.

The great achievement of Art. 209(4) HuCC compared to Art. 5 UCTD is that it has a direct sanction. If a contract term is not transparent it may be declared null and void. Therefore, the lack of transparency is a reason for unfairness on its own. It allows a contract term to be unfair on purely procedural grounds, for being procedurally unfair. In this regard, the HuCC provides for a much higher level of protection than the UCTD.

III.4.1. The benchmark consumer

There is no special definition of a benchmark consumer in Hungary. However, Art. 4(4) HuCC incorporates a general requirement of behaviour, the principle of acting in accordance with reasonable expectations under the circumstances. It is argued this general principle can be employed by the court to tailor the expected behaviour in a particular case to the age, experience and education of the particular consumer.³³⁰ Therefore, in practice the standard set by Art. 4(4) HuCC will most likely be relatively objective.³³¹ Hence, the HuCC via Art. 4(4) HuCC potentially provides a higher level of protection than the UCTD, but without concrete evidence, it is difficult to answer if this level of protection is really achieved. For a truly high level of protection it seems

³³⁰ Commentary on Art. 4(4) HuCC in Commentary on HuCC.

³³¹ Vékás 2004, p. 41.

necessary to set clearly the relatively objective standard. It seems that the nHuCC missed this opportunity as it fails to mention the benchmark consumer.

III.4.2. Intermediary conclusions

Regarding the role of transparency the HuCC sets a higher level of protection than the UCTD. First, it clarifies transparency means a consumer's real chance to understand the terms of the contract. This higher level of protection may potentially be compromised by failing to regulate the benchmark consumer. Second, transparency is an independent basis of unfairness, procedural fairness alone is able to make the contract term unfair. Third, procedural fairness is not capable of legitimating substantive unfairness because procedural fairness (Art. 209(4) HuCC) and substantive fairness (Art. 209(1) HuCC) are set on separate basis.

III.5. Limits of the test of fairness in Hungary

Hungary adopted the limitations of the test of fairness from the UCTD. These are the "mandatory rules", the "core terms" and the "individually negotiated terms" exemptions. The application of the test of fairness is also limited in time.

Additionally, in Hungary there is potentially a further limit to the test of fairness and that is the definition of a consumer. Namely, a number of statutes define consumers, which definitions often do not correspond. For example the HuCC defines consumers "*a person that concludes a contract outside his trade or business*" (Art. 685(d) HuCC). It refers to "persons" that can arguably be both natural and legal persons. On the contrary, the HuCPA (Art. 2(a) HuCPA),³³² the HuCIFEA (Shed. III pt. 4 HuCIFEA) and the HuCCA (Art. 3(3) HuCCA) limit consumers to natural persons. In most cases it will not be difficult to determine if a transaction is consumer or commercial in its nature. However, in borderline cases, problems may arise, especially in deciding if the unfair term was in the consumer or a commercial credit contract that fall under the regimes of both the HuCC and the specific statutes on consumer credit.

³³² See for comments and analysis of the different definitions: Fazekas 2003, p. 62-67; Lajos Vékás, Parerga-Eassays on the new draft Civil Code, Hvgorac, 2008, Budapest, p. 86-114; Sándor 2006, p. 198-200.

III.5.1. The “mandatory rules” exemption

The HuCC in Art. 209(6) HuCC implementing Art. 1(2) UCTD exempts from the test of fairness contract terms that are “determined by a law or is determined in accordance with the law”. It is important to point out that the provision uses the word law (“jogszabály”) as opposed to statute (“törvény”) and seems to include every legislative act. The second part of the provision seems even more dangerous as it exempts terms that are determined based on the law. What this means is a practical question, but it certainly sounds like including legislative acts of regulatory authorities, or even internal acts of public or private companies. This would significantly broaden the spectrum of terms exempted. As these acts may pursue other policy reasons than consumer protection the provisions therein may not be substantively fair for consumers. This provision potentially significantly hinders the effect of the test of fairness within the HuCC. Hence, the HuCC adopted the low level of protection provided by the UCTD. Although it seems the provision did not cause problems in practice, a high level of protection would be provided if no mandatory rules exemption is foreseen, or if it is strictly limited to the rules of mandatory statutory law. The nHuCC seems to have missed this opportunity of ensuring a higher level of protection and in Art. 6:102(5) nHuCC incorporated the same worded provision.

III.5.2. The “core terms” exemption

Art. 209(5) HuCC implements the “core terms” exemption from Art. 4(2) UCTD. According to this provision the test of fairness will not be applicable to the definition of the “main subject matter” of the contract, and to terms determining the proportion between the contractual rights and obligations of the parties (here probably meaning the price), provided they are in plain and intelligible language. By failing to mention the proportion relates to the main subject matter on the one hand and the price paid for it on the other hand, the provision opens the door for the different interpretation.³³³ One way of solving the problem is to narrow down the terms exempted by dividing contract terms on essential or core and eventual or ancillary terms. However, as the thesis shows on the example of consumer credit in Chapter V, this does not provide a desired solution.

Therefore, it remains open for interpretation what the exemption includes, especially in regard to the price. Although it seems the provision did not caused

³³³ See: II.4.2. and V.6.1.1.

problems in practice, a high level of protection is provided if no core terms exemption is foreseen, or at least if the exemption is formulated in an unambiguous manner. Hence, HuCC adopted the level of protection provided by the UCTD.³³⁴

III.5.3. The “individually negotiated terms” exemption

The test of fairness in Art. 209(1) HuCC adopted the individually negotiated terms exemption from the UCTD, but wording it in a slightly different manner, due to the fact that it is not solely a consumer protection provision. It makes clear that the test is applicable to both standard and specially drafted individually not negotiated terms and in this respect provides a higher level of protection than the UCTD. The problem that remains is how to differentiate standard, individually negotiated and individually not negotiated terms.

Under the general rules of the HuCC, a standard term is a term “that was unilaterally formulated in advance by one contractual party for repeated use, without the participation of the other party, and which the parties did not individually negotiate (Art. 205/A(1) HuCC). The definition therefore sets two cumulative conditions: 1) the term was formulated in advance by one contracting party (for a repeated use in a number of transactions); and 2) the term was not subject to individual negotiation. The length, form, mode, as well as whether the term is part of the contract or is incorporated into a separate document, are irrelevant (Art. 205/A(3) HuCC). Moreover, terms will be standard if they are pre-drafted with an intention towards their repeated use, without being actually used in practice.³³⁵ In case of conflict between a standard and a negotiated term, the latter will become part of the contract (Art. 205/C HuCC). The necessary condition of incorporation of standard terms is transparency and acceptance. The business must: 1) made possible for the other party to get familiar with the content of standard terms; and 2) the content is explicitly or by conduct accepted by the other party (Art. 205/B(1) HuCC). The HuCC provides for more stringent conditions if standard terms depart from the usual contractual practice; from the default rules of the law; or from a contractual term used in previous dealings between the parties (Art. 205/B(2) HuCC). The same will be the situation with standard terms and conditions.³³⁶ In the

³³⁴ The nHuCC likewise incorporates the exemption, formulated in the same manner, in Art. 6:102(3) nHUCC.

³³⁵ BDT 2009.2129.

³³⁶ EBH 2003.875.

above cases a standard term will become part of a contract only if, following notice³³⁷ the other party explicitly accepted them (Art. 205/B(2) HuCC).³³⁸ The contract term will not become individually. It should be underlined that Art. 205/B HuCC is a general provision applying to all contracts. Taken the fact that consumer contracts are most often contract of adhesion the rules on incorporation will most likely be fulfilled. Therefore, they are no efficient “filter” or vetting rule and in most case standard terms will become part of the contract.

In regard to individually negotiated terms, the HuCC contains no special provisions, but the Supreme Court clarified, a contract term is individually negotiated, if the consumer had real opportunity to influence the content of the contract, if he had an opportunity to modify the terms of the contract supplied by the business. If the business proves that despite having a realistic opportunity to exercise this influence the consumer failed to take advantage of it, the contract term will be considered individually negotiated, and thereby exempted from the test of fairness. It is not sufficient to rebut the presumption by just showing that the consumer accepted the terms of the contract after getting familiar with them, or after having a chance to get to know them.³³⁹ The fact that the business indicated in its standard contract that the consumer read, and accepted all the terms of the contract and the standard terms and conditions will not render the contract and its terms individually negotiated.³⁴⁰ Hence, negotiation means real opportunity to influence the content of the contract term,³⁴¹ regardless if the consumer took advantage of the opportunity. The burden of proof that the term was individually negotiated is on the business (Art. 205/A(2) HuCC).

Unlike detailed rules on standard terms the HuCC contains no special rules on individually not negotiated terms. It seems there are more arguments for applying the special regime of standard terms into these terms. First, standard and non-negotiated contract terms resemble in the way of their emergence. Both lack negotiation, the only difference is that standard terms are intended for repeated use. But, since the intention for repeated use is sufficient for a term to be standard no actual usage is necessary, in practice, it will be difficult to determine if a term is just non-negotiated or non-

³³⁷ Besides explicit, oral communication, notice can be done by highlighting, or printing in different font. See Opinion 37 HuSC. There is no sufficient notice, if the terms of the contract are printed on the back of the document in so small letters that they are hardly readable with bear eye. BDT 2011.2388.

³³⁸ Confirmed by BDT 2004. 913.

³³⁹ Pt. 2 Opinion 2/2011 HuSC.

³⁴⁰ EBH 2413.2011

³⁴¹ Commentary on Art. 205/A (1) HuCC in Commentary on HuCC.

negotiated and standard. Second, the unfairness of non-negotiated terms is a special case only for consumer contracts, placed under the same regime as standard terms in Art. 209(1) HuCC. Third, the rule on the reversal of the burden of proof is extended to individually not negotiated terms in consumer contracts (Art. 205/A(2) HuCC). Therefore, it is justified to extend the special rules for standard terms onto individually not negotiated terms.

By explicitly extending the scope of the test on individually not negotiated terms of the contract the HuCC likely provides a higher level of protection than the UCTD. Standard contract terms are regulated in Arts. 6:77 and 6:78 nHuCC copying out the above provisions save for Art. 205/A(3) HuCC that seems to be left out from the nHuCC. In addition, the nHuCC contains a separate consumer protection provision in essence providing that a contract term entitling the business for additional payments above the price will only become part of the contract upon an express acceptance of the consumer. It seems the nHuCC essentially maintains the present level of protection.

III.5.4. Time of assessing fairness

Art. 209(2) HuCC implementing Art. 4(1) UCTD stipulates that assessing the fairness of contractual terms regard is to be paid to the circumstances prevailing at the time of contract conclusion. It seems that this is also the general rule of the Hungarian contract law.³⁴² It is in line with the principle of *pacta sunt servanda*,³⁴³ a founding principle of contract law.³⁴⁴ Hence, the question is, can changed circumstances play a role in determining fairness? This question is especially important in long term contracts like consumer credit. In this section the thesis analyzes the scope and applicability of the traditional institutions of impossibility of performance (*force majeure*) and *clausula rebus sic stantibus*.

Although the HuCC does not expressly incorporates the institution of *force majeure*, Art. 312(1) HuCC probably has the same effect. This provision says that the contract will cease to exist if performance becomes impossible for a reason that cannot

³⁴² Whether a contract is void should be determined in the light of all the circumstances of the case in place at the moment of contract conclusion, law in force and the aims of the contract. BH2006. 329. See also Gyula Eörsi, Law of obligations, General part, Tankönyvkiadó, Budapest, 1975, p. 75.

³⁴³ Latin: „promises must be kept” incorporated in Art. 277(1) HuCC.

³⁴⁴ Biró 2000, p. 251.

be attributed to the fault of the parties.³⁴⁵ Impossibility might be due to physical, legal or economic circumstances, or it may be impossible in a sense of being contrary to (at least) one of the parties interests.³⁴⁶ Performance of the contract will be against the interests of the parties if the unforeseeable circumstances make the performance disproportionately, extremely difficult.³⁴⁷ These are the situations where it becomes unfair to force the parties to honour their contractual obligations.³⁴⁸

The HuCC specially incorporates the institution of *clausula rebus sic stantibus*, saying that if after concluding the contract a circumstance occurs that hinders one of the contracting parties' legitimate interests the court may modify the contract (Art. 241 HuCC).³⁴⁹ Importantly, the court is not entitled to rescind the contract but only to amend it,³⁵⁰ under a general limit that the contract cannot be modified if that possibility is excluded by mandatory law.³⁵¹ The modification is valid only for the future (*ex nunc*).³⁵²

The Supreme Court in 1973 developed three cumulative criteria for the operation of the institution: 1) parties must be in a long standing contractual relationship; 2) change in the circumstances must happen after the contract is concluded; and 3) the change must influence the interest of one of the parties.³⁵³ These conditions were later further concertized by theory and practice. Today it can be said that the first condition means parties are in a long standing relationship, if their rights are obligations are determined on a long term or continuous basis, and if no performance is completed.³⁵⁴ The second condition is specified with foreseeability; hence, it is important the change was not foreseen by the party that relies on the institution, foreseeability being judged subjectively.³⁵⁵ However, in connection with reasonable expectations under Art. 4(4) HuCC, the institution cannot be relied on if the party in question was obliged to take into account such circumstances at the moment of contract conclusion.³⁵⁶ Circumstances that

³⁴⁵ A similar provision is in Art. 6:179 nHuCC. If impossibility is attributable to one of the parties, the other is entitled for damages compensation (Art. 312 HuCC). Impossible of performance at the moment of contract conclusion will render the contract void (Art. 277(2) HuCC).

³⁴⁶ Eörsi 1975, p. 244-245; Commentary on Art. 317 HuCC in Commentary on HuCC.

³⁴⁷ BDT 2006.1366.

³⁴⁸ Eörsi 1975, p. 145.

³⁴⁹ Besides this general provision, the HuCC allows the change in the circumstances to be taken into account in specific situations like loan contracts (Art. 524(1) HuCC).

³⁵⁰ Levente Ákos Illés, 18(2) On the power of judicial contract modification, (2) Gazdaság és jog 3-9, 2010, p. 8.

³⁵¹ Commentary on Art. 241 HuCC in Commentary on HuCC.

³⁵² BH 1983.408.

³⁵³ Opinion 82/1973 of the Commercial chamber of HuSC modified by Decision 3/1978.

³⁵⁴ Illés 2010, p. 4.

³⁵⁵ Bíró 2000, p. 249. See also BH 1988.80.

³⁵⁶ Bíró 2000, p. 251, 259.

should be taken into account especially are those that relate to usual business risk and regular uncertainties.³⁵⁷ Circumstances are evaluated in each particular case (relative change). The institution is not applicable if the change is wider, affecting all the contracts or the entire national economy (absolute change).³⁵⁸ However, the Supreme Court on several occasions allowed the modification of the contracted price due to inflation which was the result of socio-economic changes.³⁵⁹ Finally, Bíró asserts, the change in circumstances must relate to performance, and not to the change in the value of contractual rights and obligations, which change might be corrected by valorisation.³⁶⁰ The third condition is satisfied if the circumstance is such that if it would have been foreseeable, the party that relies on it would not conclude the contract, or at least not with the content in question.³⁶¹ The change must relate to an important legitimate interest otherwise the institution would be used as a rule and not an exception.³⁶²

Interestingly, the nHuCC in Art. 6:192 specially incorporates the conditions for the application of the institution, merging the above into: 1) the possibility of changing the circumstances was not foreseeable at the moment of contract conclusion; 2) the party who relies on the institution did not cause the change; 2) the change in circumstances does not fall under the parties' regular business risk.

Since the institution is in essence an "escape clause" that lowers the trust in contracts;³⁶³ and questions legal certainty,³⁶⁴ it should be applied exceptionally. In determining the gravity of the change, courts should look at the entire contract, weight the parties' rights and obligations, in order to make a decision whether it is possible to amend the contract in such a way to maintain a contractual balance and that the (negative) consequences of a change is not born solely by one contracting party.³⁶⁵ Hence, in deciding whether to allow modification courts will take into account the interest of both parties, and try to balance them.³⁶⁶ It must also be mentioned that if the

³⁵⁷ Ibid.

³⁵⁸ Commentary on Art. 241 HuCC in Commentary on HuCC. See also BH 1993.670; Similarly Gf. I. 30.524/2006.

³⁵⁹ BH 2006.359 and BH 1995.659 For comments: Illés 2010, p.5.

³⁶⁰ Bíró 2000, p. 250-251.

³⁶¹ Bíró 2000, p. 248-249.

³⁶² Eörsi 1975, p. 102.

³⁶³ Ibid.

³⁶⁴ Bíró 2000, p. 247-248.

³⁶⁵ Commentary on Art. 241 HuCC in Commentary on HuCC.

³⁶⁶ Ferenc Petrik, Law of contracts, KJK Kerszöv, Budapest, 1993, p. 128.

change equally affects both contracting parties, there is no room for court intervention.³⁶⁷

It seems, the traditional contract law institutions of *force majeure* and *clausula rebus sic stantibus* allow in exceptional circumstances the reassessment of the fairness of contract terms at a later point, while the duration of the contract, due to changed circumstances. It also seems that both institutions are able to accommodate the concept of *social force majeure*.

III.5.5. Intermediary conclusions

Regarding the limits of the test of fairness it can be concluded that generally a high level of protection is ensured if no exemption from the test of fairness is provided because exemptions are open for divergent interpretation. In Hungary this is especially true for “core terms” and “mandatory rules” exemptions. Therefore, by adopting these exemptions the HuCC also adopted the level of protection the UCTD provides. The scope of “individually negotiated terms” exemption seems to be clarified and it likely that it only excludes truly individually negotiated terms. In this regard the protection is higher than in the UCTD.

The test of fairness is not flexible; it is to be applied at the moment of contract conclusion. However, the traditional contract law institutions of *force majeure* and *clausula rebus sic stantibus* generally allow the reassessment of the fairness of contract terms at a later point, while the duration of the contract, due to changed circumstances. They are also able to accommodate the concept of *social force majeure*. The two traditional institutions generally remedy the inflexibility of the test of fairness and therefore the HuCC provides for a higher level of protection than the UCTD does.

III.6. The consequence of unfair terms: remedial control

As the issue of remedial control is not in principle focus of the thesis, the essence of the rules is the following: Consumer contracts carry two exceptions from general contract law. In consumer contracts unfair standard terms or individually non-negotiated terms will be null and void (Art. 209/A(2) HuCC), and nullity may be invoked only in the interest of a consumer.³⁶⁸ Void contracts are void by the mere existence of the reason

³⁶⁷ BH 1993.670; BDT 2002.623.

³⁶⁸ In Hungary null contracts (érvénytelen szerződések) are divided onto void (semmis) and voidable (megtámadható) contracts, void contracts are further divided onto absolutely void (semmis) and relatively

for voidity (Art. 234(1) HuCC).³⁶⁹ There is no need for an action for annulment; however, for legal certainty, courts will determine if the reasons for voidity are met delivering a declaratory decision.³⁷⁰ Everyone, or every legally interested person,³⁷¹ has standing to commence action for annulment (Art. 234 (1) HuCC). Voidity is observed *ex officio* by courts,³⁷² and is not subject to limitation periods (Art. 234(1) HuCC). The effect of annulment is a relative, *inter partes* effect. Partial voidity is possible, and the void clause will render the entire contract void only if it is not possible to render performance without it (Art. 239(2) HuCC). Therefore, partial nullity will not be possible if the void clause is a core contract term. The rules of the HuCC are therefore in harmony with Art. 6(1) UCTD, which is to eliminate individual unfair terms from individual contracts.

III.7. Conclusion

Hungary went a long way to implement the UCTD. The process is rather an evolution than a revolution, a number of amendments took place until Art. 209 HuCC gained its final shape. As a result, the provisions of the HuCC largely correspond to the provisions of the UCTD. However, in the light of a border context of the existing contract law, Hungarian legal theory and practice, many dilemmas of the UCTD are clarified.

In Hungary, the test of fairness is understood as aiming to provide for substantive fairness, as the “significant imbalance” and “good faith” are one, integral criterion within Art. 209(1) HuCC. Procedural fairness is ensured by independent application of the principle of good faith as a general contract law principle (Art. 4(1) HuCC) and the independent application of the principle of transparency (Art. 209(4) HuCC).

Regarding the role of transparency, the HuCC sets a higher level of protection than the UCTD. First, it largely clarifies the meaning as the consumers’ real opportunity to get familiar with the content of standard terms. This higher level of protection may be potentially compromised by failing to regulate the benchmark consumer. Second,

void contracts (relatív semmisség). Relatively void contracts are similar to voidable contracts because voidity can be invoked only in the interest of one contractual party, but they are a special case of void contracts, as voidity is observed *ex officio* without limitation period. Relative nullity is one of the most disputes institutions in earlier Hungarian legal theory. See: Emília Weiss, Nullity of contract in civil law, Közigazgatási és Jogi Könyvkiadó, Budapest, 1969, p. 47-49.

³⁶⁹ Eörsi 1975, p. 76.

³⁷⁰ Commentary on Art. 234(1) HuCC in Commentary on HuCC.

³⁷¹ Ibid.

³⁷² Opinion of the Civil Chamber of the HuSC on the procedure to be followed in observing the reasons of nullity *ex officio*.

transparency is an independent basis of unfairness, procedural fairness alone is able to make the contract term unfair. Third, procedural fairness is not capable of legitimating substantive unfairness because procedural fairness (Art. 209(4) HuCC) and substantive fairness (Art. 209(1) HuCC) are set on separate basis.

The HuCC adopted the “core terms”, “mandatory rules” and “individually negotiated terms” exceptions from the UCTD. The scope of the “core terms” and “mandatory rules” are not clarified and in this regard the HuCC adopted the level of protection of the UCTD. However, the scope of the “individually negotiated terms” exemption seems to be clarified, and regarding this exemption the HuCC provides a higher level of protection.

The test of fairness is not flexible; it is to be applied at the moment of contract conclusion. However, the traditional institutions of *force majeure* and *clausula rebus sic stantibus* allow the reassessment of the fairness of contract terms at a later point, and seem to be able to accommodate the concept of *social force majeure*. Thus the traditional institutions generally remedy the inflexibility of the test of fairness and raise the level of protection relative to the UCTD.

Therefore, the implementation of the UCTD achieves the protection intended by the UCTD, and at many instances where the UCTD’s level of protection is not so high, the HuCC provides its own, higher level of protection. It lays down a solid ground for the fairness approach, aiming towards complete fairness (procedural and substantive fairness) and leaves limited room for freedom approach, for supporting the self-interest of the business. The danger for freedom approach remains because of the exemptions from the test of fairness.

For a higher level of protection, i.e. lowering the possibility of freedom approach, the Hungarian legislator should eliminate the exemptions from the test of fairness or at least clarify their scope. Defining the benchmark consumer and making the test of fairness flexible would also raise the level of protection, as in latter cases, a high level of protection is at the moment only achievable by reliance on the general contract law framework.

THE REGIME OF UNFAIR CONTRACT TERMS IN SERBIA

This Chapter analyzes the regime of unfair contract terms in Serbia. It particularly focuses on the basic concept of unfairness, on the role of transparency, and on the limits of the test of fairness. It aims to see how the UCTD was implemented into the national legal system of Serbia, and to answer the key question if the Serbian implementation achieves the protection intended by the UCTD, and where the level of protection provided by the UCTD is not so high, provides its own, higher level of protection.

IV.1. Development of consumer protection law and policy: a brief overview

This sections aims to briefly point to the main lines of development of consumer law and policy in Serbia and to point on the major changes that are important for the subject matter of the thesis. As consumer law and policy is an area that is under constant development, especially in consumer credit, the thesis will indicate more specific changes at places where the discussion takes place. Bellow, besides the general stapes of development, the thesis also briefly shows the regulation of unfair contract terms before the implementation of the UCTD, and the UCTD's implementation.

The socialism of the Socialist Federal Republic of Yugoslavia was unique, and differed from planned economies of the Soviet Block. The so called self-managed or autonomous socialism meant a relative scarcity of goods, the rule of dominant (monopolist) undertakings, but with the participation of working class in decision making and company management. Even if consumers were not understood in a contemporary way, their existence and importance was not negated. Consumers and their organization were seen as important contributing factors to the functioning of the state planned economy.³⁷³ The first organization of consumers emerged in the 1960's.³⁷⁴ It was the first country in the World that incorporated into its constitution the basis of cooperation between consumers and producers and traders.³⁷⁵ The intention was to

³⁷³ Dragaš Denković, The protection of consumers in SFRY, Zbornik radova Pravnog faulteta Univerziteta u Novom Sadu, Special issue dedicated for the twentieth anniversary of the Faculty of Law 95-122, 1979, p. 102.

³⁷⁴ Svetislav Taboroši, The relations of consumption in socialism: the consumer in the system of associated labour, NIO Poslovna politika, Belgrade, 1986, p.143. For more see: Denković 1979 p. 114.

³⁷⁵ Denković 1979, p. 99. This was the 1974 Constitution of the SFRY.

create a “special” model of consumer organizations, suitable for self-management socialism, where consumer organizations would be seen as partners of businesses.³⁷⁶ This was supposed to be a long process, which was never fully developed.

The period between 1991 and 2000 was characterised with civil war, economic sanctions by the UN, the blooming of grey economy, and the NATO aggression. Therefore, even though the transition from planned to market economy started in the 1990’s, due to pressing political problems, the civil war and the break up of SFRY, its economic development and European integration was delayed.

The development of a modern system of consumer protection underwent a long stagnation during the socio-economic crisis of the country. Although the *Law of Obligations Act of 1978* (hereinafter: SrbLOA)³⁷⁷ contained provisions aiming to protect the weaker party and rules relating to standard terms,³⁷⁸ the first modern type consumer legislation was the *Consumer Protection Act of 2002*.³⁷⁹ It was followed by *Consumer Protection Act of 2005*³⁸⁰ that represented the first attempt for harmonization,³⁸¹ but the result was not in line with *EU consumer acquis*.³⁸² Neither legislative act was applied in practice.³⁸³ On the institutional side, the most important steps in this period were the creation of the *Serbian Competition Authority* in 2005, the *Centre for Mediation* in 2006; and around the same time, the *Centre for Protection and Education of Financial Services Users* (hereinafter: SrbCPEFSU).

The creation of legal and institutional framework of consumer protection intensified pursuant to the 2008 *Stabilization and Association Agreement*, when Serbia formally started the process of EU integration. In line with Art.78, Serbia is obliged to

³⁷⁶ Denković 1979, p. 119-120.

³⁷⁷ Official Gazette of the Socialist Federal Republic of Yugoslavia 29/78, 39/85, 45/89, 57/89; Official Gazette of the Federal Republic of Yugoslavia 31/93; Official Gazette of the Republic of Serbia 1/203.

³⁷⁸ For analysis of SrbLOA from the angle of consumer protection see: Marko Đurđević, Protection of consumers by general rules of contract conclusion, 46(1-4) *Pravo i privreda*, 271-286, 2009.

³⁷⁹ Official Gazette of the Federal Republic of Yugoslavia No. 37/02.

³⁸⁰ Official Gazette of the Republic of Serbia No. 79/05.

³⁸¹ Tatjana Jovanić, Consumer Protection Law and Policy in Serbia: The Current State and Projections for the Future, 465-472 In: *The Yearbook of Consumer Law*, Christian Twigg-Flesner, Deborah Parry, Geraint Howells, Annette Nordhausen (eds.), Ashgate, Aldershot, 2008, p. 467.

³⁸² Jenő Czuczai, Final Report on Assessment of EU Consistency of Serbia/Montenegro Regulatory Framework for Consumer Protection, PLAC, Belgrade-Podgorica, 2006, p. 18-21. Cf Jovanić 2008 p. 467.

³⁸³ Marija Karanikić-Mirić, On Why Having “Nice Laws” Is Not Enough – Consumer Legislation in Serbia –Paper presented at the Thirteenth Mediterranean Research Meeting, Florence and Montecatini Terme 21-24 March 2012, organized by the Robert Schuman Centre for Advanced Studies at the European University Institute, p. 2.

align its consumer protection standards with those of the EU.³⁸⁴ In September 2010, a completely new SrbCPA was adopted, which entered into force on 1 January 2011. The SrbCPA is in line with the EU *consumer acquis*. It is a comprehensive statute that contains both rules of substantive and procedural law.³⁸⁵ Among the 15 EU directives it implements is the UCTD. The SrbCPA was quickly followed by the SrbFSUPA that implements the CCD. The two acts together create the main statutory framework of consumer protection in Serbia. In September 2013 the new draft SrbCPA was published without changing the regulation of unfair contract terms.³⁸⁶

One of the principle actors in the creation of consumer protection law and policy is the *Ministry of Internal and External Trade and Telecommunications* (hereinafter: SrbMinistry) and its *Division for Consumer Protection*. Other actors that are important in the regulation and enforcement of consumer protection law are the *National Bank of Serbia* (hereinafter: SrbNB) and the consumer protection organizations.

Therefore, unlike in Hungary, in Serbia consumer protection law and policy underwent a revolution rather than evolution. Following a long period of stagnation, and after adopting two consumer protection acts, the legislator decided to bring forward a completely new and comprehensive act (a virtual consumer protection code), the SrbCPA, that set consumer protection in Serbia on a novel foot.

IV. 2. Control of unfair terms before the implementation of the UCTD and the implementation of the UCTD

Before the implementation of the EU *acquis* the unfair contract terms as such were not defined and regulated. The *Consumer Protection Act of 2005* contained no reference to unfair contract terms. Protection against unfair terms in consumer contracts was guaranteed by a set of general clauses invited to protect the weaker party in contract, and by special provisions on standard contract terms in the SrbLOA. The SrbLOA is a comprehensive legal document, like the HuCC, rests on unity of legal obligations, and therefore applies to all contracts. It occasionally provides special rules for commercial

³⁸⁴ See EU Commission: http://ec.europa.eu/enlargement/pdf/Serbia/key_document/saa_en.pdf (10 Feb. 2012). See for more: Goran Papović, Andrea Fejős, The Role of Stabilization and Association Agreement in Consumer Protection, 1 *Izazovi evropskih integracija* 54-60, 2008.

³⁸⁵ See for analysis: Andrea Fejős, The Reform of Consumer Legislation in Serbia, 128-147 In: *Social Challenges of European Integrations: Serbia and Comparative Experiences*, Novi Sad, 2010.

³⁸⁶ See: <http://mtt.gov.rs/vesti/javna-rasprava-o-naertu-zakona-o-zastiti-potrosaca/?lang=lat> (27 Sept. 2013).

contracts, but makes no separate mention of consumer contracts, and is not familiar with the notion of a consumer.

There are several distinct but closely related principles on which all contracts must be based. The principle of good faith is among the most important, according to which, parties must act fairly and honestly in the formation and execution of contracts (Art. 12 SrbLOA). Further, all parties to the contract are equal (Art. 11 SrbLOA), the creation of dominant position on the market is forbidden (Art. 14 SrbLOA). Finally, there is a general prohibition to abuse rights arising out of and in connection with contracts (Art.13 SrbLOA); and the principle of equality in the value of contractual obligations in synallagmatic contracts (Art. 15 SrbLOA).³⁸⁷

The SrbLOA talks about standard contract terms differentiating standard form contracts, and standard terms and conditions. It determines standard terms as terms prepared by one contractual party (Art. 142(1) SrbLOA). Standard terms are binding on the party that did not participate in their drafting provided they were published in an ordinary way (Art. 142(2) SrbLOA), and if they were known or must have been known by the non-drafting party (Art. 142(3) SrbLOA). In case of conflict between standard and individually negotiated terms the latter will apply (Art. 142(4) SrbLOA). Any standard term that is in conflict with the aim of the contract or good business customs shall be null and void (Art.143(1) SrbLOA). In addition, the SrbLOA empowers the court to reject the application of a particular provision in the general terms and conditions which precludes the party from filing demurrers, or if, on account of this provision, the party is deprived of its contractual rights, time limits, or if the provision is unfair or harsh (Art. 143(2) SrbLOA).

The SrbLOA has a relatively long standing tradition in its application. It continued to be applied in practice even after special rules for consumer contracts were adopted, as the rules contained in the codes were vague and often useless.³⁸⁸ In implementing the consumer *acquis*, it was not amended, but a separate act was adopted.

Unlike in Hungary, following the examples of Italy and France,³⁸⁹ in Serbia, the EU *consumer acquis* was implemented by adopting a completely new and comprehensive a separate consumer protection code that contains a range of issues and

³⁸⁷ Antić asserts, the two main principles of civil law are the principle of private autonomy and the principle of good faith, and all the other, more specific principles are derived from them. Oliver Antić, *Law of Obligations*, Službeni glasnik, Belgrade, 2009, p. 37

³⁸⁸ See e.g. Karanikić-Mirić 2012, p. 2.

³⁸⁹ Marija Karanikić-Mirić, What is new in Serbian consumer (contract) law? In: 5 *Legal capacities of Serbia for European integrations* 127-146, Stevan Lilić (ed.), Faculty of Law, Belgrade, 2010, p. 129.

has a status of *lex specialis*. The SrbCPA is *lex specialis* for BtoC contracts, whereas the SrbLOA continues to be relevant as *lex generalis*, for issues which are left outside the scope of the SrbCPA.

In implanting the UCTD the SrbCPA, taking advantage of the minimal character of the UCTD, departed from it, and provided for a much more protective, a very modern test of fairness. In the following, the thesis focuses on this current regime. In particular, on the basic concept of unfairness, on the role of transparency and on the limits of the test of fairness.

IV.3. The basic concept of unfairness in Serbia

The SrbCPA for the first time explicitly regulates unfair terms. The basic concept of unfairness or the test of fairness is laid down in Art. 46(2) SrbCPA that reads:

“ A contract term is unfair if it:

- 1) results in a significant imbalance in contractual obligations of the parties to the detriment of the consumer;
- 2) causes the execution of a contract to be burdensome to the consumer without a justifiable reason;
- 3) causes the execution of a contract to be substantially different from what the consumer legitimately expected;
- 4) violates the transparency requirements of the business;
- 5) violates the principle of good faith.”

At first sight it can be noticed the test of fairness in the SrbCPA is different from the test of the UCTD and the HuCC. The test has several distinct but closely linked elements, some of which are explicitly present in the UCTD, some might be implied depending on how the test is interpreted, others cannot be read into the system of protection provided by the UCTD. However, for easier comparison, this Chapter follows the structures of Chapters II and III as much as possible and focus on the basic concept of unfairness, on the role of transparency, and on the limits of the test of fairness.

The immediate dilemma that that the language of Art. 46(2) SrbCPA raises is if the conditions in the test of fairness are set alternatively or cumulatively. Most probably even though cumulation is possible, for example a term that causes a significant imbalance in the parties' rights and obligations might very often be contrary to the principle of good faith, and might as well be a result of a non-transparent contract conclusion, it is not (or it cannot be) the correct reading of the test. Cumulative interpretation would significantly narrow down the scope of the test. An unfair term would have to satisfy a number of conditions, both substantive and procedural. On the

other hand, a perfectly transparent term might be unfair in substance or vice versa. Therefore, transparency and substance are two distinct issues, and this is how they should be interpreted. This interpretation is in line with the UCTD, which does not even expressly mention transparency within the test of fairness. Moreover, the *Slovenian Consumer Protection Act of 1998* that served as a model for SrbCPA,³⁹⁰ expressly sets the conditions alternatively. Finally, alternatively set conditions represent a more consumer friendly approach, providing for a higher level of protection.

IV.3.1. The principle of good faith

Art. 46(2)(5) SrbCPA sets the principle of good faith in as an individual ground for determining the fairness of a contract term. According to the provision, the contract term will be unfair if it violates the principle of good faith. Since there is no special interpretation on the meaning of this principle in the context of the test of fairness, the general meaning is assumed to apply for determining the fairness of contract terms.

As Serbia belongs to the family of continental legal systems, good faith is an overarching principle of its contract law.³⁹¹ The SrbLOA requires that parties act according to good faith and honesty in contract conclusion and performance (Art. 12 SrbLOA). In Serbia too, the construction of good faith and honesty (“*savesnost i poštenje*”) gives an objective meaning of the principle, like *Treu und Glauben* in German private law.³⁹² The principle of good faith is a general clause of mandatory nature.³⁹³ Although it has a wide field of application, its content is not completely undetermined. Szalma, a leading theorist on the issue,³⁹⁴ is of the opinion that though the normative content of the principle is not given by the law, its boundaries are set by other principles of the SrbLOA.³⁹⁵ The principle does not point onto the entire moral order, but to special moral or ethical values which are inherent to the given legal

³⁹⁰ Personal conversation, on 12 April 2012, with Marija Karanikić-Mirić expert in the drafting team of the SrbCPA.

³⁹¹ See e.g. Antić 2009, p. 36-50.

³⁹² Cf József Szalma: The principle of good faith, 54(5) *Glasnik advokatske komore Vojvodine* 1-31, 1982, p. 26-27; József Szalma, *Law of obligations – general part, main principles, contracts and delicts*, Faculty of Law, Novi Sad, 2009, p. 155.

³⁹³ Szalma 2009, p. 155. Cf Antić 2009, p. 40.

³⁹⁴ See also: Slobodan Perović (ed.), *Commentary on Art. 12*, In: *Commentary on Law of Obligations Act*, Book 2, *Savremena administracija*, Belgrade, 1995, p. 11-20.

³⁹⁵ See for more: Szalma 1982, p. 28. It is especially closely linked and often interrelated with the principle of the prohibition to abuse the law (Art. 13 SrbLOA). Szalma 1982, p. 23-25; Cf Szalma 2009, p. 154.

relation.³⁹⁶ It calls for an ethical behaviour according to the standards of a legal branch in which the transaction is concluded. By analysing the concrete provisions of the SrbLOA, Szalma concludes, the SrbLOA via the principle of good faith protects: 1) a contractual party against unethical behaviour of the other contracting party *in abstracto*; 2) a contractual party that acted in accordance with good faith *in concreto*; 3) the weaker contractual party by softening the provisions of the contract.³⁹⁷ Nevertheless, it is impossible to precisely determine the content of the principle, as it changes over time and it is flexible, adjusts to the facts of the case at hand. This flexibility is the great value of the institute.³⁹⁸ Therefore, the principle of good faith is a general clause of mandatory nature that sets objective standard of behaviour in line with good morals, fairness and justice.

Placing the principle into the context of procedural and substantive fairness, it seems the principle encompasses both. It represents the “widest” ground for annulment of contract terms under Art. 46(2) SrbCPA. The principle of good faith is a “safety net” and it will eliminate the contract term that does not fall under any of the more precisely determined basis of unfairness.

IV.3.2. Significant imbalance in the parties’ rights and obligations

Incorporated into Art. 46(2)(1) SrbCPA, this concept is overtaken from Art. 3(1) UCTD and is a separate basis of unfairness in the test of fairness. However, it was already inherent in the Serbian legal system as one of the founding principles of its contract law. This traditional mandatory³⁹⁹ rule is formulated as the “*principle of equality of contractual rights and obligations*” (Art. 15 SrbLOA). If compared, it can be noticed that the only difference is in the word “significant”. Therefore, the significant imbalance within the test of fairness underlines that the imbalance must be grave and smaller discrepancies in the parties rights and obligations will not make the contract term unfair. However, even the general principle does not require absolute equality in the values of contractual rights and obligations.⁴⁰⁰ The general clause is further concretized, but not limited by the institutions of gross disparity (*laesio enormis*) and

³⁹⁶ Szalma 1982, p. 31.

³⁹⁷ Szalma 1982, p. 29.

³⁹⁸ Szalma 1982, p. 7.

³⁹⁹ E.g. SrbSC Rev. 256/97 However, its infringement will not always be sanctioned (Art. 15(2) SrbLOA).

⁴⁰⁰ József Szalma, The principle of equivalence and *laesio enormis* in contracts, 11 Zbornik radova Pravnog fakulteta u Novom Sadu 273-282, 1977, p. 274.

usury. The thesis below turns to these institutions as in the absence of any other interpretation these institutions may serve as a guide to courts in determining the meaning of significant imbalance.⁴⁰¹ Although for determining significant imbalance only the objective element of the institutions is necessary, the thesis will analyze the objective element together with subjective as this discussion will be later relied on in Chapter V.

In synallagmatic contracts the conditions for the application of *laesio enormis* are fulfilled, if there is manifest disproportion (“očigledna nesrazmera”) in the contractual rights and obligations of the parties at the moment of contract conclusion, the damaged party can ask for the annulment of the contract provided he did not know and was not suppose to know the real value of the goods or services (Art. 139(1) SrbLOA). Therefore, three conditions have to be satisfied. First, the contract has to be synallagmatic. Second, there has to be a manifest disproportion between the contractual rights and obligations of the parties. Third, the injured party has to be in deceit over the real value of the goods or services. The first condition is always fulfilled as consumer contracts in general, and contracts of credit in special are synallagmatic contracts. The second condition is more difficult to prove, as the SrbLOA, like Hungary, accepts the legal standard option.⁴⁰² The difference between the HuCC and the SrbLOA is that the HuCC specifies the disparity has to be gross, while the SrbLOA accepts any degree of disparity. Nevertheless, the linguistic formulations will probably lead to the same practical result, as it is unlikely courts would annul a contract for insignificant disparity.⁴⁰³ The third element is the subjective element. The SrbLOA differs from the HuCC in the subjective element. However, as seen, although not required in the HuCC, courts read the subjective element into the test. Courts extended the interpretation of an intention to make a gift to an intention to agree to the disparity. The standpoint of the SrbLOA is similar. The injured party cannot rely on Art. 139(1) SrbLOA if he knew and therefore agreed to the difference in value. However, the SrbLOA goes even further in strengthening the subjective element, and sanctions the injured parties’ negligence. Namely, the injured party will not be able to rely on the institution if he *was supposed to*

⁴⁰¹ Although for determining significant imbalance only the objective element of the institutions is necessary, the thesis analyze both the objective and the subjective elements as this discussion is later relied on in Chapter V.

⁴⁰² Antić 2009, p. 406 *cf* Szalma 2009, p. 371.

⁴⁰³ It can be noticed that the language used to define *laesio enormis* by the Serbian legislator (manifest disproportion) is similar to the language Hungarian legislator used for defining *usury* (manifestly disproportionate advantage).

know the real value of the goods or services. Besides obvious cases when there is no place to question the equivalence of the parties rights and obligations, as the injured party knew or was supposed to know the balance may be hindered and it is likely he will pay more than a market value e.g. in case of public sale, hazardous games and when a higher price is given in affection (Art. 139(5) LOA), the subjective element is very difficult to prove. The existence of manifest disproportion between the parties' rights and obligations is a question of fact. Courts will primarily look at the difference in the market value and the contractual value⁴⁰⁴, as the first step of the test, but will not render the contract void without the existence of the subjective element. Both the subjective and the objective elements have to be present at the moment of contract conclusion.⁴⁰⁵

In a usury contract (“zeleniški ugovor”) one contracting party uses the state of need, grave economic situation, lack of experience, naivety or dependence of the other contractual party in order to gain economic benefit for itself or for someone else which is manifestly disproportionate with what he did or promised to do or give in return (Art. 141(1) SrbLOA). Perović underlines, the existence of either objective or subjective element will not make the contract usury.⁴⁰⁶ The objective and subjective elements should be in causal link between the two elements.⁴⁰⁷ Hence, there must be three elements for the operation of this institution: 1) one objective, i.e. manifestly disproportionate advantage; 2) one subjective i.e. intention to abuse, and 3) causal connection between the two. Comparing usury to *laesio enormis*, the difference between the two institutions in Serbia is even smaller than in Hungary. The SrbLOA takes the same objective element for both institutions, with a difference being in the subjective element.⁴⁰⁸ Regarding the subjective element the SrbLOA is more precise than the HuCC, as it points out grave situation can occur not just due to economic needs but also due to lack of experience, naivety, or dependence. It is important to point out that according to Perović the lack of experience can be general, but also particular to a certain sector⁴⁰⁹ like financial services and consumer credit. At the end, all subjective

⁴⁰⁴ In an action for annulment of a sales contract for immovable property the court decided there is no gross disparity, as there was no significant difference between the purchase price paid (i.e. 67.000) and the market price at the time of contract conclusion (i.e. 63.496,33). SrbSC 4160/2003

⁴⁰⁵ If the seller know about the real value of the real estate before the contract was concluded he cannot rely on the institution of *laesio enormis* (SrbSC Rev. 398/2006). Cf SrbSC Rev. 655/97 and SrbSC Rev.130/95.

⁴⁰⁶ Perović, Commentary on Art. 141, 1995, p. 282.

⁴⁰⁷ Ibid.

⁴⁰⁸ See for more: Szalma 2009 p. 375.

⁴⁰⁹ Perović, Commentary on Art. 141, 1995, p. 281.

elements come down to abuse of the grave (economic, health, or other) situation of the consumer.⁴¹⁰ Perović confirms, as in Hungary, the essence of subjective element is the *intention* to abuse.⁴¹¹

Both *laesio enormis* and usury are in place to protect against grave disparity in contractual rights and obligations of the parties, or to protect the contractual balance. Therefore, they have the same aim as the test of fairness. It follows that in case of grave discrepancy the consumer will have a choice to annul the contract term under the special rules of the unfair contract terms or to annul the contract under the general rules of *laesio enormis* or usury. The choice is limited in Hungary as core terms are exempted from the test of fairness, and therefore can only be safeguarded by *laesio enormis* or usury. The choice is unlimited in Serbia, where all the terms of the contract can be assessed for fairness, being core or ancillary. It remains to be seen how courts will approach the test of fairness in Serbia, if they will be able to depart from the established practice of applying the institutions of usury and *laesio enormis*, or if they will read in the test of fairness some elements that are not part of it (but that are present in the two traditional institutions). This is principally the danger of reading in the test any subjective element that is difficult to prove.

Without a more detailed analysis available on the concept of significant imbalance in the test of fairness, and having in mind the above analysis, it can be concluded, that the concept is most probably understood as in Hungary. This means, significant imbalance exists when a contract term taken objectively deviates from default rule of the law, and if this deviation is contrary to the aim of the contract, and when there are no other terms in the contract that would re-establish this imbalance. When the default rules are not precise significant imbalance seem to be less than gross disparity in (the market value of) the parties' rights and obligations.

In applying the traditional institutions to interpret the test of fairness, and the principle of significant imbalance therein, it is important courts bear in mind two caveats. First, by analogy to Hungary, any significant imbalance is sufficient to determine the term is unfair that is a lower level of infringement than grave imbalance. The second advantage of the principle of significant imbalance in the test of fairness is that it is an entirely objective, and does not depend on the knowledge or intention of the parties.

⁴¹⁰ Perović, Commentary on Art. 141, 1995, p. 282.

⁴¹¹ Ibid.

IV.3.3. Performance substantially different from legitimately expected

Closely linked to the principles of good faith and significant imbalance is the concept of legitimate expectations of consumer regarding the performance of the contract (Art. 46(2)(3) CPA). This concept is not expressly present in the UCTD, although it was incorporated in its earlier drafts.⁴¹² Hence, as Willett points out, it must have been anticipated by the drafters of the current version of the UCTD that the concept of legitimate expectations would be relevant.⁴¹³

Legitimate expectations, as an English law concept, arose from administrative law where it applies the principles of fairness and reasonableness to the situation where a person has an expectation or interest in a public body retaining a long-standing practice or keeping a promise.⁴¹⁴ Similarly, in private law, Micklitz and Wilhelmsson developed a “right to the protection of legitimate expectations” that should be implemented by mandatory contract or tort law rules.⁴¹⁵ The concept is based on mutual rights of contracting parties, and their optimal balance. On one hand, businesses have a right to access to free trade, the right to use freedom of contract to shape their position in contractual relations, on the other hand, consumers have a right to be fully informed of their rights, to be able to withdraw from the contract, and to have the necessary remedies to secure the enforcement of their rights.⁴¹⁶ As Willett points out,⁴¹⁷ legitimate or reasonable expectations might relate to the content and aim of the contract, in cases where consumers have certain expectation regarding performance. This might be relevant where terms allow i.e. variations from what the consumer reasonably expected, e.g. variation of price or performance. Hence, the concept of legitimate expectations has both substantive and procedural dimensions. On one hand, it encompasses a right to have information on rights and remedies (procedural dimension); on the other, in performance of contracts consumers should be guaranteed the “headline” performance

⁴¹²Art. 3(1) Amended proposal of UCTD 1992.

⁴¹³ Willett 2007, p. 269.

⁴¹⁴ Paul P. Craig, *Substantive Legitimate Expectations in Domestic and Community Law*, 55 *Cambridge Law Journal* 289-312, 1996, p. 290.

⁴¹⁵ Norbert Reich, *The Consumer as Citizen – the Citizen as Consumer – Reflections on the Present State of the Theory of Consumer Law in the EU*, p. 10 at IACLAW: http://www.iaclaw.org/Research_papers/melangescalais2ok.pdf (29 June 2013). As the TFEU does not provide a right to legitimate expectations, this right will be derived from reading together secondary and primary law, by interpretation. Cf Micklitz et al. 2009, p. 27-28.

⁴¹⁶ Hans-Wolfgang Micklitz, *Social Justice in European Private Law*, 19(1) *Yearbook of European Law* 167-204, 1999, p. 178.

⁴¹⁷ Willett 2007, p. 269.

that they reasonably expect, and not receive a varied performance allowed for by standard terms (substantive dimension).⁴¹⁸

Explicitly incorporating legitimate expectations into the test of fairness raises the level of protection. As the concept was unknown to Serbian contract law until the SrbCPA it is essential to determine the necessary preconditions for the operation of this concept. First, it is important that that performance is substantially different from what is expected. What “substantially” means is a practical question, but minor discrepancies would not be sufficient. Second, it is important that the expectation of the consumer is based on the default rules of the law, or the “headline” performance that they reasonably expect. Third, the limits of the consumer’s expectations are set by reasonableness. What is reasonable will be determined by the help of the two closely linked principles, the principle of contractual balance in the parties’ rights and obligations and the principle of good faith.⁴¹⁹

IV.3.4. Circumstances to be taken into account in determining fairness

Art. 46(3) SrbCPA incorporates the circumstances that should be taken into account in determining fairness. These are: 1) the nature of the goods or services to which the contract relates; 2) the circumstances under which the contract was concluded; 3) other terms of the same contract or of another related contract; and 4) the manner in which the contract was drafted and communicated to the consumer by the business in accordance with transparency requirements. The provision therefore largely corresponds to Art. 4(1) UCTD, but goes further and expressly incorporates transparency i.e. the way how the terms are communicated.

This incorporation raises doubts if transparency (procedural fairness) is capable to justify unfairness in substance. For example, excessive price causing gross imbalance in the parties’ rights and obligations will surely be considered substantively unfair under the “significant imbalance” ground. However, it may be that although excessive the price was transparent. If transparency is taken into account in determining unfairness, the question that emerges is if transparency is capable of justifying substantive unfairness. If the answer is yes, the excessive price will stay in the contract despite being substantively unfair. The above result was most probably not the intended effect of the test. On the contrary, the test of fairness specifically sets the

⁴¹⁸ Fejős 2013, p. 196.

⁴¹⁹ Ibid.

two types of fairness on separate basis thereby preventing their overlap. With this provision, the drafters probably intended to provide additional protection to consumers by ensuring transparency is respected at all times. Hence, the correct interpretation should be that in case of collision the rules on interpretation should not prevail over the test of fairness. Nevertheless, a different interpretation is possible. Hence, this provision maintains the level of protection of the UCTD and potentially even lowers it.

IV.3.5. The “black” and “grey” list of unfair contract terms

The SebCPA, like the HuUCTD Decree, abolishes the uncertainties surrounding the nature of the indicative list in the UCTD, and places substantively unfair terms on the “black” (Art. 47 SrbCPA); and “grey” list (Art. 48 SrbCPA). Among the black listed terms are e.g.: excluding or hindering the consumer's right to take legal action or exercise any other legal remedy for protection of their rights, particularly by requiring the consumer to take disputes exclusively to arbitration (Art. 47(1)(3) SrbCPA); restricting or limiting the evidence available to the consumer or imposing on him a burden of proof which, according to the applicable law, should lie with the business (Art. 47(1)(4) SrbCPA); terms the exclusive right to interpret contract terms (Art. 47(2)(2) SrbCPA). Therefore, settling the status of contract terms the SrbCPA provides for a higher level of protection than the UCTD does. Two terms on the grey list will be discussed further in Chapter V.⁴²⁰

IV.3.6. Intermediary conclusions

Based on the above analysis, it can be definitely said the test of fairness embraces both substantive and procedural fairness. The principle of good faith can be interpreted as aiming towards both procedural and substantive fairness, the principle of significant imbalance as aiming towards substantive fairness, and the principle of legitimate expectations as potentially aiming towards both procedural and substantive fairness. Besides the above three grounds, the test of fairness further incorporates another two basis analyzed bellow. These are the principle of transparency as an independent basis of unfairness implying procedural fairness, and the execution of a contract burdensome without a justifiable reason arguably implying substantive fairness. The widest ground of unfairness is the principle of good faith that can potentially act as a “safety net” and

⁴²⁰ See: variation clauses (V.6.2.1.); default interest (V.6.2.2.).

eliminate from the contract terms that did not fall under any of the grounds more specifically defined. Thus, in the absence of comprehensive academic writings and case law on the application of the test of fairness, the test is to be understood by enforcers as aiming towards both substantive and procedural fairness. This further means that procedural unfairness cannot override substantive unfairness, or at least it should not, taking into account the possibility due to transparency being mentioned among the circumstances to be taken into account in interpreting the test of fairness.

IV.4. The role of transparency in Serbia

The principle of transparency is given large significance in the SrbCPA where it is implemented in a much wider manner. Transparency is part of the test of fairness (Art. 46 (2)(4) SrbCPA), it is listed as a circumstance that should be taken into account in interpreting the test (Art. 46(3)(4) CPA), and is a vetting rule (Art. 44(3) CPA).

Regarding the meaning of transparency, Art. 44(1) SrbCPA asserts:

“A contract term is binding for a consumer if it is laid down in a simple, clear and understandable language and if it would be understandable for a reasonable man of the consumers’ knowledge and experience.”

The two conditions are set cumulatively, therefore the provision underlines, understanding is to be measured against the particular consumer. Further, according to Art. 44(2) SrbCPA, the business is obliged to provide a *real opportunity* for the consumer to get acquainted with the terms of the contract, with due regard to the means of communication used. This provision seems wider than Art. 5 UCTD, and explicitly provides understanding depends on a real opportunity of a consumer to get acquainted with the terms of the contract. This provision most probably obliges the business to make further steps in drawing the attention of consumers to the terms of the contract than just laying them down in plain and simple language. Indeed, it may well oblige the business to draw the attention of a particular consumer to a particular term, or even to provide additional explanations.

Regarding the question whether transparency can legitimize substantive unfairness, the general conclusion is that it cannot. The test of fairness sets five separate grounds of unfairness among which the principle of transparency is the only purely procedural. Hence, separately incorporating the principle of transparency into the test of fairness made the drafters intention clear to separate substantive and procedural fairness,

and to require both for a fair contract term. This achievement might only be jeopardized by listing transparency among the circumstances to be taken into account in determining fairness. Regarding the question if procedural fairness alone is sufficient to make the contract term unfair, the answer is yes, as transparency is an independent basis of unfairness under Art. 46(2)(4) SrbCPA.

IV.4.1. The benchmark consumer

Art. 44(1) SrbCPA directly linked the principle of transparency with the benchmark consumer. As a result, a contract term is binding on a consumer if it is laid down in a simple, clear and understandable language, understandable for reasonable men of the consumers' knowledge and experience. Insisting on a real opportunity of a consumer to understand the terms of the contract, the SrbCPA recognizes that understanding depends on factors like education and intelligence, and therefore the threshold of clarity and simplicity of language is determined compared to a benchmark consumer. The benchmark consumer in the SrbCPA is such that there is a higher level of protection than the general European benchmark of "average consumer" leaving vulnerable consumers open to exploitation. The SrbCPA does take into account special vulnerability of certain group of consumers. Whether the terms communicated to the consumer were transparent will be determined taking into account the group of consumers, the "class" to which a particular consumer belongs. Hence, instead of an "absolutely objective" standard it relies on a "relatively objective" standard that might be above or below the "average".

This "relatively objective" standard is an exception in Serbian contract law, where the obligations of the parties are traditionally measured against an objective standard, standard of a reasonable man, or standard of reasonable businessmen.⁴²¹ The fact that the standard of the reasonable man as a standard of behaviour for consumers is not mentioned, might suggest, that the intention of the drafters was exactly to prevent any attempt to make an objective estimation (as much as possible) of how the consumer was suppose to understand the communication of the business, fearing that courts would be too harsh in ruling on transparency, and aiming to develop a special sensitivity of courts towards consumers and their protection. This interpretation provides for a high level of protection. In support, according to Karanikić-Mirić, the solution of the SrbCPA

⁴²¹ These standards are specifically referred to in the SrbLOA (Art. 581, 662, 714, 751).

represents an advantage compared to the UCTD and can be seen as means for achieving a higher level of consumer protection.⁴²²

III.4.2. Intermediary conclusions

Regarding the role of transparency the SrbCPA sets a higher level of protection than the UCTD and the HuCC. First, it clarifies transparency means a consumer's real chance to understand the terms of the contract. Second, transparency is an independent basis of unfairness, and procedural fairness alone is capable to make the contract term unfair. Third, procedural fairness is generally not capable of legitimating substantive unfairness because procedural fairness and substantive fairness are set on separate basis under the test of fairness. This may only be compromised by the multiple inclusion of the principle into the scope of the test. Finally, the great advantage of the Serbian test, compared to the UCTD and the HuCC, is that it expressly regulates the benchmark consumer. Thus, the SrbCPA provides a very high level of protection and this may only be compromised by the multiple inclusion of the principle of transparency into the scope of the test.

IV.5. Limits of the test of fairness in Serbia

In order to achieve a higher level of consumer protection than provided by the UCTD the Serbian legislator intended to make the test of fairness more precise, but also, did not implement the "mandatory rules", the "individually negotiated terms" exemption and the "core terms" exemption. This was a purposeful omission aiming to eliminate difficulties in interpretation of exemptions.⁴²³ The drafters also intended to maintain continuity with the Serbian contract law tradition that did not differentiate between different types of contract terms.⁴²⁴ Thus, Art. 5(1)(24) SrbCPA specifically states, that a contract term is: "every provision of a consumer contract, including individually negotiated terms, the content of which the consumer had either negotiated or could have

⁴²² Marija Karanikić-Mirić, Unfair Terms Directive, 548-477 In: EU Consumer Contract Law, 3 Civil Law Forum for South East Europe, Christa Jessel-Holst, Gale Galev (eds.), GTZ, Belgrade, 2010, p. 460 (2010a).

⁴²³ The SrbLOA rests on the unity of contractual obligations, it relates to all contracts and contract terms. The drafters found useful to continue with the tradition of unity. Marija Karanikić-Mirić, Hans-Wolfgang Micklitz, Norbert Reich, Explanations for the draft Consumer Protection Act, material from a Conference on Consumer Rights, Belgrade, 17 September 2010. It was held by the project team that worked on the draft SrbCPA together with the SrbMinistry.

⁴²⁴ Karanikić-Mirić 2009, p. 134.

negotiated with the business, and standard terms which were drafted in advance by the business or a third party.”

As the test of fairness in SrbCPA relates to all contract terms, the only way certain terms may be exempted from the scrutiny of the test is by not becoming part of the contract. Since the rules of incorporation may be relevant in the context of consumer credit the thesis here briefly shows these rules. The SrbLOA traditionally provided more stringent rules of incorporation only to standard terms (Art. 142 SrbLOA). The SrbCPA as *lex specialis* links the incorporation of all contract terms with the principle of transparency, and acceptance. Contract terms will become part of the contract provided they are transparent (Art. 44(2) SrbCPA), and if the consumer expressly accepted them (Art. 44(3) SrbCPA). Acceptance may be given by words or conduct but silence is not sufficient (Arts. 28, 39, 42 SrbLOA). Moreover, a contract clause stating that the consumer accepted the term unless expressly rejected it, is not binding on a consumer (Art. 44(4) SrbCPA). Therefore, if a consumer fails to expressly accept, a non transparent contract term it will not become part of the contract, transparency will be a vetting rule. However, as said earlier, consumer contracts are usually contracts of adhesion, therefore, even if the consumer has a real chance to understand the terms of the contract (the terms were transparent) he has no choice but to accept them. Therefore, the main question is, can the consumers’ acceptance later be challenged? There are no special rules in the SrbCPA on this issue, thus, the general rules of the SrbLOA apply. Generally, the inner will and intention, which is not available to the other contracting party, is not legally relevant.⁴²⁵ Therefore, the general rule is that if there is a conflict between the inner and the expressed will, courts will take into account the expressed will, provided it is expressed freely and honestly (Art. 28(2) SrbLOA).⁴²⁶ This provision relates to duress and deceit. Hence, “regular” pressure to conclude the contract, e.g. a desperate need for money, will not count as valid ground for challenging acceptance. Hence, transparency and acceptance are not sufficient safeguards against the inclusion of unfair terms into the contract.

⁴²⁵ Antić 2009, p. 297-299.

⁴²⁶ Exceptionally courts may give priority to inner will. See: Higher Commercial Court 2517/2009.

IV.5.1. Consumer protection law versus general contract law

As the SrbCPA did not implement the limitations of the UCTD the question is whether limitation of contractual freedom in the SrbLOA as *lex generalis* can be overridden by SrbCPA as *lex specialis*? The limits of contracting are set in a very general manner in the SrbLOA by mandatory legal rules (*ius cogens*), public policy (*ordre public*)⁴²⁷ and good customs (*bonae mores*)⁴²⁸ (Art. 10 SrbLOA). Terms that fall within these limits are null and void (Art. 103(1) SrbLOA).

It is most likely that mandatory legal rules are drafted in order to protect the weaker contractual party, and therefore will safeguard the fairness of contract terms within the meaning of Art. 46 SrbCPA. The same will be the case with public policy and good customs. It is almost impossible to imagine a term that is unfair and is in harmony with public policy and good customs. However, it is possible, at least in theory that some terms which are mandatory in nature are actually in statutes to protect some other interest than the consumers', and as such mandatory and unfair, they are imposed on a consumer. As Antić points out, mandatory legal rules have to be observed at any event, even if they are not fair and just.⁴²⁹ This could be the case with services of general economic interest having in mind that the majority of service providers are state monopolies in Serbia. The likelihood of unfair terms is also easily imaginable in financial services contracts taking into consideration the power of service providers over the regulators. If such a collision emerges the question is whether to blindly apply the mandatory rule in accordance with the general rules of contract law, or can the term be still assessed for its fairness?

In order to answer this question one must have in mind that the entire SrbCPA, all the provisions therein are of mandatory nature. The SrbCPA expressly stipulates that consumers cannot give up the rights the SrbCPA confers on them (Art. 3 SrbCPA), and one of the rights is: the right to have contracts with fair and just terms. An additional point is that the status of SrbCPA is *lex specialis* as opposed to the SrbLOA that is *lex generalis*. Thus, in accordance with the general principle that *lex specialis derogat legi generali* the applicable legislation in case of collision would be the SrbCPA. Moreover, the SrbCPA states: “[t]his Law shall also apply to the agreements which aim at or result

⁴²⁷ See on the meaning Slobodan Perović, Law of Obligations, Službeni list SFRJ, Beograd, 1986, p. 162-168; Cf Antić 2009, p. 218.

⁴²⁸ See on the meaning e.g. Antić 2009, p. 220 with further references.

⁴²⁹ Antić 2009, ft. 590.

in circumventing the provisions of this Law” (Art. 3(5) SrbCPA), in order to make sure the application of the act is not excluded by the business. This leads to a conclusion that even mandatory statutory rules could be subject to the test of fairness, and rules invited to protect public policy and good customs and annulled if they prove to be unfair. However, even if the conclusion is correct, an enormous resistance of judiciary is expected in enforcing the rules of SrbCPA over the general principle of contract law laid down in the SrbLOA. Practice shows that in case of consumer disputes judges favour the familiar the SrbLOA over the relatively new consumer protection rules.⁴³⁰

IV.5.2. Time of assessing unfairness

Although Art. 46(3) SrbCPA overtakes the circumstances to be taken into account in interpreting the test of fairness from Art. 4(1) UCTD, it does not say when the assessment should be done. According to Karanikić-Mirić, the time for determining whether a contract term is unfair should be the moment of contract conclusion. She came to this interpretation not just by looking at the UCTD but also taking into consideration the internal logic of the general institution of absolute nullity, which requires that the reason for nullity exist at the moment of contract conclusion.⁴³¹ Additionally, the SrbCPA does not mention the time of assessing fairness within the test of fairness (Art. 46(2) SrbCPA), despite being familiar with the importance of this moment.⁴³² However, even if it is accepted the general rule for assessing fairness is the time of contract conclusion, there are exceptions under the SrbCPA and the SrbLOA. Namely, Art. 46(2)(3) SrbCPA discussed above, focuses on performance, stipulates a contract terms will be unfair if performance is substantially different from what the consumer legitimately expected under the contract. Art. 46(2)(2) SrbCPA stipulates that a contract term will be unfair if it causes the execution of the contract to be burdensome to the consumer without a justifiable reason. Moreover, the SrbLOA on several occasions refers to circumstances which could not have been avoided (*force majeure*); and it is familiar with the institution of *clausula rebus sic stantibus*.

As part of the test of fairness, Art. 46(2)(2) SrbCPA provides a *contract term will be unfair if it causes the execution of the contract to be burdensome to the consumer without a justifiable reason*. The wording of the provision suggests it relates to terms

⁴³⁰ Karanikić-Mirić 2010, p. 129. See also V.6.1.2. for examples.

⁴³¹ Karanikić-Mirić 2010, p. 144.

⁴³² In relation to the conformity of goods (Art. 51 SrbCPA); package travel (Art. 99 SrbCPA).

which do not look unfair on their face, but become such during their application. Therefore, this ground for the annulment of unfair contract terms comes into play during the performance of the contract. The conditions laid down by this provision are set cumulatively, and are the following: 1) the execution of the contract has to be burdensome; 2) the burden is not justifiable; 3) the detriment must be on the side of the consumer. All these conditions are subject to interpretation. What is burdensome, and what is justifiable will depend on circumstances of a particular case. Nevertheless, by providing this separate ground for assessing fairness, the SrbCPA provides for a higher level of protection than the UCTD.

The SrbLOA does not incorporate the *force majeure* as a separate legal principle, but at certain instances it does refer to special circumstances that could not have been foreseen, avoided or eliminated.⁴³³ In the lack of clear definition, it is uncertain what the exact content of the institution is. For example as a general rule, the debtor will be relieved from liability to pay damages if it can prove, it could not fulfil or it defaulted in fluffing its contractual obligation due to circumstances which he could not avoid or prevent (Art. 263 SrbLOA). This provision does not mention foreseeability as a necessary condition. In the Serbia legal theory *force majeure* is considered different from *casus*.⁴³⁴ *Casus* (“slučaj”) generally means the absence of guilt in contract.⁴³⁵ These are usually circumstances which could not have been foreseen, and therefore avoided. *Force majeure* is a qualified *casus*,⁴³⁶ where the emphasis is on extraordinary circumstances, and not so much on their foreseeability.⁴³⁷ What is important is that the circumstances could not have been objectively and absolutely avoided, even if they were foreseeable.⁴³⁸ Therefore, the following cumulative conditions have to be satisfied: 1) the circumstance was extraordinary or unforeseeable; 2) it was not avoidable; 3) the event was external (not attributable to the fault of the contracting party).⁴³⁹ *Force majeure* may lead to impossibility of performance (Art. 137 SrbLOA).⁴⁴⁰ Impossibility relates to practical impossibility. Therefore, if the performance is possible

⁴³³ E.g. Art. 684 SrbLOA in relation to the liability of the carrier.

⁴³⁴ See e.g. Jakov Radišić, *Law of Obligations – general part*, Nomos, Belgrade, 2006, p. 231.

⁴³⁵ Radišić 2006, p. 230.

⁴³⁶ Stevan Jakšić, *Law of Obligations – general part*, Veselin Masleša, Sarajevo, 1953, p. 242.

⁴³⁷ Radišić 2006, p. 231.

⁴³⁸ Ilija Babić, *Fundamentals of civil law – introduction to civil law and property law*, Službeni glasnik, Belgrade, 2008, p. 110.

⁴³⁹ Radišić 2006, p. 231-232.

⁴⁴⁰ If one party's performance becomes impossible due to circumstances after the contract was concluded and if this impossibility is not attributable to the fault of the parties, the contract will cease to exist (Art. 137(1) SrbLOA).

in abstracto but is extremely difficult *in concreto*, it will be still considered impossible within the meaning of Art. 137 SrbLOA.⁴⁴¹ However, if performance is only extremely expensive (economic impossibility) it might not be a good reason for declaring the performance impossible.⁴⁴² Performance has to be permanently and objectively impossible.⁴⁴³ Perović points out that *force majeure* and impossibility of performance are not the same legal institutions. *Force majeure* is one, but not the only situation when performance becomes impossible.⁴⁴⁴ On the other hand, *force majeure* can make the performance only extremely difficult, but not necessarily impossible.⁴⁴⁵

Turning now to *clausula rebus sic stantibus*, Art. 133(1) SrbLOA provides that if after the conclusion of the contract circumstances that make difficult the execution of the contract for one party, or which are such as to make the aim of the contract unrealizable, to the extent that performance does not meet the parties expectation under the contract and it would be, by a general opinion, unfair to uphold the contract, the party on whom the burden falls can ask the rescission of the contract.⁴⁴⁶ The contract however, cannot be rescinded if the party that relies on the institution, was obliged to take into account such circumstances at the moment of contract conclusion, or could have avoided or overcome them (Art. 133(2) SrbLOA).⁴⁴⁷ The institution is applicable to obligations which are due to perform but before performance. After default the institution cannot be relied on (Art. 133(3) SrbLOA). Likewise, the institution is not applicable after performance is rendered, regardless of the existence of relevant circumstances.⁴⁴⁸ Perović identifies two cumulative conditions that must be satisfied: 1) the change in circumstances must be unforeseeable; 2) circumstances must make the performance difficult, or make the realization of the contractual aim impossible.⁴⁴⁹ As a rule, changed circumstances will make the contract rescinded by the court.⁴⁵⁰ However, the court may decide to modify the contract, if the other party offers or accepts the fair modification (Art. 133(4) SrbLOA). In deciding whether to allow modification or rescission the court

⁴⁴¹ Perović, Commentary on Art. 137, 1995, p. 268.

⁴⁴² Ibid.

⁴⁴³ Perović, Commentary on Art. 137, 1995, p. 271.

⁴⁴⁴ Perović, Commentary on Art. 137, 1995, p. 268.

⁴⁴⁵ Ibid.

⁴⁴⁶ Confirmed by SrbSC Rev. 1810/98. SrbSC Rev. 5083/96. See also: Antić 2009, p. 416.

⁴⁴⁷ Confirmed by SrbSC Rev. 623/97; SrbSC 1810/98. These circumstances might be natural (earthquake, flood, etc), administrative (ban on import, export, etc.) or economic (depreciation of prices, etc.). Antić 2009, p. 416.

⁴⁴⁸ Perović, Commentary on Art. 133, 1995, p. 262.

⁴⁴⁹ Perović, Commentary on Art. 133, 1995, p. 264-265.

⁴⁵⁰ Higher Commercial Court 5077/2003.

will take into account the aim of the contract, the normal business risks, the public interest and the interest of the parties (Art. 135 SrbLOA).⁴⁵¹

Impossibility of performance and rescission or modification of the contract due to changed circumstances are different but connected institutions in Serbia. Because the same circumstances may lead to the application of both institutions, Perović asserts, the institutions may be applied interchangeably.⁴⁵² For example although economic circumstances that make the performance extremely expensive, but not impossible, are not sufficient reason for declaring the performance impossible, they may be enough ground to modify or rescind the contract due to changed circumstances.⁴⁵³

In Serbia, it seems there is no doubt the fairness of contract terms can be reassessed at a later point during performance. This is possible due to the specific ground of unfairness in the test of fairness and to the applicability of the traditional contract law institutions of *force majeure* and *clausula rebus sic stantibus*. They are also likely to be flexible to accommodate the principle of *social force majeure*. Since the test of fairness is relatively new in Serbia, alternatively the two traditional institutions can apply. Nonetheless, the test of fairness is arguably a better protection tool as the two traditional institutions were not created to accommodate “social force majeure situations” of consumers.

It can be concluded that the SrbCPA together with the traditional civil law institutions results in a much higher level of protection than the UCTD, and possibly higher than in Hungary, as changed circumstances are part of the test of fairness.

IV.5.3. Intermediary conclusions

Regarding the limits of the test of fairness Serbia ensures the desired high level of protection as it provides no exemption from the test of fairness. The test is applicable to all contract terms regardless if they are core or ancillary, individually negotiated or standard, mandatory or dispositive. The true applicability of the test to all contract terms is potentially endangered by the general limits of contractual freedom. It remains to be seen how judges will interpret this exemption, and if mandatory rules of law will be challengeable.

⁴⁵¹ SrbSC 2/94, SrbSC 50/95. See more on *clausula rebus sic stantibus*: Miodrag Mićović, *Klauzula rebus sic stantibus: De lege lata and de lege ferenda*, 57(11) *Pravni život* 445-455, 2008.

⁴⁵² Perović, *Commentary on Art. 137*, 1995, p. 268.

⁴⁵³ *Ibid.*

The Serbian test of fairness also provides a much higher level of protection than the UCTD and the HuCC because it provides contract terms that cause the execution of the contract to be burdensome without a justifiable reason are unfair. Hence, change circumstances are a separate ground of unfairness. The fairness of contract terms can be re-examined during performance of the contract. This ground of unfairness also has potentials to incorporate the principle of *social force majeure*. Additionally, the traditional contract law institutions of *force majeure* and *clausula rebus sic stantibus* generally allow the reassessment of the fairness of contract terms at a later point, while the duration of the contract, due to changed circumstances, and accommodate the concept of *social force majeure*.

IV.6. The consequence of unfair terms – remedial control

As the issue of remedial control is not in principle focus of the thesis, this section briefly presents the essence of remedial control in Serbia. The SrbCPA expressly provides unfair terms are null and void (Art. 46(1) SrbCPA). The entire SrbCPA is mandatory and any deviation from its provisions to the detriment of the consumer is null and void (Art. 3(1) SrbCPA). Nullity is of observed *ex officio* by courts (Art. 109 SrbLOA); every (legally) interested party has standing to initiate the proceeding (Art. 109 SrbLOA); submission of the claim is not subject to any limitation periods (Art.110 SrbLOA).⁴⁵⁴ The decision has relative effect, i.e. only between parties to the contract and in relation to the particular contract (*inter partes*). Nullity of a particular term might not necessarily render the entire contract void, if the contract can stand without a void provision (Art. 3(3) SrbCPA). Annulment of a core or essential term will most likely render the entire contract void, while annulment of an ancillary will most likely not. Therefore, the rules on remedial control are in line with Art. 6(1) UCTD, and interpretations of the CJEU.

IV.7. Conclusion

Serbia went a long way from neglecting any special rules for consumer protection, thorough having some rules but not enforcing them, until creating a modern system of consumer protection. The development of Serbian consumer protection

⁴⁵⁴ Besides absolute nullity, a contract may be relatively void or voidable. Voidable contracts aim to protect the private interests of consumers, and therefore the claim may be submitted only by the injured party within a given limitation period (Arts. 111-117 SrbLOA).

regulation is more subject to a revolution rather than an evolution. This “revolution” resulted in a very modern test of fairness that provides for a significantly higher level of protection than the UCTD.

The test of fairness in Art. 46(2) SrbCPA is complex. It has five basis of unfairness, some of which aim towards achieving substantive fairness, some towards both substantive and procedural fairness, and one aims towards procedural fairness. Hence, the test of fairness in Serbia is to be understood as aiming towards both substantive and procedural fairness. Overall, the test of fairness provides for a very high level of protection, much higher than the UCTD and the HuCC.

Regarding the role of transparency, the SrbCPA also sets a higher level of protection than the UCTD and the HuCC. First, it clarifies transparency means a consumer’s real chance to understand the terms of the contract. Second, transparency is an independent basis of unfairness, and procedural fairness alone is capable of making the contract term unfair. Third, procedural fairness is generally not capable of legitimising substantive unfairness because procedural fairness and substantive fairness are set on separate basis under the test of fairness. However, this may be compromised by the multiple inclusion of the principle transparency into the scope of the test. Finally, the great advantage of the Serbian test is the express regulation of the benchmark consumer.

The Serbian test of fairness also provides a much higher level of protection than the UCTD and the HuCC in regard to the limits of the test of fairness. The test is applicable to all contract terms. The true applicability of the test to all contract terms is potentially endangered by general limits of contractual freedom that raises the problem of relation between the traditional contract law rules and modern consumer protection rules. Additionally, the test of fairness expressly allows the re-assessment of contract terms for their fairness during performance. This ground of unfairness also has potentials to incorporate the principle of *social force majeure*. Additionally, the traditional contract law institutions of *force majeure* and *clausula rebus sic stantibus* generally allow the reassessment of the terms of the contract while the duration of the contract, due to changed circumstances, and seem to accommodate the concept of *social force majeure*.

Therefore, the test of fairness in SrbCPA is an almost perfect legislative solution. It is very much fairness oriented, providing both for substantive fairness and procedural fairness leaving very little room for the freedom approach.

In the future, for a higher level of protection, and complete elimination of the freedom approach, it would be useful to delete the multiple inclusion of the principle of transparency into the test of fairness. This primarily means eliminating transparency from the circumstances taken into account in the interpretation of the test of fairness. Additionally, it would be sensible to expressly provide the grounds of unfairness are set alternatively.

Perhaps it is important to express the fear towards another and more important danger. Namely, the test of fairness is new and modern, and in many aspects it departs from the traditional contract law. Therefore, fears is, it will not be applied in practice, that courts will ignore their *ex officio* obligation to rule on fairness of contract terms, either because they are unfamiliar with the new rules or because they do not approve them. So far, after almost three years of the SrbCPA's operation, no voices are heard of judgements relying on the test of fairness. Therefore, judges and lawyers should be made aware on the importance and role of the test of fairness.

CHAPTER V

THE REGIME OF UNFAIR TERMS IN CONSUMER CREDIT CONTRACTS

This Chapter analyzes the regime of unfair contract terms in credit contracts in EU, Hungary and Serbia. It particularly focuses on how the substantive fairness of core and ancillary terms is determined in consumer credit, what the role of transparency or procedural fairness is, and consequences of the limits of the test of fairness. It also tackles broader theoretical questions of regulating consumer credit. The key question this Chapter aims to answer is whether the high level of protection is achieved in consumer credit contracts in EU, and where the protection is not so high, if the protection is higher in Hungary and in Serbia.

V. 1. Characteristics of consumer credit: a general overview

When talking about credit, the first question that is, what is consumer credit? From the consumer's point of view, credit is an arrangement to receive cash, goods, or services now and pay for them in the future.⁴⁵⁵ Therefore, credit makes available funds at the present time, and allows the consumer to pay for them in the future, usually over a certain period of time, in instalments. Taking the view of a lender, consumer credit can broadly defined as "money, goods or services provided to an individual in lieu of payment,"⁴⁵⁶ or the broadest definition of consumer credit is given by the Bank of England, determining consumer credit as "lending to individuals".⁴⁵⁷ Goode defines consumer credit as "financial accommodation of some kind, that is, the provision of a benefit (cash, land, goods, services or facilities) for which payment is to be made by the recipient in money at a later date."⁴⁵⁸ Therefore, generally, there are three important elements of consumer credit. First, the consumer must receive some benefit. Second, the consumer pays for this benefit in the future. Third, repayment is always in money. In the following the thesis shows the main characteristics of consumer credit.

Consumer credit can be viewed as a product and as a service. Consumer credit product is a financial obligation or a set of mutual obligations between the creditor and

⁴⁵⁵ US Chamber of Commerce: http://www.uschamberssmallbusinessnation.com/toolkits/guide/P08_7010 (28 June 2012).

⁴⁵⁶ Steven Finlay, *Consumer Credit Fundamentals*, Palgrave Macmillan, New York, 2009. p. 4.

⁴⁵⁷ Bank of England: <http://www.bankofengland.co.uk/mfsd/iadb/notesiadb/ltoi.htm> (28 June 2013).

⁴⁵⁸ Goode 2004, p. 579.

the consumer set out in the contract. These are basically the contractual rights and obligations of the parties, or the substance of the contract. Consumer credit as a service relates to the process of providing the service, to procedural aspects of contract conclusion.⁴⁵⁹

It is not easy to talk about consumer credit in a universal regime. Consumer credit is connected to national legal systems, their legal traditions and level of economic development. The EU wide study on APR acknowledged (hereinafter: APR Study) that “[c]onsumer credit agreements are very heterogeneous products. Their characteristics vary largely from product to product and there are also significant differences among products of the same type, depending especially on the purpose of the credit, the target public, and the banking practices in each country”.⁴⁶⁰

There is a wide variety of credit products, but not all are present in one jurisdiction.⁴⁶¹ For example, the EU wide study on interest rate restrictions (hereinafter: IRR Study) divided all credits on general-purpose credits and mortgage loans. Within general purpose credits the study differentiated instalment credit, revolving credit, small secured loan and micro credit. Instalment credit further divided onto instalment loan, variable rate credit, fixed repayment credit for general purpose, financial leasing, higher purchase agreement, point of sale financing, differed payment in sales contract, home equity loan. Revolving credit is the overdraft, overrunning, revolving credit account, true credit card credit, deferred debit card credit. Small secured credit may be pawn broking and payday loan. The report divided mortgage loans onto mortgage loan, state subsidized mortgage loans, savings and loan schemes, and endowment loan products.⁴⁶² Additionally, there are various providers of consumer credit. Consumer credit is provided by commercial banks, finance houses, small loan companies, retail stores,

⁴⁵⁹ Cf Damian Chalmers, Gareth Davies, Giorgio Monti, *European Union Law: Cases and Materials*, Cambridge University Press, Cambridge, 2010, p. 793.

⁴⁶⁰ APR Study, p. 15.

⁴⁶¹ According to Dalhuisen the reason for differences in product regulation is because financing often implies some form of proprietary protection for the creditor on the assets of the debtor, for which the applicable law is determined based on the location of the assets. Jan H. Dalhuisen, *Dalhuisen on Transnational, Comparative Commercial, Financial and Trade Law*, Hart Publishing, Oxford, Portland, Oregon, 2007, p. 830.

⁴⁶² Udo Reifner, Sebastien Clerc-Renaud, RA Michael Knobloch, *Study on interest rate restrictions in the EU*, report submitted by the Institut für Finanzdienstleistungen e.V. (iff) and Zentrum für Europäische Wirtschaftsforschung GmbH (ZEW) to the EU Commission, 2010 (herinafter: IRR Study) p. 34 et seq. at DG Internal Market: http://ec.europa.eu/internal_market/finservices-retail/docs/credit/irr_report_en.pdf (28 June 2013).

credit unions and credit brokers.⁴⁶³ But again, not all institutions are present in every jurisdiction.

Finally, credit is very dynamic and is culture dependent. This is not only reflected in consumer preferences in using credit;⁴⁶⁴ but is also connected to funding techniques and financial structures used by banks, and limitations of the legal systems.⁴⁶⁵ Therefore, significant differences exist in the type and level of consumer borrowing, legal rules and the institutional framework of regulation.⁴⁶⁶ Besides cultural, differences might be attributable to the level of economic development, the institutional path dependence of the law, or the influence of different political groups.⁴⁶⁷ The greatest difference exists between common and civil law countries in utilizing and regulating consumer credit.⁴⁶⁸

Consumer credit has multiple economic benefits. On micro level (from the perspective of the consumer) consumer credit gives flexibility in managing household finance and makes available goods and services instantly, without waiting and saving for a later time. Consumer credit is a way of indirect saving,⁴⁶⁹ it allows spreading out the cost of goods over time, but it is also a tool for bridging temporary liquidity difficulties. On macro level (from the perspective of the national economy) consumer credit allows using future income of consumers, and thereby secures their participation at the market even when they would not have normally resources to do so. By bringing liquidity into

⁴⁶³ Roy Goode, *Consumer Credit*, A.W.Sijthoff, Leiden, Boston, 1978, p. 11-18.

⁴⁶⁴ E.g. German consumers traditionally not used credit cards for everyday financing. Even after foreign banks introduced the English credit card model, these cards represent a small portion of the market. Ramsay 2010, p. 373. Figures show different preferences and attitudes towards the use of credit especially between “old and new” Member States. Outstanding loan in e.g. UK (18.2%), Austria (19.3%), or Ireland (23.2%) while in Estonia (4.9%) and Latvia (3.3%) (ECRI Statistics in Nicola Jentzsch, Karel Lannoo, *Much Ado about Little? Agreement on the Consumer Credit Directive Reached*, ECRI Commentary No.2, 23. May 2007 at CEPS: <http://www.ceps.eu/book/much-ado-about-little-agreement-consumer-credit-directive-reached> (29 June 2013).

⁴⁶⁵ Dalhuisen sees internationalization of financial products one of the principle contemporary challenges. Dalhuisen 2007, p. 830.

⁴⁶⁶ Ramsay 2010, p. 373.

⁴⁶⁷ Ramsay 2010, p. 374.

⁴⁶⁸ Raifner underlines the common law and civil law countries rely on a different consumer model. The neo-liberal approach is associated with common law counties (US, UK), and social-market model with Germany. The first adopts the information based approach, and presumes the “responsible consumer” will make rational choices based on adequate information. In contrast, the second is based on a model of a “hasty and needy consumer, forced into contractual relations by social circumstances he cannot control” which therefore needs protection. Social consumer protection entails a greater degree of intervention to limit the creditors contractual freedom. Raifner 2007, p. 326. For critiques see: Ramsay 2010, p. 375. Jovanić points on another difference. Common law systems observe consumer credit from the point of view of its user, underlying the benefits it brings to its user; while civil law countries look at credit from the point of view of the creditor, the benefits it brings to the creditor, when credit becomes an instrument of speculation of financial service providers and exploitative towards the consumer. Tatjana Jovanić, *Consumer credit: legal and economic aspects*, Udruženje banaka Srbije, Belgrade, 2004, p. 17.

⁴⁶⁹ Jovanić 2004, p. 17.

households it allows continuity in consumption and therefore balances demand and supply on the market.⁴⁷⁰ It stimulates consumption which in turn increases production of consumer goods, which again leads to technological development and innovations. Finally, by advancing production and consumption, consumer credit raises the standard of living, leads to economic prosperity and consumer welfare.⁴⁷¹ Due to its importance access to credit is one of the very important rights of every consumer. Even though credit is not a human right, lately, credit is seen as a “service of general economic interest”,⁴⁷² a service that is indispensable to fully participate in the contemporary society and its economic life.⁴⁷³ Basic financial services have been classified as services of general interest in academic writing and by the EU Commission.⁴⁷⁴ The World Bank considers access to credit as a method of reducing income inequality and poverty.⁴⁷⁵

Consumer credit carries a great deal of danger. Credit represents a risk for lenders on one hand, and a risk for consumers on the other. The extensive or uncontrolled use of consumer credit may lead to overindebtedness of debtors and their households, bankruptcy, and social exclusion.⁴⁷⁶ Besides individual problems,

⁴⁷⁰ Cf Jovanić 2004, p. 13.

⁴⁷¹ See e.g. Jovanić 2004, p. 5. Consumer welfare refers to “the individual benefits derived from the consumption of goods and services” determined subjectively, by an individual's own assessment of its satisfaction of given prices and income. See OECD Glossary of Statistical Terms at the OECD: <http://stats.oecd.org/glossary/detail.asp?ID=3177> (12 December 2012).

⁴⁷² “Services of general economic interest” is an EU term for “services of an economic nature” which are subject to “public service obligations”. It is mentioned in Arts. 14 and 106 TFEU, without giving a definition. The EU Commission submits these services are different from ordinary services in a way that public authorities consider them as needed to be provided even where the market is not sufficiently profitable for their supply. The concept of services is based on the concern to ensure that a quality service is provided at an affordable price, everywhere and for everyone. It particularly covers transport, postal services, energy and communications. However, the term also extends to any other economic activity subject to public service obligations. See: Pt. 41 White paper on services of general economic interest, COM (2004) 0374 final, 12.5.2004; Pt. 17 Green Paper on services of general economic interest, COM (2003) 270 final, 21.5.2003. The term “public service obligations” refers to specific requirements that are imposed by public authorities on the provider of the service in order to ensure that certain public interest objectives are met. Pt. 20 Green Paper above.

⁴⁷³ According to Ramsay, even though EU documents do not classify financial services as services of general economic interest, credit might be argued to have such characteristics. This argument is especially proved by the existence of special institutions that provide access to credit for lower income consumers (credit unions in the UK, savings banks in Germany, or the municipal banks in the Netherlands). Iain Ramsay, Regulation of consumer credit, 266-408, In: Handbook of research on International Consumer Law, Geraint Howells, Ian Ramsay, Thomas Wilhelmsson (eds.), Edward Elgar, Cheltenham, Northampton, 2010, p. 383-384.

⁴⁷⁴ Recommendation on access to a basic payment account, C (2011) 4977.4, xxx. See also Ramsay 2010, p. 383.

⁴⁷⁵ World Bank Policy Research Report, Finance for All? Politics and Pitfalls in Extending Access, Washington, 2008, at World Bank: http://siteresources.worldbank.org/INTFINFORALL/Resources/4099583-1194373512632/FFA_book.pdf (28 November 2012).

⁴⁷⁶ Social exclusion means social disadvantage, when individuals and their households are excluded from opportunities and resources (e.g. housing, employment, healthcare, democratic participation and due

systematic default on credit by a larger number of consumers can shake the safety and soundness of financial institutions; this in turn can lead to systemic risk and sovereign debt problems. Therefore, consumer credit potentially represents an area of pressing social problems and opens important policy questions. Policy considerations raise the issue of regulation. Regulation in general can be divided into prudential regulation (regulation of safety and soundness of financial institutions), and conduct of business regulation (regulation of how financial institutions conduct business with their customers). Prudential regulation is the regulation of the legal status of creditors, licensing requirements, and prudential operation or capital requirements. Conduct of business regulation has two dimensions.⁴⁷⁷ The first is the regulation of consumer credit as a product (substantive rights and obligations of the parties). The second dimension is the regulation of consumer credit as a service (pre-contractual communication, selling methods). The thesis focuses on conduct of business regulation.

Consumer credit has several “faces.” It can be viewed from the point of view of several scientific disciplines. First, consumer credit is an important economic category. The essence of credit lies in its economic purpose, to raise the level of purchase power of consumers and satisfy their personal needs.⁴⁷⁸ Second, consumer credit is a legal contract between the creditor (lender) and the debtor (borrower, consumer). Third, credit represents an important social question, on the micro level of an individual consumer and its household, and often on the macro level on the level of entire society. Fourth, credit is closely related to behavioural science (the area of sociology, anthropology, and psychology) that studies behavioural patterns of consumers as a help tool for regulation. Finally, credit is a key policy area where regulators have to reconcile two significantly opposing interests, i.e. those of financial institutions to gain profits on free market basis and those of consumers to have access to affordable services and to receive help in financial stress. In the following the thesis focuses on the legal side of consumer credit, the contract of consumer credit.

process) that are normally available to members of society and which are key to social integration. Institute on Social Exclusion at the Adler School of Professional Psychology at <http://www.adler.edu/page/institutes/institute-on-social-exclusion/about> (28 November 2012).

⁴⁷⁷ Peter Cartwright, *Banks, Consumers and Regulation*, Hart Publishing, Oxford, Portland, Oregon, 2004, p. 5-6.

⁴⁷⁸ Jovanić 2004, p. 128.

V.2. Regulation of consumer credit in the European Union: a brief overview

Regulation of consumer credit was among the priorities of the united Europe. The first legislation, the *Directive on Consumer Credit* dates back to 1987.⁴⁷⁹ It aimed to create an environment where consumers are sufficiently protected throughout the EC and are confident to carry out cross-border transactions. However, the directive did not reach the set aims, and soon also became outdated.⁴⁸⁰ This resulted in two amendments.⁴⁸¹ Despite, the consumer credit market remained fragmented and cross-border credit transactions rare. In 1995 the EU Commission released a Report⁴⁸² that confirmed the unsuitability of the directive to new market situations and credit trends. In 2002 the EU Commission adopted its “quite far-reaching and often innovative”⁴⁸³ proposal for a revised consumer credit directive⁴⁸⁴ introducing many novelties. This consequently opened the door for a long legislative process and debate, and finally resulted in a new, revised, and less radical proposal, and the adoption of the CCD.⁴⁸⁵

In order to increase cross-border mortgage lending, in 2001 the EU Commission draw up the *European Agreement on a Voluntary Code of Conduct on Pre-Contractual*

⁴⁷⁹ Council Directive 87/102/EEC of 22 December 1986 for the approximation of the laws, regulations and administrative provisions of the Member States concerning consumer credit, OJ L 42, 12.2.1987.

⁴⁸⁰ It aimed at the two most common credit forms at that time, the hire-purchase agreements and instalment credits. In the meantime, the “cash society” was replaced with “credit society”, and some “new” ways of obtaining credit such as cards with deferred payment/credit cards, cash credit and overdraft facilities, were only partially, if at all, covered. Amparo San José, Consumer credit directive: a feasible attempt to harmonization?, ECRI Consumer Credit Newsletter, October 2002, p. 6-7 at ECRI: http://www.ecri.eu/new/system/files/Newsletter_No_6.pdf (29 June 2013).

⁴⁸¹ Council Directive 90/88/EEC of 22 February 1990 amending Directive 87/102/EEC for the approximation of the laws, regulations and administrative provisions of the Member States concerning consumer credit, OJ L 061, 10.03.1990; Directive 98/7/EC of the European Parliament and of the Council of 16 February 1998 amending Directive 87/102/EEC for the approximation of the laws, regulations and administrative provisions of the Member States concerning consumer credit OJ 1998 L 1011998. These amendments mainly focused on the cost of the credit. The 1990 amendments introduced a harmonized concept for the calculation of the APR, to which the 1998 amendments added technical details. For an overview of the 1978 CCD after amendments see: Conor Quigley, *European Community Law*, Kluwer Law International, 1997, p. 285-294.

⁴⁸² Report on the operation of Directive 87/102, COM (95) 117 final, 11.05.1995.

⁴⁸³ Geraint Howells, Proposal for a New Consumer Credit Directive: COM(200) 443, 59 Consumer Finance Law Quarterly Report 112-113, 2005, p. 112.

⁴⁸⁴ Proposal for a Directive of the European Parliament and of the Council on the harmonization of the laws, regulations and administrative provisions of the Member States concerning credit for consumers, OJ C 331E, 31.12.2002.

⁴⁸⁵ Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on credit agreements for consumers and repealing Council Directive 87/102/EEC, OJ L 133, 22.5.2008.

On the legislative process and analysis of the CCD see: Andrea Fejős, *The Features of the New Directive on Consumer Credit*, Collected Papers of the International Biannual Conference of the West University of Timisoara, Bucharest, 618-633, 2010.

Information for Home Loans.⁴⁸⁶ Since it made no significant step towards the creation of the internal market in mortgage loans, and the CCD exempted mortgage loans from its scope, in 2011 the first proposal for a binding legislation, the *Proposal for a Directive on Credit Agreements Relating to Residential Property* has been adopted.⁴⁸⁷

Credit contracts concluded with the means of distance communication are regulated by the *Directive 2002/65/EC on Distance Marketing of Financial Services*.⁴⁸⁸ Rec. 15 points out distance contracts are those where the negotiation, the offer and the acceptance is made at distance, i.e. without a simultaneous physical presence of the parties. Since the act refers to all financial services (banking, insurance, payment and investment services, including pension funds) provided at distance, it is therefore *lex generalis* for distance financial contracts.⁴⁸⁹

In the following the thesis will primarily relies on the CCD, as it has the widest scope of application, which scope was even extended to mortgage loan credits and finance lease in the selected jurisdictions. It is also a binding EU legislative act and a law in force. The CCD was adopted with an aim to facilitate the emergence of a well functioning internal market, to create a “level playing field” in consumer credit (Rec. 7 CCD), and to raise consumer confidence by providing a high level of consumer protection (Rec. 8 CCD). In order to achieve an integrated internal market the CCD is based on full harmonization (Rec. 9 CCD). However, despite begin heavily criticized by academia⁴⁹⁰ full harmonization is not followed up to the fullest extent. Some issues are completely out of scope of the CCD, and remained under national competence (mortgage loan credits, hiring and lease agreements, free of charge credits, and credits granted under especially favourable conditions), to some issues the CCD only partially apply (overdraft facilities, credit repaid within three months), and some are left to the choice of Member States.⁴⁹¹ The subjects of full harmonization were those issues that are supposed to facilitate cross-border landing.⁴⁹²

⁴⁸⁶ Endorsed by the Commission Recommendation of 1 March 2001 on pre-contractual information to be given to consumers by lenders offering home, OJ L 69/25, 20.3.2001.

⁴⁸⁷ Proposal for a Directive on credit agreements relating to residential property, COM/2011/0142 final, 31.3.2011.

⁴⁸⁸ Directive 2002/65/EC of the European Parliament and of the Council of 23 September 2002 concerning the distance marketing of consumer financial, OJ L 271, 9.10.2002.

⁴⁸⁹ See Rec.14 CCD.

⁴⁹⁰ See Fejös 2010, p. 622-624 with further references.

⁴⁹¹ This exemption relates to the British mutual savings bank and to certain agreements that modify existing credit agreements.

⁴⁹² These are: standardized pre-contractual information (Arts. 5 and 6 CCD); information to be included in the credit agreement (Art. 10 CCD), the rights of withdrawal (Art. 14 CCD), the right of early repayment

The CCD primarily regulates consumer credit as a financial service and not as a financial product.⁴⁹³ Namely, it uses two regulatory tools for providing consumer protection. The first is the regulation of providing information, particularly in pre-contractual phase. The second is to provide consumers with the right of withdrawal and early repayment.⁴⁹⁴ The CCD primarily focuses on consumer credit as a service because it mainly relies on the first regulatory tool that does not go into the parties' rights and obligations (as opposed to the second regulatory tool), probably due to difference in consumer credit markets (Rec. 26 CCD). Although the information paradigm primarily relates to consumer credit as a service, it has significance for the issue of procedural fairness. Therefore, it will be explored in the thesis to a limited extent as long as it is necessary to establish the meaning of procedural fairness in credit contract. The thesis will not analyze the second set of regulatory tools, as these two institutions are not questionable from the aspect of fairness (not at least from the point of view of the consumer). The thesis explores the connecting points between the regulation of consumer credit and the regime of unfair contract terms. In general, as laid down in Rec. 30 CCD, the CCD is not concerned with the regulation of contract law issues related to the validity of credit agreements. Therefore, issues of contract law remain under the competence of the UCTD. Consequently, the UCTD remain the focus of this Chapter, and the rules of CCD will be taken into account only insofar as they are relevant for the fairness regimes under the UCTD and the implementing national statutes.

V.3. The two systems of consumer credit

Before turning to the question unfair terms in consumer credit in Hungary and Serbia, it is necessary to briefly describe the system of consumer credit in these selected jurisdictions. The systems of consumer credit consists of legal regulation (legal framework), and the institutional structure (institutional framework) of consumer credit.

The CCD is implemented into HuCCA, with extended scope of application on mortgage loans and financial leasing. The Hungarian legislator departed from the

(Art. 16 CCD), and the fixed calculation method of the APR (Art. 19 CCD). See Margaretha Lawrynowicz in cooperation with national reporters, Implementation of the Consumer Credit Directive, a study submitted to DG for internal policies of the EU Parliament, 2012 (hereinafter: CCD Implementation Report), p. 26 at EU Parliament: <http://www.europarl.europa.eu/document/activities/cont/201201/20120130ATT36564/20120130ATT36564EN.pdf> (29 June 2013).

⁴⁹³ The same is true for other EU documents discussed above.

⁴⁹⁴ Cf Twigg-Flesner&Schulze 2010, p. 130.

established practice of partial (or integrated) implementation, and opted for modular implementation. Besides the HuCCA, HuCIFEA contains very important rules.⁴⁹⁵ The implementation of the CCD, possibly together with the financial crises, triggered the adoption of secondary legislation, the *Government Decree 361/2009 on Responsible Lending and Assessing Creditworthiness*, and *Government Decree 83/2010 on the Determination, Calculation and Publication of the APR* (hereinafter: APR HuDecree). The financial crisis motivated the *Association of Hungarian Banks* (“Magyar Bankszövetség”) to adopt the *Code of Conduct Principles of Fair Conduct of Financial Organizations Engaged in Retail Lending of 2010* (hereinafter: HuCode) parts of which were later copied in the *Government Decree 275/2010 on the Conditions of Unilateral Modification of Interest Rate Defined in the Contract* (hereinafter: UM HuDecree). An integral part of the regulation of consumer credit is the credit reporting system, regulated by *Act CXXII of 2011 on the Central Credit Information System*. Talking about the legislative framework it has to be added, that in exploring unfair terms in consumer credit agreements the HuCC is crucial. In the absence of special rules for unfair terms in consumer credit, the general rules in HuCC apply.

On the institutional side, consumer credit can be provided by financial institutions and credit intermediaries regulated by the HuCIFEA. Credit intermediaries are defined in the HuCCA⁴⁹⁶ and regulated in the HuCIFEA.⁴⁹⁷ Financial institutions (“pénzügyi intézmény”) are credit institutions (“hitelintézet”) and financial undertakings (“pénzügyi vállalkozás”) (Art. 4(1) HuCIFEA). Credit institutions are banks, specialized credit institutions, or cooperative credit institutions (Art. 5(3) HuCIFEA). Financial undertakings are e.g. financial holding companies, or branches of foreign financial institutions (Art. 6 HuCIFEA). Although the general competence of credit institutions and financial undertakings is different, from the aspect of the thesis it is important that both institutions are competent to issue loans. Loans can also be provided by payment institutions (“pénzforgalmi intézmény”) (Art. 6/A(1) HuCIFEA). Therefore, in Hungary, there is a wide range of creditors; retail loans are provided not just by commercial banks, but also by mortgage credit institutions, building

⁴⁹⁵ Before the implementation of the CCD consumer credit was regulated in dual regime. The HuCCA contained the rules for loans provided by retailers, and other non-professional lenders (trade credit); while the HuCIFEA contained rules on credit provided by financial institutions (loan credit). See for more: e.g.: Ágnes Kertész, Rules of consumer credit, 104-132 In: Bártfai Judit, Bozzay Erika, Kertész Ágnes, Wellacher Lajos, New rules on guarantee and warranty, hvgorac, Budapest, 2004; Fazekas 2007, p. 183-188.

⁴⁹⁶ Art. 3(7) HuCCA; Art. 3(1)(f) CCD.

⁴⁹⁷ See Chapter XXXI HuCIFEA.

associations, savings- and credit cooperatives, the branches and financial enterprises, as well as by insurance companies and pension funds. The thesis primarily focuses on commercial banks as creditors. Creditors are subject to strict licensing requirements laid down in the HuCIFEA, the licenses being issued, controlled and potentially revoked by the HuNB (Chapter I&II HuCIFEA). From 1 October 2013, when the HuFSA was integrated into the HuNB, the HuNB became the regulator and supervisor of the credit sector.

Unlike the complex legal and institutional framework of Hungary, this framework is simple in Serbia. The CCD is implemented into SrbFSUPA. But as in Hungary, the issue of unfair terms is exempted from the SrbFSUPA and the SrbCPA and SrbLOA apply. Additionally, in regulating consumer credit, the decisions of the SrbNB are important.

On the institutional side, in Serbia, according to Art. 5 *Banks Act of 2005* creditors are only banks.⁴⁹⁸ Since Serbia is not an EU Member State the “passport principle,” which allows financial institutions legally established in one Member State to establish and provide their services in the other Member States without further authorisation requirements,⁴⁹⁹ does not apply. Hence, the regulatory and supervisory perspective, all banks are Serbian banks. Therefore, if a foreign bank intends to spread its activities to Serbia, it has to register a separate company, a new bank in Serbia.⁵⁰⁰ Consequently, there are no branches or subsidiaries of foreign banks. The professional association of banks is the *Association of Serbian Banks* (“Udruženje banka Srbije”). It operates the *Central Credit Registry*,⁵⁰¹ and adopted a *Code of Banking Practices* (hereinafter: SrbCode). Creditors are subject to strict licensing regime, the license being given and revoked by the SrbNB. The SrbNB is also a regulatory and supervisory authority for banks. In Serbia, there are no credit intermediaries,⁵⁰² or at least no independent intermediaries. If credit contracts are concluded outside the bank, it will be

⁴⁹⁸ Official Gazette of the Republic of Serbia No. 107/05.

⁴⁹⁹ DG Internal Market: http://ec.europa.eu/internal_market/bank/index_en.htm (12 November 2013).

⁵⁰⁰ The majority of Serbian banks are owned by foreign banks. See Financial Times: <http://www.ft.com/intl/cms/s/0/866f14a8-3a42-11e3-9243-00144feab7de.html#axzz2kKHF1w3D> (9 Nov. 2013).

⁵⁰¹ Established based on Art. 63 Articles of Association of the Association of Serbian Banks as its organizational unit: <http://www.ubs-asb.com/LinkClick.aspx?fileticket=XR4m5mEjKHw%3d&tabid=55&mid=1071> (7 July 2013). See for critiques of this organizational option: Petar Milutinović, Vladimir Dobrić, The legal status of the credit registry and the protection of credit users, 58(13) *Pravni život* 89-113, 2009, p. 106-113.

⁵⁰² Confirmed by Mira Erić-Jović, (then) Vice-Governor of SrbNB, at Financial Services Users Protection Act, Forum on the SrbFSUPA, organized by Business Info Group, Belgrade, 1 February 2011.

though a representative of a bank, who is the bank's agent, and consequently, the principal (bank) will bear the responsibility for the concluded credit agreement. The legal status of such agents, which may be in a way intermediaries, is not subject to a separate regulation and the SrbLOA applies.

Therefore, as it can be seen, the system of consumer credit in Hungary is much more complex than in Serbia, both in terms of legal structure and institutional framework.

V.4. Consumer credit contracts defined

Although it is difficult to give a universal definition of consumer credit, definitions do exist, and the thesis now turns to the definitions given in the CCD, HuCC and in the SrbLOA.

In CCD defines consumer credit agreements in Art. 3(c) CCD as

“an agreement whereby a creditor grants or promises to grant to a consumer credit in the form of a deferred payment, loan or other similar financial accommodation, except for agreements for the provision on a continuing basis of services or for the supply of goods of the same kind, where the consumer pays for such services or goods for the duration of their provision by means of instalments.”

It can be seen that the CCD gives a very wide definition of consumer credit. It considers consumer credit almost any loan, save for trade credit. Besides this general definition, by looking at credit contracts to which the CCD does not apply (Art. 2(2) CCD), it can be concluded, the European legislator considers mortgage loans, overdrafts, overrunning, and even interest free loans consumer credits.

In Hungary, Art. 3(9) HuCCA defines consumer as:

“credit and loan contract defined in the HuCC, except for agreements for the provision on a continuing basis of services or for the supply of goods of the same kind, where the consumer pays for such services or goods for the duration of their provision by means of instalments”

As the CCD, the HuCCA is not applicable for trade credits, and for some credit agreements that are also exempted from the scope of the CCD e.g. free of charge credits. Unlike the CCD, the HuCCA does apply to mortgage loans and financial lease (Art. 2(3) HuCCA).⁵⁰³ The HuCCA does not define what consumer credit is, but points to

⁵⁰³ The Hungarian legislator extended the application of the HuCCA onto mortgage loans because of problems on the consumer mortgage backed consumer credit market; and onto finance lease because from a consumer protection point of view the lessors need equal protection as debtors. In practice, consumers see finance lease and consumer credit as alternative financing option. Varga 2010, p. 199.

traditional definitions in the HuCC. The HuCC knows for two kin-types of nominated contracts, i.e. credit (“hitelszerződés”) and loan agreements (“kölcönszerződés”).⁵⁰⁴

According to the Art. 522(1) HuCC:

“Under the credit agreement concluded by banks, the financial institution undertakes an obligation to maintain a specific line of credit, for a commission, in favour of the other contracting party and, if the conditions stipulated in the contract are satisfied, to conclude loan contracts or effect other credit transactions charged to the line of credit.”

Loan contracts are defined in Art. 523(1) HuCC as:

“[o]bligation of financial institutions or other creditors to place a certain amount of money at the disposal of a debtor who is obliged to repay the loan in accordance with the contract.”

Therefore, credit contracts can be concluded by banks, whereas loans can be provided by a wide range of financial and non-financial institutions, and credit agreements can only be concluded by banks. In a credit contract concluded by banks the contracting parties are the bank and its customer, and the contract creates a long term banker-customer relationship.⁵⁰⁵ In this relationship, the bank only undertakes an obligation to maintain a line of credit, and to eventually conclude a loan agreement when certain conditions set by the bank are met by the customer. Consequently, the bank is not obliged to release the money or conduct other credit activity, neither is the customer obliged to take the funds credited. The parties can only later conclude a loan contract, under which the money will be released. For maintaining the line of credit the bank is entitled for commission, which the customer has to pay, regardless of faith of the loan contract. The bank will usually maintain the line of credit as long as the customer pays the commission.⁵⁰⁶ Once a loan contract is concluded the credit contract ceases to exist, and the loan contract has its separate path of existence, under the rules applicable to loan contracts under the HuCC. Consequently, if later the credit contract ceases to exist for some reason, e.g. it expires, or the consumer is no longer creditworthy, the loan contract

⁵⁰⁴ The nHuCC kept this differentiation (Arts. 6:282 and 6:383 nHuCC).

⁵⁰⁵ Credit contracts represent a sui generis preliminary contract for loan contracts, because the obligation to conclude a credit contract, upon the fulfilment of conditions, lies only on the creditor. Judit Barta, Redrafting of the rules on loan and credit relations in the codification process 7-21 In: Bank and credit relations, Studies on the new Civil Code, Novotni, Miskolc, 2009, p. 10; cf Varga 2010, p. 198; However, from point of view of the debtor the credit contract is not a preliminary contract, but represents an optional right that empowers the debtor with unilateral right to ask the creditor to conclude a loan contract. Bíró et al. 2003, p. 258.

⁵⁰⁶ Credit contracts are commutative contracts, because the banks obligation to maintain the line of credit and an obligation to conclude a loan contract is balanced with the debtors' obligation to pay commission. György Bíró, Györgyi Csákó, Görgyi Csécsy, Annamária Herpai, Ildikó Ostváth, Basic contract types, György Bíró (ed.), Novotni Alapítvány a Magánjog Fejlesztéséért, Miskolc, 2003, p. 259.

concluded based on the credit continues to exist. An additional difference is that loan contracts are concluded with the meeting of minds on essential elements of the contract (Art. 205(1) HuCC),⁵⁰⁷ while credit contracts must be in a written form (Art. 522(2) HuCC).

The differentiation between credit and loan contracts can have practical consequences. In one case involving investment credit, the contract was concluded in writing, but failed to settle the method of payment by the bank. Later the company argued that it suffered losses because the bank did not release the agreed amount of the loan one time, but in instalments. Before making a decision on damages claims, the court had to estimate whether the parties concluded a credit or a loan agreement, as credit agreements have to be in writing, which is also an essential requirement of modification. In this case, the modification was accepted by conduct, but was not laid down in writing. The Supreme Court ruled the contract in question was a loan contract and therefore the modification was valid, and no claim for damages was awarded. Although the court did not explain its reasoning, by having a look at the facts of the case it can be seen that the parties did conclude earlier a credit contract when the financial institution checked whether all the conditions are satisfied and decided to release the funds. The issue in the case was exactly the method of releasing the funds, and this was already the matter of the loan contract.⁵⁰⁸ This case underlines that sometimes it is difficult to distinguish when the loan contract is concluded after the conditions in the credit contract are satisfied, as loan contracts might be concluded orally or even by conduct, and there is no need for a written document. However, the difference between credit and loan contract is abolished by the HuCCA as *lex specialis*. The HuCCA only refers to consumer credit contracts, but in defining credit agreements points to both credit and loan contracts of the HuCC.⁵⁰⁹ The thesis follows this approach and considers both contracts, contracts of consumer credit (loan credit).

In Serbia, the CCD is implemented into the SrbFSUPA. The scope of the SrbFSUPA also extends its application onto mortgage loan credits and finance lease, its scope of protection seem even wider than the HuCCA's. The SrbFSUPA protects *users* of all financial services, including trade credits (Art. 2(1) SrbFSUPA). Similarly, to the

⁵⁰⁷ The contract is concluded with reaching an agreement on essential elements and not with transferring possession over the object of the loan. BH 1998. 443; BDT 2006.1474. See for examples: Ferenc Petrik, Commentary on the Civil Code, Book 2, KJK kerszöv, Budapest, 2004, Commentary on Art. 523, p. 1886.

⁵⁰⁸ BH 2001.544.

⁵⁰⁹ Varga 2010, p. 198.

HuCCA, the SrbFSUPA does not define consumer credit (loan credit) but points to the traditional definition in the SrbLOA (Art. 2(10) SrbFSUPA). According to Art. 1065 SrbLOA:

“The bank undertakes an obligation to make available a certain amount of money to the user, for a determined or undetermined time, with or without purpose, and the user undertakes an obligation to pay the agreed interest and to repay the capital within the agreed time and in the stipulated way.”

As pointed out in the introduction of the thesis, when talking about consumer credit the thesis means loan credit (extended to financial lease) provided by financial institutions. The analysis of the thesis may not be applicable to certain types of credits (classified by the CCD as consumer credit) that potentially trigger a distinct fairness regime.

V. 5. Special features of consumer credit contracts

Consumer credit products share some characteristics with other retail financial products, but also have unique features. The most important features are: the importance and complexity of contracts; connection to risk and time; the underlying banker-customer relationship; soft law as a method of regulation; and increased regulation.

V.5.1. The importance and complexity of contracts

Using the economic term, consumer credits, as most retail financial products, are *credence goods*. This means that it is difficult to ascertain quality at the moment of purchase or in an extreme form may never be open for objective evaluation. Credence goods are opposed to experience goods, the quality of which can be ascertained easily and without additional costs (through use) within a reasonable period after purchase (e.g. package holidays).⁵¹⁰ Using legal language, consumer credits are abstract and intangible legal creations, when all the consumer has is information (pre- and post-contractual information, and information in the contract). The contract sets out the rights and

⁵¹⁰ David Llewellyn, *The Economic Rationale for Financial Regulation*, FSA Occasional Paper Series 1, 1999, p. 36 at FSA: <http://www.fsa.gov.uk/pubs/occpapers/op01.pdf> (8 July 2013).

obligations of the parties,⁵¹¹ it defines the product. Consequently, contracts are central to a banker-customer relationship.⁵¹²

Consumer credit contracts are complex contracts. Complexity is due to the highly technical legal and economic language used to define the terms of the contract; to high volume of contracts; and to a great variety of cost elements.

Contracts are always standard form contracts, to which standard terms and conditions are added. Standard terms and conditions are all inclusive, and contain a number of important rights and obligations of the parties.’ Hence, the majority of terms are determined unilaterally by the creditor. Additionally, consumer credit contracts are contracts of adhesion, and the consumer is offered these unilaterally determined terms on take-it-or-leave it basis. Therefore, the consumers’ freedom of contract in consumer credit comes down to one freedom, freedom to decide whether to enter into the particular contract.⁵¹³

Another aspect of complexity of credit contracts is a great variety of potential cost elements (fees, charges, commissions), their different method of calculation and connection of the credit agreement to ancillary services. The interest rate itself may be fixed or variable, and can be calculated by different methods of calculation. Charges other than interest are present in wide range of forms and schemes (set-up costs, maintenance costs, fees linked to payment transactions and drawdown, fees and charges for sureties and ancillary services, etc.).⁵¹⁴ From the aspect of fairness, all charges can be divided onto contingent, i.e. charges that are contingent on the occurrence or non occurrence of a particular event in the future, and non-contingent charges.⁵¹⁵ Credit is often connected to ancillary services, like opening an account and assuring the credit. If

⁵¹¹ Peter Ellinger, Eva Lomnicka, Richard Hooley, Ellingers Modern Banking Law, Oxford University Press, Oxford, 2006, p. 125.

⁵¹² Ross Cranston, European Banking Law: The Banker-Customer Relationship, Lloyd’s of London Press, London, 1993. p. 1.

⁵¹³ Katalin Dorkó, Retail banking transactions, KJK Kerszöv, Budapest, 2000, p. 29.

⁵¹⁴ APR Study p. 14. For example the newly revised standard terms and conditions of MKB Bank for mortgage loans differentiate: charges that occur before the granting of the loan include: application fee, administration fee, loan commitment fee, on-scene inspection; charges that normally occur during the life of the loan: disposition fee; charges that not normally occur during the life of the loan: administration fee, security valuation fee, contract modification fee when modification is initiated by the customer (except early repayment), early repayment fee, early repayment fee in case of refinancing, closing fee in case of early repayment, closing fee for early repayment by refinancing. See the MKB Bank: http://www.mkb.hu/dl/media/group_473c4ade9d0b8/group_473c4bc790528/item_2192.pdf (29 June 2013).

⁵¹⁵ Cf Willett, forthcoming.

credit is connected to insurance, the lump sum insurance costs will increase the total amount of the credit and hence the payments for capital and interest.⁵¹⁶

V.5.2. Credit in relation to risk and time

Finlay, expressing an economic point of view, points out, risk and time are the two factors that differentiate the creditor-debtor relationships from other types of relationships.⁵¹⁷

Credit involves substantial and permanent risk (credit risk) for the creditor. Risk is the expected loss associated with the debt should the borrower default. Risk is factored into the cost of the credit, consequently, the greater the risk the higher the cost of the credit will be.⁵¹⁸ Financial institutions are obliged to assess the risk of each customer. The CCD contains rules on the assessment of creditworthiness, and provides that it should be determined before the conclusion of the contract, and before the amount of the credit would be changed. Proper assessment of risk is a pre-condition for responsible lending. Besides the credit risk, the UK Financial Services Authority (hereinafter: FSA) (now Financial Conduct Authority, hereinafter: FCA) identified several other risks associated with consumer credit. These are: legal risk of not being able to enforce an unfair term; operational risk of spending management time redrafting contract terms and providing consumers with new contracts; and reputational risk that consumers may not trust a financial institution that tries to rely on unfair terms and may not want to do business with it.⁵¹⁹

Time is in the essence of credit. “[C]redit is future money made available in the present; debt is past money to be repaid in the present.”⁵²⁰ Funds are credited at one point in time, and are paid back at another, later point.⁵²¹ In between, circumstances relating to market conditions, the creditor and the consumer may change. Interest and other charges charged by the creditor, represent the effort or cost of transporting money through time. The longer the repayment, the further the creditor must go in the future to obtain funds, and therefore the greater the cost of the credit will be.⁵²² Time is an

⁵¹⁶ APR Study, p. 14.

⁵¹⁷ Finlay 2009, p. 3.

⁵¹⁸ Ibid.

⁵¹⁹ FSA at http://www.fsa.gov.uk/doing/regulated/uct/terms/risks_1 (5 June 2013).

⁵²⁰ Finlay 2009, p. 3.

⁵²¹ Finlay 2009, p. 11-12.

⁵²² Finlay 2009, p. 3.

important element of determining the price of credit. The price of the credit is calculated based on the borrowed capital and the time.⁵²³

Risk and time are very important for consumers. As credit represents prudential risk for creditors of consumer default, and a “prudential risk” for consumers for not being able to repay the loan, and as a consequence, become over-indebted and socially excluded. Basically, the longer the duration of the credit the higher the risk is it carries. The financial crisis shed light on the vulnerability of households regarding their exposure to financial risks.⁵²⁴

Therefore, risk and time are tightly related notions in relation to credit. When entering into a credit contracts both parties undertake a certain degree of risk. Risk is not a static category and may change over time. From consumers’ point of view, risk is difficult to estimate at the point of contract conclusions, as contracts are long and complex, and overall, difficult to understand, therefore the institution of unfair terms is especially important. It allows harmful terms for consumers’ to be annulled, but the contract, and therefore the funding, maintained.

V.5.3. The banker-customer relationship

Credit provided by banks entails a pre-existing banker-customer relationship, as banks as a rule grant credit only to their customers. In general, a person becomes customer when it opens an account with the bank. For the establishment of a banker-customer relationship it is immaterial what type of account is open and whether it is overdrawn.⁵²⁵ However, at some instances, a relationship may be established already when the bank agrees to open an account in the customer’s name.⁵²⁶

The opening of an account starts a long lasting and complex relationship between the bank and its customer, which involves different types of transactions thought the time. A banker-customer relationship in relation to a particular transaction will be primarily governed by the contract of credit.⁵²⁷ However, the question is, whether banks have additional duties arising out of the underlying banker-customer?

⁵²³ IRR Report, p. 93.

⁵²⁴ Gert Wehinger, *The Turmoil and the Financial Industry: Developments and Policy Responses*, 1 OECD Journal Financial Market Trends, 29-52, 2009, p. 52 at OECD: <http://www.oecd.org/finance/financial-markets/43293643.pdf> (29 June 2013).

⁵²⁵ Ellinger et al 2006, p. 119.

⁵²⁶ Ibid.

⁵²⁷ Ellinger et al. 2006, p. 125.

The banker-customer is a relationship of trust.⁵²⁸ This means, as pointed out by the OECD⁵²⁹ and the World Bank,⁵³⁰ that financial transactions must have some assurance that financial markets and institutions are safe and sound, and operate according to rules and procedures that are fair, transparent, and free from conflicts of interest and other agency problems. Once the banker-customer relationship is established the bank agrees to act as an agent, and therefore is obliged to exercise a degree of care and skill.⁵³¹ The agency relationship especially comes into play when the bank honours the customers' payment instruction, or when it gives financial advice to the customer. However, as it will be seen later, banks do not act as financial advisers for establishing a credit relationship; therefore, this aspect of the relationship of trust is less relevant for consumer credit contracts. The other aspect of agency relationship is a duty of confidentiality. Banks owe this duty in regard to financial affairs of their customers. Although confidentiality raises a number of important questions, e.g. data reporting and sharing with credit registers these issues stay outside the scope of the research.

Besides the general duty of care stemming from the agency relationship, the question is, if banks owe a higher degree of care, fiduciary duties to their customers, i.e. the duties of loyalty and fidelity. "A fiduciary is someone who undertook to act for or on behalf of another in a particular matter in circumstances which give rise to a relationship of trust and confidence."⁵³²The fiduciary relationship is the relationship of trust, and therefore a distinguished obligation of the fiduciary is loyalty. Loyalty means that the fiduciary must act in good faith; he must not make profits out of trust; he must not be in a situation where his duties and interest conflict; he may not act for his benefit or the benefit of a third person without an informed consent of his principal.⁵³³ Typical fiduciary relationships are between lawyers and their clients. Core banking activities (the taking of deposits and giving credit) are not fiduciary in their nature.⁵³⁴ In concluding a

⁵²⁸ This can also be inferred from the origin of the word credit which comes from latin credo, credere that means I believe, to believe, while creditum means to loan, to entrust.

⁵²⁹ Stephen Lumpkin, Consumer Protection and Financial Innovation: A few basic propositions, 1 OECD Journal: Financial Market Trends 1-23, 2010, p. 5 at OECD: <http://www.oecd.org/finance/financial-markets/46010844.pdf> (29 June 2013).

⁵³⁰ Susan L. Rutledge, Nagavalli Annamalai, Rodney Lester, Richard L. Symonds, Good Practices for Consumer Protection and Financial Literacy in Europe and Central Asia: A Diagnostic Tool, ECSPF Working Paper 001, August 2010, p. 22 at World Bank: http://siteresources.worldbank.org/INTECAREGTOPPRVSECDEV/Resources/GoodPractices_August2010.pdf (29 June 2013).

⁵³¹ Ellinger et al. 2006, p. 121.

⁵³² Ellinger et al 2006, p. 129.

⁵³³ Ibid.

⁵³⁴ Ellinger et al 2006, p. 130.

credit contract banks are driven with commercial interests of their own, as banks are not charitable institutions.⁵³⁵ Nevertheless, there is considerable difference between the two basic operations of the bank. Banks may have fiduciary duties in giving “investment advice.”⁵³⁶ However, in providing credit, banks are barred from advising clients. In consumer credit, fiduciary duties are important components of fair treatment of customers, fair conduct of business. They particularly come into play in relation to a duty to inform or disclose information important for contract conclusion.⁵³⁷ Therefore, they are important aspects of procedural fairness. Nevertheless, since in practice banks may be relieved from some fiduciary duties by disclosing all the relevant information, or by excluding or modifying fiduciary duties in the contract (which terms run the risk to be found unfair later),⁵³⁸ it seems that the EU Commission thought appropriate to incorporate these duties into the CCD. Consequently, nowadays, most fiduciary duties connected to consumer credit are regulated as mandatory statutory law.

V.5.4. The role of self-regulatory codes

Besides the contract and the statute, the relationship of the banker and its customer may also be influenced by self-regulatory tool, the banking code of practice. Codes of practice are a separate area of financial regulation, adopted by the banking industry, and are aimed at setting a minimum standard of good practice to be followed by banks.⁵³⁹ They contain conduct of business rules with emphasis on transparency, disclosure, suitability, and fair treatment of customers; aiming towards fair dealing. Ultimately they raise confidence in the financial system and therefore potentially increase market participation.⁵⁴⁰

Codes of conduct are more flexible instruments of regulation than statutes. They are suitable tools of intervention against unfair practices and unfair products. Therefore, although these codes most commonly contain fiduciary duties like duties of disclosure and fair treatment of customers, they may also be used as product intervention tools.⁵⁴¹

⁵³⁵ Ibid.

⁵³⁶ Ibid.

⁵³⁷ Ellinger et al. 2006, p. 135.

⁵³⁸ Ibid.

⁵³⁹ See Ellinger et al. 2006, p. 62, see also: Cartwright 2004, p. 121-149.

⁵⁴⁰ See Financial Supervision Report 2011, p. 15.

⁵⁴¹ For example in Hungary, the HuCode intervened against uncontrolled unilateral modification of the terms of the contract by creditors laying down in details under which variation clauses can be used.

Codes of conduct may be voluntary codes of conduct. But usually voluntary is limited in a sense that often only the adherence to the code is voluntary, and after expressing acceptance, financial institutions are obliged to respect the code under threat of sanctions.⁵⁴² It is important codes are effectively sanctioned, in order to ensure compliance.⁵⁴³

V.5.5. Increased regulation

Financial products and services are different from other products and services. This difference justifies increased regulatory intervention into the private law relationship of the banker and the customer, in order to protect the weaker party to the contract, the customer.⁵⁴⁴ Besides market failures regulation is increasingly motivated by social justice considerations.⁵⁴⁵

Llewellyn identified a number of differences between financial and non-financial products. The most significant, from the aspect of consumer credit, are the following: products are not purchased frequently (lack of experience); lack of consumer confidence; there is no guarantee or warranty attached; products cannot be replaced; products cannot be tested; faults cannot be rectified; information on reliability is difficult to obtain; value is not immediately clear at the point of purchase; lack of transparency; consumers future welfare is often dependent on the performance of the contract.⁵⁴⁶

Conduct of business regulation may be directed towards regulating the selling of the financial product (e.g. pre-contractual information), or regulating the product (the rights and obligations of the parties). In the sense of the thesis, product regulation aims to achieve substantive fairness, while service regulation aims to procedural fairness. Product intervention is more restrictive on the private law relationship of the parties, but not all product interventions tools are restrictive to the same degree. For example early forms of product intervention, usury ceilings, are somewhat flexible and are based on a

⁵⁴² One mechanism of ensuring acceptance is making publicly available the list of institutions that adhered to the code. This is the practice of the HuNB.

⁵⁴³ For example, non-compliance to the SrbCode is not sanctioned, and as a consequence, although a number of banks accepted the code, it is not respected in practice. Cf Svetislav Taboroši, Tatjana Jovanić, The new regulation of consumer credit in EU: harmonizing the consumer interests and economic efficiency, 57(12) *Pravni život*, 709-729, 2008, p. 729.

⁵⁴⁴ Peter Cartwright, Consumer protection in financial services: putting the law in context, 1-18 In: *Consumer Protection in Financial Services*, Peter Cartwright (ed.), Kluwer Law International, Dordrecht, 1999, p. 7; Cf Chalmers et al. 2010, p. 785.

⁵⁴⁵ Reifner 2007, p. 326.

⁵⁴⁶ Llewellyn 1999, p. 36-38.

legal standard; while modern forms of product intervention, interest rate caps, bluntly apply the same threshold to all credits.

V. 6. Unfair terms in consumer credit contracts

The core of this Chapter is the analysis of the regime of unfair terms in consumer credit contracts, the general regime of the EU, and the particular regimes of Hungary and Serbia. The focus is on how the substantive fairness of core and ancillary terms is determined in consumer credit, what the role of transparency or procedural fairness is, and the consequences of the limits of application of the test of fairness.

V.6.1. Fairness regimes of core terms in consumer credit contracts

The core term exemption can be problematic. Art. 4(2) UCTD basically exempts two kinds of terms. One is the main subject matter of the contract the other is the price/quality ratio. It is often difficult to determine what the main subject matter is, especially in complex transactions where the contract is for a number of closely related services. But the price/quality ratio causes even more troubles. The problem with this exception is whether it relates to all prices/charges terms or just the price for the goods or services that are equivalent to the “main subject matter” of the contract. Although, the logic of the exception in Art. 4(2) UCTD should be that only the price of the main subject matter is exempted and all other charges fall within the test, this is not a universal interpretation. Finally, the exception is linked to the principle of transparency, may cause even more uncertainties, as what is transparent, can also be questionable.⁵⁴⁷

The core terms exemption was implemented in Hungary, but was not implemented in Serbia. In Serbia the test of fairness applies (or at least should apply) to all contract terms, regardless of being core or ancillary. Hence, in the analysis of the core terms exemption the thesis primarily refers to Hungary.

Art. 4(2) UCTD was implemented into Art. 209(5) HuCC,⁵⁴⁸ according to which the test of fairness will not be applicable to the “*definition of the main subject matter of the contract and to terms relating to the proportion between contractual obligations of the parties*” provided they are in plain and intelligible language. At first sight it can be noticed the test is odd, it does not mention the price at all. Therefore, the provision seems even wider than Art. 4(2) UCTD, as capable of including every “proportion”

⁵⁴⁷ The analysis of core terms exception builds on: II.4.2.

⁵⁴⁸ Commentary on Art. 209(5) HuCC in Commentary on HuCC.

between contractual rights and obligations of the parties (none of which necessarily is the price, or the proportion can be between any service and the charge for it). Nevertheless, according to the Commentary on Art. 209(5) HuCC the aim of the provision is to exempt the control of services offered and the price paid for them.⁵⁴⁹ Hence, the second part of Art. 209(5) HuCC probably overtakes the phrase “the adequacy of price or remuneration, ... as against the services or goods supplied in exchange” from Art. 4(2) UCTD.⁵⁵⁰ However, without repeating that the price is to be measured towards the “main subject matter of the contract” the provision potentially opens the door for divergent interpretations. The effect of the provision would possibly be different if the Hungarian legislator would have clarified the proportion has to exist between the *main* contractual rights and obligations of the parties. This is what the legislator probably intended, as exempting every proportion is unattainable from the aspect of fairness.

The exemption is problematic, because it is often difficult to determine what the scope of the exemption is. In establishing what core terms are, following Willett, who asserts that the core terms exemption probably originates from the civilian tradition of dividing contract terms onto core or essential terms and ancillary or eventual terms of the contract,⁵⁵¹ the thesis sees if this division is helpful in limiting the scope of the exemption. Later, the thesis tries to determine what should fall under the main subject matter and price term exemptions. Finally, the thesis analyzes alternative control mechanisms to the price.

V.6.1.1. Fairness of core terms in Hungary

In order to determine the fairness regime of core terms, it is first necessary to establish what core terms are. Long before the implementation of the *EU consumer acquis*, credit was regulated in Hungary. These are the “traditional” statutory essential elements of credit contracts in the HuCC. The list of statutory essential elements extended after Hungary implemented the CCD. The number essential elements in the contract can be further widened by contractual essential elements.

The HuCC does not specify the essential elements of the contract of credit. Legal theory and practice agree the essential elements are related to the parties (contractual

⁵⁴⁹ Ibid.

⁵⁵⁰ Ibid.

⁵⁵¹ Willett 2007, p. 245.

capacity) and their rights and obligations (terms that define the principle rights and obligations of the parties).⁵⁵² Therefore, in determining the essential elements the legal definition of the credit contract should be relied on, primarily the definition of loan contract in Art. 523(1) HuCC. Consequently, the statutory essential elements are without a doubt the amount of the loan credit (or the object or subject matter of the contract),⁵⁵³ and if it is provided by financial institutions, the interest. The definition of the loan contract suggests one additional element, the “repayment of the loan according to the contract” which may be a wider notion than the interest, and include the method and time of repayment. Additionally, having a look at other provisions of the HuCC and HuCIFEA, it can be seen that credit contracts must always be in writing (Art. 210(1) HuCIFEA), and that not respecting the purpose of the loan amounts to a breach of contract (Art. 527(1) HuCC). Dorkó asserts essential elements of the credit contract are: conditions relating to repayment of the loan (duration of the loan, amount and accrual of instalments), the amount of the interest and conditions of interest repayment.⁵⁵⁴ But in BH 2002.322 the court ruled that the time of repayment is not a statutory essential element, nevertheless it may be established as such by the agreement of the parties.⁵⁵⁵ The Supreme Court took a middle ground, and ruled that if the parties reached an agreement on the amount of the loan and the rate of interest, together with the established practice of the court in relation to the repayment of the loan, this is sufficient for a valid formation of a contract of credit within the meaning of Art. 205 (1)(2) HuCC.⁵⁵⁶ Therefore, it can be concluded that in Hungary there is no universal agreement on what the statutory essential elements are. According to the wider interpretation, these are the amount of the loan, the interest, the time and method of repayment and, if applicable, the purpose of the loan, added with the written form. According to the narrower interpretation, it is sufficient if parties reach an agreement on the amount of the money to be lent and the interest to be paid, and lay down their agreement in writing.

The statutory essential elements in the HuCC are extended by statutory essential elements in the CCD. Art. 10 CCD contains detailed rules which elements the written consumer credit contract should contain. These are (depending on the type of credit): the type of credit; the identification of the creditor; the duration of the contract; the total

⁵⁵² Commentary on Art. 205(2) HuCC in Commentary on HuCC.

⁵⁵³ BH 1998.443.

⁵⁵⁴ Dorkó 2000, p. 272.

⁵⁵⁵ If the parties agree on the exact date of repayment, failure to repay on the set day will result in automatic default of the debtor, i.e. default without notice. BH 2002. 322.

⁵⁵⁶ BH 1999.176.

amount of credit with the conditions of drawdown; the borrowing rate and information relating to it; the APR; the amount, number and frequency of payments; statement of account in the form of amortization table; charges and interests without capital amortization; charges of account maintenance; interest rate and charges payable at default; warnings regarding consequences of missing payments; information relating to the right of withdrawal; information related to early repayment; sureties and insurance; notarial fees; procedure to be followed in case of termination; available ADR mechanism; information relating to supervisory authority; finally if credit is linked to the purchase of goods or services the goods or services and their cash price. Since Art. 10 CCD aims towards full harmonization,⁵⁵⁷ it is implemented as it is by Art. 16 HuCCA. The HuCCA specifically states that a contract will be void if any of the elements listed in Art. 16 HuCCA is absent (Art. 16(5) HuCCA). Therefore, the elements in Art. 16 HuCCA must also be considered as statutory essential elements. However, not all terms in Art. 16 HuCCA have the same importance. Some elements correspond to “traditional” statutory essential elements like the amount of the credit and the interest. Others are added in order to allow comparability of offers on the internal market, and to enable the consumer to make an informed choice. Besides these two ends of the spectrum there are certain elements which could be called the “grey area terms” which in a way fall under the traditional elements, but go above them. This is the case e.g. with the APR that contains more than the interest rate, but has the same aim, to be the price of the credit.

Additionally, the HUCIFEA contains rules on mandatory content of standard terms and conditions in Art. 209 HuCIFEA.⁵⁵⁸

Statutory essential elements can be extended by “contractual” essential elements, elements determined by the parties. These are those terms without which parties would not conclude the contract.⁵⁵⁹ Consumer credit contracts are all embracing, containing both a standard form and standard terms and conditions, where the creditor aims to contemplate a range of potential situations that may arise in relation to the credit. Therefore, the contract will have a number of essential elements determined as such by the will of the parties, and the long list of essential elements in the HuCCA and HuCIFEA can be significantly extended. In consumer credit, contractual essential elements raise different issues than statutory essential elements. Here the problem of

⁵⁵⁷ See e.g. CCD Implementation Report 2012, p. 26.

⁵⁵⁸ See for the content: V.6.2.

⁵⁵⁹ Commentary on Art. 205(2) HuCC in Commentary on HuCC.

genuineness of agreement is central, whether the consumer really agreed to the term in question, or whether it was individually negotiated. If the term is among standard terms and conditions than the problem is whether it was properly incorporated into the contract.⁵⁶⁰ When the term is essential by the will of the parties is often difficult to say. One would think that terms that are filled in the blank spaces of the standard form will be essential. But, as BH 1998.349 shows, this might not be the case. The contract term that included only the year of contract conclusion, and not the exact date, was considered not to be essential.

It can be seen that a credit contract can contain a number of essential elements, some of which are laid down in statutes others are determined by the will of the parties. Due to increasing regulation in the area of consumer credit, traditional essential elements in the HuCC are considerably extended by the HuCCA. Additionally, the list of statutory essential elements can be extended by the will of the parties in line with their contractual freedom. Therefore, in principle there is no limit on the number of essential elements a contract has. Core contract terms exempted from the test of fairness will surely come out of essential elements. However, due to the great number of these, the civilian tradition of dividing the terms on the contract on core and ancillary does not help in delimiting core and ancillary contract terms. The division can only be of some guidance if the traditional definition is looked at in the HuCC.

It seems that the notions of essential elements in general and essential or core contract terms as envisaged by the UCTD have different purpose, and should not be confused. Essential elements are a matter of contractual validity, where both contractual and statutory essential elements are of the same importance. In the lack of agreement on all essential terms the contract will not come to existence (Art. 205 HuCC); while if a term is found to be unfair, it will result in voidity of the term alone (partial voidity) (Art. 209/A(2) HuCC). But perhaps a more important difference is the aim of the two provisions. Namely, the potential number of essential elements and the fact that the parties' will is taken into account makes the aim of these elements the protection of the parties' contractual freedom. On the contrary the institution of unfair terms safeguards the balance in the parties' rights and obligations. The state intervenes by allowing a contract term to be annulled if it places the consumer in a significantly disadvantaged position compared to the creditor. Therefore, the aim of the institution of unfair terms is

⁵⁶⁰ See: on individually negotiated terms exemption: V. 6.1.5.; on incorporation of standard terms: V.6.2.

exactly the opposite, to protect the weaker party regardless of the “stronger” parties’ contractual freedom. It represents the other side of the coin, the intervention of the state as opposed to the will of the parties.

V.6.1.1.1. Fairness of the main subject matter

The first problematic exemption is the “main subject matter of the contract” under Art. 209(5) HuCC. The analysis of Chapter II.4.2 established the likely approach of the UCTD is the term must relate to the definition of the parties’ rights and obligations in the due performance of the contract and presented in a way that a consumer reasonably expects the terms is very important in the contract.

There is no doubt, the main subject matter will be among the essential elements of the contract, but the question is how to choose the “main subject matter” from the range of essential elements? In finding the answer the following might be of guidance: First, since credit is a nominated contract, the definition laid down in the HuCC should be taken into account and the main subject matter chosen from the statutory essential elements laid down therein. Second, regarding the “number” of main subject matters, it seems clear that both Art. 4(2) UCTD and Art. 209(5) HuCC point on *one* main subject matter. Third, the main subject matter is basically the object of the contract, which is the amount of the loan.⁵⁶¹ Finally, since consumer credit contracts are all encompassing, what the main subject matter is within the meaning of Art. 209(5) HuCC, as Advocate General Trstenjak pointed out in her opinion in *Caja de Ahorros*, should be interpreted restrictively. For all these reasons, the main subject matter within the core terms exception should be only the amount of the loan. Hence, only the amount of the loan should be exempted from the test of fairness.

Before turning to the discussion on price, the “purpose clause” clause should be mentioned. Namely, if the creditor grants the credit with a specific purpose (e.g. purchase of a particular real estate), the amount of the loan will be directly linked to the purpose of its usage, the aim of the contract, and laid down as such in the contract. Breach of purpose will be considered breach of contract (Art. 527(1) HuCC). On the one hand, it could be considered as part of the main subject matter of the contract, as it is directly linked to the amount of the loan, i.e. it is the aim of the loan. Therefore, the question is if this clause is also exempted from the scrutiny of the test of fairness

⁵⁶¹ BH 1998.443.

together with the amount of the loan? If only the amount of the loan is exempted as the “main subject matter” than the “purpose clause” does fall under the test. However, this question is probably without a practical significance. Possibly this is one of the few, if not the only term that is negotiated between the parties, taken that the consumer turns to the bank aiming to use the credit for the specific purpose, and asking the loan for this purpose. Therefore, the clause will probably (also) be exempted from the test of fairness as an individually negotiated term under Art. 209(1) HuCC.

V.6.1.1.2. Fairness of the price

The second phrase of Art. 209(5)HuCC, “the terms relating to the proportion between the contractual obligations of the parties,” probably intended to overtake the price terms exemption from the UCTD. Until now it seems Art. 209(5) HuCC did not cause problems in practice, hence the thesis will point to the potential problems the provision might cause taking the example of the UK. The principle question for determining the scope of the exemption is what is the price in consumer credit contracts?

The logical interpretation of the provision would be that the price is the monetary amount paid for the service provided that is measurable against the principle obligation of the creditor under the contract. Therefore, in the context of credit, the price the consumer pays for the loan would be the interest, as the principle obligation of the debtor. Price variation clauses and clauses relating to the method of price calculation should be subject to the test of fairness, as well as default charges and any additional charges the consumer pays in relation to the loan. However, this is not exactly a uniform interpretation, and courts do find other terms defining the cost of the loan to fall under the exception.

V.6.1.1.2.1. Controversial comparative interpretations of the exemption

The exemption caused a lot of stir in the UK that culminated in the *Abbey National* case. Namely, banks in the UK offered current accounts on a “free-if-in-credit” basis, which meant that banking in principle is free as long as the customer is in credit. If a consumer borrowed from the bank, i.e. once the credit or the overdraft limit was passed, customers were subject to disproportionately high and sometimes multiple charges. Even though the majority of customers did not incur this problem, those who did, paid a lot for the smallest overrunning. Overdraft charges represented (and still do) a

significant income for banks.⁵⁶² After thousands of individual judicial actions commenced by consumers claiming the term was unfair, the Office of Fair Trading (hereinafter: OFT) decided to commence a test case. Reg. 6(2) Unfair Terms in Consumer Contracts Regulations 1999 implemented Art. 4(2) UCTD using a copy-paste technique, that allowed for getting an authoritative interpretation of the exemption as it is exactly worded in the UCTD. The key question in the *Abbey National* was how to interpret the phrase “services supplied in exchange.” A narrow interpretation of “service” as a service of providing unauthorized overdraft would exempt this clause from the scrutiny of the test as not being connected to the main subject matter of the contract. The lower court held, unauthorized overdraft charges do not fall within the exception, as they are not core terms. On the contrary, the UK Supreme Court decided they are. It interpreted the “service” widely as the overall package of current account services i.e. that the word “service” relates to the contract as a whole, and not to individual aspects of it.⁵⁶³ The reasoning was followed by the conclusion that unauthorized overdraft charges are part of the “price and remuneration” for the package. Under the reasoning of the court these charges are not default charges, nor penalties for breach of contract.⁵⁶⁴ Rather, overdraft charges are an option exercised by the consumer. Following this logic, the obligation to pay the relevant charge was not defined as compensation for a loss suffered by the bank, but as a charge for the bank’s service, i.e. the “service” of allowing the payment to be made from the account, contingent payments due “in exchange” for the package of services. The basic reasoning therefore seemed to be that overdraft charges are exempted from the test of fairness simply because the terms formally described the charges as being for the service provided (including the “service” of exceeding the agreed overdraft).

The threshold of substantive fairness established in *Abbey National* is very low. Every term defining charges is potentially the price, including contingent charges, i.e. charges to be paid in the event of a future occurrence, as long as they are drafted in the contract as a price paid for the service, even if contingent charges are not likely to be perceived as a core of the bargain and are therefore not subject to market discipline.⁵⁶⁵ The decision was highly criticized by academia. Whittaker pointed out that some of the

⁵⁶² Mark Armstrong, John Vickers, Consumer Protection and Contingent Charges, 50(2) Journal of Economic Literature, 477-493, 2012, p. 479.

⁵⁶³ Para. 40-47 *Abbey National*.

⁵⁶⁴ Para. 86-88 *Abbey National*.

⁵⁶⁵ Chris Willett, Transparency and Fairness in Australian and UK Regulation of Standard Terms, University of Western Australia Law Review, forthcoming in 2013.

judicial statements “come very close to saying that the fact that the banks make a good deal of money out of the charges generated by the relevant terms means that they provide for part of the price or remuneration for the package of services”.⁵⁶⁶ Davies described the reasoning as “a more literal approach to the interpretation of the Regulations than is perhaps desirable”.⁵⁶⁷ Although it seems clear the UK Supreme Court was protecting the interest of banks from the “Armageddon claim”⁵⁶⁸ the provision, being not precise enough, allowed this interpretation. The case shows how wrong things can go with interpreting the exception in Art. 4(2) UCTD, and that judges will be always faced with the question of to which interest to give priority, the self interest of business, or to take a more protective approach towards consumers.⁵⁶⁹ Therefore, although the *Abbey National* is a UK national case, it essentially points to problems of interpretation of Art. 4(2) UCTD and the uncertainties it may cause. It seems, however, UK is not the only jurisdiction that faces controversial interpretations.

In *Caja de Ahorros* the contract for residential property secured by mortgage on variable interest rate contained a clause that the rate of interest due by the consumer will be rounded up to the nearest quarter of a percent higher (“rounding-up clause”). Both parties to the dispute were uncertain whether the term at issue is the main subject matter of the contract, or whether it relates to the price/quality ratio;⁵⁷⁰ but the starting point of the referring court was that the “rounding-up term is liable to constitute an essential element of a contract for a bank loan”.⁵⁷¹ It is important to note that the rounding up term is basically an interest rate variation clause, and even though normally the variation clauses would be held ancillary terms, the Spanish Supreme Court considered this element to be the core term of the contract.

In *Pohotovost* the referring Slovakian court was presuming that the APR is a price term, and thereby should be exempted from the test of fairness. Regardless of the fact that the APR relates to the total cost of credit, all the charges and fees that the consumer may incur in the process of obtaining the credit. Recently several Romanian courts referred to the CJEU whether price terms defined in Art. 3 CCD are exempted

⁵⁶⁶ Simon Whittaker, Unfair Contract Terms, Unfair Prices and Bank Charges, 74(1) *Modern Law Review*, 106-122, 2011, p. 115-116; *cf* para. 88 *Abbey National*.

⁵⁶⁷ Paul S. Davies, Bank Charges in the Supreme Court, 69(1) *Cambridge Law Journal* 21-24, 2010, p 23.

⁵⁶⁸ Phillip Morgan, Bank charges and the Unfair Terms in Consumer Contracts Regulations 1999: the end of the road for consumers?, 2(May) *Lloyd’s Maritime and Commercial Law Quarterly* 208-215, p 214.

⁵⁶⁹ Chris Willett, General Clauses and the Competing Ethics of European Consumer Law in the UK, 71(2) *Cambridge Law Journal* 412-440, 2012, p. 419 et seq.

⁵⁷⁰ Para. 44 Advocate General Trstenjak *Caja de Ahorros*.

⁵⁷¹ Para. 14 Advocate General Trstenjak *Caja de Ahorros*.

from the test of fairness under Art. 4(2) UCTD, these terms being “the total cost of the credit to the consumer”⁵⁷² and the “annual percentage rate of charge.”⁵⁷³ The CJEU’s standpoint on the above two price terms will be very important, and perhaps these express references will fundamentally change the way in which the UCTD is to be applied, and avoid controversial rulings, but for the time being, there is no useful guidance on EU level on core terms exemption.

Bellow the thesis explores if the APR or the interest should be exempted as core term from the scrutiny of the test of fairness. It argues the APR should fall under the exemption.

V.6.1.1.2.2. Is APR the price?

APR is one of the most controversial issues in harmonizing consumer credit. Before the CCD, there was no single mathematical formula for the calculation of APR, and not all cost elements were factored into its calculation. Consequently, there were considerable differences between methods used to calculate final prices (even within one country).⁵⁷⁴

Under the CCD, the APR equates, on an annual basis, to the present value of all commitments (drawdowns, repayments and charges), future or existing, agreed by the creditor and the consumer, calculated in accordance with the mathematical formula set out in CCD Annex I (Art. 19(1) CCD). Accordingly, APR is defined by the CCD as “the total cost of the credit to the consumer, expressed as an annual percentage of the total amount of credit” (Art. 3 (i) CCD; Art. 3(20) HuCCA). The “total cost of the credit” is defined as “all the costs, including interest, commissions, taxes and any other kind of fees which the consumer is required to pay in connection with the credit agreement and which are known to the creditor, except for notarial costs; costs in respect of ancillary services relating to the credit agreement, in particular insurance premiums, are also

⁵⁷²C-236/12 Volksbank România.

⁵⁷³ C-123/12 Volksbank România; C-108/12 Volksbank România.

⁵⁷⁴ The 1987 CCD mentioned the APR but it did not incorporate a single method of calculation. The amendments made steps in this direction with not success. Although Member States harmonized payments which are directly connected to the credit (e.g. interest, administration fees, and brokers’ fees) in the absence of harmonised mathematical formula practice assumed to all other fees the exception apply. Consequently, insurance fees irrespective of the purpose of the insurance; fees for bank accounts and cards; and notary fees and postage were usually not included. As a result, up to 30% of the total cost stayed outside the APR. Udo Reifner, A Correct Credit Interest and Usury Rate for Consumers Harmonization of Cost Elements of the Annual Percentage Rate of Charge, APR, final report by Institute for financial services e.V. submitted to DG SANCO, 1998, p. 2-3 at IACLAW: www.iaclaw.org/Research_papers/APR_Interestrates_Europe_iff_1.pdf (29 June 2013).

included if, in addition, the conclusion of a service contract is compulsory in order to obtain the credit or to obtain it on the terms and conditions marketed” (Art. 3(g) CCD). The “total cost of credit” however excludes “any charges payable by the consumer for non-compliance with any of his commitments laid down in the credit agreement and charges other than the purchase price which, for purchases of goods or services, he is obliged to pay whether the transaction is effected in cash or on credit” (Art. 19(2) CCD), the costs of maintaining an optional account if its costs have been clearly and separately shown in the credit agreement or in any other agreement concluded with the consumer (Art. 19(3) CCD). Therefore, the CCD excludes from its scope default charges, other charges than the purchase price which the consumer has to pay in connection with the linked transaction to credit (not charges related to the credit itself) and the costs associated with an optional account.

Nevertheless, the exclusions are restrictive, and under the CCD, the APR is the final price and it aims to embrace the costs of the credit to the fullest extent. Therefore, the APR includes interest and other charges, commissions, fees, insurance premiums⁵⁷⁵ and any other costs, regardless to whom they are paid (to the creditor or the credit intermediary).⁵⁷⁶ The APR is just an expression of all cost elements of credit in one single percentage. The aim of the APR is to ensure the fullest possible transparency and comparability of offers, and to allow consumers to make an informed decision (Rec. 19 CCD). In order to ensure comparability of information, the CCD introduced a single mathematical formula for the calculation of APR taking into account the same cost factors as laid down in the “total cost of credit” (Rec. 43 CCD).

In Hungary, APR is regulated in the APR HuDecree, according to which the APR embraces all cost elements known to the creditor (Art. 3(1) APR HuDecree; also Art. 3(10) HuCCA). It further contains a list of non-exhaustive elements that the APR should include: commissions of the intermediaries, real estate registration fees, security valuation charges, building site inspection fees, insurance and guarantee fees, account maintenance charges and means of payment charges (Art. 3(1) APR HuDecree); and an exhaustive list of elements that are excluded from the APR’s calculation: the cost of loan extension, default interest, any other charge payable upon the consumer’s default,

⁵⁷⁵ On potential problems of insurance included in the APR see: Thierry Vissol, Updating and Revising the Consumer Credit Directive (87/102), A General Commented Approach, at ECRI: www.ecri.eu/new/system/files/10+Vissol.pdf (29 June 2013).

⁵⁷⁶ Since the APR embraces any cost element the consumer needs to pay, this is way the APR is not defined as an interest rate but a rate of charge. APR Study, p. 37.

charges connected to account maintenance if the current account with the creditor was not compulsory, and charges related to the linked contract e.g. sales contract (Art. 3(3) APR Decree). Therefore, the charges that are excluded are not necessarily the usual charges, but rather occur, or at least should occur, exceptionally. Hence, in Hungary, the APR embraces all cost elements that appear in the “regular” course of the credit contract. Nevertheless, it remains uncertain if all contingent charges are excluded from its scope.

Having a look at the APR from the contractual side, the APR is the aggregate price that the consumer pays for the loan (“hiteldíj”). Therefore, in a wider interpretation, looking at the contract as the whole, the APR can be considered the “price”. However, looking at the principle obligations of the parties under the credit contract, the obligation of the creditor to release the loan, and the obligation of the consumer to pay interest for it, in a narrower interpretation the price will only be one component of the APR, the interest (“kamat”). There are arguments both for and against excluding the APR as the price from the scrutiny of the test of fairness.

Having in mind the content, i.e. the total cost of credit, and the aim i.e. raising transparency and comparability of offers, it can be concluded that the APR should not be the “price” within the meaning of the core terms exception, but only a term that aims towards transparency in the cost of credit, i.e. procedural fairness. The APR is much more than the “price” and it is not directly linked with the main subject matter of the contract.

However, there are arguments for considering the APR as the price within the meaning of Art. 209(5) HuCC. Namely, one of the justifications of the exception is that the “core terms” are subject to market discipline and therefore are more likely to be fair than ancillary terms.

However, in the financial services sector it seems that competition has a limited reach. In 2005 the EU Commission initiated an inquiry into the retail banking sector. The inquiry has identified a number of symptoms suggesting that competition may not function properly in certain areas of retail banking, among which are the areas of pricing and policy. The inquiry has found evidence of convergence of banks’ prices and policies within individual Member States, where high profitability, high market concentration and entry barriers raise concerns about banks’ ability to exploit market power over

consumers.⁵⁷⁷ Although the report does not specify the Member State in question; it is a good illustration and evidence that competition may not be as useful in policing unfair terms as anticipated. The limits of competition are also pointed out by Ramsay on the example of credit cards in tackling the question how credit card services should be priced. In the US credit card companies made enormous profits because competition, in connection with consumers' behavioural biases, focused on a wrong pricing element. Namely, as consumers tended to overestimate their future borrowing on the credit card and therefore upon conclusion of the credit card contract they did not pay attention to the high interest rate, but focused on immediate costs of the annual fee. Since the annual fee was in the focus of consumers, it was subject to competition, but other pricing elements, not focused by consumers, were not subject to competition. The competitive pressure to reduce the annual fee resulted in maintaining high interest rates, increasing late payment charges and fees.⁵⁷⁸ Therefore, without making an attempt for an in-depth analysis of the influence of competition law and policy on prices, these examples show that competition may not be as far reaching as it would be desirable.⁵⁷⁹

Going back to the discussion on APR or interest as the price, if competition focuses on the interest, the creditor will be able to raise other fees associated with the loan, which will not be subject to competition. Therefore, even though at first sight it seems unfair to exclude all (non-contingent) cost elements from the test of fairness, a deeper analysis points to the fact that the APR should be considered the price. Increased competition is directly related to consumer choice in selecting contracting parties that offer fairer contract terms. Therefore, if the APR is subject to competition is likely to be fair(er), which is a very strong argument for excluding the APR from the test of fairness, and considering it the price. Additionally, "core terms" are exempted from the test of fairness only if they are transparent, and as it will be shown later, the APR is much more transparent than the interest.

The authors of IRR Study also argue that the APR should be taken as the price of the loan. The report points out that the interest is not the price of credit. Interest is only "the parameter which in the form of the borrowing rate has been created in practice to

⁵⁷⁷ Communication from the Commission Sector Inquiry under Article 17 of Regulation (EC) No 1/2003 on retail banking (Final Report) COM (2007) 33 final, 31.1.2007, p. 3.

⁵⁷⁸ Ramsay 2012, p. 64.

⁵⁷⁹ Indeed, in November 2013 the Hungarian Competition Authority fined 11 Hungarian banks for forming a cartel by co-ordinating strategies to limit the availability of refinancing loans needed to reduce repayments at fixed exchange rate. See Banks fined over accusation of forming Hungarian cartel, at Financial Times: <http://www.ft.com/cms/s/0/ef109df0-5217-11e3-8c42-00144feabdc0.html#axzz2mAqNu65A> (23 Nov. 2013).

calculate those parts of the credit cost which depend directly on the time of the loan.”⁵⁸⁰ This study approaches the issue of price from the point of view of interest rate restrictions and argues that national legislation should take into account the APR rather than the interest as a starting point for regulation. The APR is certainly a better benchmark for interest rate restrictions as it expresses all the costs the credit involves, and therefore, if financial institutions intend to avoid harsh consequences of interest rate restrictions focusing on the interest they will impose additional charges on consumers.

Therefore, even though the aim of the “core terms” exception is to exclude as little as possible from the scrutiny of the test of fairness, there are strong arguments for the APR to be considered the price within the meaning of Art. 209(5) HuCC, for archiving a high level of protection.

V.6.1.1.2.3. Is interest the price?

Interest is the charge made for borrowing a sum of money.⁵⁸¹ Interest rate or using the language of the CCD the “borrowing rate” means the interest rate expressed as a fixed or variable percentage applied on an annual basis to the amount of credit drawn down (Art. 3(j) CCD). Looking at interest from a different angle, interest is the compensation that the consumer pays to the creditor for using the loan, which is determined as a percentage from the amount borrowed per period of time, usually one year, and which is payable in instalments.⁵⁸² Therefore, from a contractual point of view the payment of interest represents a strict obligation of the borrower to repay the borrowed capital together with the “compensation” for the use of borrowed money throughout the agreed period of time.⁵⁸³ Interest is the “price” for the borrowed money,⁵⁸⁴ or more accurately, the price which is directly linked to the amount of the loan. Other charges like administration fee are “ancillary” and only indirectly linked to the loan. The court in BDT 1998.390 expressly ruled that the counter obligation of the consumer for the taken loan is the payment of the contractual interest.⁵⁸⁵ The traditional civil law institutions of *laesio enormis* (Art. 201(2) HuCC) and usury (Art. 202 HuCC) also focus on the interest.

⁵⁸⁰ IRR Report 2010, p. 94 et seq.

⁵⁸¹ Interest, Collins Dictionary of Business, Collins, Glasgow, 2002, p. 224.

⁵⁸² Shed. 3 pt. 7 HuCIFEA See e.g. Bíró 2000, p. 188.

⁵⁸³ Cf. Bíró 2000, p.188.

⁵⁸⁴ Commentary on Art. 232 HuCC in Commentary on HuCC.

⁵⁸⁵ BH 1998.390.

Therefore, it seems, in Hungary both earlier theory and practice agree, that the price of the loan is the interest. However, *Act CXLVIII of 2011*⁵⁸⁶ that introduced price caps, in consumer to consumer (hereinafter: CtoC) transactions considered the interest the price, while in business to consumer (hereinafter: BtoC) transactions where loans are provided by financial institutions, it takes the APR as the benchmark. This fact could point to change in the attitude and the recognition of the Hungarian legislator that the APR is the price of consumer credit. Additionally, talking about the purpose of the exception in Art. 209(5) HuCC, the Supreme Court pointed out that the aim of the provision is not to protect the balance in the value between the parties' rights and obligations under the contract but to provide for "contractual justice."⁵⁸⁷ Hence, the Supreme Court confirmed the aim of the provision is to protect the weaker party, the consumer, and not to safeguard the exact monetary equivalence in the parties' rights and obligations. It should be pointed out, *Act CXV of 2008*⁵⁸⁸ inserted Art. 685(f) HuCC that specified, the counter obligation of the debtor for the taken loan is the APR, and not the interest. The provision has been removed by *Act CXLVIII of 2011*, nevertheless, it would be sensible to reinstate it, and clarify, the APR is the price. Until such clarification it remains unclear if the interest or the APR is exempted from the scope of the test in consumer credit contracts as the price.

V.6.1.1.2.4. Transparent core terms: the example of interest

Following Art. 4(2) UCTD, Art. 209(5) HuCC stipulates that "core terms" will be exempted only if they are transparent, i.e. laid down in plain and intelligible language. Though the provision probably intended to be an additional safeguard, and raise the level of consumer protection, it opened many questions, and made the already complicated provision even more uncertain. The thesis will analyze more the meaning of transparency in consumer credit later in this Chapter. At this point it is only important to point on a potential "trap" that interest as a "core term" or "price" carries with itself in credit contracts.

⁵⁸⁶ Act CXLVIII of 2011 on interest and APR moderation and on modification of certain statutes relating to financial services for ensuring transparent pricing.

⁵⁸⁷ Pt. 4 Opinion 2/2012 of the Civil Chamber of the HuSC on the unfairness of unilateral contract modification clauses in consumer credit contracts by financial institutions (hereinafter: Opinion 2/2012 HuSC).

⁵⁸⁸ Act CXV of 2008 on the modification of certain statutes for enacting the combat against usury contracts.

Namely, as a contractual element, interest is in itself very complex. Interest can be contractual and statutory.⁵⁸⁹ Statutory or default interest, as an ancillary term, falls under a different fairness regime. What is more dangerous in relation to the “core terms” exception is the contractual interest. The danger is the amount of interest paid for the taken loan will largely depend on the variability of interest rate (fixed and variable interest) and on the method of calculation and capitalization (simple and compound interest). It should be pointed out that there is a difference between interest and interest rate, although the two notions are sometimes used interchangeably. Interest is the “price” paid for the loan, the profit of the bank (adjusted to inflation), while the interest rate contains more elements. It consists of a portion of the capital borrowed, added with the profit of the bank and adjusted to the inflation.⁵⁹⁰ From the point of view of the creditor, the rate of interest will depend on: 1) the lender’s cost of obtaining the money lent; 2) the cost in making and administering the loan; 3) the risk of inflation; and 4) the risk of default.⁵⁹¹

Fixed interest rate should be differentiated from fixed instalment. As the rate of interest is usually adjusted to inflation (real interest rate as opposed to nominal interest rate), the fixed interest rate loan will not mean fixed instalments, as instalments will be adjusted to inflation, and they will not be the same at all times.

Variable (or floating) interest rate primarily depends on market fluctuations. These are expressed in benchmarks or reference rates like London Interbank Offered Rate (hereinafter: LIBOR) and EURIBOR (Euro Interbank Offered Rate)⁵⁹² or the Central Bank Base Rate. Variable interest rates may be variable multiple times. If the interest rate is connected to a foreign currency, which is (or was) a usual practice in Hungary, it will also depend on the relation between the foreign and domestic currency (currency risk). Loans denominated in foreign currency always contain a variable interest rate. These clauses for example say the rate of interest will be 3,5% plus 6 months LIBOR. Foreign currency loans are expressed and should be paid in foreign currency (contractual currency), but the actual payments will be made in the domestic currency. Consumers will not only pay higher instalments because of currency

⁵⁸⁹ Bíró 2000, p. 188.

⁵⁹⁰ *Cf* interest and interest rate, Collins Dictionary of Business, 2002, p. 224-225.

⁵⁹¹ Steven Bender, Rate regulation and the crossroads of usury and unconscionability: the case for regulating abusive commercial and consumer interest rates under the unconscionability standard, 31 *Houston Law Review* 721-811, 1994, p. 774-775.

⁵⁹² These are average interest rates estimated by leading banks in London or in the Eurozone calculated over a period of time, relative to which many financial institutions set their own rates. In Hungary the equivalent is the BUBOR (Budapest Interbank Offered Rate).

fluctuations but also because banks will vary with buying and selling exchange rates. Usually the loan is issued on a lower rate, and instalments are paid on a higher rate. This practice was employed by Hungarian banks with the Swiss franc loans.⁵⁹³

Further, the simple method of interest calculation means the instalment will contain a fixed percentage of the capital and the interest proportionately drawn down over the period of the loan. On the contrary, compound interest calculation involves a complex formula, and from a consumer's point of view contains payment of interest on the interest.

Therefore, the question is when will the interest rate be transparent? Is it sufficient for example to indicate with clear and unambiguous language in the contract that the interest rate will be variable and on which benchmarks it will depend, or should the consumer be entitled to additional explanations what that exactly means, how the different variables can affect his monthly instalments? Is it sufficient to indicate in the contract that the method of calculation is the compound method, or is the consumer entitled for more information on what the method exactly means? Having in mind the importance and complexity of the above issues, the basic question is, can these elements ever be genuinely understood by an average consumer (not to mention vulnerable consumers)? Due to complexity of the rate of interest transparency probably does not provide the desired safeguard, and would allow the inclusion of terms into the contract that the consumer did not understand and was not aware of at the point of contract conclusion. This is an additional argument why the APR should be the price of the contract, as even though the consumer may not understand all the components of it, it is more comparable, and therefore transparent. Here the wider meaning of transparency, as market transparency comes to expression.

In conclusion, in "core term" exception transparency is problematic in relation to price terms, as the interest rate includes complicated cost structure, and mathematical formulas, which seriously raise the question whether it can ever be transparent for an average consumer. Hence, transparency and procedural fairness does not give the desired safeguard against the inclusion of substantively unfair interest rates.

⁵⁹³ See e.g. as the evidence of this practice the allegations of the claimant in Gfv.IX.30.275/2011.

V.6.1.2. Fairness of core terms in Serbia

As mentioned earlier, Serbia did not implement the core terms exemption. A similar departure from Art. 4(2) UCTD was challenged in *Caja de Ahorros*. The question was whether the main subject matter and price are all together excludable from the review as contract terms, or they do fall under the UCTD but their review is limited.⁵⁹⁴ The CJEU confirmed, the exclusion is possible,⁵⁹⁵ as long as the national provision provides for higher level of protection than the UCTD.⁵⁹⁶ Since not having any exception from the test of fairness provides for a higher level of consumer protection the non-incorporation of the exception did not infringe EU law. The lack of the core term exemption certainly provides for a high level of protection, as it saves the trouble of classifying terms into different categories, and solving puzzles of what exactly each exception means and whether the clause in question falls under the exemption. Consequently, there is no need to elaborate on whether the APR (though the same arguments would apply in favour of the APR as in Hungary) or the interest is the price, or what the main subject matter of the contract is. The lack of exclusion also eliminates problems of extensive or “surprising” interpretations like the UK Supreme Court did in the *Abbey National* case. In theory it also eliminates the problem of banking practice of offering to consumers’ standardized prices, which lack negotiation and may as well lack competition.

Therefore, in Serbia the statutory protection provides a very high level of protection. The test is modern, and embraces’ as many cases of unfairness as possible. Up to the moment of finalization of the research there is not available case law that would test of substantive fairness of the price. Fear is how the courts will interpret the new concepts not known to Serbian law before, like the concept of legitimate expectations. The danger is courts will continue to apply what they are familiar with and ignore the test of fairness (basically decide *contra legem*.) Unofficial sources seem to confirm this fear. This can be demonstrated by recent cases, which although raise the issue of fairness of variation clauses, they generally point towards a tendency of not applying the test.

⁵⁹⁴ Para. 57-66 Advocate General Trstenjak *Caja de Ahorros*; Whittaker 2011, p. 108.

⁵⁹⁵ Para. 49 *Caja de Ahorros*.

⁵⁹⁶ Para. 27 *Caja de Ahorros*; para 86 Advocate General Trstenjak *Caja de Ahorros*.

Namely, for years credit contracts contained a clause that the bank may change the terms of the contract on its discretion, according to its business policy, under the condition that it informs the consumer on the change. In the period of financial crisis the banks took advantage of the clause on several occasions raising their profit margin (the fixed part of variable interest rate) significantly increasing consumers' monthly instalments. This was clearly an unfair term, and the new regulation, the SrbFSUPA expressly forbids it (Art. 8 SrbFSUPA). It repeats the language of the SrbLOA that a contractual obligation must be determined or determinable (Art. 46 SrbLOA). Moreover, the SrbFSUPA ordered the banks to amend all their existing contracts and remove these clauses under a threat of penalty (Art. 54 SrbFSUPA). This statute started the avalanche of damages claims against banks.⁵⁹⁷ However, according to unofficial sources, the courts did not base their ruling on the test of fairness to annul the, but on the fact that mandatory law was breached (here probably thinking of general limits of contractual freedom in Art. 10 SrbLOA), and the principle of good faith (Art. 12 SrbLOA).⁵⁹⁸ It should be pointed out that when the clause was in effect, the SrbFSUPA did not exist, hence, when thinking of mandatory law the court most probably meant Art. 46 SrbLOA.⁵⁹⁹ The question remains, why the courts ignored the test of fairness, especially taken the fact that the courts have *ex officio* obligation to observe the fairness of contract terms. At time of the disputes were commenced the SrbCPA was already in force. Even if the SrbCPA could not be relied on to determine the fairness of contract terms at the moment of contract conclusion, when it was not in force, the basis of unfairness that focus on performance could most probably be relied on. However, these basis bring new concepts into the Serbian contract law, the concepts of "legitimate expectations" (Arts. 46(2)(3) SrbCPA) and "performance burdensome without a justifiable reason" (Art. 46(2)(2) SrbCPA). Additionally, they also depart from the general rule that the contractual balance is to be assessed taking into account circumstances that exist at the moment of contract conclusion. Therefore, the court and the lawyers resorted to what they are familiar with, the SrbLOA.

⁵⁹⁷ So far there is around 300 cases pending, and one final. See Banks in new problem, one decision confirmed at Efektiva: <http://efektiva.rs/aktuelnosti-kredit/banke-u-novom-problemu-potvrdena-jedna-presuda> (11 November 2013). In many cases Efektiva represented its members in the dispute.

⁵⁹⁸ In the name of people! at Efektiva: <http://efektiva.rs/aktuelnosti-kredit/u-ime-naroda> (11 November 2013).

⁵⁹⁹ See another decision: Another victory: judgement against UniCredit bank, at Efektiva: <http://efektiva.rs/aktuelnosti-kredit/opet-pobeda-presuda-protiv-unicredit-banke> (13 November 2013).

The faith of the test of fairness is uncertain. So far it seems courts are reluctant to apply it. One reason for this may be in the modern character of the test of fairness that at many instances departs from the traditional contract law institutions and principles. The insertion of modern solutions into the SrbCPA was possible because the Government's working group lacked expertise to detect the "controversial" solutions proposed by distinguished EU and local experts that were working parallel, within an EU sponsored project,⁶⁰⁰ on the drafting of the SrbCPA.⁶⁰¹ However, definitive conclusions are difficult to draw until full judgements does not become publicly available, or until the Supreme Court does not take a stand on the issue. Nevertheless, it is useful to see what guide the traditional institutions of *laesio enormis* and *usury* can give to courts (assuming courts will continue relying on them in determining significant imbalance), and what other regulatory tools Serbia uses for ensuring the price of the credit is substantively fair.

V.6.1.3. Alternative control mechanisms to the price

As the IRR Study points out, usury, good morals and substantive fairness focus on the comparatively high amount of money the consumer has to pay for goods or services. But in credit contracts the price expressed in monetary units is incomparable to goods and services provided in exchange because it depends on two other factors: the borrowed capital and the time, expressed in the interest rate.⁶⁰²

Due to the special nature of interest other tools of intervention developed over time, rules that limit the interest rate or the price.⁶⁰³ The options for regulating the price are numerous. The IRR Study identified the following potential price restrictions: absolute or relative contractual interest rate ceilings (fixed by statute or court rulings); capped default interest rates; laws designed to prevent exploitation and unfair competition with effects on credit cost; restrictions on the compounding of interest; restrictions on the variability of variable interest rates; other forms of restrictions to the level of interest rate including moral consensus; antitrust regulation or laws designed to improve levels of competition; and regulations concerning early repayment fees.⁶⁰⁴

⁶⁰⁰ The "ZAP" project was sponsored by GTZ and Hans-Wolfgang Micklitz, Nobert Reich and Peter Rott were engaged as EU exerts, among local experts there were Marija Karanikić-Mirić and Tatjana Jovanić.

⁶⁰¹ See especially Karanikić-Mirić 2012, p. 5.

⁶⁰² IRR Study 2010, p. 93.

⁶⁰³ Ibid.

⁶⁰⁴ IRR Study 2010, p. 365.

More specifically, interest rate ceilings can relate to the contractual interest rate (contractual interest rate caps or usury laws) or to default interest rate (default interest rate caps). Interest rate ceilings can also restrict the method of interest rate calculation (restrictions on the variability of interest rate, on the compounding of interest and banning interest on interest). Further, restrictions can also relate to other cost elements like contractual charges (insurance fees, broker fees, account holding fees, maintenance fees) or default charges (penalties, amortization). Finally, restrictions can be imposed on other parameters of the credit like on instalments (number, size and period), the duration of the life of credit, total amount of credit or net amount of credit.⁶⁰⁵ As the analyzed regulations indented to achieve distinct policy objectives, the number of options is very wide.⁶⁰⁶ Hence, every jurisdiction has to make a choice in favour of one or more restrictions that best suit its economic development, consumer protection culture and social problems.

One option is to introduce interest rate ceilings. The benefits of this restriction are numerous. First, they respond to behavioural mistakes of consumers that underestimate the risk of high-cost credits. Second, by providing a rate ceiling substantially above the market rate the legislator reduces the high cost of proving fraud or exploitation on the market (e.g. proving usury). Third, rate ceilings aim to address failures of competition that leads to high prices on the market. Fourth, they can aim at preventing costly consequences of high cost credits like state support of individuals who become over-indebted. Finally, they sometimes aim to ensure a “fair” price in transactions.⁶⁰⁷ The criticism of interest rate ceilings is the absence of flexibility to take into account special circumstances of a particular case, or the vulnerability of the consumer in question. If in place they are applicable to all loans in general, or within the category of loans for which the ceiling is imposed. Further, ceilings may hurt the lowest income consumers from access to credit who are in fact often the indented beneficiaries of ceilings. Low income consumers will be deprived from regular loans and will resort to illegal, much more expensive, and less transparent forms of credit. Finally, ceilings may be circumvented by imposing charges, fees or compulsory insurance.⁶⁰⁸ Hence, price restrictions are not without doubt.

⁶⁰⁵ IRR Study 2010, p. 34.

⁶⁰⁶ IRR Study 2010, p. 28.

⁶⁰⁷ Iain Ramsay, *To Heap Distress upon Distress? Comparative Reflections on Interest Rate Ceilings*, 60(2) *University of Toronto Law Journal* 707-730, 2010, p. 710-711 (Ramsay 2010a).

⁶⁰⁸ Ramsay 2010a, p. 715-716; see also: Bender 1994, p. 728-732.

As Goode points out in order to provide access to credit the removal or the absence of rate ceilings have to be counter balanced by measures such as rate disclosure and licensing system with broad discretion of courts and strong enforcement machinery.⁶⁰⁹ To this, a well working competition that provides choice, available recourse to debt mitigation mechanisms like bankruptcy in case of wrong choice, should be added. Until these conditions are not satisfied price restrictions seem necessary. The only question is how far one jurisdiction will go in imposing restrictions. In this quest, there are at least two caveats. First, it is very important that the right benchmark is taken as the price, i.e. the APR. Second, if the price restriction sets a numerical limit, it is crucial to carefully select the limit, as it will set the level of substantive fairness.

Bellow the thesis analysis the applicability of the traditional institutions of *laesio enormis* and *usury* on the one hand, and the more recent regulatory tools in Hungary and in Serbia as alternative control mechanisms to the price.

V.6.1.3.1. The role of traditional safeguards of contractual balance

Based on the analysis in the thesis, it can be said, the aim of the test of fairness is primarily substantive fairness. This means, is to safeguard the balance in the contractual rights and obligations of the parties, and to remove terms from the contract that hinder this balance. However, the test of fairness is not the only instrument striving to achieve contractual balance. The traditional institutions, existing long before the emergence of the concept of unfair contract terms, *laesio enormis* and *usury* are in place to serve the same purpose. As Bíró asserts, even if a contract term falls under one of the exceptions, and is therefore exempted from the test of fairness the balance in the contractual rights and obligations of the parties may still be re-established by these institutions.⁶¹⁰ However, the question is, are these tools that originate from Roman law suitable to provide contractual fairness in modern consumer credit?

The traditional institutions rely on the parties' freedom of contract and assume parties are in equal bargaining position, and their contractual rights and obligations are in balance.⁶¹¹ Relying on this presumption, earlier courts ruled the rate of interest is

⁶⁰⁹ Roy Goode, A Comparative Outlook: Moneylending and its Regulation. *Usury in English Law*, 1 *Arizona Journal of International and Comparative Law* 38-60, 1982, p. 41-42.

⁶¹⁰ Bíró 2000, p. 239.

⁶¹¹ See e.g. EBH 1999. 106.

determined freely by the creditor,⁶¹² and interest on interest in a banker-customer relationship is allowed.⁶¹³ However, as it was discussed earlier in the thesis, in consumer transactions in general, but in credit especial, consumers are in a weaker bargaining position where the financial institution is in a power to unilaterally determine virtually all terms of the contract including the price. Consequently, the thesis argues the traditional institutions of *laesio enormis* and usury are not suitable to provide substantive fairness in the price of consumer credit contracts.

Based on the analysis in Chapter III⁶¹⁴ it can be seen there are three necessary conditions for the operation of the institution of *laesio enormis*: 1) there must be gross disparity in the value of contractual rights and obligations of the parties; 2) gross disparity has to exist at the moment of contract conclusion; 3) the injured party must not be aware of the disparity at the moment of contract conclusion. Placing the institution of *laesio enormis* into the context of consumer credit, it can be seen that the institution has its limits. First, due to particularities of consumer credit, its connection to risk and time, it may be difficult to determine when gross disparity exists, when there is difference in the market value of the parties' obligations. Gross disparity has to be proved by the claimant by pointing onto comparable offers on the market.⁶¹⁵ However, as competition is not working well between credit providers, what is all offers on the market are unfavourable for consumers? This was for example the case with loans denominated in Swiss francs. Only if the prices are transparent and comparable and the consumer has a real choice can the consumer take responsibility for the taken loan, and for his wrong choice. Second, gross disparity has to exist at the moment of contract conclusion, which does not allow for example taking into account large increases in monthly instalments due to changes in the interest rate. A credit bargain that was fair at the moment of contract conclusion does not have to stay fair during the life of the credit. The institution of *laesio enormis* is not flexible to take into account later changes in the rights and obligations of the parties. Third, variable interest rates depend on market conditions, which are not completely foreseeable at the moment of contract conclusion, especially in long term credit agreements. Therefore, gross disparity could only be claimed in fixed interest rate credit in domestic currency. Finally, the subjective element, read into the institution by the courts, in most cases will be present. At the time of

⁶¹² BH1998.391.

⁶¹³ BH 1998.495.

⁶¹⁴ See generally on *laesio enormis* and usury III.4.2.

⁶¹⁵ BH 1999.176. Cf Menyhárd 2004, p. 236.

contract conclusion consumers sign the contract without reading and understanding it, formally consenting to any imbalance in their contractual rights and obligations. Therefore, due to specific features of the interest rate, and the particularities of contract conclusion, the institution of *laesio enormis* is of little, if any, help in bringing substantive fairness to consumer credit.

It should be pointed out that Art. 201 HuCC was amended with *Act CXV of 2008* inserting a special case for consumer credit. It allowed for the possibility to annul a credit contract in case there is gross disparity between the APR and the service provided by the creditor, taking into account the circumstances of contract conclusion. The provision however was soon removed by *Act CXLVIII of 2011*. This move of the legislator could also be an additional confirmation that the general provision on *laesio enormis* in Art. 201(2) HuCC was in practice not working in consumer credit.

Turning now to usury, it was established in Chapter III that in order for one contract to be usury an objective, i.e. manifestly disproportionate advantage, a subjective i.e. intention to abuse are necessary, and a causal connection between the two. As manifestly disproportionate advantage is in practice equalled by gross disparity, which may be difficult to determine, the difference between the two institutions seems to be in the subjective element, in the intention to abuse the grave material situation. In determining this element, it can be noticed, that the institution has some special features. First of all, consumers would usually resort to a loan if they are in some kind of necessity; hence, they will be in a grave situation. However, the grave situation can have a wide spectrum. Besides obvious cases when the loan is taken for essential medical treatments or to cover some other social emergency, or finance a luxury holiday, the two ends of a spectrum, there is a fine line between investment and necessity. For example if the consumer takes a mortgage loan for buying a home, taken the fact that the consumer has no assets and potential future larger income, is it an investment or was the consumer forced by its economic situation to take the loan? The situation would be even more complicated if the consumer has some assets e.g. savings or another real estate which does not allow him to live in. Second, if credit is given to a new client, the bank will have no previous knowledge about the material situation of the consumer. Consumers, especially those in need, very often try to hide their real material situation, their true creditworthiness, knowing that low credit rating lowers their chance to get a loan.⁶¹⁶

⁶¹⁶ Menyhárd 2004, p. 239.

Therefore, information from the consumer on its creditworthiness is not the most reliable. Information other than from the consumer is available in credit registers. In Hungary credit registers definitely contain negative information (payment defaults) and also positive information (the consumer's entire credit commitments such as repayment data, amount and maturity of loans) but for uploading positive data an express consent of the consumer is needed.⁶¹⁷ Third, banks are driven by interest to gain profits. The lower the credit rating of a consumer is, the riskier the loan will be, and the higher the profit of a bank. Although the CCD aimed to remedy the situation and require creditors to lend responsibly the question is how it works in practice. Banks surely would pursue their interest for profits in borderline cases and grant loans to consumers with lower credit rating.⁶¹⁸

Although all loans are open for usury, in practice, "fast loans" or "payday" loans are good examples of usury. They were very problematic in Hungary especially during the financial crisis. Fast loans are short term unsecured loans for a small amount of cash, usually provided by financial institutions specializing in money lending, like payment institutions in Hungary. Fast loans were massively taken advantage of low credit rated consumers to cover temporary household illiquidity. Money lenders were taken advantage of the difficult material situation of consumers, advertising their products as fast and easily accessible. Though the interest rate of these loans might have not been very high, the APR was "boosted" by different charges. The APR finally reached even 400%.⁶¹⁹

Proving usury in credit contracts is very difficult. Proving the objective element is complex. Namely, outside cases where the interest rate is outrageously high, it is very difficult to determine what a just price is. It seems that courts rely on way of proving usury is by bringing evidence of the prevailing rates of interest on the market. However, having in mind the complicated structure of interest rates and even more complicated methods of calculation, and all additional charges and fees, this direction is too simplistic. More importantly, comparing market prices produces fair results only if the

⁶¹⁷ See Central Credit Registry: <http://www.bisz.hu/khr/hitelszerzodes> (23 November 2013). Note that in Serbia too both positive and negative data is reported. Association of Serbian Banks: <http://www.ubs-asb.com/Default.aspx?tabid=9822> (23 November 2013).

⁶¹⁸ This was indeed the underlying cause of the most recent financial crisis. Andrea Fejős, The Consumer in the Conditions of Socio-Economic Crisis: the Problem of Debtor Over-indebtedness with Special Emphasis on the Prevention of Over-indebtedness, 219-239 In: Individual, Family and Company in Conditions of Socio-Economic Crisis, Novi Sad, 2009, p. 220.

⁶¹⁹ Adrienn Marján, Modern usury, 5 *Studia Iuvenum Iurisperitorum: A Pécsi Állam- es Jogtudományi Kara Hallgatóinak Tanulmányai* 147-165, 2010, p. 156.

market works well and competition provides real choice for consumers.⁶²⁰ However, the existence of the objective element e.g. a high interest rate is in itself not sufficient. The consumer has to prove the creditor intended to abuse its difficult economic situation.⁶²¹ As banks are not charitable institutions they are not fiduciaries of the consumer, and are therefore allowed to pursue their own interest in concluding credit contracts. Since banks will in most cases be aware of a grave material situation of the consumer, it will be difficult to prove they had intention to abuse the same. In other words, there will often be a fine line between the bank intending to abuse the grave material situation of the consumer, and just intending to earn profit. Proving usury by the consumer, especially in the light of its lack of legal knowledge and skills and funds to litigate, places an onerous burden on the consumer. Overall, usury as a legal institution is rarely applied in practice.⁶²² Even the most obvious forms of usury, payday loans, did not reach courts.⁶²³ Therefore, in practice, consumers stayed unprotected from predatory lending practices. Therefore, just like *laesio enormis*, usury is of little, if any, help in ensuring substantive fairness of the price in consumer credit in Hungary.

As pointed out earlier, in Serbia the test of fairness applies to all contract terms, including core terms, however, it is useful to see what potentials the same institutions have in Serbia, taken the fact that although the test of fairness applies to the price, most probably courts will resort to the familiar institutions in applying it.

Building on what was said in Chapter IV,⁶²⁴ for the operation of the institution of *laesio enormis* in Serbia three conditions have to be satisfied: 1) the contract has to be synallagmatic; 2) there has to be a manifest disproportion between the contractual rights and obligations of the parties; 3) the injured party must not know and must not have known the real value of the goods or services. The SrbLOA differs from the HuCC in the subjective element. However, as seen, although not required in the HuCC, courts read the subjective element into the test. In Serbia, the subjective element goes even further, and the institution is not applicable if the injured *was supposed to know* the real value of the goods or services. Putting *laesio enormis* in the context of consumer credit the same remarks are valid as for consumer credit in Hungary, with a difference that in

⁶²⁰ Bender suggests court should rather look at variable costs and risks of lending in conjunction with the creditworthiness of the consumer. Bender 1994, p. 777.

⁶²¹ Gábor Hidasi, Hidasi and Partners Law Office, Usury rates without limits, fn24 at: http://fn.hir24.hu/gazdasag/2005/11/11/uzsorakamatok_szabalyok_nelkul (29 June 2013).

⁶²² In the period of 2005-2008 the number of cases was 50. Marján 2010, p. 150; Vízkeleti 2012, p. 6.

⁶²³ For more see Marján 210, p. 156-159.

⁶²⁴ See generally for *laesio enormis* and usury IV.3.2.

Serbia the institution is even less applicable to consumer credit, as the consumer will be almost unable to show that he was supposed to know the real value of the service. Hence the institution of *laesio enormis* is not a suitable instrument to provide for substantive fairness of the price.

Turning now to usury in Serbia, similar to Hungary, there must be one objective element, i.e. manifestly disproportionate advantage, one subjective i.e. intention to abuse are necessary, and a causal connection between the two. Putting usury in the context of credit, the institution is equally difficult to apply as in Hungary.

In defining the objective element, courts so far found that the contractual interest rate will be disproportionately high if it significantly deviates from the average rate of interest on the market for the same or similar transaction.⁶²⁵ Besides contracting a disproportionately high interest rate, courts also found the balance in the parties' rights and obligations can also be hindered by contracting more "protective clauses" ("zaštitne klauzule") clauses that protect the value of the borrowed capital.⁶²⁶ One of those clauses is the contractual interest. Contracting additional clauses does not result in disproportionately high interest rate if the contractual interest is so low that it does not maintain the borrowed capital.⁶²⁷ Contracting contractual and default interest cumulatively would normally be usurious (unless the contractual interest is very low, which is an unlikely in consumer credit contracts).⁶²⁸ According to an earlier decision of the Supreme Court, providing for additional fees and charges above the contractual interest rate would also be usurious unless the bank can prove it really incurred additional expenses in relation to the conclusion and execution of the contract that were not covered by the interest rate. In the absence of proof, fees and commissions are simulations of contractual interest, and therefore void.⁶²⁹ The problem with this standpoint is that today the APR explicitly allows charging additional fees and charges above the contractual interest rate. Once it is established the interest rate is too high, the court may lower the interest⁶³⁰ onto a just amount⁶³¹ upon the request of the debtor.⁶³² However, it seems courts are in disagreement which interest rate to apply, or how to

⁶²⁵ SrbSC Rev. 256/97; Federal Court 29/99; SrbSC 1165/02.

⁶²⁶ SrbSC Rev. 179/2001.

⁶²⁷ Goran Rakić, Contractual interest, 58(11) Pravni život 1111-1116, 2009, p. 1114.

⁶²⁸ SrbSC 179/2001.

⁶²⁹ SrbSC Rev. 13/99.

⁶³⁰ SrbSC Rev. 256/97; Higher Commercial Court 4847/1999; Federal Court 48/2000; District Court of Valjevo 438/04; Higher Commercial Court 6542/2001; SrbSC 29/2000.

⁶³¹ ScrSC 459/99.

⁶³² SrbSC Rev. 6928/97; SrbSc Rev. 386/2003.

determine the interest rate once it is established, it is too high. The contractual interest will be the default interest,⁶³³ or the average interest rate charged on the market,⁶³⁴ or it should be determined based on a report from the SrbNB, Association of Serbian Banks or commercial banks.⁶³⁵ However, as it was pointed out in relation to Hungary, the prevailing rate of interest on the market might not be fair if competition is not working well in providing fair offers. The default interest does not seem to be a good guide, as it will be discussed below, it is normally higher than the contractual interest rate. The most convincing seem to be the third option.

Regarding the subjective element the SrbLOA is more precise than the HuCC, as it points out grave situation can occur not just due to material needs but also due to lack of experience, naivety, or dependence. It is important to point out that according to Perović the lack of experience can be general, but also particular to a certain sector⁶³⁶ like financial services and consumer credit. At the end, all subjective elements come down to abuse of the grave (economic, health, or other) situation of the consumer.⁶³⁷ Perović confirms, as in Hungary, the essence of subjective element is the *intention* to abuse.⁶³⁸ However, the above analysis of usury cases seems to show in applying the institution courts tend to focus on the objective element, but a definite conclusion cannot be made without a more detailed analysis. This practice is nevertheless not in line with the specific requirement of the SrbLOA, that ask for the existence of both subjective and objective elements. The proper application of the provision, including the subjective element, especially the *intention* to abuse in consumer credit, is subject to the same critiques as usury in Hungary.

Therefore, the institutions of *laesio enormis* and usury are do not provide a suitable safeguard against the inclusion of unfair price terms into consumer credit contracts neither in Hungary nor in Serbia. The summary of the argument is that it is very difficult to prove the objective element, as it depends on competition and choice. If there is no competition offers will not be fair, and comparing offers on the market does not prove individual interest rates were high. Second, variable interest rates depend on market conditions, which are not completely foreseeable at the moment of contract conclusion, especially in long term credit agreements. The subjective element is even

⁶³³ SrbSC 1332/98.

⁶³⁴ Federal Court 29/99.

⁶³⁵ Higher Commercial Court 4847/99.

⁶³⁶ Perović, Commentary on Art. 141, 1995, p. 281.

⁶³⁷ Perović, Commentary on Art. 141, 1995, p. 282.

⁶³⁸ Ibid.

more difficult to prove given the nature of banking activities. The line will be often fine between the bank intending to abuse the consumer, and just intending to earn profits. Third, the institutions are to be applied at the moment of contract conclusion. Finally, perhaps the major fault of the institutions is that they consider the interest as the price.

Since in Serbia the test of fairness is applicable to price, if courts use the institutions of *laesio enormis* and usury to determine when the significant imbalance arises they should bear in mind two important conclusions from Chapters III and IV. First, “significant imbalance” can result in a lower level of infringement than *laesio enormis* or usury. Second, significant imbalance is purely an objective element, and no subjective element should be read into it.

V.6.1.3.2. Price restrictions

Having in the above methods of price restriction listed in the IRR Study, the thesis now sees what restrictions are available in Hungary and in Serbia.

In Hungary, perhaps the most important restriction is the contractual price cap. This restriction was introduced by *Act CXLVIII of 2011* and is in force from 1 April 2012. The restriction was introduced as one of the measures resulting from the Swiss franc loan credit scandal, as a response to pressure of interest groups, primarily consumer groups.⁶³⁹ It differentiates two regimes. The general regime for CtoC contracts is in the HuCC and the special regime for BtoC contracts in the HuCIFEA. Art. 199(1) HuCIFEA imposes a cap on the APR in the amount of the Central Bank Base Rate increased by 24%. The APR is capped at higher, Central Bank Base Rate increased by 39%, in case of credit card contracts, current account credits, or sale credits (save for car sale), and loan credits secured by suretyship. Importantly, the general regime in the HuCC takes the interest as the benchmark for the cap (Art. 232(3) HuCC), while the HuCIFEA takes the APR as the benchmark. This rule therefore recognizes the price of the credit is the APR. It is a good rule as it prevents banks from avoiding the cap by imposing additional fees and charges above the interest. It is a long awaited confirmation that in consumer credit the APR and not the interest is the price. Besides the cap, the HuCC contains some additional rules applicable for CtoC transactions. Namely, the ceiling will not render the entire contract void, but just the interest rate in excess of the

⁶³⁹ Usury rates – without rules at Fn24: http://fn.hir24.hu/gazdasag/2005/11/11/uzsorakamatok_szabalyok_nelkul (22 March 2013).

given limit (Art. 232(3) HuCC). Nevertheless, if the interest rate is below the limit, but in the opinion of the court excessive in the case at hand, the court can lower it (Art. 232(4) HuCC). It is not clear if the rules of the HuCC apply for APR (and BtoC transactions in consumer credit) as Art. 199 HuCIFEA is silent on the issue. It would be in the interest of consumers to extend the application of Art. 232(3) HuCC on the APR, as both parties are interested (the bank and the customer) to maintain the loan. However, the usefulness of the rule in Art. 232(4) HuCC is questionable, as courts will likely take the institution of *laesio enormis*⁶⁴⁰ as reference to what is excessive, and as it was argued above, this institution is of little help in consumer credit in providing substantive fairness.⁶⁴¹

In case of loans denominated in foreign currency, when the amount of the loan and the instalments are expressed in foreign currency but the actual payment is made in the Hungarian forints, the financial institution is obliged to apply the same benchmark for conversion during the life of the contract, and in determining all the costs and charges (Art. 200/A(1) HuCIFEA). The benchmark can be either the official exchange rate of the HuNB or the median exchange rate of the financial institution (Art. 200/A(2) HuCIFEA). The service currency conversion cannot be charged (Art. 200/A(3) HuCIFEA). This rule was probably introduced to stop the banking practice that loans are issued taking one benchmark, but instalments calculated by another benchmark, a benchmark that is more favourable for the bank.⁶⁴² Finally, the APR HuDecree implemented the mathematical formula for the calculation of the APR, and thereby restricted the method of calculation of the APR. Finally, the HuCIFEA contains detailed rules and restrictions on price variation clauses.

Therefore, in Hungary, the legislator intervened with a number of tools to restrict excessive prices. The intervention is new. It either results in the implementation of the CCD (like the HuAPR Decree) or is motivated by the Swiss franc denominated loan credit saga. Regulation of prices (especially in form of capping the price) is the most “severe” form of regulation of the price, and perhaps the last resort when other tools failed to provide a high level of protection.

⁶⁴⁰ Cf Commentary on Art. 232(4) HuCC in Commentary on HuCC.

⁶⁴¹ The nHuCC seems to abolish the interest rate cap for CtoC transactions. See Art. 6:47 nHuCC.

⁶⁴² Introduced by Act XCVI of 2010 on necessary modification of certain financial statutes for helping mortgage backed loan credit consumers in need. Applied from 27 September 2010.

In Serbia there are no interest rate or APR caps applicable for consumer credit contracts.⁶⁴³ Other forms of price restrictions were introduced by the SrbFSUPA, applicable from 5 December 2012. Protection is provided by Art. 34 SrbFSUPA according to which the bank is obliged to grant the credit and take payment by using the official median currency exchange rate published by the SrbNB. Additionally, the method of calculation of the APR is restricted as provided in the CCD.⁶⁴⁴ The SrbFSUPA places certain restrictions on the variability of interest rate and recently, a separate statute is adopted on default interest.

Therefore, in Serbia some forms of price regulation are present, but the most severe form, the direct price restriction is not. This might suggest other tools of control are more efficient in Serbia than in Hungary, or the absence of rules is simply a sign of a slower economic development (and similar rules as in Hungary are yet to be expected). The latter is more plausible, and the necessity of introducing price caps is voiced by practitioners.⁶⁴⁵

V.6.1.4. Core terms and other exemptions

Besides the core terms exemption the UCTD is also familiar two other exemptions, the individually negotiated terms and mandatory rules exemptions. In Hungary, the individually negotiated terms exemption is implemented in Art. 209(1) HuCC, and the mandatory rules of law exemption in Art. 209(6) HuCC. Serbia did not implement these exemptions. The thesis will now see what the relation of the core terms exemption is with the other two exemptions in consumer credit on the example of Hungary.

Building on the analysis in Chapter II, it can be said, individual negotiation is more than transparency and choice in contract terms, it is a real chance to influence the content of the term.⁶⁴⁶ It follows that a very limited number of elements are subject to negotiation in credit contracts. Probably the only truly negotiated term is the purpose of the loan (the consumer approaches the bank asking the loan for a specific purpose), and

⁶⁴³ Art. 399 SrbLOA limits contractual interest in CtoC transactions.

⁶⁴⁴ Based on Art. 11 SrbFSUPA the SrbNB adopted the Decision on the conditions and method of calculation of the annual percentage rate of charge and the outlook and content of the information sheet that is handed over to the consumer of 2011. The SrbNB also issued a detailed document on the methodology of the calculation of interest rates in credits and deposits at SrbNB: http://www.nbs.rs/export/sites/default/internet/latinica/20/statistika/metodologija_izracunavanja_ks_novo.pdf (22 November 2012).

⁶⁴⁵ Milutinović&Dorbić 2009, p. 108.

⁶⁴⁶ See also: Commentary on Art. 209(1) in Commentary on HuCC.

maybe the amount of the loan. But it is also possible that the amount of the loan is offered on “take it or leave it” basis without any negotiation. The other “core term”, the price that is excluded from the test of fairness will most likely not be negotiated. In the banking practice the interest rate and the APR are offered on standardized basis connected to the type of loan. They are offered by the bank dependent the “classification” of the client within a certain interest rate range.⁶⁴⁷ Using the language of Art. 209(1) HuCC the price will be an individually not negotiated term (or sometimes even a standard term), a term that is filled in the blank spaces in the “main contract” together with other terms like the time and method of payment, without negotiation. Hence, although one would think that in consumer credit contract at least its core terms are negotiated; this might not be the case. Therefore, the amount of the loan may be subject to double exclusion, i.e. as a core term and as an individually negotiated term. The „purpose” of the loan will be exempted as an individually negotiated term. All other terms likely follow the regime of standard terms, including individually not negotiated terms, and be subject to the test of fairness.

The third exemption, the mandatory rules of law exemption is implemented into Art. 209(6) HuCC. Without going into discussion how far this exemption may stretch in credit contracts due to the uncertain formulation of the provision pointed out in Chapter III, in this section the thesis focuses on mandatory statutory rules that most certainly fall under the exemption. In order to determine what mandatory statutory rules are exempted from the test of fairness, it is important to determine the relation of this exception to statutory essential elements of the contract. As it was pointed out above, the list of statutory essential elements is very long. This is because the elements laid down in the HuCC are extended by the elements in the CCD. Since the sanction of non-incorporation of any element from the CCD renders the entire contract void under Art. 16(5) HuCCA, it must be assumed, these are also essential terms in the eyes of the legislator having such harsh sanction. Therefore, the question is what the relation is between the mandatory rules exception in Art. 209(6) HuCC and the list of contract terms in Art. 16 HuCCA? Mandatory rules of law are limits to contractual freedom of the parties. Why some rules are mandatory is a distinct question, and might be different policy reasons for it. In this case, having a look at the CCD, the policy reason was the emergence of a well

⁶⁴⁷ See: standard terms and conditions of MKB Bank for mortgage backed loan credits: http://www.mkb.hu/dl/media/group_473c4ade9d0b8/group_473c4bc790528/item_2192.pdf (22 March 2013). See also: Bender 1994, p. 776.

functioning internal market and the raising of consumer confidence in cross border credit transaction, that was to be achieved by providing comparable offers throughout EU.⁶⁴⁸ Therefore, even though the HuCCA says that the incorporation of all the terms listed is obligatory, and provides for the sanction of nullity, these two factors cannot be interpreted as intending Art. 16 HuCCA to contain mandatory rules within the meaning of the exception under Art. 209(6) HuCC. The result would be unattainable from the aspect of fairness. The list in the HuCCA is all-encompassing; it would lead to a paradoxical result when the entire credit contract is exempted from the test of fairness. Moreover, the mandatory rules exception does not even require the terms to be transparent in order to be exempted. This is completely against the purpose of the provision, and the entire HuCCA which primarily aims to raise transparency. Therefore, the exception in Art. 209(6) HuCC in relation to the mandatory content of the consumer credit in Art. 16 HuCCA must be interpreted restrictively, as exempting only one aspect of the provision from the test of fairness, the fact that the contract has to contain all these elements. Therefore, it must be read that only Art. 16(5) HuCCA cannot be assessed for fairness,⁶⁴⁹ but all other sub-sections of Art. 16 HuCCA can. Therefore, the mandatory rules exemption and the core terms exemption in this regard will not overlap. However, as seen, in Hungary there are other rules than can be characterised as mandatory, for example the price cap which will be most certainly exempted from the scrutiny of the test of fairness. Hence, if the price is within the limit of Art. 199(1) HuCIFEA its substantive fairness cannot be questioned.

In Serbia, at least in theory, the test is truly applicable to all contract terms. Consequently, there is no need to determine if the term was core, negotiated or mandatory. However, as shown above, there is a danger courts will not respect the lack of limitations and this danger, as pointed out in Chapter IV.5.1., exists especially with mandatory rules of law.

V.6.1.5. Intermediary conclusions

Based on the above analysis of the fairness regimes of core terms in Hungary and in Serbia several basic conclusions can be drawn.

⁶⁴⁸ Recs. 1-8 CCD.

⁶⁴⁹ Art. 16(5) HuCCA was adopted based on Recs. 19, 24, and 25 CCD that provides for a possibility for Member State to lay down that the provisions of the implementing legislation is binding.

The European regime exempts core terms from the test of fairness, and this exemption was adopted in Hungary. The conclusions in relation to Hungary are the following: First, it is difficult to determine which terms fall under the core terms exemption, especially what the price of credit is. It seems that the earlier theory, practice and statutory provisions considered the interest rate to be the price, but the thesis argued that a higher level of consumer protection is achieved if the APR is the price. The argument is primarily based on transparency and choice considerations. Based on the latest regulatory instrument of price cap it seems Hungary goes in a direction of taking the APR as the price. Second, since the price is not subject to the test of fairness, the thesis considered the applicability of the two traditional institutions of *laesio enormis* and *usury* as potential mechanisms of price control. The thesis concluded that these instruments, created in completely different times, are not suitable safeguards against substantively unfair price terms. Third, the latest regulatory intervention of capping the APR also seems to confirm this conclusion. Therefore, in Hungary for contract concluded after 1 April 2012 the price is controlled by a price cap, but for contracts concluded before that date the price is still subject to the unsuitable traditional institutions, and courts have to find the way to apply the old institutions to new problems.

In Serbia, the situation is different, because the price term exemption from the general European regime is not implemented. Hence, it is not necessary to determine what the price is (although the same arguments apply in favour of the APR). The problem that Serbian consumers might face is that the test of fairness is not applied, or that the provisions of the test will be interpreted in the light of traditional the civil law institutions of *laesio enormis* and *usury*, equally not suitable for consumer credit in Serbia. Finally, in Serbia there is less direct regulatory intervention than in Hungary, importantly, the price is not capped. Nevertheless, due to the complicated structure of the test of fairness in Serbia, and their lack of embracement by practice, it seems for a high level of protection price caps are necessary in Serbia.

The difference in the regulatory approach of the two selected jurisdictions raises a broader question. Namely, the basic question is which regulatory tool is more suitable for providing a high level of protection, the test of fairness or the price cap? The two instruments seem to represent two ends of the spectrum. The test of fairness is the least restrictive instrument on the parties' contractual freedom and it is flexible. The price cap is the most restrictive and is not flexible. If the loan crosses the threshold established by

the legislator it will be considered unfair, but if it is within the threshold, it will be fair. Taken in Hungary the general limit is set at 24% added to the Central Bank Base Rate, if this rate is for example 6%, the substantively fair APR will be 30%. This threshold will certainly stop predatory lending practices and 400% APR's. However, as an instrument of general application, the percentage makes one wonder if the threshold is not too high. It is difficult to give a definite answer. In certain instances, for example low creditor consumers where the bank takes a higher degree of risk, a 30% might not be too high, but in other cases even the 28% would realistically be high. Hence, the strictly set percentage certainly prevents extortionate interest rates like the fast loans (payday) loans, but it is questionable if it provides a fair price at all times, i.e. if it generally sets a fair level of substantive fairness. The application of the test of fairness might be more complicated in individual cases, and is less certain in its final outcome, but it is also capable to deliver fairer individual results than the price cap. The preventive effect of price caps is immediate; banks are aware what threshold they cannot cross, while the preventive effect of the test of fairness is remote and depends on additional interpretations. Hence, the final note is that it is difficult to compare the price cap and the test of fairness as they are inherently different instruments; they only serve the same purpose, the ensuring of substantively fair price in consumer credit.

For a high level of protection it seems the best is the combination of the two instruments. Price cap should exist for eliminating predatory prices but the test of fairness should be also applicable as a "safety net" if the cap would not ensure substantive fairness in the particular case. Therefore, Serbia should introduce the price cap. In this task it is important to take a right benchmark as the price, i.e. the APR, and to carefully set the numerical limit. Hungary should eliminate the core terms exemption and make the test of fairness applicable to the price.

V.6.2. Fairness regimes of ancillary terms in consumer credit contracts

Ancillary terms are different from core terms; they are ancillary to core terms and are not in the focus of the bargain. For this reason, ancillary terms usually fall under a different fairness regime, and they are subject to the test of fairness in both Hungary and Serbia. The number of ancillary terms is very wide as they tend to regulate the rights and obligations of the parties in all encompassing manner. It is beyond the scope of the thesis to analyze all possible ancillary terms. Thus the thesis point on the most common

ancillary elements found to be unfair, but it will subject to a deeper analysis only two terms, variation clauses and default interest rate clauses.

Due to a long list of essential elements important for the validity of the contract it is possible that some ancillary terms are essential for contract validity and as such are laid down in the “main contract” as individually not negotiated or maybe even as individually negotiated terms e.g. time and method of payment, securities and suretyships. However, more likely, ancillary terms are standard terms, and are incorporated into the standard terms and conditions of the creditor. Standard terms and conditions are all encompassing; they are virtual codes of law.⁶⁵⁰ Financial institutions as a rule use standard terms and conditions because of their suitability to foresee and regulate all potential legal situations that may arise in relation to the conclusion and performance of the credit contract. The importance of these documents in financial contracts is proved by the fact that there are special rules for these documents in both Hungary and Serbia. The special rules go towards ensuring standard terms and conditions are transparent, and contain certain terms.

In Hungary, the HuCIFEA provides a detailed content of standard terms and conditions and the “pricing principles” of the financial institution as part of it.⁶⁵¹ Terms included are especially those that identify the financial institution; determine whether and how the interest rate may be changed; the method of interest rate calculation; other charges and fees; securities; data management of the credit register database; special rules on the method and time of interest rate calculation of foreign currency home loans (Art. 209 HuCIFEA).⁶⁵² If the institution joined the HuCode, this fact should also be indicated (Art. 207(2) HuCIFEA). Besides these mandatory elements, the content of standard terms and conditions is not limited. These terms are laid down in a separate documents (“üzletszabályzat”) (Art. 207(1) HuCIFEA) that is submitted to the HuNB upon application for license (Art. 18 HuCIFEA). Financial institutions also has to make publicly available their standard terms and conditions (Art. 203(1) HuCIFEA), and provide a free of charge copy on the request of a consumer.

In Serbia, the special rules are laid down in SrbFSUPA. Importantly, it provides that financial institutions have to draft their standard terms and conditions in line with

⁶⁵⁰ See the general discussion on standard terms and standard terms and conditions: II. 4.3.

⁶⁵¹ The rules on were considerably reformed by Act CL of 2009 on amendments of financial acts and Act CXLVIII of 2011 on interest and APR moderation and on modification of certain statutes relating to financial services for ensuring transparent pricing.

⁶⁵² This provision is further concretized in Arts. 210, 210/A and 210/B HuCIFEA.

good business practices and promote fairness (Art. 9 SrbFSUPA). Financial institutions have to make these documents transparent, i.e. place on display in business premises, and hand over a printed copy on the consumer's request and to provide additional explanation to the consumer regarding their content and the status (Art. 10 SrbFSUPA).⁶⁵³ Non compliance with Art. 10 SrbFSUPA is subject to administrative penalty (Art. 51(5) SrbFSUPA); but it is uncertain how compliance with Art. 9 SrbFSUPA will be controlled. More details on content of standard terms and conditions are laid down in a separate decision of the SrbNB⁶⁵⁴ that foresees very similar content of standard terms and conditions as the HuCIFEA. However, the above document has little value to add, as some of its provisions are incorporated in the SrbFSUPA, others are concretized and laid down in other by-laws of the SrbNB.

Because consumers pay less attention on standard terms and conditions and because of the number of terms therein, these documents represent a suitable place to incorporate unfair clauses. Since standard terms and conditions are laid down in a separate document from the "main contract" the first filter against the inclusion of unfair terms is provided by the rules on incorporation of these documents into the contract. Once incorporated standard terms and conditions have equal status with standard terms in the "main contract". It seems that there are no special rules for the incorporation of standard terms and conditions into financial contracts, but the general rules apply.⁶⁵⁵ The general rules broadly provide that standard terms have to be made available to the consumer prior the contract conclusion, and the consumer has to expressly accept these terms. However, as pointed out earlier, consumer contracts in general, and consumer credit contracts in particular are contacts of adhesion, hence, incorporation subject to transparency and acceptance will most likely be fulfilled. Thus, this initial filter, transparency or procedural fairness as a vetting rule, will most likely be without practical effect, and terms will become part of the contract. Once part of the contract ancillary terms can only be removed if they are substantively unfair.

⁶⁵³ Art. 42 Banks Act contains similar provisions on publication of standard terms and conditions.

⁶⁵⁴ Decision of the Serbian National Bank on the ways and procedures of applying standard terms and conditions of banks in dealing with clients, natural persons, Official Gazette of the Republic of Serbia No. 74/09.

⁶⁵⁵ See for general rules of incorporation: III.6.3. and IV.5.

V.6.2.1. Fairness of variation clauses

Variation clauses are clauses that allow the unilateral alternation of the terms of the contract while its duration. Lomnicka asserts there are two types of variation clauses in financial contracts. One allows the financial institution to unilaterally change any term in the contract; the other allows the change of the interest.⁶⁵⁶ Typically, variation clauses are incorporated among the standard terms and conditions.⁶⁵⁷ Since these clauses are not in line with the general rule that contracts can be modified only by the agreement of the parties, the UCTD Annex specifically provides their substantive unfairness. Terms “enabling the seller or supplier to alter the terms of the contract unilaterally without a valid reason which is specified in the contract” (Art. 1(j) UCTD Annex) may be considered unfair within the meaning of the UCTD. However, financial contracts are exempted from the rule, and financial institutions may alter the interest or other charges unilaterally where there is a valid reason, provided the consumer is informed at an earliest opportunity and provided with a right to withdraw from the contract immediately upon notification (Art. 2(b) UCTD Annex).⁶⁵⁸

The only CJEU case that involved the question of variation terms was *Invitel*. The case was about the fairness of charges for payments by money order in long term “loyalty contracts” for landline telephone services. The term was placed among the standard terms and conditions, but without following it up with any provision specifying the method of fees calculation and the consumers’ right of withdrawal. The CJEU noted that this case involved the issue of the method of price amendment rather than the fairness of the price itself, and therefore the term did not fall under the exception of Art. 4(2) UCTD.⁶⁵⁹ The CJEU confirmed that it is for the national court ruling on the fairness of a particular term to determine the fairness of the term, but instructed the national court to have regard to all the terms of the standard terms and conditions, the applicable default rules, whether the reasons for and the method of amendment are laid down in plain and intelligible language, and, if applicable, whether consumers have a right to terminate the contract.⁶⁶⁰ Advocate General Trstenjak further explained that the valid

⁶⁵⁶ Lomnicka 1999, p. 99-100.

⁶⁵⁷ Dorkó 2000, p. 37.

⁶⁵⁸ For a detailed analysis see: Eva Lomnicka, *Unilateral variation in banking contracts: an ‘unfair term’?*, In: *Consumer Protection in Financial Services*, 99-122, Peter Cartwright (ed.), Kluwer Law International, The Hague, London, Boston, 1999, p. 107 et seq.

⁶⁵⁹ Para. 23 *Invitel*.

⁶⁶⁰ Para. 30 *Invitel*.

reason for modification can be any “sufficiently important legal reason,” and the reason has to be set out in plain and intelligible language in line with Art. 5 UCTD.⁶⁶¹ Hence, it is not sufficient to repeat the general concept of valid reason, or the text of Art. 1(j) UCTD Annex but the reason has to be specified and adjusted to the case at hand, and stated with sufficient clarity.⁶⁶²

Variation clauses raise fairness concerns, because, as Advocate General Trstenjak pointed out, the amendment may shift the rights and obligations of the parties under the contract.⁶⁶³ Hence, variation clauses can distort the contractual balance, make the fair contract term unfair, and should only be allowed exceptionally. Due to additional requirements of valid reason, information and right of withdrawal, the question that arises is if variation clauses aim towards substantive or procedural fairness. It seems there are more arguments in favour of considering them as a matter of substantive fairness. First, terms on the indicative list in the UCTD are examples of substantive unfairness. Second, variation clauses are about substantive rights of financial institutions. Third, information in variation clauses does not fall under procedural fairness as the term is used in the thesis, i.e. as fairness in the process leading up to the conclusion of the contract. The contract is already concluded and terms are varied while its duration on which the consumer is informed. For reasons of clarity, this could be called post-contractual transparency. Therefore, variation clauses primarily raise concerns of substantive nature. However, variation clauses can be challenged for lacking procedural fairness if they were not transparent prior the contract conclusion. Pre-contractual transparency is not directly incorporated into the language of the UCTD Annex. This additional criterion was brought into the provision by Advocate General Trstenjak,⁶⁶⁴ and accepted by the court in *Invitel*. Hence, if variation clauses are not laid down in the contract in clear and transparent manner, including the valid reason for modification, they can be also challenged for being procedurally unfair.

In order to better understand variation clauses, it is important to point out that these terms entail two distinct steps. One is when the contract is drawn up and the clause is formulated. Here the requirement is that the term is set in a plain and intelligible language, provides for a right of withdrawal, a valid reason for modification, and perhaps to inform the consumer that he will receive a notification upon amendment of

⁶⁶¹ Para. 87 Advocate General Trstenjak *Invitel*.

⁶⁶² *Ibid*.

⁶⁶³ Para. 86 Advocate General Trstenjak *Invitel*.

⁶⁶⁴ Para. 45 *Invitel*.

the contract. The UCTD is not precise whether the valid reasons should be specified in the contract in advance or a general formulation that there is a need for a valid reason is sufficient. The second step is to apply the clause in practice. The financial institution should again specify why it changes the term, give a valid reason for modification and notify the consumer as soon as possible on the change. In the latter case transparency appears as a vetting principle for the term that is amended, as a variation clause generally contains the power to amend but the power is exercised towards another term in the contract, towards the term that regulates interest, fees and charges. Additionally, it is possible the first step, the incorporation of a variation clause is not even necessary, as the power to amend is laid down in a statute.

Variation clauses caused a lot of controversies in recent years in Hungary and in Serbia, especially in relation to loan credits with variable interest rates denominated in Swiss francs. These clauses for example read that the interest will be variable in the amount of 3% (fixed part of the interest rate; profit margin) plus 6 months CHF LIBOR (variable part of the interest rate). There were many problems with Swiss Franc loans.⁶⁶⁵ First and foremost consumers were not warned on potential risks of loans denominated in foreign currency. Moreover, these loans were suggested by banks as the best and cheapest. Therefore, consumers were misled and induced to enter into these contracts.⁶⁶⁶ Second, loans denominated in Swiss Francs carried all the disadvantages of a variable interest rate. They carried significant exchange rate risk. Third, these loans were open for additional abuses by financial institutions. For example charges and fees during the life of the contract were also accounted in the selected foreign currency, instead of the domestic currency, and consumers were charged for currency exchange. Also, when the benchmark, the CHF LIBOR decreased the financial institution failed to decrease the interest. Finally, a specific problem was present in Serbia. Due to Serbia's dependence on Euro, Swiss Franc loans were calculated in Euro and then transferred to Swiss francs.⁶⁶⁷

⁶⁶⁵ Information on practical problems with Swiss franc loans the candidate gained during her voluntary work at the Consumer Protection Association of Vojvodina, where she acted as a legal advisor for financial services in the period of 2010-2012. See also: Patassi Benedek, Suggestions for judicial resolution of the debates on loans denominated in foreign currency, 59(7) Magyar Jog 419-428, p. 421-422.

⁶⁶⁶ Note that from 2008 Art. 203(5) HuCIFEA mandates financial service providers to warn consumers on the risks of foreign currency loans.

⁶⁶⁷ Bad loans cast shadow over sharp rise in Serbian Bank profits at Financial Times: <http://www.ft.com/intl/cms/s/0/866f14a8-3a42-11e3-9243-00144feab7de.html#axzz2kKHFlw3D> (13 Nov 2013).

Swiss franc loans started to cause problems when the forint and dinar depreciated against the Swiss franc and this triggered rapid and substantial increase in consumers' instalments. Gradually all the problems of these loans and abuses by financial institutions come to light. The crisis was and still is serious, as it significantly influences a great number of households in both jurisdictions, but especially in Hungary. To illustrate, in 2010, 60% of all loan credits and 30% of all mortgage credits were denominated in Swiss francs in Hungary.⁶⁶⁸ In 2011 the aggregate debt per capita in Hungary was 2.581 Swiss Francs and in Serbia 222 Swiss francs.⁶⁶⁹ Although the aggregate debt per capita is significantly lower in Serbia, Swiss franc loans play a very significant role given the fact that until recently home loans were not even given in domestic currency.⁶⁷⁰ The reason why a number of people affected in Hungary is greater is probably because of the low credit culture of Serbia, people lack trust in banks and are afraid, as it turned out rightly, of loan credits. However, those people that are affected face similar problems than Hungarian consumers. On the wake of social problems of overindebtedness the Governments were searching for solutions. One of the measures was to change the statutory regulation of variation clauses. The thesis will bellow analyze in details these measures and their interaction with the test of fairness. It is important to note that not all problems caused by Swiss franc loans are problems of variation clauses. Variations often resulted in too extensive interpretation of these clauses that went as far as breach of contract (e.g. not lowering the interest rate when the LIBOR decreased) or breach of law (e.g. contract modification according to business policy in Serbia).

V.6.2.1.1. Fairness of variation clauses in Hungary

The UCTD Annex is implemented into the HuUCTD Decree that places variation clauses on the grey list. Consequently, a contract term that provides for a power of unilateral contract modification without a valid reason, especially to increase the monetary obligation of the other contracting party, or a power of unilateral contract

⁶⁶⁸ Swiss central bank emerges as key supporter of euro at Financial Times: <http://www.ft.com/cms/s/0/09022308-73e3-11df-87f5-00144feabdc0.html#axzz217RPbmSA> (14 Nov. 2013).

⁶⁶⁹ See: National Bank of Serbia: Swiss franc loans are no risk for financial stability at Blic: <http://www.blic.rs/Vesti/Ekonomija/271915/NBS-Krediti-u-francima-nisu-rizik-za-finansijsku-stabilnost> (13 November 2013).

⁶⁷⁰ Home loan credits finally in dinars, Press Online: <http://www.pressonline.rs/info/politika/191160/krediti-za-stan-konacno-i-u-dinarima.html> (13 November 2013).

modification with valid reason but without providing a consumer with the right to withdraw (Art. 2(d) HuUCT Decree) *may* be considered unfair.⁶⁷¹ Special rules for financial contracts are in the HuCIFEA. The key provision in regulating variation clauses is Art. 210(3) HuCIFEA (modified in 2009).⁶⁷² This clause provides that:

In consumer credit or financial leasing contracts only the *interest, charges or fees* can be unilaterally modified to the detriment of the consumer. Other terms, including changing the reasons for modification, cannot be unilaterally altered to the detriment of a consumer. The creditor can only rely on this right provided the contract contains the list of objective reasons for modification and when its pricing principles are laid down in writing.

Due to the Swiss franc loan credit scandal, the reach of this exception was subject to a lot of controversy. The thesis below tries to summarize the arguments and determine the conditions under which contract terms may be modified relying on variation clauses. The analysis especially relies on the extensive interpretation given by the Supreme Court in its Opinion 2/2012. In this Opinion the Supreme Court seems to confirm standpoints taken in an earlier decision delivered in a partial judgement, in Gfv.IX.30.221/2011 (BH 2012.41).

First, modification is limited to contracts with variable interest rate. Fixed rate loans cannot be unilaterally modified. Price valorisation, price adjustment based on benchmark e.g. LIBOR is not a unilateral contract modification within Art. 210(3) HuCIFEA. The same rules apply for modifying fees and charges (Pt.7 Opinion 2/2012 HuSC). This seems to mean that variation clauses apply to the profit margin of the bank, the fixed part of the interest rate.

Second, modification is only possible if there is a clause in the contract that empowers the financial institution for modification. The Supreme Court explains that variation clauses are generally in compliance with the HuCC. The HuCC allows the parties to modify their contract by mutual agreement. Variation is also possible by reliance on a clause among standard terms and conditions, provided the rules of incorporation are observed. The Supreme Court acknowledges, financial institutions usually take advantage of this latter option. It further explains, variation clauses are

⁶⁷¹ This provision is retained in Art. 6:104(2)(d) nHUCC.

⁶⁷² The restrictions laid down in Art. 210(3) and (4) HuCIFEA were introduced with Act XIII of 2009, and later Act CL of 2009 amending the HuCIFEA following the report: Recommendations for handling the problems of retail banking services of the Expert Committee on Retail Financial Services published in 2006. The report found that a power to vary the terms of the contract represent a significant market power for financial firms and suggested the power should be limited by law. Balázs Bodzási, The right to unilaterally modify standard terms and conditions (an analysis based on German and Austrian law), 9(1) Hitelintézeteti szemle 24-43, 2010. p. 24.

allowed as an exemption from the rule of *pacta sunt servanda*, due to specialty of financial contracts. In any event, the fairness of Art. 210(3) HuCIFEA, its mere existence, cannot be challenged, as the provision falls under to the mandatory rules exemption of Art. 209(6) HuCC. Finally, Supreme Court notes that variation clauses are different from contract modification due to changed circumstances, and Art. 241 HuCC is not applicable to variation clauses (Pt. 1 Opinion 2/2012 HuSC).

Third, unilateral modification is only possible if the contract contains an objective “list of reasons” for modification (“ok lista”). Importantly, no legal provision lists the circumstances that give rise to modification. It is up to the financial institution to determine on its own accord the reasons for modification. The only requirements are that the exhaustive list containing objective reasons became part of the contract (Art. 210(3) HuCIFEA). If the financial institution fails to foresee the particular reason, the modification will be contrary to mandatory law, it will be illegal. The reasons for modification will also be illegal if the reason does not depend on objective circumstances and the list is not exhaustive. Since any modification contrary to mandatory law is null and void under Art. 200(2) HuCC, before applying the test of fairness, courts will examine if the modification was according to the law, i.e. legal. However, the questions of legality and fairness are distinct, and legal terms may be held unfair. The test of legality seems to be the first “filter” (Pt. 2 Opinion 2/2012 HuSC). In terms of the substance of valid reasons for modification, the validity of reasons for modifications in home loans and leasing laid down in the UM HuDecree cannot be challenged due to Art. 209(6) HuCC. However, the question is what happens with the validity of reasons in other contracts than home credit and leasing. These reasons are laid down in the HuCode. The HuCode is a self-regulatory code, adopted by the Hungarian Association of Banks.⁶⁷³ It follows, that a breach of the HuCode amounts to an unfair commercial practice. The HuCode contains conduct of business rules for financial institutions and in principle binds every creditor, but only those will be sanctioned that availed themselves to the HuCode.⁶⁷⁴ The HuCode differentiates three categories of reasons: 1) change in the legal environment;⁶⁷⁵ 2) change in

⁶⁷³ Based on Act XLVII of 2008 on the Prohibition of Unfair Business to Consumer Commercial Practices, hence non adherence to the HuCode amounts to an unfair commercial practice.

⁶⁷⁴ HuNB: https://felugyelet.mnb.hu/intezmenyeknek/magatartasi_kodex (13 November 2013).

⁶⁷⁵ E.g. changes in primary and secondary legislation, changes in the public dues, in the amount or fee of the obligatory deposit insurance.

macroeconomic factors or market conditions;⁶⁷⁶ 3) change in the risk classification or creditworthiness of the consumer.⁶⁷⁷ The Supreme Court clarified, what academics voiced earlier,⁶⁷⁸ that the reasons listed in the HuCode *can* be challenged for their fairness. Therefore, the fact that the “list of reasons” incorporated into the contract is compliant with the list in the HuCode will not prevent the court to scrutiny the reasons for their fairness (pt. 5 Opinion 2/2012 HuSC).

Fourth, financial institutions can only rely on this right if they draw up “pricing principles” (“árzási elvek”) (Art. 210(3) HuCIFEA). The “pricing principles” has to contain that any change in the interest rate, fees and charges may be exercised only if the objective reason stipulated in the contract has material impact on the particular interest rate, fee or charge (Art. 210(4)(a) HuCIFEA). This obligation reflects the principle of proportionality (Pt. 6(d) 2/2012 HuSC Opinion). Although Art. 210(4)HuCIFEA contains the minimum mandatory content of “pricing principles,” these documents are not public. They are being controlled by the HuNB (Art. 210(5) HuCIFEA).

Fifth, where changes in the same circumstances warrant the reduction of interest rate, fees and charges, this must be enforced as well (Art. 210(4)(b) HuCIFEA) Consequently, a clause that excludes this right, is illegal.

Sixth, the modification of charges, fees or interest has to be published (Art. 210(6) HuCIFEA) and the notice to the consumer dispatched at least 60 days prior the change would take place (Art. 210(7) HuCIFEA). The rules on notification and a right of withdrawal are not applicable for change in variable interest rate connected to change in the reference rate. The notification must contain information on the change and disclosure on the consumers’ right of withdrawal (Art. 210(9) HuCIFEA).

Seventh, somewhat different rules apply for mortgage loan credits under Art. 210/B HuCIFEA. For example in mortgage loan credits the profit margin can only be increased if the consumer defaulted (Art. 210/B(5) HuCIFEA).

Finally, the HuCIFEA has no retroactive application. Therefore, consumers always have to rely on the provisions of the HuCIFEA that were in force at the moment

⁶⁷⁶ E.g. change the credit rating of Hungary; the sovereign risk premium (credit default swap); the base interest rate, the repurchase and deposit interest rates of the HuNB; the inter-bank money market interest rates/loan rate.

⁶⁷⁷ E.g. reclassification of the customer or the credit transaction to another risk category based on the creditor’s asset rating policy, or the creditor’s internal debtor rating policy; change in the value of the real estate collateral.

⁶⁷⁸ See: István Kemenes, On the right of financial institutions of unilateral contract modification, 20(4) *Gazdaság és Jog* 3-12, 2012, p. 6.

of contract conclusion, or when the standard terms and conditions become part of the contract (Pt. 6 2/2012 HuSC Opinion).

The HuCIFEA contains a number of restrictions of modifications. The “list of reasons” or the objective reason for modification cannot be unilaterally changed to the detriment of the consumer (Art. 210(3) HuCIFEA). The contract cannot be modified by imposing a new fee or charge or changing the method of calculation of interest, fees and charges (Art. 210(12) HuCIFEA). The annual maximal raise in fees and charges is also determined (Art. 210(4)(d) HuCIFEA). The HuCIFEA was extended by Art. 200/A HuCIFEA in 2010 dealing with loans denominated in foreign currency.⁶⁷⁹ In home loans denominated in foreign currency the same exchange rate will be applicable for issuing the loan, calculating monthly instalments, and calculating the associated fees and charges (Art. 200/A(1) HuCIFEA). This can be the median exchange rate of the HuNB or the financial institution. The financial institution cannot charge the service of currency conversion (Art. 200/A(3) HuCIFEA). This provision however relates only to loan credits for homes. A more general provision that allows the charging of fees and charges connected to the loan credit denominated in a foreign currency in that currency is in Art. 210(5)(a) HuCIFEA, added in 2011.⁶⁸⁰ It provides that only those fees and charges can be charged in foreign currency that are directly linked to the funding source of the financial institution necessary for loan maintenance and performance. Although this provision seems very broad, it then continues and gives an exhaustive list of charges and fees associated with the loan that cannot be charged in foreign currency. Contract modification fees fall in the latter category.

Therefore, the variation of interest, fees and charges is restricted but is generally allowed. It seems that in providing the exemption, the Hungarian legislator complied with the requirements of the UCTD Annex. Hence, there is no question the creditor has a right to unilaterally modify the contract, but the question is when will this modification be fair. This goes into the question of when is the objective reason a valid reason for modification. The examination of a valid reason raises both the issues of substantive fairness.

⁶⁷⁹ By Act XCVI of 2010.

⁶⁸⁰ Act CXLVII of 2011.

In determining the substantive fairness of the reasons for variation, a substantive assessment of the reason in question is necessary.⁶⁸¹ It should be noted that when talking about fairness of variation clauses the Supreme Court lists some circumstances that it previously considered questions of legality, e.g. the reason not being objective. The thesis accepts the latter standpoint, because if a clause is expressly contrary to the statutory law there is no need to determine its fairness. Nevertheless, the test of fairness can be applied to these clauses as well, and arguably, these clauses will be a matter of substantive fairness.⁶⁸² Consequently, not many reasons listed by the Supreme Court raise solely the issue of substantive fairness. The contract term will be substantively unfair if the change in circumstances that gave rise for modification arise in relation to circumstances that were not taken into account in determining the amount of the interest, fees and charges at the time of contract conclusion, or the change in the circumstance did not to exercise a real and sufficiently proportionate degree of influence on the interest, fees and charges (the principles of reality and proportionality). The contract term will also be unfair if the consumer could not foresee under what conditions burdens will be transferred onto him (the principle of transferability), although, arguably, this latter case may also point on the question of procedural fairness. Importantly, a reason for modification will be valid if it foresees circumstances that are outside the normal degree of risk the bank takes, and exercise an influence on the interest, cost and charges in a way that the bank could not foresee.⁶⁸³ The change has to be more than the regular, normal business risk the creditor encounters, and it has to exercise real and substantial influence on the business operation of the creditor. Small and insignificant changes cannot give rise to contract modification. Regular business risk cannot be transferred on the consumer as the financial institution is obliged to have proper systems and controls for risk management, and to be able to foresee the “regular” risk each credit carries. The unilateral modification should take place exceptionally, and only if the term would cause substantial losses to the bank without a change.⁶⁸⁴ Finally, if the financial institution

⁶⁸¹ In another case the Supreme Court confirmed variation clauses raise the issue of substantive and not procedural fairness, i.e. the subject of examination should be the content of the standard clause and not the process of contract modification. Gfv. VII. 30.077/2013 (BH2013. 249).

⁶⁸² Additionally, the Supreme Court considers the lack of notification or cancellation right or a clause excluding the possibility to modify the interest, fees and charges in favour of the consumer, when circumstances changed in his favour, matters of substantive fairness, despite express requirements in the HuCIFEA. The thesis will consider these issues questions of legality and not fairness. Cf Pt. 2 and Pt. 6 of Opinion 2/2012 HuSC.

⁶⁸³ See also: Kemenes 2012, p. 12.

⁶⁸⁴ See also: Kemenes 2012, p. 11.

used methods and tools in calculating risk that constitute business secret, that consumers cannot get hold of, the burden of proof is on the financial institution to show that the degree of risk in a particular case, was above the regular, foreseen and managed risk. However, if the list of reasons omits reference to extraordinary (above regular business risk) and unforeseeable character of changes, a variation clause will not automatically be considered unfair. Its fairness has to be determined in relation to the particular case, when the clause is applied (Pt. 7 Opinion 2/2012 HuSC).

Kemenes criticized this latter point. According to this author, a contract term that gave rise to modification can either be fair or unfair. Consequently, it is not possible to say that the contract term is fair if it gives rise to a minor change, and therefore does not allow the contract modification; and unfair if it leads to substantial change, and therefore allows for modification. According to Kemenes, the Supreme Court focused on the *process* of raising the interest rate, charges or fees, instead of the content of the variation clause. The mere existence of an unfair clause is a reason for its annulment, and it is not necessary to use the clause in practice. In other words, terms can be annulled if they are unfair *in abstracto*. At the moment of raising the interest rate the only question that should be answered is if the financial institution respected the contract.⁶⁸⁵ Kemenes is arguably right. The essence of the test of fairness is to challenge what the contract term allows *in abstracto*, and not its concrete result in practice. Nevertheless, it can also be accepted that often it will be difficult to determine *in abstracto* what the reason for modification can do without seeing its practical effect.

The other critique relates to the question of foreseeability. Namely, giving opinion on the relationship between Art. 241 HuCC and Art. 210(3) HuCIFEA the Supreme Court, in the partial judgement, expressly pointed out that the latter is in *lex specialis* to the former. However, as Gadó asserts, despite this acknowledgement, the Supreme Court nevertheless relied on it. Art. 210(3) HuCIFEA contains no reference to exceptionality of circumstances, but the Supreme Court read them into the provision based on Art. 241 HuCC. Gadó argues, under Art. 210(3) HuCIFEA it is not important whether the change in the circumstances was significant; the significance of the change should be taken into account within the principle of proportionality. Therefore, under Art. 210(3) HuCIFEA all changes laid down in the “list of reason” should take effect,

⁶⁸⁵ Kemenes 2012, p. 10.

and the only question is to what extent.⁶⁸⁶ Further, Gadó also subjects to critique the reasoning of the Supreme Court that the circumstance has to be unforeseeable for the creditor at the moment of contract conclusion, as under Art. 210(3) HuCIFEA it is only important that the reasons are laid down in advance in a transparent manner, and not whether they are foreseeable.⁶⁸⁷

Finally, connected to the principle of proportionality, the problem is how far the interest, changes and fees can be raised. The interest rate cap no doubt applies to the contractual interest rate, to the interest agreed at the time of contract conclusion, but the HuCIFEA does not contain any provision that would limit the maximum amount of variation. The HuCIFEA only limits the annual increase of fees and charges by no more than the annual consumer price index published by the *Central Statistic Office* (Art. 210(4)(d) HuCIFEA). It is therefore questionable if the general APR cap applies also at a later point, during the variation of the APR's components, i.e. the interest, fees and charges. The language of Art.199(1) HuCIFEA says the financial institution cannot give a loan to the consumer with a higher APR than the threshold established by it. The language "to give a loan" can be interpreted either way, as to give in general or to give at the moment of granting the credit. According to the IRR Study, since only the initial rate is the contractual interest rate the official interest rate ceiling usually only applies to this rate. This in turn may induce banks to provide so-called "teaser-rates" where a variable rate credit carries a low initial interest rate at the beginning which is consequently increased so that the overall average interest rate of the contract may go well over the rate ceiling.⁶⁸⁸ Consequently, for a high level of protection the contractual price cap should equally apply to the increased interest rate. This assurance should be provided by regulation.

Variation clauses can also be procedurally unfair and void under Art. 209(4) HuCC. The Supreme Court underlines, that a term lacking clear and legible language will be unfair in itself. In giving explanation, it continues, that the mere use of economic terms like LIBOR and mathematical formulas is not unfair. However, the financial institution has to make sure that the terms and conditions are in decent size print, with clear structure and without cross-references (Pt. 6 2/2012 HuSC Opinion). It must be noticed, this is a very narrow interpretation of transparency. It should mean a genuine

⁶⁸⁶Gábor Gadó, Unilateral contract modification in financial sector, 19(12) *Gazdaság és Jog* 3-8, 2011, p. 7.

⁶⁸⁷ *Ibid.*

⁶⁸⁸ IRR Report 2010, p. 101.

opportunity of a particular consumer to understand the terms in question, as discussed bellow. Additionally, in determining procedural fairness, arguably the circumstances leading up to the conclusion of the contract can also be taken into account (Art. 209(2) HuCC. Since many Swiss franc loans were mis-sold to consumers, this unfair commercial practice could be taken into account in determining procedural fairness.

Therefore, the complicated structure of variation clauses gives several options for their elimination from the contract. Judges finding solutions for increasingly emerging claims involving variation clauses in Swiss franc loans⁶⁸⁹ should bear in mind the following. The first step should be to determine if the variation was according to the law, i.e. the HuCIFEA. If the financial institution fails to foresee the particular reason for variation on its list of reasons, if the particular reason does not depend on objective circumstances and the list is not exhaustive, or if the consumer is not provided with a right of withdrawal or was not notified on the change in timely manner, or if the term excludes the consumers' right for favourable modification if circumstances change in his favour, the term will be illegal, and null and void under Art. 200(2) HuCC. Additionally, as variation clauses are usually among standard terms and conditions of financial institutions, courts could see if this variation clause became part of the contract, under the general rules of incorporation. This is an exceptional remedy having in mind the process of contract formation in consumer credit. If the term passes this first filter, courts should see if the variation clause was transparent.

Transparency should be interpreted as established bellow, much border than the Supreme Court did. It should be considered a real change of a consumer to *understand* the term (not just to get familiar with it). In determining procedural fairness, the circumstances leading up to the conclusion of the contract can also be taken into account, including the selling practices. Arguably, transparency can be challenged in all contracts. Finally, if the previous two steps failed or are not applicable, consumers can challenge the substantive fairness of variation clauses under Art. 209(1) HuCC. The question of substantive fairness should be the last as it is the most difficult to prove. This challenge however exempts home loan credits and lease regulated in the UM HuDecree, under Art. 209(6) HuCC. Substantive fairness should be determined based on the principles of reality and proportionality, and transferability. This means that the variation clause will be substantively unfair e.g.: when the change in the circumstances

⁶⁸⁹ See All hell breaks loose on foreign currency loan disputes- The stake is enormous. Portfolio: http://www.portfolio.hu/users/elofizetes_info.php?t=cikk&i=190424 (13 November 2013).

relied on by the financial institution did not exercise a real and sufficient degree of influence on the interest, fees and charges that would justify their increase; when the increase was not proportionate; when the increase resulted in profit gaining; when the change covered regular business risk; or the consumer could not foresee under what conditions burdens will be transferred onto him. Taking into account the “cases” of substantive unfairness, they are arguably difficult to prove, and the burden of proof is on the consumer, save for information constituting banking secret.

V.6.2.1.2. Fairness of variation clauses in Serbia

Art. 1(j) UCTD Annex is implemented into Art. 48(1)(11) SrbCPA that places any term that allows the business to unilaterally alter the terms of the contract on the grey list. The SrbCPA does not specify that there has to be a valid reason for a modification. According to Art. 48(1)(11) SrbCPA any modification, with or without a valid reason, may be challenged for fairness. Exceptions in favour of modification of consumer credit contracts are not laid down as such, but the SrbFSUPA specially talks about the change in the variable interest rate. In case of variable interest rates the financial institution has to notify the consumer in writing before the change would take place together with sending the consumer the new repayment plan (Art. 29(1) SrbFSUPA). The same rule is applicable on changes in other variable cost elements, i.e. fees and charges (Art. 29(2) SrbFSUPA). However, the SrbFSUPA lacks the guarantee the change can take effect only if there is a valid reason and the consumer is provided with a right of withdrawal.⁶⁹⁰

Instead of a valid reason for modification, the SrbFSUPA has a special provision that the contractual obligation must be determined or determinable in the contract (Art. 8(1) SrbFSUPA). The monetary obligation is determined if its amount depends on the variable elements laid down in the contract, or variable and fix elements. Variable elements are officially published. These are e.g. the reference interest rate, index of consumer prices (Art. 8(2) SrbFSUPA). These elements have to be objective, which means they cannot be influenced by will of either party to the contract (Art. 8(4) SrbFSUPA). The same requirements are later repeated within the provision on the content of credit (Art. 19(3) SrbFSUPA), financial leasing (Art. 21(2) SrbFSUPA), and overdraft (Art. 20(1) SrbFSUPA). Any clause that would direct to the change in essential

⁶⁹⁰ Non-compliance is sanctioned by monetary penalty (Art. 50 (1)(11) SrbFSUPA).

contractual elements based on the business policy of a financial institution is forbidden (Art. 8(5) SrbFSUPA).⁶⁹¹ Therefore, the SrbFSUPA provides for multiple guarantees that all the clauses in the contract depend on objectively identifiable circumstances. It should be mentioned the reason why an increased attention is devoted to objectivity is that before the SrbFSUPA banks were initiating amendments, most frequently they were raising the interest rate based on their business policy.⁶⁹² In addition, regarding foreign currency loans, the SrbFSUPA provides the financial institution is obliged to use the official median exchange rate of the SrbNB at all times (Art. 34 SrbFSUPA). If credit is conditioned on deposit, consumers are entitled for the same method of interest rate calculation for the credit and the deposit (Art. 35 SrbFSUPA).

A noticeable difference between the language of the UCTD, on the one hand, and the HuCIFEA and the SrbFSUPA, on the other hand is that the first use the term “valid reason” while the second “objective reason”. Even though in most cases a valid reason will be also an objective, and vice versa, the two words do not have the same meaning. Objective means objectively determinable, as the SrbFSUPA says, these are parameters that are officially published (probably by the SrbNB).⁶⁹³ Compared to Hungary, it seems, in Serbia the validity of the objective reason cannot be challenged. It also appears there are fewer reasons for modification in Serbia. The examples in the SrbFSUPA e.g. change in the reference rate and consumer price index are macroeconomic changes, which are only one group of reasons under the HuCode and UM HuDecree (though probably the most common in practice). Nevertheless, these reasons given in the SrbFSUPA are only examples, and not an exhaustive list, which practically leaves open the circumstances under which the interest, fees and charges can be modified. The solution of Hungary that the “pricing principles” has to be laid down in writing and the exhaustive list of reasons for modification part of the contract is better than the Serbian option. The SrbFSUPA also lacks any reference to the principle of proportionality, or an obligation of the bank to adjust or decrease the interest, fees and charges in favour of the consumer, if the objective circumstances changed in favour of

⁶⁹¹ Non-compliance is sanctioned by monetary penalty (Art. 50(1)(1) SrbFSUPA).

⁶⁹² See for details: V.6.1.2.

⁶⁹³ Again, what is objective is questionable. In finance, objective is often not absolutely objective, but leaves some degree of subjective influence. For example the recent LIBOR scandal showed that even the value of LIBOR (taken as an objective parameter under the SrbFSUPA) can be influenced by different techniques. Therefore, the corrective working should be objectively identifiable and not objective circumstance.

the consumer. However, a great advantage of the Serbian solution is that the in fairness of variation clauses can be questioned at all times, not just the objectivity of the reasons but also the reason itself, the mere existence of the reason.

Therefore, in challenging variation clauses, the same applies as in Hungary. Courts should first see if the variation took place in line with the SrbFSUPA, and if the variation clause became part of the contract. The next step is to see if the requirements of procedural fairness are fulfilled. Finally, courts should turn to assessing substantive fairness. It seems, in Serbia only the objectivity of the reason for variation and not its validity can be challenged. However, the objective reason is subject to the test itself. Namely, in Serbia, the test of fairness can be applied without limitation, and therefore there is no need to be limited on the reasons for modification. Even the rules of mandatory law like the SrbFSUPA are, at least in theory, subject to the test. Hence, the mere existence of variation clauses can also be challenged. However, the unlimited challenge relates only to newly concluded contacts. On still running, on contracts concluded after 1 January 2011, when the SrbCPA entered in force, only two grounds of unfairness in the test of fairness can be relied on. Variation clauses can only be found unfair for making the performance of the contract substantially different from what the consumer legitimately expected (Art. 46(3) SrbLOA), having both procedural and substantive meaning, or for causing the performance to be unjustifiably burdensome (Art. 46(2) SrbLOA), to determine substantive unfairness. Therefore, for claims commenced after the entering into force of the SrbCPA, courts are advised to rely on the new concepts that focus on performance in solving the problem caused by credits denominated in Swiss francs.

V.6.2.1.3. Instead of conclusion: the broader question of fairness of variation clauses

As shown above, variation clauses are subject to the test of fairness, and it is possible to question both their substantive and procedural fairness. However, is very difficult to determine the substantive fairness of these clauses. Variation clauses that e.g. allow the increase the interest rate while the duration of the contract, raise the obligation of the debtor, while the obligation of the creditor (at least from the point of view of the consumer) stays unchanged. The loan is already issued at an earlier point and under the

conditions to which the consumer adhered. Therefore, variation clauses practically allow the creditor to be more or less always in a situation as if it issued the loan under current market conditions, while in fact it issued the loan at an earlier point under (arguably) different market conditions. The characteristic of credit connected to time and risk comes to full expression. In order to measure the imbalance in the parties' rights and obligations the test of fairness should go beyond the particular contractual relationship and take into account the position of the creditor towards other debtors and creditors. This "operation" is contrary to the fundamentals of a contract that take into account the relationship between the two parties.

It seems, variation clauses are in place for economic reasons, and they are invited to protect those reasons primarily, and serve the protection of consumers only secondarily. The underlying rationale for variation clauses is to provide liquidity for the bank, but the concrete reasons for variations may be different (change in the legal environment, macroeconomic changes, or change in the consumer's creditworthiness). From a bank's point of view it is necessary to transfer the increased cost of financing onto existing debtors in order to maintain the bank's liquidity. Banks as financial intermediaries lend long and borrow short. Variation clauses are in place to remedy the consequences of this maturity mismatch. Additionally, as banks lend the borrowed funds, it is imperative their prudential operation is not compromised.⁶⁹⁴ Having no possibility to transfer the increase in the cost of resources would bring lending business to a halt or increase the cost of loans (and would potentially cause even wider disruptions). Therefore, in a big picture, consumers benefit from the possibility of unilateral increase of the interest, fees and charges, as loans are available and prices affordable. However, variation clauses should not be a profit gaining pool for the bank, but are in place only to maintain its liquidity. Therefore, it can be argued that variation clauses are not unfair from the economic point of view. And this is probably why the fairness of variation clauses in general, their existence under Art. 210(3) HuCIFEA cannot be challenged being a mandatory law within the meaning of Art. 209(6) HuCC. Nevertheless, in order to reconcile the two opposing interests, as the economic reasons justify the transfer of some of the burden of more expensive assets, it should not be a "routine" banking activity to transfer all the increase in cost of funding onto the final consumer. Changes in macro-economic conditions and in the legal environment that

⁶⁹⁴ Cf. Endre Ferenczy, Mihály Omros, Retail financial transactions and the Civil Code, 20(4) *Gazdaság és Jog* 13-16, 2012, p. 14.

occur regularly, generate moderate changes, and therefore their risk could be foreseen and calculated in the interest rate prior the conclusion of the contract, should not give rise to later change in the interest rate. However, even here, it is questionable whether consumers would like to pay much higher interest rates from the very beginning of the loan period (assuming banks play safe and calculate higher costs) or would rather settle for periodical adjustments. This dilemma is now on the table in the selected jurisdictions. Because loans denominated in any foreign currency are automatically variable loans, after the Swiss franc scandal, banks started to focus more on loans in domestic currency. However, as it turned out, this is not a good option either, as these loans are deemed to be expensive.⁶⁹⁵

It is difficult to say *in abstracto* whether one reason for variation is fair or not, as the same ground e.g. the Central Bank Base Rate can give rise to various modifications, some of which may be more others less fair. What is important to bear in mind is that the contractual balance should be maintained, increase in expenses should be equally born by both parties, and not only by the consumer. From legal point of view these terms represent an exception from the principle of *pacta sunt servanda*, and the rule that contracts are modified only by the agreement of the parties. As any exception, it should be applied exceptionally. However, the requirements of contractual balance point onto the opposite conclusion. Periodical and small adjustments (both in its favour and to its detriment) seem to be more favourable for consumers than large changes that significantly burden the consumers' household budget.

Overall, the Serbian solution seems fairer than the Hungarian and seems to provide for a higher level of protection. The number of reasons for modification is limited and these are exactly the reasons that allow moderate and constant modifications. However, the fairness of the solution might be undermined with a general uncertainty of not having an exhaustive list of macroeconomic conditions that may activate variation clauses, and by not being able to challenge the validity of the objective reason. Nevertheless, in Serbia the fairness of all clauses can be subject to the test of fairness including the provisions of the SrbFSUPA that provide the reasons for modification. For a high level of substantive protection an option would be to explicitly regulate the valid reasons for modification, like the UM HuDecree did.

⁶⁹⁵ See e.g. The loan in dinars is the most expensive at Blic <http://www.blic.rs/Vesti/Ekonomija/388389/Najskuplji-je-kredit-u-dinarima> (14 November 2013).

As the substantive fairness of these clauses is difficult to prove, courts and lawyers are advised to focus on the question of transparency. In complex contracts like consumer credit and in even more complex institutions like variation clauses there is always room for arguing the terms were not transparent and hence they are procedurally unfair under Art. 209(4) HuCC and Art. 46(2)(4) SrbCPA. In determining procedural fairness mis-selling practices of financial institutions should especially be taken into account.

Finally, although the existence of variation clauses is arguably justified, the problem is how these clauses are applied in practice. One requirement is to transfer on a consumer only as much as it is necessary to maintain liquidity. But the other requirement is not to abuse the clause. It seems that many of the present problems caused by Swiss franc denominated loan credits arise from the abuse of variation clauses. It is now up to supervisors to think of ways how consumers could be compensated. The practice of UK could serve as example where banks put aside billions of pounds to compensate victims of the payment protection insurance mis-selling scandal.⁶⁹⁶ In Serbia, after a number of cases, and the courts uniform standpoint in rendering decisions in favour of customers, the SrbNB already recommended banks to voluntarily compensate customers for unilaterally raising interest rates according to their business policy before the SrbFSUPA entered into force. The SrbNB recommends banks to lower outstanding debt by discounting the margins paid in excess.⁶⁹⁷

In the future, for a higher level of protection, the valid and objective reasons for modification should be regulated in a form of an exhaustive list. Additionally, the maximum increase in the interest, fees and charges should be capped in order to avoid “teaser rates”. Contractual price cap should equally apply to the increased interest rate, fees and charges. However, since the substantive standard set by regulation does not necessarily deliver fair outcomes in all individual cases, the test of fairness should remain applicable as “safety net.”

⁶⁹⁶ See Financial Times: <http://search.ft.com/search?queryText=ppi+misselling> (14 November 2013).

⁶⁹⁷ Recommendation on variable interest rate loan that depends on reference interest rate and/or profit margin at SrbNB: http://www.nbs.rs/export/sites/default/internet/latinica/63/preporuke_skinuto/BAN-001-08.pdf (14 November 2013). So far the recommendation seems successful. See: Banks return overpaid interest at Efektiva: <http://efektiva.rs/aktuelnosti-krediti/banke-vraca-ju-preplacene-kamate#more-1863> (14 November 2013).

V.6.2.1.4. Variation clauses and traditional contract law institutions

When talking about variation clauses, it is important to point out what the relation of this “modern” institution is to the “traditional” institutions of *clausula rebus sic stantibus* and *force majeure* is.⁶⁹⁸

Turning first to *clausula rebus sic stantibus* it can be concluded, the institution is very similar in the two selected jurisdictions. The conditions for its operation are that parties are in a long standing relationship, the change in the circumstances happened after the contract is concluded, the change was unforeseeable, and the change influenced the interest of one of the parties’ in a way to make its performance very difficult, or the realization of its contractual aim futile. Variation clauses are very similar to *clausula rebus sic stantibus*. The terms of the contract get changed due to changed circumstances after the contract is concluded. As said above, the Hungarian Supreme Court even considered variation clauses of fees, charges and interest *lex speciales* to the traditional institution. However, Gadó argues that these are completely different institutions.⁶⁹⁹

In variation clauses some of the reasons for modification are foreseeable at the moment of contract conclusion and occur regularly. On the contrary, the distinct features of the *clausula rebus sic stantibus* are that the circumstance should not be foreseeable at the moment of contract conclusion and should be exceptional. Bíró points to another crucial difference, the change in circumstances must relate to performance, and not to the change in the value of contractual rights and obligations. The first is corrected with contract modification based on *clausula rebus sic stantibus*, and the second by valorisation.⁷⁰⁰ Variation clauses basically valorise, adjust the interest, fees and charges to new market conditions. This standpoint was also confirmed by the Serbian Supreme Court, according to which, there is no place for rescission due to changed circumstances (inflation, difference between official and market exchange rate of the dinar), because these events could have been foreseen and by valorisation clause corrected.⁷⁰¹ This acknowledgement points to another difference. Variation clauses are in place to allow constant or at least more regular adjustment of interest, fees and other charges while change in the contract based on *clausula rebus sic stantibus* should be used one time and

⁶⁹⁸ This section builds on the general analysis of III.6.4. and IV.5.2.

⁶⁹⁹ Gadó 2011, p. 4.

⁷⁰⁰ Bíró 2000, p. 250-251.

⁷⁰¹ SrbSC Rev. 4250/98.

exceptionally. Therefore, although the institutions are similar, these are distinct institutions and come to play under different circumstances.

However, as Gadó asserts, *clausula rebus sic stantibus* remains applicable to all other unilateral changes save for interest, fees and charges.⁷⁰² Nevertheless, according to this author, the institution is largely inapplicable in banking contracts as it requires that the change is exceptionally and that it is due as a result of unforeseeable circumstances, none of which is true for banking practice.⁷⁰³

Turning now to *force majeure*, it can be seen, these institutions are also similar in the two selected jurisdictions. *Force majeure* relates to events that could have not been foreseen or avoided and that make the performance impossible or at least very difficult. It seems, variation clauses are different than *force majeure* clauses and the two can co-exist. *Force majeure* is something extraordinary while variation clauses are in place to allow more regular adjustments of the interest, fees and charges, or other terms of the contract. *Force majeure* is an unexpected event that makes the future performance impossible, while variation clauses affect the change in the value of contractual rights and obligations or initiate other changes that are not crucial for performance of the main contractual obligation. However, arguably, if the bank raises the interest rate based in the change to an extent that the performance of the consumer becomes impossible, the consumer could claim cessation of the contract relying on *force majeure*.

It is important to point out that for unilaterally changing other terms of the contract than interest, fees and charges the general rules apply. Accordingly, terms “enabling the seller or supplier to alter the terms of the contract unilaterally without a valid reason which is specified in the contract” (Art. 1(j) UCTD Annex) may be considered unfair. The Hungarian solution specifies, a contract term that provides for a power of unilateral contract modification without a valid reason, especially to increase the monetary obligation of the other contracting party, or a power of unilateral contract modification with valid reason but without providing a consumer with the right to withdraw (Art. 2(d) HuUCT Decree) may be considered unfair. The Serbian solution is more simple, and any term that allows the business to unilaterally alter the terms of the contract (Art. 48(1)(11) SrbCPA) may be considered substantively unfair. Therefore, clauses allowing for unilateral modification of other terms than interest, fees and charges

⁷⁰² Patassy lists three options for annulling variation clauses: 1) based the test of fairness (Art.209(1) HuC); 2) relying on *clausula rebus sic stantibus* (Art. 241 HuCC), or 3) by using the rules on standard terms (Art. 205 HuCC). Patassy, p. 419-426.

⁷⁰³ Gadó 2011, p. 4.

in Serbia are outright presumed to be unfair. In Hungary, the presumption depends on the presence of a valid reason. In practice, in order to formally respect the general rules on contract modification for which a meeting of minds is necessary, financial institutions will inform consumers on the change and provide them with a right of withdrawal. As it will be seen below, if there is a balancing right of withdrawal terms are unlikely to be considered unfair, as the contractual balance is maintained. Therefore, there will be no practical need to rely on the two traditional institutions to avoid harsh consequences of changes, but a right of withdrawal will provide a more simple solution. However, after the right of withdrawal passed, arguably, consumers can rely on *clausula rebus sic stantibus* to amend the term or on *force majeure* to rescind the contract. Additionally, consumers may choose to rely on *clausula rebus sic stantibus*, as it does not result in rescission of contract.

Therefore, variation clauses are very similar to both *clausula rebus sic stantibus* and *force majeure*, but they are different institutions and come into play under different circumstances. The two traditional institutions are in place to remedy extraordinary changes while variation clauses are in place to remedy regular adjustments. Nonetheless, they remain applicable when other terms of the contract are changed than interest, fees and charges.

V.6.2.2. Fairness of default interest terms

Besides the contractual interest, default interest is payable upon default. Although default interest is not explicitly regulated by the UCTD, it can be read into a term “requiring any consumer who fails to fulfil his obligation to pay a disproportionately high sum in compensation” (Art. 1(e) UCTD Annex) that is on the indicative list. It is implemented into Art. 2(j) HuUCT Decree and Art. 48(1)(3) SrbCPA that are on the grey list. As an ancillary term, default interest is subject to the test of fairness in both Hungary and Serbia. Moreover, being on the grey list there is a presumption that a disproportionately high sum payable as compensation is substantively unfair.

The issue of fairness of default interest arose in front of the CJEU in *Pohotovost*, where the national court asked if a penalty clause of daily 0.25% that is 91.25% yearly is unfair. The CJEU once again confirmed it is for the national court to apply the test of fairness in Art. 3(1) UCTD by taking into account the circumstances of the case at hand

under Art. 4(1) UCTD. Hence, it confirmed, default interest is subject to the test of fairness but the national court should make a decision if the interest rate in question is disproportionately high.⁷⁰⁴ However, the problem is how to determine the compensation was disproportionately high.

On the one hand, default interest has an element of compensation, i.e. it aims to compensate the creditor for the damages sustained by default. If it does not provide for full compensation the creditor is entitled to sue for the difference between the damages sustained and the default interest awarded (Art. 301(5) HuCC; Art. 278(2) SrbLOA). On the other hand, default interest has an element of sanction, it aims to compensate the creditor for the breach of contract and re-establish the contractual balance.⁷⁰⁵ Art. 278(1) SrbLOA explicitly provides that the creditor is entitled for default interest even if it did not actually sustain any damages. Therefore, it seems that default interest is an exemption from the general contract law rule that compensation should allow for *restitutio in integrum*, and no more.

In order to determine if a default interest is disproportionately high and therefore unfair, the question is on what is it payable? Is it payable after the capital or both capital and interest? In Hungary, although only default interest is payable, the unpaid contractual interest behaves as capital that entails interest.⁷⁰⁶ Therefore, in Hungary default interest on contractual interest (interest on interest) is allowed.⁷⁰⁷ In Serbia, interest on accrued contractual interest is generally forbidden (Art. 279 SrbLOA), with an exception of contracts by financial institutions (Art. 400 SrbLOA). Therefore, in principle, default interest is counted towards both the capital and the interest (accrued and future). The amount of default interest is determined by statute. In Hungary, there seem to be no special rules for default interest in consumer credit in general although mortgage loans are subject to separate regulation (Art. 210/A HuCIFEA). Hence, for credit in general the rules of Art. 301 HuCC apply. According to Art. 301(3) HuCC upon default the debtor is obliged to pay the contractual interest increased by 1/3 of the Hungarian Central Bank Base Rate, but the aggregate amount of default interest should be *at least* the Central Bank Base Rate (Art. 301(1) HuCC).⁷⁰⁸ In Serbia a separate *Act*

⁷⁰⁴ Paras. 55, 63 Photovost.

⁷⁰⁵ Bíró 2000, p. 190.

⁷⁰⁶ Commentary on Art. 301 HuCC in Commentary on HuCC. Cf BDT2007. 1520.

⁷⁰⁷ BH1994. 551. Cf BDT2004. 914.

⁷⁰⁸ These rules are retained without changes in Art. 6:48(1)&(2) nHuCC.

on *Default Interest of 2012* (hereinafter: SrbDIA)⁷⁰⁹ was recently adopted, which is applicable to all transactions. The SrbDIA sets default interest on the level of Serbian Central Bank Base Rate increased by 8% (Art. 3 SrbDIA). However, this rule does not seem to set the maximum as Art. 277(2) SrbLOA remains in force which provides that if the contractual interest is higher than the default interest, than the latter apply.⁷¹⁰ Contracting both contractual and default interest would normally be usurious. According to the Serbian Supreme Court it is forbidden to accumulate clauses in the contract that protect the capital. Hence, banks are not allowed to charge both contractual and default interest, but if the contractual interest is higher than the default interest, the former should apply.

Due to widespread practice of connecting loans to foreign currencies, the default on these loans are specially regulated, and determined by the Central Bank Base Rate of the currencies home country increased by 8% (Art. 4 SrbDIA; Art. 301(2) HuCC).⁷¹¹

As it can be seen, default interest rates are determined by statutes, but their maximum is not capped (neither in Hungary nor in Serbia). In Hungary, there is only one true default interest rate cap applicable under very exceptional circumstances.⁷¹² Therefore, it seems the rules on default interest rates are more in place to protect the creditor. This is generally a justified approach, however; there would be a need for special regulation for consumer credit, as consumer debtors very often default unwillingly, due to special hardship, circumstances amounting to *social force majeure*. Art. 32 SrbFSUPA recognized this, and as discussed bellow, in case of *social force majeure*, consumers will be relieved from paying default interest. The Hungarian legislation seems inflexible to take into account these circumstances, where the HuCC provides the obligation to pay default interest exists even if the default is justified or it is without the consumers' fault (Art. 301(1) HuCC).⁷¹³ In any case, default interest is not without limits. In Serbia the maximum will be equalled by contractual interest (if it is higher than the threshold in SrbDIA) which is subject to the test of fairness. In Hungary,

⁷⁰⁹ Official Gazette of the Republic of Serbia No. 119/12.

⁷¹⁰ SrbSC Rev. 179/2001.

⁷¹¹ See for more Gáll 2012 p. 9 et seq.

⁷¹² See Art. 210/A(5) HuCIFEA.

⁷¹³ The obligation to pay default interest is not dependent on the fault of the contracting party in breach. EBH2003. 961. This rule seems to be maintained in Art. 6:48 nHuCC.

the maximum will be 1/3 Central Bank Base Rate added to the contractual interest rate. This rate is capped, provided the cap is applicable to BtoC contracts.⁷¹⁴

Besides the general rule that courts may lower the excessive default interest rate (Art. 301(4) HuCC) upon the specific request of the debtor⁷¹⁵, and taking into account the general principle of equality of contractual rights and obligations of the parties (Art. 15 SrbLOA).⁷¹⁶ Importantly, as an ancillary term, default interest is subject to the test of fairness. Importantly, as default interest comes into play exceptionally (contingent charge), it is not factored into the APR as one of the cost elements.⁷¹⁷ Therefore, it is not the price of the loan; it is an ancillary contract term that can be assessed for fairness both in Hungary and Serbia. However, the problem is how to apply the test of fairness. First, due to partially punitive character of default interest,⁷¹⁸ it is difficult to determine when the contractual balance is re-established, i.e. how much above the missed payments is the creditor entitled to. Courts will start from comparing the default interest to the contractual interest,⁷¹⁹ but again, contractual interest is not a solid parameter, as default interest can be higher (and most probably will be) than the contractual interest. The second problem is that the black letter rules do not allow taking into account any reasons for default, any special circumstance of the consumer (especially in Hungary). The rules on default are not flexible, and the default interest comes into play the next day after the date of due instalment.⁷²⁰

In conclusion, just as variation clauses, default interest clauses will be illegal if they are contrary to mandatory law, or procedurally unfair, if the consumer lacked a genuine opportunity to understand the meaning of the clause become if would become part of the contract. Finally, a disproportionately high default interest is substantively

⁷¹⁴ Here again the issue of inconsistency between the HuCC (regulating contractual interest rate caps in CtoC transactions) and the HuCIFEA (regulating contractual APR caps in BtoC transactions) arises. The question is if in BtoC transactions the general interest rate cap of the HuCC applies to default interest (also regulated by the HuCC). It would be sensible to regulate all default interest in the HuCIFEA, as the price of credit is already laid down therein, and the special rules on default of mortgage borrowers.

⁷¹⁵ Commentary on Art. 301(4) HuCC in Commentary on HuCC.

⁷¹⁶ SrbSC Rev. 768/01.

⁷¹⁷ Specially provided by Art. 3(3) APR HuDecree.

⁷¹⁸ Edit Gáll, Rules on default interest on outstanding debt in foreign currency in the light of court practice, *Jogi Fórum Publikáció*, 1-16, 2012, p. 4 at *Jogi Fórum*: <http://www.jogiforum.hu/publikaciok/457> (29 June 2013).

⁷¹⁹ E.g. if the contractual interest rate is double the Central Bank Base Rate, the court may lower the default interest to that same level. BDT2011. 2597. Default interest is payable only when the payment of interest is agreed by the parties in the contract, however, in deciding on the matter, the court have to take into account the general principle of equality in contractual rights and obligations. SrbSC Rev. 768/01.

⁷²⁰ Commentary on Art. 301 HuCC in Commentary on HuCC. Cf BH2002. 322. See also Art. 277(1) SrbLOA.

unfair, but the general test of fairness has to be applied. If arguably the test of fairness is the main instrument to determine the fair default interest, a high level of protection will often be not provided. It is difficult to apply the test of fairness due to different interests the clause is in place to protect (primarily the creditor as opposed to the consumer).

A higher degree of regulatory intervention seems necessary for a high level of protection. At the moment, although some regulation is in place, there is no direct provision, neither in Hungary nor in Serbia that would set an absolute maximum on default interest. It would be sensible to cap default interest rates and that way provide for a higher level of consumer protection. Also, a high level of protection is provided if the legislation develops special sensitivity towards *social force majeure* circumstances.

It also deserves a note that if price terms are exempted from the test of fairness (like in Hungary) there is a danger financial institutions present default interest as the price thereby entirely exempting it from the test of fairness. Finally, unauthorized overdraft charges have the similar (punitive) character than default interest rates, raise similar concerns, but are much less regulated.

V.6.2.3. Social force majeure and ancillary contract terms

In the following the thesis explores if the concept of *social force majeure* developed in Nordic countries is applicable in Hungary and in Serbia. Since the concept emerged due to some statutory provision exactly in relation to financial services,⁷²¹ the thesis first searches for comparable provisions in the Hungary and Serbia. Later, it tackles if the traditional institutions of *clausula rebus sic stantibus* and *force majeure* are capable to accommodate the new concept, and explores its relation with the test of fairness.

It seems that both in Hungary and in Serbia, *social force majeure* is expressly accepted. In Serbia, Art. 32 SrbFSUPA provides that if after the conclusion of the contract circumstances occur that place the debtor into a grave material situation, or other important circumstances which the debtor could not influence, on the request of the debtor, the creditor can declare a stay (a moratorium) in payment for a certain period

⁷²¹ The Finnish Act on Interest allows the consumer to claim adjustment of its liability to pay default interest if difficulties in payment occurred due to illness, unemployment, or some other special circumstance. The act gives the court a wide discretion, to lower the interest rate or postpone due payment. According to Swedish Consumer Insurance Act the insurance contract will not cease to exist based on late payment of premiums, if the delay was caused by severe illness of the policy holder, the loss of liberty, delay in receiving salary or pension, or by other similar unexpected event. Wilhelmsson 1990, p. 4-5.

the duration of which the consumer will not be charged default interest onto accrued payment obligations (but the contractual interest continues to run). Therefore, this provision specifically allows taking into account social circumstances that influenced the economic situation of the debtor, and its ability to pay, providing for a mitigating solution, and therefore, expressly implement the concept of *social force majeure*. In Hungary, the HuCIFEA does not contain any like provision. But the HuFSA recently issued the *Recommendation 1/2011 on the application of general principles of consumer protection by financial institutions*. It remains in force after the HuFSA's integration into the HuNB (Art. 176(8) HuNBA).⁷²² In Section VII, this document alerts financial institutions to be ready for unexpected or *force majeure* events. Interestingly, it extends the traditional notion of *force majeure* that primarily relates to natural disasters, onto other unexpected events like illness or unemployment that result in temporary or permanent payment difficulties. The document instructs financial institutions to handle with consideration requests connected to *force majeure* situations, and suggests finding alternative solutions to cancellation of the contract. The document considers good practice if the institutions are prepared in advance for unexpected events, if long term contracts upon their conclusion already contain mitigating mechanisms for events like unemployment. Additionally, it advised, institutions should prepare debt restructuring or debt rescheduling packages. In applying these packages the financial institutions should act fairly towards consumers in drawing up new repayment plans. The only limit in the institutions preparedness for contract modification should be its prudential business operation that should not be negatively affected at any times.

Therefore, in both selected jurisdictions there is an acknowledgement that consumers often default because of some objective and unexpected event that make them unable to pay. The rules invite financial institutions to handle *fore majeure* situations with care and allow the request of the debtor for contract modification, debt rescheduling (stay in payment) or debt restructuring.

Importantly, both documents contain only suggestions and it remains on the financial institution to act upon them. This is probably a drawback of the provisions, as practice shows, financial institutions were ignoring these provisions, and additional steps were needed to accommodate *social force majeure* in the Swiss franc denominated loan

⁷²² See HuNB: https://felugyelet.mnb.hu/data/cms2303017/fogyved_ajanlas_1_2011.pdf (14 November 2013).

credit saga. Additionally, the recommendations primarily focused on defaulted debtors, while the Swiss franc loan credits also raised the question of how to prevent this default.

In finding a solution, after a number of measures, the Hungarian Government opted for direct regulatory intervention.⁷²³ In December 2011 the Government and the Association of Hungarian Banks reached agreement. Part one included the decision on amending the regulations (primarily the HuCIFEA) and allowing early repayment at preferential exchange rates. Part two contained an agreement on the actions to be taken for addressing mortgage credit defaults in arrears longer than 90 days. It was agreed that for low income consumers whose property fell below a certain threshold, the banks will convert the loan into forints discounting a certain amount up to a specified date. Part three measure aimed at mitigating the consequences of currency fluctuations and it included fixing the exchange rate.⁷²⁴ In addressing similar problems of Serbian consumers, in 2013 the SrbNB issued specific Recommendations.⁷²⁵ These included the fixing of the exchange rate, and debt restructuring, aiming to ease the repayment of more substantial loans. The recommendations were criticized as being favourable primarily for banks and delaying consumer problems.⁷²⁶ Only a couple of banks accepted them.⁷²⁷

Therefore, the recommendations incorporating *social force majeure* did not give the desired protection for consumers, and additional actions were necessary. For this reason it is important to see if in the absence of intervention consumers have any other tools to rely on. More accurately, if the traditional institutions of *clausula rebus sic stantibus* and *force majeure* are capable to accommodate the concept of *social force majeure*.

Although *force majeure* primarily relates to natural events, *force majeure* as a change in the legitimate interests of the parties is very similar to the institution of

⁷²³ See for the history of measures the Government actions on home loan credits at Government: <http://www.kormany.hu/hu/gyik/kormanyzati-intezkedesek-a-lakashitelesek-erdekeben> (14 November 2013).

⁷²⁴ Minutes of Understanding between the Government of the Republic of Hungary and the Association of Hungarian Banks at Government: <http://www.kormany.hu/download/2/fa/60000/T%C3%A1rgyal%C3%A1si%20Jegyz%C5%91k%C3%B6ny.pdf> (14 November 2013). The agreement was confirmed by Act LXXV of 2011 on Fixing the Exchange Rate of Foreign Currency Denominated Loans and on the Forced Sale of Residential Properties.

⁷²⁵ Recommendation No. 001/13 of 2013 on Swiss franc denominated housing loans at SrbNB: http://www.nbs.rs/export/sites/default/internet/latinica/55/preporuke_20130531/preporuka_BAN01_20130531.pdf (14 November 2013).

⁷²⁶ SrbNB recommendations suitable for banks, at Efektiva: <http://www.kamatica.com/vesti/efektiva-preporuka-nbs-po-meri-banaka/10527> (14 November 2013).

⁷²⁷ Banks offer deals for Swiss franc loans, at Efektiva: <http://efektiva.rs/aktuelnosti-kredit/banke-nude-nagodbe-za-%E2%80%99Esvajcarce%E2%80%99D> (14 November 2013).

clausula rebus sic stantibus.⁷²⁸ In both cases the contract is gravely hindered by circumstances that occurred after the contract conclusion, that were out of reach of the parties, and resulted in consequences that the contract was no longer what the injured party legitimately expected. In both cases performance does not have to be impossible just extremely difficult. The difference between the two institutions is that *force majeure* influences the existence of the entire contract, while *clausula rebus sic stantibus* only the validity of a particular clause. A further difference is that *clausula rebus sic stantibus* is conditioned upon foreseeability of events while *force majeure* does not. *Force majeure* comes into play even if the circumstances were foreseeable but could not have been avoided.

The concept of *social force majeure* or social obstacles in contract performance is very similar to the above two institutions. The core of the concept is that the occurrence of the event must not necessarily render the performance of the contract impossible, just make it very difficult, it must be unforeseeable at the time of contract conclusion, and not attributable to the fault of the consumer.⁷²⁹ All these elements are in the heart of both *force majeure* and *clausula rebus sic stantibus*. Importantly, foreseeability is not taken here in its absolute sense, as social circumstances that render the change (unemployment, illness) are not completely and absolutely unforeseeable. Therefore, the traditional institutions of *clausula rebus sic stantibus* and *force majeure* are capable to accommodate the concept of *social force majeure* both in Hungary and in Serbia. Consumers can rely on these institutions to get out from disadvantageous contracts or to modify the clause in question. Placing these institutions in the context of Swiss franc loans, these institutions could be especially relied on by those consumers that were subject to some *social force majeure* event, like unemployment or illness due to which they are unable to honour the substantially higher instalments. In practice, *clausula rebus sic stantibus* has more potential for application, as reliance on *force majeure* makes the contract cease to exist, and this in turn means, consumers have to repay the loan with outstanding interest and this most likely includes finding re-financing options.

A further question is what the relation is between the test of fairness and the concept of *social force majeure*? A contract term seeking certain performance that was fair at the moment of contract conclusion becomes unfair after the change in

⁷²⁸ Cf Eörsi implies *force majeure* as a change in the legitimate interests of the parties is *clausula rebus sic stantibus*. Eörsi 1975, p. 145.

⁷²⁹ For the concept of *social force majeure* see : II.4.4.

circumstances. The test of fairness in the UCTD is not flexible, and does not allow taking into account changed circumstances after the contract was concluded. The test was implemented in Hungary without providing flexibility. Therefore, in Hungary, the unfairness of unexpected difficulties that make the performance impossible can only be remedied by relying on the institutions of *clausula rebus sic stantibus* or *force majeure*. In Serbia the test of fairness expressly allows the circumstances during performance to be taken into account, and the assessment of the contract term at a later point, during performance (Art. 46(2)(2) SrbCPA & Art. 46(2)(3) SrbCPA). One basis of unfairness, performance difficult without justifiable reason (Art. 46(2)(3) SrbCPA, most probably relates to *social force majeure* events.⁷³⁰ The Serbian solution arguably provides for a higher level of protection. This is because the test of fairness was specially created to protect consumers, and a special ground of unfairness most likely contemplated *social force majeure* events. The traditional institutions were developed in different times, and their application to modern situations can only be achieved by interpretation.

Therefore, the concept of *social force majeure* seems to be explicitly acknowledged by both Hungarian and Serbian regulators, but these acknowledgements are limited by their non-binding character. Additionally, consumers can rely on the traditional institutions of *clausula rebus sic stantibus* and *force majeure* that arguably accommodate the principle in both selected jurisdictions. Finally, in Serbia, consumers can also seek the annulment of terms that become unfair in the course of their performance due to *social force majeure* events by relying on the test of fairness itself. Therefore, both Hungary and Serbia provide for a higher level of protection than the UCTD envisaged, and allow the reassessment of the fairness of contract term during the performance of the contract. The level of protection seems to be the highest in Serbia, where reassessment is allowed by the test of fairness itself. In the future, for a higher level of protection, Hungary should at least extend the application of the general test of fairness to *social force majeure* events or ideally provide for these events a separate base of unfairness, like Serbia did.

⁷³⁰ See for the analysis of this ground of unfairness: IV.5.2.

V.6.2.4. Fairness of other ancillary contract terms in credit contract

Taking into account the indicative list in UCTD Annex, besides variation and default interest clauses analyzed above, together with the terms that the FSA found⁷³¹ to be unfair in its practice of scrutinizing unfair terms and the finding of legal scholars,⁷³² several categories of terms are likely to be unfair in consumer credit contracts. These are: 1) *Penalty clauses*: terms that charge the consumer a disproportionately large sum for failure to fulfil contractual obligations or for cancelling the contract (e.g. default interest); 2) *Tying clauses*: terms that tie the consumer to the contract, while letting the financial institution to decide whether or not to provide the service; 3) *Exclusive interpretation clauses*: terms that give the financial institution the absolute right to decide if its products or services met the requirements under the contract or to interpret any term of the contract as it sees fit; 4) *Automatic extension clauses*: terms that automatically extend a fixed-length contract where the deadline for the customer opting not to extend the contract is unreasonably short; 5) *Misleading terms*: terms that mislead the consumer about the contract or his legal rights; 6) *Liability exclusion or limitation clauses*: terms that exclude or limit the consumer's legal rights or remedies when the creditor has failed to meet its obligations under the contract; clause by which the creditor waives its responsibility for the acts of its employees or agents; 7) *Transfer clauses*: terms that allow the financial institution to transfer their consumer obligations to a third party without the consumer's consent, even where this may be worse for the consumer; 8) *Clauses in linked transactions to sale*: clauses which provide that interest on loan accrues even when the goods delivered are defective, or have not been delivered at all, or the service has not been rendered; terms allowing reclaim the goods in the consumers default is minor; 9) *Miscellaneous terms*: terms that require the consumer to fulfil all his contractual obligations, while letting the creditor to avoid its own; if credit is given by a financial institution and requires a deposit payment, this requirements is considered unfair if the debtor does not gain any benefit from paying deposit; clause by which the consumer waives his right on additional period for completion in case it defaults on some instalment; the clause that provides the right of

⁷³¹ FSA: <http://www.fsa.gov.uk/doing/regulated/uct/terms> (29 June 2013).

⁷³² Jovanić 2004, p. 238-239; Jeremy Simmonds, Unfair contract terms-the banker's view, 14(3) Journal of International Banking Law 81-91, 1999, p. 83 et seq.; Jeremy Simmonds, Bankers' documents and the Unfair Terms in Consumer Contracts Regulations 1999, 17(7) Journal of International Banking Law 205-219, 2002, p. 208 et seq.

creditor to charge full interest for the entire contractual period of the loan, even if the consumer repaid its debt earlier; contracting unreasonable securities, etc.

V.6.2.5. Ancillary terms and balancing terms

In order to determine the fairness of a contract term, it is not sufficient to look at the test of fairness in an isolated manner. A contract term will be unfair if the contractual balance is hindered, and this can be established only by looking at the entire contract, all the provisions therein (Art. 4(1) UCTD; Art. 209(2) HuCC; Art. 46(3) SrbCPA). This method of determining substantive fairness can be especially dangerous in consumer credit. For example clauses that allow the financial institution to determine something completely on its own discretion and without relaying on objective parameters or circumstances are likely to be considered unfair. However, the banks discretion might be upheld e.g. a discretionary right to terminate the contract, provided the same right is provided to the consumer and therefore the contractual balance maintained.⁷³³ This result is regardless of the fact that the consumer will rarely, if ever, use this right. The problem is even more present if the same right is not available for consumers, for example the power to unilaterally amend the terms of the contract. Than the contractual balance is maintained if the consumer has an option to withdraw from the contract, or is granted with some other beneficial right that is at the same time to the detriment of the creditor. The problem is that financial institutions can abuse this principle by providing rights to consumers that they are able to predict with high degree of probability consumers will not use and “artificially” maintain the contractual balance.

The most obvious example of the danger “balancing right” carries is the right of withdrawal. Withdrawal means repayment of the loan and the outstanding interest. After withdrawal the consumer has to search for alternative financing options, which will very often include a new loan credit, usually with the purpose of refinancing the “old” loan. After repaying the first, the “old” loan the consumer will end up with the second, “new” loan, which is more expensive than the first. The second loan has to cover the interest of both loans. Taken that most often the reason for taking a loan credit is because consumers lack sufficient funds, it is doubtful that under normal circumstances they will resort to more expensive options.

⁷³³ Simmonds 1999, p. 4.

Balancing rights seem to leave a wide open “back door” for creditors to insert substantively unfair terms into their contracts. Hence, the option of providing “balancing rights” to “artificially” maintain the contractual balance carries a general danger than can undermine the achievements of the test of fairness and the level of protection it provides in EU, Hungary and Serbia.

In ruling on fairness of contract terms courts should look at if the particular right is such that the consumer could realistically rely on it, or if it was provided only to “artificially” maintain the contractual balance.

V.6.2.6. Ancillary terms and exemptions from the test of fairness

Ancillary terms may be exempted from the test of fairness as “individually negotiated” terms or the “mandatory rules.” The first type of exemption is less applicable in consumer credit contracts, especially in relation to ancillary terms. However, it is possible to think of terms that would fall under this exemption for example securities and suretyships. Nevertheless, most contract terms will be standard and incorporated among standard terms and conditions of the financial institution. Hence, the more interesting exemption for ancillary terms is the “mandatory rules” exemption taken the increasing regulation in consumer credit.

The credit sector specific regulation is most probably exempted from the test of fairness, and the fairness of these terms cannot be challenged in Hungary under Art. 209(6) HuCC. In Serbia, at least in theory, all rules are subject to the test of fairness, including sector specific regulation. However, the breach of mandatory rules can be challenged as being illegal, i.e. contrary to mandatory law, in both Hungary and Serbia.

Given the increased regulation sometimes it may be difficult to differentiate between illegal and unfair terms. In case of variation clauses, if the financial institution fails to foresee the particular reason, the modification will be contrary to mandatory law, it will be illegal. The reasons for modification will also be illegal if the reason does not depend on objective circumstances and the list is not exhaustive. This is because these requirements are specially indicated in Art. 210(3) HuCIFEA. The test of legality seems to be the first “filter,” and “legal” terms can be later questioned for their fairness. However, sometimes it is not easy to determine if the term is illegal or unfair. For example in case of variation clauses if the list of reasons does not contain the reason that the financial institution relied on, the reason will be “illegal”. If the list does contain the

reason, but it is questioned if the reason is objective, both the test of fairness and the test of legality could be applied.⁷³⁴ If both “tests” apply, the test of legality is easier to use. If the question is if the reason was a valid reason, the test of fairness applies.

Therefore, in Hungary, due to the mandatory rules exemption, consumers can only challenge ancillary terms if they were contrary to mandatory law, while in Serbia, ancillary terms in breach of regulation may be challenged for both being illegal and unfair.

V.6.2.7. Intermediary conclusions

Ancillary contract terms fall under a different fairness regime within the test of fairness than core terms, being not the core of the bargain. As the number of ancillary terms is very wide, the thesis analyzed two terms closely connected to the price of credit, price variation clauses and default interest clauses.

Variation clauses caused a lot of problems recently in Hungary and in Serbia, due to their extensive application in Swiss franc denominated housing and other credits. Variation clauses are primarily in place for economic reasons to remedy the maturity mismatch in the banks operation. Therefore, their existence is generally justified. The problem is that these clauses are too often relied on in practice and possibly seen by banks not as only as a tool to save their prudent operation, but to gain profit. This is at least how their usage is perceived by consumers. Therefore, the question is, what can consumers do to protect their interests? The first step is to see if a variation clause, usually located among standard terms and conditions, become part of the contract. Since the answer is usually yes, the next step is to examine if the variation took place in accordance with the rules of the HuCIFEA and SrbFSUPA. If the answer is no, the variation is illegal and void. If the answer is yes, it should be examined if the requirements of procedural fairness were respected, if the clause in the contract is transparent, i.e. provide a change for a true understanding. Finally, if the answer is yes, a substantive assessment is necessary. In Hungary, certain terms will be exempted from this scrutiny, under the “mandatory rules” exemption. For those that do fall under the test, it can be questioned, if the objectively identified reason was a valid reason for modification. In Serbia, it seems, this latter is not possible, but only the terms objectivity

⁷³⁴ The distinction between illegal and unfair terms is not always easy. It seems that even the Hungarian Supreme court got confused when tackling the issue. See Opinion 2/2011 HuSC.

can be questioned. However, since the test of fairness has no exemptions, in theory, even variations that were initiated based on objective circumstances can be challenged for their substantive fairness.

In the future, for a higher level of protection, the valid and objective reasons for modification should be regulated in a form of an exhaustive list. Additionally, the maximum increase in the interest, fees and charges should be capped in order to avoid “teaser rates”. Hungary should make sure the contractual price cap equally applies to the increased interest rate, fees and charges. Serbia should introduce the APR cap and make it applicable at all times. The right of withdrawal, as a consumer protection tool, is no sufficient protection against substantively unfair prices. However, since the substantive standard set by regulation does not necessarily deliver fair outcomes in all individual cases, the test of fairness should remain applicable as a “safety net.”

Comparing variation clauses to traditional civil law institutions of *clausula rebus sic stantibus* and *force majeure* it can be concluded, despite having common elements, these are different institutions and come into play under different circumstances. The two traditional institutions are in place to remedy extraordinary changes while variation clauses are in place to remedy more regular adjustments. Nevertheless, *clausula rebus sic stantibus* and *force majeure* remain applicable to all other changes than adjustments of interest, fees and charges.

Regarding default interest, if the clause passes the requirements of legality and procedural fairness, a clause can only be removed from the contract for being substantively unfair. A disproportionately high default interest is unfair, but it is difficult to apply the test of fairness. For a high level of protection a higher degree of regulatory intervention seems necessary, a default interest rate cap. Also, a high level of protection is provided if the legislation develops special sensitivity towards *social force majeure*.

In ancillary terms of consumer credit contracts, the concept of *social force majeure* seems to be explicitly acknowledged by both Hungarian and Serbian regulators, but these acknowledgements are limited by their non-binding character. As additional tools, consumers can rely on the traditional institutions of *clausula rebus sic stantibus* and *force majeure* to accommodate the principle. In Serbia, consumers can also seek the annulment of terms that become unfair in the course of their performance due to *social force majeure* events by relying on the test of fairness itself. Therefore, both Hungary and Serbia provide for a higher level of protection than the UCTD envisaged, and allow the reassessment of the fairness of ancillary contract terms while the performance of the

contract. The level of protection seems to be the highest in Serbia, where reassessment is allowed by the test of fairness itself. In the future, for a higher level of protection, Hungary should at least extend the application of the general test of fairness to *social force majeure* events or ideally provide for these events a separate base of unfairness, like Serbia did.

The analysis showed that the parties' freedom of contract is extensively limited in determining the content of ancillary contract terms. This is especially true with variation and default interest clauses. However, it seems, that here regulation is in place primarily to protect other interest than the consumers'. Namely, default rules are generally considered to be substantively fair and protect consumers against the self-interest of businesses. Deviation from default rules normally makes terms unfair in order to re-establish the balance of interests. Here, however, default rules seem to be in place to protect the interests of creditors instead of consumers. Default rules allow exemptions from general principles of contract law, i.e. *pacta sunt servanda* and *restitution in integrum* respectively, and empower creditors to unilaterally vary the terms of the contract while its duration and to charge for default. However, regulation is in place not just to allow for the exemption from general rules of contract, but also to limit these rights of creditors, and set boundaries to uncontrolled variations and extremely high charges for default. This is where the test of fairness comes into play. It should determine if the exercise of creditors' rights was excessive or fell within the boundaries set by regulation. Nevertheless, it is often difficult to see where the limit is and even more difficult where it is crossed. For this reason, for a higher level of consumer protection a higher degree of regulatory intervention would be necessary. Regulation should specify, as much as possible, the valid reasons for variation and set a cap on default interest. Nevertheless, the test of fairness should remain to be applicable. Regulation is a blunt instrument that provides a lit or sets a cap. In drafting regulation is often very default to foresee all situations that may arise in the future. Therefore, the test of fairness should be there as a "safety net," to provide for an additional control mechanism that is flexible and able to cover new circumstances and situations.

V.6.3. The role of transparency in credit contracts

Transparency and procedure fairness is very important in consumer credit. Consumer credit is an intangible and abstract legal product, involving long term

commitment and significant risks,⁷³⁵ and everything the consumer has is information. Based on information the consumer has to choose between products on the market and make a decision whether to enter into the particular contract. However, as shown, it is generally difficult to determine what the meaning of transparency and procedural fairness is. Below the thesis searches for the meaning of transparency and the role of this principle in consumer credit.

V.6.3.1. The meaning of transparency in consumer credit

The meaning of transparency is potentially “multi levelled.”⁷³⁶ It can mean clear language, decent size print, etc. but also a real opportunity of a consumer to understand the terms of the contract. As understanding depends on other factors like education and intelligence, transparency can also mean drawing the attention of a particular consumer to a particular term, or even providing additional explanations. Art. 5 UCTD suggests the principle of transparency relates only to plain and simple language of written terms and any wider meaning can only be achieved by interpretation. The meaning of transparency is clarified in Hungary and in Serbia, where transparency means consumers real change to get acquainted with the terms of the contract. This arguably mandates the business to draw the attention of a particular consumer to a particular term, and maybe even to provide additional explanations.

The CCD primarily regulates credit as a financial service. The main objective of the CCD is to allow the consumer to reach an informed decision. It sees information as the main consumer protection and harmonization tool in achieving an integrated internal market in consumer credit. With information, the CCD aims to provide consumers with an opportunity to choose between different creditors throughout the EU, and between the different contract terms these creditors offer. The CCD contains a long list of information prior the contract conclusion (Rec. 19 CCD).⁷³⁷ It differentiates pre-contractual general information (general information provided to an unlimited number of addressees) and pre-contractual specific information (specific information provided to a specific addressee). Pre-contractual information is provided on a standardized

⁷³⁵ Martin Ebers, Information and Advising Requirements in the Financial Services Sector: Principles and Peculiarities in EC Law, 8(2) Electronic Journal of Comparative Law, 2004, p. 4 at <http://www.ejcl.org/82/art82-2.PDF> (29 June 2013).

⁷³⁶ See the general discussion on the meaning of transparency: II.3.1.

⁷³⁷ Pre-contractual information is laid down in details in Arts. 4-9 CCD. From post-contractual information only the information on changes in variable interest rate is foreseen (Art. 11 CCD).

information sheet, the *Standard European Consumer Credit Information* (hereinafter: SECCI) that includes information on credit characteristics and discloses the right of early repayment and the right of withdrawal (Art. 5(1) CCD). Any additional information is annexed to the SECCI, and the consumer is entitled for the copy of the credit agreement (Art. 5(4) CCD). The CCD further requires creditors to provide “adequate explanations” to consumers that would make them possible to better understand the particular product and to assess whether it is suitable for their needs, their financial situation (Art. 5(6) CCD). It is important to point out the creditors are not obliged (or even allowed) to advise the customer, but should only explain the terms of the contract. Therefore, the CCD extensively focuses on pre-contractual transparency or procedural fairness, and aims to provide a real chance of a consumer of understanding the terms of the contract (Rec. 19; Rec 27. CCD).

However, there are several problems with the protection provided by the CCD. First, in practice, under the CCD it seems the creditor fulfilled its information obligation if it handed over the SECCI to the consumer.⁷³⁸ Second, the duty to give personalized information is not a full harmonization measure. Only the obligation is laid down in the CCD but it is left to the Member States to determine the manner in which and the extent to which such assistance will be given (Art. 5(6) CCD). Third, it is likely consumers are faced with the problem of information overload. Increasing the amount of information does not mean better understanding; on the contrary, consumers get confused with all the available information, and become unable to filter the most important.⁷³⁹

Hence, the key is to provide *adequate* information (Rec. 19 CCD). This means concise, necessary and sufficient information, which is presented in a timely manner.⁷⁴⁰ It is said to be achieved by the SECCI. However, besides the SECCI it is necessary that consumers get navigated through the terms of the SECCI and other terms of the contract. The SECCI is most likely not a sufficient tool for achieving real understanding in all loan credits. Information should be tailored to the transaction in question. Likely, information will be increased in home loan credits, being the most important financial decision of an average consumer. However, the importance and impact of other types of

⁷³⁸ Luis Banciella (DG SANCO), Consumer credit directive, presentation at Retail Financial Services, Training for Consumer Empowerment, organized by BEUC, Brussels, 24 February 2011.

⁷³⁹ Twigg-Flesner&Schulze 2010, p. 144; James Doorley, Consumer Protection and the role of Behavioural Economics in Financial, Services, presentation at Retail Financial Services, Training for Consumer Empowerment, organized by BEUC, Brussels, 23 February 2011.

⁷⁴⁰ Commission staff working document on the follow up in retail financial services to the consumer market scoreboard, SEC(2009) 1251 final, 22.9.2009.

loans should not be underestimated. Small amount loan credits intended for short term use become “dangerous” if not repaid on time. All credit contracts have potentials to significantly and negatively influence household finance, and it is important consumers are provided with necessary and adequate information. It is not about the *quantity* but about the *quality* of information that should include warning on hidden dangers the particular loan credit carries.

Therefore, the vague provision of the UCTD is concretized by the CCD that aims towards informed decision of consumers. The CCD goes above clear and intelligible language of Art. 5 UCTD and aims to provide a consumer with a real chance of understanding of the terms of the contract, by drawing the attention of a particular consumer to a particular term and providing additional explanations. However, due to the above reasons, it is questionable if the CCD achieved the set aims. Hence, the level of protection in the EU in consumer credit contracts is somewhat higher than generally but its final reach remains unclear.

In Hungary and in Serbia the meaning of transparency is generally clarified. In Hungary, it means the consumers’ real opportunity to get familiar with the content of standard terms. In Serbia, transparency means a genuine opportunity of a consumer to understand the terms of the contract.⁷⁴¹ This meaning is further concretized in consumer credit by consumer credit sector specific rules.

In Hungary, the CCD is entirely implemented into the HuCCA. The HuCCA explicitly points out that the purpose of pre-contractual information is to provide the consumer with a real opportunity to compare different offers on the market, and to make an informed decision (Art. 6(2) HuCCA). Besides copying out the list of obligatory pre-contractual information the HuCCA mandates financial institutions to provide additional explanations to consumers, in order to enable the particular consumer to estimate the suitability of the loan to its preferences and financial capabilities (Art. 11(1) HuCCA). Additional explanations include the essential elements of the contract, the estimated effects of the loan onto the financial situation of the consumer, the consequences of missed payments and default interest rates, information regarding cessation of the contract and the activation of securities (Art. 11(2) HuCCA), communicated in clear and concise manner (Art. 11(3) HuCCA). Additional rules are in the HuCIFEA and the HuCode. The HuCIFEA contains only a list of pre-contractual information (Art. 203-209

⁷⁴¹ See: III.5. and IV.4.

HuCIFEA). However, the HuCode sees the principle of transparency as one of the overarching principles of retail lending, and as general standards of responsible lending (Shed.1 HuCode). It attributes the real chance of understanding meaning to transparency, or clarity and accessibility of information (Preamble HuCode). To this effect it imposes a number of obligations on creditors. These especially include the development of transparent credit products; contact terms tailored to the needs of customers; full information on the services offered; in personal communication taking efforts to make the customers understand the conditions of the product; assistance to make consumer decisions based on longer term considerations. Therefore, if creditors comply with the HuCode any lack of the HuCCA will be remedied. Hence, the real chance of consumers to understand the terms of the contract especially includes the obligation of creditors for providing explanations. Therefore, in Hungary, the general level of procedural fairness is raised in consumer credit, where transparency means the consumers' real opportunity to understand the terms of the contract. Overall, the level of protection in consumer credit in Hungary is higher than in EU in general.

In Serbia, the rules on pre-contractual information of the CCD are implemented into the SrbFSUPA (Arts. 15-17 SrbFSUPA). The SrbFSUPA provides a general obligation of the creditor to inform consumers in a way that will enable them to compare offers on the market, and estimate the suitability of the product to their personal preferences and available funds. The information has to be presented in a manner that it does not leave any doubt (Art. 17(1) SrbFSUPA). Additionally, the SrbFSUPA requires the creditor to provide additional explanations on how the standard terms and conditions are applicable in relation to the particular credit and what generally the role of standard terms and conditions is (Art. 10 SrbFSUPA). In addition, the SrbCode contains an obligation of the creditor to explain the significance of certain elements of the contract and to specially warn the consumer on their implication (Shed. 1.2 SrbCode). In this regard e.g. it provides the bank should explain the difference between variable and fixed interest rates, and warn that variable interest rates may change especially while the duration of long term contracts; specially warn the consumer that contract terms may be varied unilaterally. However, the problem with the SrbCode is that in the lack of sanction it is not applied in practice.⁷⁴² Hence, provisions on the meaning of transparency in Serbia seem less far reaching than in Hungary. The most important

⁷⁴² Cf Taboroši&Jovanić 2008, p. 729.

aspect, additional explanations, obliges the creditor only in relation to the role of standard terms and conditions but not their content. Therefore, the Serbian level of protection in terms of procedural fairness is lower than in Hungary, and is somewhat higher than in EU. For a higher level of protection Serbia should extend the creditor's obligation of providing additional explanations to the content of contract terms in standard terms and conditions. Without this obligation the consumers' real opportunity to understand the terms of the contract is undermined.

V.6.3.1.1. The benchmark consumer

It seems there is no special consumer benchmark in consumer credit, neither in EU nor in Hungary and in Serbia. Therefore, transparency and procedural fairness is measured against a consumer that falls under the general benchmark.⁷⁴³ Therefore, in EU in general, the standard established in *Gut Springenheide* of a reasonably well informed and circumspect consumer will be applicable to consumer credit. As this *objective* standard arguably sets a low level of protection, it has been improved in Hungary (impliedly) and in Serbia (expressly) where the standard is *relatively objective*, measured towards an average member of a group of certain age, level of education and experience. The question that remains is how high to set the standard of the average consumer of a particular group? Consumer credit contracts are more complex than average consumer contracts. Consumer credits are “credence goods” and the infrequency of concluding credit contracts, adds to the lack of experience with credit. Consequently, the particularities of consumer credit is difficult to understand even for the most intelligent and educated consumers. If the standard is set too low, the value of information would be undermined by information overload. If the standard is set too high, it is feared, the standard would assume the particular group has a certain level of understanding, when in fact it does not. Therefore, it seems the relatively objective average standard is not suitable for consumer credit transitions, and any classification of consumers into groups, would undermine the aim of the CCD to reach an informed decision. Consequently, a solution can be found in diversifying information. Standard information in the SECCI is completely objective. The same is true for other standardized information, which the creditor will not modify to meet the needs of every single consumer. Therefore, standard information is *objective*. However, since the “additional explanations” are the real tools

⁷⁴³ See: III.5.1. and IV.4.1.

for achieving true understanding they should be tailored towards the consumer in question, and be entirely *subjective*. Therefore, besides consumers, information should also be categorized, on objective and subjective. Subjective information can be more tailored to needs of a particular consumer within his “group”.

Nevertheless, information as a regulatory tool has its limits. First, consumers will often choose not to read the contract or not to pay attention to additional explanations. Second, true understanding in general is questionable in consumer credit due to highly complex language and to the fact that circumstances may change while the duration of the contract. Finally, in the grasp of all the necessary information to achieve true understanding consumers will often not make rational choices. Therefore, in the future, together with an increased regulation of consumer credit as a product, what should be strived at is financial literacy or even financial citizenship.

Financial literacy means “the ability to manage one’s money, keep track of one’s finances, plan ahead, choose appropriate financial products and services and stay informed about financial matters.”⁷⁴⁴ Financial literacy is achieved by financial education. Financial education gained more attention in recent years, both in EU⁷⁴⁵ and internationally. After acknowledging that the “importance of consumer protection and financial literacy for the long-term stability of the financial sector”⁷⁴⁶ the World Bank issued a guide on good practices in financial services among which financial literacy takes an important place. However, as the World Bank points out, financial literacy initiatives are complementary to, and not a substitute for, consumer protection regulation.⁷⁴⁷ Financial citizenship is one step further from financial literacy. The concept of financial citizenship on one level it is concerned with budgeting, avoiding excessive debt and managing credit, on the other level, it relates to education on financial markets and market risk.⁷⁴⁸ A financial citizen is knowledgeable about market risk, a willing participant in the financial markets and is dependent on it for long term

⁷⁴⁴The World Bank, Good practices for financial consumer protection, June 2012, p. 29 at World Bank: http://siteresources.worldbank.org/EXTFINANCIALSECTOR/Resources/Good_Practices_for_Financial_CP.pdf (29 June 2013).

⁷⁴⁵ DG Internal Market: http://ec.europa.eu/internal_market/finservices-retail/capability/ (29 June 2013).

⁷⁴⁶ Rutledge et al. 2010, p. 1.

⁷⁴⁷ World Bank 2010, p. 29.

⁷⁴⁸ Gail Pearson, Financial Literacy and the Creation of Financial Citizen, 3-29, In: The Future of Consumer Credit Regulation: Creative Approaches to Emerging Problems, Michelle Kelly-Louw, James Nehf, Peter Rott (eds.), Ashgate, Aldershot, 2008, p. 3.

economic security.⁷⁴⁹ Therefore, financial citizenship is the future; however, at the moment what should be strived at is a good level of financial literacy among citizens.

V.6.3.2. Transparency as independent basis of unfairness

Under Art. 5 UCTD the lack of transparency has no independent sanction, and the contract term cannot be removed from the contract solely for being procedurally unfair. This lack is not remedied in the CCD, sanctions for failure to inform are left to be determined by Member States (Rec. 26 CCD). Besides specific sanctions towards financial institutions like administrative penalty (Art. 54 SrbFSUPA) or sanctioning the lack of information as unfair commercial practice (Art. 20(6) SrbCPA), the lack of procedural fairness is also sanctioned within the test of fairness. In both Hungary and Serbia the lack of procedural fairness is an independent basis of unfairness (Art. 209(4) HuCC; Art. 46 (2)(4) SrbCPA). Hence non-transparent terms in credit contracts are capable to be annulled for being contrary to procedural fairness. In this regard, the level of protection provided in Hungary and Serbia is much higher than in EU in general.

Finally, the UCTD is not clear what the relation between procedural and substantive fairness is. This uncertainty is maintained in consumer credit, as the CCD is silent on the question of sanction for failure to inform in pre-contractual stage of the contract. This lack is remedied in Hungary and in Serbia, where transparency is an independent basis of fairness, i.e. set on separate foot from substantive fairness. This in turn means that procedural fairness cannot legitimize substantive unfairness. A contract term will only be fair if it satisfies the requirements of both procedural and substantive fairness. In this regard, the level of protection provided in Hungary and Serbia is much higher than in EU in general.

It is important to point out that relation between the UCTD and the UCPD. The two regimes are seemingly different, as the UCPD is without prejudice to contract law and, in particular, to the rules on the validity, formation or effect of contracts (Art. 3(2) UCPD). However, it might happen that the same pre-contractual communication is eligible to be assessed for fairness under both the UCTD and the UCPD. The UCPD regulates commercial communication before the contract is concluded. It defines commercial practice as a practice that is contrary to the requirements of professional diligence and materially distorts or is likely to materially distort the economic behaviour

⁷⁴⁹ Pearson 2008, p. 5.

with regard to the product of the average consumer, or of the average member of the group (Art. 5(2) UCPD). Advertising is without a doubt a commercial practice and falls under the regulatory regime of the UCPD. The problem is the status of other pre-contractual communication other than advertisement. Since pre-contractual information has an effect on the validity of the contract, there is no doubt once the contract is concluded, the information communicated before the contract is concluded will fall under the regime of the UCTD. However, if the contract is not concluded the consumer can only base its action on the UCPD. This scenario is very implausible. Most likely the consumer will be induced to conclude the contract by an unfair commercial practice (particularly by mis-selling of the product). This leads to another important point. Namely, as established in by the CJEU in *Perenicova*, unfair commercial practices under the UCPD can be taken into account as relevant circumstances under Art. 4(1) UCTD in interpreting the test of fairness in Art. 3(1) UCTD. This means, in consumer credit contract, mis-selling practices can be taken into account in determining the procedural fairness of contract terms. Hence, if a contract was mis-sold, this increases the likelihood of a contract term to be unfair.

V.6.3.3. Instead of conclusion: transparency in a wider picture

Transparency in consumer credit means a genuine chance of understanding the terms of the contract. This includes providing standard information and also drawing the attention of the particular consumer to the particular term and giving additional explanations so that the consumer can reflect on his financial capacities. The key of achieving true understanding seems to be in receiving additional explanations. However, in order to determine the value of transparency and procedural fairness in consumer credit there are more underlying questions that should be answered. The first question is how far the information and disclosure obligation of the creditor goes. The second problem is if the financial institution equipped to provide adequate information. The third and the most important is can the consumer truly make use of the information received.

As pointed out earlier, the bank is not the fiduciary of its customer, and therefore it is allowed to pursue its own interest in the credit transaction. Nevertheless, fiduciary duties may come into play when the bank provides additional explanations i.e. “advise like information” and fiduciary duties may relate to disclosure of information important

to conclude a contract.⁷⁵⁰ These are mostly the information that is laid down in the CCD. Consequently, fiduciary duties will mostly come into play in determining the *quality* of information provided and mode of its presentation, as opposed to the *quantity* of information, as CCD precisely lays down *which* information should be provided *when* to the consumer. The CCD basically “codifies” the fiduciary duties of the bank. However, the duty to disclose has its limits. It relates only to information important for the contract in question, and lenders are typically not obliged to disclose e.g. that there are cheaper loans on the market.⁷⁵¹ The information is in place to allow the consumer to shop around, and compare offers on the market. But the question is whether financial institutions should disclose there are cheaper or better suitable loans for the particular consumer offered by themselves? This obligation would conflict with the fact that lenders are not financial advisers; but it would be in line with the requirements of procedural fairness, and the objective of the CCD that sees consumers as informed decision makers. Therefore, in order to reconcile the opposing interest, if creditors disclose that other types of loan credits are offered by their financial institution, they should refrain from suggesting which to choose. Bank clerks offering credit are not qualified financial advisers. Hence, fiduciary duties should stop by disclosing the types of loan credits on offer. This leads to a further problem, the lack of qualification and skills of employees of financial institutions.

The SrbFSUPA expressly obliges financial institutions to employ qualified people and professionally train them (Art. 14(2) SrbFSUPA). Persons selling financial products must have the necessary qualification, to act in line with good customs and business ethics, to respect the personal integrity of the customer, and to provide full and accurate information (Art. 14(1) SrbFSUPA). The HuCode contains similar but less far reaching provision. It obliges creditors to prepare in timely manner their personnel for giving accurate and full information (Shed. II(1)(i) HuCode). Nevertheless, in practice it remains questionable how accurate and especially how tailored information can be given by ordinary bank clerks.

Finally, and most importantly, information as a regulatory tool has its limits. One obvious limit is competition and choice. If consumers have no choice they cannot make an informed decision based on shopping around and estimating different offers on the market. Competition and choice is crucial as consumer credit contracts are contracts of

⁷⁵⁰ Ellinger et al. 2006, p. 135.

⁷⁵¹ Bender 1994, p. 810.

adhesion, and consumers cannot influence the content of the contract. They can only switch between suppliers of terms. Second, consumers often choose not to read the contract. Third, true understanding in general is questionable in consumer credit due to highly complex language and to the fact that circumstances may change while the duration of the contract. Finally, in the grasp of all the necessary information to achieve true understanding consumers will often not make rational choices.

In the future, together with an increased regulation of consumer credit as a product and enhancing competition, what should be strived at is financial literacy or even financial citizenship. As a short term objective, banks should make sure consumers are given additional explanations on the terms of the contract necessary for achieving genuine understanding.

V.7. Freedom of contract and the regulation of consumer credit

The traditional notion of freedom of contract is significantly limited in consumer credit. Consumer credit contracts are unilaterally drafted by the creditor, and the consumers' freedom of contract comes down to only one freedom, freedom to accept the terms of the contract or decline them, and switch suppliers. The creditors' freedom is much wider and includes all types of freedom.⁷⁵² Due to this significant imbalance in power regulation aims to limit the contractual freedom of creditors and protect consumers. This type of regulation is not a new phenomenon, it was already known in Ancient Rome. Credit and debt was an accepted feature of everyday life in ancient Rome, and for many, a major source of income.⁷⁵³ The Romans already differentiated between credit for consumption, i.e. credit for the support of living and lifestyle; and credit for production.⁷⁵⁴ Credit was characterised by high interest rates,⁷⁵⁵ and grave sanctions for non-payment of debts, the debtor and its family often ending up in slavery.⁷⁵⁶ Consequently, early regulatory intervention focused on limiting slavery and on setting interest rate ceilings.⁷⁵⁷

⁷⁵² Basedow 2008, p. 922.

⁷⁵³ Jean Andreau, *Banking and Business in the Roman World*, Cambridge University Press, Cambridge, 1999, p. 12.

⁷⁵⁴ See for more: Obrad Stanojević, *Loan and interest: historical and comparative study*, Institut za pravnu istoriju, Belgrade, 1966, p. 87-122.

⁷⁵⁵ In the classical period in ancient Rome it was common to charge 12% of interest. Stanojević 1966 p. 110; see also on interest rates: Andreau 1999, p. 90-99.

⁷⁵⁶ See in more details: Stanojević 1966, p. 72-85.

⁷⁵⁷ In the post-classical period, Justinian determined the maximal rate of interest at 6%, with an exception of rich (4%) and bankers (8%), from which bankers paid 6% to the state. Stanojević 1966, p. 133-134.

Regulation was historically characterized by fragmentary regulation of particular forms of credit. Modern laws have a more universal approach, but some loans, like mortgage credit are frequently subject of separate rules.⁷⁵⁸ There are significant differences in legal rules and the institutional framework of regulation between jurisdictions.⁷⁵⁹ In recent times globalization reduced difference between national financial markets, but the law in essence remained domestic.⁷⁶⁰ Regulation is national because it reflects: historical differences and cultural dependence of credit;⁷⁶¹ funding techniques and financial structures used by banks; particularities and limitations of the legal system under which financial products have to function;⁷⁶² level of economic development; influence of different political groups;⁷⁶³ level of financial literacy; access to justice and available redress mechanisms; access to credit and debt management; *ex ante* and *ex post* monitoring of credit suppliers.

Therefore, freedom of contract is not an aim in consumer credit but rather its fairness. Regulation is in the interest of both the consumers (e.g. lack of information and ability of consumers to utilize information; reasonable degree of assurance of safety of financial products) and the financial institutions (e.g. clear standards create a level playing field).⁷⁶⁴ Therefore, the question is which regulatory tools to use to achieve a high level of protection? The test of fairness is only one regulatory tool. Additionally, fairness can also be ensured by more direct regulation, conduct of business regulation, aiming towards regulating the product or the service.

In the EU, regulation is focused on regulating credit as a service, principally relaying on remedying information asymmetries by providing information to consumers. However, information as a regulatory tool has its limits. Therefore, product intervention is desirable, together with raising the financial literacy of consumers and the level of competition between the credit providers. Product intervention is exercised at national level. The body of product regulation is increasingly growing; many were motivated by

⁷⁵⁸ Ramsay 2010, p. 369.

⁷⁵⁹ Ramsay 2010, p. 373. The most notable differences in regulation of consumer credit are perhaps between EU and US models. See: Ramsay 2010, p. 376-379; Geraint Howells, Thomas Wilhelmsson, EC and US Approaches to Consumer Protection: Should the Gap be Bridged?, 17(1) Yearbook of European Law 207-267, 1997.

⁷⁶⁰ Dalhuisen 2007, p. 830.

⁷⁶¹ E.g. German consumers have not traditionally used credit cards for everyday financing. Even though foreign banks introduced the English credit card model, these cards represent a small portion of the market even today. Ramsay 2010, p. 373; Dalhuisen 2007, p. 830.

⁷⁶² Dalhuisen 2007, p. 830.

⁷⁶³ Ramsay 2010, p. 374.

⁷⁶⁴ Llewelyn 1999, p. 27 et seq.

the recent financial crisis and the Swiss franc denominated credit scandal. However, it can be noticed, the regulatory intervention in Serbia is much less restrictive than in Hungary, and Serbia still largely relies on the test of fairness in limiting the parties' contractual freedom. This raises the question of how far regulation should go in intervening into the parties' contractual freedom?

The financial crises raised fundamental questions about the regulation of credit markets. It showed that "small" regulatory gaps like allowing loans in foreign currency can cause "large" social problems. It also showed lacks in both prudential and conduct of business regulation,⁷⁶⁵ and wider ethical problems⁷⁶⁶ connected to the operation of banks and financial markets in general. Regulation should balance the different interest involved, the private interest of the creditor and the debtor, and the overarching public interest. On the simplistic level, the interest of the creditor is to generate profit, and the interest of the consumer to have access to cheap loans. On a broader level, the interest of creditors is to operate in a stable regulatory and institutional environment, while the interest of the consumers is to have access to justice and mitigating mechanisms in case of payment difficulties. In the interests of both parties' is that consumers are able to regularly honour payment obligations and to have a stable financial system. Therefore, while the creditor and the debtor are governed by opposing short term goals, they have common long term objectives. The long term objectives largely correspond to the overarching public interest of safe and sound financial system, and solvent consumers. Hence, the key seem to be in adequately addressing the opposing short term goals of consumers and financial institutions.

In order to balance the different interests involved, contemporary consumer credit regulation is based on the balance between availability and safety of credits and product regulation.⁷⁶⁷ Besides remedying market failures, it aims to make credit markets more competitive, to promote consumer confidence, ensure the fairness of the contract,

⁷⁶⁵ E.g. the mis-selling of payment protection insurance in the UK that relied on abusing regulatory loopholes coupled with light-touch supervision. The scandal initiated wide reforms in the UK. See: Eilis Ferran, Regulatory Lessons from the Payment Protection Insurance Mis-selling Scandal in the UK, 13(2) European Business Organization Law Review 247-270, 2012.

⁷⁶⁶ E.g. LIBOR scandal. See Financial Times: <http://www.ft.com/indepth/libor-scandal> (14 November 2013).

⁷⁶⁷ Ramsay 2010, p. 369.

prevent and treat overindebtedness, and provide access to credit for low income consumers.⁷⁶⁸

Access to credit is a right of every consumer. Credit is a service that is indispensable to fully participate in the contemporary society and its economic life, it is said to gradually become a “service of general economic interest”. Another aspect of access to credit is competition. As mentioned, competition between consumer credit providers is limited. Because competition increases consumer choice and availability of credit (cheaper credit), one aspect of contemporary regulation is to make consumer credit markets more competitive.⁷⁶⁹ However, increasing competition in financial services sector is not without doubt. Economists argue, increased banking competition (especially on mortgage market) will make economies more leveraged and potentially lead to macro-financial imbalances.⁷⁷⁰ Access to credit is opposed to “financial exclusion,” that is, the lack of access to the mainstream financial system, including credit offered by non-commercial banks.⁷⁷¹ Therefore, it is important to find a right balance in access to credit. Uncontrolled access and “cheap credit” carries of danger of over-indebtedness. But not having access to mainstream financial services forces consumers to turn to loan sharks offering extremely expensive credit, and also opens the door for over-indebtedness.

⁷⁶⁸ Ramsay 2010, p. 370. The availability of credit is also linked to reliable system of securities. Securities improve the terms of the contract, typically by increasing the amount of the loan, extending the period of the loan, and lowering the interest rate. Tajti 2002, p. 67.

⁷⁶⁹ One attempt to increase competition in retail banking is the UK reform effort of ring-fencing the retail from investment banking. Final Report of the Independent Commission on Banking, 2011 at UK Parliament: <http://www.parliament.uk/documents/lords-committees/economic-affairs/reporticb/ResponseICBReport.pdf> (29 June 2013).

⁷⁷⁰ Javier Andrés, Oscar Arce, Banking Competition: Housing Prices and Macroeconomic Stability, 122 (565) *The Economic Journal*, 1346-1372, 2012.

⁷⁷¹ Therese Ann Willson, Supporting Social Enterprises to Support Vulnerable Consumers: The Example of Community Development Finance Institutions and Financial Exclusion, 35 *Journal of Consumer Policy* 197–213, 2012. p.198. For different definitions see: Ramsay 2012, p. 373. Access to mainstream credit is greatly increased by creating alternative lending structures for low income consumers (e.g. credit unions in the UK) Ramsay 2010, p. 384; on the importance of non-commercial banks in combating financial exclusion see: Willson 2012, p. 198.

There is not single definition of over-indebtedness.⁷⁷² While some refer only to borrowing (secured and unsecured credits), others adopt a wider definition that extends to payment difficulties on household bills.⁷⁷³ Over-indebtedness can be defined as a situation in which households “are objectively unable, on a structural and ongoing basis, to pay short-term debts, taken out to meet needs considered to be essential, from their habitual income provided by work, financial investments or other usual sources, without recourse to loans to finance debts contracted previously.”⁷⁷⁴ It means long term inability to honour accruing payment obligations of the entire family. The causes of over-indebtedness are numerous. Some reasons are attributable to the fault of the consumer others are not (active and passive over-indebtedness).⁷⁷⁵ Over-indebtedness can arise from sudden shocks to expenditure or income flows (divorce, unemployment, illness) or might cumulate over time (low income; poor money management; over-commitment, over-spending). Often it will result from a combination of factors such as low income combined with changed circumstances like divorce.⁷⁷⁶ Over-indebtedness triggers severe and long term consequences for the debtor and its family. It may lead to a loss of home, financial exclusion, severe stress, physiological and health problems, divorce and a distortion of family, and may put basic needs at risk. It ultimately leads to social exclusion of the debtor and its family. Importantly, over-indebted consumers ultimately become the burden of the state. Therefore, the important measures for prevention treatment of overindebtedness should be addressed by regulators. The most important

⁷⁷² For different definitions see: Didier Davydoff, Grégoire Naacke, Elodie Dessart, Nicola Jentzsch, Filipa Figueira, Marc Rothmund, Wolf Muller, Elaine Kempson, Adele Atkinson, Andrea Finney, Towards a Common Operational European Definition of Over-Indebtedness, a report submitted to the EuC (DG Employment, Social Affairs, Equal Opportunities) by CEPS-OEE-PFRC, 2008, p. 32-36 at University of Bristol: <http://www.bristol.ac.uk/geography/research/pfrc/themes/credit-debt/pfrc0805.pdf> (29 June 2013).

(29 June 2013). The definition of over-indebtedness has to be delimited from neighboring notions of poverty, consumer insolvency and bankruptcy. See Udo Reifner, Johanna Kiesilainen, Nick Huls, Helga Springeneer, Consumer Overindebtedness and Consumer Law in the European Union, final report submitted to DG SANCO by Institute for financial services e.V. Erasmus University Rotterdam/School of Law, University of Helsinki/Helsinki Collegium for Advanced Studies, 2003, p. 18-21 at IACLAW: http://www.iaclaw.org/Research_papers/iff_OverindebtednessandConsumerLaw.pdf (29 June 2013).

⁷⁷³ Elaine Kempson, Over-indebtedness in Britain, A report submitted to Department of trade and Industry, September 2002, p. 7 et seq. at University of Bristol: http://www.ggy.bris.ac.uk/pfrc/Reports/Overindebtedness_Britain.pdf (29 June 2013).

⁷⁷⁴ See the Economic and Social Committee’s definition in Combating Poverty and Social Exclusion, A statistical portrait of the European Union 2010, Eurostat statistical books, 2010, ft. 5, at Eurostat http://epp.eurostat.ec.europa.eu/cache/ITY_OFFPUB/KS-EP-09-001/EN/KS-EP-09-001-EN.PDF (29 June 2013).

⁷⁷⁵ Iain Ramsay, Between Neo-Liberalism and the Social Market: Approaches to Debt Adjustment and Consumer Insolvency in the EU, 35 Journal of Consumer Policy 421–441, 2012, p. 425 (Ramsay 2012a).

⁷⁷⁶ For various factors see Davydoff et al. 2008, p. 12-21; Ramsay 2012a, p. 425-426; For EU see: IRR Report 2010, p. 129.

preventive measures are: adequate information and advice of consumers, financial literacy and budget management education, debt counselling, registration of debtors and efficient legal protection.⁷⁷⁷ Measures important to treat over-indebtedness are: the existence of personal bankruptcy, efficient ADR system, and debt counselling in general, and special legislative measures like the debt restructuring and contract variation in cases of hardship or *social force majeure*.⁷⁷⁸

The balance between the two seemingly opposing goals of access to credit and prevention of over-indebtedness should be ensured by responsible lending. Responsible lending means providing credit, based on background checks and professional judgment to consumers who can accommodate regular repayments without getting into financial difficulties. It goes hand in hand with responsible borrowing, the consumers own responsibility to borrow only as much as it can repay.⁷⁷⁹ The CCD intended to achieve responsible borrowing by providing information for making an informed decision. As shown, this approach has a number of obstacles, one of which is the lack of financial literacy. Therefore, responsible lending is the responsibility of the creditor, to assess the consumers creditworthiness on the basis of sufficient information, obtained in the first place from the consumer, creditor must “know the client”, and where appropriate, by consulting the relevant database (Art. 8(1) CCD). Creditworthiness is assessed at the time of granting the consumer credit, and before any significant change in the total amount of credit (Art. 8(2) CCD). A distinct question is whether the creditor is able to be fully informed on the creditworthiness of the consumer. Therefore, besides increasing the responsibility of the creditor and the debtor for the taken loan, mitigation techniques should be in place that allows channelling temporary financial difficulties of consumers, and preventing the difficulties to become permanent. These are especially the debt mitigation techniques and sensibility of the law towards *social force majeure*.

The challenges of contemporary regulation can be achieved by various means or tools. The test of fairness and product and service intervention tools are only some regulatory options. Besides, the set aims can be achieved by e.g. developing alternative lending structures, or rely on broader economic and social policies.⁷⁸⁰ According to

⁷⁷⁷ See e.g. Jovanić 2004, p. 298; Reifner et al. 2003, p. 15.

⁷⁷⁸ See e.g. Ramsay 2012, p. 467-498 Jovanić, 2004 p. 303-304; Fejős 2009, p. 222-223.

⁷⁷⁹ Andrea Fejős, The Impact of Information on Responsible Lending and Responsible Borrowing in the European Union, 4(12) *Pravni život* 751-764, 2009, p. 753-755.

⁷⁸⁰ Iain Ramsay, Consumer Credit Law, Distributive Justice and the Welfare State, 15(2) *Oxford Journal of Legal Studies* 177-197, 1995, p.177 et seq.

Ramsay, the best is to combine all regulatory options.⁷⁸¹ The intensity of regulation should depend on the availability of alternative source of funding for consumers on one hand, and on the availability of redress mechanisms, and debt mitigation techniques, on the other.

V.8. Conclusion

Consumer credits are abstract legal products, embedded in complex contracts to which consumers accede without an opportunity to exercise any influence over the terms therein. Consumer credits are important sources of funding for both banks and consumers, but because of significantly opposing interests and imbalances of powers, they are heavily regulated. The unfair contract terms regulation is only one tool of intervention, the least restrictive into the parties' contractual freedom that co-exists with the other sector specific regulation. The thesis explored the interaction of the regime of unfair contract terms regulation and consumer credit specific regulation on the one hand, and their relation to traditional contract law institutions, on the other hand.

Regarding the core terms of credit contract it can be concluded that it is difficult to determine what falls under the "core terms" exemption, especially what the price is. However, the reasons of transparency and choice seem to be more in favour of considering the APR the price rather than the interest. In the absence of applicability of test of fairness in Hungary, the traditional institutions of *laesio enormis* and *usury* created in completely different socio-economic times are not suitable safeguards against substantively unfair price terms. In this sense, the level of protection in Serbia is much higher than in Hungary, where no exemption from the test of fairness is foreseen. Finally, it is questionable if price caps in Hungary sets a sufficiently high level of substantive fairness. By comparing the two regulatory instruments, the price caps in Hungary and the test of fairness in Serbia, it can be concluded that price caps certainly prevent extortionate interest rates but it is questionable if they provide a fair price at all times, i.e. if a fairly high level of substantive fairness is ensured. The application of the test of fairness might be more complicated in individual cases, and is less certain in final outcome, but it is also capable to deliver fairer individual results than the price cap. The preventive effect of price caps is immediate; banks are aware what threshold they cannot cross, while the preventive effect of the test of fairness is remote and depends on

⁷⁸¹ Ramsay calls this approach the "third way". Iain Ramsay, Consumer Credit Regulation as 'The third way'?, at IACLAW: http://www.iaclaw.org/Research_papers/thirdway.pdf (29 June 2013).

additional interpretations. Hence, it is difficult to compare the price cap and the test of fairness as they are inherently different instruments; they only serve the same purpose, the ensuring of substantively fair price in consumer credit. For a high level of protection it seems the best is the combination of the two instruments. Price caps should exist to eliminate predatory prices but the test of fairness should be also applicable as a “safety net” if the cap would not ensure substantive fairness in the particular case. Therefore, Serbia should introduce the price cap. In this task it is important to take a right benchmark as the price, i.e. the APR, and to carefully set the numerical limit. Hungary should eliminate the core terms exemption and make the test of fairness applicable to the price.

Regarding the ancillary terms of the credit contract the thesis extensively analyzed the fairness of variation and default interest rate clauses, and the general applicability of the doctrine of *social force majeure* in selected jurisdictions. Variation and default interest clauses are subject to considerable product regulation. The applicability of the test of fairness is limited with the boundaries of regulation. Regulation seems to be in place to make an exemption from general rules of contract in order to advance the interest of creditors, by granting them a right to unilaterally change the terms of the contract after their conclusion or to charge a higher interest than necessary for contractual restitution. Because of this, together with granting the right, regulation also limits financial institutions in exercising their rights. However, in determining the substantive fairness of these terms, it is often difficult to determine the precise limits of these boundaries. In the future, for a higher level of protection, the valid and objective reasons for modification should be regulated in a form of an exhaustive list. Additionally, the maximum increase in the interest, fees and charges should be capped in order to avoid “teaser rates”. Hungary should make sure the contractual price cap equally applies to the increased interest rate, fees and charges. Serbia should introduce the APR cap and make it applicable at all times. The right of withdrawal, as a consumer protection tool, is no sufficient protection against substantively unfair prices. However, since the substantive standard set by regulation does not necessarily deliver fair outcomes in all individual cases, the test of fairness should remain applicable as a “safety net.”

In ancillary terms of consumer credit contracts, the concept of *social force majeure* seems to be explicitly acknowledged by both Hungarian and Serbian regulators, but these acknowledgements are limited by their non-binding character. As additional

tools, consumers can rely on the traditional institutions of *clausula rebus sic stantibus* and *force majeure* to accommodate the principle. In Serbia, consumers can also rely on the test of fairness itself. Therefore, both Hungary and Serbia provide for a higher level of protection than the UCTD envisaged, and allow the reassessment of the fairness of ancillary contract terms while performance of the contract. The level of protection seems to be the highest in Serbia, where reassessment is allowed by the test of fairness itself. In the future, for a higher level of protection, Hungary should at least extend the application of the general test of fairness to *social force majeure* events or ideally provide for these events a separate base of unfairness, like Serbia did.

Regarding substantive fairness of the terms of consumer credit contracts it can be generally concluded that additional product intervention tools are needed both in Hungary and in Serbia. The test of fairness is difficult to apply. This is primarily due to the connection of consumer credit to risk and time, but also due to limited competition between providers of credit and therefore competition may not provide the desired choice in products. Nevertheless, the test of fairness should be applicable as a “safety net” to cover new contract drafting techniques and circumstances that the regulation could not anticipate.

In the EU, credit is in the first place regulated as a service. Consequently, there are numerous rules aiming to ensure procedural fairness. These rules provide for “layered” information obligation of the creditor, from simple standard information to providing personalized explanations. As a result, it is clear; in consumer credit transparency means a real chance of a consumer to understand the terms of the contract. This is achieved by giving standard information but also by drawing the attention of a particular consumer to a particular term and providing additional explanations. It is important to find a right balance between the quality and quantity of information, to provide adequate information. The key seem to be in providing additional explanations. In this sense the level of protection is higher in Hungary than in Serbia. In Serbia the creditor is only obliged to explain the role of standard terms and conditions but not their content. Therefore, for a higher level of protection in Serbia, creditors should have an explicit obligation to explain the content of the terms.

Nevertheless, procedural fairness has its restrictions. These stem from the limits of information as a regulatory tool, and limits of competition. In the future, together with an increased regulation of consumer credit as a product and enhancing competition, what should be strived at is financial literacy or even financial citizenship.

Due to limited reach of procedural fairness in consumer credit, it is very important that procedural fairness is not capable to justify substantive unfairness. On the level of the EU, transparency remained without an independent sanction, and as a result, the relation between substantive and procedural fairness staid unsettled. In this regard, the level of protection provided in Hungary and Serbia is much higher, where based on general rules, the non-transparent terms are capable to be annulled for being contrary to procedural fairness, and this also means, procedural fairness cannot legitimize substantive unfairness.

To conclude, both procedural and substantive fairness are strengthened in consumer credit by additional tools, product specific tools, in EU in general, and in Hungary and Serbia in particular. On the level of EU, these tools focus on procedural fairness. It can be therefore said, the protection of consumers in consumer credit in EU certainly embraces the limited fairness approach (procedural fairness) but its reach towards full fairness (substantive and procedural) remains debatable. In Hungary and Serbia substantive fairness is further ensured primarily by direct product regulatory tools. Hence in Hungary and Serbia the level of protection in consumer credit is higher than in EU in general. It aims towards embracing the full fairness approach (procedural and substantive fairness), but for achieving this goal, further product intervention seems crucial.

ENFORCEMENT REGIMES OF UNFAIR TERMS IN CREDIT CONTRACTS

This Chapter analyzes the regime of enforcement focusing on preventive enforcement of unfair terms in consumer credit contracts. The key question it aims to answer is whether there are specifically designed and operated preventive enforcement mechanisms in EU, Hungary and Serbia as to make for genuinely effective preventive control and set a high level of consumer protection.

VI.1. Enforcement of unfair terms: setting the problem

Enforcement is difficult to define. In the broadest sense enforcement encompasses the mechanisms and rules through which businesses or others are held to their legally imposed responsibilities.⁷⁸² Enforcement is a complex system of administrative, judicial and extra-judicial procedures with divided competences between different enforcement agents (consumers, businesses, government organs, public agencies and consumer protection organizations) applying different types of enforcement (public and private, individual and collective, formal and informal, *ex ante* and *ex post* enforcement). Narrowing down the types of enforcement onto redress mechanisms for consumers the number of possibilities stays very broad. The procedures and the blend of procedures differ from country to country, even terminological consensus on different enforcement mechanisms is absent. The most comprehensive list is given by the CLEF Glossary. It differentiates between: “traditional” ADR mechanisms that are arbitration, mediation and the ombudsman; specific court procedures for obtaining collective redress like group actions, representative actions or US-style class actions, and other means of obtaining redress for consumers through skimming-off actions, test cases or injunctions.⁷⁸³ To illustrate the different approaches, the EU wide study on alternative means to individual ordinary court procedures for consumer redress (hereinafter: ADR Study)⁷⁸⁴ identified the following alternatives: direct negotiation

⁷⁸² Colin Scott, Enforcing consumer protection laws, 537-562 In: Handbook of Research on International Consumer Law Geraint Howells, Iain Ramsay, Thomas Wilhelmsson, Edward Elgar, Cheltenham, Northampton, 2010, p. 538.

⁷⁸³ CLEF Glossary of the Consumer Law Enforcement Project, p. 57-59 at http://www.cojef-project.eu/IMG/pdf/d_CLEFfinalguidelines_76647.pdf (14 May 2013).

⁷⁸⁴ Jules Stuyck, Evelin Terryn, Veerle Colaert, Tom van Dyck, Neil Peretz, Nele Hoekx, Piotr Tereszkiwicz, An analysis and evaluation of alternative means of consumer redress other than redress through ordinary judicial proceedings, Final report by The Study Centre for Consumer Law – Centre for

between the consumer and the business; mediation and arbitration; small claims procedures; collective actions for damages and injunctive relief.⁷⁸⁵

The question of enforcement of unfair terms is very important as the effectiveness of the test of fairness, and the high level of protection it provides largely depends on the effect of its enforcement.⁷⁸⁶ There are two types of enforcement of unfair terms. Enforcement can be corrective and the preventive. Corrective (remedial or negative control) answers the question what happens to an individual term that was found to be unfair. The preventive (positive control) enforcement answers the question what enforcement agents can do to prevent the future use of a particular term or the emergence of unfair terms in general in contracts with consumers. The UCTD accommodates both types of enforcement. Corrective control is provided by Art. 6 UCTD that aims to eliminate individual terms from individual contracts. The decision on elimination having relative effect, i.e. only between the parties to the contract and in relation to the particular contract. The control incorporated into Art. 7 UCTD is preventive, designed not only to nullify unfair terms, but more radically, to eliminate them from the marketplace, having an absolute or collective effect.⁷⁸⁷

One of the weaknesses of remedial control is that its effectiveness depends on the initiative of consumers, who are often without a legal background and a possibility to afford legal representation. Moreover, “classical” redress in a form of a court judgment has several faults. First, court procedures are long and expensive. Second, the judgment is effective only as to the term that is invalidated. Third, the judgement is effective only in relation to the business that was party to the contract. Therefore, the consequence of the individual judgement is a *res judicata* in relation to a specific term and to the parties in the dispute (*inters partes* effect).⁷⁸⁸ It follows, that these court decisions are not much help cleaning up the market from unfair terms in consumer contracts. In order to eliminate the term from the market each business that uses a like term should be sued separately. In the meantime, while the judgment is rendered, competition is distorted between the business that was obliged to relinquish the term and those that may continue to use it. Finally, even after one contract term has been declared void, there is a risk its

European Economic Law Katholieke Universiteit Leuven submitted to DG SANCO, January 2007 (hereinafter: ADR Study) at DG SANCO: http://ec.europa.eu/consumers/redress/reports_studies/comparative_report_en.pdf (13 June 2013).

⁷⁸⁵ ADR Study 2007, p. 5.

⁷⁸⁶ Faure&Luth 2011, p. 353.

⁷⁸⁷ Workshop No. 5 UCTD Conference, p. 190.

⁷⁸⁸ See e.g. UCTD implementation report, p. 22.

use will continue by other businesses, not party to the dispute, or even by the same business, using a different term on its face that has equivalent effect to the invalidated term.⁷⁸⁹ Therefore, remedial control alone is not sufficient to provide for a high level of consumer protection.

In order to address this problem Art. 7(1) UCTD requires:

“Member States shall ensure that, in the interests of consumers and of competitors, adequate and effective means exist to prevent the continued use of unfair terms in contracts concluded with consumers by sellers or suppliers.”

Such means are to include provisions enabling persons or organisations that have a “legitimate interest in protecting consumers” to take action under the national law before the courts or competent administrative bodies for a decision as to the fairness of a contract term (Art. 7(2) UCTD). As for legal remedies Art. 7(3) UCTD provides that they “may be directed separately or jointly against a number of sellers or suppliers from the same economic sector or their associations which use or recommend the use the same general contractual terms or similar terms.” Therefore, the real power in terms of enforcement is in Art. 7 UCTD seeking preventive enforcement. However, it is up to the national legislator to decide on enforcement agents that will be empowered to protect the collective interests of consumers and the procedures and remedies they can use.⁷⁹⁰ In other words, Art. 7 UCTD seeks a certain result to be achieved but national legislators decide on the method of reaching it. It is important to point out that the mere existence of enforcement mechanisms is not sufficient. Art. 7(1) UCTD asks for *genuinely effective* mechanisms. The result sought is the elimination of unfair contract terms from the marketplace, for which courts and administrative bodies must have “adequate and effective means”, i.e. a real power to oblige businesses to remove unfair terms from their contracts.⁷⁹¹ These powers are usually exercised by an authorization to impose civil, criminal or administrative penalties which might be directed to a particular business or to a group of businesses belonging to the same economic sector or associations.⁷⁹² In the

⁷⁸⁹ Scepticism towards private enforcement by individual consumers has been raised many times by academia. See for example: Hugh Collins, Freedom to Circulate Documents: Regulating Contracts in Europe, 10(6) European Law Journal 878-803, November 2004, p. 793.

⁷⁹⁰ The mechanism of control selected depend on the function of freedom of contract, and the relationship of the idea of substantive justice and the principle of party autonomy. Marion Trager, Party Autonomy and Social Justice in Member States and EC Regulation: A Survey of Theory and Practice, 57-74 In: Standard Contract terms in Europe: A Basis for and a Challenge to European Contract Law, Hugh Collins (ed.), Kluwer Law International, Alphen aan den Rijn, 2008, p. 62.

⁷⁹¹ UCTD implementation report, p. 23. See also Workshop No. 5 UCTD Conference, p. 190.

⁷⁹² UCTD implementation report, p. 23.

following the thesis focuses on preventive enforcement mechanisms, in EU, Hungary and Serbia.

VI.2. Preventive control of unfair terms

The preventive control of unfair terms is very important because businesses will always find a way to incorporate unfair terms into their contracts. These terms are later unlikely to be removed by consumers relying on remedial control. Therefore, for a high level of protection, preventive enforcement mechanisms should be in place that are capable of eliminating terms from a number of contracts before their actual usage in practice. Although, preventive control provides a much higher level of protection than remedial control, not all preventive enforcement mechanisms have the same preventive effect. Preventive control via injunctions leads to potentially lower level of protection than preventive control ultra-preventive mechanisms.

Under Art. 7(2) UCTD the exercise of preventive control belongs to courts or administrative authorities, but in essence, the provision obliges Member States to introduce an action for injunction.⁷⁹³ Injunctions are regulated by *Directive 98/27/EC on Injunctions* (hereinafter: ID).⁷⁹⁴ The ID contains minimum standards on the rights of EU based qualified entities⁷⁹⁵ to take legal actions, and it lays down certain procedural aspects.⁷⁹⁶ An action for injunction, within the meaning of ID, encompasses an order requiring the cessation or prohibition of any infringement (Art. 2(a) ID), and where appropriate, the publication of the decision or corrective statement with a view to eliminating the continuing effects of the infringement (Art. 2(b) ID); and a payment of a fine into a public budget for failing to comply with the decision within the given time limit (Art. 2(c) ID). The ID is a very short legislative act that leaves a wide discretion to Member States, but in effect, injunction procedures follow the rules applicable to ordinary court proceedings in the vast majority of the Member States.⁷⁹⁷ The principle remedy for injunction procedures is “a cease and desist order” without a possibility to

⁷⁹³ Micklitz at all 2009, p.148.

⁷⁹⁴ Directive 98/27/EC of the European Parliament and of the Council of 19 May 1998 on injunctions for the protection of consumers' interests, OJ L 166 , 11/06/1998.

⁷⁹⁵ The list of “qualified entities” is published in: Commission communication concerning Article 4(3) of Directive 98/27/EC of the European Parliament and of the Council on injunctions for the protection of consumers' interests, concerning the entities qualified to bring an action under Article 2 of this Directive OJ C 039, 16/02/2006.

⁷⁹⁶ Micklitz at all 2009, p. 355.

⁷⁹⁷ ADR study 2009, p. 14.

claim damages.⁷⁹⁸ As injunctions procedures are provided for collective actions, individual consumers usually cannot initiate this type of procedure.⁷⁹⁹

In relation to unfair contract terms, injunctions as a rule represent a negative control. This is because they provide for the elimination of contract terms that are already incorporated into contracts. The difference between individual and collective action (action for injunction) is that it eliminates terms from all contracts that are already concluded with a particular business. This leads to the second function of injunctions that is the positive control. By eliminating unfair terms from already concluded contracts or preventing their future use, injunctions remove unfair terms from already concluded contracts where the term did not yet produce an unfair effect. Hence, Art. 7 UCTD via injunctions in effect provides for collective control that can be also preventive. However, this system of eliminating unfair terms based on actions for injunctions is a “negative” system. Once a term is deemed to be unfair, the court orders it to be removed from the contracts. However, normally the business will replace the annulled term by another, which may have the same effect, but the only way to remove it is to commence a novel procedure.⁸⁰⁰ Moreover, if the business does not comply voluntarily with the court decision, a separate action has to be commenced to enforce any available penalty for a non-compliance with the decision on annulment. Therefore, clearing up the marketplace from unfair terms via injunctions is slow, as terms have to be annulled one by one. Injunctions alone are a tool that has limited effect and provides for a fairly high level of protection, but not the highest level. Nevertheless, as it will be seen later, injunctions combined with other preventive powers potentially are efficient tools that provide for a high level of protection.

Besides injunctions, the new *Directive 2013/11 on Alternative Dispute Resolution* (hereinafter: ADRD)⁸⁰¹ obliges Member States to create ADR mechanisms for solving consumer to business disputes that rest on the principles laid down in the ADRD. ADR bodies generally represent “negative” control as they only solve particular cases the decision having *inter partes* effect. However, one of those principles, the principle of transparency has potentials for preventive effect. Namely, ADR bodies will have to publish activity reports that *inter alia* contain information on the number of

⁷⁹⁸ Ibid.

⁷⁹⁹ Ibid.

⁸⁰⁰ UCTD implementation report, p. 24.

⁸⁰¹ Directive 2013/11/EU of the European Parliament and of the Council of 21 May 2013 on alternative dispute resolution for consumer disputes and amending Regulation (EC) No. 2006/2004 and Directive 2009/22/EC, OJ EU L 165/63, 18.6.2013. It should be transposed by 9 July 2015 (Art. 25 ADRD).

disputes and types of complaint, the percentage of disputes solved positively for consumers, and the rate of compliance. Importantly, any systemic or significant problems that occur frequently *may* be accompanied by recommendations on how problems can be avoided (Art. 7(2) ADRD). Nevertheless, the general preventive effect of ADR as a method of dispute resolution seems to be very remote, and it will depend on the powers and authorities of particular ADR bodies.

Having in mind the potential drawbacks of injunctions, and also ADR, Member States should strive at is the “positive” control and “ultra-preventive” mechanism. This is a type of control that takes place before a term would be ever used, before it would come into circulation on the market. Ultra-preventive mechanisms represent the substantive control of fairness that goes beyond the test of fairness.⁸⁰² It is not explicitly foreseen but is allowed by the UCTD, by virtue of Art. 8 UCTD (“the minimum harmonization clause”). The aim of ultra-preventive control is to make possible for standard terms to reflect the interests of both contracting parties.⁸⁰³ Hence, ultra-preventive methods are beneficial for both businesses and consumers. Consumers are protected by elimination unfair terms from the marketplace, and businesses are assured their standard terms will remain in contracts.⁸⁰⁴

VI.2.1. Ultra-preventive enforcement models and methods

In deciding whether to allow the ultra-preventive type of review of fairness the legislator has to decide if this task will be vested into an administrative body or the judiciary. Fairness in advance is usually assured by the administrative model, while judicial provides *ex-post* control.⁸⁰⁵ There are a number of possibilities how to achieve genuinely efficient preventive enforcement. In this section the thesis presents three comparative ultra-preventive enforcement models: the Israeli model of pre-approval of standard terms, the Dutch model of collective bargaining in drafting standard terms, and the UK model of market clearance by public agencies. It than turns to proposals for ultra-preventive controls on EU level, and to certain tools that could be added to existing

⁸⁰² Faure &Luth 2011, p. 353.

⁸⁰³ Takáts 1987, p. 154.

⁸⁰⁴ Collins 2004, p. 797, 803.

⁸⁰⁵ Bender 1994, p. 799.

control mechanisms as to render their control more effective, without creating a separate ultra-preventive enforcement mechanism.

The Israeli model is very unique. A separate body, the *Tribunal for Standard Contracts*⁸⁰⁶ consisting of experts is set up to review and rule on the fairness of standard terms *before* they would be used. The Tribunal basically operates as a “reading agent.”⁸⁰⁷ After the Tribunal’s approval, the term becomes valid and an additional judicial scrutiny is not possible. If the Tribunal finds the terms to be unfair, the term will be amended or annulled. This decision can be appealed to the Supreme Court and is open for public scrutiny. Standard terms are subject to voluntary submission or a number of other bodies are empowered to apply for annulment (public authorities and consumer organizations). Submission is obligatory for some types of contracts like credit card contracts, and contracts of monopolistic corporations. If the review is successful, the contract will be approved for five years. Besides review, the Tribunal can also give guidance as to which terms it considers fair.⁸⁰⁸ The drawback of this system is time consumption. Therefore, it is generally suitable for some sectors like insurance and banking.⁸⁰⁹ Nevertheless, in Israel, the Tribunal is of general competence, but unfortunately, it did not provide satisfactory results in the banking sector. After twenty years of operation no standard contract had ever been thoroughly examined nor had the Tribunal ever approved or invalidated any term in a banking contract.⁸¹⁰ The reason for this is, on the one hand, probably in the fact that submission for scrutiny (save for credit card contracts) is not obligatory, on the other hand, the fact that courts failed to exercise their share of the control.⁸¹¹ As a result, banks feel safe, knowing they will not have any significant consequence of having unfair terms in their contract. Hence, the Israeli model is potentially an efficient tool for achieving fairness in consumer contracts and the highest level of protection, but has drawbacks that undermine its effectiveness in banking contracts.

Another method for eliminating unfair standard terms is the Dutch model of organised system of collective consumer agreements, where standard form contracts are

⁸⁰⁶ Sec. 6&7 Standard Contract Terms Act 1982 in Sinai Deutch, Controlling Standard Contracts- The Israeli Version, 30 McGill Law Journal 458-477, 1984-1985, p. 474.

⁸⁰⁷ Ben-Shahar 2010, p. 22.

⁸⁰⁸ See for more: Deutch 1984-1985, p. 473-477.

⁸⁰⁹ Workshop No. 5 UCTD Conference, p. 191.

⁸¹⁰ Sinai Deutch, Protection of the Bank Customer: By Statute or by Ethical Codes - Which Is Preferable? An Israeli Perspective, 2 DePaul Business and Commercial Law Journal 419-439, 2003-2004, p. 428.

⁸¹¹ Cf Ibid.

drafted based on negotiation between consumer protection and professional organisations. Trade association members who agree to the terms and conditions under the system are not allowed to use any other standard terms. Standard terms and conditions are periodically reviewed (every three to five years).⁸¹² This system works well in the Netherlands as it has a culture of negotiation, tolerance and resolving disputes out of court.⁸¹³ Nevertheless, not all sectors have negotiated standard terms and conditions,⁸¹⁴ and it is uncertain how the system works in the area of financial services and consumer credit.

Under the UK enforcement model, market clearance from unfair contract terms is principally vested in public agencies.⁸¹⁵ Earlier, the control of unfair terms in consumer credit was in the competence of the OFT being the UK's consumer and competition protection authority. Despite that the FSA was entrusted with conduct of business supervision of regulated financial institutions.⁸¹⁶ This was in line with the general role of the OFT being a leader in fighting against unfair contract terms on the UK market.⁸¹⁷ However, after the reform,⁸¹⁸ it seems, the FCA will take over this lead in financial contracts.⁸¹⁹

Public agencies in the UK (OFT, FSA-FCA) are empowered with significant powers.⁸²⁰ The foremost important power is to commence injunction procedures on behalf of consumers⁸²¹ but the powers to investigate and publish information are significant negotiation tools. After receiving a notification on a term that is potentially unfair, it is examined by expert teams specializing in unfair contract terms within the

⁸¹² Franziska Weber, Christopher Hodges, The Netherlands, 129-166 In: ADR in Europe, Christopher Hodges, Iris Benöhr, Naomi Creutzfeldt-Banda (eds.), Hart Publishing, Oxford, Portland, Oregon, 2012, p. 137.

⁸¹³ Weber&Hodges 2012, p. 130.

⁸¹⁴ In 2011 there were 62 sets of agreed terms and conditions, but the sector of healthcare e.g. stayed outside the scope of these agreements. Weber&Hodges 2012, p. 137.

⁸¹⁵ Reg. 11 Unfair Terms in Consumer Contracts Regulation (hereinafter: UTCCR) a variety of bodies gained power to seek injunctions, but only one consumer organization is listed as "qualified body".

⁸¹⁶ The division of responsibilities was laid down in: The Unfair Terms in Consumer Contracts Regulations 1999 & Enterprise Act 2002: A Concordat Between the Office of Fair Trading (OFT) and the Financial Services Authority, Annex: The division of responsibilities between the OFT and FSA, 2009, at OFT: http://www.offt.gov.uk/shared_offt/general_policy/674008/UTCCR-concordat.pdf (12 December 2012).

⁸¹⁷ Willett 2007 p. 407

⁸¹⁸ From April 2013, due to Financial Services Act 2012, the FSA is split into two authorities, the FCA responsible for conduct of business, and the Prudential Regulation Authority responsible for prudential regulation/supervision of financial institutions.

⁸¹⁹ Regulation and supervision of consumer credit will be transferred from the OFT to the FCA in April 2014. See HM Treasury: <https://www.gov.uk/government/consultations/a-new-approach-to-financial-regulation-transferring-consumer-credit-regulation-to-the-financial-conduct-authority> (2 July 2013).

⁸²⁰ Regs.10-15 UTCCR; Part 8 Enterprise Act 2002 (seek enforcement orders).

⁸²¹ Reg. 12 UTCCR.

authorities. Since the power to commence a court process is discretionary,⁸²² before initiating an action for injunction, the authorities can use their powers to persuade the business to remove or amend the term in question.⁸²³ It is a practice to ask for formal commitments, “undertakings.”⁸²⁴ Therefore, basically by “threatening” of taking an action, the authorities encourage voluntary compliance.⁸²⁵ Public authorities also have significant investigative powers. This includes the power to obtain documents and information if the suspicion of drawing up an unfair term for repeated use arises, or in order to check whether the business complied with undertakings it was committed to.⁸²⁶ Another important power of public agencies is a power to publish information and advice.⁸²⁷ To this effect, the OFT and the FCA (FSA) issued principles and guidelines on how to avoid the use of unfair terms in the future, and which terms they consider unfair.⁸²⁸ In these documents the authorities explain what unfair terms are, what are their powers, what they intend to achieve, which terms they consider unfair, and why. This way the authorities appear as important standard setters.⁸²⁹ The FCA alerts businesses that unfair terms represent a multitude of risk for the financial institutions.⁸³⁰ In order to avoid unfair terms, the FCA encourages them to be aware of the law, their wider

⁸²² Reg. 10 UTCCR.

⁸²³ In 2007, the FSA published guidance, the Unfair Contract Terms Regulatory Guide as part of the FSA Handbook. This guide sets out the FSA’s policy on how it will use its powers under the UTCCR. It was updated in August 2012. <http://fsahandbook.info/FSA/html/handbook/UNFCOG/1> (12 December 2012).

⁸²⁴ FSA: <http://www.fsa.gov.uk/Pages/Doing/Regulated/uct/library/index.shtml> (12 December 2012); OFT: <http://www.of.gov.uk/OFTwork/consumer-enforcement/#named6> (12 December 2012).

⁸²⁵ For a good summary see: OFT <http://www.of.gov.uk/about-the-of/legal-powers/legal/unfair-terms/of-powers#UQGh6R1c2bE> (12 December 2012); for a detailed description of the process of communication between the regulatory authority and the business is nicely described in: FSA’s interpretation of the Unfair Terms in Consumer Contracts Regulations 1999, Speech by Katherine Webster, Manager of the Unfair Contract Terms Team, FSA, CML’s 7th annual legal issues for mortgage lenders conference, 13 Jan 2009, at FSA:

http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2009/0113_kw.shtml (12 December 2012).

⁸²⁶ Reg. 13 UTCCR.

⁸²⁷ Reg. 15 UTCCR.

⁸²⁸ The most notable publications of the OFT are the Briefing note on unfair standard terms (OFT143, revised 2005) at OFT: http://www.of.gov.uk/shared_of/business_leaflets/unfair_contract_terms/of143.pdf (12 December 2012) and the comprehensive Unfair contract terms guidance (OFT311) 2008 at OFT: http://www.of.gov.uk/shared_of/reports/unfair_contract_terms/of311.pdf (12 December 2012). Besides these documents with general scope of application, the OFT also published guidance on more specific issues e.g. Calculating fair default charges in credit card contracts, A statement of the OFT’s position (OFT 842) 2006 at http://www.of.gov.uk/shared_of/reports/financial_products/of842.pdf (12 December 2012). For all documents of the OFT on unfair terms see: <http://www.of.gov.uk/about-the-of/legal-powers/legal/unfair-terms/guidance#UQGdzx1c2bE> (12 December 2012). The FSA published: Unfair contract terms: improving standards in consumer contracts, January 2012, FSA: http://www.fsa.gov.uk/static/pubs/guidance/fg12_02.pdf (12 December 2012).

⁸²⁹ Willett 2007 p. 407.

⁸³⁰ FCA: <http://www.fca.org.uk/firms/being-regulated/unfair-contracts/risks> (17 June 2013).

responsibility to treat customers fairly and to have systems and controls in place to ensure the fairness of contract terms. This latter for example means to follow the FCA's publications on unfair terms, the published undertakings, and to revise the form contracts from time to time by experts.⁸³¹ Finally, a significant power of authorities is to participate in creation, drawing up or endorsement of codes of conduct. The most important in code is the FCA Handbook. It recently became richer with a separate section on unfair contract terms, explaining the power of the FCA.⁸³²

An example of a successful intervention of OFT (in the future likely the FCA) was into credit card default charges. After learning about the problem, the OFT commenced an investigation, and based on results of the investigation, it negotiated with credit card companies. It reached an agreement on the maximum of the overdraft charges, and as a follow up issued guidance how to calculate fair overdraft charges.⁸³³ In case of bank overdraft charges, where the OFT was unable to reach agreement with the industry, it used its power to commence court actions. Instead of injunctions opting for a test case that aim to establish a judicial precedent. However, as the judgment of the court (the famous *Abbey National* case) was unfavourable for consumers, the OFT continued negotiations, and at least made the banks to make the charges more transparent or prominent.⁸³⁴ Therefore, the system of enforcement in the UK largely relies on self-control, or the self executing market clearance, and this is possible due to authority and powers of public agencies.⁸³⁵ This does not mean that there are no unfair terms in the UK, but they are being eliminated more efficiently than by other enforcement mechanism. The OFT "traditionally" appeared as a bargaining agent for consumers, and tried to achieve changes though negotiations. Nevertheless, there may be doubts how successful the negotiations are with the banking industry. In *Abbey National* the OFT was not able to reach an agreement. Ramsay points out that in recent years the OFT

⁸³¹ FSA: http://www.fsa.gov.uk/pages/Doing/Regulated/uct/terms/risks_1/index.shtml (17 June 2013).

⁸³² FCA: <http://www.fshandbook.info/FS/html/FCA/UNFCOG/1> (17 June 2013).

⁸³³ Where credit card default charges are set at more than 12 pounds, the OFT will presume that they are unfair, and is likely to challenge the charge unless there are limited. A default charge is not fair simply because it is below 12 pounds. Setting a threshold for intervention is a pragmatic pro-consumer action that is designed to give the industry the opportunity to change its practice without litigation. See OFT: <http://www.of.gov.uk/news-and-updates/press/2006/68-06#.UQJXph1c2bF> (20 February 2013). It is supported by detailed guidance to the industry as to how to reduce the likelihood of public enforcement in Calculating fair default charges in credit card contracts, A statement of the OFT's position (OFT 842) 2006 at http://www.of.gov.uk/shared_of/reports/financial_products/of842.pdf (20 February 2013).

⁸³⁴ Personal Current Accounts - Unarranged Overdraft Charges: Decision on an investigation under the UTCCRs and next steps (OFT 1154) 2009 at OFT: http://www.of.gov.uk/shared_of/personal-current-accounts/of1154 (20 February 2013).

⁸³⁵ Micklitz 2008, p. 31.

might have changed its approach, and in the future will focus more on test cases of “high-impact,”⁸³⁶ instead of informal negotiations. Future will show how successful the preventive powers of the FCA will be. Therefore, the example of UK shows, the empowerment of public agencies to pursue injunctions together with other preventive powers, and their pro-active use, potentially secures a high level of protection.

Apart from the existing system of control provided by the UCTD, there were suggestions for more unified mechanisms on EU level. The creation of a European system to eliminate unfair terms would have improved the practical enforcement of the UCTD and maximised its impact. In this connection the EU Parliament, in the amendments to the 1991 proposal for the UCTD suggested creating a *Community Mediator* for unfair terms.⁸³⁷ Soon thereafter the EU Commission sketched out the appointment of the EU Ombudsman that would be mainly for transnational consumer complaints.⁸³⁸ Later, it was indeed appointed but its competence is far from consumer complaints, and focuses on maladministration in the institutions and bodies of the EU.⁸³⁹ Hence, the introduction of ultra-preventive mechanism on EU level was abandoned and it remained an option for national legislators.

Besides changes in control mechanisms, there are certain additions to the existing mechanisms that could render controls more effective. These are: empowering the courts to identify unfair terms *ex officio*, possibility for consumer protection associations of obtaining damages, introduction of accelerated procedures, publishing terms judged to be unfair, widening of the scope of judgments to all similar terms, adopting adequate sanctions, and encouraging negotiating collective agreements.⁸⁴⁰ The *ex officio* power of courts is dealt with on EU level, starting from *Oceano*. It is a very important enforcement tool, as courts are obliged to take into account, or to scrutinize terms *ex officio* for fairness, even their fairness is not subject of the dispute. The possibility of enforcement agents to obtain damages is not very wide spread in the EU. Damages compensation is typical for the US-style class actions, which are not present in their original version in the EU. Nevertheless, in some Member States consumer protection organizations can claim damages.⁸⁴¹ As for other additional safeguards of fairness

⁸³⁶ Ramsay 2012, p. 317-359.

⁸³⁷ UCTD implementation report, p. 26.

⁸³⁸ Ibid.

⁸³⁹ EU Ombudsman: <http://www.ombudsman.europa.eu/home.faces> (17 February 2013).

⁸⁴⁰ Workshop No. 5 UCTD Conference, p. 197.

⁸⁴¹ See more on the US-style class actions e.g.: Deborah Hensler, Using class actions to enforce consumer protection law, 515-536 In: Handbook of Research on International Consumer Law, Geraint Howells, Iain

injunctions can be granted in accelerated procedure, especially when it is limited to judge the fairness of a contract term, and does not allow damages award. The widening the scope of the judgement onto similar terms is not the EU practice and the judgement relates only to the term that was subject to the dispute. Publication of the term that is found unfair is provided by the ID, and therefore is implemented into national statutes. Encouragement to negotiate collective agreements is not an EU wide practice, but it is present in some Member States like the Netherlands. Finally, sanctions are not harmonized. Member States are obliged to provide for “adequate” sanctions. The general sanction for the use of unfair terms is annulment of the term, but exceptionally it may trigger the imposition of penalties.⁸⁴²

VI.2.2. Intermediary conclusions

Having in mind the procedural autonomy of Member States, the EU provisions on enforcement have limited reach. They only require a certain result to be achieved, but a method used depends on internal legal orders, and enforcement traditions of Member States. Each Member State is familiar with some form of preventive mechanism, ADR and collective action, with their unique combination, but not all provide for ultra-preventive effect. However, only efficient preventive enforcement, primarily ultra-preventive can remedy the information failure and behavioural biases of consumers, and provide fairness in consumer transactions.⁸⁴³ Ultra-preventive mechanisms provide for a highest degree of consumer protection. It is therefore important that Member States have such mechanisms in place.

In selecting ultra-preventive enforcement mechanisms, it is important to bear in mind, that enforcement is closely linked to national regulatory traditions and cultures,⁸⁴⁴ and therefore it is possible that one model works well in one country, but would not

Ramsay, Thomas Wilhelmsson (eds.), Edward Elgar, Cheltenham, Northampton, 2010. In EU the US-style class actions does not exist. Instead group actions, representative actions and test cases are used, that include some features of the US-style class actions but are considerably different. ADR Study p. 12-14 (summary); p. 261-320 (detailed overview). It should also be noted that this area of collective redress is subject to a dynamic development in the EU at present. More and more states introduce some form of possibility to claim damages.

⁸⁴² Penalties are usually imposed for non-compliance with the injunctions order (or judgment). See ADR Study 2007, p. 339-341.

⁸⁴³ Faure&Luth 2011, p. 337 et seq.

⁸⁴⁴ Fabrizio Cafaggi, Hans-Wolfgang Micklitz, Administrative and Judicial Collective Enforcement of Consumer Law in the US and the European Community, EUI Law Working Paper, 22/2007, p. 9.

work in another.⁸⁴⁵ Also, it is possible that one model works well generally, but does not in a particular industry. Ultra-preventive mechanisms largely rely on negotiation. In fact, empirical research showed that negotiation is the most popular way of resolving consumer-business disputes.⁸⁴⁶ Probably because of the importance of negotiation in ultra-prevention, and the negotiation power of financial institutions, some successful models might not work with financial institutions. This why it is important to carefully select the organ entrusted with ultra-preventive enforcement in financial contracts, in order to ensure financial institutions get an “equal” negotiating partner.

Comparatively, “true” ultra-preventive mechanisms like pre-vetting of contract terms (Israel) or collective negotiation (the Netherlands) are rare. The reason perhaps is that genuine ultra-preventive mechanisms go beyond the test of fairness, and provide an additional substantive control, or simply that such systems require a lot of resources, and considerably slows down the speed of economic transactions. However, some form of ultra-preventive mechanisms, or preventive combined with ultra-preventive elements like in the UK (injunctions combined with negotiation), should be encouraged. It is therefore not necessary to have special mechanisms that are designed for eliminating unfair contract terms from the marketplace, but ultra-preventive elements can be incorporated into existing dispute resolution mechanisms and procedures.

VI.3. Enforcement of unfair terms in consumer credit contracts in Hungary

In Hungary, enforcement is a complex system consisting of enforcement agents and enforcement mechanisms. This section maps the system, focusing on enforcement regimes in credit contracts. It aims to answer if Hungary has genuinely effective preventive enforcement mechanism(s) that ensure a high level of protection in consumer credit contracts.

The central role in private enforcement is given to non-governmental associations of citizens, to consumer protection organizations.⁸⁴⁷ They participate in creation of

⁸⁴⁵ See the description and contrast of different models: Simon Whittaker, Contractual Control and Contractual Review in England and France, 13(6) European Review of Private Law 757-778, 2005; See for German, French and UK models: Micklitz 2008, p. 25-30.

⁸⁴⁶ ADR Study 2007, p. 9.

⁸⁴⁷ A consumer protection organization is an organization whose aim is the representation of consumers interests, this aim laid down in its articles of association, that operates in the filed of consumer protection for minimum two years, and has at least 50 members (Art. 2(e) HuCPA).

consumer protection policy; represent the interests of consumers in consultative bodies (Art. 45 HuCPA); inform, advice (Art. 17/B(6) HuCPA), educate consumers (Art. 17 HuCC); participate in extra-judicial enforcement (Art. 21(2) HuCPA) and collective judicial protection (Art. 39 HuCPA; Art. 209/B HuCC).⁸⁴⁸ All these activities can be linked to enforcement of unfair contract terms. From 1 October 2013 public enforcement in the area of financial services is vested in the HuNB. *Act CXXXIX of 2013 on the Hungarian National Bank* (hereinafter: HuNBA) integrated the HuFSA into the HuNB, thereby empowering the HuNB for micro-and macro prudential regulation and supervision. In order to accommodate the new role, the organizational structure of the HuNB is changed. A new organ, the Financial Stability Board (“Pénzügyi Stabilitási Tanács”) was created, that in effect overtook the powers of the HuFSA. In unfair contract terms enforcement, the HuNB is now empowered for collective protection (Art. 164 HuNBA) and individual consumer protection via the HuFAB (Art. 178 HuNBA). The other important actor in public enforcement in Hungary is the ombudsman or the Commissioner for fundamental rights (“állampolgári jogok biztosa”, hereinafter: HuCFR), though not having direct consumer protection objectives, in practice plays a significant role in preventive enforcement.

Special ADR mechanism for solving disputes was “traditionally” the Hungarian Consumer Arbitration Boards.⁸⁴⁹ However, from 1 July 2011 ADR of financial contracts is vested in *Financial Arbitration Boards* (“Pénzügyi Békéltető Testület”; hereinafter: HuFAB).⁸⁵⁰ The HuFAB are special arbitration boards in place to solve disputes between consumers and financial institutions regarding the conclusion of contracts and their performance (Art. 96 HuNBA). Therefore, consumers might turn to the HuFAB alleging the unfairness of a contract term. However, dispute resolution via the HuFAB is not designed to have preventive effect. The decision of the HuFAB is valid only to the dispute in question and only between the parties (*inters partes* effect). Moreover, the role of the HuFAB is to provide fast, cheap and efficient dispute resolution of already

⁸⁴⁸ See for more: Tamásné Ritter, István Garai, The role and place of civil associations in consumer protection, 57-78 In: Consumer protection codex, Közigazgatási és jogi könyvkiadó, Budapest, 1998

⁸⁴⁹ See for a brief description: Andrea Fejős, Consumer Protection in Sales Transactions in Hungary, 49(4) *Acta Juridica Hungarica* 441-468, 2008, p. 460-463; see for details: Andrea Fejős (Fejes), Consumer Arbitration Boards in Hungary – a Model for Out-of-Court Consumer Dispute Settlement in Serbia?, 57(13) *Pravni život* 483-500, 2008, p. 486-497.

⁸⁵⁰ Based on Act CLVIII of 2010 on the Hungarian Financial Supervisory Authority. See more on the operation of HuFAB and critiques: Péter Gárdos, Rácz András, Some thoughts on the Financial Arbitration Board, 20(4) *Gazdaság és Jog* 17-20, 2012.

arisen disputes.⁸⁵¹ Hence, the HuFAB is not designed to have preventive powers. The potentials of the existence of the HuFAB should not be underestimated as the HuNB publishes and regularly updates the list of financial institutions that undertook an obligation to accept the HuFAB decisions as binding, and those that did not.⁸⁵² Hence, although not designed for, the mere existence of the HuFAB has some preventive effects. In addition, Hungary is familiar with other out-of court procedures with general scope of application, the arbitration (“választottbíróság”) and the mediation (“közvetítés”). These procedures could in theory be used for solving unfair contract terms disputes, however, they are not suitable ADR methods for consumer disputes.⁸⁵³ Additionally, due to confidentiality reasons, it is unlikely these procedures have preventive and even less likely ultra-preventive effects. Therefore, ADR is primarily in place to provide corrective control in individual cases, and besides the mere existence of the HuFAB, does not have preventive effect.

Collective and potentially preventive protection is provided by collective actions (“közérdekű kereset”). Importantly, in Hungary preventive actions can only be used against standard terms in consumer contracts (Art. 209/B(1) HuCC). This raises the arguably more theoretical than practical question of what happens with individually not negotiated terms, the category that the HuCC expressly acknowledges. Most probably, the regime of standard terms should be extended onto these terms.⁸⁵⁴ The HuCC empowered a number of organs and organizations to commence an action for annulment of unfair contract terms (Art. 209/B(1) HuCC), the list of which is laid down in Art. 5 of *Decree Law 5 of 1978 on the Entering Into Force and Enforcement of the HuCC*. These are: 1) the public prosecutor; 2) the minister, or the head of the authority; 3) the clerk and the main clerk; 4) professional chambers; 5) consumer protection organizations;⁸⁵⁵ and 6) any designated body in other Member State that is competent to commence actions for injunction under the ID.⁸⁵⁶ Additionally, the HuNB is empowered for collective litigations against financial institutions it supervises, provided the unfair terms

⁸⁵¹ This limitation can be inferred e.g. from Art. 104 HuNBA that conditions the commencement of ADR to the consumers’ proof of attempting to reach settlement with the financial institution.

⁸⁵² HuNB: https://felugyelet.mnb.hu/pbt/bal_menu/pu_szolgaltatok (14 November 2013).

⁸⁵³ This is primarily because both mediation and arbitration are expensive compared to the value of consumer disputes; additionally submission to mediation is voluntary. See more Fejős 2008 p. 459-460.

⁸⁵⁴ See for arguments Chapter III.6.3.

⁸⁵⁵ The associations of consumer protection organizations are only empowered to commence collective actions, if the direct protection of consumers is incorporated among their aim of operation EBH 2009.1974.

⁸⁵⁶ This list of empowered organs and organizations is maintained without changes in Art. 6:105(1) nHuCC.

used harm the interest of a larger number of consumers (Art.164(1) HuNBA). The same power is repeatedly vested in consumer protection organizations (Art. 164(8) HuNBA).

In Hungary, collective actions have preventive power because an action may be commenced against terms drafted and published, but not yet used in practice (Art. 209/B(2) HuCC).⁸⁵⁷ Regardless of whether the term was used, the court will annul the contract term, and order a ban on its future use (Art. 209/B(1) and 209/B(3) HuCC). The preventive action might be also taken against the business that did not draft or use an unfair contract term, but made a public recommendation of its usage (Art. 209/B(4) HuCC).⁸⁵⁸ The Supreme Court instructs courts to observe the fairness of contract terms even if the term is null and void for some other reason e.g. illegality and regardless why the claim is submitted (Pt. 1 Opinion 3/2011 HuSC).⁸⁵⁹ However, for reasons of *res judicata*, collective actions cannot include consumers that were previously involved in individual or collective actions on the same subject matter. Also, an action cannot be commenced against the same business and contract term by more empowered enforcement agents. But, a new action may be initiated for the annulment of another contract term involving the same parties and even the same contract (Pt. 4 Opinion 3/2011 HuSC). Reaching of a settlement is forbidden, as it would include persons that are not party to the dispute (Pt. 5 Opinion 3/2011 HuSC). Finally, the Supreme Court contemplated the situation, when the business might modify or delete the potentially unfair terms from the contract while the duration of the collective action. It underlined the preventive function of collective actions and made an exception from the general rule that the court will rule on terms as they were at the moment of *lis pendens*. If the business changes or deletes the term during the process, the court will rule on fairness of the new term even though this term was not subject to the dispute at its commencement (Pt. 6 Opinion 3/2011 HuSC). The result of annulment is an *erga omnes* effect, or more accurately a *quasi erga omnes* effect, as the effect of the judgment is not towards anyone (any business), but any contract (present or future) concluded by the business with the terms in question (Art. 209/B(1) HuCC).⁸⁶⁰ It is an exception from the general rule, the *inter partes* effect of the judgment, applicable for individual consumer disputes.

⁸⁵⁷ The same provision is maintained in Art. 6:105(3) nHuCC.

⁸⁵⁸ E.g. when standard terms are drafted by professional chambers or associations, and the business in dispute just recommends their use. The consequence of annulment will be to forbid the recommendation of the terms in question. See Commentary on Art. 209/B(4) HuCC in Commentary on HuCC.

⁸⁵⁹ The provision is now in Art. 6:105(4) nHuCC. In one earlier case, the public prosecutor failed to claim unfairness, and in the lack of explicit claim, the court found no power to decide on the unfairness of a contract term. See: Pf.VI.21.095/2007.

⁸⁶⁰ This provision is in Art. 6:105(2) nHuCC.

However, despite the judgment having an *erga omnes* effect, it will only relate to the business in the dispute and to the particular contract term. Hence, its preventive function will be limited, as other businesses may continue to use the same contract term, or use terms, different on their face but having equivalent effect. Though such terms run a risk of being annulled, a separate action will have to be commenced. In addition to the general consequence of nullity, the court may order the publication of the judgment. Publication must be made on the expense of the business. The text and method of publication is determined by the court; but it has to contain the exact wording of the contract term, the declaration that it is unfair, and the reasons of unfairness. Only the particular contract terms and the courts' main line of reasoning is published and not the entire judgment. If publication is made online, the court has to determine where and for how long it should be available for public notice. The court also had to determine the deadline of publication (Pt. 7 Opinion 3/2011 HuSC).⁸⁶¹ Publication of the judgment can be useful in a sense that consumers and organs empowered to pursue collective actions might get some guidance and awareness on which contract terms are unfair. It also gives an opportunity for businesses to modify their contract terms.⁸⁶² Additionally, if the amount of damages is determinable, in collective actions commenced by the HuNB, besides annulment, damages can also be claimed (Art. 164(3) HuNBA). As mentioned, it is not a usual EU practice to allow damages claim in collective actions. Claiming damages seems to be an exemption foreseen only for financial contracts, taking the language of Art. 209/B HuCC that only talks about banning the future use of terms. Practice will show, if the potential for damages claim, and the new power of the HuNB will improve the effectiveness of this remedy in practice. Nevertheless, despite having ultra-preventive elements, collective actions are inherently of limited reach in eliminating unfair terms from the marketplace.⁸⁶³

Consumer credit is also subject to administrative enforcement. Importantly, the HuNB is empowered to conduct a consumer protection investigation against financial institutions to control their compliance with consumer protection regulation, and ultimately fine the institutions, if violation is detected (Art. 88 HuNBA). This is an important power given that a number of rules supplementing the test of fairness are in

⁸⁶¹ Rules related to publication are now codified in the Art. 6:105(2) nHuCC.

⁸⁶² Commentary on Art. 209/B(4) HuCC in Commentary on HuCC.

⁸⁶³ Szentiványi sees the limited reach of injunctions as the reason why in practice terms in standard terms and conditions drawn up by financial businesses were not challenged in the past. Iván Szentiványi, Banks standard terms and conditions and consumer protection, 9(1) *Gazdaság és Jog* 10-15, 2001, p. 11.

the HuCIFEA. However, since the supervisory function of the HuNB is very new future will show the practical impact of this power. At the moment, the HuCFR seems to be the most significant in preventive administrative enforcement, even though consumer protection is not among its objectives. Namely, under *Act CXI of 2011 on the Commissioner for Fundamental Rights* (hereinafter: HuCFRA) the primary objective of the HuCFR is to control the observance of constitutional rights of citizens (Art. 1 HuCFRA) by public organs and public service providers (Art. 18 HuCFRA). However, in practice, consumers did turn to the HuCFR for help, either because they were misinformed or because their rights were not sufficiently protected elsewhere.⁸⁶⁴ Therefore, the HuCFR was compelled to help consumers. Since the statute failed to determine precisely the scope public service providers (and it still does) the HuCFR interpreted public service providers widely, as including financial service providers.⁸⁶⁵ Hence, in practice the HuCFR gradually extended its competence onto constitutionality of practices of financial institutions, recognizing that in modern times the real danger for the infringements of constitutional rights of citizens lies in the activity of businesses using their economic advantage rather than in the operation of state administration.⁸⁶⁶ The HuCFR considers banks as companies providing public or service of general economic interest.⁸⁶⁷

In its actions the HuCFR relies on the constitutional rights of the right to property, legal certainty and due process,⁸⁶⁸ and applies the “special investigation” procedure (Arts. 38-39 HuCFR). The activities of the HuCFR are wide ranging in the area of financial services and consumer credit, and also touch upon unfair terms. The HuCFR specially dealt with issues like infringement of consumer credit contract provisions, unilateral contract modification, the practice of financial institutions on informing consumers, the non-transparency of standard contract terms, and debt collection practices. It dealt with the enforcement practices of e.g. the HuFSA and

⁸⁶⁴ Orsolya Fekete, Contemporary problems of consumer protection, 55(10) *Magyar Közigazgatás* 608-620, 2005, p. 618.

⁸⁶⁵ In OBH 6501/2001. The HuCFR developed a “public service provider test” according to which any service provider that operated on a market with no or limited competition and provides essential services to the public regardless of being part of the government, or not, is considered public service provider. See Adrienn Dezső, Barnabás Hajas, Egon Haupt, Zoltán Juhász, Péter Seres, Éva Tersztyánszkykyné Vasady, László Tóth, Csilla Éva Varga, Financial law project 2011/3, Office of the Fundamental Rights Commissioner (hereinafter: HuCFR project 2011), p. 10 at HuCFR: www.obh.hu (27 February 2013).

⁸⁶⁶ Barnabás Lenkovic, Banking transactions in the Ombudsman’s practice, 23-50 In: *Bank and credit relations, Studies on the new Civil Code*, Novotni Kiadó a Magánjog Fejlesztéséért, Miskolc, 2009, p. 23.

⁸⁶⁷ Lenkovic 2009, p. 24; See for more: HuCFR project 2011, p. 12 et seq.

⁸⁶⁸ HuCFR Project 2011, p. 13.

pointed out the need for responsible lending.⁸⁶⁹The HuCFR appears to be an authoritative intermediary between administrative and government organs, and between consumers on the one hand, and administrative and government organs on the other. Upon receipt of a number of complaints on the same issue, or becoming aware of a really unjust treatment of a person, the HuCFR will commence an investigation. This investigation includes both revealing the legal background and the practical consequences of the law. If the HuCFR finds the constitutional rights of citizens were infringed it will issue recommendations to public administration (like the HuFSA) and the government (Ministries). It will primarily suggest a legislative change, but it can also reconcile or mediate differences between different organs. It seems that the HuCFR had a number of successes. For example its investigation revealed that Consumer Arbitration Boards are not suitable to solve financial services disputes as a result of which the HuFAB was created. The HuCFR advocated the unilateral modification of contracts should be settled by the law, and the statute has been adopted.⁸⁷⁰ It seems that the list is very long, and although most probably the legislative changes are not to be solely credited to the HuCFR, certainly it had large influence over their adoption. It is very important that the HuCFR is competent and willing to recognize and raise pressing but politically sensitive issues, when it could easily say they are outside its competence. More importantly, the HuCFR raises overarching questions and conducts investigations to find out to what extent the legal provisions and the existing government organs guarantee a proper enforcement of consumer rights.⁸⁷¹The work of the HuCFR in preventive enforcement is very impressive, and therefore it plays an important role in the system of enforcement of financial services in Hungary, and in achieving the objective of a high level of protection.

VI.3.1. Intermediary conclusions

All the above enforcement mechanisms and enforcement agents contribute to preventive enforcement. Some, like the HuFAB, are preventive by their mere existence; others took a more pro-active role. Surprisingly, the most influential is the administrative organ that would by the strict interpretation of its competences lack power to act. But, the number of complaints “forced” the HuCFR to extend its competence onto financial

⁸⁶⁹ HuCFR Project 2011, p. 12.

⁸⁷⁰ HuCFR Project 2011, p. 14.

⁸⁷¹ OBH 1600.2008.

institutions. However, although the HuCFR seems very successful, the question is if the HuCFR is the right institution to be entrusted with preventive enforcement. Namely, the problem with the HuCFR is that it does not have a power to force action, and the success of the institution largely depends on the authority of the HuCFR itself.⁸⁷² In the future, the HuNB should consider a more pro-active role in preventive enforcement. It has more efficient and concrete powers towards financial institutions than the HuCFR and could play a similar role to the OFT and the FSA (FCA) in the UK. It is important that the HuNB engages in ultra-preventive enforcement of unfair terms, that it issue guidance of which terms it considers unfair, and negotiate the inclusion of terms into the contract. Actually, as a result of one investigation into mortgage loans, the HuCFR suggested the modification of the HuCIFEA that would oblige financial institutions to submit their standard terms and conditions for pre-approval to the (than) HuFSA.⁸⁷³ Similar suggestions were voiced by academia.⁸⁷⁴ Although, pre-approval of terms may be argued to require resources and time and is therefore the costs of control outweigh its benefits, the HuNB would certainly have to take the initiative and be more vigorous in promoting fair contract terms. In the past, the HuFSA was not very active in preventive enforcement,⁸⁷⁵ and failed to engage in ultra-preventive enforcement.

In the future, the HuNB should appear immediately as an authoritative and standard setter organ, and devote special attention to ultra-prevention of unfair terms. The HuNB as supervisor of financial sector it is the best authority to “detect” unfair terms (on its own accord, or consumer complaint). It has sufficiently skilled manpower and financial resources, and it should have specialized teams or at least experts on unfair contract terms. The HuNB should rely on its power to seek injunctions, on its power to impose fines for violation of consumer protection regulation, and none the least, on its power of being a Central Bank, and issue guidance and ask for undertakings from financial institutions.

Therefore, although preventive enforcement in consumer credit is present, with ultra-preventive elements, the problem of unfair terms is not sufficiently addressed. Hungary only formally satisfied the requirement of Art. 7(1) UCTD, but it failed to

⁸⁷² Cf Arts. 31-38 HuFCRA. See also: Andrea Fejős, Ombudsman in Vojvodina, 188-202 In: Társadalom és Tudomány, Válogatás a II. Vajdasági Magyar Tudományos Diákköri Konferencia human tárgyú dolgozataiból, Novi Sad, 2005, p. 192.

⁸⁷³ Lenkovic 2009, p. 28. See also OBH 4999.2003.

⁸⁷⁴ Szentiványi 2001, p. 14.

⁸⁷⁵ For example in 2011 the HuFSA commenced two collective actions. HuFSA: https://www.pszaf.hu/topmenu/apszaf/jogorvoslati_eljarasok/kozerdeku_keresetek.html?query=k%C3%B6z%C3%A9rdek%C5%B1%20kereset (27 February 2013).

comply with the substance of the provision that asks for genuinely effective enforcement mechanisms that would eliminate unfair terms from the Hungarian market and ensure a high level of consumer protection.

VI.4. Enforcement of unfair terms in consumer credit contracts in Serbia

In Serbia, enforcement is also a complex system consisting of enforcement agents and enforcement mechanisms. This section maps this system, focusing on enforcement regimes in credit contracts. It aims to answer if Serbia has genuinely effective preventive enforcement mechanism(s) that ensure a high level of protection in consumer credit.

The central role in private enforcement is granted to consumer protection organizations. These are non-profit organizations established as associations of citizens.⁸⁷⁶ Like in Hungary, they are established in order to inform, advice and educate consumers; cooperate with other organs and organizations (Art. 128 SrbCPA), represent consumer interests in consultative bodies, in judicial and extra-judicial procedures, and in front of other government organs (Art. 130 SrbCPA). Public enforcement in consumer credit is concentrated in the SrbNB that acts as regulator and supervisor of financial institutions. The SrbNB operates the SrbCEPFSU, but is not empowered to initiate collective actions. Finally, although following the example of Hungary the ombudsman maybe could extend its competence onto financial institutions there is no evidence of such practice.⁸⁷⁷

In Serbia, there is no extra-judicial dispute resolution mechanism specifically designed for the resolution of consumer-business disputes as the SrbCPA failed to it (Art. 132-136 SrbCPA). In choosing from existing ADR mechanisms, Serbia opted for mediation. Mediation (“posredovanje”) is regulated by the *Mediation Act of 2005* (hereinafter: SrbMA)⁸⁷⁸ and can be arranged for solving civil and commercial disputes save for disputes which are in exclusive jurisdiction of courts (Art. 1 SrbMA). Institutional mediation is generally conducted at the *Centre for Mediation*, but mediation in the area of financial services and therefore consumer credit is in the hands of the SrbNB and its SrbCPEFSU. The procedural rules are laid down in *Decision on the Ways*

⁸⁷⁶ See more Andrea Fejős, The Impact of EU Norms and Policies on Consumer Protection Enforcement in Serbia, 34 *Journal of Consumer Policy* 247-268, p. 254.

⁸⁷⁷ Fejős 2013a, p. 253.

⁸⁷⁸ Official Gazette of the Republic of Serbia, No. 18/2005.

of Complaint Handling by Banks and Financial Leasing Providers and the Activities of National Bank upon the Notification of User Complaints 2011 (hereinafter: SrbADR Decision).⁸⁷⁹ Although this mediation is specially designed for financial services, it is not a special consumer to business ADR method, as it provides ADR for all users of financial services, natural and legal persons. It seems that mediation by the SrbCPEFSU is even less preventive than dispute resolution by the HuFAB. First, submission to the process is entirely voluntary (Pt. 9 SrbADR Decision). This fact undermines the effect of the decision which is legally enforceable, and is equalled with a court settlement (Pt. 14 SrbADR Decision). Second, the mediator is entitled to decide if there is a case for amicable dispute resolution (Pt. 8 SrbADR Decision). This raises the concern of bias towards banks that would result in rejection of perfectly valid claims. Third, the result of mediation is an agreement, a settlement between the parties, and therefore has only an *inter partes* effect, and relates to the dispute in question. The effect of mediation by the SrbCPEFSU is therefore the same as the decision of the HuFAB; it is limited to the parties and to the subject matter of the dispute and has not preventive effect. Finally, contrary to the practice of the HuFAB, mediation by the SrbCPEFSU has a certain level of confidentiality and the results of mediation are not subject to public scrutiny. This eliminates any additional preventive effect the procedure could have. Therefore, due to a number of limits the procedure has, its preventive effect is very limited, if any.⁸⁸⁰ Besides mediation, parties may resort to arbitration, which is however, as in Hungary, not a suitable procedure to solve consumer-business disputes.

Collective judicial protection in unfair contract terms comes down to injunctions (“mere zabrane”). The particularities of injunctions are laid down in Arts. 137-146 SrbCPA. Procedural rules were incorporated into the *Civil Procedure Act of 2011*⁸⁸¹ within a special *Procedure for the Protection of Collective Rights and Interests of Citizens*. However, in 2013 the procedure was declared unconstitutional by the Constitutional Court. This deletion probably does not affect the possibility of injunctions and the protection of collective interests of consumers laid down in the SrbCPA. However, it does make unclear what preventive effect injunctions have. Namely,

⁸⁷⁹ Official Gazette of the Republic of Serbia No. 65/2011.

⁸⁸⁰ See also: Fejős 2013a, p. 252-253; see for recommendations to improve ADR in Serbia: Andrea Fejős, *Out-of-Court Consumer Dispute Resolution in Serbia: Current State and Recommendations for the Future*, 43-58 In: *New Legal Solutions in Consumer Protection*, Kragujevac, 2009, p. 53-55; also Fejős 2013a, p. 264.

⁸⁸¹ Official Gazette of the Republic of Serbia Nos. 72/2011, 49/2013, 74/2013.

collective actions can be commenced if the collective interests of consumers are infringed. As a result, the court may: 1) declare null and void any unfair term in the consumer contract; 2) order the business to immediately discontinue the future use of unfair terms; 3) order the business to publish at its own expense the injunction of unfair contract term (Art. 143 SrbCPA). Therefore, injunctions may have dual function. They serve to cease the unlawful actions and to order corrective actions. The provision seems not sufficiently precise, i.e. what the order to immediately discontinue the future use of unfair terms means. If it relates only to already used contract clauses, or generally, bans businesses from contracting unfair clauses. Since the clauses have to be indentified, most probably the answer is in the former solution. This in turn means that the preventive effect of injunctions in Serbia is limited. Its fullest effect is expressed only towards those consumers that had the clause in question in their contracts, but did not feel its disadvantageous effect. Besides the sanctions applied by the competent court, the SrbMinistry is empowered to publish, on its web site, the commenced actions for injunctions and judgments delivered upon those requests (Art. 141 SrbCPA). This publication may have preventive effect. However, injunctions are further limited by not being a suitable procedure for awarding damages (Art. 134 SrbCPA). Damages remain subject to a separate civil litigation.

The greatest limitation of injunctions that may completely undermine the effectiveness of the institution is the fact that only consumer protection organizations are empowered to commence collective actions. This power is vested in those organizations that are properly registered (Art. 129-130 SrbCPA).⁸⁸² Although registration arguably aims to ensure a certain level of professionalism, this is not achieved in practice. Consumer organizations lack expertise and/or funding for commencing and conducting complex cases. Importantly, they lack negotiation powers over powerful financial institutions.⁸⁸³ Until now only one action was commenced.⁸⁸⁴ Therefore, injunctions in Serbia are no efficient tools of eliminating unfair terms from the marketplace, and provide a low level of protection. In the future, for a higher level of protection, the funding and professionalization of consumer organizations should be increased,⁸⁸⁵ and

⁸⁸² Criteria for registration are laid down in: Rules on the Records of Consumer Organizations and Associations of Consumer Organizations of 2005. The SrbMinistry maintains the list of registered organizations and their associations (Art. 129 SrbCPA).

⁸⁸³ See for more Fejős 2013a, p. 255, 264-265

⁸⁸⁴ First time in Serbia – collective action at Efektiva: <http://efektiva.rs/aktuelnosti-krediti/prvi-put-u-srbiji-kolektivna-tuzba> (22 June 2013).

⁸⁸⁵ Fejős 2013a, p. 364-365.

the number of enforcement agents empowered to commence collective actions extended.⁸⁸⁶

In Serbia the only administrative organ with significant enforcement powers is the SrbNB. The competences of SrbNB are laid down by a number of statutes. For the present research the most important is the SrbFSUPA. The SrbNB has significant direct regulatory and enforcement powers. It may draft statutes, adopt secondary regulations and issue measures against violation of the regulation. The SrbFSUPA foresaw a number of fines for misdemeanour (Art. 50, 51 SrbFSUPA) some of which are directly linked to unfair terms. For example financial institutions will be fined for incorporating a clause into the contract that gives them unilateral discretion to change or enforce terms in accordance with their policy (Art. 50(1) SrbFSUPA). Basically, fines are seen as the main enforcement tool in the SrbFSUPA. They are foreseen for violating virtually any provision of the SrbFSUPA. Therefore, the incorporation of an unfair term in Serbia will have a dual effect. On the contractual side it may render the contract clause or the entire contract void, and on the administrative side, trigger an administrative fine. The incorporation of these provisions potentially has significant preventive effect, as fines are much more efficiently enforced than contracts. Besides issuing a fine, the SrbNB will publish on its web site the names of the financial institutions fined for violation of the SrbFSUPA (Pt. 22 SrbADR Decision). Also, the mediator within the SrbCPEFSU observes serious violations *ex officio*. Namely, upon receipt of a complaint by the consumer, if it notices that the financial service provider violated some of the mandatory provisions of the SrbFSUPA for which a penalty is provided, it will warn the service provider to correct the behaviour and impose a penalty (Pt. 18 SrbADR Decision). When it comes to unfair terms it is not clear whether the creditor will have to correct or delete the unfair term from all contracts or only to stop using the term in the future. Nevertheless, the preventive effect of the fines cannot be questioned, provided the SrbNB in practice does exercise its powers. Until now the SrbNB imposed a couple of fines; however it failed to publish these decisions on its web site.⁸⁸⁷

Therefore, the role of the SrbNB is very important in eliminating unfair contract terms from the marketplace. On the one hand, the SrbNB can draft legislation and directly propose legislation to the Parliament. In drafting legislation, the SrbNB may

⁸⁸⁶ The Serbian Competition Authority should take a leading role in collective enforcement. Fejős 2013a, p. 365-366.

⁸⁸⁷ See KBC and Alfa Bank have to pay 55 million dinars, at Efektiva: <http://efektiva.rs/aktuelnosti-krediti/kbc-i-alfa-banka-moraju-da-plate-55-miliona-dinara-posle-prijava-klijenata> (28 September 2012).

forbid (i.e. black list) terms that it considers unfair. On the other hand, the SrbNB as a government organ and a regulatory authority is entitled to adopt secondary legislation, in which it can act as a standard setter. Finally, it is empowered to impose fines which power has potentially a very significant preventive effect. In conclusion, the SrbNB has potentials of providing a high level of consumer protection, and genuinely prevent the circulation of unfair terms in consumer credit contracts. However, the role of the SrbNB would be more efficient and provide for a much higher level of protection, if it would use its powers to actually negotiate fair terms, similarly to the activities of OFT and FSA (FCA) in the UK.

VI.4.1. Intermediary conclusions

Overall, it can be said the preventive enforcement is not sufficiently addressed in Serbia. Collective actions are not operational as the only enforcement agents are the weak consumer organizations that constantly lack funding and expertise. Mediation by SrbCPEFSU has minimal, if any, preventive effects. It therefore seems that in Serbia preventive to deterrent effects of fines. Hence, effectively there are no genuinely preventive enforcement mechanisms and tool in place, and Serbia did not achieve the level of protection intended by the UCTD. The level of protection provided in Serbia is much lower than in Hungary. In the future, for a more efficient use of collective actions, a higher level of protection, the funding and professionalization of consumer organizations should be increased, and the number of enforcement agents empowered to commence collective actions extended. More importantly, since all enforcement powers are concentrated in the hands of the SrbNB; the SrbNB should be acting pro-actively in eliminating unfair terms from the marketplace, having the example of the authorities in the UK. Otherwise, in the lack of preventive enforcement mechanisms all the advantages of a very modern and wide reaching test of fairness in the SrbCPA is undermined and a high level of protection unachieved. Like Hungary, Serbia formally satisfied the requirement of Art. 7(1) UCTD, but it failed to comply with the substance of the provision that asks for genuinely effective enforcement mechanisms that would eliminate unfair terms from the Serbian market and ensure a high level of consumer protection.

VI.5. Conclusion

Art. 7 UCTD seeks for establishment of genuinely effective enforcement mechanisms. However, it only asks for a certain result to be achieved but leaves wide discretion to national legislators in deciding on the method of reaching the aim. The EU legislative documents asking for injunctions and ADR to be in place likewise refrain from details and leave up to nation states to create enforcement models. Therefore, there are no specifically designed preventive enforcement mechanisms in the EU that Member States could transpose. In the future, the EU Commission should also specially encourage ultra-preventive enforcement and show examples of good practices to Member States.

By having a look at the two above described national systems of enforcement it can be seen that they are similar in regard to financial contracts in general, but somewhat different from the particular angle of preventive enforcement. In both Hungary and Serbia there are two procedures available for enforcement of unfair contract terms, one extra-judicial and one judicial. As for the preventive effect of ADR, in this regard Serbia and Hungary are similar. The ADR procedures are created for obtaining individual redress and besides the mere existence of the institution, no other preventive effect can be identified. However, while collective actions in Hungary have ultra-preventive elements (possibility to commence action against the terms that have been published but not used, possibility to extend the action already commenced onto amended term, option to claim damages) in Serbia injunctions have no such features. Further, the difference between the two systems is considerable when it comes to enforcement agents. In Hungary a number of enforcement agents are empowered to file for injunctions, while in Serbia only consumer organizations have this power. Since consumer organizations are weak, the deterrent effect of injunctions is undermined. Additionally, the work of the HuCFR is notable in preventive enforcement of unfair terms in Hungary, while the ombudsman has no similar role in Serbia.

Now that the HuNB gained novel powers, the two enforcement systems become closer. In both Hungary and Serbia the regulation and supervision of financial institutions is in the hands of their central banks. However, their powers of these institutions seem to be somewhat different. While in Serbia the SrbNB cannot commence collective actions, in Hungary the HuNB can. Importantly, both institutions are empowered to issue fines. These fines may be also issue for the violation of special

sector specific consumer protection regulation in the HuCIFEA and in the SrbFSUPA many of which are in place to ensure procedural and substantive fairness of the terms of the contract.

In order to ensure a high level of protection and provide a genuinely efficient preventive enforcement mechanism, both Hungary and Serbia should insert ultra-preventive elements into their existing enforcement mechanisms and procedures primarily to those applied by the HuNB and the SrbNB. These institutions should have special screenings mechanisms, and experts competent to detect and fight unfair terms. They should give guidance to financial institutions on terms they consider to be unfair, and adopt the practice of seeking undertakings, i.e. formal commitments from financial institutions. In other words, for a achieving a high level of protection they should adopt the good practices of the OFT and the FCA (FSA) in the UK.

At the moment, although the level of protection seems to be considerably higher in Hungary than in Serbia, primarily because of the wider scope of collective actions and the activity of the HuCFR, there are no genuinely preventive enforcement mechanisms that are designed as such and are producing satisfactory results in practice in eliminating unfair terms from consumer credit contracts, neither in Hungary nor in Serbia. Consequently, the desired high level of protection is not achieved.

CHAPTER VII

THE FUTURE OF UNFAIR CONTRACT TERMS REGIMES

This Chapter briefly outlines the future of unfair contract terms regimes in EU, Hungary and Serbia. It focuses on the initiatives for contract law reform and analyzes the proposed tests of fairness, in particular the basic concept of unfairness, the role of transparency and the limits of the test of fairness. The key question of this Chapter is whether the new solutions would provide for a higher level of protection.

VII.1. Review of consumer acquis and unification of EU contract law

After the analysis conducted in the thesis, it can be said, the UCTD failed to reach its aim of providing an overall high level of consumer protection. However, as the problem was not isolated to the UCTD, and as the inconsistencies between different sectors specific directives became increasingly apparent, the issue of a contract law reform emerged.

The reform was inspired by the idea of a unified EU contract law. As Lando pointed out, harmonization of contract law on sector-specific basis maintained differences in contract laws in Europe and created a “nontariff barrier to trade.”⁸⁸⁸ However, the idea of a unified EU contract law is not new. The first effort of contract law unification was made by the *Commission on European Contract Law* (est. in 1982) and its successor, the *Study Group on a European Civil Code* (est. in 1999) the work that result in a soft law instrument, the *Principles of European Contract Law* (PECL). However, the EU Commission took a formal action only in 2001 by launching a public consultation on EU contract law.⁸⁸⁹ The aim was to collect information on the need of EU action, in particular, if the existing sectoral (vertical) approach of harmonization should be maintained, and whether the uniform application of EU law is affected by the lack of consistency among the EU legislative instruments.⁸⁹⁰ The conclusions from the consultation were brought forward in the *Action Plan on Contract Law* in 2003.⁸⁹¹ Here the EU Commission pointed out the need to: increase the quality and coherence of EU

⁸⁸⁸ Ole Lando, *Optional or Mandatory Europeanization of Contract Law*, 8(1) *European Review of Private Law* 59-69, 2000, p. 61.

⁸⁸⁹ Communication from the Commission to the Council and the European Parliament on European Contract Law, COM (2001) 398 final, 11.07.2001.

⁸⁹⁰ DG SANCO: http://ec.europa.eu/consumers/rights/communication2001_en.htm (21 March 2013)

⁸⁹¹ Commission Communication to the European Parliament and to the Council: A More Coherent European Contract Law: An Action Plan, COM (2003) 68 final, 12.2.2003.

acquis in the area of contract law; to promote EU wide general contract terms; and to examine further the opportunities of non-sector-specific solutions such as an optional instrument.⁸⁹² Therefore, the question was not any more whether there is a need for an EU action in the unification of contract law, but how the aim will be achieved. The road towards the unification of the EU contract law is not easy. Main challenges are posed by the need to reconcile different contract law traditions of Member States, but also by the idiosyncratic law making in the EU, and fragmented scholarship.⁸⁹³ Over the years there were many EU private law projects,⁸⁹⁴ and the issue was subject to considerable academic debate. Additionally, the revision of consumer *acquis* and reform efforts towards the unification of EU contract law were parallel and overlapping. In the following the thesis only points on the main steps of development. The next step was the *Communication on the Revision of Acquis* in 2005⁸⁹⁵ that outlined the plan for developing the *Common Frame of Reference*.⁸⁹⁶ According to the EU Commission, it is a “long-term project which aims at providing the European legislators with a ‘toolbox’ or a handbook to be used for the revision of existing and the preparation of new legislation in the area of contract law. This toolbox could contain fundamental principles of contract law, definitions of key concepts and model provisions.”⁸⁹⁷ Finally, in 2007 the EU Commission adopted a *Green Paper on the Review of the Consumer Acquis*.⁸⁹⁸ This document proposed the modernization of eight directives, among which was the UCTD. It did not refer to the earlier EU Communication, apart from mentioning “the CFR researchers” whose preparatory work served as a starting point for the Green Paper.⁸⁹⁹ This (deliberate) omission, as later become clear, pointed on the fact that at this stage the two projects become disconnected.⁹⁰⁰

In efforts to revise consumer *acquis*, following the Green Paper, the EU Commission presented its *Proposal for the Directive on Consumer Rights* in 2008.⁹⁰¹

⁸⁹² DG SANCO: http://ec.europa.eu/consumers/rights/actionplan_en.htm (21 March 2013).

⁸⁹³ See for more: Tibor Tajti, The unfathomable nature and future of the European private law project, 2 *China-EU Law Journal* 69-94, 2013, p. 72-83 (Tajti, 2013a).

⁸⁹⁴ For a list of most commonly recognized projects see: Tajti 2013a, ft.24.

⁸⁹⁵ Communication on European Contract Law and the revision of the *acquis*: the way forward, COM(2004) 651 final, OJ C 14, 20.1.2005.

⁸⁹⁶ DG SANCO: http://ec.europa.eu/consumers/rights/communication2004_en.htm (21 March 2013).

⁸⁹⁷ DG SANCO: http://ec.europa.eu/consumers/rights/contract_law_en.htm (21 March 2013).

⁸⁹⁸ Green Paper on the Review of the Consumer Acquis. COM (2006) 744 final, 08.02.2007.

⁸⁹⁹ DG SANCO: http://ec.europa.eu/consumers/rights/contract_law_en.htm#green (21 March 2013).

⁹⁰⁰ Martijn W. Hesselink, The Consumer Rights Directive and the CFR: two world apart? 5(3) *European Review of Contract Law* 290-303, 2009, p. 294.

⁹⁰¹ Proposal for a Directive of the European Parliament and of the Council on consumer rights, 8.10.2008, COM (2008) 614 final.

The proposal was reduced to four directives including the UCTD. However, the final legislative instrument, the *Directive 2011/83/EU on Consumer Rights*⁹⁰² left the UCTD without substantive changes.⁹⁰³

In efforts to unify the EU contract law, following the *Communication on the Revision of Acquis*, the *Joint Network on European Private Law* est. in 2005 delivered the academic *Draft Common Frame of Reference* (hereinafter: DCFR) in 2008.⁹⁰⁴ The DCFR is a comprehensive document that contains principles, definitions and model rules of contract law.⁹⁰⁵ It is a “copy” of a typical Continental Civil Code, but besides *de legel lata*, also contains *de legel ferenda* rule, rules towards which EU should strive at.⁹⁰⁶ It is intended to be applied primarily in the area of contractual and non-contractual rights and obligations and related property matters (Art. I.–1:101 DCFR). This wide scope led some commentators to see the DCFR as a “draft of the central components of the European Civil Code.”⁹⁰⁷ It is important to note the DCFR is not a consumer code it rather takes a unified approach of BtoB and BtoC contracts.⁹⁰⁸ This unified approach is followed in the future.

In 2010 the EU Commission set up an *Expert Group* on a Common Frame of Reference to assist the EU Commission in making further progress in the development of the future EU contract law instrument.⁹⁰⁹ The task of the *Expert Group* was to prepare a proposal on the CFR by selecting, revising, and supplementing the provisions of the DCFR that are of relevance to contractual relationships in the internal market. In addition, in 2010 the EU Commission released the *Green Paper Towards a European Contract Law*,⁹¹⁰ exploring options for the best instrument of EU contract law in terms

⁹⁰² Directive 2011/83/EU of the European Parliament and of the Council of 25 October 2011 on consumer rights, amending Council Directive 93/13/EEC and Directive 1999/44/EC of the European Parliament and of the Council and repealing Council Directive 85/577/EEC and Directive 97/7/EC of the European Parliament and of the Council, OJ L 304 , 22.11.2011.

⁹⁰³ The Directive only amends Art. 8 UCTD mandating Member States to inform the EU Commission if they take advantage of the minimal harmonization clause.

⁹⁰⁴ Principles, Definitions and Model Rules of European Private Law: Draft Common Frame of Reference, at DG JUSTICE: http://ec.europa.eu/justice/contract/files/european-private-law_en.pdf (2 Nov. 2011).

⁹⁰⁵ DG JUSTICE: http://ec.europa.eu/justice/contract/background/index_en.htm (23 March 2013).

⁹⁰⁶ Tajti 2013a, p. 75.

⁹⁰⁷ See e.g. Horst Eidenmüller, Florian Faust, Hans Christoph Grigoleit, Nils Jansen, Gerhard Wagner, Reinhard Zimmermann, The common frame of reference for European private law – policy choices and codification problems 28(4) Oxford Journal of Legal Studies 659-708, 2008, p. 659.

⁹⁰⁸ For critiques of this approach see: Geraint Howells, The Scope of European Consumer Law, 1(3) European Review of Contract Law 360-372, 2005, p. 369.

⁹⁰⁹ Commission Decision 2010/233 setting up the Expert Group on a Common Frame of Reference in the area of European Contract Law, OJ L 105/109 2010.

⁹¹⁰ Green Paper on policy options for progress towards a European Contract Law, COM(2010)348 final, 1.7.2010.

of its nature, scope of application (BtoB and/or BtoC contracts) and material scope (only general rules of contract law, or general rules combined with specific contracts). In 2011 the *Expert Group* delivered a *Feasibility Study* that consisted of a complete set of contract law rules,⁹¹¹ following which the EU Commission opened the first public consultation.⁹¹² Finally, in October 2011 the EU Commission published its *Proposal for a Regulation on a Common European Sales Law* (hereinafter: pCESL).⁹¹³ As Tajti asserts, the EU Commission at some point become aware that the DCFR will not become the EU's first common civil code and that the only feasible approach of contract law unification is on sectoral basis. As a result of this "novel" approach, the most important legacy of the DCFR is the pCESL.⁹¹⁴ Taking the words of the EU Commission, "the overall objective of the proposal is to improve the establishment and the functioning of the internal market by facilitating the expansion of cross-border trade for business and cross-border purchases for consumers. This objective can be achieved by making available a self-standing uniform set of contract law rules including provisions to protect consumers, the Common European Sales Law, which is to be considered as a second contract law regime within the national law of each Member State."⁹¹⁵ Therefore, "where the parties have agreed to use the Common European Sales Law, its rules will be the only national rules applicable for matters falling within its scope."⁹¹⁶ Therefore, the pCESL applies as optional law, and unifies EU contract law in sales transactions. This proves Tajti's point that before starting to create a uniform instrument, EU has failed to answer the most basic question if a common EU civil code is generally needed or realizable, or the only feasible option is sector specific harmonization.⁹¹⁷

VII.1.1. Autonomous initiative for (unifying) standard contract terms

Besides the work on the development of EU contract law, the EU Commission had two autonomous initiatives related to standard contract terms. One initiative was the CLAB project or the *European Database on Unfair Terms in Consumer Contracts* launched by the EU Commission immediately after the adoption of the UCTD. The idea

⁹¹¹ DG JUSTICE: http://ec.europa.eu/justice/contract/files/feasibility_study_final.pdf (12 March 2013).

⁹¹² DG JUSTICE: http://ec.europa.eu/justice/contract/expert-group/index_en.htm (12 March 2013).

⁹¹³ Regulation on a Common European Sales Law, COM (2011)0635 final, 11.10.2011.

⁹¹⁴ See Tajti 2013a, p. 76.

⁹¹⁵ pCESL: Explanatory Memorandum: Grounds for and objectives of the proposal.

⁹¹⁶ pCESL: Explanatory Memorandum: Existing provisions in the area of the proposal.

⁹¹⁷ Tajti 2013, p. 70.

was to create an instrument for monitoring the practical enforcement of the UCTD in the form of a database on court judgments, administrative decisions, voluntary agreements, judicial settlements and arbitration decisions. This database consultation was free of charge.⁹¹⁸ The CLAB project was initially launched for a period of five years, that come to end in 2000, and this is approximately the time when the database ceased to be updated.⁹¹⁹ The other initiative called for a creation EU-wide general contract terms that could contribute towards a more coherent contract law.⁹²⁰ The creation of the EU wide terms would be achieved by drawing on the experiences of Member States and setting up an EU administered web site.⁹²¹ This initiative also included the publication of guidelines on standard terms in order make sure EU rules and EU policies, particularly the UCTD are not violated.⁹²² Though the EU Council welcomed the initiative,⁹²³ the idea was soon abandoned.⁹²⁴ Therefore, at least for the time being, any autonomous efforts to unify or collect standard contract terms are abolished.

VII.2. European alternatives to the fairness regime of the UCTD

In the following the thesis explores the features of the test of fairness in the most important documents that emerged as a result of EU contract law unification, the DCFR and the pCESL, in particular focusing on the basic concept of unfairness, the role of transparency and the limits of the test of fairness. The problem of preventive enforcement will not be discussed, as the two documents failed to address the issue.

VII.2.1. The regime of unfair terms in the DCFR

Book II section 4 contains the rules on unfair terms in the DCFR. The regime of unfairness in the DCFR for BtoC contracts in Art. II—9:403 DCFR reads the following:

“In a contract between a business and a consumer, a term [which has not been individually negotiated] is unfair for the purposes of this Section if it is supplied by the

⁹¹⁸ On CLAB statistics see UCTD Implementation Report, Annex III.

⁹¹⁹ On CLAB in details see: Hans-Wolfgang Micklitz, Malek Radeideh: CLAB Europa –The European Database on Unfair Terms in Consumer Contracts, 28 *Journal of Consumer Policy* 325–360, 2005.

⁹²⁰ Put forward in Pt. 85 Action Plan on Contract Law.

⁹²¹ Ibid.

⁹²² Pt. 87 Action Plan on Contract Law.

⁹²³ Communication on the Revision of Acquis, Introduction.

⁹²⁴ In the First Annual Report on European Contract Law and Acquis Review COM (2005) 456 final, the EU Commission announced that it does not consider “appropriate” to host a web site on which market participants would exchange information relevant to the development of European standard contract terms. For comments see: Simon Whittaker, *On the Development of European Standard Contract Terms*, 141-161 In: *Standard Contract Terms in Europe: A Basis for and a Challenge to European Contract Law*, Hugh Collins (ed.). Wolters Kluwer, 2008, p. 147-156.

business and if it significantly disadvantages the consumer, contrary to good faith and fair dealing.”

In terms of the basic concept of unfairness, the DCFR relies on the two general clauses, without determining their meaning and relation. However, Art. I-1:103 DCFR (Good faith and fair dealing) clarifies “good faith” refers to a standard of conduct characterized by honesty, openness and consideration for the interests of the other party to the transaction or relationship in question. It then goes on, “it is, in particular, contrary to good faith and fair dealing for a party to act inconsistently with that party’s prior statements or conduct when the other party has reasonably relied on them to that other party’s detriment.” The explanatory notes following this provision clarify the composite expression “good faith and fair dealing” is different from “good faith” on its own. It implies a completely objective interpretation, while good faith on its own can be interpreted as having a subjective meaning. Hence, it seems good faith has a primarily procedural meaning within the DCFR, but it can also have a substantive meaning given that the provision talks about “reasonable reliance” that is arguably similar to “reasonable expectations”⁹²⁵ and potentially has substantive meanings. Nevertheless, the significant imbalance surely has substantive meaning. In terms of substantive fairness, the DCFR places contract terms on a “grey list” in Art. II-9:410 DCFR (Terms which are presumed to be unfair in contracts between a business and a consumer). Art. II-9:409 DCFR (Exclusive jurisdiction clauses) “black lists” exclusive jurisdiction clauses.

Regarding the role of transparency, Art. II-9:402 DCFR (Duty of transparency in terms not individually negotiated) makes clear transparency means drafting and communicating contract terms in plain and intelligible language. It further clarifies, in consumer contracts a term can be considered unfair only based on the breach of duty of transparency. Moreover, Art. II-9:407 DCFR (Factors to be taken into account in assessing unfairness) adds transparency as overall criteria of fairness giving a meaning to transparency as a real opportunity of consumers to get acquainted with the terms of the contract. Hence, compared to the UCTD, the DCFR clarifies the meaning of transparency and makes it an independent basis of unfairness. However, like the UCTD, the DCFR makes no mention of the benchmark consumer.

In relation to the limits of the test of fairness, Art. II-9:407 DCFR does not refer to the moment of contract conclusion as a decisive moment for applying the test of

⁹²⁵ See for discussion on reasonable or legitimate expectations: IV.3.3.

fairness. Additionally, as the DCFR contains contract law rules of a more general scope of application. Art. III–1:110 DCFR (Variation or termination by court on a change of circumstances) incorporates *clausula rebus sic stantibus*; and Art. III–3:104 DCFR (Excuse due to an impediment) *force majeure* that allow termination or modification of contract due to changed circumstances after its conclusion.⁹²⁶ Therefore, changed circumstances most probably can be taken into account in reassessing the fairness of contract terms at a later point, after the contract is concluded. Nevertheless, the DCFR adopts the rest of the exemptions from the UCTD. The test of fairness outright exempts individually negotiated terms in Art. II–1:110 DCFR (Terms “not individually negotiated”) clarifying that individually non negotiated terms do not have to be standard terms. Art. II–9:406 DCFR (Exclusions from unfairness test) retains the “price terms” and “mandatory rules” exemptions. The “price term” exception although formulated in somewhat different manner, “the unfairness test extends neither to the definition of the main subject matter of the contract, nor to the adequacy of the price to be paid” retains the dangers the exemption carries.⁹²⁷ The mandatory rules exemption is instead “mandatory statutory or regulatory provisions” it talks about “provisions of the applicable law” with probably equally the same effect.

The DCFR retains the uncertainty of how to interpret the basic concept of unfairness within the test of fairness, i.e. if the test should be given a primarily substantive or procedural meaning. The DCFR provides a higher level of protection in terms of the meaning of transparency, and by providing a separate sanction for the breach of this principle. This in turn clarifies, that procedural fairness cannot justify substantive unfairness. DCFR retains the level of protection of the UCTD in terms of exemptions. Additionally, the DCFR does not refer to the moment of contract conclusion as a decisive moment for the application of the test, and it specially incorporates the institutions of *clausula rebus sic stantibus* and *force majeure*. Hence, the DCFR probably intended towards the full fairness approach (substantive and procedural fairness) but this aim is not completely followed up. At certain instances it leaves room for the freedom approach (procedural or substantive fairness). Nevertheless, overall, the protection provided by the DCFR is higher than the UCTD’s.

⁹²⁶ See also: Kare Lilleholt, Anders Bernhard Mikelsen, The DCFR rules on unexpected difficulties in performance, 17(4) European Review of Private Law 573-580, 2009, p. 578.

⁹²⁷ See also Chris Willett, Unfair Terms 55-79, In: A factual Assessment of the Draft Common Frame of Reference, Luisa Antonioli, Francesca Fiorentini (eds.) Sellier, Munich, 2010, p. 68-74. See for all comments: p 55-79.

VII.2.2. The regime of unfair terms in the pCESL

Unfair contract terms are regulated in Chapter 8 divided into sections (Section 1: General provisions; Section 2: Unfair contract terms in CtoB contracts; Section 3: unfair terms in BtoB contracts). This section considers rules applicable for BtoC contracts. It is important to point out, the scope of the pCESL is limited to sales transactions and related services (Art. 5 pCESL), and is not applicable in linked sales to credit agreements (Art. 6 pCESL). Therefore, credit agreements linked to the sale are exempted from the scope of the pCESL,⁹²⁸ and remain within the scope of the UCTD. Hence, the pCESL is not relevant from the aspect credit contract. Nevertheless, the thesis briefly analysis the test of fairness in pCESL as it may point on the future direction of development.

The test of fairness is set in Art. 83 pCESL (Meaning of "unfair" in contracts between a trader and a consumer), and reads the following:

“In a contract between a trader and a consumer, a contract term supplied by the trader which has not been individually negotiated within the meaning of Article 7 is unfair for the purposes of this Section if it causes a significant imbalance in the parties' rights and obligations arising under the contract, to the detriment of the consumer, contrary to good faith and fair dealing.”

At first sight it can be noticed the test is very similar to the test of fairness in DCFR, and it was probably somewhat influenced by it.⁹²⁹ Therefore, without additional explanations where the provisions are the same or very similar, the explanatory notes of the DCFR could be used. For example in determining the meaning of “good faith and fair dealing.” This leads to the same comment on the DCFR regarding the basic concept of unfairness. In terms of substantive fairness, contrary to the DCFR (grey list) and the UCTD (indicative list), Art. 84 pCESL contains a black list of contract terms (Contract terms which are always unfair).

As for the role of transparency, Art. 82 pCESL states terms are transparent if they are drafted and communicated in plain and intelligible language, but without further

⁹²⁸ Linked credit agreement means: (i) the credit in question serves exclusively to finance an agreement for the supply of specific goods or the provision of a specific service, and (ii) those two agreements form, from an objective point of view, a commercial unit; a commercial unit shall be deemed to exist where the supplier or service provider himself finances the credit for the consumer or, if it is financed by a third party, where the creditor uses the services of the supplier or service provider in connection with the conclusion or preparation of the credit agreement, or where the specific goods or the provision of a specific service are explicitly specified in the credit agreement (Art. 3(1)(n) CCD).

⁹²⁹ See also: Hans-Wolfgang Micklitz, Norbert Reich, The Commission Proposal for a “Regulation on a Common European Sales Law (CESL)” – Too Broad or Not Broad Enough?, EUI Law Working Paper, 4/2012, p.56. See for the analysis of pCESL provisions on unfair terms: p. 55-58.

clarification. It also lacks an independent sanction, and the regulation of the benchmark consumer. Therefore, under the pCESL the meaning of the principle remains uncertain, and the relation between procedural and substantive unfairness unsettled.

In terms of the limits of the test of fairness, Art. 83 pCESL contains the circumstances that should be taken into account when assessing fairness. It does not refer to the moment of contract conclusion as a decisive moment of applying the test of fairness. Additionally, as the pCESL contains contract law rules of a more general scope of application, Art. 89 pCESL incorporates *clausula rebus sic stantibus*; and Art. 88 pCESL *force majeure* that allow modification or termination of contracts due to changed circumstances after the contract is concluded. Hence, like under the DCFR, changed circumstances can most probably be taken into account to reassess the fairness of a contract term. The pCESL retains all other familiar exemptions in Art. 80 pCESL (Exclusions from unfairness test), but settles what the “mandatory rules” exclusion means. It provides that the test of fairness is not applicable for assessing the fairness of other rules of Common European Sales Law, i.e. the rules of the pCESL. The pCESL exempts individually negotiated terms. Art. 7 pCESL (Not individually negotiated contract terms) defines individually not negotiated terms as terms “supplied by one party and the other party has not been able to influence its content,” placing the burden of proof on the business but makes no mention of standard terms. Finally, the pCESL retained the “core terms” exemption using somewhat different language than the UCTD and the DCFR “the definition of the main subject matter of the contract or to the appropriateness of the price to be paid” probably having the same effect.

The test of fairness in pCESL is very similar to the test of fairness in the UCTD. Most importantly, it retains the uncertainties of whether the basic concept of unfairness should be given a more procedural or a substantive meaning, and what is the relation between procedural and substantive fairness is. However, it also clarifies some uncertainties of the UCTD. Importantly it implicitly allows the contract term to be reassessed for its fairness after the contract is concluded due to changed circumstances. Hence, although the pCESL probably intended towards the full fairness approach (substantive and procedural fairness), this aim is not followed up, and the door is open for the freedom approach (procedural or substantive fairness). Overall, the protection provided by the pCESL is higher than the UCTD’s but it lower than the DCFR’s.

VII.3. The future of unfair contract terms regulation in Hungary

The HuCC was prepared in a different socio-economic environment and it was amended hundreds of times, many of which happened after the change of regime.⁹³⁰ The need for a completely new legislative act was contemplated as early as in 1989. However, the first draft was ready only in 2002,⁹³¹ and the final draft in April 2009 followed by *Act CXX of 2009 on the Civil Code*, and the *Act XV of 2010 on the Entering Into Force of Act CXX of 2009*. However, this latter act was subject to harsh opposition. According to Vékás the code had conceptual problems, and was often very badly drafted.⁹³² Finally, *Act LXXIII of 2010* declared that the civil code will not enter into force.⁹³³ At the same year, the Government established a *Codification Committee*,⁹³⁴ with Vékás as its chair. The Committee published a new proposal in December 2011. The nHuCC was finally adopted in 2013 and is planned to enter into force on 15 March 2014.

The nHuCC is based on the existing legislation, primarily the HuCC and the case law. It does not take any foreign codification of civil law as model, but frequently uses individual comparative solutions. Although the HuCC is intended to represent a code of civil law, it maintained the existing legislative technique, and EU law is implemented into government decrees, without amending the HuCC⁹³⁵ (save for the implementation of the UCTD). One of the basic questions in drafting the new HuCC was the legislative technique used for regulating consumer law, i.e. whether it should be in a separate code or within the nHuCC. This touched upon a more general question, the place of consumer private law within the Hungarian legal system. The two main problems were the imperative nature of consumer law, and the increasing body of EU law that requires constant updating and adjusting the existing civil law rules.⁹³⁶ At the end, the existing

⁹³⁰ Lajos Vékás, General explanatory notes, In: *The Codification Committees proposal of the new Civil Code with explanations*, Lajos Vékás, Péter Gárdos (eds.), Complex, Budapest, 2012, p. 1.

⁹³¹ The concept of the new Civil Code adopted by Government Decree 1003/2003. For comments: Lajos Vékás, *Suggestions for modernizing general contract law (Theses for debate for concepts of the new civil code- I part)*, 3(3) *Polgári jogi kodifikáció* 3-14, 2001. Lajos Vékás, *Suggestions for modernizing the general contract law (Theses for debate for concepts of the new civil code- II part)*, 3 (4-5) *Polgári jogi kodifikáció* 3-14, 2001.

⁹³² Lajos Vékás, *Critiques and suggestions for improvement of the Governments new Civil Code proposal*, 55(9) *Magyar Jog* 577-590, 2008.

⁹³³ *Act LXXIII of 2010 on Not Entering Into Force of Act CXX of 2009 on Civil Code and on Connected Statutory Amendments*.

⁹³⁴ *Government Decree 1129/2010 on Creation of the New Civil Code*.

⁹³⁵ Vékás 2012, p. 1

⁹³⁶ Lajos Vékás, *Preliminary theoretical questions on the new Civil Code*, *hvgorac*, 2001, p. 74-75.

solution is retained, consumer protection rules remained dispersed and the test of fairness is placed in the nHuCC.

The existing regime of fairness is maintained without crucial changes. The basic concept of unfairness is inferred from reading together Art. 6:102(1) nHUCC (unfair standard terms) and Art. 6:103(1) nHUCC (unfair terms in consumer contracts). According to this test, a standard or an individually not negotiated contract term is unfair, if contrary to the requirement of good faith, unilaterally and without justification causes a significant imbalance to the detriment of the consumer. Therefore, as it can be seen, the test of fairness is identical to the test of fairness in the HuCC. The principle of good faith as an overarching principle is maintained in Art. 1:3 nHuCC. However, good faith is separated from mutual cooperation. This may potentially lead in the future to giving a more substantive meaning to the principle. Nevertheless, since the test of fairness did not change its wording, the analysis of Chapter III most likely applies, where the thesis showed the test of fairness in Hungary primarily aims towards achieving substantive fairness. The circumstances to be taken into account in interpreting the terms of the contract are now in Art. 6:102(2) nHuCC with identical content to Art. 209(2) HuCC. Namely, the unfairness shall be assessed taking into account: 1) the nature of the contractual obligation; 2) all the circumstances that existed at the time of contract conclusion; and 3) all the other terms of the contract or with other contracts between the parties. In terms of substantive fairness, the “black” and “grey” list of contract terms is transferred from the HuCTD Decree to Art. 6:104 nHuCC. The two terms analyzed in Chapter V stayed on the grey list.

Regarding the role of transparency, Art. 6:103 nHuCC contains an interesting provision. Namely, Art. 6:102(3) nHuCC dealing with unfair standard terms keeps the “plain and intelligible” language in defining transparency for the purpose of the core terms exemption. Art. 6:103(2) nHuCC on the other hand, instead of the “clear and understandable language” construction uses the word “unambiguous,” in giving transparency a separate sanction. This arguably immediately means a higher level of protection and a consumers’ real chance to understand the terms of the contract. In other words, under Art. 6:103(2) nHuCC a term will be non-transparent and hence unfair if the consumer did not have a real chance to understand the term because it was ambiguous. It can be noticed the lack of transparency is sanctioned with nullity only in consumer contracts. Hence, in consumer contracts procedural unfairness alone is sufficient to make the contract terms unfair, and being on a separate foot, procedural fairness cannot justify

substantive unfairness. The nHuCC fails to mention the benchmark consumer, but it does incorporate the principle of reasonable expectations as a general contract law principle in Art. 1:4 nHuCC.

In terms of exemptions, the “mandatory rules,” “core terms” and “individually negotiated” terms exemptions are maintained with identical content as general rules in Art. 6:102 nHuCC, most probably applicable also to standard terms in consumer contracts. Provisions on standard terms from Art. 205/A HuCC and Art. 205/B HuCC are now in Art. 6:78 nHuCC and Art. 6:79 nHuCC respectively. An additional safeguard of fairness is that in consumer contracts any standard term for additional fees or charges (above the price paid) will become part of the contract subject to an explicit acceptance of the consumer (Art. 6:80 nHuCC). Art. 6:102(2) nHuCC retains the moment of contract conclusion as decisive for applying the test of fairness. However, *clausula rebus sic stantibus* is incorporated in Art. 6:192 nHuCC, and *force majeure* in Art. 6:248 nHuCC.

The nHuCC also regulates the issue of preventive enforcement of unfair contract terms, but without introducing crucial changes to the present regime. The list of organs and organizations is kept in Art. 6:105(1) nHuCC. The preventive power of collective actions is laid down in Art. 6:105(3) nHuCC, according to which, an action may be commenced against an unfair term already drafted and published, but not yet used in practice. Also, collective action might be also taken against the business and term that is only publicly recommended the usage (Art. 6:105(4) nHuCC). The result of annulment i.e. the *erga omnes* effect, or more accurately a *quasi erga omnes* effect is kept in Art. 6:105(1) nHuCC. It seems that the only novelty in the nHuCC is the express provisions on publication of the judgement, laid down in the same provision. Hence, it seems the nHuCC maintained the present level of protection.

Overall, it can be said that the test of fairness in the nHuCC aims towards complete fairness (procedural and substantive fairness) and leaves limited room for freedom approach, for supporting the self-interest of the business. The danger for freedom remains because of the exemptions from the test of fairness. Hence, in general, despite some improvements in its fairness regime, the nHuCC maintains the level of protection provided by the HuCC.

VII. 4. The future of unfair contract terms regulation in Serbia

Serbia is one of the rare countries in Europe that has no civil code. At the end of 2006 the Government established a *Commission for Civil Law Codification*.⁹³⁷ The new Civil Code of Serbia will consist of four books including a book on contract and tort law. The drafters are of the opinion that the codification was necessary as it will make order in the presently scattered regulation, with essential modernization of institutions, and adjust the legislation to ratified international conventions and the EU Law.⁹³⁸ The *Commission for Civil Law Codification* delivered its first consultative report in 2007 that aimed to enhance discussion.⁹³⁹ It was followed by the first preliminary draft in 2009.⁹⁴⁰ In drafting contract law the starting point was the SrbLOA,⁹⁴¹ which is basically modernized both in terms of contract law institutions and individual contracts. The preliminary draft makes no mention of consumers and consumer contracts, and there are no indications of any intention to amend the SrbLOA in order to implement, at least some elements, of the *consumer acquis*.⁹⁴² It is therefore to assume, that it intended to provide general rules for all contracts and left the consumer specific provisions to the SrbCPA.⁹⁴³ Consequently, the changes might only affect the general rules of contract law incorporated in the SrbLOA.

In September 2013 the SrbMinistry put forward for public discussion a new *draft Consumer Protection Act* with making changes the regulation of unfair contract terms.⁹⁴⁴ It can be therefore said, the regime of unfair terms is unlikely to change in the near future in Serbia.

⁹³⁷ Decision on establishing the Commission for Civil Law Codification of 2006.

⁹³⁸ Explanatory Memoranda to the preliminary draft of the Civil Code of the Republic of Serbia, at Ministry of Justice: [http://www.mpravde.gov.rs/images/obrazlozenje\(1\).pdf](http://www.mpravde.gov.rs/images/obrazlozenje(1).pdf) (22 November 2012).

⁹³⁹ Government of the Republic of Serbia, Commission for Civil Law Codification, Work on the drafting of the Civil Code, Report of the Commission with Open Questions, 3(11) Legal Life, 2007, p. 5–407.

⁹⁴⁰ Government of the Republic of Serbia, Commission for Civil Law Codification, Preliminary Draft of the Civil Code of Republic of Serbia, Book two, Law of obligations, Belgrade, 2009, p. 1-451 at Ministry of Justice: <http://arhiva.mpravde.gov.rs/lt/articles/zakonodavna-aktivnost/gradjanski-zakonik/> (3 July 2013).

⁹⁴¹ Karanikić-Mirić 2010, p. 438.

⁹⁴² Ibid.

⁹⁴³ The drafters were aware of consumers, and their special status in contract law, as on one occasion, the draft makes reference to standard terms negotiated for consumers by consumer organizations (Art. 155 Draft).

⁹⁴⁴ See SrbMinistry: <http://mtt.gov.rs/vesti/javna-rasprava-o-nacrtu-zakona-o-zastiti-potrosaca/?lang=lat> (27 September 2013).

VII.5. Conclusion

Having a look at the alternatives to the present regimes of unfair terms regulation in EU, Hungary and Serbia, it can be concluded that the DCFR and the pCESL are somewhat better alternatives for the regulation of unfairness than the UCTD is. However, they do not provide better alternatives to the current regulation of unfair terms in Serbia and to the current and future regulation in Hungary. The fairness regime in Hungary provides at least the same level of protection as the DCFR or the pCESL would. The fairness regime of Serbia provides a much higher protection than the DCFR or the pCESL would. Regarding Hungary, the regime of the nHuCC is not much different to the current regime of the HuCC, and largely maintains the present level of protection. Finally, in Serbia there are no current alternatives to the test of fairness. It can be therefore said, the new solutions would overall not provide a significantly higher level of protection.

CHAPTER VIII

CONCLUSION

The thesis tackled the components of the “models of fairness” particularly in consumer credit contracts in the EU in general, and in Hungary and Serbia in particular. The foundation of the research was the principle EU legislative act on unfair contract terms, the UCTD. As the UCTD contains a combination of rules that set standards of fairness and rules on enforcement of these standards, the “models of fairness” of the thesis reflect these two components.

The standards of fairness depend on the presence of and relationship between procedural and substantive fairness. Substantive fairness means fairness in the content of contract terms. Procedural fairness is fairness in the process leading up to accepting the terms. As consumers are weaker parties to the contract, regulation aiming to limit the stronger parties’ freedom of contract is justified and necessary. State intervention is especially justified in consumer credit transactions due to special features of credit contracts. Hence, the only question is, how far regulation goes? The fairness oriented approach tends to re-establish the contractual balance between the parties. A complete fairness approach means achieving both substantive and procedural fairness. A limited fairness approach opts for either substantive or procedural fairness, leaving room for the parties freedom of contract protecting their self-interest regarding the process leading up to the conclusion of the contract (procedural freedom), or in terms of the substance of contract terms (substantive freedom). A high level of consumer protection is achieved if the parties’ freedom is limited and a complete contractual fairness is achieved (substantive and procedural fairness). Still high, but somewhat lower level of fairness is achieved if only substantive fairness is provided (substantive fairness and procedural freedom). A much lower level of protection is provided by only ensuring procedural fairness (procedural fairness and substantive freedom). Finally, a low level of protection (or no protection) is ensured if regulation is absent or if it reinforces the freedom approach (substantive and procedural freedom).

The second component of the models of fairness is the rules and procedures, tools and mechanisms for enforcing the standards of fairness. A high level of protection is guaranteed only by specifically designed and operated preventive enforcement mechanisms that make for genuinely effective preventive control that is capable to

eliminate unfair terms not just from individual contracts but also wider, from the entire marketplace.

VIII.1. The European fairness model

The European fairness model in consumer credit is undetermined, and leaves many questions open for Member States to settle according to their internal legal order.

It is not clear if Art. 3(1) UCTD includes both procedural and substantive fairness, and what their relationship is. One general clause, the “significant imbalance” without a doubt aims to ensure substantive fairness. But “good faith” allows for the inclusion of both substantive and procedural fairness. Therefore, a wider interpretation of the basic concept of unfairness includes both substantive and procedural fairness. In a narrower interpretation it most likely points only to substantive fairness, or in an extreme interpretation, only to procedural fairness. Hence, though the intention of the UCTD was probably to provide in the first place for substantive fairness, i.e. a high level of protection entails at least some level of substantive fairness, it is uncertain if the language of Art. 3(1) UCTD achieves this aim.

Procedural fairness is further inferred from Art. 5 UCTD, but the reach of this provision is unclear. The literary reading points to the language used in written contracts, but placing Art. 5 UCTD in context with other provisions, transparency seems to mean a genuine chance to understand the terms communicated. In consumer credit contracts, this vague provision is concretized by the CCD, that aims towards informed decision by providing numerous and multi-layered information to the consumer. The CCD goes above clear and intelligible language of Art. 5 UCTD and aims to provide a consumer with a real chance of understanding, by drawing the attention of a particular consumer to a particular term and providing additional explanations. However, it is questionable if the CCD achieved the set aims. The reach of transparency becomes even less clear as understanding is measured against a reasonably well informed and average consumer, without guidance on how to determine the average and without having special sensitivity towards vulnerable consumers.

Procedural fairness is not an independent basis of unfairness. Under Art. 5 UCTD the lack of transparency has no independent sanction. This lack is not remedied in the CCD. Therefore, under the EU rules a contract term cannot be removed from the contract for solely being procedurally unfair. This provides for a low level of protection.

The relationship between procedural and substantive fairness is not clear. The reading of the UCTD providing for a high level of protection is that the principle aim of the UCTD was to ensure the substantive fairness of contract terms and procedural fairness as a rule cannot justify substantive unfairness. Otherwise, creditors could easily communicate substantively unfair terms, i.e. standard terms included in standard terms and conditions or standard contract, in a transparent manner, and thereby escape the test of fairness. Nevertheless, the preferred reading of general primacy of substantive fairness over procedural fairness is not the only reading and hence a high level of protection is not unquestionably provided.

The test of fairness is subject to a number of exceptions. Individually negotiated and mandatory rules are exempted at all times, and core terms if they are transparent. The most significant exemptions are the core terms exemptions, as the exemption can be interpreted very broadly as including almost any charge, and it is debatable what the price of the credit is. The exemptions in general, but the core terms exemption in special lowers the level of protection the UCTD provides.

The test of fairness is not flexible. Under Art. 4(1) UCTD it is to be applied at the moment of contract conclusion, and changed circumstances (e.g. illness, unemployment) cannot be taken into account. Hence, the concept of *social force majeure* cannot be included into the scope of the UCTD. This lack significantly lowers the level of protection.

Consumer credit in the EU is in the first place regulated as a service, focusing on procedural fairness. Transparency rules of the CCD read together with the UCTD provide for a higher level of protection in terms of procedural fairness than the UCTD would provide alone. But, the EU model lacks additional product intervention tools that would strengthen substantive fairness. Taken the unclear language of the test of fairness, it is questionable, if the UCTD is sufficient to guarantee substantive fairness. It can be therefore said, the protection of consumers in consumer credit in the EU definitely embraces the limited fairness approach (procedural fairness), but its reach towards full fairness (substantive and procedural) remains debatable.

In terms of enforcement, besides remedial control that makes a particular unfair contract term in a particular contract void, Art. 7 UCTD goes further and asks for true preventive enforcement mechanisms to be put in place that are capable of eliminating unfair terms from the national marketplace. Art. 7 UCTD seeks for establishment of genuinely effective enforcement mechanisms. However, it only seeks a certain result to

be achieved but leaves wide discretion to national legislators in deciding on the method of reaching the aim. The EU legislative documents asking for injunctions and ADR to be in place likewise refrain from details and leave up to national states to create enforcement models. Therefore, there are no specifically designed preventive enforcement mechanisms in the EU that Member States could transpose.

In conclusion, the European model has many gaps and faults. Nevertheless, lacks can be overcome on national level. After all, EU law should establish only standards that are later raised (in case of minimal harmonization) and concretized by national laws. In the future, the test of fairness suggested in the DCFR and pCESL would lead to a somewhat higher level of protection (the DCFR's protection being higher than the pCESL's). However, this potential would be undermined by failing to require Member States to have genuinely effective preventive enforcement mechanisms in place.

VIII.2. The Hungarian fairness model

The Hungarian fairness model provides for a reasonably high level of protection, overcoming some of the deficiencies of the European model.

The basic concept of fairness is understood as aiming to provide for substantive fairness, as there is no dispute neither in theory nor in practice that "significant imbalance" and "good faith" are one, integral criteria within Art. 209(1) HuCC. Procedural fairness is ensured by an independent application of the principle of good faith as a general contract law principle (Art. 4(1) HuCC) and by the principle of transparency (Art. 209(4) HuCC).

The principle of transparency laid down in Art. 209(4) HuCC adopted the unclear language of the UCTD. However, reading the provision together with other provisions of the HuCC the meaning of transparency is largely clarified in a sense that it is the consumers' real opportunity to get familiar with the content of standard terms. The meaning of this principle is further concretized in the context of consumer credit where it means a real opportunity of a consumer to understand the terms of the contract. This is primarily achieved by the creditors' obligation to provide additional explanations on the content of terms of the contract. Therefore, the level of protection in Hungary is higher than the protection offered by the European model. This higher level of protection may be potentially compromised by failing to specially regulate the benchmark consumer.

Procedural fairness is an independent basis of unfairness. Under Art. 209(4) HuCC a contract term can be removed from the contract for solely being procedurally unfair. This provides for a high level of protection.

The relationship between procedural and substantive fairness is clear. Procedural fairness is not capable of legitimating substantive unfairness because, as indicated above, procedural fairness (Art. 209(4) HuCC) and substantive fairness (Art. 209(1) HuCC) are viewed as separate bases of unfairness. This ensures a high level of protection.

The test of fairness is subject to a number of exceptions. The scope of the “individually negotiated terms” exemption seems to be clarified, and regarding this exemption the HuCC provides a higher level of protection. Nevertheless, this exemption is less significant in consumer credit, where virtually all terms of the contract are not negotiated, but are rather imposed on the consumer on take it or leave it basis. The scope of the “core terms” and “mandatory rules” exemptions are not clarified and in this regard the HuCC adopted the level of protection of the UCTD. The mandatory rules exemption has a potential to exclude a number of contract terms falling under sector specific consumer credit regulation. The core terms exemption is problematic because it is not clear if the interest or the APR is exempted from the test. Since the price is not subject to the test of fairness, in Hungary, the interest in earlier concluded contracts is potentially controlled by traditional institutions of *laesio enormis* and *usury*. However, these instruments that are created in completely different times are not suitable safeguards against substantively unfair price terms. In newer contracts, the APR is controlled by a recently introduced price cap. It remains unclear if price caps or the test of fairness provides a higher level of protection. Nevertheless, since core terms are exempted from the test of fairness in Hungary, having this safeguard, definitely raises the level of protection compared to the European model. Although the scope of some exemptions is clarified or other safeguards are in place, the exemptions from the test of fairness provide for a low level of protection.

Ancillary terms are subject to the test of fairness. The thesis analyzed the fairness of variation clauses and default interest rate clauses. These clauses are subject to considerable product regulation in Hungary. The applicability of the test of fairness is limited with the boundaries of regulation. Regulation seems to be in place to make an exemption from general rules of contract in order to advance the interest of creditors, by granting them a right to unilaterally change the interest, fees and charges after the

contract is concluded (variation clause) or to charge a higher interest than necessary for contractual restitution (default interest). Because of this, together with granting the rights, regulation also limits financial institutions in exercising their rights. However, in determining the substantive fairness of these terms, it is often difficult to see the precise limits of these boundaries. Hence, the level of protection the test of fairness provides remains uncertain.

The test of fairness is not flexible. Art. 209(2) HuCC limits its application to the moment of contract conclusion. However, changed circumstances that allow for re-assessment of fairness at a later point after the conclusion of the contract can be accommodated by the traditional institutions of *clausula rebus sic stantibus* and *force majeure*. Additionally, these institutions also seem to embrace the concept of *social force majeure*. The principle is also explicitly acknowledged by non-binding consumer credit specific rules. Therefore, the level of protection in Hungary is higher than envisaged by the UCTD, and allow the reassessment of the fairness of ancillary contract terms while performance of the contract.

Although the UCTD was implemented in Hungary with slight variations, reading together the “new” rules with the existing contract law framework and the consumer credit specific regulation, a much higher level of protection is provided. In consumer credit, these rules are strengthened by product regulation tools focusing on both procedural and substantive fairness. Hence in Hungary, the level of protection in consumer credit is higher than in EU in general. It embraces the full fairness approach (procedural and substantive fairness), leaving limited room for freedom approach, for supporting the self-interest of the business. The freedom approach is potentially compromised by the presence of exemptions.

In terms of enforcement, besides remedial control, Hungary is familiar with preventive enforcement tools and mechanisms. The HuFAB is preventive by its mere existence, but the decisions it renders lack such effect. A number of enforcement agents are empowered to commence collective actions, among them importantly the HuNB. Collective actions have ultra-preventive elements but they are not suitable tools for genuine ultra-preventive protection. The HuCFR took a pro-active role, and is in practice very important in preventive enforcement, but lacks sufficient competence and tools for a genuinely effective enforcement. Therefore, at the moment, although preventive enforcement is present, there is no genuinely preventive enforcement mechanism that

produces satisfactory practical results in eliminating unfair terms from consumer credit contracts in Hungary. Consequently, the aimed high level of protection is not achieved.

The regulation of unfair contract terms is unlikely to substantially change in the near future, as the nHuCC maintains the level of protection of the HuCC, failing to clarify or eliminate the drawbacks of the present test.

Nevertheless, the Hungarian model provides for a much higher level of protection against unfair terms in consumer credit contracts than the European model.

VIII.3. The Serbian fairness model

The Serbian fairness model also provides for a reasonably high level of protection, overcoming some of the deficiencies of the European model.

The basic concept of fairness in Art. 46(2) SrbCPA should be understood as aiming towards both substantive and procedural fairness. The test of fairness is complex, and contains five basis of unfairness, some of which aim towards achieving substantive fairness, some towards both substantive and procedural fairness, and one towards procedural fairness. Hence, the test of fairness clarifies that both substantive and procedural fairness have to be achieved for a contract term to be fair. This approach provides for a very high level of protection.

Regarding the principle of transparency, Art. 46(2)(4) SrbCPA did not adopt the language of the UCTD. The SrbCPA clarifies transparency means a consumer's real chance to understand the terms of the contract. However, in consumer credit, this meaning of transparency is potentially compromised, as creditors are only obliged to explain the status of standard terms and conditions rather than their content. Hence, the level of protection is lower than the Hungarian model provides, and is somewhat higher than the European model envisages. Understanding is measured by reference to a reasonable man of the consumers' knowledge and experience. Therefore, the SrbCPA regulates the benchmark consumer setting a relatively objective standard. In this regard, the protection in Serbia is higher than the protection provided by European and Hungarian models.

Procedural fairness is an independent basis of unfairness, procedural fairness alone is capable of making the contract term unfair. This provides for a high level of protection.

The relationship between procedural and substantive fairness is arguably clear. Procedural fairness is generally not capable of legitimising substantive unfairness

because procedural fairness and substantive fairness are set on separate basis under the test of fairness. However, this high level of protection may be compromised by the multiple inclusion of the principle of transparency into the scope of the test.

The test of fairness has no exceptions. The test is applicable to all contract terms regardless of being individually negotiated, core or mandatory. In this regard, the SrbCPA ensures a much higher level of protection than the European and Hungarian models provide. This means, there is no need to determine what the price is, because the test of fairness applies to both the interest and the APR. However, it remains to be seen how the SrbCPA will in practice be applied to the price. Most likely the test of fairness will be interpreted in the light of the traditional civil law institutions of *laesio enormis* and *usury*, equally not suitable for consumer credit in Serbia. It is also questionable how the test will be applied for mandatory rules especially when this scrutiny conflicts with traditional rules. Therefore, although not having exemptions from the test of fairness provides for a very high level of protection, its practical reach in Serbia remains uncertain. Regarding variation clauses and default interest clauses the same conclusion applies as for Hungary.

The test of fairness is flexible. It expressly allows the re-assessment of contract terms for their fairness during performance, by providing two separate basis of unfairness focusing on the stage of performance. One ground of unfairness most likely incorporates the principle of *social force majeure*. Additionally, changed circumstances and *social force majeure* can also be accommodated by the traditional institutions of *force majeure* and *clausula rebus sic stantibus*. Thus the Serbian level of protection is higher than the protection the other two models provide.

Therefore, the test of fairness in SrbCPA is an almost perfect legislative solution. It is very much fairness oriented, providing for both substantive and procedural fairness and leaving very limited room for the freedom approach. It provides for a very high level of protection. Uncertainties of the UCTD are mainly clarified or abolished by the test itself. Nevertheless, additional guarantees of fairness are also ensured by traditional contract law institutions. Some rules are strengthened in consumer credit by additional tools, product specific tools, but Serbia is generally characterized by less regulatory intervention than Hungary, and in providing fairness, Serbia significantly relies on the test of fairness in the SrbCPA. It can be generally concluded, the level of protection in consumer credit is higher in Serbia than in EU in general, and is somewhat higher than in Hungary. It embraces the full fairness approach (procedural and substantive fairness),

leaving limited room for the freedom approach, for supporting the self-interest of the business. This very high level of protection however can be compromised by not applying the test of fairness in practice.

In terms of enforcement, besides remedial control, Serbia is familiar with preventive enforcement tools and mechanisms, but their number and effect is less than in Hungary. The preventive effect of the SrbCEPFSU's existence is less than the HuFAB's. Only consumer protection organizations are empowered to seek injunctions, and probably for this reason, collective actions are practically non-existent in Serbia. The most important actor in enforcement of consumer credit is the SrbNB that relies on administrative sanctions in exercising its powers, but has so far failed to take action in preventing the circulation of unfair contract terms. Hence, there are no genuinely preventive enforcement mechanisms that are producing satisfactory results in practice in eliminating unfair terms from consumer credit contracts in Serbia. The desired high level of protection is not achieved. The level of protection seems to be even lower than in Hungary.

The regulation of unfair terms is unlikely to change in the near future, as there seem to be no plans in that direction.

Overall, the standard of fairness is much higher in Serbia than in EU and it is somewhat higher than in Hungary. However, these rules are undermined by limited enforcement, and hence overall, Serbia did not reach the aimed level of protection of the European model, and its protection is on a lower level than that given by the Hungarian model.

VIII.4. Recommendations for a higher level of protection

The European, Hungarian and Serbian “models of fairness” referred to in the thesis reflected two components, the rules on standards of fairness and rules on the enforcement of these standards. Based on the above analysis, it can be concluded, the standards of fairness are set much higher in Serbia than in Hungary. However, these standards are undermined by lacks in enforcement. Overall, the Serbian model provides for a lower level of protection than the Hungarian model, but a higher level than the European model. Below the thesis gives suggestions on ways and methods of increasing the level of protection in the selected models.

In tackling the question of when contract terms are unfair the models of fairness in the thesis focused around the presence of two basic concepts, the concepts of

substantive and procedural fairness. The present research showed the effectiveness of procedural fairness is limited, stemming from the limits of information as a regulatory tool, and limits of competition. Therefore, regulation should ensure substantive fairness. The general test of fairness is one regulatory tool that can provide substantive fairness. However, as the general test is often difficult to apply in consumer credit, a high level of protection requires more specific forms of product regulation. Nevertheless, the test of fairness should always be applicable as a “safety net” as it provides flexible standards that can cover new contract drafting techniques and circumstances that the regulation could not anticipate.

In terms of enforcement, it is very important that genuinely preventive enforcement mechanisms, ultra-preventive mechanisms, are in place that are able to eliminate unfair terms from a large number of contracts before these terms would produce harmful effects for consumers.

The European model could be improved by settling some of the disputed issues of the general test of fairness. The relationship between procedural and substantive fairness should be settled in a way that the primacy of substantive fairness is ensured at all times. Procedural fairness should not be capable of justifying substantive fairness. Nevertheless, procedural unfairness alone should be sufficient to make the contract term unfair. The meaning of procedural fairness should be clarified and the benchmark consumer regulated in a way to show sensitivity towards vulnerable consumers. The test of fairness should not have exemptions. Alternatively, if the exemptions are maintained, they should be clarified in a way to include as little as possible. The test of fairness should be flexible, and also applicable at a later point, during performance in order to accommodate changed circumstances. In terms of enforcement, the EU Commission should specially encourage ultra-preventive enforcement and show examples of good practices.

The Hungarian model could be improved by eliminating the exemptions from the test of fairness or at least clarifying their scope. Importantly, Hungary should eliminate the core terms exemption and make the test of fairness applicable to the price. In terms of variation clauses regulation should spell out, as much as possible, the valid reasons for variation and specify the contractual price cap applies even after the increase in interest, fees and charges. Regarding default interest, regulation should set a cap on default interest. Defining the benchmark consumer and making the test of fairness flexible, especially extending its application to *social force majeure* situations would

also raise the level of protection. As for enforcement, the HuNB should use the powers and tools it has to provide for genuinely effective preventive enforcement of unfair terms. It should take a leading role in ultra-preventive enforcement.

The Serbian model could be improved by deleting certain references to transparency (i.e. eliminating transparency from the circumstances taken into account in the interpretation of the test of fairness) so as to be clear that transparency cannot legitimise substantive unfairness. Serbia should also introduce price caps. In this task it is important to take a right benchmark as the price, i.e. the APR, and to carefully set the numerical limit. In terms of variation clauses, regulation should specify, as much as possible, the objective and valid reasons for variation and extend the applicability of price caps onto price variations. Regulation should also set a cap on default interest. Additionally, Serbia should extend the financial institutions duty to give additional explanations on the substance of contract terms. Finally, there is a need to raise awareness on the role and importance of the test of fairness. Regarding enforcement, the number of enforcement agents empowered to pursue collective actions should be extended, and the SrbNB should take a leading role in ultra-preventive enforcement.

To conclude, achieving a high level of consumer protection in consumer contracts in general and consumer credit contracts in particular, means achieving fairness, as opposed to maintaining the parties' contractual freedom. True fairness can only be achieved by regulation that strives towards complete fairness (substantive and procedural fairness), and enforcement tools and mechanisms that provide for a genuinely preventive enforcement of unfair terms. Only their combination achieves a true high level of protection in consumer (credit) contracts.

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ANNEX

The original version of the most important legal provisions analyzed

Hungarian

Art. 209(1)HuCC (the test of fairness):

Tisztességtelen az általános szerződési feltétel, illetve a fogyasztói szerződésben egyedileg meg nem tárgyalt szerződési feltétel, ha a feleknek a szerződésből eredő jogait és kötelezettségeit a jóhiszeműség és tisztesség követelményének megsértésével egyoldalúan és indokolatlanul a szerződési feltétel támasztójával szerződést kötő fél hátrányára állapítja meg.

Art. 209(2) HuCC:

A feltétel tisztességtelen voltának megállapításakor vizsgálni kell a szerződéskötéskor fennálló minden olyan körülményt, amely a szerződés megkötésére vezetett, továbbá a kikötött szolgáltatás természetét, az érintett feltételnek a szerződés más feltételeivel vagy más szerződésekkel való kapcsolatát.

Art. 209(4) HuCC:

Az általános szerződési feltétel és a fogyasztói szerződésben egyedileg meg nem tárgyalt feltétel tisztességtelenségét önmagában az is megalapozza, ha a feltétel nem világos vagy nem érthető.

Art. 209(5) HuCC:

A tisztességtelen szerződési feltételekre vonatkozó rendelkezések nem alkalmazhatók a főszolgáltatást megállapító, illetve a szolgáltatás és az ellenszolgáltatás arányát meghatározó szerződési kikötésekre, ha azok egyébként világosak és érthetőek.

Art. 209(6) HuCC:

Nem minősülhet tisztességtelennek a szerződési feltétel, ha azt jogszabály állapítja meg, vagy jogszabály előírásának megfelelően határozzák meg.

Serbian

Art. 46(2) SrbCPA (the test of fairness):

Nepravičnom ugovornom odredbom smatra se odredba ugovora koja:

- 1) za posledicu ima značajnu nesrazmeru u obavezama ugovornih strana na štetu potrošača;**
- 2) za posledicu ima okolnost da izvršenje ugovorne obaveze opterećuje potrošača bez opravdanog razloga;**
- 3) za posledicu ima okolnost da se izvršenje ugovora značajno razlikuje od onoga što je potrošač osnovano očekivao;**
- 4) je protivna zahtevu javnosti u postupanju trgovca;**
- 5) je u suprotnosti sa načelom savesnosti i poštenja.**

Art. 46(2)(3) SrbCPA:

Kriterijumi na osnovu kojih se utvrđuje da li je određena odredba ugovora nepravična su:

- 1) priroda robe ili usluga na koje se ugovor odnosi;
- 2) okolnosti pod kojima je ugovor zaključen;
- 3) ostale odredbe istog potrošačkog ugovora ili drugog ugovora sa kojim je potrošački ugovor povezan;
- 4) način na koji je postignuta saglasnost o sadržini ugovora i način na koji je s obzirom na zahtev javnosti potrošač obavešten o sadržini ugovora.

Art. 5(1)(24) SrbCPA:

Ugovorna odredba jeste svaka odredba potrošačkog ugovora, uključujući posebne pogodbe o čijoj sadržini je potrošač pregovarao ili mogao da pregovara sa trgovcem i opšte odredbe čiju sadržinu je unapred odredio trgovac ili treća strana.

Art. 44(1) SrbCPA:

Ugovorna odredba obavezuje potrošača ako je izražena jednostavnim, jasnim i razumljivim jezikom i ako bi je shvatio razuman čovek potrošačevog znanja i iskustva.