



Dear reader,

There have been many discussions this year about the problems arising from fast or 'instant' loans, and the first proposals have been prepared for solving these problems legally. The topic is not characteristic of Estonia alone: excessively easy access to consumer loans has brought with it over-borrowing by consumers in all of the Nordic and Baltic countries. However, there are slight and sometimes even quite significant differences in the methods used in a bid to tackle these problems from one country to the next. In this *Juridica International* publication, consumer-credit experts from seven Nordic and Baltic countries share and reflect upon their national experiences. Their research results demonstrate that so-called soft solutions such as a notification obligation for lenders or additional requirements imposed on advertising of fast loans do not produce the desired effect on their own. Rather, the experiences of our neighbours indicate that a requirement of licensing for creditors, establishment of interest-rate restrictions, and measures under procedural law should be central if one is to avoid implementing requirements related to consumer credit without having holistically and fully assessed what is necessary. It is pleasant to see that Estonia is among those moving toward the above-mentioned solutions. We would like to offer a big 'thank you' to the Estonian–Norwegian scientific co-operation programme that has enabled publishing the outcomes of the research carried out under the project EMP205.

Last year marked the passing of 20 years since the adoption of the Law of Property Act. For an Estonia that had just restored its independence, the Law of Property Act was the legislation that served as the first pillar in shaping a legal order focused on market economic relations, and its importance for the functioning of modern economic circulation cannot be overestimated. The jubilee of the Law of Property Act was celebrated on 28–29 November 2013 in Tartu with an international conference, and selected works from among the presentations at that event make up the first portion of this issue, examining developments in the law of property. Also here, via a recurring theme of the articles, we are given a look at the experiences of other countries and have an opportunity to learn from them: there is land-register reform in progress both in Scotland and in Latvia, and it seems that the systems there are becoming increasingly similar to the one we are using. W. Faber provides us with an opportunity for comparison, to consider whether and to what extent the Estonian law on proprietary security rights corresponds to the modern solutions of the Draft Common Frame of Reference (DCFR). C. Von Bar and C. Martinson show well that any kind of legislative solution requires a clear understanding of the main concepts of the law (here, of property).

But the traditional concepts of law are exactly what our fickle and rapidly changing time has challenged. The relevance of things as physical objects is constantly decreasing in a digital world and digital business. In a loan taken out online or via a mobile phone, personal contact between the lender and the borrower is lost and readiness to take loan decisions on the spur of the moment increases. However, just as progress requires innovation, people need something routine and secure to manage their lives. Accordingly, it is especially nice that *Juridica International* is once again published on paper, not only as an online version. Then again, you could just as well read it on a tablet as you relax in a rocking chair beside a fireplace. Enjoy the reading!

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Why do We Need *Grundstücke* (Land Units), and What are They?

On the Difficulties of Divining a European Concept
of ‘Thing’ in Property Law

1. Things

Mutual understanding of the law of ‘property’ or ‘things’ in Europe is at present an especially arduous undertaking. The problem starts with just isolating a suitable designation for the reference point for proprietary rights. Whilst it is not possible to develop the thesis here,¹ I would maintain that, as a first rough-and-ready categorisation for the purposes of pan-European stock-taking appraisal, one should distinguish between ‘objects’, ‘objects of commerce’, and ‘things’. ‘Objects’ encompasses everything apart from ‘persons’ that is susceptible to the application of rules of private law, an ‘object of commerce’ is an ‘object’ that can be the subject matter of a sale or gift, and a ‘thing’ is anything that can be made the reference point for a right that enjoys protection against third parties and is thus ‘absolute’ (in the sense that it is not merely relative). The best approach is to distinguish between real and normative things. Real things exist independently of law; have an intrinsically formed and demarcated *corpus*; and, in consequence of this attribute, are capable of forming the subject matter of property rights. Normative things, in contrast, do not subsist as a matter of nature; they owe their existence and their capacity to be the reference point of property rights solely to an exercise of legal imagination—legal norms, in other words. This is the case, for example, not merely with regard to debts and other rights to a performance and for shares in companies and partnerships but also even in relation to parcels of land, or *Grundstücke*. *Grundstücke* belong to that set of normative things that in most legal systems are capable both of being owned and of being the subject matter of other property rights; claims and shares, on the other hand, are normative things that are susceptible only to (mere) property rights, not to ownership as such.

¹ Details and supporting material will appear in the first volume of my forthcoming work *Gemeineuropäisches Sachenrecht*. Publication is envisaged for 2015.

2. Terminology

Normative things may be subdivided into things with a physical substratum and purely normative things. Both have hitherto lacked a uniform European terminology. With regard to things in the first group, the word 'Grundstück' (literally meaning 'piece of land'), which is also invoked by Germany's Bürgerliches Gesetzbuch, or BGB (albeit with a technical signification of its own), seems to all intents and purposes an appropriate label within the domain of German-language legal scholarship. The German language simply lacks a better word. In the end, some word has to be used, and 'Grundstück' is at least not a bad choice. Of course, each legal language must find its own expression for the *Grundstück* concept. That the common law (which is not alone in this) lacks a genuine linguistic equivalent for *Grundstück*^{*2} and that even the legal systems that invoke the word as a *terminus technicus* associate it with variant meanings^{*3} is simply something that has to be taken on board. For legal scholarship in the English language, no ready candidate presents itself, for terms such as 'land' and 'parcel [or plot] of land' already carry very different signification. Their inappropriateness emerges all the more clearly as we probe the ramifications of the *Grundstück* concept. A tentative suggestion—inspired by the official English-language translation of the Swedish Land Code (the Jordabalk, or JB)^{*4}—might be 'land unit'. The Estonian language, I am informed, has no difficulty here and can operate with the word 'maatükk'.

3. Entities of the landscape capable of being the subject matter of property rights

What, in substance, is at issue? The answer is that, in forming *Grundstücke* (or, more precisely, entities for which we use that nomenclature in the text that follows), legal systems create objects in the landscape that are capable of supporting property rights. A landscape or terrain, although readily perceptible to the senses and hence often (but rashly) labelled 'corporeal', is not in itself a thing. Things—that is to say, entities capable of

² 'Estate' would be a suitable word, but it is no longer used to denote the subject matter of rights in land; rather, it refers to the rights themselves. 'Grundstück' may best be translated perhaps as 'tenement'. The latter word has the advantage that, in contrast to 'estate', it at least describes a thing (what is held, not how long it is held). Nowadays, however, the concept is often (especially in Scotland) confined to application for flats. Furthermore, the term extends further than the notion of *Grundstück* we are invoking, because 'tenement' also encompasses some rights in land (as does the word 'hereditaments' and also another use of 'Grundstücke', within the meaning of German law: see §96 of Germany's Bürgerliches Gesetzbuch, or BGB).

³ Article 46 §1 of the Polish civil code defines *Grundstücke* as 'parts of the earth's surface that are the object of special ownership'; §27 (a) of the Czech Cadastre Law (344/1992) defines a *Grundstück* (albeit expressly only for the purposes of the same legislation) as the 'part of the earth's surface that is partitioned off from the neighbouring parts by the boundary of a regional authority or by the boundary of an area of land registration'. A distinction is drawn between *Grundstücke* and parcels of land (plots). Only parcels of land—areas or spaces that are described and recorded in the land register—may be transferred. A *Grundstück*, however, even if it only amounts to a portion of a plot, can also be leased and can be acquired by prescription (J. Spáčil, M. Spáčil. *Přehled judikatury ve věcech občanskoprávních vztahů k pozemkům*. Prague 2011, p. 85). Possession of part of a plot (a 'Grundstück' in the sense of this terminology) requires real and outwardly visible demarcation, but such demarcation is also sufficient (a *Grundstück* must merely make itself manifest, according to Supreme Court 23.1.2002, 22 Cdo 96/2000, Soudor civilních rozhodnutí Nejvyššího soudu C 987, and also Supreme Court 30.4.2006, 22 Cdo 806/2006; see http://www.nsoud.cz/Judikatura/judikatura_ns.nsf/WebSearch/A6791F824D7F0DBBC12579830059A423?openDocument&Highlight=0). The most neutral concept in Austrian law is that of 'land'. A tract of land becomes a *Grundstück* when it is registered with its own number as part of a cadastral municipality in the boundary cadastre or the land-tax cadastre (under §7a of the Austrian Vermessungsgesetz, or VermG, and §5 (1) of the Austrian Allgemeines Grundbuchsanlegungsgesetz, AllgGAG). Subsection 7a (1) of the VermG gives the following definition: 'A *Grundstück* is that part of a cadastral municipality that is designated as such with its own number in the boundary cadastre or the land-tax cadastre.' To some extent, the notion of a plot or parcel of land (*Parzelle* or *Grundparzelle*) is used as a synonym for the notion of a *Grundstück*. These cadastres are the foundation of the land register; their data on the location and boundaries of *Grundstücke*, along with the mode of use of each *Grundstück*, are carried over to the land register (§2 (2), sentence 1 of the Austrian Grundbuchumstellungsgesetz). As for Spanish law, TS 10.12.1960, RAJ 1960, No. 4095, on pp. 2664, 2666, once described a *finca* as 'a portion of the earth's surface that is enclosed by a polygonal line and is the object of ownership'. Portuguese law, in contrast, refers only to the ground (*solo*) and not the earth's surface (*superfície*). Under Article 204 (2) of the Portuguese Código Civil (CC), the idea of an agricultural *Grundstück* corresponds to a bounded part of the ground and what we might call an urban *Grundstück* is a building connected to the ground.

⁴ The translation of Chapter 1, §1 begins thus: 'Real property is land. This is divided into property units. A property unit is delimited either horizontally or both horizontally and vertically.' The term 'property unit', while avoiding the two-dimensionality flaw of terms such as 'parcel of land', has the weakness that 'property' as a word is overly inclusive. The official English translations of Sweden's land law and cadastral legislation are accessible via the Kungliga Tekniska högskolan (Swedish Royal Institute of Technology) Web site, at <http://www.kth.se/abe/inst/fob/avd/fastighetsvetenskap/publikationer/slcl>.

being the reference point of property rights—come into being within a terrain only once it is parcelled out. It is only after subdivision into distinct plots of land in accordance with the rules of law created for that purpose^{*5} that subsisting or potential^{*6} entities capable of supporting property rights emerge—namely, *Grundstücke*.

4. The purpose of forming *Grundstücke*

To understand what *Grundstücke* are, one must first address the preliminary question of why one actually needs the legal concept of *Grundstücke*. The answer varies from one field of law to another. There are large areas of law that require the notion of ‘movables’, but not that of *Grundstücke*, in order to reach their goals; as a rule, criminal law belongs to that category.^{*7} Conversely, even though they are all concerned with *Grundstücke*, property law, on the one hand, and, for example, tax law, land-surveying law, planning law, and construction law on the other, need not read the concept in the same way and indeed do not do so.^{*8} Not

⁵ This is stated imprecisely by M.I. Spyridakis. *Epitomo Nomikó Lexikó*. Athens and Komotini, Greece 2008, p. 9 (as soon as the various parts of Earth’s surface are demarcated and marked off from one another by natural or artificial markings, a *Grundstück* arises; however, that is the case only where a legal system does not actually require more than such action, and those times, if they ever existed, have long since passed). An interesting insight into earlier conditions might be furnished by Swedish legislation. It provides that the boundaries of a *Grundstück* (actually, *fastighet*), once they have been determined under the law (*lagligen bestämd*), follow the ground markings fixed in accordance with the law (*laga ordning*). If those markings can no longer be ascertained with certainty (*fastställa med säkerhet*), they are identified through the aid of cadastral plans (*förrättningskarta*), purchase documents, and possession and other criteria. If statutorily recognised ground markings are entirely absent, a *Grundstück* is determined with the aid of a plan (a *karta*) and documents (see Chapter 2, §3 of the JB). If need be, one may also resort to border posts (*rå*) and mounds of stones (*rör*) and to other markings accepted in ancient times (Chapter 2, §4 of the JB).

⁶ A ‘landscape’, therefore, is not even an ownerless thing. Even ownerless things must at least be ‘things’—i.e., potential subject matter of property rights. Consequently, besides real things, only *Grundstücke* (or, according to the national terminology, immovables) and not ‘land’ can be ownerless. Section 928 of the German BGB, for example, permits abandonment of a *Grundstück*. In consequence, it becomes ownerless until the state exercises its right of appropriation, as it is entitled to do, and this is registered in the land register. However, under Article 1345 of the Portuguese CC (which is based on the almost identically worded Article 827 of the Italian Civil Code), ‘immovable things [*coisas imóveis*] without a known owner are regarded as state property’. In Italy and Portugal, state ownership thus arises automatically, *ex lege*. Therefore, immovables are never ownerless; an act of appropriation is not required. The situation is the same in Spain. *Inmuebles* (or *bienes inmuebles*) likewise vest in the state if they have no other owner (under Article 17 of the Law on the Property of the Public Administration, or ‘Ley del Patrimonio de las Administraciones Públicas’, law 33/2003, of 3.11.2003; see also L. Díez-Picazo, A. Gullón. *Sistema de Derecho Civil*, Vol. III, Part 1: Derechos Reales en General, 8th ed. Madrid 2012, pp. 176–177).

⁷ In the German Criminal Code, the word ‘Grundstück’ appears only in §106b (on disturbing the activity of a legislative body in its building ‘or the appurtenant *Grundstück*’). In some ancillary criminal legislation (e.g., in §18 (1) 13) of the Waste Shipments Law, or ‘Gesetz zur Ausführung der Verordnung’, (EG) No. 1013/2006 des Europäischen Parlaments und des Rates vom 14. Juni 2006 über die Verbringung von Abfällen und des Basler Übereinkommens vom 22. März 1989 über die Kontrolle der grenzüberschreitenden Verbringung gefährlicher Abfälle und ihrer Entsorgung), a person may be punished for denying a representative of the relevant authorities ‘entry to a *Grundstück* or living quarters, offices, or business premises’. Section 287 of Germany’s Strafgesetzbuch (StGB) criminalises unlicensed lotteries of ‘immovable things’. All of these provisions obviously have nothing to do with protection of property rights; *Grundstücke* can be neither stolen (§242 of the German StGB) nor embezzled (§246 of the StGB). However, in Portugal and Spain, besides altering of boundary markers, the usurpation of property rights in immovables (the *usurpação de coisa imóvel* and the *usurpación de derecho real inmobiliario*, respectively) is a criminal offence (under Article 215 of the Portuguese Código Penal (CP) and Article 245 of Spain’s Código Penal). The notion of the immovable found in Article 215 of the Portuguese CP corresponds to that of an immovable in Article 204 of the Portuguese CC (J.M. Damião da Cunha, in Jorge de Figueiredo Dias (ed.). *Comentário Conimbricense do Código Penal, Parte Especial: Artigos 202.º a 307º* (Vol. II). Coimbra, Portugal 1999, pp. 261–262, 270).

⁸ An example from German building regulations is to be found in §4 (1) of the Lower Saxony Bauordnung (BauO): ‘The building plot is the *Grundstück*, within the meaning of civil law, on which a building project is carried out or on which a structural work is located. The building plot may consist of several adjacent *Grundstücke* if and to the extent that a public-land charge ensures that all structural works on the *Grundstücke* would comply with the public building regulations if the *Grundstücke* were one *Grundstück*.’ An example from German tax law can be seen in §70 of the Bewertungsgesetz, specifically §70 (1): ‘Every economic unit of patrimony in land constitutes a *Grundstück* within the meaning of this law. (3) A building that is constructed on another’s ground [...] is a *Grundstück* within the meaning of this law even if it has become a component part of the ground.’ In Portugal, there are at least four separate definitions of ‘prédio’ (referring to a *Grundstück*). Article 204 (1) (a) of the Portuguese CC regards the rural and urban *Grundstücke* (*prédios rústicos e urbanos*) as immovable things (*coisas imóveis*). In translation, ‘[a] rural *Grundstück* is a delimited part of the soil and the existing constructions on it that are not economically independent, and an urban *Grundstück* is any building incorporated into the soil with the land that will serve as an amenity’ (*ibid.*, Article 204 (2)). Article 1 (2) of the regulation on the land cadastre (Regulamento do Cadastro Predial, DL 172/95, of 18.7.1995) defines the word ‘prédio’ as referring to ‘a limited portion of the earth’s surface, one that is juridically independent, including water, plantations, buildings, and constructions of every kind that are present on it or are attached to it with an enduring quality, as well as independent units within the regime of condominium-ownership’. However, under this provision, the idea of *Grundstück* within the meaning of the law on cadastres does not encompass those waters,

even the law of obligations and the law of property necessarily operate at all times to the same end with the notion of *Grundstücke*; therefore, they also endow it with distinctly different content.⁹ It follows that one has to confine oneself to a property-law notion of *Grundstücke* and, as a first step, settle for the proposition that the formation of *Grundstücke* serves the purpose of setting up property rights for the usable parts of the planet. Without *Grundstücke*, that would be impossible: without them, there would be no entity susceptible to control; no-one would know which part of Earth is the subject matter of the relevant property right.

5. Products of imagination

Grundstücke for the purposes of property law are, accordingly, things in which, as in the landscape from which they are cut out in normative excision, a physical substratum inheres. The so-called law of immovables refers to this at numerous points. Indeed, a not inconsiderable number of the property rights that may be acquired in accordance with its rules would otherwise be quite inconceivable: rights of occupation and rights of way, to name but two, are cases in point. That does not mean, however, that *Grundstücke* owe their character as things to the materiality of the soil that forms part of them. The opposite is the case. Properly analysed, their element of earthy foundation does not even confer on them the quality of corporeality. Of course, one can stand in a field and get one's shoes dirty; in this sense, one may say there is a 'corporeal' thing when referring to the field. That, however, is not the sense of 'corporeality' that is determinative for the purposes of property law. The paramount task for this 'law of things' lies, rather, in constructing an 'entity' in the first place—that is, in constituting as a normative matter a spatial unit capable of supporting property rights.¹⁰ Real things derive from their corporeality a demarcation to other things; this determines their capacity to be the subject matter of property rights. The position is different for *Grundstücke*. They

plantations, buildings, and constructions listed at the end of Article 2, item 1 of the Code on Council Tax (DL 442-C/88, of 30.11.1988, (i.e., the 'Código da Contribuição Autárquica'), since superseded by the Property Tax Code (CIMI), or 'Código do Imposto Municipal sobre Imóveis', DL 287/2003, of 12.11.2003). Article 2 of the Portuguese CIMI, for its part, reads: 'For the purposes of this code, 'prédio' means every fraction of the territory, including waters, plantations, buildings, and constructions of every kind, that is incorporated into the fraction with an enduring quality or is set upon it, provided that these are part of the patrimony of a natural or legal person and under normal circumstances have an economic value, along with the waters, plantations, buildings, and constructions [...] on the terrain [*terreno*] that enjoy economic independence [...], even if they are situated on a fraction of the territory that is a component part of another patrimony [...].' The Land Register Code (or Código do Registo Predial), DL 224/84, of 6.7.1984, for its part, serves the purpose of publicising the legal relationships associated with the *Grundstücke* and providing for legal certainty in 'dealings' (*comércio jurídico imobiliário*) with them. Consequently, the notion of *Grundstück* in land-registration law does not draw on Article 204 of the Portuguese CC; it is based instead on the cadastre and tax law. *Grundstücke* and immovable are thus one and the same for the purposes of the law on land registration (Seabra Lopes. *Direito dos registos e do notariado*, 6th ed. Coimbra, Portugal 2011, pp. 322–324).

⁹ In German law, for example, the notion of 'tenant relationships related to a *Grundstück*' (in §578 of the German BGB) encompasses the letting of part of the surface of a camping site (OLG Frankfurt, 20.6.1985, NJW-RR 1986, p. 108) and the letting of the outside wall of a house for the attachment of a vending machine (see O. Palandt. Introduction to §535 (97). – W. Weidenkaff (ed.). *Bürgerliches Gesetzbuch*, 71st ed. Munich 2012). The position is similar in Portugal. Portuguese law admittedly does not follow the German conceptual distinction between tenancies with fruits (*Pacht*) and tenancies without (*Miete*), but it does differentiate between renting (*contrato de locação*) immovable things (*arrendamento*) and renting movables (*aluguer*). *Arrendamento* encompasses all immovable in the sense of Article 204 (2) of the Portuguese CC and, thereby, for example, urban and agricultural *Grundstücke* (Pires de Lima and Antunes Varella, *Código Civil Anotado, Artigos 762-1250* (Vol. II), 4th ed. Coimbra, Portugal 2010, Note 2 to Article 1023, p. 344). The tenancy may be related to either the whole *Grundstück* or merely parts of it. In the case of urban *Grundstücke*, for example, outside walls and terraces may be leased for advertising purposes and windows may be leased to persons who wish to watch a festive procession (L. Menezes Leitão. *Direito das obrigações*, Vol. III: Contratos em especial, 4th ed. Coimbra, Portugal 2006, pp. 308–309).

¹⁰ This is not the same as the phenomenon conceptualised in Austria by means of the notion of the 'corpus' of the *Grundstück* or land register. Under Austrian law, one or more *Grundstücke* may together be registered in the land register as a so-called *Grundbuchskörper* (land-register corpus), where they together constitute a *Grundbucheinlage* (or land-register enclosure) (J.C.T. Rassi, *Grundbuchsrecht*, paragraph 5). It is even possible for *Grundstücke* that are not spatially connected with one another to be registered as a single land-register corpus (see §§ 5 and 34 of the AllgGAG). The Austrian concept of the land-register corpus is derived from that of the *corpus tabulare* and therefore is designed only to express the proposition that not just the surface of the ground but also the strata of earth under it, the airspace above it, and the component parts of the *Grundstück* (most especially the buildings) forming parts of the legal entity constitute the land-register enclosure (see J.C.T. Rassi, *loc.cit.*). On this basis, Heinrich Demelius (*Österreichisches Grundbuchsrecht: Entwicklung und Eigenart* Article Vienna 1948, p. 17) has commented that 'it is indeed not a surface but a corpus'. That is admittedly correct without qualification, but it does not latch on to the critical point; in reality, Demelius has put the cart before the horse. That is because spatiality does not invest *Grundstücke* with any corporeality in the sense of being marked off. Yet it is precisely on that point that they differentiate themselves from the so-called 'movable' things. In the case of *Grundstücke*, the corporeality has to be generated by a determination by the legal system.

must firstly be fashioned by the legal system into a thing (into a *corpus*), and, moreover, this must be done from all sides—i.e., in the airspace, in the earth, and in the surface area. Their characteristics determined by the physics of nature are (as such) actually an obstacle to the quality of being a thing. This issue can be overcome only by the legal system. Consequently, *Grundstücke* owe their existence and their capacity to be the subject matter of property rights entirely to property law. *Grundstücke* are admittedly things with a physical substratum, but they are nonetheless normative things. They resemble the geometric figures that would arise if, by means of a computer program, three-dimensional gridlines were superimposed on the farthest-flung part of the earth. In the end, *Grundstücke* in the sense applied in property law are products of imagination. *Grundstücke* do not exist as a product of nature—that is to say, they are not separated from one another by corporeality. Their individualisation is a consequence of legal intervention. One could say that *Grundstücke* are needed everywhere, yet they are required only where people monopolise not merely the use of goods and rights but also the use of their living space on Earth by means of property law. Societies of hunter-gatherers do not have a concept of *Grundstücke*; planned economies need them only to a limited extent^{*11}; and for the use or exploitation of the oceans and sea beds, the notion of constructing *Grundstücke* is unworkable in its very approach. That is because the formation of *Grundstücke* for the law of property serves the purpose of monopolising resources in the hands of private individuals or corporations. Such monopolisation is ruled out in those regions that belong, or should belong, to everyone.

Because *Grundstücke* are legal constructs, they can only be partitioned^{*12} and merged in accordance with legal rules. The partitioning of *Grundstücke* is an everyday occurrence; merger, in contrast, is not. Nevertheless, it remains correct that the number and size of *Grundstücke* may be increased and decreased. What cannot be increased is only the land itself that a *Grundstück* normatively requires for its formation. That makes interests in land a particularly coveted asset. That asset's monopolisation necessitates stable relations, and stable relations demand a large measure of legal certainty. Where something is very much coveted, moreover, it is unsurprising to find from a comparative-law perspective a variation in the breadth of normative regulation which is often quite appreciable. The law on the formation of *Grundstücke* and the law on the use of *Grundstücke* confirm this. The law on the formation of *Grundstücke* is concerned with striking the difficult balance between party autonomy, with aspirations for polymorphism in legal transactions, and the imperative of protecting third parties against excessive complexity; the focus in the law on the use of *Grundstücke* is on ordering optimally tiered entitlements in relation to land among as many individuals and legal persons governed by private law as possible.

6. Corporeality, space, and normativity

6.1. A fixed connection with the land

It is repeatedly asserted in discussion of *Grundstücke* that they are made up of areas, 'portions of the surface of the earth'. This is correct in so far as an object of commerce can be characterised as a *Grundstück* only if it is firmly connected to the ground, the *fonds de terre* (French civil code, Article 518).^{*13} It is incorrect,

¹¹ A striking example can be found in Article 142 of the Civil Code of Tajikistan. Under that provision, only buildings and installations fall under the label 'immovable'. That is because the ground and soil are in the exclusive ownership of the state and are outwith private legal commerce (R. Knieper *et al.* *Das Privatrecht im Kaukasus und in Zentralasien*. Berlin 2010, p. 339).

¹² Depending on the composition of the surface of the landscape, however, the partitioning of *Grundstücke* may be restricted for purposes of ensuring reasonable husbandry. Under Article 1376 (1) of the Portuguese CC, for instance, the area cultivatable in agriculture (arable land or *terrenos aptos para a cultura*) may not be reduced to below the minimum area prescribed for regional cultural unity. Moreover, under Article 1376 (2) of the Portuguese CC, partitioning of rural *Grundstücke* is not allowed if one result is that a parcel would become an enclave—irrespective of whether it would exceed the minimum area prescribed for regional cultural unity. The legislator's intention in setting forth this rule (and in Article 1552 of the Portuguese CC) was to preclude the creation of new servitudes (rights of way, or *servidão de passagem*), which it regarded as one of the problematic consequences of *Grundstücke* divided into small parts (P. de Lima, A. Varela. *Código Civil Anotado: Artigos 1251-1575* (Vol. III), 2nd ed. Coimbra, Portugal 1987, comment 5 on Article 1376, p. 259). Under Article 1377 of the Portuguese CC, however, areas of the ground (*terrenos*) that serve a purpose other than agriculture or constitute parts of urban *Grundstücke* may be divided almost at will. The merger of rural *Grundstücke* belonging to the same proprietor is the subject of the rules in Article 1382 of the Portuguese CC.

¹³ Irritatingly, however, it seems that in Europe there is not even consensus about this concept. Therefore, for example, in the Netherlands, *grond* (meaning 'ground') is defined in Article 3:3 of the Burgerlijk Wetboek (BW), which, in turn, invokes Article 5:20 of the BW (material describing in more detail what objects forming the subject matter of the right of ownership of the *grond* are encompassed). It includes the surface of the earth. The surface of the earth is, in its turn, understood

however, to regard a mere area of the ground as a *Grundstück*: nobody can step into a two-dimensional area, grow crops on it, or build on it; in terms of property law, one cannot do even the slightest thing with it.

Although its physical substratum—the ground—is, accordingly, insufficient in itself to form a *Grundstück*, it remains necessary as a requirement in the construction of *Grundstücke*. Without a fixed connection with the land, no object becomes a *Grundstück* capable of supporting property rights. The airspace above a house is not a fit object for separate ownership, even if (in cities) money is expended in vast amounts for permission to use it via encroachment with an overhanging high-rise building and the transactions may be labelled a ‘sale’.^{*14} The converse position, which Section 3(e) of the Irish Land and Conveyancing Law Reform Act 2009 assumes with the proposition that different layers of air above a building may have different owners,^{*15} does not convince me. A layer of air remains just a layer of air, though encapsulated in measurements of length, breadth, and height; it still does not form a *corpus*. The open volume for playgrounds and car parks under a modern stilt or pillar construction forms part of the co-ownership of all the flat-owners in the same manner as a dependent part of the *Grundstück*. For it to become a *Grundstück* in its own right and thus an independent thing, the open space would have to be enclosed. Equally, someone who has established a dwelling on a houseboat^{*16} or the top deck of a double-decker bus cannot claim to have a *Grundstück* of their own. Neither boat nor bus has a fixed connection with the water over which the boat floats or the ground on which the bus stands.^{*17}

6.2. Space

A *Grundstück* captures a space.^{*18} That space arises from the notional demarcation from other spaces. Property law, as a notional starting point, draws its horizontal boundaries (offset vertically upward and downward) in parallel to the boundary lines that are projected by survey in two dimensions on the earth’s surface. The latter often occurs by resort to a cadastre (if there is one)—i.e., an official description of the parcels of land. The vertical lines run upward and downward perpendicularly to the boundaries that delimit the land as a horizontal plane. Both lines—the horizontal and the vertical—serve to demarcate and define the *Grundstücke*—both in relation to other *Grundstücke* and as against spaces devoid of *Grundstücke*. Everything that the contours of the space delineate (not, we note, everything that is to be found within that space) is the *Grundstück*.

as signifying the upper limit of ownership of immovables (see C. Asser [-F.H.J. Mijnsen *et al.* (eds). *Zakenrecht*, 15th ed. Deventer, The Netherlands 2008, p. 108, item 81) and is itself the subject matter of the right of ownership (T.M. *Parlementaire Geschiedenis van het Nieuwe Burgerlijk Wetboek*. Parlementaire stukken, Book V: Zakelijke rechten. Deventer, The Netherlands 1981, p. 120). If an edifice is placed on the ground and joined to it such that ownership of the edifice follows ownership of the ground, this will be regarded as a change in the surface of the *Grundstück* in accordance with the attributes of the edifice (F.H.J. Mijnsen *et al.*, *loc. cit.*).

- ¹⁴ The correct view is expressed in *Rolfe (Inspector of Taxes) v. Wimpey Waste Management Ltd* [1988] STC 329, 357 (Harman J, *obiter*: airspace separated from the ground below it is not an ‘item of property’). That, of course, does not preclude burdening a *Grundstück* with a property right for enjoyment of the airspace above the ground and registration of that right in the relevant register—e.g., as a servitude in the form of a special right of fly-over (W. Sohst. *Das Spanische Bürgerliche Gesetzbuch: Text und Kommentar*, 2nd ed. Berlin 2003, comment on Article 350, p. 88, with references to Spanish case law).
- ¹⁵ J.C.W. Wylie. *The Land and Conveyancing Law Reform Act 2009: Annotations and Commentary*. Dublin 2009, p. 39, paragraph 33, with notes 51 and 54.
- ¹⁶ HR 15.1.2010, NJB 2010 No. 189 (a houseboat remains a movable thing even if it cannot move away under its own steam and can be towed away from its moorage by no more than only a few metres because a nearby bridge is too low to accommodate it; the boat does not even become an immovable if it is firmly connected to the local water and electricity supply).
- ¹⁷ Quite what satisfies the requirement for a firm connection can, in turn, be problematic in any individual case. In general, however, one will tend to demand the criterion—as, for example, the Czech Constitutional Court has (6.5.2003, ÚS 483/01, Šbírka nálezů a usnesení 30 (2003) No. 60, p. 107)—that the object not be removable from the ground without becoming damaged and that its connection with the ground withstand the normal forces thrown at it by the elements. A similar position is taken with the formulation in Article 334 (3) of the Spanish CC (‘Immovable things are: [...] everything that is firmly connected to an immovable thing such that it cannot be separated from it without destroying the material or damaging the object’).
- ¹⁸ In French academic writing, the point is rightly made that ownership of a *Grundstück* has as its subject matter a portion of the sovereign territory—namely, the ground—and the elements connected with it (J.-L. Bergel *et al.* *Les biens*. – J. Ghestin (ed.). *Traité de droit civil*, 2nd ed. Paris 2010, p. 188, paragraph 154). That ownership is not, however, confined to the ground. The delineation of the ‘goods’ need not occur merely in one plane. Rather, it presupposes a spatial representation of the three-dimensional volume that the *Grundstück* encapsulates. The parcel of the earth is only a horizontal cross-section of that space (*ibid.*, p. 191, paragraph 156; similarly, R. Savatier. *La propriété de l’espace*. Dalloz 1965, I, p. 213: ‘La surface ne peut servir qu’à porter et à soutenir un volume [...] l’immeuble ayant découpé la surface sur laquelle repose sa propriété doit nécessairement achever la représentation de celle-ci, en découpant, dans l’espace, le volume qu’il assoit sur cette surface’).

The image of the *Grundstück* as a cube (which would arise from a square ground plot) is, however, an illustrative simplification. That does not have anything to do with the curvature of the earth, which for the purposes of property law for the most part can in any case be disregarded, and nor has it anything to do with the fact that the formation of *Grundstücke* is not dependent on adherence to particular geometric figures; even in the two dimensions of the surface, *Grundstücke* need not possess straight boundary lines. Rather, the aspect of the distance of the upper and lower horizontal lines from the contours of the (notional) ground area is what cannot be expressed meaningfully for property-law purposes in numerical measurements. *Grundstücke* do not end anywhere within (for example) 200 metres above and 30 metres below the surface of the earth.^{*19} Such a rule would not make sense for property law, because it would be too inflexible. The monopolisation of powers over an individual's living space must be shaped effectively, of course, so that investment in *Grundstücke* is worthwhile, but it must not exceed the degree of exclusive control that is tolerable for the commonwealth. That forces each legal system to make difficult evaluations of competing interests. Quite how far the subject matter of an immovable property right should extend vertically can be determined (in contrast to the horizontal limitation) only in consideration of the nature of the ground, the permitted modes of use, the location, and the interest of the community in also using the relevant space. In consequence, *Grundstücke* 'taper off' in height and depth. They may vary in their height and depth for different purposes and in a manner depending on their location and features.^{*20}

6.3. Subject matter and right

This peculiarity of *Grundstücke* is put into words more easily and handled more practically if it is visualised not from the standpoint of the subject matter itself but from the perspective of the particular rights in *Grundstücke* that are allowed. Seen in that manner, the model works without exception. European legal systems continually change perspective so far as provisions determining *Grundstücke* are concerned. They substitute for the description of the subject matter *Grundstück* a restriction of the content of the property right permitted to subsist in respect of it. As a frame of reference they, for the most part, define the most extensive property right in a *Grundstück*—on the continent, civilian ownership. In doing so, they implicitly also give an affirmative answer to the question of whether the same concept of *Grundstück* is really fitting for all property rights; the efficacy of the so-called limited property rights too is specified according to its content and not according to the volume of the thing to which it refers. A mortgage has the same *Grundstück* for its subject matter as ownership or another property right does.^{*21} Were the law to proceed otherwise and assign each property right and its specific configuration by the parties to its own *Grundstück*, the legal position would become dramatically complicated. Admittedly, possession assumes a special role. If to some extent the law on possession recognises possession of a part, it also recognises subject matter distinct from that over which ownership and other 'genuine' property rights subsist; consequently, acquisitive prescription of parts of another's *Grundstück* is made possible.^{*22} However, this merely confirms that

¹⁹ National rules on permitted heights for flying over a *Grundstück* do not alter this at all. They do not entail any universally valid statement as to the spatial volume of *Grundstücke*; rather, they address in this context merely an issue of detail. In Great Britain, for example, under the rules on air-traffic control (S.I. 1985/1714, reg. 5 (1) (e)), an aircraft may not fly 'closer than 500 feet [approx. 153 metres] to any person, vessel, vehicle or structure'. Special rules provide for take-off and landing. See also *Bernstein of Leigh (Baron) v. Skyviews & General Ltd* [1978] QB 479, 487G, per Griffiths J (one cannot have the absurdity of a trespass committed every time a satellite passes over a suburban garden). Common law has, in fact, always recognised immunities for the benefit of operators of aircraft. They derive from instances having to do with the operation of hot air balloons (*Pickering v. Rudd* (1815) 4 Camp. 219, 220f, 171 ER 70, 71) and in modern law have a statutory basis in Section 76 (1) of the Civil Aviation Act 1982.

²⁰ One example among thousands is furnished by *Grundstücke* located in the Athenian suburb of Ymittos. In order to prevent critically adverse impact on the circulation of air into the city of Athens, residents of the suburb may only build houses with no more than two storeys. A *Grundstück* in Ymittos hereby encompasses a lesser space than does a *Grundstück* in another part of the city.

²¹ However, from the standpoint of some legal systems, the position is different if *Grundstücke* are 'merged'; in that case, an encumbrance burdening one of the original *Grundstücke* does not automatically extend to the new (larger) *Grundstück*. That legal outcome implies, however, that 'merger' of *Grundstücke* in such cases is a contradiction in terms. Conversely, if a *Grundstück* is partitioned, whether a burden remains for the new *Grundstücke* will depend on the nature of the encumbrance. § 1026 of the BGB, for example, provides: 'If the burdened *Grundstück* is partitioned, then, where the exercise of the real servitude is confined to a defined part of the burdened *Grundstück*, those parts that lie outside the area of exercise are freed from the servitude.'

²² See for the common law *Zarb v. Parry* [2011] EWCA Civ 1306, [2012] 1 WLR 1240 and from the extensive body of Italian case law, for example, Cass. 27.2.2008, No. 5134, Riv. notariato 2008, p. 1069; Cass. 13.12.2005, No. 27413, Juris data DVD;

everywhere possession oscillates between being a state of affairs and being a right. Since in England it is not *Grundstücke* that are registered but estates, some questions are posed there rather differently. Some property rights, such as rights of way and hunting rights, define their spatial reference points themselves, so to speak. Their outer boundaries are determined by the same rules that fix the outer boundaries of an estate. In other words, they are not tied to one or more *Grundstücke*; instead, they constitute independent units themselves.

The change in descriptive level from entity to ownership thereof is, admittedly, merely a dictate of practicability, but in theory it is not dishonest just because the existence of a thing is inseparably bound up with its capacity to be or become the subject matter of a property right; the notion of a thing is co-determined by the content of the property right. Hence, one may say that a *Grundstück* ends where the owner's entitlement to use ends—and that is the point from which the owner has no mere interest in user that is worthy of protection.

Because *Grundstücke* are conceived of as (normatively) demarcated spaces, minerals and other resources in the soil do not themselves constitute *Grundstücke*—even when, as seams of coal are, they are visibly set apart from other layers of earth. At best, they are immovables.

6.4. The formation of *Grundstücke* above and below the ground surface

Linguistically, the German word 'Grundstück' denotes *ein Stück des Grundes*—literally, 'a piece of ground'. A *Grundstück* is, accordingly, in the literal sense a surface, whereas a *Grundstück* in the legal sense is a space. To regard a *Grundstück* for the purposes of property law as a 'piece of ground' is to nurture a false conception of the 'corporeality' of *Grundstücke*. That point, together with the fact that nowhere today must 'ground' and 'building' necessarily be united in the same hands, makes it possible for space above and below the surface of the earth also to be regarded as *Grundstücke* for the purposes of property law, if the latter ascribes to them an independent capacity to be the subject matter of property rights. What is indispensable is merely the proposition that things designated as *Grundstück* must be firmly connected to the surface of the ground. All other aspects, in contrast, are merely a question of the effectiveness of juridical concepts. A spatial understanding of the concept of *Grundstück*, applied consistently, could appreciably lighten the load in the conceptual toolbox of property law.

Since all legal systems of Europe migrated (once more) towards the idea that at least certain parts of buildings—sometimes even entire buildings and other edifices constructed by humans—are to be regarded as distinct entities in property law, they have in essence effected a separate formation of *Grundstücke* in the space lying above and below the surface of the ground. In this manner, flats and other artificial spaces have normatively been rendered independent things. An obvious step is to regard them as *Grundstücke* on the basis that, in accordance with the provisions of the relevant legislation (e.g., on opening of a separate land registry file), they are separated from the other flats in the same building. The same applies to whole houses, individual storeys, cellars, and even naturally occurring subterranean spaces. Wherever ownership of *Grundstücke* is divisible horizontally as well as vertically, one must also tackle the question of which entities arise on account of the horizontal division. In terms of property law, they can only be *Grundstücke* in their own right.

Trib. Napoli 19.10.2005, Giur. Merito 2006, p. 1696; Cass. 24.5.2004, No. 9913, Juris data DVD; Cass. 11.6.1998, No. 5809, Mass. Giust. civ. 1998, p. 1287; Cass. 1.3.1995, No. 2332, Mass. Giust. civ. 1995, p. 480. The defence of *usucapio* (*eccezione di usucapione*) is typically raised in Italy in an action for adjustment of the boundary (*actio finium regundorum*); it requires complete and exclusive possession of part of the area (Cass. 24.5.2004, *loc.cit.*; Cass. 3.5.1993, No. 5115, Mass. Giust. civ. 1993, p. 800). German law recognises the possibility of partial possession of things in §865 of BGB. Any spatially delineated part of a thing can be the subject matter of partial possession, including, for example, a garden area or a parking space on another's *Grundstück* (MünchKomm [-Joost], BGB, Vol. VI, 5th ed. Munich 2009, §865, paragraph 3). Whether by means of partial possession it is possible to acquire an integral part of another's thing prescriptively (as advocated by Soergel [-Marly]), BGB I, 13th ed. Stuttgart, Germany 2000, §93, paragraph 25) is, however, disputed (J. von Staudinger [J. Jickeli, M. Stieper. *Bürgerliches Gesetzbuch*. Berlin 2004, §93, paragraph 32). Under Article 1045 of the Greek Civil Code, in contrast, it is unproblematic for a neighbour to acquire ownership of part of an adjacent *Grundstück* by means of extraordinary *usucapio*. This presupposes 20 years of proprietary possession without interruption (Areopag. 980/2007, Isokrates database). The part of the *Grundstück* in dispute must be fenced off (e.g., Appeal Court of Larissa 894/2006, Isokrates Database; Areopag. 623/1999, Isokrates database) or determined with sufficient precision in some other manner. Where the nature of the ground rules out other possibilities, even continual exploration and monitoring of the land may suffice (Areopag. 1430/1992, Isokrates database; see also Areopag. 757/2008, NoB 56 [2008], p. 2450).

6.5. Formation of *Grundstücke* by partition of land

A *Grundstück* has to be individualised if it is to be able to discharge its function as a thing. The individualisation is effected by partition of the land in accordance with the rules of the law. In all systems, those rules invoke the geometric figure of the two-dimensional area. Information about its size in square metres is not in itself sufficient to identify that area.^{*23} What is needed instead is its contours and its fixation by points of reference^{*24}; the fewer the demands a legal system makes regarding the form of a *Grundstück* and the more irregular its contours may be, the more such points of reference are needed. The area projected onto the planet by the contours and points of reference remains for its part a merely notional construct. That is hardly reflected in everyday speech, of course: in rural settings, people often speak of their 'area' when they mean their *Grundstück(e)*. In that case, spatial connotations reverberate in the word 'area'. It also enjoys an echo in the law, because if one knows the contours and the position of a *Grundstück*, one can set about defining the space that said *Grundstück* fills. The circumstances in which *Grundstücke* arise in Europe do not appear to have been grasped in all their details; it remains a task of comparative legal historical research to shed light on the subject.^{*25} Two basic models come into question. It is conceivable that at the start there was an occupation of parcels of land by earlier inhabitants and immigrants—made manifest to all and sundry by some means or other and, at any rate, accepted later by the legal system. However, it seems more realistic to suppose that at the beginning of the aeon that has moulded our present-day law, land was allocated to its users under a hierarchical feudal system of grants with the nature of a franchise: a legal transaction as a matter of form but an act of sovereignty as a matter of substance. In England, the consequences of this model are still palpable to this day.^{*26} In the allocation of landed estates for the grantee's own use, the first step was completed towards the formation of *Grundstücke*. The smaller the sub-units became, the more precisely the course of the border had to be marked out. A *Grundstück* was identified in that allocated parcel of land as soon as the legal system furnished the private rights referable to it with *erga omnes* effects and permitted their transfer. Formation of *Grundstücke* and recognition of ownership of land went hand in hand: in allowing ownership of land, one created *Grundstücke*; in creating *Grundstücke*, one made ownership of land possible. In contrast, the formation of *Grundstücke* and the substance of ownership are not interwoven: the emergence of *Grundstücke* does not presuppose a notion of ownership that has a civilian character—that is, a concept in which the right of ownership is perpetual and indivisible. There is nothing in the internal logic of property law that compels one to deploy an identical right of ownership across all types of things; it is only necessary that each of those rights of ownership specify the subject matter of the right.

²³ Tellingly. According to TS 12.5.2010, RAJ 2010 No. 3692, p. 10570, an action for vindication under Article 348 of the Spanish CC may only be raised once the thing in question is individualised—with the aid of, among other things, precise specification of the surface area by means of the four cardinal points, such that the lay of the thing is fixed. Accordingly, a site plan is required. It is not sufficient for the purposes of Article 348 CC to invoke a right of ownership of a ground area with a specified size in square metres. See also the Czech Supreme Court 23.1.2002, 22, Cdo 96/2000, Soubor civilních rozhodnutí Nejvyššího soudu C 987 (even for the purposes of acquisitive prescription, a *Grundstück* must at least 'show' itself) and OLG Frankfurt/Main 28.1.1985, MittRhNotK 1985, pp. 43, 44 (one cannot 'conceive of ownership of a *Grundstück* differently from ownership of a defined area of the ground').

²⁴ For example, Areopag. 1170/2011, Isokrates database (contracts pertaining to *Grundstücke* must state the exact measurements of the *Grundstück*, the boundaries of the *Grundstück*, and the names of the neighbouring owners, and they must be notarised; furthermore, a topographical plan of the *Grundstück* is required, which depicts the *Grundstück* in the context of its neighbouring *Grundstücke* and the road layout and shows not merely the form of the *Grundstück* but also its exact location, direction, and area, and this plan must be notarised (a cadastre exists only for the Ionian Islands and the Dodecanese—that is to say, for the areas that were conquered by Napoleon and intermittently had their own civil codes; there, the parties can make do with a reference to the entry in the cadastre)) and J.L. Bergel *et al.* (see Note 18), p. 193, paragraph 157 (the separation of ownership of an immovable begins with the demarcation of the ground area by charting of the parting line with the adjacent *Grundstücke*). The English system works with a so-called title plan—that is, a contour based on the Ordinance Survey maps. Such a plan is required for the registration (Land Registration Rules 2003, SI 1417, r. 5 (a)). An official illustration can be found at http://eservices.landregistry.gov.uk/www/wps/QDMPS-Portlet/resources/example_title_plan.pdf; for details, see the Land Registry's Practice Guide 40 (22 June 2012) and its supplements (<http://www.landregistry.gov.uk/professional/guides/practice-guide-40>), particularly Supplement 5 (on title plans).

²⁵ Broadly to the same effect, see P. Grossi. *La proprietà e le proprietà nell'officina dello storico*, Quaderni fiorentini XVII (1988), pp. 359, 394 ff. See also C. Castronovo, S. Mazzamuto. *Manuale di diritto privato europeo*, Vol. II: Proprietà obbligazioni contratti. Milan 2007, pp. 28–31.

²⁶ Traces of this can, of course, be identified in other legal systems. The Greek state, for example, has remained a sort of superior owner of the so-called *Vakúfia*. These are areas that were not in private ownership within the Ottoman Empire and that served religious purposes instead or belonged to the general public or community. Under the terms of the London Protocol of 3.2/22.1.1830, the newly created Greece accepted the usufructuary and administrative rights of the Muslim population in respect of these areas; the state became their superior owner (among other items from the case law addressing this, see Areopag. 454/2011, NoB 59 (2011), p. 2177; Appeal Court of Larissa 384/2011, Isokrates database).

6.6. Changes in the *Grundstück's* make-up

Save for special restrictions on dealings, the formation of a *Grundstück* is bound up with the possibility of transfer and acquisition of ownership of it. *Grundstücke* are not, however, entities that are fixed for all eternity. Their aggregate number can be increased by partition and sometimes may even be reduced by merger. With *Grundstücke*, such processes are, of course, clearly more complicated than with real things. To achieve the same effect with real things, one need only break them up, take them apart, or assemble them in such a way that a new commodity comes into being. In each case, a merely physical occurrence suffices to bring about a new object capable of being owned. *Grundstücke*, in contrast, are normative things, and, therefore, their partition and merger too are normative processes. The mere planting of a hedge, digging of a ditch, or building of a wall do not make two *Grundstücke* out of one; nor does the removal of the hedge or wall or the filling in of the ditch make one *Grundstück* out of two—not even when they have the same owner.^{*27}

The merger of *Grundstücke* is a comparatively rare occurrence. Typically, the underlying reason lies outside property law and also, accordingly, the mechanisms are often just as extraneous. The most frequently cited example is the merger of *Grundstücke* in the course of intervention by public authorities acting under statutory powers so as to effect a consolidation or re-parcelling of land. A more difficult question to answer is whether *Grundstücke* can also be merged through the exercise of a right of ownership subsisting in relation to them. That is because a 'merger' of *Grundstücke* effected at the initiative of their owners is unproblematic from a property-law point of view only if it is related to two hitherto completely unencumbered *Grundstücke*—in which case, from the isolated standpoint of the right of ownership, the merger is also meaningless. It is undertaken merely to simplify what has become a complicated set of entries in the land register or in order to satisfy the demands of planning law, which requires a specified minimum area of ground for the construction of a building. One may maintain, therefore, that the consolidation of two *Grundstücke* is always a process that is prompted by 'externalities'; it always follows the internal logic of re-parcelling of land and never the logic of property law. Such a process can certainly cause appreciable difficulties for property law if, for the purposes of obtaining planning permission, *Grundstücke* have to be consolidated that are already burdened with rights of third parties. If a union of two *Grundstücke* is not precluded precisely because of that complication or at least made dependent on the agreement of the creditors about the priority of their rights in respect of the new *Grundstück* that is to emerge,^{*28} the law must itself decide what is to happen with the encumbrances burdening the original *Grundstücke*.

It is comparatively easy to interpret the partition of *Grundstücke* coherently in property-law terms. A partition of *Grundstücke*—if it is not the consequence of action by a public authority under public law (such as a compulsory acquisition)—results either from the fulfilment of a requirement in a norm of property law that provides for the acquisition by operation of law of parts of a *Grundstück* or from an exercise of the right of ownership of the *Grundstück* being partitioned that is dependent on the participation of others. The law on acquiring ownership by operation of law has the effect of creating new *Grundstücke* primarily by virtue of its rules on prescription. Moreover, many legal systems count their law on good-faith acquisition as within this domain. In some places at any rate, on the assumption that there is an appropriate system of land registration in place, those land-registration rules may also effect the creation of new *Grundstücke*.^{*29} Under

²⁷ Occasionally, of course, there is dispute as to whether, where two adjacent areas belong to the same owner, there is not already a single immovable. The Polish Supreme Court 30.10.2003, IV CK 114/2002, OSNC 2004/12/201, Biul.SN 2004/12/6 answered this question in the negative. Neighbouring *Grundstücke* that are owned by the same person but have different registrations in the land registry remain different immovables for as long as they are not joined in a single land registration. The Polish Supreme Court 27.12.1994, III CZP 158/94, OSNC 1995/4/59 took the contrasting view that an immovable is an area that is owned by a holder of rights and that is enclosed externally by *Grundstücke* belonging to other holders of rights; the position with regard to the land registration is immaterial.

²⁸ Under Article 22 (2) of the Polish Land Registration and Mortgages Act, land that is burdened with limited property rights can only be merged if the persons entitled to do so agree on the priority of these rights over the land that arises out of the merger. In the Czech Republic, almost every merger (and every partition) of *Grundstücke* requires the permission of the local planning authority. Permission must be applied for by all owners of the *Grundstücke* involved, under §77 in conjunction with §82 (2) of the Planning Law, 183/2006, as quoted in the *Czech Law Gazette*—the result is a 'planning decision' (*územní rozhodnutí*). Only *Grundstücke* of the same kind can be merged; one cannot unite a garden with a field. Above all, §4 (7) of the Katasterverordnung (26/2007 in the *Czech Law Gazette*) must be heeded: 'It is not allowed to merge parcels or parts of parcels for which there are diverse statements of rights or diverse statements related to rights. Parcels and parts of parcels for which a real burden is registered, the extent of which is recorded in a geometric plan, constitute an exception.'

²⁹ In France, for example, the publicity of the register in cases associated with *Grundstücke* (*publicité foncière*) makes it possible to identify a *Grundstück*. That is because the register of immovables (*fichier immobilier*) established in 1955 facilitates the

German law, for example, public faith in the land register (see §892 of the German BGB) is related to not merely the property rights it records but also even the very existence of the *Grundstück* that is registered.^{*30}

Continuity of pre-existing encumbrances poses a far less acute problem in relation to partition, as opposed to merger, of *Grundstücke*. That is because the universal principle is for encumbrances of the original *Grundstück* to continue in relation to the newly constituted *Grundstück(e)*.

7. The formation of *Grundstücke* and the character of the ground

The character of the surface of the earth that belongs to the *Grundstück* is, as a rule, irrelevant for the actual formation of the *Grundstück*. The subject matter may be either an urban space or a rural one; equally a *Grundstück* can consist of a building plot, arable land, meadowland, woodland, or waste land, and it may lie in the hills or on the plains. The surface of the ground is inconsistent with the capacity of its parts to be the subject matter of property rights only if the physical character is such as to cause the legislator to reserve land of the relevant type for state ownership or in some other way render it *extra commercium*. Statutory provisions that prohibit the partition of agricultural or forestry land into units below a set minimum size ultimately have the same effect. That is because such rules boil down to the rule that agricultural land and forestry land must be of at least the given minimum size if they are to qualify as the subject matter of property rights. In all other cases, however, the classification of *Grundstücke* according to the character of the surface of the ground is material only with respect to the type of property rights possible for use of that land.^{*31}

search for an existing *Grundstück* by means of various registers—namely, a personal register for every holder of a property right in an immovable, a register for every immovable, and a register of parcels (which encompasses multiple pools of owned parcels on the basis of the cadastre). In France, the publicity in cases related to *Grundstücke* has only a declaratory effect. It has no significance for the relationship between vendor and purchaser or for the question of transfer of ownership between them. The statements in the register serve merely to protect a third party who has acquired competing rights from the same transferor (L. Aynès, P. Crocq. *Les sûretés: La publicité foncière*, 5th ed. Paris 2011, p. 287, paragraph 634). This follows from Article 30 (1) of Decree 55-22, of 4.1.1955, on the reform of publicity in matters related to *Grundstücke* ('Décret n° 55-22 portant réforme de la publicité foncière'). *Inter vivos* dispositions of *Grundstücke* that are not registered are effective only against those third parties who acquire competing rights to the same *Grundstück* from the same transferor on the basis of transactions that require registration. Publicity has the function, moreover, of furnishing the administration with information about the relevant *Grundstück*. The legal position in Belgium conforms to the same model in all essential respects. Registration is not a requirement for the effectiveness of the transaction with regard to the relationship between the parties *inter se*. Registration in the register (*transcription*) is necessary only in order to confer effectiveness on the transaction with regard to third parties (Article 1 of the Law of 16 December 1851 on the Revision of the System of Hypothecs, or the *Loi sur la révision du régime hypothécaire*; for details, see M. Grégoire. *Publicité foncière, sûretés réelles et privilèges*. Brussels 2006, p. 40, paragraph 125). Things are exactly the same under Article 2644 of the Italian CC:

The legal transactions listed in the previous article are not effective against third parties who, on whatever legal basis, have acquired rights in respect of the immovable on the basis of a registration effected before the registration of those legal transactions. After registration [of those transactions], a [later] registration of rights acquired from the predecessor in title [of the party first registering] can have no effect as against the party first registering, even if the acquisition [by the party registering later] is referable to an earlier date.

³⁰ BayObLG 6.2.1981, MittBayNot 1981 pp. 125, 126; BayObLG 11.5.1995, MittBayNot 1995, pp. 291, 293 ('The public faith in the register also extends to the fact that the registered *Grundstück* legally exists as such') and also OLG Frankfurt 28.1.1985, MittRhNotK 1985, pp. 43–44 ('Since one cannot conceive of ownership of a *Grundstück* other than in relation to a defined area of the ground, the registration of the area of the *Grundstück* belongs to the part of the content of the register that maps to the public faith in the register'). For further details, see J. von Staudinger (-Gursky), *Bürgerliches Gesetzbuch*. 2008, §892, paragraph 33.

³¹ Article 204 (1) of the Portuguese CC expressly includes as immovables, among other things, 'the agricultural and the urban' *Grundstücke* and, moreover, the 'waters' (and Article 204 (2) of the Portuguese CC elaborates on what is meant by an 'agricultural' or 'urban' *Grundstück*), but this terminology taken from Article 374 of the Portuguese CC of 1867 has been retained only for tenancy-law and tax-law purposes (Pires de Lima. *Das coisas*. – *BMJ* 91 (1959), pp. 207, 211; Pires de Lima, Antunes Varela. *Código Civil Anotado: Artigos 1.º-761.º* (Vol. 1), 4th ed. Coimbra, Portugal 1987, comment 3 on Article 204, p. 196; on tax law, see also A. Menezes Cordeiro. *Tratado de direito civil português*, Vol. I: Parte geral. Part 2: Coisas, 2nd ed. Coimbra, Portugal 2002, p. 127). To escape the difficulties in distinguishing between a *prédio rústico* and a *prédio urbano*, tax law has recently adopted the notion of the mixed *Grundstück* (*prédio misto*). In the private-law context, however, that too is of no importance (J.A.C. Vieira. *Direitos reais*. Coimbra, Portugal 2008, p. 160). In Italy, the position is no different, although there legislation distinguishes between agricultural (Article 846 ff. of the Italian CC) and urban (Article 869 ff. of the Italian CC) immovables. The reason for this distinction is entirely a public-law one. Whilst the Spanish Civil Code does not draw a distinction between *fincas rústicas* and *fincas urbanas*, the matter is addressed in case law and scholarly writing. It hinges on the locality where the *Grundstück* is situated and, moreover, on, among other things, the area's population density, the existence of surrounding development, and the current use (W. Sohst (see Note 14), comment on Article 1523,

Where, additionally, special modes of acquisition fall to be considered, that is typically not a matter of property law but rather of public-law requirements to obtain consent. A more precise analysis is called for only for those spaces whose visible surface is partly or completely filled with water. In those cases, a distinction has to be drawn along several lines—in particular, according to whether the water is flowing or static and, furthermore (in either case), whether the water falls under a regime of public law or of private law. However, consideration of that aspect of matters cannot be developed further within the confines of this contribution.

8. Grundstücke, not immovables

There remains the question of the relationship between ‘Grundstücke’ and ‘immovables’ (‘immovable things’). Of course, one might take the view that all is entirely the same whichever word one uses to denote the parts of the planet Earth that are capable of being the subject matter of property rights—be they *Grundstücke*; immovables (or immovable things); or, to borrow from the title of Alfred Ross’s immortal article on legal realism, simply ‘tû-tû’.³² A fair number of jurists thus regard ‘Grundstücke’ (or, more precisely, the relevant national language’s word for a parcel of land) and ‘immovable’ to be one and the same.³³ That is true even for many in Germany, where the BGB takes pains to avoid the notion of an ‘immovable thing’ and refers only to ‘Grundstücke’. In recognising ‘movable things’, the BGB also implies its counterpart—the ‘immovable thing’—even though it uses the term ‘Grundstücke’.³⁴ While that might be so, it does not resolve our difficulty. That difficulty, moreover, is not a mere consequence of the fact that other legal systems regard the *fonds de terre*, *tierras*, or whatever they may be called as only a subset of immovables (such that every plot of ground is an immovable but not every immovable is ground) while the common law manages to avoid both concepts and makes do with ‘land’. In their essence, they all display the same weakness. They classify entities according to a criterion that is of relevance to property in, at best, secondary contexts; in other words, they tackle the secondary question before the main one. The first question, which alone is the focus of this contribution, is this: what exactly is the specific subject matter of an exclusive right of use of the ground? That question is not answered by the term ‘land’ or ‘immovable’ (referring to *immeuble* or *unbewegliche Sache*); someone who actually equates immovables and *Grundstücke* merely swaps words without advancing the substance of the matter one jot. This is because one might perhaps say that the surface of the ground, a house, a body of water, a farm animal³⁵, or a right over another’s *Grundstück* is ‘land’ or an ‘immovable’ but not that they are *Grundstücke* in the sense that, in our view, matters.

pp. 263–264). Not all of the *Grundstücke* in the countryside are *fincas rústicas*, and not all *Grundstücke* in urban areas are *fincas urbanas* (R.M. Roca-Sastre *et al. Derecho hipotecario*, 9th ed. Vol. III. Barcelona 2008, pp. 203–210). The owners of neighbouring *Grundstücke* enjoy under Article 1523 (1) of the Spanish CC a right of pre-emption in respect of a *finca rústica* that is no larger than a hectare and is actually used for agriculture (details can be found in the Law on the Modernisation of Agricultural Development (Law 19/1995, of 4.7.1995, ‘Ley de Modernización de las Explotaciones Agrícolas’); see M. Eberl, B. Selbherr, *Immobilienrecht in Europa: Spanien*. – S. Frank, T. Wachter, *Handbuch Immobilienrecht in Europa*. Heidelberg, Germany 2004, pp. 1391, 1407). Finally, the Roman-law distinction between agricultural land (*praedia rustica*) and town land (*praedia urbana*) survives also in some of the provisions of the Greek Civil Code (e.g., in its Articles 619, 620, 1024, 1029, 1162, and 1163). Town land is land that by custom or law is destined to be built or rebuilt upon, irrespective of whether or not it has already been built on (Areopag. 498/1953, NoB (A) 1953, p. 855; Areopag. 632/1967, NoB 16 [1968], p. 239; Areopag. 1793/2006, ArchN 2007, p. 582) and regardless also of the public-law planning on land use. Agricultural land serves the cultivation of fruits (Areopag. 534/1956, NoB 5 [1957], p. 184; Areopag. 632/1967, *loc.cit.*; Areopag. 506/1965, NoB 14 [1966], p. 425). However, the distinction enjoys only limited significance in a purely property-law context—e.g., where the question is who the direct possessor of the *Grundstück* is. That is because the question of whether a person exercises normal control over the *Grundstück* depends on whether that person undertakes the actions corresponding with the nature of the land (C.L. Kousoulas, *Empragmato Dikaio*. Athens and Thessaloniki 2004, p. 138).

³² The article, originally written in Danish, has been published at least three times: in the *Festschrift for Henry Ussing* (Copenhagen, Denmark 1951), pp. 468–484; in *Scandinavian Studies in Law* 1957, pp. 138–153; and in *Harvard Law Review* 1956–57, pp. 812–825.

³³ This is the position under Article 18 (1) of the Slovenian Property Code (*SPZ*) (on which see M. Tratnik, *Das neue slowenische Sachenrecht*. – *WGO Monatshefte für Osteuropäisches Recht* 45 (2003), pp. 94, 99); under §119 (2) of the old Czech Civil Code (of 1964) and §498 (1) of the new one (of 2014); and in numerous other countries, such as Sweden, where *fastighet* and *jord* are only rarely sharply distinguished (in *Svenska Akademiens Ordbok*, at <http://g3.spraakdata.gu.se/saob/>, however, ‘jord’ appears as a term denoting the object of ownership of land).

³⁴ For example, Staudinger (–Jickeli/Stieper), BGB (2004), preliminary comment on §§ 90–103, paragraph 37 (‘Immovable things are *Grundstücke*, including their integral component parts’).

³⁵ E.g., Article 524 of the French, Belgian, and Luxembourg civil codes. See also Article 334 (6) of the Spanish CC (wherein facilities for breeding animals and beehives count as immovables if connected to a *finca*, though the animals themselves do not).

The notion of an immovable thus extends appreciably further than does the notion of a *Grundstück*. There is an almost endless number of objects that, though not *Grundstücke*, are classified by national legal systems as immovables.³⁶ In using the term '*unbewegliche Sache*', '*immeuble*', or '*land*', the relevant national terminology does not encapsulate the proposition that these items are the potential subject matter of property rights effective against third parties. Astonishingly, there does not appear to have been a word created, to this day, for that attribute that is cut out for Europe. We believe that '*Grundstück*' can fill that gap, as it conceptually grasps the object individualised by the legal systems in respect of which a person asserts a right when he claims to be the land-owner. 'Immovables' ('immovable things') is a general category no different from categories such as 'generic goods', 'fungibles', and 'consumable goods'. A legal system or a juridical dogmatic framework deploys them for purposes different from those for which we propose using the term '*Grundstück*'. The notion of immovables as currently embodied in most of the legal systems that invoke it is concerned with certain issues consequent from the formation of *Grundstücke*, such as the modes of acquisition and the transfer of rights that must be registered, or with articulating the proposition that a person who has a right of use of another's *Grundstück* or a power of sale over it may also have resort to possessions of the debtor that serve husbandry of the land. Naturally, such rules have to be developed separately, not merely as between distinct types of property rights and, in a European context, moreover, from one legal system to another.³⁷ Furthermore, there may be a need to distinguish not between movables and immovables but, rather, between registered things and things not required to be registered (as Article 3:10 of the Dutch Burgerlijk Wetboek does). More important, however, is that such rules always presuppose another—namely, that the relevant legal system permits and facilitates the excision of entities from the land that are capable of forming the subject matter of property rights. The 'movable'/'immovable' dichotomy therefore fails to hit the essential target.³⁸ A 'movable' is capable of being owned not because the object is movable (running water and dockside rail-mounted gantry cranes³⁹ are movable) but, rather, because it is spatially separated from other objects and, therefore, as a real thing, capable of being exclusively assigned to a party. An 'immovable', in contrast, is not by nature a thing; it only becomes a thing when it assumes the form of a *Grundstück*. Categorising things as 'movables' rests on a fuzzy concept, though, for the most part, the repercussions are not especially disruptive. If, however, one contrasts 'movables' against 'immovables' and moulds the latter into its own legal category, the fuzziness snowballs into a serious conceptual problem.

³⁶ A further example is furnished by Article 334 (7) of the Spanish CC, where even the 'fertiliser that is destined to supply a landed estate' is immovable, provided that it is 'on the premises where it is to be applied'.

³⁷ There is not merely any guarantee that the distinction between movable and immovable follows the same rules everywhere. It is also not guaranteed that they achieve the same purposes. The Spanish CC, for example, in its systematic structures attributes to the differentiation between movable and immovable things far less significance than the German and the Italian codes do (L. Díez-Picazo, *Fundamentos del derecho civil patrimonial*, 5th edition, Vol. III: Las relaciones jurídico-reales, el registro de la propiedad, la posesión. Madrid 2008, pp. 203, 206). Moreover, unconsidered invocation of the definition of a *Grundstück* as an immovable may lead to irritations even within a single legal system. Díez-Picazo dryly observes (*ibid.*, p. 212) that it is not imperative that there be a requirement of judicial approval when a minor wishes to sell a dovecot and that a disposition of a dovecot by an adult be able to be effected only by means of notarised writing (*escritura pública*) merely because Article 334, item 6 of the Spanish CC treats a dovecot placed on a *Grundstück* as an immovable.

³⁸ That is evident in how one and the same thing can be at the same time both movable and immovable in some legal systems. That is the case not only in France but also, for instance, in Spain. TS 21.12.1990, RAJ 1990, No. 10359, p. 13270, for example, had to do with a dispute about the realisation in money of irrigation systems that had been sold but were on a *Grundstück* burdened with a hypothec. The court accepted that, by force of the agreement, the hypothec extended to the irrigation systems. On the one hand, they were movable goods under Article 111 of the Mortgage Act (Ley Hipotecaria, LH), but at the same time also (as accessories) *inmuebles por destinación o pertenencias*. Given this background of a dual characterisation of such things, scholarly writing has been forced to distinguish between 'genuine' and 'improper' immovables and has noted that the Spanish CC, in contrast to the French civil code, does not state that all things are either movables or immovables; it only states that they are to be regarded as either movables or immovables (L. Díez-Picazo, *op cit.*, p. 210). However, this does not necessarily make matters appreciably clearer.

³⁹ According to Dutch and Belgian case law, however, these are also 'immovable' things (HR 24.12.2010, NJB 2011 No. 199; Cass. 14.2.2008, Pas. belge 2008 No. 110, p. 440).



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The Scandinavian Approach to Property Law, Described through Six Common Legal Concepts

1. Contribution to the European project?

It is interesting to see other lawyers' reactions when they encounter the Scandinavian approach to property law.^{*1} In fact, it is interesting to see the reactions of Scandinavian lawyers when they realise that we have an approach that others react upon. One purpose with this article is to provoke more of these reactions. Ideally, doing so could lead to some reflections on what we all do as property lawyers. The Scandinavian approach is not only a matter of legal culture. It also brings a perspective that can be useful for the understanding of law and what law is. In a time of far-reaching internationalisation of law, thoughts such as these can be rather helpful and contributing. One example of this is that the Scandinavian approach to property law played a role in the Draft Common Frame of Reference (DCFR) project. The approach served as a work method in development of the DCFR rules on transfer of ownership.^{*2}

Regardless of the methodological contribution, the DCFR rules did not come to share the characteristics of the Scandinavian approach.^{*3} This illustrates that the approach can be of use while not governing all choices. For avoidance of misunderstanding, it might be necessary to stress this fact.^{*4} I am not a prophet proclaiming the Scandinavian approach better than others. My ambition with this article is just to explain a perspective on property law that, in the ideal case, might contribute with some reflections on what we all do as property lawyers.

One thing that property lawyers do is to involve objects in their argumentation. Property objects are, for obvious reasons, important in property law. All objects are however, conceptual. Therefore every property lawyer faces the risk of employing conceptual logic, for better or worse. The preference in the Scandinavian approach is very much against conceptual logic. A very general description of the Scandinavian approach is that it is relational to a fairly great extent. Scandinavian property lawyers deal with relations and keep each

¹ I have illustrated some typical reactions in C. Martinson. *Ejendomsrettens overgang – Norden kontra verden*. Nordiska Juristmötet 2008. See <http://jura.ku.dk/njm/38/martinson-claes/>.

² W. Faber. Overview of content and methodology: Book VIII of the DCFR. – *The Edinburgh Law Review* 2010 (14)/3, p. 502.

³ The DCFR uses a unitary structure; see Book VIII, Article 2:101 and 2:201.

⁴ It is, of course, up to the reader to judge what I do. See, for example, the reasonable opinion of Professor G.L. Gretton. Review. – *The Edinburgh Law Review* 2009 (13), p. 170. For whatever the knowledge of it is worth, my intention is sincerely what I say it is.

of them apart without connecting a solution of one problem to the solution of a problem in another relation. We also think that context matters. This has effects on how we use legal concepts.

It is not self-evident how the Scandinavian approach should be presented. As I have mentioned above, Scandinavian lawyers do not have a general notion of having a particular approach. That is not a topic in the legal education, nor has it been a theme in legal research. The fact that the approach stems from legal theoretical discourse in 1900–1975 does not mean that there is any description of an approach as such. What I do here is to construct such a description. I have done this from a general analysis of legal argumentation in Scandinavia, and primarily the Swedish argumentation. My description depicts the Scandinavian approach in a rather consequent and distinct way.

I have chosen to do my presentation by using concepts in a way that I hope can function as common ground. This is not only to aid the reader, but also to allow some comparative remarks. Each of the following sections deals with a legal concept that is more or less familiar to quite a few lawyers. The concepts are ownership, transfer of ownership, unjustified enrichment, the coming into existence of a claim, *accessio*, and *traditio*.

2. Ownership

To explain the Scandinavian legal approach to ownership, I like to use a recent case from the European Court of Human Rights, in Strasbourg: the case *Gillberg v. Sweden*, from April 2012.⁵

Gillberg is a university professor in child and adolescent psychiatry.⁶ He and his team conducted a lengthy large-scale study of pre-school-age children that looked at hyperactivity and attention-deficit disorders in children (ADHD and DAMP). Gillberg had promised confidentiality to the volunteers in the study, since the research involved a very large quantity of privacy-sensitive data on the children and their relatives. This became a problem after the study was finished and the results presented in several books and articles. Two people, a researcher in sociology and a paediatrician, wanted access to the research file. They claimed support for this claim in Swedish legislation on public access to official records.⁷ Gillberg refused to give them access, because of the promise of confidentiality. He refused even though the Administrative Court of Appeal had decided that he had to grant access. It made no difference that the vice-chancellor of the University of Gothenburg's threatened to bring him before the Public Disciplinary Board if he did not. Gillberg's team of researchers supported him, and the research file was never revealed. Three of Gillberg's colleagues destroyed it. Since it was voluminous, this took several days.

Gillberg was convicted for misuse of office under Chapter 20, Article 1 of the Swedish Penal Code. So was the vice-chancellor of the university, since he had failed to ensure that the documents were available for release.

Professor Gillberg sued Sweden before the European Court of Human Rights in Strasbourg. He claimed that he had a right under Article 8 of the Convention for the Protection of Human Rights and Fundamental Freedoms not to impart confidential information and that this right had been breached by his criminal conviction. He also claimed that he had a negative right, within the meaning of Article 10 of the convention, not to supply the disputed research material.

The above is but a brief description of the case, but it is enough for an understanding of what the judges did in their decision. From a Scandinavian approach to law, the judges developed very surprising reasoning. What they did was to use the concept of ownership to decide the case. They said this:

“... the crucial question can be narrowed down to whether the applicant, as a public employee, had an independent negative right within the meaning of Article 10 of the Convention not to make the research material available, although the material did not belong to him but to his public employer, the University of Gothenburg, and despite the fact that his public employer—the university—actually intended to comply with the final judgments of the Administrative Court of Appeal granting K and E access to its research material on various conditions, but was prevented from so doing because the applicant refused to make it available. [...] In the Court's view, finding that the applicant

⁵ *Gillberg v Sweden*, 41723/06, Strasbourg, 3 April 2012.

⁶ http://en.wikipedia.org/wiki/Christopher_Gillberg.

⁷ Tryckfrihetsförordning (1949:105), Chapter 2.

had such a right under Article 10 of the Convention would run counter to the property rights of the University of Gothenburg.*⁸

From a Scandinavian approach to law, this is indeed a remarkable way of reasoning. It is remarkable because ownership of the documents was not at all the issue. The issue concerned the interests that the parties had with respect to disclosure of certain information.

By bringing in the concept of ownership, the judges moved the attention away from the real issue.*⁹ What they say is the crucial question is an issue that has nothing at all to do with the real interests behind the conflict. In their crucial reasoning, they decide the case by referring to a different set of interests. This effect is amplified by the fact that the judges actually consider ownership of the physical objects. They change the object of the conflict from the information into the papers.

The judges make their decision by employing clear simplification. This can be illustrated by the question of whether the decision would have been different if Gillberg had himself provided all of the paper material needed for the study and kept all of the documents produced at home. Since academic projects in medicine are often carried out in co-operation with private companies, something of this sort could easily have occurred. The question therefore shows that such simplified reasoning can lead to haphazard results. From the Scandinavian perspective, it is important to avoid haphazard results and reasoning divorced from the real interests at hand. In that view it is seen as too simplistic to reason with conceptual logic as the Strasbourg judges did. The legitimacy of a decision should proceed mainly from the strength of the argumentation, not from formal authority alone.

With the Scandinavian approach the concept of ownership would not have been used in construction of the solution. In addition the Strasbourg judges' reasoning would have been excluded also for another reason. Their reasoning lacked assumptions as to the consequences of the normative implications, and such assumptions are important in Scandinavian argumentation. The possible consequence of academic researchers in future using private papers for their academic projects would have formed part of a valid argument. The judges would then have contemplated whether this would open an easy way to avoid public access. If so, the decision could well have been that ownership of the papers is of less importance than public access. In the Scandinavian approach, legal issues are to be resolved not only by means of the norms and the concepts but also through striking a balance between the interests behind the norms and concepts. Taking the possible consequences into account is one of the ways to assure that such a balance is striven for and that the underlying interests are not forgotten.

The Strasbourg judges' decision also illustrates the extent to which legal reasoning can lack consideration of the interests behind the concepts. The decision is truly remarkable in this sense, especially in view of the purpose of the Strasbourg court. The court should have been deciding on the limits for protection of some interests of individuals versus the state. In this specific court, the concept of ownership is, by convention, used to grant individuals protection against the state.*¹⁰ What the judges did, was however to use the concept against the individual. It was not used to prevent the state from interfering with the rights of the individual but for something else. From what we can read, the judges used the concept instrumentally and came to their conclusion via conceptual logic.*¹¹

The reasoning in this case is, in other words, a clear example of something other than the Scandinavian approach.*¹² It is an illustrative example of how the concept of ownership can be used as a tool that

⁸ Sections 92–93 of the judgement.

⁹ It should be pointed out that the judges' reasoning in the case encompasses much more than I have mentioned here. Therefore, the decision can, and should, be described as a wiser and more elaborated decision. What I do in this article is accord much weight to the fact that the judges proclaim that 'the crucial question' is that of ownership of the material.

¹⁰ One might remark that the ownership/property rights article of the 1952 additional protocol to the Convention for the Protection of Human Rights and Fundamental Freedoms (that is, Article 1) protects also legal persons and therefore claim that the state is a legal person that should be protected. Here, I will comment on this only as another illustration of what the Scandinavian approach is not. Such reasoning would be seen as conceptual logic parted from, *inter alia*, the fundamental fact that the convention is an agreement between states.

¹¹ Again, please note that I give very great weight to the fact that the judges claim that 'the crucial question' is that of ownership of the material. Please note also that I do understand that the legal culture in Strasbourg should not be Scandinavian. I am not saying that the judges have applied bad reasoning; I state only that they did something very different from what a judge would do if taking the Scandinavian approach.

¹² The fact that the Swedish and the Finnish judge participated in the decision, and that the registrar was Swedish, does not change this fact. What I describe is an approach to law in general. There is no reason to speculate as to what might have

interferes with the decision-making process rather than supporting it. This is also an illustration of how difficult the tool is to use. It can be used without no-one even noticing that they use it upside down.

That the concept of ownership is complex and difficult to apply is a central theme in the Scandinavian approach. In fact, one could say that the latter approach was to some extent developed around the concept of ownership.^{*13} Ownership is always understood in relative terms and as a more specific interest in the relation and context at hand. To underscore this, Scandinavian lawyers even tend to avoid using the concept when dealing with legal issues.^{*14} Since the relations are kept apart a clearer way is to use words such as 'priority' or refer to a 'better right' of one party with respect to the other.

The case before the Strasbourg court should, with the Scandinavian approach, be resolved with reasoning that balances the interests between individual employees of the state and their employer, the state. At the same time, it should achieve balance between the society's interests in promotion of research and the same society's interest in access to research material. All norms that are found to be relevant should be used in determination of this balance. Since there are norms that point in different directions, the arguments need to be evaluated. One normative argument that would be considered strong is that an employee shall not be able to make his employer bound by a personal promise, especially if that promise goes against statutory law. In the decision-making process, it would be important also to reflect upon such things as the various consequences of the norm that any proposed decision would establish.

There is, of course, much more to be said if one were to try to describe how legal decisions are made. What I have done in this section of the paper is mainly to give an illustration of what the Scandinavian approach is, from the starting point of what it is not. I hope the illustration proves the point. There are reasons for the Scandinavian scepticism about use of the concept of ownership in the construction of solutions. With the Scandinavian approach, we try to not even involve that concept in the legal reasoning.

3. Transfer of ownership

The concept 'transfer of ownership' can be used to build solutions for a lot of different legal issues. It can be used as the starting point for a superstructure for the norms that regulate the issues. The structure can make it easy to find a way among the norms, and it can govern how the solutions are constructed in such a way that the process appears to be rendered clear and predictable. These possible advantages are neither the less not good enough for the Scandinavian approach. The Scandinavian approach is to not use the concept at all. We have no superstructure, and we prefer not letting such a concept govern either the solutions or the reasoning.

The Scandinavian way is instead to deal with each issue separately, without connecting the issues to a superstructure that involves ownership. What we do is to use different problem categories to sort and analyse different kinds of issues pertaining to property.^{*15} These categories are contractual relationships between two parties, non-contractual relationships between two parties, double transfer, unauthorised transfer, priority relative to the transferee's creditors, and priority relative to the transferor's creditors. The

been said among the 17 judges and why they happened to employ argumentation that is so remarkable from a Scandinavian perspective.

¹³ See, for example, the overview by M. Lilja. National Report on the Transfer of Movables in Sweden. – W. Faber, B. Lurger (eds). *National Reports on the Transfer of Movables in Europe, Vol. 5: Sweden, Norway and Denmark, Finland, Spain*. Munich: Sellier 2011, pp. 27–31. – DOI: <http://dx.doi.org/10.1515/9783866539099.1>.

In the same volume, J.-O. Færstad, M. Lilja. National report on the transfer of movables in Norway and Denmark, pp. 214–215. – DOI: <http://dx.doi.org/10.1515/9783866539099.205>. See also the overview in C. Martinson. *Transfer of Title Concerning Movables, Part III: National Report: Sweden*. Frankfurt 2006, pp. 10–13.

¹⁴ See, for instance, K. Rodhe. *Handbok i sakrätt*. Stockholm 1986, pp. 175–176.

¹⁵ The majority of Swedish literature on property law uses this kind of categorisation. Most evident is probably the book by Zetterström, since the title he adopts is 'The four main cases of property law'. S. Zetterström. *Sakrättens fyra huvudfall*, 3rd ed. Uppsala, Sweden: Iustus förlag 2012. See also T. Håstad. *Sakrätt avseende lös egendom*, 6th ed. Stockholm: Norstedts Juridik 1996; G. Millqvist. *Sakrättens grunder: En lärobok i sakrättens grundläggande frågeställningar avseende lös egendom*, 6th ed. Visby, Sweden: Norstedts Juridik 2011; H. Hessler. *Allmän sakrätt: om det förmögenhetsrättsliga tredjemansskyddets principer*. Stockholm: P.A. Norstedt & söner 1973. See also the Norwegian monograph by T. Falkanger and A. T. Falkanger. *Tingsrett*, 7th ed. Oslo, Norway: Universitetsforlaget 2013. For an example of an earlier and different kind of categorisation, see Ö. Undén. *Svensk sakrätt*, 10th ed. Lund, Sweden: Liber läromedel 1976. See also the old but specific comment in English by F. Vinding Kruse. What does 'transfer of property' mean with regard to chattels? A study in comparative law. – *American Journal of Comparative Law* 1958, p. 500.

solutions to these problems are not connected to each other. Each conflict is simply dealt with on its own merits.

This means, for example, that transferee C might win out against transferor B's creditors CR but lose out relative to B's transferor A. The reason for this is simply that we prefer to decide on issues from the starting point of the typical interests in a relationship between two typical parties to a conflict. As we see the situation, the arguments in unauthorised-transfer conflicts differ from the arguments in conflicts on priority before the transferor's creditors.

An effect is in other words that the solutions of two different conflicts are not co-ordinated with each other. This is not something for which we strive. We do, however, see such an effect as rather unproblematic. The alternative—to connect the solutions to each other—is seen as problematic for the same reasons seen in the example I used on the concept of ownership. A connection would mean involving considerations that are not directly relevant for the problem between the parties. They might even interfere with the decision-making process rather than support it.

To illustrate, I will give another example. The background is a real case from a local court, a few years ago.

Party A was in a hire-purchase contract with B for the land and cottage she owned.^{*16} After a year, B falsified the documentation such that it appeared that B had bought the property from A and paid for it. B used the falsification to become registered as the owner in the land register. Then, B got her elderly uncle C to sign some papers that made it seem that he had bought the property from B. After this, C was registered as the owner in the land register. Some while later, A recognised what had happened and sued C.

C, the elderly uncle, said in the court hearings that he had only helped his sister's daughter out. He also explained that he was very sorry that he could not give A the property back, since it had, by the time of the court proceedings, been sold on to D. Actually, D had, in his turn, even sold the property to E.

In the Scandinavian context, this case is almost as simple as it gets. Since A says that she claims the property and C says he does not, the decision must be that A shall be given priority above C.

What A needs to do after this is to sue the one who turned out to be the person having a claim. This is now E. If E then claims that he has a better right than A, the relation of the two has to be addressed. It would be a rather easy case to decide, since E, according to Swedish legislation, cannot make a good-faith acquisition when B has falsified the documents.^{*17}

The example illustrates how each relation is dealt with separately in the Scandinavian approach. A downside with this might seem to be that people such as A must make claims with respect to several other people and may even have to go to court on multiple occasions. For practical reasons, however, this picture is not entirely accurate. If A resolves her issue with one of the others, preferably the most central of them, this makes it easier to get the others to follow.

Also, there is a special rule with respect to land. According to this rule, A only needs to sue the person who is registered as the owner at the time when A files suit; A need not sue anyone else to whom C sells the property after being sued. The judgement becomes valid also against D and E. This special rule can be compared to a rule on transfer of ownership. The effects of the rule could be described as a rule that gives A ownership unless C, D, or E makes an acquisition that transfers A's ownership. There is however a fundamental difference since the Swedish system is built from the opposite starting point.

As I have mentioned above, the example of A's sale of land is based on a real case.^{*18} I have chosen this case since the actual outcome illustrates also another aspect of the concept of transfer of ownership. The case between A and C is an easy case, and A should win, as already noted. Regrettably, the parties did not argue the case very clearly, and they employed the ownership concept. The local court judge ended up deciding that A should not get what she claimed, since C did not own the property. The decision is just two short sentences and it is not logic. The only way to get it to become logic is to read it with an implied understanding that, since C is not the owner, he cannot give ownership back. That line of thinking is a mistake. It

¹⁶ This is not a commonplace type of contract in the context of Swedish land transactions; the parties happened to choose terms of this sort.

¹⁷ I have elaborated on this theme in C. Martinson, *Funktionalismen och bättre rätt till fast egendom*. Svensk Juristtidning 2008, pp. 669–687.

¹⁸ Mariestads tingsrätts dom 2006-11-08, målnummer T28-06. To refine the example, I have made the choice above to modify the circumstances slightly in the telling. In actuality, it seems likely that B falsified the documentation such that C appeared to be the one who bought from A.

illustrates that it might not be so intuitive to follow the Scandinavian approach. To avoid ownership in the analysis is not always easy. The case therefore also illustrates that the concept can lead one's thought into conceptual logic. Norwegian professor Sjur Brækhus expressed the problems we sometimes experience as if the concept of ownership has 'a strong influence over the mind'.^{*19}

From the Scandinavian perspective, it is, in fact, not only the concept of ownership that creates these kinds of problems. Legal concepts do affect our way of understanding reality. On the other hand, this effect is something we need. All legal concepts are, of course, to some extent, normative simplifications that should be used. The legal concepts are central to law. Without them, law would not be law. It would at least be very different. The reason for which the Scandinavian approach sees some concepts as problematic is that the underlying ambition of the Scandinavian approach is realism. It is seen as important that the law be fairly close to the real concerns associated with a specific problem. Transfer of ownership is one concept that has been evaluated from this perspective, and it has been found to be more problematic than helpful.

While this might seem to be a strange choice, at least we Scandinavians are not alone. The thinking behind US law is somewhat similar where transfer of ownership is involved. The US law professor Karl Llewellyn put it thus:

Unless a cogent reason be shown to the contrary, the location of title will govern every point which it can be made to govern [...]. The burden is put upon any individual issue to show why it should be honored by being severed from the Title-lump in any particular, and given individualized treatment. Now this would be an admirable way to go at it if the Title concept [...] had been tailored to fit the normal course [...]. But Title was not thus conceived, nor has its environment of buyers and sellers had material effect upon it. It remains, in the sales field, an alien lump, undigested. It even interferes with the digestive process.^{*20}

4. Unjustified enrichment

Another concept that is problematic from the Scandinavian standpoint is that of unjustified enrichment. It is a concept unfit for the Scandinavian legal environment. One reason for this is that we do not use a transfer-of-ownership superstructure. Since we deal with the relations one by one, we already include the arguments as to what may lead to unjust results in our analysis from the beginning.

Another reason we find unjustified enrichment unsuitable is that it is not a good tool for directing behaviour. There are other methods and incentives to prevent people from doing such things as using other people's property.

A third reason is that we find it better to keep issues separate from each other. They should be dealt with specifically in the context of the kind of relationship the issues have to do with. Unjustified enrichment seems to be a concept that is so broad and blunt that its use is risky.

The conclusion that unjustified enrichment is unfit for the Scandinavian legal environment could be claimed to be scientifically proven. Two Scandinavian researchers draw this conclusion in their theses in 1950.^{*21} Interestingly, the concept has nonetheless been gaining supporters in recent years. They claim that there are reasons to conduct a new evaluation and that it is now time to review what they see as old and out-dated arguments.^{*22}

I will return to the issue of critics and supporters, but first I would like to give a glimpse of how we approach these issues. Again I will use an example from a real case:^{*23}

An oil company delivered 15,951 litres of diesel fuel to a farm. This delivery was a mistake—the delivery should have been to another site. When the oil company realised the mistake, they charged the receiving

¹⁹ S. Brækhus. *Omsetning og kredit 3 og 4, omsetningskollisjoner I og II*. 1998, p. 6.

²⁰ K. Llewellyn. Through title to contract and a bit beyond. – *New York University Law Quarterly Review* 1938 (15), p. 169.

²¹ J. Hellner. *Om obehörig vinst särskilt utanför kontraktsförhållanden*. Stockholm, Sweden: Almqvist & Wiksell 1950; A. Vinding Kruse. *Restitutioner: et bidrag til undersøgelsen af berigelsesgrund- sætningen i dansk og fremmed ret*. Copenhagen, Denmark: Gads forlag 1950.

²² M. Schultz. Nya argumentationslinjer i förmögenhetsrätten. Obehörig vinst rediviva. – *Svensk Juristtidning*. 2009, pp. 946–959; J. Munukka. Är obehörig vinst en svensk rättsprincip. – *Ny Juridik* 2009/3, pp. 27–34.

²³ Attunda tingsrätts dom 2008-05-22, målnummer T673-07.

farmer, but the farmer refused to pay. Since the parties could not come to an agreement, the case was decided in the local court. The decision was, in the part relevant here, very brief:

By using the diesel without paying for it [the farmer] made such an economic gain that he, according to general private-law principles on unjustified enrichment, reasonably should have to pay.

The decision does not follow the Scandinavian approach. In fact, it is rather remarkable that the judge refers to unjustified enrichment. More important, however, is that the example shows something that the critics of this concept have claimed for decades. If we accept this concept, lawyers will stop analysing the issues and instead just decide by using the concept. The results might then be rather haphazard. One could, for example, argue that it is actually the oil company who make an unjust profit, since they forced the farmer to, in effect, become their customer.

If the diesel case were to be handled in a Scandinavian functional way, the analysis could involve addressing circumstances such as these: Whose mistake was it that the diesel was used? Was someone careless? To what extent was the use made knowingly? At what point in the course of events did any of the parties respond to the wrongful delivery, and how? Was it before or after the farmer started to use the fuel? What consequences would a norm built on the decision lead to? How would people in the diesel market behave if one were to make a decision of a certain kind? Who would stand what risk if the decision were to be one way or the other? How frequent could cases such as these become? What sums do they involve?

In other words, the Scandinavian approach deals with these issues contextually. In the Scandinavian legal systems, there are, in my opinion, rather few examples of problems with unjustified-enrichment issues. It is always hard to say something about the reality from the empirical evidence of a lawyer, but it is a fact that the concept of unjustified enrichment has not been used in our tradition. We have managed without it.

As I mentioned in the beginning, there is, however, some debate on the issue nowadays. Some hold that the Supreme Court actually did use the idea of unjustified enrichment in an *obiter dictum* and also made one or two decisions wherein they used such a principle. Others hold that this is just wishful thinking. The debate has not come very far yet.^{*24} I could illustrate this by describing a debate I participated in myself. A professor who is in favour of the concept of unjustified enrichment used this simile: 'We should wake "the corpse" and see how it will solve thousands of legal problems that we have!' Since I represented the other side in the debate, I replied: 'But isn't it enough to **imagine** the results we will get if we ask a corpse to solve thousands of legal problems?'

In any case, there is reason to do more research into how we actually handle these problems. This is already one subject of research projects, but more could be done.^{*25} Among the important reasons for doing this research is that we must be able to communicate with lawyers internationally on how we deal with these issues.^{*26} Another reason is that Scandinavian law is under such international influence that we need to remind ourselves of what we actually have instead. To some Scandinavian lawyers it might now seem that our law is underdeveloped. Under such circumstances, it is easier to prefer to have something before not having something. It can therefore appear easier to have the concept than to refrain from it.

5. The coming into existence of a claim

'The coming into existence of a claim' is a long-winded way of expressing a concept. This concept is applied nonetheless and can be found in, for example, the DCFR.^{*27} For the Scandinavian approach, this concept might well be the most troublesome one of all to deal with. From what I have described so far, it follows that the Scandinavian approach strives after not letting conceptual logic be decisive. That outcome is hard

²⁴ Another reason can be illustrated by the Finnish experience, wherein the concept is used but at the same time criticised, in such a way that the situation can be described as exhibiting strong dualism. This dualism is seen as unproblematic in practice, however, since the question has never been a big issue. T. Wilhelmsson. Comment at Nordiska Juristmötet 2008 (p. 438 in the proceedings document *Nordiska Juristmötet 2008*). See [http://jura.ku.dk/njm/38/monsen-erik/Debat i pdf-format](http://jura.ku.dk/njm/38/monsen-erik/Debat%20i%20pdf-format).

²⁵ See, for example, E. Monsen. *Berikelseskrav. Vederlagskrav og vinningsavståelseskrav ved urettmessig utnyttelse av ting og rettighet*. Oslo, Norway: Cappelen Akademisk Forlag 2007; E. Monsen. *Urettetiget berigelse (obehørig vinst) som grundlag for betalingskrav. – Nordiska Juristmötet 2008*, pp. 337–353. See <http://jura.ku.dk/njm/38/monsen-erik/>.

²⁶ Compare T. Wilhelmsson (see Note 24), p. 439.

²⁷ DCFR III – 5:106.

to avoid, however, when the concept is all about describing whether a relation includes something or not. Since we need to communicate whether the relation at a certain point in time involves a claim or not, it is hard to avoid the concept.

For this reason, the Scandinavian legislators have not been able to avoid the use of the concept in their legislation. It is probably fair to say that there has not even been such an ambition of avoidance. We do have several rules wherein the legislator has used the term 'the coming into existence of a claim'. The Act on General Limitation is one of these, and another is the *actio Pauliana* rule on rescission of security given to a creditor for existing debt. One can find rules of this sort in diverse fields of legislation, among them marriage law, the law of succession, an act on promissory notes, the law of legal procedure, and debt enforcement law.

The Scandinavian approach to rules such as these is to hold that the concept is dependent on the purpose of the rule. This means that we have no general idea as to when a claim comes into existence. Instead we say that the moment in time differs with the context. In theory, one result could be described as a specific claim being able to be seen as coming into existence at different times when we use different rules.

What I have just said might seem remarkable, or worse. The logic behind this approach is, however, that we prefer being able to decide on the solution to a problem with priority to the real interests in the relevant context. The directly relevant arguments should be decisive. It is of low relevance to hold that it has been decided that the claim came into existence at a certain point in time in relation to another kind of conflict than the one at hand. As I have explained when considering transfer of ownership, we like to deal with each issue separately, without connecting the issues to a superstructure. The coming into existence of a claim is such a superstructure. Unlike when dealing with the concept of transfer of ownership, we do use the phrase 'coming into existence of a claim'. In actuality, we even use the concept. What we do, however, is to use it contextually.

To illustrate the approach, I shall give an example. There is a real case behind this example too:^{*28}

A supplier of clothing and a clothing store made a contract in March 2004. The supplier undertook to make deliveries of clothing on certain dates. Deliveries were made for a time, up until December 2004, when the clothing store went bankrupt. It was a private limited company. Under Swedish law, an owner can become personally liable if continuing to do business with a nearly insolvent company unless he completes certain formalities and investigates the financial situation. The owner of the supplying company had not done this. Therefore it was claimed that he should be liable for all debt that had come into existence in the final months before the bankruptcy.

The legislation stipulates liability for all claims that have come into existence during a certain period. Two alternatives were discussed in connection with the case at hand. One alternative was that the claims proceeding from the contract came into existence when the parties signed the contract. The other alternative was that they came into existence when each respective delivery was made. In the latter case but not the former, the owner would be liable.

The case I refer to was settled out of court, but there is illustrative argumentation to be considered from the case nevertheless. It is from a legal opinion that the store obtained from a former president of the Supreme Court.^{*29}

The former president began his reasoning by pointing out that the purpose of a rule can be of importance when one is determining the time at which a claim came into existence. After this, he claimed that the direct purpose of the rule in question is to protect the creditors by giving some creditors security. He also claimed that the indirect purpose is to provide an incentive to investigate the financial situation. According to the former president, these purposes should not be seen as of any 'special nature'. Accordingly, he argued, there is no reason for divergence from the ordinary view on when a claim comes into existence. This is the day the contract is signed. With a possible exception for contracts that can be terminated through notification, the former president claimed that this is 'generally the most natural' solution.

This one paragraph describes the essence of the argument. What the former president does, in other words, is to argue that, in essence, there is a natural resolution of the issue. The remainder of the eleven pages consists of briefs on what other authors have claimed in legal doctrine and of comparisons with other rules wherein the coming into existence of a claim is a requisite.

^{*28} The case seems to have been settled, but it was first tried in Stockholms tingsrätts dom 2009-02-18, målnummer 14-935-06, and appealed to Svea Hovrätt, 2009-03-10.

^{*29} Legal opinion of T. Gregow. Received by Stockholms tingsrätt, 2008-03-26, in the case mentioned.

From the critical point of view that I adopt here, the conclusion is that even the best of Scandinavian lawyers struggle with the concept. The Scandinavian approach is definitely not to deal with issues by deciding what is the most 'natural'. That would be equivalent to deciding on something other than the real issue.

The real question to ask is another one. It could be put this way: Should an owner of a private limited company be personally liable for deliveries that he receives in accordance with an existing contract if said owner fails to perform the statutory investigations into the financial situation?

This question should be dealt with through consideration of elements such as the consequences, the frequency, the size of the liability, possible effects on the market, and so on. If the decision is that he should be liable, the claim should be seen to come into existence when the deliveries were received, and vice versa.

The effect of the approach as described might seem remarkable. It should be noted, therefore, that the relevant liability rule in the Swedish Companies Act has been questioned. It has been held that it would be much better to rewrite the rule and make it more in accordance with the real question. The rule could be instead that the people behind a company should be liable if they act negligently toward others when they ought to know that the other company is going bankrupt.^{*30}

Regardless, there is, of course, reason to question the Scandinavian approach when one considers how we use the concept of the coming into existence of a claim. Indeed, some Scandinavian lawyers have done so in recent years.^{*31} They ask whether it wouldn't be better to actually build the system on a simple principle—e.g., that all contractual claims come into existence when the contract is signed. If this is taken as the starting point, the legislator could make deviations from this point where finding it necessary. So far, this critique has not had much impact. The axiomatic counter-argument is that there are so many situations wherein the concept might be relevant that it is very hard to foresee what the needs for deviations might be and that this situation could lead to an increased risk of problems being solved through conceptual reasoning rather than consideration of the real issues.

6. *Accessio*

The next concept to explore is *accessio*. Most Swedish lawyers do not know what this concept means. After all, we have used it very little. Our rules on *accessio* are limited to a few specific contexts, and even then we do not use the word. The reason for this is that the Scandinavian approach deals with relations. *Accessio* pertains to objects, and objects should not be at the centre of attention; people should. Again, objects are conceptual. This entails a risk of the definitions of objects becoming the means of deciding the outcome of a conflict.

To illustrate the Scandinavian approach to *accessio* issues, I will use an example invented for a textbook: B sells old cars. The car stereo in one of the cars is nice, so A buys just the stereo. B and A agree to leave the stereo in the car until the next week. When B sells the car the next day, he forgets about the matter. The buyer of the car, C, takes the car with him.

A Scandinavian lawyer would deal with this case as a good-faith acquisition. The relationship between people is what should be dealt with. For us, it would be strange to start dealing with the case by deciding that the stereo is a part of the car until being removed from it.

This does not mean that the problem of *accessio* disappears. On the basis of the Swedish Act on Acquisition of Chattels in Good Faith, A shall have a more or less limited priority. If C acted in bad faith, A shall have direct priority before C, and if C acted in good faith, A shall have the right to pay C and thereby obtain the stereo. The reason that these problems have not been given much attention lies in the nature of the Scandinavian approach. These problems do not arise frequently, and the parties deal with the situation pragmatically in many cases. In the event that A has to pay C in order to obtain the stereo, A would probably not wish to pay the value of the stereo and the costs that C will incur. In the case of A being given direct priority, the problem might be resolved by C paying A.

As you can see, this is not an elaborate way of dealing with these issues. There is, however, a general preference here too. Do not create norms on issues that have had little practical importance. The

³⁰ As suggested by S. Lindskog in his speech at Göteborgs Domarakademi, in Gothenburg on 19 September 2011.

³¹ See, for example, M. Schultz. Skadeståndsfordrans uppkomst. – *Juridisk Tidskrift* 2010/11, pp. 870–889; J. Heidbrink. Tankar om kontraktfordringars uppkomst. – *Juridisk Tidskrift* 2010/11, pp. 858–869.

Scandinavian legislator has applied this policy for a long time, and said policy is in this respect comparable to common law.

Still, we do have some specific rules on *accessio*. There are rules on what should be seen as a part of land or a part of buildings. There are also rules for ships and aeroplanes. Interestingly, these rules can be described as a mix between the relational and the conceptual. The rules for land and buildings draw a distinction between objects in light of the background: objects that have been attached by someone other than the landowner can be excluded from accession. The same goes for objects that the landowner attached without regard for the fact that someone else claims them.^{*32}

It should be pointed out also that we might now see development of a more general principle affecting accession. The general problem has been raised in Scandinavian legal research.^{*33} A principle of *accessio* is not something strange to have in the Scandinavian environment. It just needs to mesh well with the relational starting point of the Scandinavian approach.

7. *Traditio*

The concept of *traditio* is used somewhat differently between the individual Scandinavian countries. Here, I will look only at *traditio* in Sweden and only at the buyer's position in the case of the seller's bankruptcy. The latter example illustrates both the strengths and the weaknesses of the approach.

The Swedish principle of *traditio* has to a large extent been developed by judges' decisions. Over the last 50 years, this development has increasingly been driven by the argument that *traditio* prevents creditor fraud. The deciding issue when one is drawing the line for priority has, therefore, become whether the seller is cut off from his possibilities for controlling and disposing of the goods. This is a problematic norm, since the Swedish *traditio* principle does not leave room for agreements to leave the goods with the seller. What the buyer can do is register an acquisition when the goods are left with the seller, but the registration rules are not suitable for every kind of transaction. In some situations, it has, therefore, been hard to figure out what to do.

One category of difficult transactions has involved two companies with the same person as the sole owner. Since the owner controls the goods and can dispose of them for the selling company after the transaction, some have held that the company buying the goods should not get priority. This was consequential to the conception that cutting off the possibility to control and dispose of the goods should be decisive.

When the Supreme Court finally, in 2007, got a chance to decide on a refined case, they gave priority to the buying company.^{*34} They reached this decision by using the above-mentioned control and dispose argument. Since the owner of the company would be liable for embezzlement if he disposed of the goods for the selling company, the selling company had lost enough of its control. The judges pointed out that it was important that the crime would truly be embezzlement and not the milder form of offence—disposing of property to the detriment of someone else's right. They meant that the decision would not be consistent if the milder form had been enough, since every seller is liable for that offence if he disposes of what he has already sold. If the boundary were drawn there, there would, according to the judges, never be a need to fulfil the requirements of *traditio* and registration for 'all transactions'.

The decision is in line with the Scandinavian approach. What the judges do is see function as more important than form. The transaction has the effect of the owner having less incentive to dispose of the goods for the seller's account.

There is, however, much that can be said about the reasoning in this case, also from the perspective of the Scandinavian approach. In many ways, the decision is actually not a very characteristic one in this legal culture.

One central point of criticism has to do with the argument that all transactions would be affected by the resolution of this case. This claim is not at all characteristic of the Scandinavian approach, and one could question whether this is really what the judges mean. The judges may well have decided that transactions between companies that have the same representative are exempt from *traditio* in certain circumstances.

³² Jordabalken 1970:994, Chapter 2.

³³ P. Strömgren. *Tillbehör och accession*. Uppsala, Sweden: Iustus förlag 2012.

³⁴ Supreme Court case NJA 2007, p. 413.

Since the rest of the judges' arguments in the case pertain mostly to the usefulness of transactions of this kind and point out that there are other rules that protect the creditors, the judges could simply have decided that there was enough reason to make an exemption. The ability to make contextual exemptions of this type is actually a major concern in the Scandinavian approach! Indeed, it is quite possible that the decision will indeed be interpreted in this way, as an exemption for transactions between two companies with one and the same person as the sole owner.

Also, there were obvious arguments that the judges did not contemplate, even though they had been used by the Supreme Court judges in a case 12 years earlier, 1995.^{*35} In that case, the judges argued that the cutting off (of the seller's control and possibility for dispose) need not be full and complete for the condition to be met. It was enough if the control and dispose possibilities were reduced, as long as the probability of being able to confirm that there had been a transaction was high and also information on the transaction had been disseminated to some extent.

It is possible to describe the differences as if the judges had employed two distinct norms. The judges in the later case, from 2007, used a cutting-off principle. The judges in the earlier case, in contrast, applied a broader norm that could well be described as a *traditio* principle.^{*36}

What the two decisions illustrate, *inter alia*, is that the choices are not obvious when one creates a solution via the Scandinavian approach. There are difficulties in deciding on what actually should be seen as functional. The Scandinavian approach, as every other approach does, has its difficulties and weaknesses.

8. Contrasting of approaches, a route to a better understanding of law

I have illustrated a few things about the Scandinavian approach by explaining how we handle six common legal concepts. Some of these concepts are not used in the Scandinavian approach, since we simply approach the issues in a relational and contextual manner. The concepts that we do use are also used in a relational way, with contemplation of the context.

It is hard for me to say whether it is useful for lawyers from other legal cultures to learn about the Scandinavian approach. I do, however, believe that it can be good to contrast the approach found in one culture with the approaches that others utilise. At its base, this has to do not only with legal culture but also with the understanding of law and what law is.

³⁵ Supreme Court case NJA 1995, p. 367.

³⁶ It could be noted that a committee is now working on a governmental proposal to abandon the principle of *traditio*. See Justitiedepartementet, Kommittédirektiv 2013:28 Köparens rätt till varor i förhållande till säljarens borgenärer.



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Proprietary Security Rights in Movables—European Developments:

A Spotlight Approach to Book IX DCFR

1. Introduction: Some problems and developments

Proprietary security rights in movable assets are an issue of significant practical importance in all European countries. Accordingly, it may be appropriate to start this article with a statement of reassurance: If you are a practitioner—an attorney, a judge or notary, or a lawyer in the banking business—you have no need to be afraid. There is no forthcoming European legislation turning your well-known national system upside down within the next couple of years. In fact, for the time being, there is no European legislation in sight in this area at all.

However, if you are a practitioner, you may wish certain issues to be resolved in a suitable and efficient way, within a framework providing legal certainty. Depending on the jurisdiction you practise in, the particular problems in that respect may differ. I may start a short list of examples by referring to my own country, Austria. Under the Austrian regime for proprietary security rights, many goods are, from a practical point of view, completely precluded from being used as collateral for credit. Because of a strict understanding of the principle of publicity, which applies both to pledge rights and to transfers of ownership for security purposes, the security provider must actually be dispossessed of the encumbered assets.^{*1} Consequently, it will not be possible to use the encumbered asset (machine, motor vehicle, or other asset) for the debtor's business. A narrow exception, allowing 'symbolic' delivery, applies in cases where handing over the collateral goods would, on account of their physical character, be 'impossible or unreasonable';^{*2} but the scope of this rule is very uncertain in practice (which, for example, makes it extremely difficult to pledge inventory).

Matters are certainly easier under German and Estonian law, wherein a transfer of ownership for security purposes is possible by way of *constitutum possessorium*—i.e., on the basis of a mere agreement, without physical delivery.^{*3} However, such a security interest is generally lost once the encumbered asset (e.g.,

¹ §451 of the Austrian Civil Code.

² §452 in conjunction with §427 of the Austrian Civil Code. For an account on the latter provision in the English language, see W. Faber. National report on the transfer of movables in Austria. – W. Faber, B. Lurger (eds.). *National Reports on the Transfer of Movables in Europe, Volume 1: Austria, Estonia, Italy, Slovenia*. Munich: Sellier European Law Publishers 2008, pp. 1–218, on p. 88 ff. – DOI: <http://dx.doi.org/10.1515/9783866537019>.

³ See M.-R. McGuire. National report on the transfer of movables in Germany. – W. Faber, B. Lurger (eds.). *National Reports on the Transfer of Movables in Europe, Volume 3: Germany, Greece, Lithuania, Hungary*. Munich: Sellier European Law

a truck) crosses national borders. In fact, the differences between the legal regimes concerning proprietary security rights adopted in the various European countries cause a lot of practical problems, and, on account of the mandatory *lex rei sitae* rule in private international law, these problems can hardly be overcome by contractual regulation.

If you are advising a large firm producing raw materials or goods that are sold under retention of title, you may want your client's security interest to be 'durable'—i.e., to persist upon resale of these goods by your client's customer, or when the material is used in a further production process by the buyer. Both will be impossible in, for instance, the Netherlands.^{*4}

If you are a judge in Estonia or Germany, you may—perhaps—feel somewhat uncomfortable when ruling (in accordance with the prevailing opinion) that a transfer of ownership for security purposes is valid without delivery^{*5} whereas the creation of a pledge, which is functionally equivalent, would not.^{*6} Or you may wish to find clear guidance in the law on how to integrate 'new' or 'modern' forms of proprietary security, such as financial leasing or sale and lease-back transactions, into the legal framework in an adequate way.

I have not spoken of academics so far, nor did I speak of the people preparing legislative drafts for the Ministry of Justice. You may want your legal system to be both adequate and dogmatically consistent. And you may long for some inspiration.

At this point, I should draw your attention to a set of model rules published as Book IX of the Draft Common Frame of Reference (DCFR) in 2009.^{*7} This set of rules is influenced mainly by the 'functional' approach and the 'notice filing' concept adopted in Article 9 of the American Uniform Commercial Code (UCC). However, the working group responsible for Book IX DCFR, headed by Professor Ulrich Drobnig, managed to 'Europeanise' the American archetype in several instances and to present the rules in a much clearer and more stringent way than in Article 9 UCC. This set of rules, although originating from a private academic initiative, could actually operate as a motor for future law-reform projects in Europe in a medium-term or long-term perspective. Such reform could be implemented as an EU regulation (either replacing or—perhaps more likely—amending the existing national systems, as in the case of an optional instrument). Alternatively, if there is not sufficient political will at the pan-European level, individual states

Publishers 2011, pp. 1–192, on p. 101 ff. – DOI: <http://dx.doi.org/10.1515/9783866539006>; K. Kullerkupp, *Vallasomandi üleandmine. Õigusdogmaatiline raamistik ja kujundusvõimalused* ['Transfer of Movable Property: Dogmatic Legal Framework and Scope of Contractual Arrangements']. Tartu, Estonia: Tartu Ülikooli Kirjastus 2013, p. 259 f (in Estonian), p. 356 f (English summary). From a *de lege ferenda* perspective, abolishing the transfer of ownership for security purposes and *constitutum possessorium* as a mode of transfer has been suggested by V. Kõve, *Varaliste tehingute süsteem Eestis* ['The Estonian System of Property Transactions']. Tartu, Estonia: Tartu Ülikooli Kirjastus 2009, pp. 242, 354 (in Estonian), p. 388 (German summary). However, also this author accepts that transferring ownership for security purposes by way of *constitutum possessorium* is possible under the law currently in force in Estonia.

⁴ Under Dutch law, contractual stipulations to 'extend' the security right established by retention of title in the case of resale—which is possible under, for example, German or Austrian law through assignment of the reselling buyer's claim for the purchase price to its seller (so-called *verlängerter Eigentumsvorbehalt*)—are prevented by the mandatory provision of Article 3:84(3) of the Dutch Civil Code. This rule provides that security agreements shall not serve as a basis (*causa*) for transfers, including assignments of claims. Regarding the situation of new goods being produced from the goods sold under retention of title, Article 5:16 of the Dutch Civil Code in its paragraphs (2) and (3) (which are also mandatory) provide that the producer acquires sole ownership of the product, which causes retention of title to be an unsuitable security device in selling of raw materials or semi-furnished products. See, for example, A. Salomons, National report on the transfer of movables in The Netherlands. – W. Faber, B. Lurger (eds.), *National Reports on the Transfer of Movables in Europe, Volume 6: The Netherlands, Switzerland, Czech Republic, Slovakia, Malta, Latvia*. Munich: Sellier European Law Publishers 2011, pp. 1–157, on pp. 67, 102 ff., 131 ff. – DOI: <http://dx.doi.org/10.1515/9783866539235>.

⁵ §92(1) in conjunction with §94 of the Estonian Law of Property Act ('LPropA'); §929 in conjunction with §930 of the German Civil Code, addressing the transfer by *constitutum possessorium*.

⁶ §281 and §282 of the LPropA; §1205 of the German Civil Code.

⁷ Published in C. von Bar, E. Clive (eds.), *Principles, Definitions and Model Rules of European Private Law: Draft Common Frame of Reference (DCFR) Full Edition* (in six volumes). Munich: Sellier European Law Publishers 2009. On Book IX of the DCFR in particular, see, for instance, R. Macdonald, Transnational secured transactions reform: Book IX of the Draft Common Frame of Reference in perspective. – *Zeitschrift für Europäisches Privatrecht* ('ZEuP'). 2009, pp. 745–782; M. Brinkmann, *Kreditsicherheiten an beweglichen Sachen und Forderungen: Eine materiell-, insolvenz- und kollisionsrechtliche Studie des Rechts der Mobiliarsicherheiten vor dem Hintergrund internationaler und europäischer Entwicklungen*. Tübingen, Germany: Mohr Siebeck 2011, p. 435 ff. (in German); W. Faber, Das Mobiliarsicherheitsrecht des DCFR: Perspektiven für eine Reform in Österreich bzw in Europa? – *Juristische Blätter* ('JBL') 2012, pp. 341–358 (part 1), 424–432 (part 2) (in German), with further references. Regarding older draft versions, see also H. Beale, Secured transactions. – *Juridica International* 2008, pp. 96–103; A. Veneziano, A secured transactions' regime for Europe: Treatment of acquisition finance devices and creditors' enforcement rights. – *Juridica International* 2008, pp. 89–95.

could harmonise their laws in accordance with a common model regulation, which would still make it possible to draw up a common registration system for proprietary security rights (facilitating cross-border transfers of goods and cross-border lending).⁸

So far, to my knowledge, only one—or, probably more correctly, already one—European country has followed the DCFR in adopting a notice-filing system; that is Belgium, with an act of law dated 11 July 2013 that amends the Belgian Civil Code.⁹ To the best of my knowledge, the DCFR had a strong influence on the drafters, although Belgian law did not adopt all choices made in the DCFR¹⁰ and there are differences in terms of structure. In Scotland, the Law Commission is currently investigating the issue with a view to reporting on it before the end of 2014.¹¹

As to content and scope, Book IX DCFR covers all classic types of proprietary security rights as well as all ‘modern’ devices providing some means of proprietary security on a contractual basis (financial leasing, hire purchase, etc.).¹² It applies to collateral of all types of movable assets, tangible and intangible (goods, receivables, patent rights, etc.), present and future. Also, the rights secured may be present or future. Furthermore, there are no limits as to the persons covered: The security-provider may be a business or a consumer (with some specific provisions applying in the latter case).¹³ No distinction is made between ‘domestic’ and ‘international’ cases.

Book IX DCFR is a complex set of rules, extending to 131 articles spread over seven chapters. Certainly, the articles are anything but easy to read when one encounters the text for the first time. Since space is limited, I will not even try to provide a systematic overview of Book IX. Instead, I will apply a ‘spotlight approach’, pointing at only a few selected central features. The focus will be not on the draft rules themselves but, rather, on the way they operate.

2. A ‘functional approach’: One type of ‘security right’ (plus ‘retention of ownership devices’)

I have mentioned the problem of completely divergent publicity regimes for pledges and transfers of ownership for security purposes, along with the difficulty of adequately integrating ‘new’ forms of security into a legal framework. This may be supplemented by the fact that different European legal systems recognise different types of security rights. My first ‘spotlight’ is related to these issues.

The solution adopted by the DCFR is a ‘functional approach’ as promoted by Article 9 UCC, meaning that Book IX DCFR converts all limited proprietary rights functioning as security and all transfers of ‘full’ rights for security purposes—such as the transfer of ownership for security purposes (*Sicherungsübereignung*) and the assignment of claims for security purposes (*Sicherungsabtretung*)—into one single type of ‘security right’ (IX.–1:102 DCFR). This single type of ‘security right’ is subject to a uniform regime governing, in particular, all aspects of creation, priorities, and enforcement (where the secured creditor will generally have ‘only’ a right to preferential satisfaction from the collateral; not a right to separate the

⁸ For a discussion of various options, see M. Brinkmann (Note 7), p. 468 ff. See also W. Faber (Note 7), p. 431 ff.; K. Kreuzer. Die Harmonisierung des Rechts der Mobiliarsicherheiten. – J. Basedow et al. (eds). *Europäisches Kreditsicherungsrecht. Symposium im Max-Planck-Institut für ausländisches und internationales Privatrecht zu Ehren von Ulrich Drobnig am 12. Dezember 2008*. Tübingen, Germany: Mohr Siebeck 2010, pp. 31–70, on p. 47 ff. (in German).

⁹ See the instrument entitled ‘Loi modifiant le Code Civil en ce qui concerne les sûretés réelles mobilières et abrogeant diverses dispositions en cette matière / Wet tot wijziging van het Burgerlijk Wetboek wat de zakelijke zekerheden op roerende goederen betreft en tot opheffing van diverse bepalingen ter zake’, published on 2 August 2013 in *Belgian Law Gazette* no. 2013009377, p. 48463.

¹⁰ In particular, Belgian law did not adopt the policy that retention of title and comparable devices should be effective only if registered (see the second paragraph of Section 5, below).

¹¹ A discussion paper published by the Scottish Law Commission in 2011 concludes that wholesale adoption of the model of Article 9 of the UCC would not be appropriate but suggests that Scots law would benefit from adopting some of its ideas. The paper proposes that there should be a new type of security right that could cover both corporeal and incorporeal movable property, along with an online register where such rights are to be entered. See Scottish Law Commission’s Discussion Paper on Moveable Transactions (Discussion Paper No. 151, of June 2011).

¹² The DCFR’s IX.–1:101(2) in conjunction with IX.–1:102 (on security rights) and IX.–1:103 (on retention of ownership devices).

¹³ See, for example, IX.–2:107 DCFR (on restricting global securities, security rights in future assets and security rights over future salaries, pension rights, and equivalent income) and certain provisions governing enforcement, such as those in IX.–7:103(2) and IX.–7:107 DCFR.

goods).^{*14} This, evidently, solves the problems of consistency and legal certainty related to ‘new’ forms of security addressed above, and it facilitates international co-operation with respect to trade, financing, and drawing up of a common registration system (or, at least: compatible national registration systems) for collateral. Apart from that, this ‘functional’ approach taken by Book IX DCFR has some further practical implications. For instance, ‘security assignments’ of claims (and security transfers of goods) no longer prevent multiple collateralisation of the same assets: the second creditor intending to create a security right will not be left unsecured on account of the *nemo dat* principle; he will be secured with second priority, and so on. Thereby, the ‘security right’ approach also aids in mitigating the problem of ‘over-collateralisation’, or *Übersicherung*—i.e., that the value of the collateral assets far exceeds the secured claims (in Germany, where this problem plays a prominent role, courts found themselves forced to counter-act by adopting, among other approaches, application of the principle that contracts *contra bonos mores* are void^{*15} and by acknowledging a personal claim against the secured creditor to release collateral assets that are no longer necessary for covering the secured right^{*16}).

There is one exception to this ‘functional approach’ in Book IX: So-called retention of ownership devices (including retention of title, hire purchase, financial leasing, and comparable devices)^{*17} are treated as a separate constructive category throughout Book IX. In practical terms, however, the differences are not very striking.^{*18} The most important aspect is that the holder of a retention of ownership device is, in fact, entitled to separate (recover) the sold goods from the buyer’s estate; i.e., the owner’s right is not limited to a right to preferential payment.

3. Creation, effectiveness, and priority

My second ‘spotlight’ addresses some major conceptual characteristics of Book IX DCFR, which, as becomes apparent in the discussion that follows, generate certain practical effects. To see the difference, let us first consider how, traditionally, proprietary security rights come into existence in continental European legal systems. Such legal systems usually define certain requirements that must be met for a security right to be created (e.g., conclusion of a security agreement and/or a ‘real agreement’, plus delivery or registration), and once these requirements are cumulatively fulfilled, the security right comes into existence and is effective against everyone.^{*19} The DCFR parts with this—as one might call it—‘all or nothing’ principle and draws a clear distinction among three individual elements on the level of property law: creation, effectiveness against (certain) third persons, and priority.^{*20} Each of these has its own functions, and a separate chapter in Book IX is devoted to each (chapters 2–4).

¹⁴ This effect, however, is already achieved by insolvency law in at least a number of EU member states today (e.g., §51(1) of the German Insolvency Act or §10(3) of the Austrian Insolvency Act) and, therefore, does not constitute a substantive change. Rather, this can be seen as a step toward dogmatic consistency.

¹⁵ See, for example, from the German Supreme Court, or *Bundesgerichtshof*, BGH 12.3.1998, IX ZR 74/95. – *Neue Juristische Wochenschrift* (‘NJW’) 1998, p. 2047 (in German).

¹⁶ See BGH 27.11.1997, GSZ 1/97, GSZ 2/97. – *Entscheidungen des Bundesgerichtshofs in Zivilsachen* (‘BGHZ’) 137, p. 212 (in German), addressing ‘subsequent’ over-collateralisation resulting from revolving global security rights created by standard terms.

¹⁷ See IX.–1:103 DCFR.

¹⁸ IX.–1:104 DCFR declares most parts of Book IX applicable to such devices. As to substance, specific rules are provided only for creation and enforcement (in chapters 2 and 7 of Book IX DCFR).

¹⁹ A certain exception can be found in French law, wherein creation is effected by (written) contract (see Article 2336 of the French Civil Code), but opposability against third parties requires publicity—which can be achieved through dispossession (see Article 2337 of the French Civil Code) or registration (see Article 2338). Compare also the new Belgian regime (addressed in Note 9), distinguishing creation (in Articles 2 and 4) from opposability against third parties, again effected by registration (see Article 15) or dispossession (see Article 39).

²⁰ See the illustrative analysis by R. Macdonald (Note 7), p. 769. See also Comment B to IX.–2:101, DCFR Full Edition (Note 7), p. 5409 ff.

3.1. Creation (Chapter 2)

The first of these three elements is ‘creation’, which means that the security right comes into existence as a (limited) proprietary right. In consequence, the secured creditor is entitled to enforcement and satisfaction from the encumbered asset. Also, some third-party effects set in, however limited. In particular, a subsequent acquirer of the encumbered asset can acquire it free of these encumbrances only under rules on good-faith acquisition.^{*21}

There are different modes of creating a security right^{*22} or a retention of ownership device,^{*23} which I will not explore in more detail here. The basic modes of creating a security right are ‘granting’ by the security provider (comparable to creating a pledge)^{*24} and ‘retention’ by the secured creditor upon transferring of the asset (comparable to the traditional retention of title).^{*25} It is worth noting what creation requires and what it does not require. If we take the creation of a security right by ‘granting’ as an example, it is required that the parties have concluded a valid ‘contract for proprietary security’ and a ‘real agreement’ (*Verfügungsgeschäft*) and that both the asset (collateral) and the secured right exist. In addition, the asset(s) must be identified by the parties.^{*26} It is, however, not required for the element of ‘creation’ that possession be transferred or any kind of registration be performed.

3.2. Effectiveness against (certain) third parties (Chapter 3)

Such additional prerequisites must, however, be fulfilled by the security right in order for it to become ‘effective’ against certain important types of third parties. The three categories of third parties for which this is required are:^{*27}

- a) other holders of proprietary rights, including effective security rights, in the encumbered asset;
- b) a creditor who has started the process of execution against those assets and has already obtained a position providing protection against a subsequent execution; and
- c) the insolvency administrator of the security provider (who, so to say, represents all unsecured creditors)—it is, therefore, necessary to have an ‘effective’ security right in order to be protected in the matter of the security provider’s insolvency.

‘Effectiveness’ against these third parties can be achieved via three distinct methods. The general method, which is applicable to all types of assets, is registration (in an online, publicly accessible ‘European register of proprietary security’).^{*28} It is noteworthy that registration does not include any strict identification of the encumbered assets; nor does it presuppose that the security right has already been ‘created’. Alternatively, a security right in corporeal movable assets can be made effective by one’s holding possession of the encumbered asset,^{*29} and a security right over ‘financial assets’ and ‘financial instruments’ can be made effective through exercise of ‘control’ over the encumbered assets.^{*30}

²¹ Further examples of effects against third parties resulting from mere ‘creation’ are listed in Comment B to IX.–2:101, DCFR Full Edition (Note 7), p. 5409 ff.

²² See IX.–2:101 ff. DCFR. Special rules in IX.–2:301 ff. DCFR deal with the creation of security rights in specific types of assets.

²³ See IX.–2:201 DCFR.

²⁴ See IX.–2:105 ff. DCFR, including specific good-faith acquisition rules in IX.–2:108 and IX.–2:109 DCFR.

²⁵ See IX.–2:113 DCFR.

²⁶ See IX.–2:102 and IX.–105 DCFR. In addition, these rules provide that the asset must be transferable and that the security provider must have the right (as owner) or authority to grant a security right in the asset.

²⁷ See IX.–3:101(1) DCFR.

²⁸ See IX.–3:102(1) in conjunction with the registration rules in IX.–3:301 ff. DCFR.

²⁹ See IX.–3:102(2)(a) in conjunction with IX.–3:201 ff. DCFR.

³⁰ See IX.–3:102(2)(b) and IX.–3:204 DCFR. For example, ‘control’ is exercised if a financial asset entered in book accounts held by a financial institution may only be disposed of with the secured creditor’s consent; cf. IX.–3:204(2)(a) DCFR. This resembles the concept of ‘control’ applied under Directive 2002/47/EC on financial collateral arrangements. See OJ L 168/43, 27.6.2002.

3.3. Priority (Chapter 4)

Chapter 4, finally, regulates the regime of priorities between different rights *in rem* in one and the same asset. According to the basic rule,^{*31} priority is determined in accordance with the order of the relevant times (*prior tempore potior iure*). With regard to the relation between competing security rights—which is of the primary interest here—the relevant time is the time of registration, or the point in time when the security right otherwise becomes effective (whichever is earlier).^{*32}

The basic *prior tempore* principle is, however, subject to one important exception: IX.–4:102 DCFR provides ‘superpriority’, which means that certain rights are granted priority over certain other rights even if effectiveness was achieved later. The most important example is that (effective) ‘acquisition finance devices’ (i.e., retention of title and functionally equivalent devices) take priority over any security right (or other limited proprietary right) ‘created by the security provider’. Accordingly, for instance, where a buyer under retention of title has previously ‘pledged’ all future inventory, the acquisition finance device will take priority over earlier security right in inventory.^{*33}

3.4. Practical effects of splitting up creation, effectiveness, and priority

Apart from providing a technical framework for implementing the policy choice of granting privilege to acquisition financing, the splitting up of creation, effectiveness, and priority into three independent categories produces a number of remarkable practical effects. For example, it is possible to perform a registration even before a security right is ‘created’ in the sense of Chapter 2 and even before the contract for proprietary security is concluded.^{*34} Via such ‘advance filing’, effectiveness as well as priority can be ‘reserved’ for a creditor at a fairly early stage. Accordingly—and this will certainly be interesting for banks—a ‘secured’ rank can be guaranteed to the future lender already at the time of negotiation of the credit, and an attractive rank can be reserved for possible future extensions of credit. Secondly, collateralisation of ‘global units’, such as ‘all goods held as inventory’, is facilitated. In contrast to other registration systems, here precise ‘identification’ of the encumbered assets does not have to be achieved in the register—i.e., it need not exist for effectiveness and priority, only for creation. Accordingly, mistakes related to identification can be corrected later also, while the effectiveness and priority resulting from a registration already carried out can be maintained.^{*35} Thirdly, also securing future debts, even ‘all debts’ resulting from a business relation, is facilitated by allowing of filing before creation (which alone requires that the secured right already exist).

³¹ See IX.–4:101 DCFR.

³² See IX.–4:101(2)(a) DCFR.

³³ See IX.–4:102(1) DCFR. This functionally converges with the solutions adopted by courts in a number of legal systems, including Germany (with the so-called *Vertragsbruchtheorie*, assuming that a global assignment of future claims is void if it is intended to cover claims that the assignor is bound to assign to its suppliers who deliver goods under an ‘extended reservation of title clause’) and France (real subrogation). See BGH 30.4.1959, VII ZR 19/58. – BGHZ 30, 149 (in German); French Supreme Court, Commercial Chamber (or ‘Cour de cassation, chambre commerciale’) 20.6.1989, No. 88-11.720. – *Bulletin des arrêts de la Cour de cassation – Chambres civiles* (Bull. civ.) 1989 IV, No. 197, p. 131 (in French); see also V. Sagaert. Cour de cassation française, 26 Avril 2000 – priority conflict between the seller under title retention and the assignee of the resale claim. – *European Review of Private Law* 2002, pp. 823–835, with further comparative observations.

³⁴ Clarified by IX.–3:305(2) DCFR.

³⁵ For instance, according to §5 in conjunction with §29 of an Austrian draft proposal (see Note 39, below), identification of the collateral assets would have to be carried out in the register, and in case of doubt as to which assets are attached by the security right, the narrower coverage would be presumed (§5(3)). The draft was criticised for forcing the creditor to put considerable efforts into a concise description identifying the collateral and for causing the register to be overloaded with data. See M. Brinkmann (Note 7), p. 464; M. Gruber. Das Register für Mobiliarsicherheiten. Überlegungen zu Funktion und Organisation. – *Österreichische Juristen-Zeitung* (‘ÖJZ’) 2007, pp. 437–443, on p. 441 ff. (in German).

4. Notice-filing

My third ‘spotlight’ is on the functioning of the electronic register. In this respect, the DCFR applies a ‘notice filing’ system, following the example of Article 9 of the UCC. I confine myself to three characteristic features, which have the effects detailed below.^{*36}

Firstly, entries in the register have no ‘constitutive effect’ on the creation (or termination) of security rights. As we have seen, ‘creation’ in the sense applied in Chapter 2 does not require registration or other acts promoting publicity.

Secondly, the information obtainable from the register does not have to be particularly precise and detailed. The information may be limited to notice that a security right (or retention of ownership device) might be in existence. Described more precisely, the minimum information accessible from the register consists of:^{*37}

- a) the name and contact details of the security provider (which information is characteristic of any personal folio system);
- b) the name and contact details of the secured creditor;
- c) the date of registration (which is particularly important for determination of priority relations); and
- d) a ‘minimum declaration’ as to the encumbered asset and an indication as to the categories of assets (defined in a list) to which the encumbered assets belong.^{*38}

No details on the secured claim(s) must be provided, nor must the collateral be ‘identified’, in the sense of the common property-law principle of specificity, in the register. This may be regarded as reasonable in order to prevent security providers from becoming ‘debtors of glass’ (fully transparent debtors), as it has been put in the discussion on a law-reform project launched in Austria a couple of years ago,^{*39} which ultimately failed for lack of support by banks and other businesses. These circles were not attracted by the idea that even persons without any business relationship with the security provider (e.g., competitors) should be provided with detailed information about the security provider’s amount of debt and conditions of credit,^{*40} and that they might obtain a relatively detailed overview of the debtor’s means of production (such as machines and licences), ultimately allowing conclusions as to the debtor’s methods of production, quantitative capacities, and technical expertise.

In addition, where a potential creditor or business partner initially only intends to get a rough overview of the security provider’s financial situation, it may well be that information in brief form by reference to certain categories of assets can serve this function better than very detailed information that includes full identification. In particular, this may be the case where the person searching the register does not understand the language in which the entry is made (whereas the DCFR-specified categories could be displayed in any of several languages)—which one can presume would be a standard problem with a pan-European register.^{*41}

³⁶ On the following, see Comment C to IX.–3:301, DCFR Full Edition (Note 7), p. 5497. For a general introduction to characteristics of a notice-filing system (in addition to the literature quoted in Note 7), see, for example, E.-M. Kieninger, *Gestalt und Funktion einer „Registrierung“ von Mobiliarsicherungsrechten*, – *Rheinische Notar-Zeitschrift* (‘RNotZ’) 2013, pp. 216–225 (in German); H. Sigman, *Perfection and priority of security rights*, – H. Eidenmüller, E.-M. Kieninger (eds), *The Future of Secured Credit in Europe*, Berlin: De Gruyter 2008, pp. 143–165, 151 ff. – DOI: <http://dx.doi.org/10.1515/9783110970678.143>.

³⁷ See IX.–3:308(a)–(d) DCFR.

³⁸ See IX.–3:306(1)(b) and (c) DCFR. The provision on the ‘minimum declaration as to the encumbered assets’ in IX.–3:306(1)(b) DCFR is supplemented by IX.–3:306(2) DCFR, according to which ‘a declaration that the creditor is to take security over the security provider’s assets or is to retain ownership as security is sufficient’. What this means exactly does not become sufficiently clear from the comments to that provision; cf. DCFR Full Edition (Note 7), p. 5505. The wording of paragraph 2 does not help much; it even creates somewhat of an impression that subparagraph (b) in IX.–3:306(1) would address a specification not as to the encumbered asset (however limited that specification might be) but of the type of security interest (security right or retention of ownership device). From the comments (*ibid.*), however, it appears clear that the provision really deals with a description of the assets involved.

³⁹ Published in Martin Schauer (ed.), *Ein Register für Mobiliarsicherheiten im österreichischen Recht*, Vienna: Manz 2007 (in German), p. 33 ff. (recommendations) and p. 43 ff. (draft articles plus comments). This draft was not an ‘official’ (state-originated) legislative proposal; it was developed by a ‘private’ research group composed of academics and notaries.

⁴⁰ In the case of a pledge—see §29(3) in conjunction with §7(2) of the Austrian draft (Note 39)—it is required that both the amount of the secured claim and the interest rate be registered.

⁴¹ Further problems associated with language and the registration system proposed in Book IX of the DCFR (such as non-discrimination with respect to language) are discussed by Jacobien Rutgers, *Registered European security instrument in a*

Thirdly, any precise information, such as whether a proprietary security right has, in fact, been created, has not ceased to exist, and which assets exactly are used as collateral can be ascertained only by means of further enquiries. The source of information for such further enquiries is the secured creditor, whose name and address are visible in the register. There is—at least—a two-part logic underlying this approach:

- The secured creditor is the most reliable source for such information. The alternative source, the security provider, would be subject to significant conflict of interests: He would profit from offering the prospective creditor far-reaching collateralisation, and this could create a risk that the actual situation of encumbrances is not reported correctly. In order to be truly sure, prospective creditors would, therefore, contact the original secured creditor anyway. This, by the way, is consistent with a practice commonly applied in the German banking context, wherein future creditors must obtain an overview of non-publicised security transfers.^{*42}
- The notice-filing system further builds upon this superior reliability of the creditor and imposes on the creditor a duty to give such additional information.^{*43} However, said duty arises only if the request for additional information is made with the security provider's approval. This involves the second prong of the logic underlying the DCFR model: Whereas minimal information, which is not necessarily reliable, should be readily available to the general public, it should be up to the security provider to decide to whom detailed and valid information is to be disclosed. The security provider will approve a request if he has a vital interest in obtaining credit from this third person or entering into a business relationship with that person. If, on the other hand, approval is not given, a prospective business partner should be left suspicious.

In this way, Book IX provides a kind of midpoint in its solution regarding publicity. The extent to which the security provider becomes a 'debtor of glass' is reduced in comparison to registration regimes providing full publicity (such as that under the Austrian draft proposal of 2006/2007).^{*44} On the other hand, the DCFR system certainly provides more publicity than does the Dutch 'undisclosed pledge'^{*45} or the current Austrian solution addressing security assignments of claims^{*46} (in the latter, the information provided by bookkeeping entries is accessible only to those to whom the bookkeeping is disclosed, from which it follows that third parties are fully dependent on the security provider's approval of giving information). And, evidently, Book IX provides more publicity than the German and Estonian transfer of ownership for security purposes, which lacks any publicity if made by way of *constitutum possessorium*.

Fourthly and finally, further characteristics of the registration system^{*47} include that entries in the register are made directly by the secured creditor^{*48} and require the prior consent of the security provider. Such declarations of consent too are made directly in the register.^{*49} The register is to operate as a personal folio system; i.e., entries are filed against identified security providers.^{*50} The register operates electronically

multilingual European Union. – S. van Erp *et al.* (eds.). *The Future of European Property Law*. Munich: Sellier European Law Publishers 2012, pp. 153–163. – DOI: <http://dx.doi.org/10.1515/9783866539310.153>.

^{*42} See H.-J. Lwowski. Ökonomische und rechtliche Anforderungen an ein optimal funktionierendes Mobiliarkreditsicherungsrecht aus der Sicht der Praxis. – J. Basedow *et al.* (eds.) (Note 8), pp. 173–181, on p. 178 *ff.* (in German).

^{*43} See IX.–3:319 DCFR. The information duty is sanctioned by liability rules and specific good-faith acquisition provisions; see IX.–3:322 and IX.–3:323 DCFR.

^{*44} See Note 39, above.

^{*45} The Netherlands have adopted a (constitutive) registration system not intended to serve publicity interests: Under Article 3:227 of the Dutch Civil Code, an 'undisclosed pledge' can be created by an entry in a register (not searchable by the public) maintained by the competent tax authority, which apparently has the purpose merely of avoiding the possibility of backdating security agreements. Alternatively, an undisclosed pledge can be created via establishment of an 'authentic deed' (in practical terms, a notarial deed). See, for instance, M. Veder. Netherlands. – H. Sigman, E.-M. Kieninger (eds.). *Cross-Border Security over Tangibles*. Munich: Sellier European Law Publishers 2007, pp. 193–220, on p. 195 *ff.* – DOI: <http://dx.doi.org/10.1515/9783866537057>

^{*46} In Austria, the publicity requirement laid down for pledges (in §452 of the Austrian Civil Code) is applied by analogy to security assignments of claims. The law is considered to require either notice to the debtor (given by either the security provider or the secured creditor) or an entry in the bookkeeping program of the security provider that points at the creation of the security right. For a detailed account, see, for example, H. Wiesinger. *Kreditsicherung durch Forderungsabtretung*. Vienna: Manz 2010 (in German).

^{*47} On the following, see Comment C to IX.–3:301, DCFR Full Edition (Note 7), p. 5497 *ff.*

^{*48} See IX.–3:305(1) DCFR.

^{*49} See IX.–3:306(1)(d) and IX.–3:309 DCFR.

^{*50} See IX.–3:302(1) DCFR.

and is directly accessible to its users in online form;^{*51} that is, the filing and searching are executed online. Access to the register for search purposes is open to anyone (subject to the payment of—rather low—fees).^{*52} The register can be searched either for entries filed against an individual security provider or for entries pertaining to specifically defined assets,^{*53} provided that information sufficiently detailed for identifying individual assets was provided upon registration (e.g., the serial number of a machine). Entries are made directly by the parties, without involvement of a public registrar who might have to check the particulars of the security right and the content, let alone the validity of the registered facts. This should facilitate rapid or even immediate processing of filings, so that achievement of third-party effectiveness for security rights is not delayed or impeded.

5. Further features

Another aspect that should be spotlighted briefly is costs. The examples of countries operating notice-filing systems indicate that the registration system can be run, and be used, at considerably low cost.^{*54}

The final areas I want to touch on, at least briefly, are retention of title and functionally equivalent devices (so-called acquisition finance devices).^{*55} We have already mentioned one important aspect – namely, that acquisition finance devices are granted ‘superpriority’.^{*56} Such superpriority can be contractually extended to proceeds from the collateral goods in the case of resale.^{*57} Further aspects include, first and perhaps most notably, Book IX DCFR requiring acquisition finance devices to be registered in order for ‘effectiveness’ to be gained against third persons in the sense of Chapter 3.^{*58} This is a departure from the approach in many European countries and proves to be a major point of criticism^{*59}; however, the problem is mitigated by a grace period of 35 days from delivery^{*60} and by the fact that a single act of registration can, in effect, cover all future deliveries within a long-term business relationship.^{*61}

Secondly, it is noteworthy that Book IX accepts both the concept of a) ‘retention of ownership’ in a strict sense—i.e., retention of the full right of ownership, which is enforced by the seller (secured creditor) through termination of the contract and recovery of the goods—and that of b) retention of a mere security right, in which case the seller does not terminate the contract but enforces its secured claim and also does not recover possession of the goods but has a right to preferential payment from the collateral. Thirdly, I want to point out an innovative solution for situations wherein goods sold under retention of ownership (or a similar device) are used by the buyer to produce ‘new goods’ (called ‘production’ in the DCFR). Provided that the parties have concluded an agreement to this effect, the ‘producer’ (the buyer) acquires sole ownership of the products but the supplier of material is entitled against the producer to

⁵¹ See IX.–3:302(2) DCFR.

⁵² See IX.–3:317 DCFR.

⁵³ See IX.–3:318 DCFR.

⁵⁴ For example, as of January 2014, the fee for registering a security right (filing a ‘financial statement’) is 20.00 USD (if the registering is done electronically) and the fee for a search request is \$25.00, in New York (the corresponding fees in Ohio are \$12.00 and \$20.00, respectively, and those in Pennsylvania are \$84.00 and \$12.00).

⁵⁵ The concept of ‘acquisition finance devices’ is defined in IX.–1:201(3).

⁵⁶ See Section 3.3.

⁵⁷ Proceeds from a resale by the buyer under retention of ownership (or a similar device) are covered by IX.–2:306(3) DCFR (as ‘other proceeds’). In cases of these, extension of the security right requires agreement by the parties. Effectiveness is achieved by registration of the extension to proceeds. If registration is performed, proceeds from an acquisition finance device are also granted the superpriority of the original security interest. By means of this superpriority, the seller under retention of title trumps creditors of the buyer to whom the latter has previously granted a global security right in all future claims. See also Section 3.3 in the context of Note 33, above.

⁵⁸ See the general rule in IX.–3:107(1) DCFR.

⁵⁹ E. Dirix. Security rights in the DCFR from a Belgian perspective. – V. Sagaert *et al.* (eds). *The Draft Common Frame of Reference: national and comparative perspectives*. Cambridge, UK; Antwerp, Belgium; Portland, Oregon: Intersentia 2012, pp. 313–320, on p. 319. The Belgian legislator followed Dirix and in its recent reform did not adopt a registration requirement for retention of title devices (see Note 9).

⁶⁰ According to IX.–3:107(2) DCFR, if registration is effected within 35 days after delivery of the asset supplied, the acquisition finance device is effective from the date of creation.

⁶¹ See W. Faber (Note 7), p. 425f.

compensation for the value of the material, secured by a proprietary security right in the new goods.^{*62} This solution takes care of the producer-buyer's sovereignty interests just as much as of the supplier's value interests.

6. Conclusions

In conclusion, I believe that Book IX DCFR offers several solutions that are both efficient and appropriate in their substance. I do not wish to argue for an uncritical wholesale adoption. Some of its concepts are particularly complex and different from the law seen today in many European countries. Difference, as we know, has some deterrent effect in the development of law. But if the overall results are significantly better, the force of arguments (or, rather, fears) grounded in issues of difference alone should decrease.

The crux of the matter, therefore, is to determine in detail and with care in what regard and to what extent the solutions offered by these model rules would actually be a step forward. This evaluation will actually be unique from each individual Member State's perspective and may again be different when one is focusing not on potential national reforms alone but on some kind of European integration in this area—in particular, encompassing a common European registration system. It is clear to me that such evaluations take their time, and this is good. Hasty decisions are usually not the best ones. Such evaluations may (and do), of course, reveal problems, which I hope will lead to attempts to modify or amend the model rules proposed in the DCFR and to re-evaluation of the issue in view of them. For example, the facilitating of global security rights evidently increases the 'risk' of one first-rank creditor absorbing the value of more or less all movable assets. Lower-ranked secured creditors and also unsecured creditors may be left with virtually nothing in the event of the debtor's insolvency. This requires some basic discussion as to the extent to which such an effect can be considered acceptable. On that basis, countermeasures should probably be adopted, such as 'carving out' a certain percentage in the eventuality of insolvency.

In any case, there is reason to hope that secured-transactions law in Europe can make considerable steps forward in the years to come.

⁶² See IX.–2:308(1) and (2)(a) DCFR. See also VIII.–5:201(1) DCFR, to which Book IX refers in this regard, along with comments C and D to VIII.–5:201, DCFR Full Edition (Note 7), p. 5067 *ff.* The security right in the product is effective on the condition that the extension agreement is registered (see Comment C to IX.–2:308, DCFR Full Edition, p. 5469 *ff.*). This can be handled at once when one is registering the original retention of ownership device. Finally, the (super-)priority of the security right is not affected, provided that the security right validly extends to the product – i.e., provided that this has been agreed upon by the parties; see IX.–4:103(1)(b) DCFR and Comment C to IX.–2:308, DCFR Full Edition, p. 5470.



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Developments in the Scottish Law of Land Registration

1. Introduction

This article considers the background to the recently enacted Land Registration etc. (Scotland) Act 2012, which is due to come fully into force in 2014. A useful starting point may be to draw some general comparisons between Scotland and Estonia, with the aid of the following table.^{*1}

	Scotland	Estonia
Population	5.3 million	1.3 million
Area	78,387 km ²	45,227 km ²
Commencement of public land registration	1617	1747 (though discontinued in the Soviet era)
Percentage of area in Land Register	23% (almost all the rest is in the Register of Sasines)	61% (land held by the state does not have to be registered; 90% is in cadastre systems)
Registered title units	2.3 million (56% in the Land Register and 44% in the Register of Sasines)	969,000
Parts of a Land Register entry	A. Property (mapped) B. Proprietorship C. Securities D. Burdens	1. Cadastral information 2. Proprietorship 3. Burdens 4. Securities

In broad terms, the table simply shows that Scotland is a larger country than Estonia: with a population four times greater and being one and a half times larger by area. It also has more than double the number of registered title units. With this in mind, it is perhaps difficult not to think about 18 September 2014. On that date, there will be a referendum in Scotland on independence from the United Kingdom. Perhaps the main argument against separation is that Scotland is in a better position as part of a larger country^{*2}, yet Scotland is considerably bigger than Estonia.

¹ The main sources of the information here are <http://eulis.eu/service/countries-profile/estonia/> and <http://www.ros.gov.uk/pdfs/landmasscoveragereport2012.pdf> (most recently accessed on 29.1.2014).

² See <http://www.bettertogether.net/> (most recently accessed on 29.1.2014).

If one examines the last part of the table, a marked similarity between the format of the Estonian and Scottish land registers can be seen. Accordingly, there may indeed be things that these two countries can learn from each other.

2. The Registration Act 1617

Scotland was one of the first countries in the world to introduce legislation on land registration.^{*3} It did so in 1617, more than a hundred years before Estonia did.^{*4} The Registration Act of that year, written in old Scots, provides the following:

Oure Souerane Lord Considdering the gryit hurt sustened by his Maiesties Liegis by the fraudulent dealing of pairties who haveing annaliet their Landis and ressaut gryit soumes of money thairfore [...] FOR remedie whereoff and of the manye Inconvenientis whiche may ensew thairupoun HIS Maiestie with aduyis and consent of the estaittis of Parliament statutes and ordanis That thair salbe ane publick Register.^{*5}

The fundamental reason for the legislation was individuals selling the same piece of land more than once. Stopping fraud such as this necessitated a register, and that register had to be a public one. Section 55 (1) of the Estonian Law of Property Act is to a similar effect.^{*6}

The 1617 Act established a register known as the Register of Sasines.^{*7} It is run by a government department known as Registers of Scotland.^{*8} This is in contrast with Estonia, where the register is under court supervision. The head of the department or chief registrar is known as the Keeper of the Registers of Scotland (or more commonly as ‘the Keeper’). The name ‘Sasine’ comes from the now obsolete ceremony of ‘giving Sasine’, wherein the transferor had to hand over symbols of the land to the transferee as part of the transfer process.^{*9} Those symbols were earth and stone.

The key features of the Register of Sasines are the following. First and most importantly, it is a register of *deeds* rather than a register of title. In effect, it is a warehouse; one that contains millions of deeds. To be more accurate, one could say that it contains millions of **copies** of deeds. When a deed of transfer is sent to the register, a copy is made of it and the original returned to the transferee. In the old days, the copy was made with quill and ink. More recently, photocopying has become available, and now, of course, there is digital scanning.

The Register of Sasines is organised into 33 local areas, called counties. The register can be searched within a particular county for the relevant deeds by a) person and b) the address of the property. However, the register itself does not directly state who the owner is: the relevant deeds have to be interpreted. There is also no national map or cadastre. Indeed, it became possible to register deed plans only from 1924.^{*10}

The Register of Sasines is a ‘negative’ registration system. In other words, the validity of a transfer depends entirely on the validity of the deed being registered. For example, a deed of transfer granted by someone who is not the owner of the land in question will be ineffective. So too will a deed granted by

³ See http://www.ros.gov.uk/public/about_us/history.html (most recently accessed on 29.1.2014).

⁴ Public land registries were introduced in Estonia in 1747. See M. Kaing, Real property cadastre in Estonia. – V. Parsova, V. Gurskiene, M. Kaing (eds). *Real Property Cadastre in Baltic Countries*. 2012, p. 11. Available at <http://www2.llu.lv/homepg/zigk/materiali/V.Parsova,%20V.Gurskiene,%20%20M.Kaing.%20Real%20Property%20Cadastre%20in%20Baltic%20Countries.pdf> (most recently accessed on 29.1.2014).

⁵ In modern English: ‘Our Sovereign Lord considering the great hurt sustained by His Majesty’s people by the fraudulent dealing of parties who, having transferred their land and received great sums of money therefor [...] for remedy whereof and of the many inconveniences which may ensue thereupon, His Majesty with the advice and consent of the estates of Parliament sets forth a statute and ordains that there shall be a public register.’

⁶ See P. Pärna, The Law of Property Act—Cornerstone of the Civil Law Reform. – *Juridica International* 2001, p. 93.

⁷ For an overview, see G.L. Gretton, A.J.M. Steven, *Property, Trusts and Succession*, 2nd ed. Haywards Heath: Bloomsbury Professional 2013, paragraphs 6.8–6.13.

⁸ See <http://www.ros.gov.uk/> (most recently accessed on 29.1.2014).

⁹ See K.G.C. Reid, *The Law of Property in Scotland*. Edinburgh: Law Society of Scotland / Butterworths 1996, paragraph 89 (referring to G.L. Gretton).

¹⁰ Conveyancing (Scotland) Act 1924, Section 48.

someone who lacks legal capacity to do so. Also, there is no protection for someone relying on the register in good faith. Finally, no state indemnity/compensation system can be called upon if something goes wrong.

Conveyancing in the Register of Sasines is complex. It can be done only by experts—in practice, trained lawyers—because it is necessary to know how to find the relevant deeds and how to check them correctly. Therefore, pressure grew in the 1960s and 1970s for adoption of a simpler system.^{*11}

3. The Land Registration (Scotland) Act 1979

That pressure led to the Land Registration (Scotland) Act 1979, which was enacted in the dying days of the government that preceded Margaret Thatcher's coming to power. The 1979 Act established the Land Register of Scotland.^{*12} It too is run by Registers of Scotland.

Under the 1979 Act, land is transferred from the old register to the new as and when the land is sold for the first time after the new register's coming into operation.^{*13} According to the latest figures, 56% of title units are now in the Land Register, with 44% still in the Register of Sasines. Clearly, there is still a long way to go before completion of the transition from the old register to the new one.

The key features of the Land Register under the 1979 Act are the following. Firstly, it is based on the English Land Register and English legislation. This was where things started to go wrong, as Scottish property law is rather different from that in England.^{*14} Although Scotland is perhaps most famous in European private-law terms for being a mixed legal system, its property law is strongly civil in character. Secondly, the Land Register is a register of title, of similar nature to the Estonian Land Register. Registers of title were a development of the nineteenth century, and there are three main families of such registers: a) the Germanic systems, b) the Torrens systems^{*15}, and c) the English systems.^{*16} In all of these, the register directly states who the owner is. In addition, the Land Register is divided into the same local areas as the Register of Sasines. Fourthly, each property has a title sheet rather like one of the deed cards in the board game Monopoly. Each title sheet has a unique title number. For example, the title number for Edinburgh Castle is MID1 ('MID' is the abbreviation for 'Midlothian'). The title sheet has four parts, per the table on the first page of the article. Part A, the Property Section, identifies the property relative to a national map. Mapping is a major innovation in comparison with the Register of Sasines. Part B, the Proprietorship Section, identifies the land-owner. Part C is the Charges Section, identifying any mortgages (or 'standard securities', if one wishes to use the correct technical term). Finally, part D, the Burdens Section, addresses any servitudes or other encumbrances. A fifth feature is that the register itself is entirely electronic.

Sixthly, in another huge change relative to the Register of Sasines, the Land Register is a 'positive' system of registration with immediate indefeasibility. In other words, the validity of an entry in this register does *not* depend on the validity of the underlying deed. Imagine that Brait grants a deed transferring five fields to Maarja when, in fact, he owns only four of them and a mistake is made in the plan attached to the deed. The fifth field is owned by Triin. Maarja acquires ownership of all five fields if the Keeper registers her as the owner, even although Brait owned only four of them.^{*17} This effect has become known as the Keeper's 'Midas touch', after King Midas, who turned everything he touched into gold. Under the 1979 Act, everything that the Keeper touches becomes valid.^{*18} Maarja's acquisition of ownership is immediate, taking place as soon as registration is performed.

^{*11} G.L. Gretton and A.J.M. Steven (see Note 7), paragraph 6.14.

^{*12} Land Registration (Scotland) Act 1979, Section 1.

^{*13} The Land Register was brought into operation in stages by county, with the process beginning in 1981 and with the final counties being added in 2003.

^{*14} See, for example, K.G.C. Reid (see Note 9), paragraph 2: 'A lawyer trained in Scotland can without difficulty (other than linguistic difficulty) read and understand a book about the law of property in Germany [...]. But he is likely to be perplexed and bewildered by a book on the law of property in England.'

^{*15} Notably Australia and New Zealand.

^{*16} E. Cooke. *The New Law of Land Registration*. Oxford: Hart Publishing 2003, p. 11.

^{*17} Land Registration (Scotland) Act 1979, Section 3(1)(a).

^{*18} Scottish Law Commission. Discussion paper on land registration: Void and voidable titles. (paper 125, 2004), paragraph 5.34. Available at <http://www.scotlawcom.gov.uk/publications/> (most recently accessed on 29.1.2014).

What can happen if mistakes such as this occur? The 1979 Act provides for a process called rectification.^{*19} Utilising it, Triin as the former owner of the fifth field can apply to have the register rectified, against Maarja's interests. However, as with the English legislation that influenced the 1979 Act, rectification is generally not available against a proprietor in possession without that person's consent. Accordingly, if Triin happened to be abroad while the transfer took place and Maarja took possession of the extra field in good faith, it might be impossible to rectify against her in this manner.

Finally, the 1979 Act offers a system of state indemnity (compensation) when someone suffers a loss through the Keeper rectifying or refusing to rectify the register.^{*20} In the above example, Triin would be entitled to compensation if the register does not get rectified in the end.

It became apparent as the 1980s and 1990s progressed that the new system, while in many ways being a great improvement on the Register of Sasines, was defective. The 1979 Act itself is inadequate and all too brief. It extends to only 30 sections, and some of these are on other topics. Moreover, in the words of Professor George Gretton, it 'has all the intellectual sharpness of a mashed potato'.^{*21}

At a practical level too, the legislation was not working: land was moving from the old register to the new register too slowly. As has already been mentioned, about 44% of titles are still in the old register rather than the new one. Indeed, only 23% of Scottish land mass is covered by the new register. This is because land held by public bodies or estates owned by aristocratic families are rarely sold.

A further problem with the 1979 Act is that immediate defeasibility is not very consistent with underlying principles of property law such as the *nemo plus iuris ad alium transferre potest quam ipse habet* rule (which one can translate as 'no-one can give what he does not have'). Reference can be made again to the example of Brait, Maarja, Triin, and the fifth field. What the 1979 Act does is create its own set of property-law rules, leading to what the Scottish Law Commission has called 'bijuralism'.^{*22} The result is incredibly complex.

A final difficulty is that possession is used rather too bluntly to protect a registered proprietor. Why should Triin, who happened to be away from her field for a matter of weeks, lose out? In fact, there was a case in Glasgow that involved competing parties hiring locksmiths to change the locks on the door to a flat so that they could assert that they were in possession.^{*23} Another case involved divers moving bollards in a river to assert possession of the relevant part of it on behalf of owners of other land who were supermarkets—one of which had an interest in erecting a bridge over the river.^{*24}

On account of all the defects, the Keeper of the Registers of Scotland asked the Scottish Law Commission to review the 1979 Act. A public body that advises the Scottish Government on law reform, the Scottish Law Commission has five commissioners and various legal and administrative support staff. The project focusing on the 1979 Act was initiated by the property-law commissioner of the time, Professor Kenneth Reid. His term as a commissioner concluded in 2005, and it fell to his successor—the above-mentioned Professor Gretton—to complete the job. Throughout the project, the Scottish Law Commission had the benefit of a member of staff from Registers of Scotland being seconded to work for it. The commission eventually published a lengthy two-volume report, in 2010, which included a new draft Land Registration (Scotland) Bill.^{*25}

The report was accepted in substantial part by the Scottish Government, and legislation based on the draft bill was brought before the Scottish Parliament. This entered into law as the Land Registration etc. (Scotland) Act 2012.

¹⁹ Land Registration (Scotland) Act 1979, Section 9.

²⁰ *Ibid.*, Section 12.

²¹ In his case comment on *Kaur v. Singh*. See 1997 SCLR 1075 at 1085. See also *Short's Tr. v. Keeper of the Registers of Scotland*, 1996 SC (HL) 14 at 26: 'Nobody could accuse the Act of being well drafted.' But the blame should not be heaped on the draftsmen. The underlying policy was not thought through sufficiently well. See *MRS Hamilton Ltd v. Keeper of the Registers of Scotland*, 2000 SC 271 at 275 per Lord President Rodger.

²² Scottish Law Commission (see Note 18), paragraph 1.11.

²³ *Kaur v. Singh*, 1997 SCLR 1075.

²⁴ *Safeway Stores plc v. Tesco Stores Ltd*, 2004 SC 29.

²⁵ Scottish Law Commission, Report on Land Registration (SLC 222, 2010). Available at <http://www.scotlawcom.gov.uk/publications/>.

4. The Land Registration etc. (Scotland) Act 2012

The reason that the 2012 Act is scheduled to come into force in late 2014 is that there needs to be a transitional period for Registers of Scotland, solicitors, and others to prepare.^{*26} One can note several key features of the new legislation. Firstly, it is a much longer and more sophisticated piece of legislation than the 1979 Act, extending as it does to 124 sections. This makes it of a very similar length to the Estonian Land Register Act of 1993. Secondly, its underlying theme is evolution rather than revolution.^{*27} The Land Register continues as an electronic mapped register of title. Thirdly, the 2012 Act enables the process of moving over from the Register of Sasines to the Land Register to be sped up.^{*28} All transfers of land must be registered, not just transfers upon sale.^{*29} Where there is no transfer, the owner of the land may apply for voluntary registration.^{*30} In addition, from a date yet to be decided by the Government, the Keeper will be able to move land from the old register to the new register compulsorily.^{*31}

Fourthly, immediate defeasibility and, along with it, the Midas touch and bijuralism are eliminated. Let us return to our example. Maarja would not become the owner of the fifth field, for the 2012 Act introduces **deferred** defeasibility, rather akin to the position in Estonia^{*32} and in Germany.^{*33} This means that if Kaspar, a third party acting in good faith, were to purchase the field from Maarja, he would acquire ownership because he is entitled to rely on the register.^{*34}

Fifthly, the role of possession is reduced. The mere fact that someone registered as proprietor is in possession of the land does not entail that person is protected. Yet possession does play a role in relation to defeasibility. If we go back to our example once again, Kaspar will be protected from rectification only if the total time for which he and predecessor Maarja have been in possession of the field is at least a year.^{*35} Accordingly, if the initial transfer from Brait to Maarja and then the transfer onward to Kaspar took place in the course of the one summer, while Triin, the original owner of the fifth field, was in Salzburg, Triin would be able to have the register rectified. Kaspar's remedy would be compensation from the Keeper. What the 2012 Act is doing here is making a choice with a division between who gets 'the mud' and who gets 'the money'.^{*36}

Sixthly, the system of indemnity is reformed and replaced with what is known as 'the Keeper's warranty'. The 2012 Act provides that 'the Keeper, in accepting an application for registration, warrants to the applicant that, as at the time of registration, the title sheet to which the application relates (a) is accurate [...] in so far as it shows an acquisition, variation or discharge in favour of the applicant'.^{*37} Therefore, if the Keeper registers Maarja as the owner of the fifth field and then rectifies the register upon Triin turning up within a year to contest this, compensation must be paid to Maarja. This is the position when Maarja is in good faith. If she is in bad faith, compensation is excluded.^{*38} It is worth emphasising that the Keeper's duty to pay compensation is more extensive than is generally seen in the Germanic systems; there, compensation is normally payable only for mistakes that are directly the registrar's fault.

Finally, the 2012 Act introduces 'advance notices'. In this there was influence from the German *Vormerkungen*^{*39} as much as from English law.^{*40} At the moment, problems that arise in Scotland in the time between settlement of the sale transaction and registration are covered by the selling solicitor's indemnity

^{*26} See <http://www.ros.gov.uk/2012act/background.html> (most recently accessed on 29.1.2014). For an overview, see G.L. Gretton and A.J.M. Steven (see Note 7), paragraphs 6.21–6.79.

^{*27} Scottish Law Commission (see Note 25), paragraph 1.7.

^{*28} *Ibid.* (see Note 25), Part 33.

^{*29} Land Registration etc. (Scotland) Act 2012, Sections 48 and 50.

^{*30} *Ibid.*, Sections 27–28.

^{*31} *Ibid.*, Section 29.

^{*32} Estonian Law of Property Act 1993, Section 56.

^{*33} Bürgerliches Gesetzbuch (BGB), Section 892.

^{*34} Land Registration etc. (Scotland) Act 2012, Section 86.

^{*35} *Ibid.*, Section 86(3)(a).

^{*36} The phrase about 'the mud or the money' comes from T.W. Mapp. *Torrens' Elusive Title: Basic Legal Principles of an Efficient Torrens' System*. 1978, paragraph 4.24, and it is used extensively by the Scottish Law Commission in its report.

^{*37} Land Registration etc. (Scotland) Act 2012, Section 77(1)(a).

^{*38} *Ibid.*, Section 78(b).

^{*39} BGB, Sections 883–888. See, for example, D. Assman. *Die Vormerkung*. Tübingen, Germany: Mohr Siebeck 1998.

^{*40} Land Registration Act 2002, Section 72.

insurance. A 'letter of obligation' is issued in this regard. In Scotland, independent notaries do not act in land transactions. Instead, there are simply solicitors acting for the seller and solicitors for the buyer. Concerns expressed by the Scottish legal profession as to whether insurance cover would continue to be available indefinitely on reasonable terms led the Scottish Law Commission to recommend the introduction of advance notices, described below.

When registered in the Land Register, these notices give protection for a period of 35 days. Take the following example. On day 1, Katri agrees to buy a piece of land from Peter. On day 2, she registers an advance notice in the Land Register. The next day, Peter fraudulently sells the same land to Kristina. On day 4, Peter grants a deed of transfer to Kristina, which she registers in the Land Register; then, on day 5, he grants a deed of transfer to Katri, which she registers in the Land Register. Under general principles of property law, Kristina 'wins' because she registered first. But because Katri has filed an advance notice, she becomes the owner upon registration of the deed of transfer on day 5. Similarly, Katri would prevail against any of Peter's creditors who try to execute diligence with respect to the land—i.e., who try to enforce any debts against the land in the time covered by the advance notice.

5. Conclusions

What are the lessons of the Scottish experience? First, land registration is a hugely important area of property law and critical in economic terms. Any reform of it needs to be carefully considered and given appropriate resources and time. Secondly, as always with law reform, comparative law must be drawn from and used appropriately. The mistake with the 1979 Act was to look only at English law. In the preparation of what is now the 2012 Act, the Scottish Law Commission rightly took a far broader approach. Thirdly, rules on land registration should be as consistent as possible with the underlying system of property law. Bijuralism should be rejected. The 2012 Act is a significant step forward for Scotland and to a certain extent makes our system closer to that in Estonia.



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Reform of Land Registration in Latvia

1. Introduction

Usually a distinction is drawn between 'land' and 'chattels'. One source describes the difference thus: 'For example, a brick in a builder's yard is a chattel; once used to build a wall, it becomes a part of the land; and if the wall is knocked down, the bricks become chattels again'.^{*1}

What is known as the *superficies solo cedit* principle is extracted from the sources of Roman law (Gaius, D. 41, 1, 7, 10):

When someone builds on his own site with another's materials, he is deemed to be owner of the building because all that is built on it becomes part of the soil. However, the owner of the materials does not thereby lose his ownership of them [...]. Hence, if the house should collapse for some reason, the owner of the materials can have a vindication for them and have an action for their production.^{*2}

The same principle is prescribed by Section 968 of the Latvian Civil Law^{*3} (hereinafter also 'CL'): 'A building erected on land and firmly attached to it shall be recognised as a part thereof.'

Similar use of the term 'land plot' (the concept of *Grundstück*) can be found in §94 of the German Civil Code^{*4} (Bürgerliches Gesetzbuch, or BGB).

Although the Latvian CL does not use the term 'land plot' or 'plot of land', it rather frequently employs the term 'immovable property' (see, for instance, Subdivision II of Sub-chapter IV of Chapter III: 'Rights of Owners in Regard to Immovable Property in General'), which is regarded as a synonym for the term 'immovable' in the doctrine associated with the Latvian CL.^{*5}

Therefore, the terminology of the Latvian CL meshes with the common understanding of what the 'land', 'plot of land', or 'immovable' is, even though Latvian law does not always draw strict distinctions among the above-mentioned terms or mark out a clear delineation between the immovable as an object of rights and the right or interest in the immovable.

¹ E.H. Burn, J. Cartwright. *Maudsley & Burn's Land Law Cases and Materials, Ninth Edition*. Oxford University Press 2009, p. 6.

² *The Digest of Justinian, Volume 4: English Language Translation Edited by Alan Watson*. University of Pennsylvania Press 1998, p. 3.

³ Civillikums (Civil Law). 'Valdības Vēstnesis', 41, 20.2.1937 (in Latvian).

⁴ Bürgerliches Gesetzbuch. BGBl. I S. 42, 2909; 2003 I S. 738. English text available at http://www.gesetze-im-internet.de/englisch_bgb/ (most recently accessed on 6.2.2014).

⁵ A. Grūtups, E. Kalniņš. *Civillikuma komentāri. Trešā daļa. Lietu tiesības. Īpašums* ['Comments on the Civil Law, Part III: Property Law, Ownership'], 2nd edition. TNA 2002, p. 23 (in Latvian).

In line with other codes of civil-law systems, the CL does not use the term ‘estate’ in the meaning of the ‘amount of a person’s interest in land’,⁶ although the term ‘estate’ might be used sometimes in the meaning associated with heritage (see Sections 1021 and 1288 of the CL).

Although the CL distinguishes between movable (chattels) and immovable things (in Section 842), very little attention is devoted to this important feature of modern civil law. In this regard, the regulation in the CL is strikingly similar to that of Roman law. For instance, the CL provides for acquisition of ownership pursuant to delivery (in its Sections 987–997) no matter whether it is a chattel or an immovable at issue. Acquisition of property through prescription (addressed in Sections 998–1031 of the CL) refers to chattels just as well as to immovables. The only distinction mentioned here is in Section 1023 (‘Prescription for the acquisition of movable property shall be considered completed after the elapsing of one year’) as compared to Section 1024 (‘A person who has possessed an immovable property for a ten-year period in accordance with the provisions on prescription [...] shall be recognised as a person who has acquired such immovable property through prescription’). Although acquisition of immovable property through prescription usually is regarded as incompatible with the land-registration system (there are a few exceptions, but these have to do only with unregistered rights⁷, not those rights that are already registered—*praescriptio contra tabulas*), the possibility of such acquisition is still admitted, at least in theory. Moreover, it has even been concluded that in such cases the rights of an unregistered proprietor can lead to rectification in favour of the registered adverse rights of another person.⁸ However, such conclusions seem to be based on outdated sources and for this reason can be regarded as incorrect.⁹

As to the principles of land registration, Latvian law indirectly features all of the most important.

The principle of obligatory registration is prescribed by Section 1477 of the Latvian CL: ‘Corroboration shall be required in those cases wherein the transaction grants property rights over immovable property.’

The principle of public credibility is prescribed by Section 994 of the CL: ‘Only such persons shall be recognised to be owners of immovable property as are registered in the Land Register as such owners.’

The principle of certainty is prescribed by Section 993 (3) of the CL, which states that ‘each immovable property that is not an appurtenance to another such property must be registered in the name of the new owner as a new [...] parcel’. This principle is also prescribed by Section 29 of the Land Register Law¹⁰: ‘A separate division for each independent immovable property shall be opened in a land register.’

The principle of seniority is prescribed by Section 35 of the Land Register Law: ‘[T]he priority right of corroboration shall be determined in accordance with the time of corroboration in a division of a land register.’

These principles are supplemented by the principle of a relevant process in a parallel with the principle of transparency, which is prescribed by Section 101 of the Land Register Law: ‘Anyone may examine land registers and request references, excerpts, true copies, and certificates therefrom.’

Also the principle of disposition is prescribed, by Section 57 of the Land Register Law: ‘Corroboration may be requested only by owners of immovable property and persons for the benefit of whom or against whom the corroboration is performed, as well as in the [other] cases specified by law—[involving] judicial and other state authorities or officials.’

The principle of legality is prescribed by Section 77 of the Land Register Law, which states the following:

When examining a request for corroboration, a judge of a Land Register office shall only ascertain the following:

- 1) that the request is in conformity with the provisions of Sections 57, 58, and 60–68;
- 2) that other, already corroborated rights or another request for corroboration that arrived on the same day is not an obstacle to corroboration (Section 75);
- 3) that the rights the corroboration of which is requested are among the rights referred to in Sections 31 and 44 that are related to an immovable property;
- 4) that the documents upon which a request is grounded do not contain anything that is obviously illegal.

⁶ B.A. Garner (ed.). *Black’s Law Dictionary*, 7th ed. West Group 1999, p. 567.

⁷ S. Jourdan. *Adverse Possession*. LexisNexis 2003, p. v (ISBN 0406982511).

⁸ A. Grūtups, E. Kalniņš (see Note 6), p. 158 (in Latvian).

⁹ J. Rozenfelds. Aktuālas lietu tiesību problēmas [‘Topical issues of property law’]. *Aktuālas tiesību realizācijas problēmas. Collection of papers of the 69th Conference of the University of Latvia. Latvijas Universitātes 69. konferences rakstu krājums*. Riga, Latvia: LU Akadēmiskais apgāds editorial panel Prof. J. Rozenfelds, Prof. K. Torgāns, Prof. I. Čepāne, Prof. S. Osipova, Prof. R. Balodis, Prof. V. Liholaja, Associate Prof. A. Kučs 2011, pp. 9–16 (in Latvian).

¹⁰ Zemesgrāmatu likums (Land Register Law). ‘Zinotājs’, 16, 29.4.1993 (in Latvian).

Finally, the principle of priority is prescribed by Section 73 of the Land Register Law, which states that the '[p]riority right to fulfilment shall, with account taken of the exceptions provided for in the following sections (Sections 74 and 75), be given to such a request for corroboration as was received earlier in a Land Register office', and Section 74: 'Requests for corroboration that are submitted to a Land Register office during the working hours of one and the same day or are received in an office by post by the end of reception hours shall be recognised as having arrived at the same time.'

However, one of the most important principles, the backbone of any land-registration system (*numerus clausus* law), which limits the number of types of right that could be acknowledged as associated with the character of real property, is nowhere expressly stated—in a contrast against, for instance, the Swiss Civil code^{*11} with its Section (1) 959).

All of the above-mentioned principles were established as soon as the Latvian CL and the Land Register Law of 1937 were reinstated. However, it turned out that, in practice, some of those principles were neglected. This probably can be explained by lack of understanding of the above-mentioned principles. Only after considerable time had passed did there arise awareness as to how important these principles are for the property market.

The Latvian CL declares unrestricted rights of an owner to the airspace above the immovable property and the land strata. Physical unity of property is understood as restrictions provided by law to horizontal division of the immovable property or to fragmentation of property (the so-called entropy of the physical unity of property)^{*12}, ensuring the physical unity of property both in the land strata below and in the airspace above the property, on the *ad caelum* principle.^{*13} In a difference from most modern laws of its kind, the CL formally does not allow any deviations from physical unity of property (see Section 1042). Fundamental importance was assigned to the physical unity of property during the process of drafting of the CL. It was highlighted that the CL was following the general tendencies of codification of its time: '[W]ith the last relics of feudal law, the European codes are gradually losing the double property [i.e., a dualistic approach] and building a united system of ownership rights' by abandoning 'civil-law feudalism'^{*14}.

Latvian CL uses the term 'land strata', while the law titled 'On Subterranean Depths'^{*15} uses, , the term 'subterranean depths'.^{*16}

There are four types of rights to another's property (*ius in re aliena*) under the Latvian CL—a servitude, the real charge, a pledge right, and a right of pre-emption. The first of these is such a right in respect of the property of another as restricts ownership rights associated with it, with respect to utilisation, for the benefit of a certain person or a certain parcel of land (see Section 1130).

Attached to immovable property, a real charge is a permanent duty to provide the specified performance in terms of money, in kind, or by *corvée*, repeatedly (see Section 1260). This institution can be regarded as equivalent to what is defined by the Estonian Law of Property Act, in the first part of its Section 229 ('An immovable may be encumbered such that the actual owner of the immovable must pay periodic payments in money or in kind to the person for whose benefit the real encumbrance is established, or perform particular acts').

A pledge right is a right with regard to property of another (addressed in Section 841) on the basis of which the property serves to secure the claim of a creditor such that the creditor is able to receive from the property payment for said claim (see Section 1278).

¹¹ Zivilgesetzbuch (Swiss Civil Code). English text available at <http://www.admin.ch/ch/e/rs/2/210.en.pdf> (most recently accessed on 6.2.2014).

¹² F. Parisi. Entropy of property. Available at http://www.law.gmu.edu/assets/files/publications/working_papers/01-14.pdf (most recently accessed on 6.2.2014).

¹³ The *ad caelum* approach was developed in the Middle Ages from a fragment of Roman law in the Code of Justinian (see <http://www.duhaime.org/LegalDictionary/C/CuiusEstSolumEjusEstUsqueAdCaelum.aspx> (most recently accessed on 6.2.2014) – D. 43, 24, 22, 4, a reference to the Roman law made in the prototype of the CL's Article 1042—i.e., Article 877 of the Codification of the Baltic Local Laws (BLL), as quoted from Свод Гражданских Узаконений Губерний Прибалтийских. Издание 1864 года, со включением статей по Продолжению 1890 года. – С. Петербург. Издание кодификационного отдела при государственном совете, б.г. (in Russian), by means of the Civil Law. See also *Kodifikācijas nodaļas 1937. gada izdevums*. Riga, Latvia: Trešais iespiedums 1938 (in Latvian).

¹⁴ O. Ozoliņš. Civiltiesību reforma Latvijā ['Reform of civil law in Latvia']. – *Darbam un tiesībām*. Latvijas krimināltiesību biedrības izdevums 1939, p. 158 (in Latvian).

¹⁵ Likums 'Par zemes dziļēm' (law 'On Subterranean Depths'). 'Latvijas Vēstnesis', 87 (572), 21.5.1996 (in Latvian).

¹⁶ J. Rozenfelds. Entropy of physical unity of property (*ad caelum*) in the Latvian law: The quality of legal acts and its importance in contemporary legal space. A paper at the International Scientific Conference, University of Latvia, 4–5 October 2012, p. 615 of proceedings document (ISBN 978-9984-45-564-8).

Next, a right of pre-emption is a right to acquire immovable property alienated by another person, by taking precedence over the acquirer thereof in relation to priority as against him, and the assumption of his or her rights (see Section 1381).

The practice applied for land registration initially (until the Soviet invasion in 1940) did not fix any buildings in place. 'Inventory' of the buildings was introduced only during the Soviet occupation.

2. Splitting of the land unit during introduction of the Civil Law (the civil code)

In the restoration of the Latvian CL of 1937, which was abandoned during the Soviet occupation (formally it ceased existing as law on 26 November 1940)^{*17} and reinstated on 7 July 1992, there was introduced an important additional feature that was at odds with the important *superficies solo cedit* principle—which had formed the backbone of the original version of the CL.

The law On [the] Time and Procedures for Coming into Force of [the] Introduction, Inheritance and Property Law Part of the Renewed Civil Law of the Republic of Latvia of 1937^{*18}, of 7 July 1992 (in force since 1 September 1992), restored the CL as a complex act and at the same time applied several exceptions to Section 968 of the Latvian CL regarding buildings erected during the Soviet occupation. From this point on, the formerly clear-cut understanding of what is 'land', a 'land plot', or an 'immovable' was blurred.

This status has become known as 'dualistic property' though also sometimes—erroneously—applied in a system of 'divided property'. A system of divided property involves existence of separate rights over land owned by another person. This refers to the right to the property of another (*ius in re aliena*) that may manifest itself as a servitude, a hereditary leasehold (*emphyteusis*), or the right to build (*superficies*), while a united property is maintained. The system of divided property is a restriction to the ownership right in favour of another person's right. A dualistic system of property, in contrast, allows parallel existence of separate ownership rights—to the building and to the land. That is, the dualistic system is based upon the presumption that two sovereign ownership rights linked to one and the same spatially delimited object are possible.^{*19}

The main difference between the system of divided and that of dual-nature property lay in the manner in which the property was registered in the land register. While property associated with the former was registered in the same division (folio) of the Land Register (or *Zemesgrāmata*), the latter had to be registered in two separate divisions of the register as soon as it appeared, in a completely new phenomenon arising in 1993. This was a grave consequence of literal interpretation of what was prescribed by Section 29 of the Land Register Law (adopted on 22 December 1937, restored on 4 May 1993): 'A separate division for each independent immovable property shall be opened in a land register.'

At first glance, the meaning of this norm seems clear enough. As soon as it is declared that some buildings should be regarded not as a part of land but as an 'exception' to the principle of *superficies solo cedit*, a new division (again, folio) should be opened for every such property.

Should that norm have been interpreted more flexibly, the fatal mistake could have been avoided. Unfortunately, at the time when this dual-registration system was launched, the law was still being interpreted in a very narrow way, as was customary for lawyers of the old Soviet school.^{*20}

Thus two separate immovable properties were 'created' with the opening of two separate divisions in the Land Register, while in the common understanding there is simply a chattel (made of construction materials) built on the land, with these two physically 'separate' items being, in fact, the same land unit.

¹⁷ Latvijas PSR Tautas Komisāru Padomes paziņojums 1940.g. 25. novembrī. KPFSR Civilt kodeks [‘announcement of the Council of National Commissioners of the Latvian Soviet Socialist Republic dated 25 November 1940, on the civil code of the Russian Soviet Federative Socialist Republic’]. Rīga, Latvia: Latvijas PSR Tieslietu Tautas komisariāta izdevums 1940 (in Latvian).

¹⁸ Likums 'Par atjaunotā Latvijas Republikas 1937. gada Civilt kodeksa ievada, mantojuma tiesību un lietu tiesību daļas spēkā stāšanās laiku un kārtību' (law 'On [the] Time and Procedures for Coming into Force of [the] Introduction, Inheritance and Property Law Part of the Renewed Civil Law of the Republic of Latvia of 1937'). 'Ziņotājs', 29, 30.7.1992 (in Latvian).

¹⁹ J. Rozenfelds. *Superficies solo cedit* in Latvian law. – *Journal of the University of Latvia: Law* 2013/5, pp. 120–136.

²⁰ J. Rozenfelds. Latvijas privāttiesību attīstības tendences pēc neatkarības atjaunošanas *de facto* [‘Trends in the development of private law since the *de facto* renewal of Latvian independence’]. *Tiesību harmonizācija Baltijas jūras reģionā pēc ES paplašināšanās*. Collection of papers of the international conference in 2007. LU Akadēmiskais apgāds 2012, pp. 381–389 (ISBN 978-9984-45-531-0).

3. Implementation of the law in practice

Nobody could imagine how widespread and far-reaching those changes would become in practice. Once established, the separate rights to buildings became more and more complicated in the course of time.

Although it is not possible to establish a direct connection between the dramatic growth in split or divided property and the new ways of interpreting the law related to the land-registration technique, still it should not be viewed as a pure coincidence that at the time when numerous new split properties had to be registered in the Land Register, some authors offered the idea that the strict margins of the regulation of property rights to be registered in the Land Register could be widened by means of analogy.

For instance, by applying disposition as described in Section 2126 of the Latvian CL ('Upon registering a lease or rental contract in the Land Register, the lessee or a tenant shall acquire property rights, which are valid also with respect to third persons'), it would be possible to register in the Land Register an agreement reached between or among co-owners of a given building and thereby solve a problem that otherwise could lead to inevitable division of the property, the latter seeming impractical.^{*21}

This idea was opposed, however, by another author, who claimed that using of analogy in such cases should be regarded as violation of the *numerous clausus* principle.^{*22} The practice with the former theory prevailing was shaken by the fierce criticism of the established pattern. However, after a short time during which applications to register such agreements were rejected, the previous practice was reinstated, thanks to a crucial ruling of the Supreme Court stating that such agreements can indeed be registered, given that personal rights are also 'connected' with the rights *in rem*.^{*23} Perhaps the very fact that numerous agreements of such a kind had already been registered in the Land Register facilitated this turn of the tide.

So, if until the above-mentioned ruling, it was possible—at least in theory—to insist that the *numerous clausus* principle, although not expressly set forth in Latvian law, nevertheless plays some role as a tool for distinction of rights *in rem* from rights *in personam*, any such reflection faded in light of the 'fit for all' formulation by the Supreme Court: since almost anything is 'connected' to something else, that court ruling disrupted the line between the two types of rights that had existed, although not always clearly, thus far.

4. 'Mandatory rental payment', amendment in 1997, and 'long lease' agreements and construction on another's land

Soon after the situation of dual property was created, it became apparent that somehow the relationship between the owner of the building on another's land and the owner of the encumbered land must be resolved. This necessity arose from the very fact that by encumbering the land with someone else's property rights to a building on the same land, the land owner is entitled to compensation by the building's owner. Somehow, the practitioners who were first faced with this problem came up with the idea that such compensation could be defined as 'rental payment'. Since the legislation of the time did not deal with this problem, somebody expressed the idea that there was indeed some similarity to a rental contract^{*24} by analogy with what could be found in Section 2123 of the Latvian CL ('If lease or rental payment has not been specifically agreed upon but the same subject matter had previously been leased or rented by the same person, then it shall be presumed that the previous provisions have not been changed. However, if such a standard does not exist and the parties have expressed only general statements that the payment shall be agreed upon between them, the amount of the payment shall be determined by a court at its discretion').

²¹ A. Grūtups, E. Kalniņš. *Civillikuma komentāri. Trešā daļa. Lietu tiesības. Īpašums* ['Comments to the Civil Law, Part III: Property law, ownership']. Otrās papildinātais izdevums / TNA 2002, p. 263 (in Latvian).

²² E. Virko. Zemesgrāmatu pieejamība un ticamība (Availability and Credibility of Land Registers). 'Jurista Vārds', 1.4.2008 13 (517) (in Latvian).

²³ Latvijas Republikas Augstākās tiesas Senāta Civillietu departamenta 5.12.2012. spriedums lietā Nr. SKC-1800 (Judgement SKC 1800, adopted by the Civil Case Department of the Senate for the Supreme Court of the Republic of Latvia on 5.12.2012). Available at <http://at.gov.lv/files/uploads/files/archive/departamenti/2012/1800-sk-2012.doc> (most recently accessed on 10.2.2014) (in Latvian).

²⁴ A. Grūtups, E. Krastiņš. *Īpašuma reforma Latvijā* ['Reform of Ownership in Latvia']. Rīga, Latvia: Mans Īpašums 1995, p. 309 (in Latvian).

Notwithstanding the fact that an ‘analogy’ between the situation described in Section 2123 of the CL and the artificially created split of the encumbered plot of land into two separate immovable properties hardly existed, the idea of the ‘mandatory rental payment’ soon became a common pattern in the proceedings that were usually initiated by the owners of the encumbered plot of land.

Later on, in consequence of the amendments to the law on restoration of property rights and privatisation, these ‘mandatory rental payment’ became the norm.

The first subsection of Section 12 of the Latvian Cities Land Reform Act^{*25} of 20 November 1991 originally was worded thus:

In all [...] cases wherein the original owner’s land has [in the meantime] been built upon, or where, in accordance with urban planning and construction projects, it is intended to erect thereon constructions necessary to satisfy the needs of society, the former owners of the land or their heirs shall be entitled, as they choose:

- to claim restitution of their title to the property and to obtain from the owner of the building or construction [...] the payment of rent, of which the maximum amount shall be fixed by the Cabinet [...]; or
- to request that they be granted the right of ownership or use of another plot of land, of the same value, situated within the administrative boundaries of the same town, depending on the intended use of such land; or
- to receive compensation in accordance with the statutory conditions.

The law of 8 May 1997^{*26}, which entered into force on 6 June of the same year, added to that subsection the following language: ‘Where the former owners of the land or their heirs have recovered title to land on which are erected any facilities [...], the annual amount of rent payable for the land shall not exceed five per cent of its cadastral value.’

5. The ‘voluntarily divided plot of land’

Amendments to the law On [the] Time and Procedures for Coming into Force of Introduction, Inheritance and Property Law Part of the Renewed Civil Law of the Republic of Latvia of 1937^{*27} (introduced on 24 April 1997 and in effect since 21 May 1997) applied the above-mentioned exception to the principle of *superficies solo cedit* not only to the dwellings erected during the Soviet period but also to those buildings that had been erected after introduction of the Latvian CL if the land was granted on the basis of a lease agreement for at least 10 years and if the lessor gave his or her permission for the construction work. This specific case became nicknamed the ‘voluntarily divided property’ for purposes of distinguishing it from the properties covered by the earlier regulation, which dealt with the dwellings erected during the Soviet occupation. The latter from now on would be known as dealing with ‘compulsorily divided property’. This option was exploited by numerous developers of newly created residential blocks, which were then divided into individual flats and eventually sold to private persons. Business went smoothly until the crisis of 2008 struck. As a part of the notorious austerity measures, the Cabinet introduced a special tax on buildings used as a dwelling (on top of the tax on the immovable property—i.e., on the land—that already existed). At the same time, apparently for fiscal reasons, the cadastral value of the property increased dramatically. From this time on, the rent payments collected by land-owners from the owners of the buildings on the ‘divided properties’ have been a hot topic.

‘Mandatory rent payment’ became subject to numerous changes with the law On the Land Reform in the Cities of the Republic of Latvia. It was revised repeatedly: via amendments on 6 December 2007^{*28}; after

²⁵ Likums ‘Par zemes reformu Latvijas Republikas pilsētās’ (Latvian Cities Land Reform Act). ‘Ziņotājs’, 49, 19.12.1991 (in Latvian).

²⁶ Grozījumi likumā ‘Par zemes reformu Latvijas Republikas pilsētās’ (Amendments to the Law ‘On the Land Reform in the Cities of the Republic of Latvia’). ‘Latvijas Vēstnesis’, 126/127 (841/842), 23.5.1997 (in Latvian).

²⁷ Grozījums likumā ‘Par atjaunotā Latvijas Republikas 1937.gada Civillikuma ievada, mantojuma tiesību un lietu tiesību daļas spēkā stāšanās laiku un kārtību’ (Amendments to the Law ‘On [the] Time and Procedures for Coming into Force of [the] Introduction, Inheritance and Property Law Part of the Renewed Civil Law of the Republic of Latvia of 1937’). ‘Latvijas Vēstnesis’, 112 (827), 7.5.1997 (in Latvian).

²⁸ Grozījums likumā ‘Par zemes reformu Latvijas Republikas pilsētās’ (Amendments to the Law ‘On the Land Reform in the Cities of the Republic of Latvia’). ‘Latvijas Vēstnesis’, 199 (3775), 12.12.2007 (in Latvian).

having been scrutinised by the Constitutional Court, which issued a decision on 15 April 2009^{*29} (admitting that the previous amendment violated property rights protected by Section 105 of the Constitution and therefore was invalid with effect from 1 November 2009), with the new version raising the percentage of mandatory rent to six per cent of the cadastral value of the plot of land; and once more, after a second decision of the Constitutional Court, handed down on 27 January 2011^{*30}.

6. The problem of restoration of physical unity of plots of land

With the passing of time, the ephemeral character of the ‘coexistence’ of two rights—the ownership of land and the ownership of the building on the relevant plot of land—became more and more apparent.

Dissatisfaction was felt by both parties. The holders of the encumbered plots of land were unhappy because they felt that their rights were limited in comparison with the situation of owners of unencumbered plots of land. The owners of the buildings and, especially, the owners of the flats felt unhappy because, in their understanding, the ‘mandatory rental payment’ caused an additional burden. They frequently refused to enter into an agreement with the owner of the encumbered plot of land. This led to numerous cases of litigation.

Several research works were commissioned by the Ministry of Justice with the goal of improvement to the legislation. Some results were published even in 2008. Legal opinion focusing on the legal framework of *ius in re aliena* in the Latvian CL stressed the necessity of introducing new institutions—the long lease (*emphyteusis*) and the right to erect a building on another’s land (*superficies*).^{*31}

Another legal opinion devoted to consequences of the system of divided property in practice suggested that some changes had to be carried out in the regulation of divided property after the achievement of land reform in Latvia.^{*32}

Although none of the above-mentioned legal opinions insisted that legal reform in this area was urgent, the Ministry of Justice continued its work, ordering further developments, which were targeted at, if not complete elimination of the situation of divided property, at least a move toward diminishing its negative effects in relation to property matters.

A special team was established within the Ministry of Justice to draft proposals for eradication of the system of dual, or, as it was called at the time, divided property. The misleading term ‘divided property’ apparently came into being because some members of the above-mentioned working group saw an analogy between the situation they were facing and that present when the original Latvian CL came into force, back in 1937.

²⁹ Latvijas Republikas Satversmes tiesas 15.4.2009. spriedums ‘Par likuma ‘Par zemes reformu Latvijas Republikas pilsētās’ 12.panta otrās daļas vārdu ‘daudzdzīvokļu dzīvojamās mājas’ un pārejas noteikumu 7.punkta un likuma ‘Par valsts un pašvaldību dzīvojamo māju privatizāciju’ 54.panta otrās daļas pirmā teikuma un pārejas noteikumu 40.punkta atbilstību Latvijas Republikas Satversmes 1. un 105.pantam’ (judgement by the Constitutional Court of the Republic of Latvia adopted on 15.4.2009 on compliance of the wording ‘multi-apartment residential houses’ under the second part of Section 12 of the law ‘On the Land Reform in the Cities of the Republic of Latvia’ and of Section 7 of the transitional provisions and of the first sentence of the second part of Section 54 of the law ‘On Privatisation of the State and Municipal Buildings’ and of Section 40 of the transitional provisions with Sections 1 and 105 of the Constitution of the Republic of Latvia). ‘Latvijas Vēstnesis’, 60 (4046), 21.4.2009 (in Latvian).

³⁰ Latvijas Republikas Satversmes tiesas 27.1.2011. spriedums ‘Par likuma ‘Par zemes reformu Latvijas Republikas pilsētās’ pārejas noteikumu 7. punkta, ciktāl tas attiecas uz zemi zem daudzdzīvokļu mājām, un likuma ‘Par valsts un pašvaldību dzīvojamo māju privatizāciju’ pārejas noteikumu 40.punkta atbilstību Latvijas Republikas Satversmes 1. un 105.pantam’ (judgement by the Constitutional Court of the Republic of Latvia adopted on 27.1.2011 on compliance of Section 7 of the transitional provisions of the law ‘On the Land Reform in the Cities of the Republic of Latvia’ as far as it pertains to the land underneath multi-apartment buildings and of Section 40 of the transitional provisions of the law ‘On Privatisation of the State and Municipal Buildings’ with Sections 1 and 105 of the Constitution of the Republic of Latvia). ‘Latvijas Vēstnesis’, 17 (4415), 1.2.2011 (in Latvian).

³¹ J. Rozenfelds. Pētījums par Civillikuma Lietu tiesību daļas (ceturtās, piektās, sestās un septītās nodaļas) modernizācijas nepieciešamību [‘Research on the necessity of updating the chapters on property law (IV, V, VI, and VII). Available at www.tm.gov.lv/files/archieve/lv_documents_petijumi_cl_ceturta_piekta_sesta_un_septita_nodala.doc (most recently accessed on 4.2.2014) (in Latvian).

³² PAR: nekustamā īpašuma tiesību regulējums pēc zemes reformas pabeigšanas – Civillikuma zemes un ēku nedalāmības koncepta pilnīgas ieviešanas problēma [‘On regulation of ownership rights after accomplishment of the land reform—the problem of complete implementation of the principle of integrity of the land and building in the Civil Law’]. Available via <http://www.tm.gov.lv/lv/nozares-politika/petijumi> (most recently accessed on 4.2.2014) (in Latvian).

Such an analogy seems to be completely unfounded and the idea doomed to failure. Regulation prescribed in the legislation that preceded the CL of 1937 envisaged the existence of a surface (*dominium directum*, or *Ober-Eigentum*) and of the right to buildings (*dominium utile* or *Unter-Eigentum*). Unlike in the present situation, the two were recorded in the same division of the Land Register.^{*33} The law designed back in 1938 that would have empowered owners of the rights to buildings (again, *dominium utile* or *Unter-Eigentum*) to buy out the rights to the land within five years^{*34} was never fully implemented—both sets of property rights in the ‘competition’ came to an abrupt end on account of the nationalisation carried out under the Soviet system in the 1940s.

Nevertheless, that law was taken as a model for several draft laws that should lead to the same result by means of no fewer than 20 steps in an extremely complicated procedure through which owners of dwellings eventually must become full owners of the undivided property, leaving the previous land-owners with monetary compensation.

It is no wonder that the concept has still not been fully implemented in the five years since. The concept was released in 2013.^{*35}

Several acts had to be amended for the reaching of the latter target.^{*36}

Once the principle of *superficies solo cedit* is disrupted, it is enormously difficult, if not impossible, to set matters right. Any rights to land once registered become absolute, with the consequence that this step is in many cases irreversible. Although skill and great efforts are invested, there seem to be few opportunities to obtain effective results in the foreseeable future. Whatever the outcome might be, it is doubtful whether the consequences of ill-fated ‘exceptions’ to the principle of *superficies solo cedit* as prescribed by Section 968 of the CL and established by the law On [the] Time and Procedures for Coming into Force of [the] Introduction, Inheritance and Property Law Part of the Renewed Civil Law of the Republic of Latvia of 1937 of 7 July 1992 will ever be completely reversed, with a return to normality. Once established, any rights to land inevitably become permanent, and once registered in the Land Register, they become public and virtually irreversible. Any attempt even to scratch them against the will of the person whose rights might be diminished through rectification of registration, would be regarded as an act of deprivation.

7. Conclusions

Four points can be made in summary. Firstly, there is significant difference between the present legal regulation and the pre-war regulation. Secondly, Latvian experience shows that once the principle of *superficies solo cedit* is disrupted, it is extremely difficult, if not impossible, to put things right. A third key point is that any rights to the land once registered are rendered absolute, and this in many cases also means their becoming irreversible.

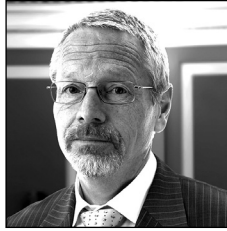
Finally, land registration in Latvia is too complicated, and it features unnecessary deviations from the main principles recognised for land registration. This is a situation that needs to be corrected.

³³ V. Bukovsky. Codification of Local Laws of the Baltic regions with amendments of 1912-1914 and with comments in two volumes. Vol. I. Riga: Typography of G.Gempel and Co, 1914, p.406 (in Russian). F. Konradi, A. Valters. *Lietu tiesības. Baltijas vietējo likumu kopojuma trešās daļas skaidrojumi* [‘Property Law: Explanations to Part III of the Codification of the Baltic Local Laws’]. Riga, Latvia 1935, p. 211 (in Latvian).

³⁴ Ministru Kabineta 1938. g. 8 dec. Likums par dalītu īpašuma tiesību atcelšanu (law adopted by the Cabinet on 8 December 1938, ‘On Cancellation of Divided Ownership Rights’). Riga, Latvia: Likumu un Ministru kabineta noteikumu krājums 1938, p. 46 (in Latvian).

³⁵ Tieslietu ministrijas redzējums par dalītā īpašuma problemātikas risinājumu konceptu (Vision of the Ministry of Justice on Solution of the Problem of Split Ownership Rights), 22.6.2013 Available at <http://www.tm.gov.lv/lv/cits/tieslietu-ministrijas-redzejums-par-dalita-ipasuma-problematikas-risinajumu-konceptu>- (most recently accessed on 4.2.2014) (in Latvian).

³⁶ Likums ‘Par valsts un pašvaldību dzīvojamo māju privatizāciju’ (Law on Privatisation of the State and Municipal Buildings). ‘Latvijas Vēstnesis’, 103 (386), 11.7.1995 (in Latvian); Likums ‘Par zemes reformu Latvijas Republikas pilsētās’ (Latvian Cities Land Reform Act); Likums ‘Par atjaunotā Latvijas Republikas 1937.gada Civillikuma ievada, mantojuma tiesību un lietu tiesību daļas spēkā stāšanās laiku un kārtību’ (law ‘On [the] Time and Procedures for Coming into Force of [the] Introduction, Inheritance and Property Law Part of the Renewed Civil Law of the Republic of Latvia of 1937’); Civil Law.



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Norway: Non-secured Instant Loans to Consumers^{*2}

1. Introduction

This article deals with the Norwegian legal framework concerning non-secured ‘instant’ loans to consumers. The loans are ‘instant’ because the procedure of applying for and granting them is meant to be fast and uncomplicated, often so as to make the money available the same day as the loan is applied for, or just a few days later. There is no requirement of a mortgage, surety, or other security right. The loan is not granted for a specific purpose. The business idea is obviously to offer access to cash rather informally and on short notice; the term ‘easy loan’ is often used in advertising on the Internet. In Norwegian, such loans are often called *forbrukslån*, literally ‘loans for consumption’.

Non-secured instant loans to consumers are offered by several actors in Norway. The most important lenders seem to be banks, providing loans either directly or through intermediaries. Those offering credit services to Norwegian customers (whether banks, other financial institutions, or even businesses established abroad) are subject to public licence and supervision requirements (see Section 2). In practice, there are likely to be few cases of credit granted to consumers living in Norway by institutions not established in Norway and not offering their services here (the consumer thus having actively contacted the lender abroad); no statistical information is available, however.

Advertising indicates that the following example is representative.^{*3} The consumer may borrow between NOK 5,000 and NOK 400,000 (EUR 625–50,000). The effective annual percentage rate (APR) varies between 9.59 and 21.24 per cent and the initial rate depends on the borrower’s ‘financial situation’. The amortisation period is, at maximum, 15 years. The borrower may repay the loan at any time at no extra cost, as the interest rate is variable. The borrower must be a Norwegian citizen, have an income, and have no active debt collection actions against him.

There is one provider of even smaller instant loans, Folkia AS.^{*4} For such loans the relative costs are higher; a loan of NOK 1000 (EUR 125) for one month, for example, has a staggering APR of 9242 per cent, due not least to NOK 350 (EUR 44) of set-up charges. Folkia AS is a rather small actor in the Norwegian credit market but the business concept has naturally drawn some public attention.

Alternatives to the loans described above are overdraft facilities and credit cards, both of which are rather common. Credit costs are regularly quite high for these alternatives as well.

¹ The author would like to thank Katherine Llorca for her text editing.

² The research leading to these results has received funding from the Norway Financial Mechanism 2009–2014 under project contract No. EMP205.

³ From Bank Norwegian AS (www.banknorwegian.no, most recently accessed on 7 February 2014). For other examples, see DnB (www.dnb.no, most recently accessed on 7 February 2014); Santander Consumer Bank (www.santander.no, most recently accessed on 7.2.2014); GE Money Bank Norge (www.gemoney.no, most recently accessed on 7.2.2014).

⁴ See folkia.no (most recently accessed on 7.2.2014).

For the sake of completeness and in order to paint a clearer picture of the market, it should be mentioned that credit for unspecified purposes may also easily be obtained in the form of credit secured under a previously-established mortgage—typically a mortgage on the consumer's home—in the form of either a draft facility or a fixed loan. This requires a little more paperwork but is usually less expensive than the loans just described. Consumer mortgages are mostly provided by banks, and a new loan secured under the mortgage will typically be provided by the same bank. A loan from another bank, secured by a second mortgage, can serve the same purposes.

Household debt is high in Norway. Home loans and an expensive property market are the main reasons for this, and 'loans for consumption' make up just a small proportion (less than three per cent) of total household debt.⁵ On the other hand, such loans are much more commonly the object of debt settlement and debt collection cases against consumers (see Section 3, below).

2. Licensing, supervision, and marketing

2.1. Licensing and supervision

Providing credit and acting as an intermediary for the provision of credit are examples of 'financial services', and financial services may only be offered by—among others—banks and finance companies licensed under the Financial Institutions Act.⁶ Norwegian businesses of this kind are subject to supervision by the Financial Supervisory Authority of Norway.⁷

Norway is a party to the Agreement on the European Economic Area (EEA). This agreement includes rules on the four freedoms corresponding to the rules of the treaties of the European Union, and much of the secondary EU legislation, including legislation on financial markets, has been made binding on non-EU members of the EEA. As a result, credit institutions licensed and supervised in another EEA member state are allowed to offer financial services in Norway.⁸ Branches of such credit institutions need a licence under Norwegian law.⁹ The provision of financial services by foreign credit institutions (cross-border services) is subject to supervision by the Financial Supervisory Authority of Norway and so are the activities of Norwegian branches of foreign credit institutions.¹⁰

These rules on licence requirements and on supervision are stricter in Norway than in many other countries. Licence requirements and supervision probably contribute considerably to compliance with consumer protection rules, as the loss of one's licence—or a warning that it may be lost—is a more efficient enforcement tool than available civil law remedies.

There are general rules in the Financial Institutions Act and related regulations concerning the organisation, capital, etc. of institutions offering financial services.

2.2. Requirements regarding marketing and conduct of business

Chapter 3 of the Financial Contracts Act deals with credit contracts.¹¹ The scope of the chapter is somewhat wider than the title indicates. Some of the rules concern the contractual relationship between lender and borrower, addressing the conclusion and validity of the contract, mandatory rules on the content of the contract, etc. Other rules primarily concern the marketing of credit contracts and the lender's information duties. The latter are mainly rules of conduct, and violation of these rules may ultimately have consequences for the lender's licence to act as a financial institution. In addition, the Consumer Ombudsman and the Market Council are authorised to take measures against unfair commercial practices and unfair contract

⁵ Finanstilsynet, *Finansielt utsyn 2014* ['Risk Outlook 2014: The Financial Market in Norway'], Oslo 2014, pp. 24–25.

⁶ *Lov 40/1988 om finansieringsvirksomhet og finansinstitusjoner* (Financial Institutions Act), Sections 1-2 and 1-4. Some narrow exceptions for credit sales and for occasional credit are of little interest and will not be dealt with here.

⁷ *Lov 7. desember 1956 nr. 1 om tilsynet med finansinstitusjoner mv.* (Financial Supervision Act), Section 1.

⁸ Financial Institutions Act, Section 1-4, No. 4.

⁹ Financial Institutions Act, Section 3-3.

¹⁰ Administrative regulation 717/1994, Section 9 and administrative regulation 326/1994, Section 11.

¹¹ *Lov 46/1999 om finansavtaler og finansoppdrag* (Financial Contracts Act).

terms. The basis of this control can be found in both the Financial Contracts Act and the Marketing Act.^{*12} Some of the rules have a double edge and a violation may have consequences both in contract law and in public law; for example, a breach of information duties may both affect the contractual relationship and at the same time lead to reactions from the Financial Supervisory Authority or the Consumer Ombudsman and the Market Council. In addition to the rules in the Financial Contracts Act (see below), general rules on marketing apply, such as restrictions on sales or marketing by telephone etc.

Directive 2008/48/EC, on consumer credit agreements, is transposed through Chapter 3 of the Financial Contracts Act. The rules corresponding to the rules of the Directive on pre-contractual information and on information that must be included in the credit contract will not be dealt with in detail here.

Marketing of credit contracts must include information on the borrowing rate, the total amount of credit, APR, etc., specified by means of a representative example.^{*13} A glance at some Web pages indicates that lenders generally comply with these requirements. Some of the Web pages even include loan calculators, illustrating how costs vary with the loan amount and the credit period.

More specific information on the credit contract in question must be given 'in good time' and before the consumer is bound by the contract.^{*14} To give such information 'in good time' when the business concept is instant credit may seem like a contradiction in terms. Most likely, the information is given by e-mail, so the consumer must decide for himself how much time is needed to study it.

The lender must also provide 'adequate explanations', enabling the consumer to 'assess whether the proposed credit agreement is adapted to his needs and to his financial situation'.^{*15} At least for the smallest loans, it seems more or less impossible to offer individual explanations of this kind; the administrative costs would be too high. Directive 2008/48 (Art. 5(6)) allows Member States to adapt this rule to the circumstances, but no such adaptations have been made in Norway. Regarding this rule, compliance may turn out to be questionable for providers of the loans here discussed.

The lender must assess the consumer's creditworthiness, if necessary by consulting a relevant database.^{*16} To date (February 2014), no relevant database or register (positive or negative) has been established in Norway. A proposal for legislation on a consumer debt register was submitted to Parliament in September 2013 but was subsequently withdrawn by the new government in November 2013, before it had been discussed at all in the Parliament; the new government wanted to re-evaluate 'some elements of the proposal'.^{*17}

Today, assessment of a consumer's creditworthiness is based on an enquiry submitted to a credit reference agency, in addition to confirmation of employment. Credit reference enquiries can be carried out online; the consumer receives a paper copy of the answer a few days later. The agency will often report previous income and property, based on public information from tax authorities, the Land Registry, etc. and, where necessary, recent debt collection actions against the consumer. Credit reference agencies are private businesses and need a licence from the Norwegian Data Protection Agency. Rules of conduct are imposed by the licence. In February 2014, nine licences were active.^{*18}

Under the Financial Contracts Act, Section 47, the lender has a duty to warn the consumer if the lender could not have been unaware of the fact that the consumer, because of his financial situation or other circumstances, should seriously consider foregoing the loan. The warning (literally 'dissuasion') must be given in writing and, if possible, also orally if the contract has not yet been concluded. A breach of the lender's duty to warn may lead to an adjustment of the consumer's obligations under the contract if that is deemed reasonable by a court.

The duty to warn the consumer goes further than the information duties under Directive 2008/48. The Norwegian government held that the lender's duty to warn was based on general principles of loyalty in contractual relationships and thus was not contrary to total harmonisation as envisaged by Directive 2008/48. The government also referred to remarks in the preamble to the directive (paragraph 26 in the

¹² *Lov 2/2009 om kontroll med markedsføring og avtalevilkår mv.* (Marketing Act); this Act is also a transposition of Directive 2005/29/EC, on unfair commercial practices.

¹³ Directive 2008/48, Art. 4; Financial Contracts Act, Section 46.

¹⁴ Directive 2008/48, Art. 5; Financial Contracts Act, Section 46 a.

¹⁵ Directive 2008/48, Art. 5(6); Financial Contracts Act, Section 46 c.

¹⁶ Directive 2008/48, Art. 6; Financial Contracts Act, Section 46 b.

¹⁷ Prop. 195 L (2012–2013), *Endringer i tinglyssingsloven mv. (registrering av gjeld)* (the Government's proposal to the Parliament); Meld. St. 17 (2013–2014), *Tilbaketrekning av Prop. 195 L (2012–2013), Endringer i tinglyssingsloven mv. (registrering av gjeld)* (the Government's white paper to the Parliament).

¹⁸ See www.datatilsynet.no (most recently accessed on 12.4.2014).

final version) on responsible lending.^{*19} Responsible lending duties did not become incorporated into the final version of the directive.

Adjustment of the consumer's obligations due to lack of warning under the provision in Section 47 of the Financial Contracts Act has not yet been invoked successfully before the Norwegian Supreme Court (and, in total, it has been invoked in only three cases).^{*20} The consumer's obligations have been adjusted in a few cases by the Financial Complaints Panel (*Finansklagenemnda*), but the consumer has lost in most cases.^{*21} So far, it seems fair to say that the duty to warn the consumer is a frail consumer protection instrument.

3. Consumer insolvency

Legislation concerning debt settlement for private individuals was introduced in Norway in 1992.^{*22} This legislation aims to give persons with serious debt problems the possibility to regain control over their financial situation.

Under the Debt Settlement Act, a debtor may apply to the local Enforcement Officer for the opening of a protected period of negotiations with creditors. The Enforcement Officer has an important role in the civil enforcement system, and his decisions may be appealed to the local court of first instance. Negotiations are opened if the criterion of serious debt problems is met, the applicant is willing to co-operate, and debt settlement would not be considered 'offensive' for the reasons specified in the Act. There is a debt moratorium during the negotiation period.

Debt settlement is either voluntary or compulsory. The settlement is voluntary if the debtor's proposal is not opposed by any creditor. If negotiations for a voluntary settlement fail, a compulsory settlement may be decided on by the court. The proportion of voluntary settlements has increased and now amounts to around 80 per cent of all debt settlements.^{*23}

To obtain a settlement, the debtor must—as a rule—sell assets that are not needed for a minimum standard of life. Further, the debtor must agree to use any income exceeding a fixed minimum as a dividend to his creditors for a period of normally five years. If the settlement is fulfilled, the debtor is then discharged (with some exceptions for secured loans, etc.).

Today, it is accepted that debt settlement may be decided on without any dividend at all for the creditors. Such 'zero settlements' now amount to around 60 per cent of the total number of settlements.^{*24} In these cases too, the settlement period is normally five years. The high number of 'zero settlements' indicates that the debt settlement regime is particularly important for persons without normal employment.

The total number of settlements of debt is not high—68 negotiations opened per 100,000 inhabitants of Norway in 2011. The total number of debt settlements peaked in 2011 and has not decreased much in 2012 and 2013. In Oslo, the number has increased in the same period.^{*25}

From a comparative perspective^{*26}, the relatively high number of voluntary settlements and 'zero settlements' is quite interesting.

It seems that 'loans for consumption' account for larger share of the total debt in typical debt settlements than they used to, some years ago.^{*27} Of the total number of debt collection cases against consumers, 13 per cent are related to loans for consumption.^{*28}

¹⁹ Ot.prp. nr. 22 (2007–2008), p. 40 (the Government's proposal to the Parliament).

²⁰ Norsk Retstidende (Rt.) 2003, p. 1252; Rt. 2004, p. 156; Rt. 2013, p. 388.

²¹ See, for example, FINKN-2011-577 and FINKN-2011-274.

²² *Lov 99/1992 om frivillig og tvungen gjeldsordning for privatpersoner* (Debt Settlement Act).

²³ Statistics made available by the Ministry of Children, Equality and Social Inclusion (February 2014). See also C. Poppe, R. Lavik, *Hvorfor øker antall gjeldsordningssaker i Oslo?* ['Why is the number of debt settlement cases increasing in Oslo?']. Oslo: Statens institutt for forbruksforskning 2013, pp. 32–33.

²⁴ Statistics made available by the Ministry of Children, Equality and Social Inclusion (February 2014).

²⁵ See C. Poppe, R. Lavik (Note 22), pp. 9–13. Statistics made available by the Ministry of Children, Equality and Social Inclusion (February 2014).

²⁶ For international comparisons, see, for example, J. Spooner, 'Fresh start or stalemate? European consumer insolvency law reform and the politics of household debt. – *European Review of Private Law* 21 (2013)/3, pp. 747–794. Insolvency and Creditor/Debtor Regimes Task Force (World Bank, Working Group on the Treatment of the Insolvency of Natural Persons), 2013.

²⁷ See C. Poppe, R. Lavik (Note 22), pp. 51–56.

²⁸ Prop. 195 L (2012–2013), 21.

Municipalities have a duty to assist—‘as far as possible’—persons trying to obtain debt settlements under the Debt Settlement Act, and the municipalities also have general duties to give advice under legislation on social services.^{*29} The availability of such assistance and advice seems to vary quite a lot from one area to another.

A survey done in January 2014 showed that ‘loans for consumption’ led to 12.5 percent of the debt collection cases (compared to two per cent for home loans). Small claims from mail order purchases, parking fines, etc. were the basis of the majority of debt collection cases.^{*30}

4. Contract law

Credit contracts are regulated in the Financial Contracts Act in addition to general contract law—legislated and non-legislated.

A credit contract is not binding on the consumer unless it is ‘in writing’, but writing includes electronic means of concluding a contract as long as the content of the contract is available to the consumer at the time of conclusion and the conclusion of the contract is made authentic in a reliable manner.^{*31} The banks have developed a solution for electronic signatures, a solution that is applied both by banks and by other businesses offering the loans dealt with in this article. In this way, a credit contract can be validly concluded on the Internet.

Unfair marketing practices or breach of pre-contractual information duties does not automatically affect the contractual relationship but may, depending on the circumstances, lead to revision of the contract based on general contract law. Terms not included in the written contract are not binding on the consumer unless the lender proves that the term was accepted by the consumer.^{*32}

It was explained under Subsection 2.2 above that breach of the duty to warn a consumer (where necessary) about the risks of taking out a loan may lead to adjustment of the consumer’s obligations under the contract.

The consumer has a right to withdraw from the credit contract within 14 calendar days of signing or of receiving relevant information concerning the right of withdrawal, whichever is later.^{*33} If the consumer exercises his right to withdraw, he must repay the money received, with interest (at the nominal interest rate). The lender is not entitled to any other compensation except possible charges by a public administrative body. These rules apply even to small loans, whereas Directive 2008/48 applies only to credit contracts involving a total amount of credit of at least EUR 200.^{*34} For the very short-term credit contracts, the right of withdrawal seems to offer the ‘cunning’ consumer an easy way out of paying set-up fees.

There are no provisions in the Financial Contracts Act on the maximum credit costs allowed. A provision in the Price Measures Act prohibiting ‘unreasonable’ prices is generally thought to have little importance in today’s liberal market economy.^{*35} The most relevant provision to apply in an assessment of potentially excessive credit costs is Section 36 of the Formation of Contracts Act, the so-called general clause, common to all the Nordic countries.^{*36} This provision, with some small additions regarding non-negotiated terms, has been regarded as sufficient transposition of Directive 93/13/EEC, on unfair contract terms in contracts with consumers.

The general clause has almost never been applied by Norwegian courts so as to adjust an agreed price or remuneration, at least not because the price was regarded as too high (in some cases regarding ground leases, the rent has been adjusted *upwards* in order to compensate for inflation).^{*37} This is also in line with

²⁹ Debt Settlement Act, Section 1-5; *Lov 131/2009 om sosiale tjenester i arbeids-og velferdsforvaltningen* (Social Services Act), Section 17.

³⁰ Finanstilsynet, *Finansielt utsyn 2014* (see Note 4), p. 25.

³¹ Financial Contracts Act, Sections 8 and 48.

³² Financial Contracts Act, Section 48(4).

³³ Financial Contracts Act, Section 51 b; cf. Directive 2008/48, Art. 14.

³⁴ See Directive 2008/48, Art. 2(2)(c); cf. Preamble, para. 10.

³⁵ *Lov 66/1993 om pristiltak* (Price Measures Act), Section 2. See also the Supreme Court judgment in Rt. 1996, p. 407.

³⁶ *Lov 31. mai 1918 nr. 4 om avslutning av avtaler, om fuldmagt og om ugyldige viljeserklæringer* (Formation of Contracts Act), Section 36.

³⁷ K. Lilleholt. Application of general principles in private law in the Nordic countries. – *Juridica International* 2013, pp. 12–19.

Directive 93/13, Art. 4, which excludes from the unfairness test any balancing between the ‘main subject matter’ and the price.^{*38} Adjustment of the price is not entirely excluded under the general clause, but it should not normally be done unless there are elements of misleading information, fraud, or unfair exploitation.^{*39}

In private law, there are no rules dealing in particular with high interest rates. The notion of usury is not applied in contract law. The parallel in contract law to usury in criminal law is a provision on invalidity because of unfair exploitation. The provision is rarely applied nowadays.

Under the Late Payment Act, the interest rate in cases of late payment is fixed at eight percentage points above the Norwegian Central Bank’s key policy rate, set every six months. The late payment interest rate currently (February 2014) stands at 9.75 per cent per year (no compound interest).^{*40} The rules are mandatory where the debtor is a consumer and the parties cannot validly agree to additional penalties etc.^{*41} However, the ordinary contractual interest rate may still be claimed by the creditor.^{*42} For the loans we are dealing with here, the contractual interest rate will often be the higher one, not least because it will normally include compound interest. A claim for late payment interest may be reduced if the consumer had a good reason not to pay—for example, where the obligation to pay was contested.^{*43} This rule is probably of scarce practical interest for loan contracts.

5. Criminal law

In criminal law, usury relates to unfair exploitation and not to the interest rate or other forms of remuneration.^{*44} A provision on usury has not been included in the General Criminal Act 2005 (not yet in force); it was argued that the Price Measures Act (which also contains a penalty provision) was sufficient.^{*45} In criminal law, cases on usury have also been rather rare, although, in a case from 2007, the Supreme Court pointed out that usury was obviously not of pure historical interest—the case dealt with blatant exploitation in criminal circles.^{*46} The situation in that case was not at all similar, however, to the regular offering of fast loans to consumers dealt with here. It seems fair to say that rules on usury in criminal law are of little interest in this field.

6. Conclusions

Norway has, to date, been practically spared the consequences of the financial crisis. Aside from the future negative effects of international markets, there is currently more concern about growing household debt and a potential housing bubble. Instant loans make up just a small share of household debt. These loans still create serious problems, however, for a vulnerable group of consumers, as is shown by the role of such loans in consumer debt settlements.

Arguably, the most efficient consumer protection in this field lies in licence and supervision requirements, which apply to all providers of credit, and in the Consumer Ombudsman’s control of marketing activities. The Financial Services Act regulates the relationship between lender and consumer, but the protection of the consumers’ rights through contractual remedies has proved difficult, both because it is slow and costly and because courts and tribunals have been rather reluctant in their application of consumer protection legislation.

³⁸ See, though, some interesting comments by General Advocate Wahl in Case C-26/13.

³⁹ See the Supreme Court Judgment in Rt. 1969, 664 regarding law prior to the general clause.

⁴⁰ *Lov 100/1976 om renter ved forsinket betaling m.m.* (Late Payment Act), Section 3(1).

⁴¹ Late Payment Act, Section 4.

⁴² Late Payment Act, Section 3(2).

⁴³ Late Payment Act, Section 4(a); see for example, the Appeal Court decision in LB-2011-36899.

⁴⁴ *Almindelig borgerlig straffelov 22. mai 1902 nr. 10* (General Criminal Act), Section 295.

⁴⁵ Ot.prp. nr. 22 (2008–2009) (the Government’s proposal to the Parliament), p. 386.

⁴⁶ Rt. 2007, p. 583.



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Regulation of Instant Loans and Other Credits in Swedish Law

1. General overview

Until the 1980s, the Swedish credit market was strictly regulated. In the wake of the deregulatory reform that took place in that decade, the range of consumer loans has since increased dramatically. Apart from ordinary mortgage loans and loans for more expensive goods, there are sales of all other sorts of consumer goods on credit, both in stores and via the Internet. Since 2006, there has also been a range of easy-access non-secured consumer loans (hereinafter ‘instant loans’) – in other words, short-term loans for relatively small sums that are to be repaid quickly. Characteristic of the instant loans is that they normally are also linked to a high APR and a certain fixed charge. In Swedish, the term ‘SMS loan’ is sometimes used, because the application for credit can in some cases be made via a text message (SMS).

The creditors are credit institutions – i.e., banks and credit-market companies but also other financial institutions. Credit institutions are regulated in their business primarily by the Banking and Financing Business Act (‘Lagen (2004:297) om bank- och finansieringsrörelse’). Both banks and financing businesses require a licence for their operations where the Swedish Financial Supervisory Authority (FSA) is the regulator. A licence is also required for those financial institutions that provide loans to consumers. A new law has been introduced on certain undertakings that works with consumer credits, (‘Lagen (2014:275) om viss verksamhet med konsumentkrediter’).^{*1}

In recent years, Swedish households have increased their debt levels significantly.^{*2} Household debt has grown from 90% of disposable income in the mid-1990s to 171.7% in 2013. Household debt is to a large extent due to the increase in mortgage loans. About 70% of households own their home, which is probably why 81% of household debt consists of mortgage loans.^{*3} Many people experience problems with repaying their loans: 434,627 people had a debt that was registered with the Swedish Enforcement Agency in 2013, of whom 62% were men and 38% were women. The total amount of debt that the Enforcement Agency has to collect have increased, to about EUR 7.8 billion in 2013 from an annual level of about EUR 6.5–7 billion in

¹ See FFFS 2014:8(Föreskrifter och allmänna råd om viss verksamhet med konsumentkrediter). (FSA, Regulations and guidelines on certain activities with consumer credits.)

² See D. Finocchiaro *et al.* Hushållens skuldsättning, bostadspriserna och makroekonomin: en genomgång av litteraturen in Riksbanken [‘Household debt, house price and macroeconomy: a review of the literature’]. – *Penning- och valutapolitik* [‘Monetary and exchange rate policy’] 2011/1, pp. 6–28.; Statens bostadskreditnämnd. Hushållens skuldsättning i spåren av finanskrisen—en internationell jämförelse [‘Household debt in the wake of the financial crisis - an international comparison’]. Marknadsrapport (Market report), February 2011; M. Persson. Households indebtedness in Sweden and implications for financial stability – the use of household-level data. BIS Paper 46, May 2009.

³ Svenska bankföreningen (the Swedish Bankers’ Association). *Bolånemarknaden i Sverige* [‘The Mortgage Market in Sweden’]. 2011, p. 6.

each of the three preceding years. One explanation for the increase in debt is interest on existing debts. The largest group with debts handled by the Enforcement Agency consists of people who lack an income, but a second group with increasing debt levels is made up of those people with an annual income of over EUR 33,070. The debt level is increasing most in the 61+ age group. The average debt across the various groups amounts to around EUR 4,400 per debtor.^{*4}

In 2012, 53,709 applications for an order for repayment of instant loans were filed with the Enforcement Agency. This represents an increase of 40% from the figure for the equivalent period in 2011.^{*5} According to the Enforcement Agency, about 50,000 people in Sweden have a record of non-payment registered with the Enforcement Agency because of instant loans. In 2013, in total, 1,157,751 applications for an order to pay were made to the Enforcement Agency. According to the Enforcement Agency, one person usually has several records of non-payment registered against his or her name. The number of people behind the applications is not known, however, since the statistics are not maintained at the level of the individual. It is not uncommon for the first order to pay to have to do with a mobile-phone subscription, the second with e-trade, and the third with an instant loan. In all probability, the instant loans have been taken out to pay back other loans.

Bearing in mind the number of orders to pay and the fact that it has become easier to borrow money, one should not be surprised that the risk of individuals and families being affected by debt has increased. Worrying reports from both the Enforcement Agency^{*6} and the FSA^{*7} indicate that 20% of all Swedish households have problems coping with unforeseen expenditure in the amount of at least EUR 2,200, and 10% of households (i.e., 350,000) have problems making ends meet. The Enforcement Agency has estimated that about 400,000 people in Sweden are in debt.^{*8} In 2008, there were 6,603 bankruptcies, 660 of which pertained to individual traders and 334 to natural persons. In 2012, there were 7,737 bankruptcies, with 878 associated with individual traders and 266 with natural persons. In 2008, 6,528 applications for debt restructuring were submitted, and 4,376 of the proceedings sought were initiated, while the equivalent figures for 2013 were 9,184 and 5,357, respectively. In conclusion, there has been an increase in the number of people who have problems paying, and this is probably connected to the debt crisis and the financial worries affecting large parts of the world.

2. A legal and institutional overview

Loans to consumers are covered by both the legislation on business operations, such as the Bank and Financing Business Act, and civil-law regulations, in the Consumer Credit Act (2010:1846). This act has incorporated the EC directive on credit agreements for consumers^{*9}. The point of departure of the Swedish Consumer Credit Act is, however, that the rules shall apply also to credit agreements that do not fall within the scope of the above-mentioned directive. Hence, the act addresses all types of credit that a trader may extend to a consumer.^{*10} The Consumer Credit Act is applicable to the loans a trader gives or offers a consumer—in other words, with respect to both credit agreements and the marketing of credit—as is made clear in the first paragraph of Section 1. The act also applies to loans that are given or offered to a consumer by someone other than a trader if the credit is provided by a trader acting as an intermediary for the creditor. The act also contains provisions for certain obligations for credit brokers, laid down in Section 1's second paragraph.

Not covered by the ambit of the law, however, are statutory loans that are submitted for state funding or loans issued by a pawnbroker in accordance with the Pawnbrokers' Act ('Pantbankslagen', 1995:1000), according to Section 3 of the Consumer Credit Act. Moreover, there is an exemption with regard to some of

⁴ See the statistics from the Enforcement Agency at <http://www.kronofogden.se/Statistik.html> (most recently accessed on 30.1.2014) and C.-J. Lejländ. Svenskarna sätter rekord i skulder ['The Swedes are setting records in debts']. – *Dagens Industri*, 6 October 2012, p. 6 (Today's Industry) (in Swedish).

⁵ See press release of the Enforcement Agency 28-08-2012.

⁶ See the Enforcement Agency report 'Alla vill göra rätt för sig' ['Everyone wants to do the right thing'], 2008; SOU 2008:82 p.70-75 (Vägen tillbaka för skuldsatta) (in Swedish).

⁷ Hushållens ekonomiska förmåga, Finansinspektionens rapport ['The financial capacity of households, FSA report'], number 27-06-2007 (in Swedish).

⁸ See Note 6.

⁹ 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.

¹⁰ See Ds 2009:67, p. 58 (Ny konsumentkreditlag).

the provisions for credit invoices—i.e., short-term credit that is given in conjunction with the sale of goods or services. The above-mentioned exemption also applies to certain credit-card loans, certain credit not linked to a purchase that has a short credit period and low charges, interest-free credit agreements, and credit agreements for free deferred payment of a current debt, according to the first to third paragraphs of Section 4 of the Consumer Credit Act. Mortgage agreements, which are not covered by the scope of the EC directive, fall within the scope of the act but, as is the case with credit that is given by investment companies or credit institutions for financing the purchase of financial instruments, only some of the provisions of the act apply; see Section 4 of the Consumer Credit Act (specifically, the fourth and fifth paragraphs). The rules that apply to consumer credit in general also apply to instant loans.

The regulatory authorities in the field of consumer credit—the FSA and the Swedish Consumer Agency—also issue certain rules, among them the FSA’s general guidelines regarding consumer credit and the Consumer Agency’s general guidelines on consumer credit.^{*11} These guidelines, or recommendations for how traders should act, are an expression of how the authorities believe the Consumer Credit act should be applied. They do not, however, require traders to act in the manner described or necessitate judicial review by a court.^{*12}

According to Section 49 of the Consumer Credit Act, it is the Consumer Agency that supervises the application of the Consumer Credit Act. This agency’s supervisory role does not, however, cover either the Swedish National Bank (the Riksbank) or consumer credit provided by banks and credit-market companies, which are supervised by the FSA, or the Enforcement Agency’s operations. The above-mentioned derogation entails most of the handling of consumer credit falling outside the remit of the supervisory operations of the Consumer Agency. With regard to operations supervised by the FSA, the derogation has been explained as being due to the fact that a trader who is already supervised by a certain authority should be supervised by the same authority where compliance with the Consumer Credit Act is involved.^{*13} In Chapter 13 of the Bank and Financing Business Act, there are further, detailed provisions regarding the supervision carried out by the FSA vis-à-vis credit institutions and foreign financial institutions. In Chapter 8 of the same act, there are business provisions addressing the loan operations of a credit institution.

The supervision of compliance with the provisions of the Consumer Credit Act is thus shared between the Consumer Agency and the FSA. According to the *travaux préparatoires* of the act, the importance of the work of the two authorities being largely consistent is emphasised.^{*14} The prerequisite is for these two authorities to consult each other with regard to supervisory matters. The question of whether not all lending establishments giving credit in accordance with the Consumer Credit Act should lie within the supervisory remit of the FSA in the same way as credit institutions has been discussed at length,^{*15} with such unification not yet in place.

The Consumer Agency in its supervisory capacity has the authority to order a trader to stop granting credit if that trader does not comply with the provision for credit assessments in Section 12 of the Consumer Credit Act, authority granted by Section 51 of that act. A decision regarding an injunction may be linked to a fine. If deeming it sufficient, the Consumer Agency may instead issue a warning. The warning can be combined with a penalty to the company that has not carried out adequate credit assessment of a consumer when granting credit.^{*16} The penalty can be set at a minimum of 5 000 SEK and a maximum of 10 million SEK, Section 52. According to the *travaux préparatoires* of the act, ordering a company to stop giving credit is a severe measure. Decisions as to whether such an injunction shall be issued must be made on a case-by-case basis. Flagrant or repeat infringements act in favour of an injunction.^{*17} In its inspections of various pay-day loan companies in 2012–2013, the Consumer Agency found that the credit assessments

¹¹ FFFS 2014:11(Finansinspektionens allmänna råd om krediter i konsumentförhållanden) and KOVFS 2011:1 (Konsumentverkets allmänna råd om konsumentkrediter).

¹² Government Bill 1976/77:123, pp. 349–351(Regeringens proposition med förslag till konsumentkreditlag m.m.); A. Erikson, G. Lambertz. *Konsumentkrediter. Kommentarer till 1992 års konsumentkreditlag* 1993, p. 331 and the following pages (Consumer credit. Commentary on the 1992 Consumer Credit Act).

¹³ See Government Bill 1976/77:123, p. 147; Lagutskottets betänkande (Legislation Committee report) 1977/78:5, p. 21; A. Erikson, G. Lambertz (see Note 12), p. 332.

¹⁴ See Government Bill 1991/92:83, p. 145 (Regeringens proposition om ny konsumentkreditlag).

¹⁵ See Government Bill 2009/10:242, p. 78 (Ny konsumentkreditlag).

¹⁶ See SFS 2014:83 and Government Bill 2013/14:34 (Sanktionsavgift vid bristande kreditprövningar.)

¹⁷ See Government Bill 2013/14:34 p. 17 c.f. Government Bill 2002/03:139, p. 255 (Reformerade regler för bank- och finansieringsrörelse).

carried out by many companies were inadequate. Between 2011 and 2013, 19 pay-day loan companies were given a warning for inadequate credit assessments.^{*18}

If a trader supervised by the FSA violates Section 12 of the Consumer Credit Act, the FSA has the right to take the measures stipulated in Chapter 15 of the Bank and Financing Business Act. The intervention shall be in the form of an injunction for certain measures to be taken within a certain amount of time or may consist of a ban on enforcing decisions or of an observation report. If the infringement is serious, the licence of the credit institution shall be revoked, whilst a warning shall be issued if one is sufficient. If the infringement is not serious or is excusable, the FSA may refrain from intervention. If a credit institution has been informed of a decision with regard to an observation report or warning, the FSA may decide that the institution in question shall pay sanctions.^{*19}

In conclusion, the Consumer Agency's sanctions associated with a trader violating Section 12 of the Consumer Credit Act are more limited than what applies to the FSA in relation to credit institutions. A further difference between the FSA and the Consumer Agency is that the idea is not for the Consumer Agency to inspect all traders under its supervision. Instead, the intention is for random inspections to be carried out. The Consumer Agency shall focus its resources primarily on targeted efforts where there is reason to believe that the Consumer Credit Act is not being complied with. It is, however, up to the agency to decide independently which measures shall be taken.^{*20} As for the FSA, the work shall be geared mainly toward following the development of the business of individual companies on an ongoing basis so that the FSA can quickly make an assessment of a particular company and obtain a comprehensive picture of the risk exposure of that company.^{*21}

3. Administrative measures

a. Licensing

As described above, both banks and financing businesses are operations that require a licence and fall within the supervisory remit of the FSA. However, no licence is required for those so-called financial institutions that give credit to others than consumers without receiving repayable funds from the public. For these operations, it is the reporting duty in accordance with the Certain Financial Operations (Reporting Duty) Act that applies. (Lag (1996:1006) om anmälningsplikt avseende viss finansiell verksamhet).^{*22} The scope of the latter act has been expanded several times^{*23} and includes financial institutions—i.e., both natural and legal persons dealing with currency exchange or other financial activities. Here, 'other financial activities' refers to professional operations that consist primarily of providing one or several of the operations specified in paragraphs 2, 3, and 5–12 of Section 2 of the Bank and Financing Business Act's Chapter 7 (for example, giving or providing credit or credit with a lien in property or claims).

The categories of companies and private individuals registered as financial institutions with the FSA are highly varied. The list includes everything from major financial companies targeting qualified corporate customers to private individuals who work with currency exchange on a smaller scale. To complicate matters, there are operations that offer credit but still are not covered by the duty to report that is stipulated in the above-mentioned act. The financial activities have to be professional in nature if there is to be an obligation to report. Moreover, the company's main operations must consist of dealing with one or more of the activities listed in Section 1 of Chapter 7 of the Bank and Financing Business Act ((paragraphs 2, 3, and 5–12). Only companies that grant credit professionally and wherein the giving of credit is the main operation are subject to the duty to report. In order to reinforce the protection of consumers with respect to granting of credit and thereby reduce the problem of debt to the fullest extent possible, the legislator has

¹⁸ Press release from the Consumer Agency, <http://www.konsumentverket.se/Lagar--regler/Rattsarenden/Varningar-enligt-konsumentkreditlagen/>. Homepage of the Consumer agency, most recently accessed 6.8. 2014.

¹⁹ See Government Bill 2002/03:139, p. 381 and the following pages; Government Bill 2009/10:242, pp. 79, 121.

²⁰ See A. Eriksson, G. Lambertz (see Note 12), p. 335.

²¹ See Government Bill 2002/03:139, pp. 372–373.

²² See amendments in the 1996 Act through SFS 2014:279 and 2014:561.

²³ See for example Government Bill 1999/2000:145 (Penningtvätt och betalningsöverföring); Government Bill 2002/03:139, p. 598 (Reformerade regler för bank- och finansieringsrörelse) and note 22.

introduced a new law on certain operations that involve consumer credit.^{*24} As has been mentioned above, a licence from the FSA is required before one is allowed to pursue such activities.

b. Marketing and advertising restrictions

The Consumer Credit Act contains rules that, specifically for consumer credit, complement the general provisions on marketing set forth in the Marketing Act (2008:486). The EC directive on unfair business-to-consumer commercial practices has been incorporated into Swedish law with the latter act.^{*25} Section 7 of the Consumer Credit Act, in its first paragraph, stipulates that a trader, when marketing credit agreements—of whatever sort—shall provide information about the APR for the credit. According to the second paragraph of Section 7, more detailed information shall be provided if the marketing includes a figure other than the APR. Examples include the interest rate and a charge or other cost. Despite the fact that the FSA supervises credit institutions for purposes of ensuring that they comply with the Consumer Credit Act with respect to credit assessments, it is the Consumer Agency that supervises the same institutions to ensure their compliance with Section 7 of the Consumer Credit Act with regard to the marketing of credit. The Consumer Agency thus conducts monitoring to ensure that all companies offering consumer credit comply with the Marketing Act's rules.

The Consumer Agency has noted that the marketing of pay-day loans has been aggressive. Therefore, the Consumer Ombudsman has in a few cases taken certain pay-day loan companies to the Swedish Market Court. In MD 2007:17, for example, the creditor was banned from marketing pay-day loans on the radio, television, and its own Web site and from portraying the credit as an easy and quick way to resolve financial problems. In MD 2010:30, the marketing used was regarded as not being compatible with good marketing practices, since the marketing had stressed the possibility of a quick credit solution as a decisive factor in relation to the conditions of other credit solutions.

c. The system of debt counselling

A person experiencing financial difficulties can seek advice from a budget and debt adviser, who can be found in any of the municipalities in Sweden. The availability of these services is required by law. The advisers may give advice on how to resolve a situation wherein an individual has incurred excessively large debts, by, for example, helping to draw up a household budget and assisting the debtor before and during a debt-restructuring procedure. One problem with the services of these advisers is that in some municipalities it may take as much time as 56 weeks before one can set up a meeting with a budget and debt counsellor.^{*26} On the other hand, only three municipalities in Sweden fully lack access to a budget and debt adviser,^{*27} and the advice is generally free of charge and is funded by the government. Demand for debt counselling has increased. In 2008, Sweden's municipal budget and debt counsellors had 12,505 clients, but in 2012, the figure had increased to 44,000.^{*28}

Municipal consumer advisers too should be mentioned in this context.^{*29} Their task is to provide general information, more details, and guidance to individual consumers on specific matters.^{*30} They can also act as a mediator in disputes between a specific consumer and a specific trader. Consumer guidance is available

²⁴ See Ds 2013:26 (Viss kreditgivning till konsumenter), Government Bill 2013/14:107 (Om viss verksamhet med konsumentkrediter).

²⁵ See Directive 2005/29/EC of the European Parliament and of the Council of 11 May concerning unfair business-to-consumer commercial practices in the internal market and amending Council Directive 84/450/EEC, Directives 97/7/EC and 2002/65/EC of the European Parliament and of the Council and Regulation (EC) No 2006/2004 of the European Parliament and of the Council (the Unfair Commercial Practices Directive).

²⁶ See SOU 2013:72, p. 133 (Ut ur skuldfällan).

²⁷ *Ibid.*

²⁸ See SOU 2013:78, p. 235 (Överskuldssättning i kreditsamhället?).

²⁹ See also the Consumer Agency's report 2010:21. Kommunernas konsumentvägledning – bra men okänd [‘The municipalities' consumer counselling—good but unknown’]. See the same report with respect to the four ‘Consumer Bureaux’ to which belongs for example Konsumenternas Bank- och Finansbyrå (the Consumers' Bank and Financial Bureau), which provide information and guidance to private persons in their respective markets.

³⁰ See, for example, Government Bill 1985/86:121 (Regeringens proposition om inriktningen av konsumentpolitiken m.m.).

in most municipalities, but about half of the population of Sweden know nothing of this, even though only seven per cent of the country's inhabitants live in municipalities without consumer-guidance officers of their own. In 2011, consumer-guidance officers dealt with 94,000 complaints.^{*31} The Swedish Consumer Agency estimates that these officers can mediate a settlement in about 95% of the disputes involved.^{*32}

Several measures have been discussed for application, among them review of the structure of consumer support (for example, Web-based information provided by various players) and a national guidance service for individuals—a financial 'ER' designed to combat over-indebtedness.^{*33}

d. Positive/negative credit registers

It is fairly easy for a credit provider to make a reasonably reliable assessment of a potential credit recipient in order to establish whether that person risks becoming over-indebted. Firstly, the debtor must state the household's monthly income and expenditure in the credit application, along with its assets and liabilities. To facilitate the assessment, credit information is usually obtained from a specialist private company (one such company is Upplysningscentralen).

In the first paragraph of Section 2 of the Credit Information Act (1973:1173), credit information is defined as consisting of information, opinions, or advice submitted for guidance in the assessment of a person's financial creditworthiness or reliability. As for particulars related to private persons, the following information is usually included in the credit information: name, address, current residence, household members (i.e., national identification number(s) of any spouse and/or children under 18 living in the same residence), marital status, year of any immigration or emigration, and income figures from the annual income-tax assessment. If the debtor runs a business, particulars of any ownership of real estate and presentations of the balance of outstanding credit for which no security has been furnished or for which the only security consists of someone having provided a surety for the credit involved are included. Finally, particulars are given of any records of non-payment—i.e., failure to settle a debt in time.

The Credit Information Act applies to credit information related to both legal and natural persons, but the provisions differ in certain respects, depending on the character of the person involved. The main aim of the Credit Information Act is, however, to prevent one's personal integrity from being violated unduly because of the contents of the information conveyed or on account of false or misleading information being stored or disclosed.^{*34} This is particularly important since no-one's details may be deleted from a credit-information register.^{*35}

With certain exceptions, credit-information activities are permitted only after a licence has been obtained from the Swedish Data Inspection Board. One exception is that a licence is not required for a Swedish credit institution. Except in a few specific cases, credit-information activities are deemed to involve someone providing credit information against a fee or as part of business operations; see Section 1. There are about 15 companies that have been granted a licence from the Data Inspection Board to work with credit information. Most of the information, however, is submitted by a few major credit-information companies. They have created computer registers that contain information about all natural persons over the age of 15 in Sweden and all legal persons in the country. In the several amendments made to the Credit Information Act in recent years, the intention has been to reinforce privacy of individuals in credit-information operations.^{*36} Since credit information is used for a credit assessment in determination of whether a consumer will be able to repay a loan, it is important that the pieces of credit information supplied be up to date, relevant, and correct. The credit-information companies retrieve information from many sources,

^{*31} See the Consumer Agency's report 2012:4. *Kommunernas konsumentvägledning – en lägesrapport 2012* ['The municipalities' consumer counselling system – a progress report, 2012'].

^{*32} See A. Bakardjieva Engelbrekt. *Från materiella regler till genomföranderegler: en ny fas i det europeiska rättssamarbetet på konsumentskyddsområdet* ['From material rules to implementation rules: A new phase in the European judicial co-operation in the area of consumer protection']. – *Europarättslig tidskrift* ['European Law Magazine'] 2007, pp. 588–589.

^{*33} See SOU 2013:72 and SOU 2013:78.

^{*34} See Government Bill 2002/03:139, p. 209.

^{*35} Ds 2008:34, p. 19 (Ett starkare skydd för den enskildes integritet vid kreditupplysning); cf. the Retention of Data Directive (Directive 2006/24/EC of the European Parliament and of the Council of 15 March 2006 on the retention of data generated or processed in connection with the provision of publicly available communications services or of public communications networks).

^{*36} Ds 2008:34; Government Bill 2009/10:151.

primarily public sources and registers—for example, the Swedish Tax Agency, the Enforcement Agency, and the Swedish Companies Registration Office registers. In principle, the information that can be obtained from the authorities is publicly available to everyone.

e. Responsible lending obligations

The Consumer Credit Act includes rules pertaining to ‘responsible lending’ in the form of the trader’s obligation to provide pre-contract information, perform credit assessments, and adhere to good lending practices. These rules are in line with ‘market law’ and have been approved by the business sector. The aim of market rules is not primarily to protect the individual consumer; instead, it is to maintain competition and create a well-functioning market. The market rules set forth in the Consumer Credit Act, however, also are intended to protect the consumer and contribute to reinforcing the consumer’s position.^{*37} The Consumer Credit Act does not, however, provide for any civil-law sanctions for infringements.

According to Section 6 of the Consumer Credit Act, the credit provider shall observe good lending practices in the relationship with the consumer. The credit provider shall safeguard the interests of the consumer to a reasonable extent and provide the consumer with the explanations he or she requires.

What constitutes good lending practices is determined through ethics rules that have been agreed upon by representatives from the sector and the supervisory authorities. Also, statements from the supervisory authorities can provide guidance as to the interpretation of the concept.^{*38} Items 2.1.1 and 2.1.2 of the general guidelines issued by the Consumer Agency provide guidance with regard to the concept of good lending practices. The FSA in its guidelines refers only to Section 6 and 12 of the Consumer Credit Act.^{*39} The guidelines are recommendations and are not mandatory. There are no contractual sanctions if the guidelines are not followed.

Under these terms, the trader shall provide the consumer with the explanations and information that he or she needs in order to be able to determine whether a credit agreement suits his or her needs and financial situation. The government bill that led to the Consumer Credit Act emphasises that the consumer may need explanations in order to be able to choose between types of credit or to be able to estimate the cost of the credit in question. The obligation to explain does not mean, however, that the trader is obliged to give advice to the consumer. The circumstances of an individual case may, on the other hand, be such that the trader, for reasons of good lending practices, should dissuade the consumer from concluding a credit agreement. It should be stated also that the obligation to explain applies, in principle, for the full duration of the agreement even if it is aimed primarily at providing the consumer with sufficient information to allow assessing whether the credit suits his or her needs and financial situation.

The obligation to explain shall be regarded as having been fulfilled when the trader has provided all the explanations that the consumer in question requires. The explanations must, therefore, be adjusted on the basis of the consumer’s case-specific needs. That is why—according to the *travaux préparatoires* of the relevant act of law—it is not possible to state exactly which explanations shall be provided. The government bill, however, stresses that the information provided to the consumer by the trader about the main features of the proposed credit (see Sections 8–10) should often lead to explanations. Moreover, it emphasises that if a consumer so demands, the trader shall be prepared to explain in more detail the meaning of the information. It is often justifiable for the trader to explain to the consumer what will happen if payment is delayed even if the consumer has not requested that information. Furthermore, the trader should ensure in a suitable manner that the consumer has understood the explanations given in their important details.^{*40}

It is assumed that the concept of good lending practices includes the requirement that the lender shall provide the consumer with fair information about the credit. There is reason to impose greater demands for explanations to be given for certain types of credit—for example, credit that entails a particularly high

³⁷ Government Bill 1992/92:83, p. 33 (Regeringens proposition om ny konsumentkreditlag); Government Bill 2002/03:139, p. 587; Government Bill 2009/10:242, pp. 46. An important part of the consumer protection in the EC directive behind the Consumer Credit Act from 2010 consists of the requirement with regard to the trader’s obligation to provide information. See 2010/11:CU5, p. 6, and see also Directive 2008/48/EC.

³⁸ See Ds 1990:84 (Ny konsumentkreditlag), p. 45; Government Bill 2009/10:242, p. 90; Government Bill 1991/92:83, pp. 33–34.

³⁹ See Chapter 2 of FFFS 2014:11 (FFFS = Finansinspektionens författningssamling) and FSA decision memorandum 10-4628, 2011-10-05.

⁴⁰ See KOVS 2011:1, 2.1.1 (Konsumentverkets allmänna råd om konsumentkrediter).

risk of indebtedness and types of credit that are designed in such a way that it is difficult for the consumer to understand them. With respect to these types of credit, the credit provider shall base the information on the explanation needs of the consumer. This means that the consumer must be able to pose questions orally to a person who is an expert in the relevant area and receive an answer to those questions without delay.

However, if a consumer has previously concluded an agreement with regard to a certain credit product with the credit provider, the credit provider should normally presume that further explanations will not be necessary unless the consumer specifically asks a question.

4. Contractual measures

a. Unconscionability doctrine

A contract term that is unfair can be reconciled or disregarded, in the manner stipulated in the general clause of Section 36 of the Contracts Act (1915:218). The rule is designed in such a way that it can be applied in particular to benefit a weaker party, such as a consumer in relation to a trader, even if the rule can also be applied to equal parties to a contract. The idea is that Section 36 of the Contracts Act shall serve as a last resort for situations involving rights worthy of protection if and when the specific consumer-protection legislation cannot be applied. The paragraph was introduced in 1976 and is often used in legal cases as a last resort.

There are several reasons for a term in a contract to be regarded as unfair; these might involve the meaning of the term, the circumstances wherein the agreement was signed, events that took place later, or other circumstances. When a review is being made, the terms of the contract shall be considered in light of all the circumstances related to the contract and of the contract as a whole. If a court finds one term to be unfair, that term can be reconciled such that it becomes fair, or it can be disregarded entirely. After reconciliation, the rest of the contract normally remains as it is, although reconciliation or the disregarding of one term may also lead to a more extensively amended contract or to the contract becoming void. The fairness of a term shall be assessed on the basis of what is normal in similar circumstances in consideration of the legislation and trade practices.^{*41} However, Directive 93/13/EEC, on unfair terms in consumer contracts, also governs the assessment of Section 36 of the Contracts Act when consumer contracts are involved. This means that a standard term in a consumer contract is unfair under Section 36 if, contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations under the contract to the detriment of the consumer.^{*42} The directive proceeds from a more rigorous approach than does Section 36, which means that unreasonable conditions shall be disregarded if the contract could exist without the condition. The courts should—instead of the unfair term—apply utilisation of dispositive law. This imposes a more stringent model for traders than the adjustment of the contract terms as provided for by Section 36. In fact, the adjustment possibility under Section 36 has been further limited by the directive. In the assessment of whether a contract term is unfair, one may not consider circumstances that have come about since the conclusion of the contract, which could mean that the condition in question is considered reasonable.^{*43}

From the Supreme Court's case law to date—NJA (*Nytt Juridiskt Arkiv*, the Supreme Court periodical) 1996, p. 3 and NJA 1999, p. 304—we may conclude that the fact of a bank neglecting its duties of investigating the creditworthiness of the debtor can only exceptionally lead to the debtor or a guarantor being exempted from repaying the loan.^{*44}

b. Responsible lending doctrine

In conjunction with providing credit, the credit provider shall check to ensure that the consumer is in such a financial position as to be able to fulfil the terms of the credit contract, under Section 12 of the Consumer Credit Act. The rule is designed primarily to underscore the responsibility of the trader to ensure that

⁴¹ J. Ramberg, C. Ramberg, *Allmän avtalsrätt*, 8th edition. 2010, p. 175 (General contract law).

⁴² See Section 11 of the Law on contracts terms in consumer relationships ('lag (1994:1512) om avtalsvillkor i konsumentförhållanden').

⁴³ See U. Bernitz, *Standardavtalsrätt* ['Law of standard contracts'], 8th edition. 2013, pp. 159–160.

⁴⁴ See A.H. Persson, Protection of consumer non-professional surety guarantors in Sweden. – A. Colombi Ciacchi, *Protection of Non-professional Sureties in Europe: Formal and Substantive Disparity*. 2007, pp. 267–269.

people do not borrow more money than they are able to repay, in order to combat indebtedness of consumers.^{*45} The credit assessment shall be based on sufficient information about the consumer's financial situation, and credit shall be granted only if the consumer's financial position allows the ability to fulfil his or her contractual obligations. When the amount of credit is substantially increased, a new credit assessment shall be made, to enable an estimate of the current solvency of the borrower. The aim of a credit assessment is, accordingly, to appreciate the consumer's current and future solvency. The credit assessment should be based on written information or other reliable sources, such as a credit-reference check. A consumer's solvency should be assessed on the basis of his or her income, assets, expenditure, and debts, along with any credit documents.^{*46}

If the credit applicant lives in a household with other residents, the financial situation of the entire household should be taken into account to a suitable extent. The trader shall collect information about the consumer in this extent and, working from this information, make an appraisal of the consumer's solvency, then, on the basis of that assessment, determine whether the credit that has been applied for shall be granted or not. In this process, consideration should be given to reasonable living conditions; there is guidance to help the credit provider in the Consumer Agency's calculations of such costs.^{*47} With regard to the condition that a credit check shall be based on sufficient information, the *travaux préparatoires* of the Consumer Credit Act asserts that the trader must collect enough information for ensuring that the assessment of the consumer's solvency with regard to the credit in question can be performed with as great a degree of certainty as possible.^{*48}

The trader is normally responsible for obtaining a holistic view of the financial situation of the consumer. For this, several sources of information might be required. The information normally includes the income of the consumer, along with details of other credit commitments. If the information indicates that solvency is uncertain on account of the income level, it might be important to look at capital. If a security will be given for the credit, information with regard to that security must be collected. The fact that a consumer provides a security for the credit does not normally have an impact on the credit assessment. Even if information about the value of the security indicates that it covers the credit amount and credit costs, the underlying rule is still that the customer must have sufficient financial resources to pay the charges, interest, and instalments at the rate that has been agreed on even without the security: the value of the security may decrease over time and might not be sufficient at the time of sale, and that could lead to a large amount of the credit remaining non-covered.^{*49}

Moreover, the *travaux préparatoires* of the act states that information indicating that there is no record of non-payment is not sufficient for granting of credit, no matter how small the amount of the credit is. Likewise, the fact that there is a record of non-payment should not on its own determine whether the credit applicant is deemed to lack the financial preconditions for fulfilling the associated obligations. A consumer may be solvent for the credit in question despite the existence of several records of non-payment. There is, however, nothing to prevent the credit provider from rejecting the credit application because of a record of non-payment.

When a trader collects information about a credit applicant, several sources of information may be required. Information can be retrieved from the consumer, from a credit-information company, from a database run by an authority (such as the Enforcement Agency), or from the credit provider's own database or other register. The sources of information that are used for any particular credit assessment, especially if they partially overlap, must be determined by the requirement that the assessment be based on sufficient information.^{*50} The consumer should normally be asked to say something about his or her financial situation, but information from the consumer is not sufficient in practice. The consumer's information should always be checked with the aid of an up-to-date credit-reference check. If the trader obtains information via a credit-reference check, the information obtained is, in combination with the information the

⁴⁵ See Government Bill 2002/03:139, p. 587; cf. Ds 1990:84, p. 45.

⁴⁶ See FFFS 2014:11, Chapter 2.

⁴⁷ See KOVS 2011:1, 2 3 2; cf. Ds 1990:84, p. 53, regarding those on whom a credit check shall be carried out.

⁴⁸ See Government Bill 2009/10:242, p. 100.

⁴⁹ See Government Bill 2009/10:242, p. 100; cf. Government Bill 1991/92:83, pp. 106 and the following pages; Government Bill 2002/03:139, pp. 252 and the following pages and p. 587.

⁵⁰ See FFFS 2014:11 and decision memorandum FSA 10-4628.

provider receives from the consumer, generally enough, though this depends on how complete and reliable the information from the credit-reference check is.

In several cases from the 1990s, the Supreme Court ruled that the consequences of deficiencies in a credit assessment can only in rare, exceptional cases entail the obligation to pay being reconciled in accordance with Section 36 of the Contracts Act.^{*51} The effectiveness of the sector-based sanction system has, because of these decisions, been questioned every so often. This is why a civil-sanction proposal has been up for discussion.^{*52} The *travaux préparatoires* of the current Consumer Credit Act states, however, that a sector-based sanction system is more suitable and more effective, and it is also compatible with the requirements of the underlying directive.^{*53}

c. APRC / interest-rate restrictions

The question of a cap on interest rates under Swedish legislation has been discussed several times. Proposals for the introduction of a cap on interest rates in the context of collection have been submitted by the Tax Agency, for example.^{*54} The Consumer Agency has put forward proposals related to the possible introduction of a limit to the level of interest on overdue payments that can be agreed upon between a credit provider and a consumer.^{*55} Commissioned by the Ministry of Finance to draw up a proposal, A. Eriksson favoured an interest rate not exceeding 15 percentage points above the percentage that corresponds to the reference interest applicable at any particular moment in time in accordance with Section 9 of the Interest Act (Räntelagen, 1975:673).^{*56} The proposals put forth have not led to an amendment of the law. The *travaux préparatoires* of the Consumer Credit Act states that proposals of an interest-cap have been criticised by several referral organisations. The Riksbank, for instance, described an interest-rate cap as a blunt instrument in comparison to provisions addressing unfair contract terms and usury.^{*57}

The issue of an interest-rate cap has also been discussed within the framework of the enquiry into amendment of the Debt Restructuring Act.^{*58} The conclusion, however, was that directly limiting the possibilities for consumers to take out necessary or unnecessary credit on what can in objective terms be deemed 'rotten terms' should be kept to a minimum.

d. Restrictions on interest (for late payment, in relation to claims for damages, etc.)

Certain provisions related to interest can be found in both the Interest Act (1975:673) and the Consumer Credit Act. The Interest Act is to a large extent optional, unlike the Consumer Credit Act, which is mandatory. The point of departure of the Interest Act is that it is primarily the contract provisions pertaining to interest that apply. Section 1 of the Interest Act, in its second paragraph, stipulates that the act applies insofar as nothing else has been agreed upon, pledged, or specially prescribed. However, the amount of interest that a credit provider may charge for extending credit is not regulated by the Interest Act. On the other hand, Section 18 of the Consumer Credit Act includes a rule stipulating that the credit customer is obliged to pay a special charge for the credit, apart from or instead of interest, only if this has been agreed on and if said charge is related to costs incurred by the credit provider for the credit. According to the *travaux préparatoires* of the Consumer Credit Act, the aim of the provisions is to limit the possibility of the credit provider charging interest in the form of a fee.^{*59} While there are rules about percentages in the Interest Act, the optional nature of the act leaves it up to the parties to decide the level of interest to be charged.

⁵¹ NJA 1992, p. 351; NJA 1993, p. 163; NJA 1994, p. 381; NJA 1996, p. 3; NJA 1996, p. 19; NJA 1999, p. 304; NJA 1999, p. 408.

⁵² Ds 1990:84; Government Bill 1991/92:83, pp. 34–35; Government Bill 2009/10:242, pp. 56–57.

⁵³ Government Bill 2009/10:242, pp. 56–57.

⁵⁴ Skatteverkets redovisning den 27 december 2004 ['Tax Agency report, 27 december 2004']; see also SOU 2008:82, p. 293 (Vägen tillbaka för skuldsatta).

⁵⁵ Konsumentverkets (Consumer Agency) report 2003:4, p. 31. (Överskuld sättning).

⁵⁶ See A. Eriksson. PM 2005/1958, p. 50 (Konsumentskyddet inom det finansiella området).

⁵⁷ See Government Bill 2009/10:242, p. 34.

⁵⁸ See SOU 2008:82, pp. 214–215.

⁵⁹ See Government Bill 1991/92:83, p. 53. See also the discussion above on cases MD 2008:3 and MD 2009:34, in the section on marketing.

If nothing has been agreed upon explicitly, provisions are applied to the interest a consumer who has not paid a debt in time shall be charged from the deadline until the debt has been paid—i.e., interest on overdue payment. If the contract does not feature any terms pertaining to interest on overdue payments, interest shall be calculated for a year in line with a percentage that corresponds to eight percentage points above the reference interest rate applied at any given moment in accordance with Section 9 of the Interest Act. According to Section 9, the reference interest rate shall be determined every six months, through a special decision by the Riksbank. From 1 July until 31 December 2013, the reference interest rate was set at one per cent; accordingly, the interest on overdue payment amounted to nine per cent under Section 6. However, the rule has never been applied. As the regulation is dispositive, the parties can probably decide upon, in addition to penalty interest, contractual interest for the time of default, but the legal situation is unclear.^{*60} If a debtor has been prevented from paying in time by illness, unemployment, or a similar circumstance that he or she has not prevailed over and if an obligation to pay full interest in consequence of overdue payment is therefore regarded as unreasonable, the interest that otherwise would be charged may be reconciled; see Section 8.

There are two provisions of Swedish law that, in practice, set a cap to the interest that may be charged for credit: there is a civil-law provision in Section 31 of the Contracts Act and a criminal-law provision in Chapter 9, Section 5 of the Penal Code.^{*61} The aim of Section 31 of the Contracts Act is to prevent anyone from reaping obviously unreasonable financial benefits through misappropriation from someone else by abusing the other party's situation of disadvantage—in simple terms, taking advantage of a person's distress, innocence, thoughtlessness, or dependence on him or her in order to gain a benefit that is clearly disproportionate to the consideration afforded. Therefore, there must be a considerable difference in what is demanded of the two parties before the provision is applicable. Court proceedings should be prompted by the invalid action. The legal consequence for breaching Section 31 of the Contracts Act is that the contract is considered invalid. As in general procedural law, the burden of proof is on the party that alleges there to have been abuse.

Section 5 of Chapter 9 of the Penal Code stipulates in its first paragraph that a person who in connection with a contract or other legal transaction takes advantage of someone else's distress, innocence or thoughtlessness, or relationship of dependence on him or her in order to obtain a benefit that is clearly disproportionate to the consideration afforded or for which no consideration will be provided shall be sentenced for usury to a fine or, at most, two years' imprisonment.^{*62} Also, a person shall be sentenced for usury who, in connection with the granting of credit in a business activity or other activity that is conducted habitually or otherwise on a large scale, obtains interest or another financial benefit that is manifestly disproportionate to the counter-obligation; see Chapter 9's Section 5, second paragraph. If the crime is gross, imprisonment for at least six months and up to four years shall be imposed.

Where the limit for usurious interest shall be set is not entirely clear. In NJA, the Supreme Court deemed a credit provider liable for usury in 1995 after that credit provider had offered and granted consumers loans with an APR of 125–137%. The Supreme Court, however, declared that it is not possible to determine whether the price of credit is reasonable by merely looking at the APR.^{*63} In order to conduct a fair assessment, one must take into account the amount of credit, the credit period, and how the credit costs are to be paid. An overall assessment must be made, therefore, of the interest and the terms in general. It has been repeatedly debated whether the APR on pay-day loans should not fall under the criminal-usury provision. The APR for one of the least expensive pay-day loans in the Swedish market was 1,746% in May 2012, and the most expensive loan had an APR of 18,200%.^{*64} The Consumer Agency reported a pay-day loan company to the police for usury in 2012, but the company closed up shop and the criminal investigation therefore was closed.

^{*60} M. Mellqvist, I. Persson. *Fordran och skuld* [Claims and liabilities], 9th edition. 2011, pp. 79–80.

^{*61} See SFS 1962:700 (Svensk Författningssamling).

^{*62} See N.O. Berggren *et al.* *Brottsbalken. En kommentar* [‘The Penal Code – a comment’], 1 May 2012, accessed via the Zeteeo information system, specifically the comment on Chapter 9, Section 5 of the Penal Code.

^{*63} Cf. even NJA 1941, p. 44; 1955, p. 574; 1963, p. 195; 1964, p. 213.

^{*64} See http://www.svd.se/naringsliv/nyheter/sverige/astronomiska-rantor-for-sms-lan_7052339.svd, 3.9.2008 (most recently accessed on 6.8.2014) (Astronomical interest rates for payday loans).

A licence from the Data Inspection Board is required for running a collection agency, under Section 2 of the Debt Recovery Act (1974:182).^{*65} There are rules in the Debt Recovery Act on how a debt-recovery business may be run. The business shall apply good recovery practices and thereby not cause the debtor any unnecessary harm or inconvenience. Nor should the debtor be subjected to any undue pressure or any other undue recovery measures. Before legal action is taken, the debtor shall receive a claim in writing, and each claim shall state the name of the creditor and the basis for the claim. If the claim includes sub-items such as a capital receivable, interest, and charges for costs, these shall be presented individually. As for interest costs, the accrued interest, the percentage, the period, and the amount that together form the basis for the calculation shall be presented. The claim shall also indicate the deadline by which the claim must be paid at the latest.

The measures for which a debtor is obliged to pay the creditor and the amount to be paid are stated in the Act on Debt Recovery Costs (1981:739). The debtor has a duty to compensate for the cost of sending claim letters, amounting to EUR 20, in accordance with the requirements of the Act on Debt Recovery, and EUR 6.50 for a payment reminder, provided that the parties have agreed to this. If the debtor and creditor have jointly drawn up a payment plan for the remainder of the debt and this has been sent to the debtor, the creditor has the right to charge EUR 19 for it.

Only when the claim has not been paid before the deadline stated may legal action be taken. The debtor is obliged to reimburse the creditor for costs incurred during the recovery process if those measures were necessary.

5. Insolvency law

a. Enforcement for debts

Enforcement of payment of debts in Sweden is regulated by the Act on Order for Payment Procedure ('Lag (1990:746) om betalningsföreläggande och handräckning'). This method is very easy and inexpensive for the creditor to use in order to receive payment from the debtor. Provided that the due date for payment has passed and the debt is monetary in nature, the creditor may apply for a payment order against the debtor with the Swedish Enforcement Authority.^{*66} Said authority then verifies the debt, which is done via the application.^{*67}

The application to the Swedish Enforcement Authority for an order for payment can result in any of three distinct outcomes, depending on the defendant's choice. Firstly, if the defendant pays the entire debt (or a part thereof), the Swedish Enforcement Authority must promptly be informed, with the application being withdrawn if the debtor pays the entire debt. Secondly, if the defendant contests the debt, the applicant may decide whether the application shall be passed on to a court for further processing or dismissed by the Swedish Enforcement Authority. Thirdly, if the defendant does not contact the Swedish Enforcement Authority, the latter shall issue a verdict, which states that the defendant is obliged to pay the debt associated with the claim.^{*68}

Only if the claim is deemed unjustified or unwarranted is the application immediately returned to the applicant. In that case, the applicant may request the Swedish Enforcement Authority to hand over the case to the court system, where the case shall then be processed. Otherwise, the Swedish Enforcement Authority dismisses the case.^{*69} Debt recovery too is executed by the Swedish Enforcement Authority. An application for a payment order must state whether or not the Swedish Enforcement Authority should execute. Unless the applicant applies for later enforcement of the verdict, the order shall be executed immediately.^{*70}

⁶⁵ The Debt Recovery Act is complemented with rules in the Debt Recovery Ordinance (1991:956) and the Data Inspection Board's regulations on licences (DIFSI 2011:1).

⁶⁶ See Sections 1 and 2 of the Act on Order for Payment Procedure.

⁶⁷ In the application, the claim and the grounds for it shall be stated so that the defendant understands what the claim is related to. When the application is submitted, the Swedish Enforcement Authority sends the defendant a letter providing for an order to pay on the basis of the claim. See Sections 10 and 25 of the Act on Order for Payment Procedure.

⁶⁸ See Sections 33 and 42 of the Act on Order for Payment Procedure.

⁶⁹ See Sections 23 and 33 of the Act on Order for Payment Procedure.

⁷⁰ See Chapter 2, Section 1 of the Enforcement Code.

b. The debt-restructuring system

When a bankruptcy is finalised in a Swedish court and a natural person is involved, he or she is not exempted from his or her debts after the proceeding. In such a situation, the most suitable solution is often to initiate debt-restructuring proceedings if the individual is insolvent and encumbered with debts that he or she probably will not be able to settle in the foreseeable future. Debt restructuring entails a debtor being wholly or partially exempted from the responsibility of paying off the debts in the course of the debt-restructuring process. The restructuring mechanism has several aims: Chief among them is for the restructuring to be rehabilitating. People with a high level of debt should have the possibility of solving their financial problems and thus given a second chance, an opportunity for a more tolerable life situation. This aim to rehabilitate, however, must be weighed against the creditors' valid interest in make their claims.

Debt-restructuring procedures are regulated by the Debt Restructuring Act (2006:548).^{*71} The Enforcement Agency alone processes restructuring cases, according to Section 2. That agency may grant restructuring even if one or several debtors are opposed to it. The Enforcement Agency also processes reviews of restructuring decisions, and the decisions of the Enforcement Agency can be appealed to the District Court.

It is the debtor who initiates the application for debt restructuring, according to Sections 10–11. Before applying for restructuring, the debtor may have tried to reach a voluntary agreement with the creditors. In order to reach such an agreement, the debtor may have received advice from a municipal debt and budget counsellor, as paragraph 2 of Section 2 points out. These counsellors shall also provide the debtor with support and advice for his or her application for debt restructuring and then, after the decision, provide the debtor with assistance for the full duration of the payment plan. The Consumer Agency is the co-ordinating central authority for municipal budget and debt counsellors, according to Section 2's third paragraph.

Debt restructuring may be granted to a natural person residing in Sweden if he or she is insolvent and so indebted that his or her ability to repay the debts in the foreseeable future cannot be presumed (this is referred to as the qualified insolvency condition) and if, in consideration of the debtor's personal and financial situation, it is appropriate to grant debt restructuring (this is the general appropriateness condition), See Section 4 of the Debt Restructuring Act. It should be noted that the two conditions stated in Section 4 are cumulative; in other words, both must be fulfilled for debt restructuring to be granted.

For completion of an assessment with regard to the appropriateness condition, the circumstances surrounding the origin of the debts, the efforts made by the debtor to settle the debts, and the way in which the debtor has participated in the course of the debt-restructuring decision process shall be taken into account.

In essence, the Debt Restructuring Act applies only to private individuals, but traders who are natural persons may, under certain circumstances, be granted debt restructuring as stipulated in Section 4 (fourth paragraph).^{*72} The debtor shall not have been prohibited from trading under the Trading Prohibition Act (1986:436), and, unless extenuating circumstances exist, the trader shall not previously have been granted debt restructuring; see Section 6.^{*73} The two material conditions—the above-mentioned qualified insolvency condition and general appropriateness condition—are intentionally general in nature.

The implication of granted debt restructuring is that the debtor, for a set term—as a rule, five years—shall live on limited financial resources, and any surplus that may arise shall be divided between/among the creditors. The division is normally determined by a payment plan that is drawn up when debt restructuring is granted. This division basically encompasses all financial debts that the debtor incurred before the date of the decision to start the restructuring process (under Section 7's first paragraph). Debt restructuring does not, however, include debts related to maintenance under family law or a debt for which the creditor has the right of pledge, the right of lien, or other preferential rights, according to Section 7's third paragraph.

It is the Enforcement Agency that is responsible for drawing up a debt-restructuring proposal, according to Sections 9 and 19. The debtor must, however, support the decision and actively participate in various ways in the processing of the case. The Enforcement Agency, as the body of first instance, decides whether to grant debt restructuring or not, under Section 21. Before a decision is made, the proposal must be sent to all the creditors involved, but it should be pointed out in the letter sent to the creditors that failure to comment on the proposal made in the letter does not prevent a decision to grant debt restructuring; see Section 20.

⁷¹ See further changes in SFS 2011:472 (Svensk författningssamling).

⁷² See proposal for a new legislation, namely debt restructuring for entrepreneurs. See SOU 2014:44 (F-skuldsanering. En möjlighet till nystart för seriösa företagare) (F-Debt restructuring. An opportunity to a fresh start for serious entrepreneurs).

⁷³ See NJA (Nytt Juridiskt Arkiv, the Supreme Court periodical) 2013, p. 689.

The Enforcement Agency can, moreover, decide in favour of debt restructuring even regardless of one or more creditors actually being against the decision. A review shall be performed as soon as possible after the deadline given to the creditors in the letter requesting a response to the proposal. However, Section 29 does provide that the decision may be appealed to the District Court. It should be noted that a decision regarding debt restructuring entails a prohibition of enforcement measures, in accordance with Section 22.

To be able to decide whether a debtor shall be granted debt restructuring, the Enforcement Agency may obtain information from other authorities, under the terms of Section 14. If the Enforcement Agency decides to grant debt restructuring, this decision shall be announced, according to Section 21. The decision to grant debt restructuring entails, according to Section 23, the debtor being 'let off' from paying the debts associated with the debt-restructuring process to the extent to which these are reduced. With debt restructuring, the debtor is also, with certain exceptions, released from paying those debts that are not known about in the case at hand. A debt-restructuring decision may be executed before it has entered into legal force, according to Section 37; therefore, the payment plan is in effect from the date of the first decision.

There is sometimes reason to review a decision to grant debt restructuring; see Sections 24 and 26–28. If the debtor has employed certain unfair methods, the Enforcement Agency may revoke the decision to grant debt restructuring with respect to the claim of a creditor. If the debtor deviates from the payment plan and that deviation is severe, the Enforcement Agency may either revoke or amend the decision to grant debt restructuring. In particular, if the debtor deliberately refrains from adhering to the plan, the decision to grant restructuring shall be revoked, while amending the decision may be the measure applied in other cases. An amendment might, for instance, entail extending the end date of the payment plan.

Also, the Enforcement Agency may amend the decision to grant debt restructuring at the request of a debtor, under Section 25. The decision can be amended if the debtor's financial situation has improved or deteriorated substantially since the decision was made and this is not due to circumstances that could have been foreseen at the time of the decision or if extraordinary factors are involved. If the debtor has become financially better off, he or she should apply for an amendment in order to avoid a situation wherein the payment plan is extended because a creditor has found out about the change in circumstances and requested a review of the decision; see Section 24 and Section 26. When a decision on debt restructuring is amended, the payment plan may be extended by, at most, seven years, under Section 26 of the Debt Restructuring Act.

The Debt Restructuring Act has been found to be insufficient. The original act, which came into effect in 1994 has been subject for several inquiries and reviews. A government bill is being drawn up that deals with extending the possibility of being granted debt restructuring.^{*74} Also an government inquiry with a strategy for combating indebtedness is recently written.^{*75}

6. Legislation in development

Currently, several legislative measures are being processed with the aim of improving the situation for people who have trouble making payments. The legislator has appointed several government commissions to map out the debt situation and to propose new measures for curbing over-indebtedness. Proposals have been made to implement 1) less complicated requirements for debt relief^{*76}; 2) amendment to and modernisation of the usury legislation; and 3) a 15-year final statute of limitations for claims that have not been fully paid, from the date of the payment decision and execution.^{*77}

In summary, a clear picture exists of the problems that exist in Swedish credit society. However, how to solve the problems is much debated among creditors, consumer organisations, and others, whereas the legislator has not been able to implement many solutions. Although the problems have been examined in several government investigations, reports, and analyses, the concrete legislative changes are few. Nor has there been any revolutionary new case law in favour of consumers from the Supreme Court. Therefore, it is impossible to say what measures would be most effective for solving the problems, since most options have not been tried yet. They remain only proposals.

⁷⁴ See SOU 2013:72 and Directive 2013:57.

⁷⁵ See SOU 2013:78.

⁷⁶ See SOU 2013:72.

⁷⁷ See SOU 2013:78.



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The Way to Over-indebtedness— Intensive Marketing, Easy Access to Loans, and Insufficient Legislation (Denmark)

Consumer credit is increasingly offered, for various purposes and in various ways. In particular, electronic Web and SMS loans have been growing considerably over the last few years, and they attract attention owing to their high costs. The easy access to credit, in combination with intensive marketing, contributes to increased private borrowing, thus creating a debtor culture. The fact that easy access to credit is not only to the benefit of the consumer is reflected in the main register for default on private debt in Denmark. Here more than one in 20 adult Danes are registered with a bad credit history, and the defaulted debt has doubled in the last six years. The focus of this article, therefore, is on the legal problems related to easy access to non-secured consumer credit as illustrated by Danish legislation. It will be suggested that the legislation is not functioning effectively and that more well-proportioned solutions are needed. A modern approach should recognise that consumer credit differs from other consumer arrangements, because consumers run a special risk of becoming over-indebted—not only to their own detriment but ultimately also to that of society. One of the possible solutions is to limit marketing and introduce responsible lending standards.

1. Introduction

Consumer credit is increasingly offered, for various purposes and in various ways. In Denmark, Web-based and Short Message Service (SMS) loans have been growing dramatically since 2007, and they particularly illustrate the problems associated with lending and, especially, borrowing. The focus of this article will, therefore, be on these loans. The facts outlined below accentuate the problems.

The marketing of consumer loans is intensive, and it does look tempting when it says this:

You can use the money for whatever you want—forget everything about reporting and follow-up by your banking consultant! Recapture your freedom and control your own finances—it is only reasonable!*

¹

Generally, the marketing sends out the signal that it is okay to borrow and contributes to the creation of a debtor culture with messages such as “Why wait when you can get what you want now?” (without having to do something so apparently old-fashioned as saving up first). Through this, the traditional social condemnation of being indebted is becoming erased.

Web and SMS loans are not only marketed intensively. They are also easier to obtain than ordinary loans. The Internet and SMS media facilitate borrowing. Accordingly, a loan can be obtained at home, by computer or phone, without a physical meeting with the creditor. The not overly stringent assessment of creditworthiness, furthermore, increases the chances of getting a loan. The assessment is done “without budgeting and boring questions”, and frequently the one and only requirement is that the borrower not be in a debt default register.² The answer is provided within a few minutes, after which the amount of the loan is transferred to the borrower’s account.

However easy it is to borrow, it is equally expensive. The Web and SMS loans address the (typically) young part of the population, which is accustomed to using electronic media. Especially the SMS loans seem to appeal to very young borrowers and involve particularly high costs. Thereby, part of a generation is risking starting adult life indebted—with debt that could follow this part of the generation for many years to come, as debt relief is only rarely granted to young people and only in rare cases includes consumer loans.

Furthermore, with their assessment of creditworthiness not being the strictest, the Web and SMS loans are addressed to individuals who are already indebted and who would have difficulty in getting a less cost-intensive loan (e.g., from a bank). The short maturity of the loans and advertisements stating that one can borrow when short of money for things such as a holiday trip also illustrate that the loans are directed at individuals with temporary financial difficulties or with few savings. If you compare Web and SMS loans with other loans, the following seems to apply as a rough rule of thumb: the shorter the maturity, the higher the costs. The fact that the formula for calculating the APR depends on the maturity only partly explains this relationship.³

That the high costs of the loans are due to the creditor’s increased risk in connection with these types of loans seems to be only a qualified truth. The costs related to the loan mean that the amount of the loan will often be far more than repaid; accordingly, a debtor who is not paying the last instalments is not necessarily a bad piece of business. The loans consist of small amounts, and the risk that a debtor cannot repay the entire amount of the loan will be spread over the majority of paying debtors. Interest on default enters in if the loan is not paid back on time and there is assistance of the bailiff’s court in collecting the debt, including seizure of any property of the debtor.

The focus of this article is on the legal problems related to easy access to non-secured consumer loans as illustrated by Danish legislation.⁴ Since these types of loans are often taken up via electronic means, this will be used as an example throughout the article. The question is whether the legislation is functioning effectively and provides well-proportioned solutions. If not, which would be the more appropriate solutions?

¹ See www.SMSlaane.dk. All Web sites referred to in this article were visited on 15 January 2014 and are in Danish.

² Links to a series of providers can be found at www.laane-siden.dk/lan-penge. See also the site referred to in Note 1.

³ See the calculations from Mybanker.dk A/S in L.L. Andersen, V. Greve, *Åger* [‘Usury’]. Copenhagen: Thomson Reuters 2010, p. 161 ff. (NB: all books and articles cited in this paper are in Danish unless otherwise is stated).

⁴ The electronic means particularly include the Internet (specifically the World Wide Web) and SMS, but other means, among them the Wireless Application Protocol (WAP), are gaining ground in greater numbers. Typically, a computer, which today also might be a tablet computer or mobile phone, is used as a communication tool in this connection.

2. The market situation

2.1. Products

So-called instant loans obtained on the Web or by SMS consist, basically, of two types of loans: SMS loans are for small amounts, ranging from 500 to 5,000 Danish kroner (DKK) (67 to 670 euros (EUR), typically borrowed for 15 or 30 days, and the APR is often 1,500–4,500%.⁵ Web-based loans are of a somewhat larger size, up to DKK 100,000 (EUR 13,400), repayable within a longer period of time than SMS loans, and the APR is typically 35–50%.

Even though the cost-intensive SMS loans in particular may give rise to worry, a complete list of the loan providers involved does not exist. Information from the three major loan providers that the Danish Consumer Ombudsman has obtained and relayed to the press shows that loans have increased from less than 40 million DKK (EUR 5.36M) in 2010 to more than DKK 91M (EUR 12.2M) in 2012 and that in 2013 more than 19,000 individuals took out SMS loans. In overall terms, the number of electronic loans has quadrupled since the financial crisis took shape in 2008.⁶

Consumer credit granted by companies who do not take deposits amounted to 21 billion DKK (EUR 2.81B) by the end of 2013. Of these loans, 41.2% were unsecured loans, 40.9% charge-account cards and credit cards, and 17.9% secured loans. These loans amounted to ‘only’ DKK 14B (EUR 1.88B) 10 years ago. The cost-intensive SMS and Web loans fall under the category of unsecured debts, which have also increased in the last decade, from DKK 5.1B to 8.7B (EUR 0.68B to 1.17B).

However, the loans are easily overlooked when one considers the total Danish lending market. Here one will find far more extensive financing through banks and mortgage-credit institutions, which, however, also contributes to the total debt of Danes and, consequently, their ability to repay unsecured debts, among other debt. In comparison, at the end of 2013, loans to households amounted to DKK 435B (EUR 58.31B) for the banks and DKK 1,319B (EUR 176.8B) for the mortgage-credit institutions.⁷ In overall terms, the loans of banks to households have doubled within the last 10 years.

2.2. Consumers

As far as can be ascertained, there are no statistics on whether SMS and Web loans actually cause an increase in over-indebtedness among consumers. The figures from the two private (negative) credit registers, wherein individuals with a bad credit history are registered, therefore having difficulty in taking out further loans, do not mention which types of loans specifically cause the defaulted debt. The electronic loans probably account for a share of the total, given that more than one in 20 Danes are registered as having a bad credit history, that defaulted debt has doubled in the last six years, and that those registered represent particularly heavily the young part of the population, and when one considers the facts that loans are easily accessible via electronic means and that these loans have been increasing over the last few years and are directed specifically at the mentioned section of the population.

The main register for defaulted private debt—Experian (formerly known as RKI, Ribers)—in January 2014 included 5.24% of the adult population (232,804 persons), and the average debt is approx. DKK 72,000 (EUR 9,651). The 31 to 40 age group makes up the largest share, with 7.59% being registered (61,855 individuals). Defaulted debt has increased from DKK 8.5B (EUR 1.14B) in 2008 to DKK 17.0B (EUR 2.28B) in 2014.⁸ By comparison, 147,650 individuals were registered in Denmark’s second register—Debitor Registret—as of 1 February 2014.⁹

⁵ EUR 1 was DKK 7.46 on 19 April 2014.

⁶ Unknown. Forbrugerrådet: Regeringens plan om indgreb mod kviklån er ikke nok [‘The Danish Consumer Council: The government’s plan of action on instant loans is not enough’]. – *Information* (newspaper), 6 February 2013; E. Ingvorsen. 2300 fanget i gældsælde med sms-lån [‘2,300 caught in the debt trap with SMS loans’]. – *Ekstra Bladet* (newspaper), 18 January 2014. It has not been possible to obtain the data in question from the Danish Consumer Ombudsman.

⁷ Statistics Denmark. Forbrugerkredit 4. kvartal 2013, NYT fra Danmarks Statistik nr. 55 [‘Consumer credit, 4th quarter of 2013, NEW from Statistics Denmark, No. 55’], 6 February 2014.

⁸ See www.experian.dk/presse/rki-rapporten-2013-de-unge-er-lyspunktet-i-dystert-billede-af-danskernes-gæld.html.

⁹ See www.registret.dk/presse/talogfakta.html.

2.3. Creditors

Web and SMS loans are to a certain extent granted by finance companies. Finance companies are subject to consumer law but not necessarily to the same public regulation as that governing Danish banks. Of course, banks are, as finance institutions, subject to financial regulation if they operate in the market for instant loans, as GE Money Bank and Ekspres Bank (formerly known as HandelsFinans) do, or if their loans are granted through a private intermediary, an example being LånLet granting private loans from Basisbank.

It is true that, in principle, finance companies are subject to the Danish Financial Business Act, as they fall under the designation of finance institutions—cf. Clause 5 (1) (6) of said act—but they are not qualified as finance institutions (see Clause 5 (1) (1)) and are not subject to the supervision, capital requirements, limits of engagements, etc. of the Danish Financial Supervisory Authority.^{*10} The provisions pertaining to finance institutions laid down in that act are aimed instead at the ownership of such companies by finance institutions; for instance, the finance company Sparxpres is owned by Spar Bank. Accordingly, in cases of such ownership, the finance company can be subject to more provisions of the Financial Business Act.

The reason that finance companies, apart from in these cases, are not themselves subject to the same control and restrictions as financial undertakings is that they base their activity on equity capital and borrowing; accordingly, they differ particularly from banks, which can accept deposits and other means subject to repayment. The providers of SMS loans fall within this category of finance companies. They are typically small undertakings without any affiliation with banks—examples are Folkia ApS, Mobillån Danmark ApS, and Kvik Automaten ApS (which is part of the Finnish undertaking Ferratum) and TrustBuddy AB (which is registered in Sweden). As one can see, the undertakings often have a Nordic and Baltic field of operation. An illustration of the fact that providers work across borders is Vivus. It is owned by 4finance ApS and part of the 4finance Group, which has branches in Latvia, the UK, Spain, Sweden, Finland, Poland, Lithuania, Russia, Canada, Georgia, the Czech Republic, and Estonia.

The Association of Danish Finance Companies (Finans og Leasing) is the professional interest group for Danish-registered companies that operate in the field of financing.

3. Legal and institutional overview

The basis for the Danish legislation is the traditional tort and contract law, including ‘the Contract Act’.^{*11} The main act of relevance is the Consumer Credit Act,^{*12} which includes a verbatim implementation of the main parts of the second Consumer Credit Directive (2008/48/EC) and, implemented also, the first Consumer Credit Directive (87/102/EEC) with amendments, hereinafter the CCD 2008 and the CCD 1987, respectively.^{*13} Other relevant legislation is the Act on Financial Advisers; the Bankruptcy Act; the Civil Justice Act; the Consumer Agreement Act; the Electronic Commerce Act; the Financial Business Act; the Interest Rate Act; the Marketing Practices Act; the Penal Code; the Executive Order on Good Business Practice for Financial Advisers; the Executive Order on Good Business Practice for Financial Undertakings, Investment Associations Etc.; the Executive Order on information to consumers about prices etc. in banks; the Executive Order on information to consumers about prices of loans/credit offered and rates of exchange; and the Executive Order on unfair marketing in consumer relations.^{*14}

While finance institutions are subject to the Financial Business Act and its licensing regime, other lenders are, as mentioned, not subject to a licensing scheme. The Financial Authority (Finanstilsynet) supervises

^{*10} Lov om finansiel virksomhed – Consolidated Act No. 948, of 2 February 2013.

^{*11} Aftaleloven – Consolidated Act No. 781, of 26 August 1996.

^{*12} Kreditaftaleloven – Consolidated Act No. 761, of 11 June 2011.

^{*13} The Residential Property Credit Agreements Directive (2014/17/EU) falls outside the scope of this article.

^{*14} In the order mentioned: Lov om finansiel rådgivning – Act No. 599, of 12 June 2013; Konkursloven – Consolidated Act No. 11, of 6 January 2014; Retsplejeloven – Consolidated Act No. 1139, of 24 September 2013; Forbrugerftaleloven – Act No. 1457, of 17 December 2013; E-handelsloven – Act No. 227, of 22 April 2002; Renteloven – Act No. 743, of 4 September 2002; Markedsføringsloven – Consolidated Act No. 1216, of 29 September 2013; Straffeloven – Consolidated Code No. 1028, of 22 August 2013; Bekendtgørelse om god skik for finansielle rådgivere – Order No. 1582, of 18 December 2013; God skik-bekendtgørelsen – Order No. 928, of 28 June 2013; Prisoplysningsbekendtgørelsen – Order No. 1210, of 24 October 2010; Skiltning-bekendtgørelsen – Order No. 1203, of 28 September 2010; Bekendtgørelse om urimelig markedsføring i forbrugerforhold – Executive Order No. 1084, of 14 September 2007.

finance institutions and related lenders. The Consumer Ombudsman institution covers all types of lenders, though its powers specifically related to finance institutions are restricted. Its field of responsibility is laid down mainly in the Marketing Practices Act.

Specifically for the domain of this article, the guidelines of the Danish Consumer Ombudsman for the marketing of short-term or small loans on the basis of distance selling agreements (Retningslinjer for markedsføring af kortfristede eller mindre lån indgået som fjernsalgsaftaler af 4. februar 2009) furthermore apply. The guidelines are directed particularly at SMS loans. The guidelines have been issued by the Consumer Ombudsman pursuant to Subsection 24 (1) of the Marketing Practices Act after negotiations with representatives of consumers and relevant commercial groups. In this way, the Consumer Ombudsman tries to affect the behaviour of the business community. As legal source the guidelines have the character of legally non-binding ‘soft law’ rules, but they may be a good source of inspiration for the determination of fair marketing practices. Accordingly, the guidelines only imply a legal obligation for the providers of these loans to the extent that the guidelines are considered to specify fair marketing practices; the guidelines are an expression of the general opinion of the Consumer Ombudsman in this respect. Financial undertakings are subject to specific rules on fair practices. The Consumer Ombudsman has entered into co-operation with the Nordic and Baltic countries, where many of the loan providers are found.

Whereas specific appeal boards exist for banks and mortgage-credit institutions (for instance, the Danish Complaint Board of Banking Services (Pengeinstitutankenævnet) will cover the banks in the market for instant loans), there is no such appeal board for other credit providers. Apart from having the option of taking legal action before the courts, consumers can also choose to file a complaint with the general independent complaints board, the Consumer Complaint Board (Forbrugerklagenævnet). The Consumer Complaint Board considers consumer complaints related to goods and services purchased from traders. The main rule is that the price of the goods or services at issue must be at least DKK 800 (EUR 107) but not exceed DKK 100,000 (EUR 13,404). The minimum amounts may cut off complaints on loans of very small amounts, such as SMS loans. Also, the board will consider a complaint only if the consumer has already attempted in vain to solve the problem with the business. It considers complaints in writing, and it is difficult for the consumer to have cases addressed in this venue that require further evidence.

4. Scope—*de minimis*

The efforts to establish an internal European market for consumer credit by way of the Consumer Credit Directive (CCD) and achieve the consumer protection linked with this objective are rarely extended to SMS loans.^{*15} Beyond the scope of the CCD 1987 and the CCD 2008 fall, among other types of credit, credit in small amounts, short-term loans, and credit free of interest; cf. Article 2, Subsections 2 (c) and 2 (f). Such an exception also applied within the scope of application of Section 3 of the Danish Consumer Credit Act as in force before 2010. Today’s version of that act does not apply to credit agreements under which the credit is granted free of interest and without any other charges, or where the credit has to be repaid within three months and has insignificant charges; see Section 3 (1).

The Latin expression ‘*de minimis non curat lex*’ (meaning ‘the law does not concern itself with trifles’) seems to be the rationale behind the lower threshold limits for application of the law. Apparently they safeguard a certain proportionality of the protection offered by the law. Lenders and consumers should not give or read more information than necessary, and it could be feared that the obligations of the lender will imply that credit of limited amount and/or duration will not be offered; for instance, the obligations can be considered particularly onerous for small-business-owners.^{*16}

Lower threshold limits seem inappropriate in the context of lending, and the expensive SMS loans illustrate this. Short-term loans can be just as worthy of the borrower’s protection as loans having a longer maturity period. Similarly, many small loans, often with a high APR, can be at least equally burdening financially and justify protection as much as one large loan. Accordingly, many loans—even free credit—may be

¹⁵ The Directive on Financial Distance Selling (2002/65/EC), however, can be applied to, for example, SMS loans. If this is done, such a loan falls within the scope of efforts to integrate an internal European market as referred to therein.

¹⁶ Bet. 1509/2009 om gennemførelse af forbrugerkreditdirektivet [‘Danish Report No. 1509/2009, about the CCD’], p. 51, read together with FT (*Folketingstidende*, the official journal of the Danish Parliament) 1989–90, Appendix A, column 2062.

the straw that breaks the camel's back. The limited amount of the loan may imply that the consumer will not reflect much on the incurring of debts.

The inexpediency of lower threshold limits is accentuated by the easy access to expensive Web or SMS loans. In Denmark, for instance, the SMS loans were the reason for the lower threshold limit of the former Consumer Credit Act being abolished when the CCD 2008 was implemented in 2010.^{*17} With removal of the loophole in the law, the lenders would be subject to the exhaustive obligations of the Consumer Credit Act, including the duty to inform.

5. Measures

5.1 Marketing restrictions

The prohibition of particularly aggressive marketing (for instance, of unsolicited offers) is specifically stipulated in the Danish Marketing Practices Act. However, such bans do not prevent marketing of credit being brought into the private living room of the consumer through commercials, the Internet, etc., which may be instrumental in the consumer's taking out of credit. The general requirements are the following:

In his market behaviour, the lender must observe the bans that are laid down by the Marketing Practices Act and that generally are reflected in Section 1, about fair marketing practices. The expression 'marketing' with respect to the notion of **fair marketing practices** is used in the 1973 preparatory work on the Marketing Practices Act, Section 1, dealing with actions undertaken for the purpose of carrying on business.^{*18} The broad construction has been adopted by more recent case law.^{*19} According to the preparatory work, the wording of the general provision also makes protection against **unfair terms in consumer contracts** possible.^{*20} In connection with the implementation of the EU Directive from 1993 on unfair terms in consumer contracts, it was found that there was no need to change the broad construction of Section 1 of the Danish Marketing Practices Act and that it should continue to be construed in the same way.^{*21} Today, the provision could be regarded rather as a supplement to the general provisions in terms of private law that are found in both the Contract Act and the Consumer Credit Act, and it facilitates public intervention with regard to the contract terms of businesses.^{*22} For instance, both Section 36 of the Contract Act and Section 1 of the Marketing Practices Act regulate unfair terms of contract. Anyway, the provision in Section 1 of the Marketing Practices Act is not limited to cases wherein a contract term is unfair because it results in an imbalance in the rights and duties of the parties. Section 1 is also applied to contract terms that are unfair from a public interest point of view because they counteract transparency in the market or unfairly affect buying decisions.^{*23}

The special bans of the Marketing Practices Act exemplify the general norm of Section 1 of that act;^{*24} especially Section 3, on misleading or unfair marketing, and Section 6, on unsolicited offers, which are particularly interesting in the context of lending. However, regardless of the fact that the marketing of Web and SMS loans is intensive, such unfair influence is rarely at issue, and Web sites offering instant loans or television commercials for SMS loans are not to be regarded as unsolicited offers. If the lender, when granting the credit, has received an electronic address from the borrower, the lender may market credit; cf. Section 6 (2). For instance, a bank may, by e-mail or SMS, offer a more favourable consumer-credit agreement.

Instead of Section 3 of the Marketing Practices Act, financial undertakings are governed by a similar provision in Section 4 of the Executive Order on Good Business Practice for Financial Undertakings.

¹⁷ Bet. 1509/2009 (see Note 16), p. 52.

¹⁸ FT 1973–74, Appendix A, column 2256.

¹⁹ Accordingly, the threat of debt collection was in violation of Section 1 of the Marketing Practices Act. See U (*Ugeskrift for Retsvæsen* judicial journal, cited by year and page) 1976.810 SH (for 'Sø- og Handelsretten', the Maritime and Commercial Court). See also U 1982.973 SH, with respect to unsanctioned debt-collection costs.

²⁰ Bet. II 681/1973 om markedsføring, forbrugerombudsmand og forbrugerklagenævn ['Danish Report II No. 861/1973, on marketing, the consumer ombudsman, and the consumer complaint board'], p. 18; FT 1973–74 (see Note 18), column 2256.

²¹ FT 1993–94, Appendix A, column 7257.

²² In U 1999.633 SH with regard to a bank's change of conditions. Here the Maritime and Commercial Court referred to the Marketing Practices Act.

²³ FT 1993–94 (see Note 21), column 7258.

²⁴ Bet. II 681/1973 (see Note 20), p. 19.

Section 6 of the Marketing Practices Act also applies to financial undertakings; cf. Section 2 (*e contrario*). For consumers, it is supplemented by Section 4, on unsolicited offers, under the Consumer Agreement Act.

Through the implementation of parts of the Directive on Unfair Trading Practices (2005/29/EC), the general ban on unfair trading practice in Article 5 (1) of said directive is reflected in both the Marketing Practices Act and the Executive Order on Good Business Practice for Financial Undertakings. The types of marketing that would under any circumstances be considered unfair—blacklisted actions—are in Danish legislation listed in an appendix to the Executive Order on unfair marketing in consumer relations.

For providers of short-term or small loans taken out in the form of distance selling agreements (SMS loans), the requirements stipulated under points 2 and 3 of the guidelines of the Consumer Ombudsman for marketing of such loans largely reflect the requirements applying to marketing in general and the specific duty to display information when marketing consumer credit, which applies to other businessmen. In this context, the guidelines do not lay down further requirements for this group of providers. The only specific duty to provide information is that the lender in his marketing material inform of the procedures for the paying out of the loan and about when the borrower may dispose of the amount; cf. point 8.

5.2. Information

Even though Web and SMS loans, because of the *de minimis* rule in the CCD 2008, will typically fall outside the scope of the fully harmonised duty to inform set forth in that Directive, these are now subject to the CCD-2008-identical provisions of, especially, the Danish Credit Agreement Act and the Danish Marketing Practices Act.

If a credit agreement is entered into through the Internet or by SMS, WAP, etc., the lender must, furthermore, meet the requirements of the Electronic Commerce Act implementing the Directive on Electronic Commerce (2000/31/EC), which basically reflects total harmonisation.

With regard to providers of short-term or small loans taken out under distance selling agreements (SMS loans), the requirements pursuant to point 7 of the guidelines of the Consumer Ombudsman for marketing of such loans can be observed in the special wording stating that the terms of a loan agreement entered into by means of a Web site, SMS, or other means of distance communication are accepted only to the extent that it can be documented that the consumer received information about and accepted the terms before entering into the agreement. It is especially important to provide clear information about procedures for payment of the loan, about when the borrower may dispose of the amount, and about compensation in the event of exercise of the right of withdrawal; cf. points 8 and 9. Notwithstanding this, the guidelines to a large extent reflect what already applies in Danish law. They refer to provisions of both the Consumer Agreement Act and the Electronic Commerce Act; see, for example, the comment in point 3 of the guidelines.

5.3. Rights of withdrawal and early repayment

The contract terms normally decide the payment procedure. However, the Credit Agreement Act's Section 25 simplifies the procedure, since payment to a bank in Denmark is timely if it occurs before the payment deadline imposed by the credit agreement.

As already mentioned, even though Web and SMS loans are typically not within the scope of the protection of the CCD 2008, because of the *de minimis* rule of the Directive, Danish law does provide such protection of consumers through the enlarged scope of application of the Danish Credit Agreement Act. Accordingly, the provider of a Web or SMS loan is subject to the rights of withdrawal and early repayment set forth in Sections 19 and 26 of the Credit Agreement Act (Articles 14 and 16 of the CCD 2008). The right of withdrawal stipulated in the Credit Agreement Act's Section 19(6) takes precedence over Part 4 of the Consumer Contract Act, which covers distance selling agreements or agreements entered into outside the lender's permanent establishment.

5.4. Adequate explanations

While there are provisions for advice that target financial undertakings, other creditors are not covered by such provisions. Section 7a (8) of the Consumer Credit Act is connected with the provisions about information and seems to address a duty to explain the credit agreement. It seems a step too far to consider Subsection 7a (8) to stipulate a duty for the creditor to advise the debtor about, for instance, more suitable products offered by other creditors. According to Subsection 7a (8), creditors and, where applicable, credit intermediaries shall provide explanations to the consumer that are adequate for placing the consumer in a position enabling him to assess whether the proposed credit agreement is suited to his needs and to his financial situation—where appropriate, by explaining the pre-contractual information to be provided in accordance with Subsections 7a (1) and (2); the essential characteristics of the products proposed; and the specific effects they may have on the consumer, including the consequences of default on payment by the consumer. Subsection 7a (8) implements Article 5 (6) of the CCD 2008. Member States may adapt the manner by which and the extent to which such assistance is given, as well as by whom it is given, to the particular circumstances of the situation in which the credit agreement is offered, the person to whom it is offered, and the type of credit offered. Denmark has not done so.

5.5. The obligation to assess creditworthiness and check credit registers

Credit assessment can be described as a professional lender's examination and assessment of the financial standing of a prospective borrower, including the borrower's ability to repay the credit.^{*25} Often lenders will make a credit assessment of their own accord, but, as something new, the almost word-for-word implementation of Article 8 of the CCD 2008 means that Section 7c of the Danish Credit Agreement Act stipulates an explicit duty to conduct a credit assessment of consumers applying for loans. Especially as regards short-term or small loans taken out via distance selling agreements, a similar duty has existed since 2009 in the guidelines of the Consumer Ombudsman, point 5, for which reason any businessman must make a proper credit assessment and secure sufficient documentation of the financial standing of the consumer. With the implementation of the credit-assessment duty in Section 7c of the Consumer Credit Agreement in 2010, it is, however, this duty that should be emphasised.

Pursuant to the Consumer Credit Act's Subsection 7c (1), the lender must, before the conclusion of the credit agreement, assess the consumer's creditworthiness on the basis of sufficient information—where appropriate, obtained from the consumer and, where necessary, on the basis of consultation of the relevant database.

The question as to when information is considered to be sufficient is not further specified in that Act or in the Directive. This applies to both quantity and quality. The question pertains in part to the minimal information a lender 'must' obtain to ensure a sufficient basis for assessing whether a consumer can repay a loan, partly to how much information the lender 'may' obtain without this being at the expense of the personal protection laid down in the Act on the Processing of Data and Chapter 9 of the Financial Business Act on disclosure of confidential information. The interest of the consumer is protected in both cases. On the one hand, it is ensured that no loans are granted that the consumer cannot repay; on the other hand, privacy is protected. In contrast to the second case, the first case safeguards the traditional considerations associated with credit assessment, including also the interest of the lender.^{*26}

Which information the lender has the right and duty to obtain will depend on a specific assessment of whether there is a factual need for the information in view of the purpose of the retrieval.^{*27} The amount of credit requested and any previous borrowing must be presumed to influence this assessment.

²⁵ L.L. Andersen, H. Juul. *Introduktion til kreditretten* ['Introduction to the Credit Law'], 2nd ed. Copenhagen: Thomson 2006, p. 115.

²⁶ T. Jørgensen. *Forbrugerkredit – retligt og retspolitik* ['Consumer Credit – Law and Legal Policy']. Copenhagen: Thomson Reuters 2010, p. 298 ff.

²⁷ NOU 2009: 11. Kredittavtaler. Gjennomføring i norsk rett av forbrukerkreditt direktivet (2008/48/EF) m.m., ['Norges Offentlige Utredninger, Official Norwegian Reports 2009/11: Credit agreements – implementation in Norwegian law of the Consumer Credit Directive (2008/48/EC) and more'], p. 58 ff. (in Norwegian).

The lender must, when doing so is relevant, obtain information from **the consumer**. Thus the lender's duty to obtain information is counterbalanced by what can be regarded as the consumer's duty to provide the information needed, as the loan is granted on the basis of this information. The consumer's obligation to provide information does not include facts that are of no importance for the credit assessment.

Whether, and to what extent, it is necessary to seek information in a relevant **database** must be weighed against the legal and factual circumstances.^{*28} If the lender has received sufficient information from the consumer, often it will not be necessary also to seek information in a database. As noted above, in Denmark, there are two private (negative) credit registers—Experian and Debitor Registret—where bad payers are registered.

It appears from the Credit Agreement Act's Subsection 7c (3) that if the credit application is declined on the basis of a database search, the lender must immediately and at no charge inform the consumer of the result of the search and provide further information about the database in question. Conversely, the lender has no duty to inform the consumer of why the application is declined if it is declined on the basis of other circumstances than a database search—e.g., on the basis of the information provided by the consumer. A situation wherein the lender grants credit even though the consumer has not been found creditworthy is not covered by the duty to report either; granting a loan in this situation is not explicitly prohibited. The legal consequences are to be found in the general tort law. This applies regardless of whether the basis on which the credit assessment is made derives from a database or elsewhere. It could be stated that it usually would be precisely in such situations that a consumer would benefit the most from information of this nature.^{*29}

It does not seem obvious that Web and SMS loans meet the requirements of the credit-assessment duty in both the Credit Agreement Act, Section 7a and point 5 of the Consumer Ombudsman's guidelines when, for example, the following advertising statement is made: 'Creditworthiness at Vivus.dk means that the customer must not be registered in one of the following credit registers: Experian and Debitor Registret.' This seems to be the main condition for obtaining a loan with most of the suppliers, where the credit assessment, besides being limited, also seems to be automated. Further conditions are often a demand for a Danish residence and an age demand (TrustBuddy and Vivus: 20 years, Kvik Automaten and Ferratum: 23 years).

5.6. Responsible lending

Responsible lending is parallel to the concept of responsible borrowing, which is often expressed as the consumer's accountability for borrowing or as making the consumer accountable through financial education.

Responsible lending is an independent legal measure. However, it is often associated with other protective measures. It is linked especially to the obligations to assess creditworthiness and to dissuade. It also is related to advisory services. These measures often express considerations not found within the statute book, such as good practice, due diligence, and loyalty.

Responsible lending as an independent measure is the only measure that directly can prevent irresponsible lending, since it in its essence prohibits granting an irresponsible loan. The associated measures are not suitable. An analysis of these measures reveals a number of ambiguities, resulting in legal uncertainty.^{*30} An obligation to assess creditworthiness does not prevent the creditor from granting irresponsible credit; this is only the case if, besides the credit-assessment duty, a ban is applied to granting of loans in cases of, for instance, a negative credit assessment (a principle of responsible lending). Rather, the measures can be counterproductive by protecting creditors – for example, where the consumer, despite the creditor's advice, decides to apply for credit anyway. The associated measures will only in certain situations prevent irresponsible lending and borrowing. This is the case when the creditor, proceeding from the assessment of creditworthiness, actually refrains from granting a loan or when the consumer, acting on the basis of the creditor's dissuasion, actually refrains from borrowing.

Danish law is largely an expression of responsible borrowing. The creditworthiness obligation set forth in Article 7c does not seem to change the fact that the demands in Denmark for the assessment of creditworthiness are low. The consumer still bears the risk for repayment of the loan; see U 1997.522 Ø (Østre Landsret, Eastern High Court), dealing with an 18-year-old man who bought a 10-year-old car (a BMW) for

^{*28} Compare with comment 28 in the preamble to the CCD 2008, which is not, however, formulated without ambiguity.

^{*29} NOU 2009: 11 (see Note 27), p. 57.

^{*30} T. Jørgensen (see Note 26), pp. 281 ff., 474 ff.

DKK 220,000 (EUR 29,489). Even when damages (the economic loss) are granted to the consumer on the basis of the general tort law in the case of irresponsible lending, the amount is often reduced on account of the borrower's participation in the loan agreement.^{*31}

5.7. The unconscionability doctrine

Parts of the unconscionability doctrine can be found scattered across several general laws. The provisions have mainly a Danish (or Nordic) origin and can be sought in contract law dealing with unfair contracts or expressed in considerations such as due diligence, good practice, and loyalty that are not in the statute book. However, general prohibitions addressing unfair commercial practices have an EU origin. Some sections of civil law even contain a criminal-law counterpart. This applies to the Contract Act's Section 31, on exploitation, which is originally from 1917 and has an almost identical sister provision in the Penal Code's Section 282, on usury.

Section 31 of the Contract Act and Section 282 of the Penal Code saw its most recent Danish formulation in 1975 on the basis of the Danish usury committee's recommendation from 1971.^{*32} In order to make it easier to fight white-collar crime, the formulation of the two sections was changed such that the demands were reduced with regard to exploitation, and when it could be claimed to have taken place.^{*33} On the same occasion, Section 36 of the Contract Act was inserted, and, among other portions, Section 300b, regarding other exploitation, was inserted in the Penal Code. Besides handling the same considerations as Section 31, it was stressed, as a motivation, that Section 36 relies on 'considerations for the general protection of consumers and others against an economically stronger and more experienced party'.^{*34}

According to Subsection 36 (1) a 'contract may be modified or set aside, in whole or in part, if it would be unreasonable or at variance with the principles of good faith to enforce it'. The same applies to other legal acts. In making of a decision thereunder, the 'circumstances existing at the time the contract was concluded, the terms of the contract and subsequent circumstances' shall be considered; see Subsection 2. Section 36 constitutes a clean-up provision when compared to the more specific rules in the Contract Act (e.g., Section 31) and bears resemblance to the omnibus clauses in Section 22 of the Credit Agreement Act (on reduction of unfair costs) and the Contract Act's Section 33 (to enforce a declaration against the principles of good faith). As will become apparent from the discussion below, it is not unusual for the provisions to be applied simultaneously. Generally, it is the injured party (the consumer) who has the burden of proof.

The civil-law parts of the Directive on Unfair Contract Terms (93/13/EEC)^{*35} were implemented in 1994 in Chapter IV of the Contract Act, but the public-law parts of the Directive are presumed to be implemented via the Marketing Practices Act.^{*36} In connection with this, Section 38c was inserted. In certain situations, the provision places the consumer in a better position than does Section 36. For example, Subsection 36 (2) applies to consumer contracts with the modification that subsequent circumstances to the detriment of the consumer shall not be considered.

5.8. Addressing usury (exploitation)

From an economic point of view, usury can be regarded as an interest rate that is 'out of line with the market rate' and, accordingly, higher than is necessary for paying for the risks that the creditor bears in consideration of the market risk.^{*37} From a legal point of view, a usurious rate is an unusually high rate, either compared to a maximum rate established by law, which objectively can be controlled by an authority, or compared to a higher behavioural norm, which will be an object of subjective control—i.e., it will depend on

^{*31} *Ibid.*, p. 308.

^{*32} The mentioned provisions of the Contract Act and the Penal Code were changed by law 250, of 12 June 1975. The relevant act came into force on 1 July 1975 and relies on Bet. 604/1971 om åger ['Danish Report No. 604/1971, on usury'].

^{*33} FT 1974–75, Appendix A, column 781.

^{*34} *Ibid.*, column 791.

^{*35} Amended by the Consumer Rights Directive (2011/83/EU).

^{*36} Act No. 1098, of 21 December 1994.

^{*37} Com(1995) 117, item 273.

the circumstances, such as the borrower's weaker position or ignorance.³⁸ Denmark—and many other EU member states—have chosen the latter solution.

Both Section 31 of the Contract Act and Section 282 of the Penal Code deal with exploitation of another person's inferiority—i.e., 'another person's financial or personal distress, lack of knowledge, thoughtlessness or an existing dependency relationship to obtain or contract for a benefit that is substantially disproportionate to the consideration or for which no consideration is to be given'. The person so exploited is not bound by his declaration of intention. The same applies if the exploitation is a result of acts by a third party and the person to whom the declaration of intention was made realised or ought to have realised this.

Section 282 of the Penal Code begins with the wording 'Punishment for usury...' and indicates that both provisions are meant to deal with usury and are addressed to lenders. The borrowers' counterpart is stated in Section 30 of the Contract Act, regarding fraud, and Section 279 of the Penal Code, dealing with embezzlement.

Criminal- and civil-law sanctions are not directly connected. This must be the case even though the legislative power has striven toward achieving an identity between Section 282 of the Penal Code and Section 31 of the Contract Act. The relation between the two identical 'sister provisions' seems to function in such a way that if usury is punished according to Section 282 of the Penal Code, then the agreement can also be rendered void in accordance with Section 31 of the Contract Act; in relation to this, also see U 1978.596/2 Ø, where the borrowers, after the lender was fined for usury, were awarded a repayment on the basis of the fact that the credit agreements were void. The opposite does not seem to be the case: civil-law invalidity does not necessarily imply that the act is punishable. The enumeration in the Penal Code is exhaustive, unlike the enumeration of reasons for invalidity in Chapter III of the Contract Act. However, even though no requirement for applying Section 282 exists, a person who enters an agreement in an indecent way—i.e., by exploiting the other party's economic difficulties or any other inferior position—is fined or sentenced to up to six months in prison according to Section 300b. Handling yield from usury (fencing) is punished in the same way under Section 300c. Furthermore, a matter can be associated with some of the other provisions in the Penal Code, typically those on the other financial crimes in Chapter 28 of the Code—e.g., embezzlement according to Section 279 or blackmail according to Section 281. Sections 285–287 of the Penal Code frame the sentencing set forth in Section 282.

In the following discussion, the focus is on the civil-law provision in Section 31 of the Contract Act. Even though the APR often is extremely high for credit agreements made via long-distance communication, including Web and SMS loans, this does not necessarily indicate any kind of exploitation. An essential mismatch in the *quid pro quo* (here, the credit costs being extremely high)³⁹ is only one of the conditions for applying Section 31 of the Contract Act. The mismatch is assessed according to the conditions at the time of entry into the agreement. It is not only the mutual services' economic value that should be taken into account but also the economic risk that the creditor bears, such as whether the borrower gives security for the loan.

Besides the content of the agreement, Section 31 of the Contract Act is related to a certain behaviour. Thus invalidity requires that the promisee by acquiring or stipulating a service that is significantly disproportionate to the *quid pro quo* (the content of the agreement) unjustifiably has used the promisor's inferior position. The promise must be caused by this condition. In connection with granting of credit, the inferior position is typically caused by economic difficulties. These difficulties can also be related to another person, whom the promisor (the borrower), for example, wants to help. It is not a requirement that the promise be made on the promisee's (the creditor's) initiative. Invalidity is not ruled out either if the borrower received expert advice before making the promise. These factors can, however, be considered in a court's assessment of whether exploitation has taken place or not.

According to Section 31 of the Contract Act, the creditor must finally have been aware of the borrower's inferior position. This can be difficult to prove in connection with loans obtained via distance communication. Here it is doubtful whether there has been such close contact between the two parties that the creditor has concrete knowledge of the borrower's position. It is not an obvious conclusion that everybody who

³⁸ *Ibid.*, item 274.

³⁹ However, one can hold that the content of the agreement is used in practice as circumstantial evidence of fulfilment of the requirement; cf. L.L. Andersen, P.B. Madsen. *Aftaler og mellemmand* ['Contracts and Intermediaries'], 6th ed. Copenhagen: Karnov Group 2012, p. 164's footnote with reference to U 1945.617 Ø.

obtains extremely cost-intensive credit is in an inferior position—e.g., thoughtless or lacking in insight.^{*40} However, such a conclusion is indicated in U 1980.340 H with respect to punishment for usury and illegal lending activities. If the creditor is acting in good faith in relation to the condition, then the agreement is valid.

If a creditor has taken advantage of a borrower's lack of money to demand extremely high costs ('usury interest') for the credit granted, it can be difficult for the borrower to pay back the credit by, for example, borrowing the amount elsewhere. While invalidity according to the wording in Section 31 affects the entire promise, the courts have often changed the agreed fee, taking Section 31 as a legal basis.^{*41} At least this applied in practice before Section 36 of the Contract Act was added.

The limited (printed) legal and appeals-board practice related to Section 31 of the Contract Act illustrates that the provision has not had the increased impact that was the intention behind extension of the field of application in 1975. Before the amendment of Section 31 of the Contract Act in 1975, the provision was seldom appealed to (and usury as addressed in Section 282 of the Penal code was seldom reported).^{*42}

Situations that were regarded as exploitation (usury) in case law before 1975 would also be usury after 1975. Situations that were not regarded as exploitation (usury) before 1975 might be regarded as usury after 1975.

Before the amendment of Section 31 of the Contract Act in 1975, it gave rise to 14 printed judgements about credit. In six of them, the court found that exploitation had taken place. These cases are U 1924.841 Ø, U 1930.932 Ø, U 1930.957 H, U 1938.540 H, U 1945.617 Ø, and U 1960.613 H. Specifically with respect to reduction, it can be noticed that in U 1930.932 Ø the interest rate of 24% was not disproportionately high under the given circumstances. On the other hand, there was disproportion between the collection fee of DKK 4,589 (EUR 615) and the debt-collection work, and the fee was reduced to DKK 2,000 (EUR 268). In U 1945.617 H, it was decided that the creditor should repay DKK 300 (EUR 40) of the interest paid, DKK 680 (EUR 91) in total. In U 1960.613 H, the interest rate of 33% per annum was cut to 25% *per annum*. Interest rates on loans with other finance companies were at that time 15–20% *per annum*, but, because of the borrower's voluntary composition with his trade creditors, the creditor ran a larger risk.

Since 1975, just one judgement in which the court only used Section 31 with regard to credit has been printed. In U 1978.596/2 Ø, a lending company had influenced a number of borrowers to issue index-linked mortgage bonds with content that was burdensome and difficult to foresee. The actual yields were not under 29% per annum. After the creditor was sentenced for usury, the borrowers were awarded recovery, which was debited to the borrowers on the basis of interest of 15% per annum from the yields received, such that they did not experience an unfounded enrichment at the lending company's expense.

Before its amendment in 1975, Section 282 of the Penal Code gave rise to two printed judgements regarding credit, U 1936.169 Ø, considering a loan for the purchase of furniture, and U 1936.351 H, dealing with a business-owner in an emergency situation. As for cases after the change, see U 1978.596/2 Ø, regarding the handling of yield from usury (fencing), and both U 1978.962 V and U 1980.340 H, dealing with the same kind of usurious business.

The usury-related provision in the field of civil law must be considered to have lost its practical importance relative to the omnibus clauses, through which one can avoid the 'usury judgement' specified in Section 31 of the Contract Act. The fact that the receiver knows or ought to know that somebody has used, for instance, the promisor's carelessness implies that it is both dishonest and unfair to maintain a claim in line with the promise; compare with Sections 33 and 36 of the Contract Act. The content of the omnibus clause in Section 22 of the Credit Agreement Act can be included in Section 36 of the Contract Act (in consumer relations, Section 38c; cf. Section 36).

Both case law and appeals-board practice to a minor extent reflect that omnibus clauses have the characteristics of clean-up provisions and, therefore, should be used only if no other relevant provisions apply. After the amendment of Section 36 of the Contract Act, it has not been unusual that Sections 31 and 36 of

⁴⁰ T. Ingvarsson. Lån i telefon – dags att reglera? ['Loans on the phone—time to regulate?']. – *Juridisk Tidskrift* (JT) 2009–10, p. 388 (in Swedish).

⁴¹ M.B. Andersen. *Grundlæggende aftaleret* ['Fundamental Contract Law], 4th ed. Copenhagen: Gjøellerup 2013, p. 385; L.L. Andersen. *Aftaleloven med kommentarer* ['The Contract Act with Comments'], 5th ed. Copenhagen: Jurist- og Økonomforbundets Forlag 2008, p. 207, with reference to U 1924.841 Ø, U 1930.932 Ø, U 1945.617 Ø, and U 1960.613 H (for 'Højesteret', the Supreme Court) and U 1978.596/2 Ø.

⁴² Bet. 604/1971 (see Note 32), pp. 8 ff. and 11. The printed judgements related to this until 1971 are found in appendices 1 and 2.

the Contract Act apply at the same time, or that Sections 31, 33, and 36—as a safe bet—apply at the same time; see, for example, the Contract Act as considered in U 1990.65 H, regarding an unsuccessful speculation business. The Danish Competition and Consumer Authority seldom deals with usury-related cases, and the Danish Complaint Board of Banking Services has not decided in favour of any claims that finance institutions' interest rates, fees, or charges have been usurious.^{*43} The latter board seems to place emphasis rather on the amount, considering matters related to Section 36, instead of making a concrete judgement of whether exploitation has taken place according to Section 31.

5.9. A maximum cost?

In 1855, the ordinary interest maximum was abolished in Danish law, and in 1924 it was abolished specifically for loans secured with property.

When the private-law provision originally was established in Section 31 of the Contract Act from 1917, there was a request for a comprehensive and flexible provision rather than a more 'rigid and old-fashioned' interest maximum. This is related especially to a certain behaviour (the exploitation) and not only the content of the agreement (the high costs). In case law, there will—in principle—be established a certain maximum cost for credit. This is a result of the fact that a reduction can take place especially according to Sections 31 and 36 of the Contract Act (in consumer matters, Section 38 c; cf. Section 36) and the omnibus clause in Section 22 of the Credit Agreement Act, along with the limit to reasonable costs—see, for example, U 1987.699/2 V, about reduction of a student loan under Section 36 of the Contract Act, and U 1985.986 Ø, about agreed litigation interest of 33% per annum, which violated (the present) Section 22 of the Credit Agreement Act or Section 36 of the Contract Act.

It is not an objective maximum. What may be considered 'usury interest' or to be unreasonable depends on the concrete circumstances. How great a reduction can be achieved will in each case depend on, apart from the content of the agreement, especially the general competitive situation and the risk that the creditor bears relative to the specific borrower. However, a certain kind of objectivisation takes place when legal practice is investigated with a view to finding out whether any given APR is usual for the type of loan in question. Accordingly, it seems difficult to reduce an unusually high APR for a concrete loan agreement when the market itself determines the norm for this.

Danish Complaint Board of Banking Services special practice related to reduction of front-end fees from the beginning of the 20th century was ignored by the Eastern High Court's ruling of 24 May 2006. The High Court did not find that the APR of 12.75% for the concrete loan at issue (in case 185/2004) differed from the credit costs under comparable loan agreements. This was decided on the grounds that the law does not establish provisions that directly regulate the size of formation fees or which items are ascribable to this. The formation fees may be ignored only if the costs under the present circumstances can be regarded as unreasonably high; cf. Sections 36 and 38 of the Contract Act and Section 22 of the Credit Agreement Act. The ruling has been used in the Complaint Board's later practice, which refers to the judgement. See cases 157/2005, 178/2005, 201/2005, 23/2006, 319/2006, and 61/2009.

Without taking the concrete circumstances into account in assessment of whether exploitation has taken place or not, it is thought-provoking that the numerical quantities that were regarded as usurious interest within civil law before 1975 (an interest rate of 30–60% per annum) are not a rare sight in connection with the consumer loans that many finance companies offer today, not least in connection with Web and SMS loans. The loans do not seem to have become less cost-intensive within the last four years:

As for **consumer loans taken out via the Internet**, the 'price' (the costs) for borrowing DKK 10,000 (EUR 1,340) for a period of one year were, for example, the following on 15 March 2010:^{*44}

APR of 34.4% (www.gemoneybank.dk, from GE Money Bank)

APR of 37.3% (www.onkelbob.dk, from Sparxpres, which is owned by Spar Bank)

APR of 39.3% (www.extracash.dk, from ExtraCash A/S)

APR of 46.3% (www.ekspresbank.dk, from Ekspres Bank (the former Handelsfinans))

⁴³ T. Jørgensen (see Note 26), p. 371 ff.

⁴⁴ *Ibid.*, p. 373 ff.

The APR is stated for a loan of DKK 5,000 (EUR 670) for a period of two years. It was not possible to find the price for a loan of DKK 10,000 (EUR 1,340) for a period of one year.

APR of 50.5% (www.pengeautomaten.dk, from IKANO Finans A/S)

With rather different operators, the price on 15 January 2014 seems to show an increase:^{*45}

APR of 42.0% (www.onkelbob.dk, from Sparxpres, which is owned by Spar Bank)

APR of 48.5% (www.extracash.dk, from ExtraCash A/S in co-operation with Ekspres Bank A/S)

APR of 50.4% (www.laanlet.dk, from LånLet in co-operation with Basisbank)

APR of 46.1% (www.pengeautomaten.dk, from IKANO Finans A/S)

APR of 46.3% (www.selenefinans.dk, from Selene Finans A/S in co-operation with Basisbank)

As for the so-called **SMS loans** and **micro loans**, these can also be taken out via the Internet. For example, on 15 March 2010 the prices for borrowing DKK 1,000 (EUR 134) were these:

APR of 2,230% (www.ssl.folkia.dk, from Folkia ApS)

APR of 2,969% (www.mobillan.dk, from Mobillån Danmark ApS)

APR of 2,334% (www.SMSkviklan.dk, from SMS-Kviklån A/S)

APR of 1,355% (www.ferratum.dk, from the Finnish company Ferratum)

At Mobillån and SMSkviklån, there is an application fee of DKK 25 (EUR 3.35).

In 2014, more operators had changed. To a much larger extent, they only seem to offer loans with a loan period of 30 days. At Ferratum, the APR was 7,850% for a 14-day loan.

The prices for a 30-day loan on 15 January 2014 were these:^{*46}

APR of 1,410% (www.folkia.dk, from Folkia ApS)

APR of 2,828% (www.mobillan.dk, from Mobillån Danmark ApS)

APR of 2,230% (www.ferratum.dk, from the Finnish company Ferratum)

APR of 4,467% (www.trustbuddy.com/dk, owned by TrustBuddy AB, which is registered in Sweden)

APR of 2,230% (www.kvikautomaten.dk, from Kvik Automaten ApS, which is part of Ferratum)

The previous operator SMS-Kviklån A/S (using www.SMSkviklan.dk) was known for its high costs. One of the highest APR indications was seen on 15 July 2008: the APR was 1,122,000% for a loan of DKK 500 (EUR 67) for 15 days.

5.10. Restrictions to interest for late payment and damages claims

The Interest Rate Act's terms on interest before and after the correct time of payment apply, including default (penalty) interest, unless otherwise is agreed or follows from the business practices.

In the case of a consumer's default, the interest is normally fixed. There is also a limit to the costs for which a creditor can claim compensation in connection with violation. Preceptive maximum limits follow from Section 9a, which establishes that the creditor may demand that the borrower pay the creditor's reasonable and relevant costs in connection with extrajudicial collection of the debt, unless the delay in payment is not due to the borrower's conditions, and Section 9b, respectively, which states that three charges added to a reminder of DKK 100 (EUR 13.4) each and a debt-recovery fee of DKK 100 can be claimed.

It is possible to lower unreasonably high contractual interest rates according to Section 36 of the Contract Act, which also deals with overdraft interest on accounts and default interest; see, for example, U 1991.202 Ø, regarding outstanding balances due according to the credit agreement; U 2004.1268 H, regarding liability in connection with the use of company payment cards; and the Danish Complaint Board of Banking Services cases 290/1993 and 94/1993, regarding reduction of overdraft interest on deposit accounts from 25 to 21.75 per cent per annum and from 32 to 21.5 per cent per annum, respectively.

⁴⁵ For www.ekspresbank.dk, a precise number was not presented on the homepage. The site www.gemoneybank.dk now only grants loans of DKK 50–100,000 for a period of 12–120 months, with the APR being 10.2% for borrowing DKK 100,000 for a term of 12 months.

⁴⁶ The function for indication of the APR did not work at the Vivus site (www.vivus.dk), which is why Vivus is not included in the outline.

5.11. The debt-settlement system and debt-counselling

After payment problems have occurred (post-contract), the main focus is on getting the consumer out of debt. Here debt-counselling plays an important role. A few other ways in which over-indebted persons are helped should be mentioned, though.

The private sector

No law states that the creditor shall help a debtor in default. Instead, the legal system's focus is on helping creditors to enforce their claims. However, if the creditor agrees, the debtor and the creditor can make a deed of arrangement. An arrangement may feature a reduction of the debt and extension of the payment, or it can be a new credit agreement, on other terms. An arrangement can be made out of court as well as in court. An arrangement does not have to be with just one creditor; an out-of-court arrangement can be made with the other creditors. A few creditors voluntarily offer debt-counselling, often combined with an arrangement. Since 2009, the Danish mortgage bank BRFKredit's Team Dwelling Help (Team Bolighjælp) has sought out and helped customers with delayed payments.

In 2010, the Danish consumer interest organisation the Danish Consumer Council (Forbrugerrådet) estimated that there were 20 to 50 independent financial counsellors, hereunder 'money advisers', in Denmark. The advisers were not subject to minimum requirements of education, branch standards, and supervision. Examples of bad advice were seen, where counselling of indebted persons took the form of exploitation and left the persons involved more indebted afterwards.

The Act on Financial Advisers, which came into force on 1 January 2014, places special focus on companies offering independent advice about financial products but can also cover independent debt-counselling. The term 'independent' or similar terms will mainly be used for such advisers—see Section 9—and a licensing regime is introduced. To give financial counselling will hereafter demand an authorisation from the Financial Services Authority, which will be the supervisory body. The Financial Services Authority lays down more detailed rules on qualification requirements for employees of a financial adviser (see Section 6) and has, pursuant to Section 7(2) and Section 26(4), established the Executive Order on Good Business Practice for Financial Advisers. Before this act came into force, the more general provisions in Section 1 and Section 3 of the Marketing Act, and Section 7a(8) of the Credit Agreement Act could be applied to other financial advisers than financial undertakings.

Attempts to establish a branch organisation have been made by the association of independent financial advisers (INFIA—Sammenslutningen af uvildige økonomiske rådgivere). A single independent adviser (Uvildige.dk) has developed its own ethics guidelines, stated in general, vague terms.

The social economic organisation the Debt Company (Gældskompagniet) is associated with both the private sector and the semi-public sector. It offers advice and help to citizens with creditor negotiations. For this group as a not-for-profit organisation with voluntary advisers, the payment depends upon the citizen's income. From 2012, the Debt Company has been part of the voluntary organisation the Social Legal Help (Den Sociale Retshjælp).

The semi-public sector

Free Legal Help (Retshjælpen in Denmark and Fri rettshjelp in Norway) is publicly financed and was established in 1885 in Denmark. The help depends upon the income of the household and encompasses most of the legal matters of daily life including advice about debt settlement and other legal aspects of debt. The advisers include, among others, law students.

In the early 1980s, the Danish Bar and Law Society (Advokatsamfundet) established the Lawyers Guard (Advokatvagten), where people in many cities, independent of income, can talk to a lawyer or an assistant attorney and receive verbal legal advice for free. Other voluntary organisations in this field are the Social Legal Help as already mentioned and the Mother Help (Mødrehjælpen), which offer free social, economic, and legal advice to targeted socially disadvantaged mothers. In a quite new phenomenon, a few voluntary organisations offer debt-counselling. Since 2008, there has been an appropriation of DKK 16M (EUR 2.14M) over a period of four years to establish debt-counselling, through which volunteers can help the

most vulnerable citizens. In 2012, the funding for free debt advice, delivered by voluntary organizations, was extended for another four years with the amount of DKK 38M (EUR 5.10M).

The public-supported offices of the Free Legal Help and Lawyers Guard are regulated in the Civil Justice Act, Chapter 31; Executive Order on Legal Aid by Attorneys; and Executive Order on Grants to Legal Aid Offices and Attorneys Guards. The other voluntary organisations that offer debt advice are not regulated.

The public sector

A few municipalities offer citizens with debt problems free advice. For instance, in 2010 København Kommune established a debt-counselling centre in connection with Valby Borgerservice.

In court, the judge has a limited duty to provide guidance. According to the Civil Justice Act's Subsection 500 (1), the bailiff's court, in the necessary extent, guides a party who is not represented by a lawyer with regard to his legal rights. More than getting the debtor out of debt, this duty is related to the court's other duties to provide guidance according to said act (e.g., to witnesses), securing a fair trial. When a hire-purchase agreement is defaulted on, the bailiff's court has a more explicit role than that with Web and SMS loans. In conditional sale (retention of ownership of the sold item until payment is made), the creditor shall, as a general rule, take back the item sold and cancel the debt; see the Consumer Credit Act's Chapter 10.

Another way to help natural persons out of debt is debt relief. The conditions for this are rather tight. According to Section 197 of the Bankruptcy Act, it should firstly be beyond hope that the debtor will get out of the debt. In practice, this means that the debtor most likely will not be able to fulfil his obligations to the creditors for the next few years (about five years). This assessment is based on, among other elements, the total amount of the debt, the age of the debtor, income, a prognosis (in light of the person's age, education, and job), and disposable income. Another condition is that the debt relief will lead to permanent improvement of the debtor's economic situation. If debt relief is granted, the debt is either reduced or cancelled; see Section 198. Debt relief will normally not be granted if the debtor is unworthy. The Bankruptcy Act explicates the situations in question in Section 197. Two of these situations are the debtor not having paid off the debt when he had a reasonable possibility of doing so and him having acted irresponsibly in relation to economic matters—for example, if the debt is from luxury consumption goods or the debt is systematically built up to the public. The Danish Tax and Customs Administration (SKAT) can cancel debt to the public. The conditions for this, in the Public Collection Act⁴⁷, Section 13, match Section 197 of the Bankruptcy Act.

5.12. Sanctions

Sanctions in civil law for violation of the consumer-credit legislation are found in the traditional tort and contract law, including Sections 31, 33, and 36 of the Contract Act, but also in the special rules, including those in the Credit Agreement Act, where unreasonable costs in connection with a loan can be ignored under Section 22. Violation of certain parts of the obligation to provide information is also specifically regulated in Sections 23 and 24 of the Credit Agreement Act, where Section 23, about lacking and incorrect indication of credit costs, is relevant for Web-based and SMS loans.

Violation of the provisions made in the Marketing Practices Act can be dealt with especially by means of notices, injunctions, and damages, according to Section 20; cf. Section 27. The Consumer Ombudsman can issue a notice if the action is clearly against the rules and cannot be changed by negotiation; cf. Subsection 27 (2). While violation of Subsections 3 (1) and (2), about, among other things, misleading marketing, and Section 6, on non-requested marketing, may lead to a fine under Subsection 30 (3), violation of Section 1, about good marketing practices, cannot be punished. In practice, for example, the Consumer Ombudsman on 3 October 2012 announced that a complaint against Selene Finans Danmark A/S and LånLet A/S had been filed. The complaint was about a claimed violation of Section 14a of the Marketing Practices Act related to lack of credit information in connection with presentation of financing solutions on the companies' homepages.

Violation of the Executive Order on Good Business Practice for Financial Undertakings has not been sanctioned within civil law. The Danish Financial Supervisory Authority can issue an enforcement notice

⁴⁷ Inddrivelsesloven – Act No. 1333, of 19 December 2008.

under Subsection 35 (1) if good practice is violated. Violation of terms of a notice or of, for example, Section 4's terms on misleading marketing can lead to a fine under Section 36.

Violation of the terms of a notice on unsolicited approaches under Subsection 4 (1) of the Consumer Agreement Act is sanctioned in Subsection 34 (1) of the same act. Furthermore, such a promise given by the consumer is invalid under Section 5. The provision can only be appealed to by the consumer. The consumer can choose to demand that the terms in the agreement be met, instead of accepting that the agreement is not binding. There is no time limit in connection with exercise of the provision. The consumer's right to free himself from the agreement is, however, restricted by the general rules about invalidity of agreements and when the consumer has exercised passivity.

In extreme cases, aggressive business practices can violate Section 279 of the Penal Code, regarding fraudulence.^{*48} In addition, criminal sanctions appear from the special legislation, such as Chapter 13 of the Credit Agreement Act. Also, Section 56 of that act allows for the use of fines. Fines are not, however, allowed in connection with all provisions of the act. This applies to, for example, the credit-assessment duty in Section 7c, because the provision is vaguely formulated.^{*49} In contrast, a person, who is found guilty of serious or repeated breach of the obligation to provide information can be fined under Subsection 56 (2).

6. Initiatives

Regardless of the increase in Web loans and especially in SMS loans, the political drive via legislation has been limited, and the topic gains the attention of the media only a few times a year.

In 2008, the Social Democrats (re)submitted a draft resolution about a possible limit on the APR for consumer loans equivalent to the interest for the minimum lending rates plus 15%. Within the Danish parliamentary year, the resolution only managed to get directed to a committee hearing; therefore, it was not adopted.^{*50}

In 2009, the political debate about instant loans ended with the then economy and trade minister, Brian Mikkelsen (of the Conservative party), refusing to intervene. The Consumer Ombudsman, however, made use of his opportunity to formulate some guidelines jointly with the businesses and thereby created the guidelines for the marketing of short-term or small loans on the basis of distance selling agreements. The purpose of the guidelines was to fill the legal gap in which these agreements were placed since they, on account of the *de minimis* limit, were not covered by the previous Credit Agreement Act. They were prompted by 'problems associated with this type of loan' and motivated by a need for 'clarification of what demands can be placed on the operators for such loans'.^{*51}

In 2010, the Social Democrats advanced a parliamentary resolution to force the government to introduce a bill banning SMS loans and to initiate joint Nordic co-operation with the aim of banning SMS loans across the Nordic region. The Social Democrats referred to the heavy increase in the number of SMS loans in Sweden. The ban was motivated by the consideration that taking out a loan is a far-reaching action and, therefore, a personal meeting between the lender and the borrower, where the pros and cons of various types of loans can be discussed, is needed. In the parliamentary resolution, it further came out that the SMS loan operators to a large extent did not follow the Consumer Ombudsman's guidelines for SMS loans. The resolution was rejected by the parties that constituted the parliamentary basis for the then liberal and conservative government.^{*52}

The same year, the CCD 2008 was implemented, mainly in the Credit Agreement Act. On the basis of the report from 2009 on the implementation of the CCD 2008 in Danish law, the *de minimis* limit in the Credit Agreement Act as then in force was removed, such that the costly SMS loans were also covered by the

⁴⁸ See, for example, U 1996.1080 V (for 'Vestre Landsret', the Western High Court) for discussion of fictitious invoices and U 1990.621 H on hidden unpaid debts in cars.

⁴⁹ Compare with the minority (one member) in Bet.1509/2009 (see Note 16), p. 96 ff.

⁵⁰ Proposed resolution B 33 from the 2008–2009 session of the Folketing, which is a revised resubmission of part of proposed resolution B 118 from the previous session of the Folketing, second session.

⁵¹ The Danish Consumer Ombudsman's guidelines for the marketing of short-term or small loans on the basis of distance selling agreements p. 1 ff.

⁵² Proposed resolution B 218 from the 2009–2010 session of the Folketing. The resolution was rejected on 1 June 2009, where 51 voted for it and 57 against.

comprehensive obligations in the amended act, such as the obligation to provide information.^{*53} However, the number of SMS loans has risen since the amendments were made. This may indicate that the amendments do not work or are not complied with in practice.

In 2013, it was discussed whether an appeals board for instant loans should be established in order to reduce the number of cost-intensive loans. The same year, the area of focus of the Consumer Ombudsman was once again credit markets and correct information about loans. He would focus on whether credit and loan providers comply with the provisions of the Marketing Practices Act and the Credit Agreement Act and would in this connection renew the guidelines for SMS loans. No material on this is available yet (January 2014), though. Also in 2013, the debt-collection agency Intrum Justitia, which provides the information on more than 40% of the persons who are registered in the RKI register of bad payers, refused to collect on cost-intensive SMS and Web loans. They regarded these as ‘ethically and morally objectionable’.

7. The sufficiency of the legislation

It is obvious that the easy access to borrowing via electronic means contributes to Danes’ willingness to borrow money and to their financial difficulties. As already indicated, the often cost-intensive consumer credit has increased by DKK 7B (EUR 0.94B) and unsecured loans by DKK 3.6B (EUR 0.48B) in 10 years. The fact that the increasing borrowing is not offset by a corresponding increased ability to pay is illustrated by the fact that more than every 20th adult Dane has a history of bad credit today and that non-performing debt has doubled over the last six years. The borrowing facilities are restricted via the registration of debtors in default, and recovery through the bailiff’s court implies that the reality becomes the opposite of what the advertisements promised—the freedom, welfare, and right of managing one’s own economy are restricted.

Worst affected are the group who have used instant loans to enable paying the instalments of other loans. Their negative spiral of debt seems to be a consequence of **society** not having, at an earlier stage, impeded their indebtedness or provided remedial measures such as debt advice, which is only in its initial stage in Denmark, or a (state-financed) scheme of social loans for financially vulnerable consumers who do not have access to consumer credit from the banks. Neither does a **creditor** have a special obligation to assist a debtor in the event of default. In other words, **the borrower is responsible for his own indebtedness**. In the legislation, this finds expression in the fact that the protection consists in strengthening the individual’s choice by means of the duty to provide information and that the provisions regarding usury in the Danish Contract Act and the Penal Code are seldom used for the benefit of the borrower. Thus, the freedom of contract and the liberal basis in the form of a *caveat emptor* (buyer be aware) ethos prevail.

In Western countries, the access to loans in respect of private individuals has been the principal condition for the economic growth after the war.^{*54} However, credit is not only crucial for growth in society; in terms of over-indebtedness, it also has a downside, in the form especially of personal and socio-economic negative implications. Borrowed money does not in itself imply real wealth; it comprises solely potential for creating wealth.^{*55} Credit differs from other services: what the consumer subsequently pays for through the credit costs is the actual opportunity of usage that the loan amount implies. If the consumer uses the loan amount for, say, education, establishment of a business, or health care, creation of wealth is possible.^{*56} If the amount of the loan is spent on purchases of a dwelling and consumer goods, it can enable the creation of welfare. However, as is indicated above, lending has an embedded risk of loss of welfare if the consumer is not able to repay the credit. It may be characterised by poverty and life-long indebtedness, which, for instance, may entail loss of central goods such as a dwelling, dissolution of marriage, social exclusion, and influence on one’s health and well-being. The implications for the individual (at micro level) may, in turn, have societal implications (at macro level). The personal implications are reflected on a societal basis in, among other things, increased costs for social services, the legal system (the bailiff’s court), and the health-care system.

⁵³ Bet. 1509/2009 (see Note 16), p. 52.

⁵⁴ C. Poppe. Ansvar for egen gjeld? [‘Responsibility for one’s own debt?’]. – K. Asdal, E. Jacobsen. *Forbrukerens ansvar* [‘The Consumer’s Responsibility’]. Oslo: Cappelen Akademisk forlag, p. 251 (in Norwegian).

⁵⁵ U. Reifner. European Coalition for Responsible Credit – Principles of Responsible Credit. – C. Twigg-Flesner *et al.* (eds). *The Yearbook of Consumer Law 2008*. Hampshire: Ashgate 2007, p. 419 (in English).

⁵⁶ *Ibid.*

Consequently, every society must set the limit between society's and the individual's liability for unmanageable debt. In 2008, Kronofogden (the Swedish bailiff) estimated that Sweden's at least 400,000 over-indebted individuals cost society at least 30–50B Swedish kronor annually, inclusive of reduced production due to over-indebtedness, and a similar Norwegian survey is on the way.^{*57} Such figures call for society to play an active role in the handling of debts. Also, the financialisation of the global economy emphasises that there are limits as to how far the individual's responsibility can be extended if anything goes wrong. The considerations supplement the social aim, which also applies to aid to people in the grip of debt. The aim finds its expression in the modern welfare state, which is normally characterised by being a safety net for the citizens. If a citizen must resort to expensive loans in order to cope with the daily necessities and if the state does not take care of the indebted person, the state transfers its protection of welfare and leaves it to the (lacking) ability of the individual.

If one reads the preparatory work for the Credit Contract Act, the word 'over-indebtedness' is not mentioned, and it is only quite briefly mentioned in the preamble to the CCD 2008.^{*58} The lack of awareness that consumer credit has the inherent risk of over-indebtedness is due probably to the fact that policy-makers traditionally compare the consumer-credit legislation to other consumer legislation and apply the associated considerations. This applies especially in the European context, in which the desire is to increase welfare through increased competition (the internal market) and thereby an increased range of consumer credit and access to it, instead of to protect consumers against unintended (financial) consequences of their actions. Apart from the consumer's interest, preventing **over-indebtedness** safeguards societal interests far more than does the consideration of consumer protection. Over-indebtedness is not necessarily a matter of the consumer being exploited or being irresponsible at the moment of conclusion of the contract. It may just as well involve a 'reasonable' credit agreement and the consumer simply not being able to afford to pay the amount back. In contrast to this, **consumer protection** traditionally is aimed at preventing the businessman from taking advantage of his stronger position and thereby obtaining an unreasonable agreement.

By virtue of their high costs and the related debt problems, Web and SMS loans are especially illustrative of the present adjustment not being able to prevent over-indebtedness. Beyond the existence of poor licensing and supervision regarding these consumers, the present protection measures in the legislation seem to be insufficient.

In their capacity as short-term loans and minor loans, SMS loans will be outside the scope of protection of the CCD 2008. However, even though protection is provided in relation to such loans in Denmark's Credit Contract Act, contrary to the hoped effect the said act does not seem to have minimised the cost-intensive loans.

Neither do the Consumer Ombudsman's guidelines for SMS loans, which to a large extent are an expression of current law in the form of good business practice, especially with respect to the marketing, seem to have restrained SMS loans and the high costs they often involve.

The volume of **information** has not been decreased by the CCD 2008 and, accordingly, the Danish Credit Agreement Act. The most important information is at risk of being lost amidst **information overload** when, for example, up to 22 compulsory pieces of information are stated in the agreement, the lender can attach further information, and the consumer receives other information in connection with distance selling or consumer goods bought on credit. Not all consumers read, understand, or know how to use the information. With respect to financial capability, some empirical data indicate that only 21% of young people answer a question on the price of instalment loans correctly.^{*59} 'Low' monthly instalments often become the focus of the borrower instead of the APR, and establishment charges etc. are often disregarded when a low interest rate or no interest is offered. An increase in **financial literacy** will be especially beneficial to

⁵⁷ Kronofogden. Alla vill göra rätt för sig. Överskuld sättningens orsaker och konsekvenser ['Everyone wants to do the right thing: Causes and consequences of over-indebtedness']. – KFM Rapport 2008:1, pp. 6, 56 ff. (in Swedish). As part of the research project titled 'Financialisation of Social Welfare', led by C. Poppe, of SIFO, a cost/benefit analysis of the Norwegian municipal debt advice (WP7) is in the course of preparation.

⁵⁸ The **European** purpose of the consumer-credit legislation is related to the internal market for consumer credit. The aim will involve advancing consumer welfare; however, it does not seem to address the detriment of welfare in connection with over-indebtedness. In a **Danish** context, the word 'over-indebtedness' is not mentioned at all in bet. 839/1978 om køb på kredit ['Danish Report No. 839/1978, on credit sale'], which formed the basis for the former, purely Danish-initiated consumer-credit legislation—i.e., the Danish Credit Sale Act (kreditkøbsloven—Act No. 275, of 9 June 1982). The aim was to increase consumer protection, though.

⁵⁹ The Money and Pension Panel. Unges privatøkonomi 2011 ['Young people's economy 2011'], a survey. Copenhagen 2011, p. 6.

the already rational consumers, not so much to irresponsible consumers who may also be under-trained.^{*60} It is, however, the latter group that needs the most financial education. Informational material and budget templates can, for example, be found on the Money and Pension Panel's Web site.^{*61} However, not all consumers have (or can obtain) the same high **financial capability** or will use such material. A Danish study of young people's borrowing shows that 'non-academically-oriented young people' characterise the group of financially weak young people who take out expensive consumer loans.^{*62}

Whether or not the 'electronic lenders' actually provide the compulsory information is a different matter. The Consumer Ombudsman has several times proved a breach of the notification duty. For SMS loans, the information is often provided in advance via statements by the establishments on homepages through which efforts are made to comply with the information duty.^{*63} The volume of the compulsory information is not necessarily suitable for brief text messages, as used by SMS.

As to the **right of withdrawal**, the loan amount is typically used, and the consumer is still bound by, for example, a purchase agreement. On account of the right of withdrawal, the consumer is required to act responsibly subsequently, even though he may have acted irresponsibly in the contract situation. Actually, when the pre-contractual duty to inform about the right of withdrawal is without information on the costs the use of the right incurs a consumer, it may contribute to consumers taking out loans on the basis of the idea that they have a free credit facility within the 14 days for which the right of withdrawal lasts. **Early repayment** seems quite irrelevant in the context of SMS loans, on account of their short maturity period.

As is mentioned above, the provisions related to **usury** are seldom applied in favour of the borrower. Web and SMS loans are often connected with easy access and high costs. These two things are not necessarily an appropriate combination. In the context of distance selling agreements, it is difficult to talk about utilisation in the sense of Section 31 of the Contract Act, or usury in the sense of Section 282 of the Penal Code.

Consideration for preventing over-indebtedness prevails generally with regard to responsible lending. As mentioned above, this protects consumers from borrowing if it is anticipated that they will have difficulties in paying back the credit. However, this means has not been applied in Danish law, in which a principle of **responsible borrowing** still applies. The latter means reduces but does not exclude the discussion of usury and the imposition of a **maximum cost** on SMS and Web loans, in relation to which questions of consumer protection are particularly relevant since the consumer through his need for loans is on less equal footing with a stronger businessman than a consumer in other consumer agreements and, therefore, is more readily subject to exploitation.

8. Solutions

As the legislation seems insufficient, it should be discussed how well-proportioned solutions can be provided. If one looks at the present protective measures, **focused and consumer-friendly information** in combination with **increased financial literacy** via such means as information campaigns or studies in personal economics at school can, of course, further the desired conditions. Since the duty to provide information has its limits, further means will be discussed below that can be introduced into Danish law if one wishes to reduce over-indebtedness and the number of expensive Web and SMS loans.

The EU has not yet shown an interest in those SMS loans that are not covered by the CCD 2008's field of application. The solutions will be left to national law and will often be centred on specific prohibitions as other means; such means as the duty to provide information, which constitutes a minor interference in the parties' freedom of contract, have already been tested (compare with the principle of proportionality set forth in Article 5 (4) of the Treaty on the European Union). Just as they may restrict the parties' freedom of contract, such prohibitions may constitute a restraint to free competition in the EU market. However, this is a contemporary example of an area in which a strong social interest may exist that justifies national

⁶⁰ G. Pearson. Financial literacy and the creation of financial citizens. – M. Kelly-Louw *et al.* (eds). *The Future of Consumer Credit Regulation*. Hampshire: Ashgate 2008, p. 27 (in English).

⁶¹ See www.raadtilpenge.dk.

⁶² The Money and Pension Panel. Unges forbrugslån og opsparing ['Young people's consumer loans and savings'], a survey. Copenhagen 2008, p. 6.

⁶³ See www.forbrugserombudsmanden.dk.

regulation interfering in the internal market. Whether or not a given prohibition is in accordance with EU law must be decided upon on a concrete basis.

8.1. Authorisation and supervision

In general, **an authorisation** is not required for granting or providing credit in Denmark. All businesses that grant credit to consumers are covered by the regulation in and proceeding from the Danish Consumer Credit Act. However, an authorisation is required if one is to do the kind of business addressed by the law on finance institutions. Yet it is not the finance institutions that are the main players behind easily accessible loans characterised by extremely high costs. It is the other lenders—those without an authorisation.

Introducing a licensing scheme for money-lending businesses under Danish law has been considered. However, the considerations were rejected. In particular, the arguments were that such a scheme would involve considerable administration and that the scheme had to comprise special demands for the lender's qualifications since otherwise it would imply that less reliable lenders may gain access to 'display public authorisation'.⁶⁴ The great social importance of lending and the implications that mainly irresponsible lending may have for not only the individual consumer but also society in general counts heavily in favour of an authorisation scheme for lenders being reconsidered. Such schemes are known of from, for example, the British Consumer Credit Act and the Australian Consumer Credit Protection Act.

On an overall basis, being involved in certain credit activities without having a credit authorisation should be prohibited (it is appropriate that, for example, private individuals who grant credit not be covered in these activities). An authorisation scheme renders it possible to deprive a lender who, for instance, grossly or several times violates the regulations' terms on protective measures of his authorisation. In itself, this possibility will presumably serve as a deterrent, acting in favour of greater compliance with the legislation and the protective measures in this connection.

8.2. Product limitation and access to credit

From political quarters, to what extent Web and SMS loans are deemed desirable is seldom announced. An increased range of products is traditionally considered good, and prohibition of certain products, such as SMS loans, is only rarely discussed. If there are simple, standardised products from among which to choose, a consumer will more easily be able to take care of himself. Conversely, a product ban is also associated with further reflections. It does not seem to be the main issue that a credit agreement is concluded by way of a remote communication tool (a mobile phone or the Internet). Rather, at issue seems to be the fact that these loans are associated with high costs and are easily accessible, often with a possibility of quick payment. Consequently, the consideration should be instead whether **the access to loans and obtaining quick payment** can be rendered more difficult. The temptation of quick payment of a loan amount would be less, and the fact of the loan amount not having been used yet also will make it easier for the consumer to exercise the right of withdrawal. Therefore, by way of such other methods, the question becomes one of product limitations rather than a product ban.

8.3. Marketing

Prohibitions of especially aggressive marketing (e.g., of a non-requested application) are already specified by law. However, these prohibitions do not hinder the consumer's receipt of marketing of credit via advertisements, the Internet, etc., which material may contribute to the consumer seeking credit. Consequently, **a limitation to the marketing of loans** is an obvious step. However, it would be more readily acceptable to prohibit specific elements in the marketing. Displaying of signs, including APR, should not be prohibited.

A marketing ban or at least a limitation should be specified in EU context, since, generally, this area has already been adjusted from European quarters. As to the payment of loans, the CCD 2008 to a certain extent gives access to adjustments in this area on a national basis.

⁶⁴ Bet. 604/1971 (see Note 32), p. 25 ff.

8.4. Maximum cost

Thus, finance companies and other lenders can almost decide for themselves how expensive a loan is going to be. Primarily, the cost-intensive SMS and Web loans raise the question of whether **a limit as to how much a loan may ‘cost’** should be reintroduced.

To answer the purpose, the considerations should be related to **a limitation of costs (cost ceiling)** for credit rather than **an interest maximum (interest-rate ceiling)**. Consequently, **a limitation of costs** will constitute a ‘maximum price’ for loans. However, **an interest maximum** would not necessarily minimise the costs for the credit. Instead of interest, fees can be charged. It is not unusual that the cost-intensive loans are free of interest and that one or several extremely high fees—e.g., related to the taking out of a loan—must be paid instead.

A maximum cost implies a prohibition against granting loans in excess of that maximum. The prohibition is related to the terms of the agreement. Whether a specific legal maximum cost approaches a proper prohibition or is only a limitation will, however, depend on the wording of the potential provision. An interest or maximum cost will typically be related to external circumstances—for instance, be fixed to a certain interest rate, which is adjusted in accordance with the fluctuations of the money market or in relation to the Bank of Denmark’s bank rate or the like.^{*65} If the limitation is related to the parties’ internal affairs, it is not a proper prohibition.

In European respects, there seem to be no obstacles to introduction of a maximum cost or to usury more generally being governed by national law.^{*66} The central aim of both the CCD 1987 and the CCD 2008 is to improve the transparency instead of adjusting the credit costs.

The introduction of a maximum cost in Danish law would not be such a fundamental breach of Danish legal tradition as one might think. In Danish legislation, provisions for maximum prices already exist; for example, Subsection 9b (2) of the Interest Act restricts the size of reminder fees. Certain control of costs, including interest, can already be done pursuant to mainly Section 22 of the Credit Agreement Act and Section 36 of the Contract Act.

The **pros** of introducing a maximum cost are that it is an efficient way of preventing unreasonable credit agreements. It makes the legislation clear, as it is easy to see when a lender has gone above the maximum, which would make it easier to enforce the provision. Thereby, the drawbacks of the present legislation would be eliminated, including the provisions on exploitation (in Section 31 of the Contract Act and Section 282 of the Penal Code) and the general clauses (in Section 22 of the Credit Agreement Act and Section 36 of the Contract Act). The provisions’ vague wording is subject to reluctance to apply these provisions on the part of the courts. They do not necessarily hinder loans having such remarkably high costs that the costs are referred to in public as ‘usury’. A number of circumstances may indicate that excessively high costs are, in fact, being levied in comparison to the risk of loss to which the lender is exposed.^{*67} Indeed, the provisions may act as a safety valve in the event of social force majeure affecting a specific consumer, but the lender can possibly redistribute the costs by further increasing his ‘prices’ for consumers as a whole. In contrast, a maximum cost too would be of benefit to consumers as a whole.

The **cons** of introducing a maximum cost are that **it is difficult to determine an appropriate maximum cost rate for all the various types of loans**. The risks of loss on lending vary. In particular, there may be a disparity between the borrower’s creditworthiness and the value of the security, if any, for the loan.^{*68} Also, there may be a difference in the administration costs.^{*69} One may claim that these objections do not apply only to a general maximum cost, that they also apply to a specific maximum in certain fields of loans, such as loans against mortgage on real property.^{*70} However, this does not seem evident.

⁶⁵ *Ibid.*, p. 24.

⁶⁶ Com(1995) 117, item 282. However, item 297 in the same work indicates that the Commission finds it desirable that discussion of usury at Community level be conducted. If necessary, it would be logical for suitable provisions on usury at Community level to be determined. Also, in relation to credit secured for real property, usury and maximum cost are a theme. In its Green Paper on credit secured on real property in the EU, the Commission states that it has refrained from interfering in this area, one that has substantial social aspects; see Com(2005) 327, item 26.

⁶⁷ In relation to commercial banks, see H. Juul. *Pris og kvalitet på pengeinstitutområdet* [‘Price and Quality in the Banking Sector’]. Copenhagen: Gads Forlag 2006, p. 202 ff.

⁶⁸ Cf., for example, bet. 604/1971 (see Note 32), pp. 7, 24; bet. 839/1978 (see Note 58), p. 40.

⁶⁹ Bet. 604/1971 (see Note 32), p. 25.

⁷⁰ E.g., bet. 604/197 (ibid.).

Indeed, it is inexpedient for the same upper limit to apply to all types of credit. This can be remedied through **differing cost maxima**. In a number of other countries, there is or has been a maximum cost.^{*71} In particular, this is the case in Belgium, France, and to a certain extent also Holland. The legislation in these countries illustrates that, for instance, different maxima can be set in various quarters, determined on the basis of the type of credit, its amount, and the period of credit and/or depending on the average costs of the credit institutions.

Further cons of introducing a maximum cost are that it may be feared that **lenders will completely refrain from granting loans to borrowers that imply a high risk of non-repayment** and that these borrowers will be referred to the black market. In light of the level of cost that certain consumer loans have, the question is whether this consumer group should take out such loans at all to which there is relatively easy access. Obtaining loans on the black market seems to be less accessible, and, on the basis of the present level of costs related to certain consumer loans, one might consider whether the level differs from the prices on the black market.

Furthermore, the argument could be advanced that **a statutory maximum cost against its purpose will render it common to require the maximum allowed credit costs** as well in the less hazardous cases and thereby promote an undesired increase of the costs in practice.^{*72} The argument is confirmed by the fact that the fixing of the maximum price for reminder fees in Subsection 9b (2) of the Interest Act implies that creditors often overlook the words ‘not exceeding DKK 100’ in the wording of the act and charge the maximum amount of DKK 100 (EUR 13.4) for each dunning letter. However, this does not document the fear that everyone will make use of maximum prices upon granting of credit.^{*73} The scenario of competition in reminder fees is not the same as that for borrowing, in which the borrower can opt out of the raising. The argument is contrary to the prerequisite that lenders have a desire to compete for borrowers. It is that prerequisite on which the internal European market for lending rests.

Based on a weighing of the pros and cons of a maximum cost, the conclusion is that a maximum cost is a relevant option for Danish law. Even though it seems less radical, an obligation for financial businesses to document why an interest rate is X% above the bank rate seems a less obvious solution.^{*74} Such documentation does not seem to appeal to the group of borrowers who are interested in financial businesses’ pricing.

However, before introduction of a maximum cost should be considered, it seems appropriate to strengthen the courts’ possibilities of setting aside unfair credit agreements in accordance with the present provisions, especially Section 22 of the Credit Agreement Act and Section 36 of the Contract Act. Also, the introduction of a responsible lending standard as a separate provision would restrict the need for fixing of a maximum cost for credit, even though the two measures do not exclude each other. Responsible lending comprises in itself credit free of charge—i.e., in which the repayment consists solely of the amount of the loan. Such credit can (also) constitute a financial burden to the borrower. A maximum cost does not have this advantage.

8.5. Responsible lending

In itself, none of the three protective measures to which responsible lending is often connected—a duty of credit assessment, a duty to give advice, and a duty of dissuasion—prevents irresponsible lending. Therefore, as a concept, responsible lending should be distinctly connected to irresponsible lending, consequently ensuring that no credit is granted that the consumer is not supposed to be able to repay. Legal norms such as good (lending) practice and loyalty are too vague to ensure this, even though they can possibly influence the assessment that is made in accordance with, for example, Section 36 of the Contract Act. Therefore, a provision on good lending practice such as Section 5 of the Swedish Consumer Credit Act (konsumentkreditlag) is not sufficient.

⁷¹ With respect to maximum cost in other European Union member states, see Com(1995) 117, item 276 ff.; the proposal for parliamentary resolution B 33 from the 2008–2009 Danish parliamentary session with respect to a ceiling on the annual costs, on a percentage basis (i.e., in terms of APR) for consumer loans; and the reply to question 3 on the proposal for a parliamentary resolution filed by the Trade and Industry Committee on 24 February 2009.

⁷² See, for example, bet. 604/1971 (see Note 32), p. 25; bet. 839/1978 (see Note 58), p. 40; SOU 1975:63 Konsumentkreditlag m. m. [‘Statens Offentliga Utredningar, Government Official Reports on a consumer credit act etc.’], p. 193 ff. (in Swedish).

⁷³ See, *e contrario*, H. Juul (Note 67), p. 204.

⁷⁴ See, *e contrario*, H. Juul (*ibid.*).

There is a lot to be said in favour of the lender under the legislation being assigned a duty to refrain from granting credit in certain situations—i.e., in favour of a prohibition of irresponsible lending: The duty of credit assessment set forth in the CCD 2008 seems to be appropriate only to the extent that also a duty applies to refrain from granting credit in the cases in which the credit assessment has a negative result: when the consumer is considered unworthy of obtaining credit. The vague wording of the duty of credit assessment referred to in the CCD 2008 furthermore implies a need in national law for implementing a measure for the assessment; a ban would contribute to the determination of such a measure.⁷⁵ Indeed, it speaks against the imposition of a ban that the result of a negative credit assessment would presumably already be that the lender refuses the credit application; in general, it is the lender who suffers the loss if the credit is not repaid. However, counting in favour of the imposition of a ban is that in a number of situations the lender may have an interest in the credit being granted regardless of a negative credit assessment. Even though a lender may assess the consumer's ability to repay as being low, such factors as the chance of a profit through high credit costs may eclipse the risk that the lender takes. The directive cannot be considered an objection to conclusion of a credit agreement in this or in other situations. Indeed, it speaks against the imposition of a ban if the consumer on an 'enlightened' basis (e.g., through counselling) has chosen to indebted himself. However, a rationale is lacking for a consumer who objectively should not take out a loan but who subjectively wants one to indebted himself to the detriment of especially himself, a possible guarantor, and eventually society. There is, in fact, quite a heavy objection to a ban in its restriction to the parties' autonomy, and the fact that in relation to the consumer it can be considered paternalism. But the socially, highly weighty (though often overlooked) consideration of prevention of over-indebtedness is in favour of a restriction of the freedom of contract, no matter that the lender or the consumer is willing to assume a further risk upon the lending.

The most expedient thing to do is to impose a ban on irresponsible lending at a European level, which enjoys a greater focus in the Residential Property Credit Agreements Directive (2014/17/EU). An explicit ban in the CCD 2008 would have been able to restrict the legal uncertainty that the duty of credit assessment set forth in Article 8 applies to national law. Instead, specific elaboration of the duty of credit assessment has been left to the Member States. Apparently, EU law does not stand in the way of imposing a ban on irresponsible lending. Accordingly, several Member States have implemented such a duty, among them Finland and Sweden.

The imposition of such a ban should be done in conjunction with introduction of an authorisation scheme for lenders and intermediaries in consideration of the social implications of lending. The idea of credit assessment should still be applied, so the lender can assess whether, on the basis of internal measurements, he wants to grant credit to a specific consumer. However, as to responsible lending, the weight should be on whether the potential credit agreement is 'unsuitable' for that consumer; see, for example, the Australian Consumer Credit Protection Act from 2009, Clauses 115–119, 128–131, 138–142, and 151–154. The latter presupposes that socially an external metric for when a loan is considered irresponsible will be determined.

8.6. An appeal board for instant loans

For consumers, a political proposal for an appeal board for instant loans would mean having the possibility of filing a complaint if they think they have been treated unfairly or are paying unreasonably high interest on a loan. Danish consumers already have the opportunity to have their legal complaints handled by the Complaint Board of Banking Services, by the Consumer Complaint Board, and by the courts. One may still fear that many of those who obtain instant loans will not take the opportunity of complaining at all. A borrower who takes out expensive instant loans without thinking of the consequences will hardly be part of the group likely to complain the most.

An appeal board does not become effective until the 'damage' has occurred, whereas above-mentioned provisions such as a maximum cost could prevent the damage from arising. Consequently, an appeal board helps to treat the symptoms but does not remove the cause. Similarly to all other post-contractual reactive measures, the actions of an appeal board should be tied in with pre-contractual preventive measures.

⁷⁵ C. Herresthal. Die Verpflichtung zur Bewertung der Kreditwürdigkeit und zur angemessenen Erläuterung nach der neuen Verbraucherkreditrichtlinie 2008/48/EG. – *Zeitschrift für Wirtschafts- und Bankrecht (ZWuB)*. 2009, p. 1177 (in German).

9. Conclusions

How to protect consumers and how to prevent over-indebtedness is mainly left to national law where the CCD 2008's field of application does not cover easily accessible minor loans such as SMS loans. Other kinds of consumer credit are mainly EU harmonised, so it is primarily left to the EU to find solutions.

With regard to solutions, the protective measures must be considered in interaction. No measure should stand alone. However, there is variation in the weight that should be accorded to individual measures. From the examination above, this seems an appropriate balance:^{*76}

There should be an authorisation system for both credit providers and credit intermediaries. These must—but not necessarily to the same extent—respect the protective measures in the legislation. The information should be pared back, easy to understand, and adapted to the rationale behind the information obligation at each stage of a (potential) credit agreement. It is useful to increase the education of consumers (e.g., young people at school). Yet, there are limits to how much the financial literacy of consumers can be improved. The right of early repayment appears to be enough; the introduction of the right of withdrawal in the CCD 2008 seems to be unnecessary. Also, the introduction of the obligation to assess the consumer's creditworthiness seems unnecessary. Assessing creditworthiness should be only for the creditors' own use, not an obligation. Lenders should, wherever possible, not play a dual role. Advice should, therefore, be reserved for independent advisers. Instead, the focus on responsible lending as an independent protection measure should be increased. The other protective measures in themselves are insufficient to prevent over-indebtedness. Accordingly, the law must impose a duty for the creditor not to offer credit in certain situations (i.e., a prohibition of irresponsible lending). Responsible lending as an independent measure lessens but does not exclude considerations for introducing a maximum to how much a loan may cost. Nevertheless, the opportunity currently found in Danish law to alleviate unfair credit agreements should be strengthened. Prohibiting certain forms of credit, such as SMS loans, seems unnecessary. At the EU level, marketing and possibly access to credit should be restricted.

⁷⁶ See also T. Jørgensen (Note 26), p. 530 *ff.*



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Instant Loans: Problems and Regulations in Finland

1. Introduction

1.1. The market situation and problems in Finland

Instant loans have been a hot topic among citizens, authorities, businesses, media, politicians, researchers, and the legislature in recent years in Finland—i.e., since the first instant loans were granted via SMS, in 2005.^{*1} The instant loan was an unprecedented financing product; it opened the credit market to people previously excluded from it, and the general interest in the instant-loan business led to new companies. Accordingly, the expansion of the instant-loan business was very rapid.

Instant loans have faced general disapproval: they have been seen as a financial abuse of weak consumers, often using aggressive and tempting marketing. According to several research reports and statistics, it is unquestionable that instant loans have caused severe over-indebtedness problems for many consumers. On the other hand, instant loans can be described as a solution for consumers suffering from short-time shortage of money without invoking of credit cards or other consumer credit of larger amounts.^{*2}

There is no official or legal definition for an **instant loan**. Usually it is understood as lump-sum consumer credit amounting to a few hundred euros that should be paid back in two weeks to three months. Since the loan amount is low and the repayment period is very short, the actual annual percentage rate of credit costs is very high.^{*3} In Finland, instant-loan operations are conducted by businesses other than banks and credit institutions.

In general, consumer loans are very common in Finland—along with other Western countries. Plentiful consumer loan-taking has become an everyday phenomenon and is socially accepted.^{*4} One development of the last decade can be described as a shift from a savings society toward a **credit society**.^{*5} This is a very

¹ There is no precise information about when the instant-loan market was established, but several sources indicate that it occurred in 2005. For instance, see V. Pönkä, E.-L. Parkkali. Pikaluottojen oikeudelliset ongelmat [‘The legal problems of instant loans’]. – *Defensor Legis* 2010/5, p. 585 (in Finnish); Finnish Ministry of Justice. Report of the Instant Loan Working Group ‘Pikaluottolainsäädännön muuttaminen’ [‘The amendment of consumer-credit provisions pertaining to instant loans’], report 17/2012, OM 17/41/2011 (in Finnish).

² According to the opinion of Suomen Pienlainayhdistys ry (the Finnish Instant Loan Association), included in the report of the Instant Loan Working Group (see Note 1).

³ The average APR was approximately 900% in 2011. See the report of the Instant Loan Working Group, p. 29 (see Note 1).

⁴ V. Mutttilainen. *Luottoyhteiskunta. Kotitalouksien velkaongelmat ja niiden hallinnan muodonmuutos luottojen säännöstelystä velkojenjärjestelyyn 1980- ja 1990-luvun Suomessa* [‘The Credit Society: The Indebtedness Problems of Households and Change from Credit Rationing to Debt Arrangements in 1980s and 1990s Finland’]. Helsinki 2002 (in Finnish); K. Rantala, H. Tarkkala. Luotosta luottoon. Velkaongelmien dynamiikka ja uudet riskiryhmät yhteiskunnan markkina- ja talouden peilinä [‘From trust to credit: The dynamics of indebtedness problems and new risk groups’]. – *Yhteiskuntapolitiikka* 2010/1, p. 20 (in Finnish).

⁵ V. Mutttilainen (see Note 4).

pertinent description in view of the fact that over 50% of Finns had some form of loan in 2013 and about a third of Finns had consumer credit, and that these proportions have been quite stable for about a decade.^{*6} However, the average amount of consumer credit has been decreasing over the last five years—in spring 2013, the average amount of consumer credit per debtor was EUR 8,100, but in 2009 the amount was EUR 9,800.^{*7} The most popular types of consumer credit are bank loans (16% of all consumer debtors), bank accounts with a credit limit (17%), credit cards (5%), and hire purchase (5%).^{*8} Instant loans are clearly more uncommon. Only 2.4% of all consumers who have some form of consumer credit had instant loans in spring 2013.^{*9}

At first it seems that instant loans do not play a remarkable role in consumers' total indebtedness. However, instant loans are a cause of **one third** of all court decisions related to consumer debt claims (see the chart in Section 9), heavily burdening the district courts and also enforcement authorities. In fact, this proportion has been increasing in the last five years.

Easily accessible instant loans have proved to be quite a popular financing product, especially for those lacking the opportunity to obtain a loan from a bank or other, similar credit company by reason of their weak financial standing. According to several research reports, instant loans have been the most common among consumers who engage in only short-term planning of their financial situation or who have problems with controlling their financial issues, along with those whose income is low or whose expenditures have exceeded their income, especially single parents, the young, and the unemployed.^{*10} Furthermore, about 60% of instant-loan debtors have taken out more than one instant loan.^{*11} Several Web forum discussions pertaining to instant-loan problems were analysed in 2012.^{*12} This research indicates that in some cases the shame of indebtedness and the fear of getting a bad credit history may even cause panic-driven obtaining of instant loans aimed at repayment of the previous loans. This reactive instant-loan behaviour results in skyrocketing indebtedness stemming from the high costs of the loans, but at the same time the over-indebted consumer may still retain a good credit history if paying back the loans on time. Instant loans are not the only reason for consumers' over-indebtedness problems, but they still play a considerable role: a survey of financial and debt advisers (conducted in 2011) indicates that about half of the advisers consider instant loans to be the main reason for the over-indebtedness problems of the majority of their clients.^{*13}

1.2. Overview of the consumer-credit regulations

The Consumer Protection Act^{*14} (CPA) is the general law applicable in business-to-consumer relations. The most important consumer-credit regulations can be found in its Chapter 7. In December 2010, the whole chapter was revised in connection with the implementation of the Consumer Credit Directive, but the chapter includes also non-harmonised, purely national provisions. The CPA's Chapter 7 includes regulation of consumer-credit contracts, consumer-credit marketing, and contractual relations to be followed

⁶ Federation of Finnish Financial Services. *Säästäminen, luotonkäyttö ja maksutavat* ['Savings, credits, and payments'], spring 2013 (in Finnish). Available via <http://www.fkl.fi/> (most recently accessed on 12.4.2014).

⁷ *Ibid.*

⁸ *Ibid.*

⁹ *Ibid.*

¹⁰ *Ibid.*; R. Kaartinen, J. Lähdemaa. *Miten ja mihin nuoret käyttävät pikavippejä ja muita kulutusluottoja?* ['For What Purposes and How Do Young People Use Instant Loans and Consumer Credit?']. Ministry of Trade and Industry (MTI-financed studies) 10/2006, November 2006; E. Valkama, V. Mutttilainen. *Maksuvaikeudet pikaluottomarkkinoilla* ['Payment Difficulties Associated with SMS Loans']. Helsinki: National Research Institute of Legal Policy (Research Communications No. 86) 2008, pp. 46–49 (in Finnish). See also A. Peltonen, Department of Consumer Law. *Kuluttajavelallisen aseman parantamiseen tähdänneet toimenpiteet 1990-luvulta lähtien* ['Measures Aimed at Improving the Position of the Consumer Debtor Since the 1990s in Finland']. Finnish Consumer Agency (Publications Series 1/2009), pp. 21–23 (in Finnish); O. Juurikkala. *Essays on Psychology and Morality in Economic Analysis of Law: Behavioral Paternalism in Consumer Credit Regulation*. Joensuu, Finland: Publications of the University of Eastern Finland (Dissertations in Social Sciences and Business Studies, No. 40) 2012, pp. 12–13.

¹¹ Federation of Finnish Financial Services (see Note 6).

¹² K. Rantala. *Vippikierteen muotokuva* ['The "portrait" of instant-loan thread']. National Research Institute of Legal Policy, Research Brief 24/2012 (in Finnish). Available via <http://www.optula.om.fi/> (most recently accessed on 12.4.2014).

¹³ Finnish Consumer Agency. *Kysely talous- ja velkanuovojille velkaantumisen taustatekijöistä 2011* ['Survey for Financial and Debt Advisers about the Background to Consumers' Indebtedness']. Available via <http://www.kuluttajavirasto.fi/> (most recently accessed on 12.4.2014) (in Finnish).

¹⁴ Kuluttajansuojalaki (Consumer Protection Act), 20.1.1978/38, as amended.

throughout the credit ‘life cycle’. In addition, Chapter 6a of the CPA sets forth some disclosure obligations for distance selling of various financial products, such as consumer credit.

Alongside the CPA’s Chapter 7, chapters 2 and 3 lay out general provisions on marketing to all kinds of consumers and on consumer relations, including those in which consumer credit is involved. In this respect, the legislation is based on the directive on unfair business-to-consumer commercial practices in the internal market (Directive 2005/29/EC). In practice, the role of these regulations is quite limited, as the CPA’s Chapter 7 contains very specific and detailed provisions addressing consumer-credit relationships and credit-marketing.

The Credit Information Act^{*15} (CIA) includes the provisions for personal and business credit data. According to the CIA, ‘**credit data**’ is defined as data pertaining to the payment ability or willingness to pay of a natural person or a company and that are used in granting or controlling of credit. Consequently, the provisions of the CIA are applied for almost all of the information handled during the lending process. The CIA also provides regulation on credit-data registries, such as requirements applying to credit-data businesses, the content of a credit-information register, and time limits associated with credit-data register entries.

The Interest Act^{*16} (IA) regulates the interest rate for late payment. In addition, an amendment to the Consumer Protection Act, which entered into force on 1.6.2013, imposes a limit on the interest rate for the cost of consumer credit of less than EUR 2,000.^{*17}

The Act on Registration of Creditors^{*18} (also referred to as the Registration Act, or RA), which was enacted in connection with the comprehensive reform of the CPA’s Chapter 7, requires that consumer creditors principally hold a certain registration if they are to be allowed to conduct consumer lending business. The purpose of the act was to enhance the supervision of consumer lending and to ensure the professionalism and reliability of the creditors.

In addition to consumer-protection legislation, there are several laws that apply in cases of consumer indebtedness and payment problems. The Debt Collection Act^{*19} (DCA) regulates the debt collection related to consumer credit and other receivables from consumers, setting forth, *inter alia*, good debt-collection practice, limitations to debt-collection costs, and disclosure obligations. Consumers’ financial and debt counselling is a governmental service with its own special law (the Act on Financial and Debt Counselling^{*20}). The over-indebted consumer has an opportunity to apply for the adjustment of private debts under the Act on the Adjustment of the Debts of a Private Individual^{*21} (Debt Adjustment Act, or DAA), which is a court process.

If the consumer and the creditor have a disagreement related to the credit agreement, a consumer can apply for a settlement process involving the Consumer Disputes Board, which is a statutory alternative dispute-resolution organ (see the Act on the Consumer Disputes Board^{*22}). The Consumer Disputes Board is entitled to announce non-binding decisions on disputes between consumers and businesses. Another finance-related alternative dispute-resolution body is the Banking Complaints Board of the Finnish Financial Ombudsman Bureau (FINE), which handles only banking-related disputes. Both FINE and its Banking Complaints Board were established by the Federation of Finnish Financial Services, the Finnish Financial Supervisory Authority (FSA), and the Consumer Agency by mutual agreement.

1.3. Instant-loan regulation: Key turning points

The consumer-credit-related legislation has been revised several times. From the perspective of consumer credit—in particular, instant loans—there have been three main legislative amendments in recent years. These amendments are briefly introduced in this section of the paper, but they are dealt with more thoroughly in the following sections.

¹⁵ Luottotietolaki (Credit Information Act), 11.5.2007/527, as amended.

¹⁶ Korkolaki (Interest Act), 20.8.1982/633, as amended.

¹⁷ CPA, Chapter 17, Section 17 a.

¹⁸ Laki eräiden luotonantajien rekisteröinnistä (Act on Registration of Creditors), 27.8.2010/747, as amended.

¹⁹ Laki saatavien perinnästä (Debt Collection Act), 22.4.1999/513, as amended.

²⁰ Laki talous- ja velkaneuvonnasta (Act on Financial and Debt Counselling), 4.8.2000/713, as amended.

²¹ Laki yksityishenkilön velkajärjestelystä (Act on the Adjustment of the Debts of a Private Individual), 25.1.1993/57, as amended.

²² Laki kuluttajariitalautakunnasta (Act on the Consumer Disputes Board), 12.1.2007/8, as amended.

The first amendment to the CPA's Chapter 7, which entered into force in February 2010, established new obligations for consumer creditors, such as identification of the consumer and banning of night-time lending. In addition, the criminalisation of usury was revised to match the current conditions. These regulations are purely national—not based on EU-level directives.

Immediately after this, the comprehensive reform of Chapter 7 of the CPA entered into force in December 2010. The primary objective with this reform was the implementation of the EU Consumer Credit Directive (CCD), but still the previous amendments were preserved. The new Chapter 7 also includes regulations on good lending practice and the creditor's obligation for assessment of a consumer's creditworthiness. In addition, it established a supervision system and an obligation of registration for all consumer creditors. Consumer-credit agreements for under EUR 200 were beyond the scope of the CCD, but, because of the problems detected with instant loans, the reform of consumer-credit legislation was developed to cover all types of consumer credit.^{*23}

Thirdly, the most recent and most essential amendment, entering into force in June 2013, made provisions for a maximum annual percentage rate of charge allowed for a consumer credit. In addition, it specified an obligation of assessment of creditworthiness. These legislative changes too are completely national in nature.

2. Registration of consumer-credit providers

The Consumer Credit Directive's Article 20 requires that Member States ensure that creditors be regulated or be supervised by a body or authority independent from financial institutions. In Finland, this article was implemented by establishment of a system of registration of consumer creditors via the Registration Act. The Consumer Credit Directive itself does not require licensing or a registration system for consumer creditors, but in Finland, this solution was deemed necessary to ensure the reliability and professional qualifications of consumer creditors and to facilitate the supervision of the consumer lending business.^{*24}

Pursuant to the Registration Act, only a registered consumer creditor is eligible to engage in consumer-credit business.^{*25} The obligation to register does not, however, apply to institutions that are under the Finnish FSA's supervision, consumer creditors that finance only the acquisition of consumer goods they sell, the government, or a creditor from another EEA country who temporarily provides consumer credit in Finland.^{*26}

The registration of consumer creditors is not only based on notification; the creditor must meet the qualifications for registration under the law. The registration requirement for consumer creditors means, in fact, that consumer lending is a licensed business.^{*27} First, a consumer creditor must meet the standard criteria to conduct business in Finland and not be the subject of bankruptcy proceedings.^{*28} If the consumer creditor is a natural person, that person must also be of legal age, and that person's competence to enter into a contract must not be limited.^{*29} Secondly, the special requirements for a consumer lending business are **reliability** and **the necessary knowledge of the consumer lending business**,^{*30} which are described in more detail below.

During the registration process, the registration authority will perform a reliability assessment, which means evaluation, from the reliability perspective, of all persons in charge of business, such as:^{*31}

- a private entrepreneur;
- the CEO and deputy CEO;
- the members and deputy members of the Board of Directors;
- the members of the supervisory board and corresponding members of the institution;

^{*23} Government bill HE 24/2010 vp, p. 13.

^{*24} *Ibid.*, Chapter 4.3.

^{*25} RA, Section 2.

^{*26} RA, Section 1.

^{*27} Government bill HE 24/2010 vp, Chapter 4. K. Määttä. Pikaluottojen sääntely oikeustaloustieteellisestä näkökulmasta ['Instant-loan regulation from the perspective of law and economics']. – *Lakimies* 2010/3, p. 278 (in Finnish).

^{*28} RA, Section 4.

^{*29} *Ibid.*

^{*30} *Ibid.*

^{*31} RA, Section 5.

- general partners (in partnership companies);
- other members of senior management; and
- those who, directly or indirectly, own at least one tenth of the shares or voting rights or have comparable control of ownership.

A person shall not be considered **reliable** if he or she has been sentenced to imprisonment in the last five years or has within the past three years been sentenced to another penalty for a crime on account of which he or she may be considered to be unsuitable to hold a responsible position in a consumer lending company or act as a significant shareholder.^{*32} Also not considered reliable is a person who otherwise has been proved by his or her past activities to be unsuitable for the corresponding task.^{*33}

The consumer creditor is required to possess **the necessary knowledge of consumer lending**, in view of the nature and extent of the consumer lending business.^{*34} Only members of the creditor's senior management are required to meet the knowledge criteria.^{*35} According to the government bill for the act, this means collective assessment: each member of the senior management need not have all of this knowledge; it is sufficient that the senior management as a whole fulfil the consumer lending knowledge requirements.^{*36} Basically, one or some of the members of the senior management must meet all of these requirements. If the creditor also conducts other business than consumer credit, the requirement applies to those persons who are actually responsible for credit operations.^{*37}

The necessary knowledge of consumer lending is described in the government bill as knowledge of consumer-credit regulation, along with technical knowledge, skills, and complementary personal qualifications. Knowledge about consumer lending can be based on several years of practical work experience in the consumer lending business or appropriate education—for instance, an academic degree in business or law. The larger the consumer lending business, the higher the standards for the knowledge of consumer lending required.^{*38}

3. Responsible lending

3.1. Background

The Consumer Credit Directive does not actually set forth an obligation for the Member States to issue responsible lending standards in their legislation. The Consumer Credit Directive does, as a recommendation, encourage the Member States to promote responsible consumer lending practices.^{*39} Responsible lending, however, played a clearly stronger role in the preparation of the present directive. For example, in 2005 the Commission proposed that, in the provisions of the Directive, the creditor and credit intermediary would be required to comply with a specific **principle of responsible lending**.^{*40} This requirement was not included in the final directive.

In Finland, there was seen to be an increasing need for provisions for responsible lending practices, not only because of the directive-based recommendation but also due to the fact that consumer lending had become more common, the supply of credit had increased, and new types of consumer credit (such as instant loans) had emerged.^{*41} Consequentially, the Finnish legislator issued the provisions on **good lending practice** that took their place in the CPA's Chapter 7. Good lending practice was meant to refer to the general terms for consumer marketing, procedures in business-to-consumer relations, and prohibition of unfair contract terms. However, a special provision on good lending practice was necessary for reasons of clarity.^{*42}

³² *Ibid.*

³³ *Ibid.*

³⁴ RA, Section 4.

³⁵ RA, Section 6.

³⁶ Government bill HE 24/2010 vp; proposal of RA, Section 6.

³⁷ RA, Section 6.

³⁸ Government bill HE 24/2010 vp; proposal of RA, Section 4.

³⁹ Consumer Credit Directive, Introduction, Chapter 26.

⁴⁰ COM(2005) 483 final, Article 5.

⁴¹ Government bill HE 24/2010 vp, Chapter 3.4.

⁴² *Ibid.*, Chapter 4.2.

The provisions for responsible lending can be found in the CPA's Chapter 7 under the same subheading ('The Creditor's Duty of Responsible Conduct'). These responsible lending provisions are divided into good lending practice, obligation to assess the consumer's creditworthiness, and verification of the consumer's identity.^{*43}

3.2. Good lending practice

Consumer creditors are required to comply with **good lending practice**^{*44} as an essential part of responsible lending obligations, accordingly:

The creditor shall act responsibly in lending.

It is required in particular that the creditor:

- 1) not market credit in manner that could clearly impair the consumer's ability to consider carefully whether or not to obtain the credit;
- 2) not use the granting of credit as the primary marketing method when marketing other consumer goods or services;
- 3) not collect additional fees and charges for text messages or other communication services in credit-marketing, credit-granting, or other customer service;
- 4) provide the consumer with sufficient and clear information prior to the conclusion of the credit agreement, for the consumer to assess whether the credit is suitable for his or her needs and financial situation; and
- 5) in situations of payment delay, provide the consumer with information and advice on how to prevent the occurrence or worsening of payment difficulties, manage situations of inability to pay, and take a responsible approach to payment arrangements.

The provisions laid down in Subsection 1 and Subsections 2(1–4) also apply to credit intermediaries. The provisions laid down in Subsection 2(4), however, do not apply to suppliers of goods or services that act as credit intermediaries in an ancillary capacity.

The legislative history points to the main purpose of good lending practice as being to prevent inappropriate lending practices and highlight the creditor's obligation to act openly and honestly, along with consideration for the interests and financial situation of the consumer.^{*45} Good lending practice is intended to be a flexible legal norm, suitable for various types of consumer credit and changes in financial products, reinforcing the general consumer marketing and consumer relations provisions in the CPA's chapters 2 and 3, along with other consumer-credit regulations, in the CPA's Chapter 7.^{*46} The whole 'life cycle' of the consumer credit—from credit-marketing to debt-collection procedures and dispute resolution—should be subject to the obligations of good lending practice.^{*47}

In essence, the aim of good lending practice is to prevent consumers' over-indebtedness. The creditor shall not grant a loan when the applicant's financial situation does not indicate the ability to repay the loan.^{*48} Under the CPA, the consumer creditor shall first assess the consumer's creditworthiness on the basis of the consumer's incomes and other sufficient financial information (see Subsection 3.3). Good lending practice, in practice, consists of following **certain minimum financial requirements** for granting of consumer credit.^{*49}

The minimum requirements for granting of a loan are not described in the law, but the government bill uses the credit-data register as an example for evaluation of the sufficiency of the consumer's financial situation. For instance, several payment defaults in the credit-data register may pose a hindrance to granting of credit, while a single payment default does not necessitate an absolute prohibition of lending. In the cases

⁴³ CPA, Chapter 7, Sections 13–16.

⁴⁴ CPA, Chapter 7, Section 13.

⁴⁵ Government bill HE 24/2010 vp, p. 33.

⁴⁶ *Ibid.*

⁴⁷ *Ibid.*

⁴⁸ A. Makkonen. *Vastuullinen luotonanto* ['Responsible Lending']. Jyväskylä, Finland 2012, pp. 150–151 (in Finnish); government bill HE 24/2010 vp, p. 33.

⁴⁹ A. Makkonen (see Note 48), p. 150.

of default on payment, the creditor is obliged to take into consideration the number and the type of the payment defaults, alongside how recent the defaults are and the reasons for them.^{*50}

When taking into account the aim of good lending practice, one should not approach the question of the minimum financial requirements for the consumer only from the perspective of credit history; also the consumer's financial situation must be taken into consideration, as a whole.^{*51} As is explained in Subsection 13, Finnish credit-data registers include only information on payment default—they do not describe the consumer's financial situation overall. In addition, the obligation to assess a consumer's creditworthiness requires the creditor to conduct the evaluation of the consumer's financial situation by using information on income and other relevant financial matters. In this way, these two obligations—of creditworthiness assessment and good lending practice—must be applied as a whole.

Marketing that could impair the consumer's decision-making are expressly prohibited in line with good lending practice.^{*52} For example, marketing credit as a risk- and worry-free solution to financial difficulties, or by highlighting the instant access to credit while at the same time agitating toward ill-considered borrowing, does not comply with good lending practice.^{*53} Furthermore, good lending practice rules out giving additional benefits or a lottery a dominant position in the marketing of credit products, and the same is true of offering additional interest or a discount on the condition that a product is bought on credit.^{*54} The main message of credit marketing should be the credit itself and the features of the credit.^{*55} It must be noted that the Consumer Protection Act uses the term 'marketing', which in the Finnish legal praxis means not only advertising but also other ways to provide information to the consumer and practices aimed at entering into a contract.^{*56}

Good lending practice requires that sufficient and clear information be disclosed to the consumer in support of the consumer's decision-making.^{*57} The creditor must provide adequate and clear explanations, to enable the consumer to assess whether he or she is able to fulfil the obligations of the credit contract and also evaluate which credit product would be the most appropriate. Moreover, additional information should be provided when requested by the consumer.^{*58} Standardised information for the consumer is not always sufficient, especially with more complex credit products and larger loan amounts.^{*59}

Applied over the entire life cycle of the credit relationship, good lending practice requires the creditor to disclose information, provide advice in cases of payment difficulties, and have a responsible approach toward payment arrangements.^{*60} The creditor's obligations in payment difficulty situations are addressed in Section 5.

The provision on good lending practice was updated in June 2013 with a prohibition of collecting additional costs related to marketing of credit, loan applications, or customer service. This provision prevents only these additional costs' collection by the creditor—the consumer is still obliged to pay, for example, the phone operator's fee for the call.^{*61} This amendment is linked to regulation of maximum rates, aimed at preventing adding extra costs to consumer credit in other ways. Maximum interest rates' regulation is explained in more detail in Subsections 6.1–6.3.

3.3. Assessment of creditworthiness

Another essential part of responsible-lending-based obligations is that of assessing the consumer's creditworthiness, which is a mandatory action for consumer creditors under the CPA. Prior to entry into a credit agreement, the creditor is obliged to **evaluate whether the consumer can fulfil the obligations of**

⁵⁰ Government bill HE 24/2010 vp, p. 33.

⁵¹ A. Makkonen (see Note 48), p. 151.

⁵² CPA, Chapter 7, Section 13.

⁵³ Government bill HE 24/2010 vp, pp. 33–34.

⁵⁴ *Ibid.*

⁵⁵ *Ibid.*

⁵⁶ Government bill HE 32/2008 vp, p. 19.

⁵⁷ CPA, Chapter 7, Section 13.

⁵⁸ Government bill HE 24/2010 vp, pp. 34–36.

⁵⁹ *Ibid.*

⁶⁰ *Ibid.*, pp. 33–36.

⁶¹ Government bill HE 78/2012 vp, p. 18.

the credit contract.^{*62} The creditworthiness assessment shall be conducted on the basis of all sources of the consumer's **income** as well as **other sufficient financial information.**^{*63}

In the legislative history, the function of the creditworthiness assessment obligation has been described more extensively. The key factor is verifying that the consumer's financial situation is sufficient in relation to the credit obligations by using a credit-data register,^{*64} which is generally considered an integral part of professional consumer lending. While this information does not in itself detail the consumer's overall financial standing, it does indicate whether the consumer has been in serious default on payment.^{*65} Granting a loan without checking the credit history would be possible only in exceptional circumstances, notably in the situation wherein the creditor is already familiar with the consumer's financial background on the basis of their prior customer relationship.^{*66}

Determining the consumer's credit history or using a credit-scoring system is not sufficient on its own for fulfilling the obligation of a creditworthiness assessment. According to the legislative history, the creditor is also obliged to evaluate the consumer's **actual ability** to repay the loan. Therefore, creditworthiness must be assessed not only on the basis of the consumer's income (that is, all income received by the consumer) but also in view of the type(s) of income involved. Subsequently, types of income such as salary and pension, as well as expenditures, debts, assets, and other property, must be taken into consideration, along with a determination of whether the consumer is already a guarantor. The creditor should also take into account any factors affecting the continuity of income, such as whether the consumer's employment is fixed-term or permanent. Furthermore, the factors that may effect an increase of expenditure, such as the risk caused by rising interest rates, should be included in the overall evaluation.^{*67}

The requirement of a creditworthiness assessment applies for small consumer loans too.^{*68} However, the extent of the creditworthiness assessment also depends on the amount of the consumer credit; the higher the amount, the more thorough the procedure and the more the financial information needed.^{*69} For example, analysing the effects of possible rising interest rates is relevant only for larger loan amounts and longer loan periods—as in the case of housing loans.

Furthermore, it is required that the creditor not use only, for example, 'checkboxes' on the loan application forms and Web pages when collecting information related to the consumer's financial standing. The creditor should also reasonably ensure that the information given by the consumer is true and correct, by, for example, requesting additional documentation on income sources (salary, pension, etc).^{*70}

3.4. Verification of a consumer's identity

The third part of the responsible lending provisions under the CPA is a creditor's obligation to verify the consumer's identity and to retain the verification data.^{*71} This was included in the first amendment pertaining to instant loans, which came into force in February 2010. The purpose of the provision is to prevent delinquency in consumer lending, especially for situations wherein a false identity is used when one is applying for credit.^{*72} In addition, the personal-data legislation reinforces this obligation, as was held in a Supreme Administrative Court case wherein granting a loan without verifying the loan applicant's identity was deemed contrary to the general principles of personal data's protection under the Personal Data Act.^{*73}

^{*62} CPA, Chapter 7, Section 14.

^{*63} *Ibid.* The provision on creditworthiness assessment came into force in December 2010 and was revised in June 2013. The original provision required creditworthiness assessment **on the basis of sufficient information on the amount of credit and other circumstances.** The main reason for the reform was that a creditworthiness assessment obligation was seen as appropriate also in cases of consumer loans for smaller amounts, such as instant loans. See government bill HE 78/2012 vp, p. 11.

^{*64} Government bill HE 24/2010 vp, pp. 35–36; government bill HE 78/2012 vp, pp. 18–19.

^{*65} Government bill HE 241/2006 vp, p. 12.

^{*66} Government bill HE 24/2010 vp, pp. 35–36; government bill HE 78/2012 vp, pp. 18–19.

^{*67} *Ibid.*

^{*68} *Ibid.*

^{*69} *Ibid.*

^{*70} *Ibid.*

^{*71} CPA, Chapter 7, Sections 15–16.

^{*72} Government bill HE 64/2009 vp, pp. 20–22.

^{*73} Case KHO (referring to the Supreme Administrative Court) 8.1.2010, No. 1568/1/09.

According to the CPA, the creditor is obliged to take care to verify the consumer's identity prior to entry into a credit agreement.^{*74} If the creditor verifies the consumer's identity electronically, the identification method used must meet the requirements stated in the Act on Strong Electronic Identification and Electronic Signatures.^{*75} On a practical level, these requirements mean that the verification methods permissible are an **official identification document** (such as a passport, driver's licence, or identity card issued by the government) and **strong electronic identification** such as an officially issued electronic identity card, online banking credentials, or a mobile certificate that meets the applicable standards of the law. Once the identity verification has been initially conducted by means of an official identity document or strong electronic identification, the consumer's identity may thereafter be verified via a personal identifier—for instance, a consumer-specific PIN code.^{*76}

4. Regulations on credit data

4.1. The general principles of credit-data regulation

The Credit Information Act^{*77} regulates issues related to the use of credit data. According to the CIA, '**credit data**' refers to information that is intended to indicate ability to pay, a willingness to pay, or other relevant financial information.^{*78} It is essential to note that the CIA covers not just credit information from business and credit-data registers but also **all data detailing the party's financial standing**, such as information on income sources, expenditures, financial commitments, and corresponding information. Accordingly, the CIA applies to the entire creditworthiness assessment process and is not limited to issues related to credit-data registers.

The CIA regulates requirements and restrictions on credit data that the creditor is obliged to follow when granting or controlling credit. Therefore, the provisions of the CIA must be applied in conjunction with the obligation of creditworthiness assessment as regulated in the CPA. It can be concluded that the CIA limits in a certain way the information that a creditor is entitled to utilise in the credit-granting process. On the other hand, the guiding principle of the CIA is that the credit assessment must be carried out by means of necessary and relevant information.^{*79} On a practical level, this means that the CIA does not necessarily set restrictions on utilising relevant information that objectively describes the consumer's financial standing.

When handling credit data, the creditor is obliged to comply with **good credit-data practice**. This requires that credit data be handled carefully, that the quality of the credit data be ensured, and that disclosure obligations and data security be maintained. Furthermore, the data must be kept secure in a proper and appropriate manner, and the internal supervision for proper handling of credit data must be ensured. An important principle to be upheld is that the customer has the right to be evaluated only on the basis of relevant and accurate information.^{*80}

The CIA provides more detailed requirements regarding credit data's quality and information sources that the creditor is allowed to use. Only necessary and relevant financial information may be used in the credit-granting process. The creditor is entitled to obtain credit data directly from a credit-data register, an appropriate official register, or the creditor's own customer database. Other credit data shall be obtained only with the consumer's consent.^{*81}

⁷⁴ CPA, Chapter 7, Section 15.

⁷⁵ *Ibid.*

⁷⁶ *Ibid.*

⁷⁷ See Note 15.

⁷⁸ CIA, Section 3.

⁷⁹ CIA, Sections 5 and 6.

⁸⁰ CIA, Section 5.

⁸¹ CIA, Section 6.

4.2. The information provided by credit-data registers

Finnish credit-data registers covering individuals are based on **negative credit information**, which means information on **payment default**. The credit-data legislation does not allow registering positive credit information—in other words, information on outstanding debts and other financial commitments. Legislative actions related to a positive credit-data register were recently considered, but the report^{*82} on the legal background recommended that new credit-information legislation not be initiated yet, because of, for instance, the forthcoming personal-data regulation at the EU level intended to harmonise the personal-data legislation of all EU member states.

The CIA includes provisions on requirements for the credit-data business,^{*83} entries in credit-data registers^{*84}, and retention periods for register entries^{*85}. Credit-data registers are non-public and maintained by privately held businesses.^{*86} The CIA merely sets restrictions and limitations for using and collecting credit data, which means that the minimum coverage of a credit-data register is not regulated. In practical terms, the coverage of the credit-data register is also a business question for the provider of credit data; therefore, credit-data providers usually intend to maximise the information contained in the register.

A credit-data register essentially consists of information included in several official registers, but the information sources also include the creditors and the consumers themselves. Accordingly, a credit-data register collects information on payment default from several sources and consolidates this into a single register.^{*87} Credit-data-register information on private persons is restricted and is to be used only for purposes that are permissible under the CIA, such as consumer lending. However, it is important to note that most of the credit information included in official source registers, such as court registers and enforcement registers, is public—even when the information pertains to private persons.

Credit-data registers include a wide range of information, from diverse judicial processes related to default on payment. The enforcement process for private debts is divided into two phases in Finland: the creditor must firstly claim the receivable in a court procedure^{*88} prior to the debt-enforcement process. The credit-data registers include information on both of these phases: the court decisions on debts and also on long-lasting debt-enforcement processes and lack of assets and possessions on the debtor's part. Information on other debt-related court proceedings—namely, a private person's debt adjustment, business restructuring, and bankruptcy—can also be entered in a credit-data register.

When a private person's debt adjustment is based on an agreement between the debtor and the creditors instead of court proceedings, a credit-data-register entry pertaining to the contract is possible, but only **the debtor** is entitled to apply for this registration.^{*89} The requirements state that the debtor must confirm the payment default and the debt arrangement must concern several creditors, or the arrangement must otherwise be extensive.^{*90} On a practical level, creditors usually require the credit-data-register entry before entering into a debt-adjustment agreement.^{*91}

The creditor is entitled to report an overdue payment to the credit-report register only if the payment is at least 60 days overdue and the possibility of a credit-data-register entry is specified in the terms and conditions

⁸² A. Saarenpää. *Näkökohtia luottotietojen kokoamisen ja käytön sääntelystä* ['Perspectives on the Regulation of Gathering and Using of Credit Information']. Ministry of Justice, Reports and Guidelines 22/2013.

⁸³ CIA, Chapter 3.

⁸⁴ CIA, Sections 12–15.

⁸⁵ CIA, Section 18.

⁸⁶ There are currently two credit-data-register companies in Finland: Suomen Asiakastieto Oy and Bisnode Finland Oy (the latter provides credit information via the Soliditet credit-data register).

⁸⁷ A. Makkonen (see Note 48), p. 99.

⁸⁸ The most common court procedure related to debts with a specific sum, based on a contract, a commitment, or other written evidence, is the **summary procedure**, which can be used when the matter is not under dispute. It is more straightforward than the regular civil procedure: only a brief application for summons is required, and the creditor is not obliged to attach written evidence to the application. As in all civil procedures, the court will notify the debtor about the procedure in written form, and if the debtor does not submit a defence to the court within the given time, the court will pass judgement in favour of the creditor—unless the creditor's claim is clearly without basis. However, if the creditor's claim turns out to be unclear or under dispute, the case shall be transformed into a regular civil procedure. See the Code of Judicial Procedure ('oikeudenkäymiskaari'), 4/1734 (as amended), Chapter 5.

⁸⁹ CIA, Section 13.

⁹⁰ *Ibid.*

⁹¹ A. Makkonen (see Note 48), p. 110.

of the credit agreement. In addition, the creditor is required to send an appropriate notice to the debtor with 21 days' notice prior to entry in the register. It is important to note that entry in the credit-data register is not possible when the debtor and creditor have agreed on a new payment schedule for the outstanding debts.^{*92}

In addition to payment-default information, the credit-data register can include information pertaining to contract-related competence, to ensure the legal competence of the person. The source is the public guardianship register, maintained by the local register offices of Finland.^{*93}

A person may also apply for a credit-data register entry for '**own credit stoppage**',^{*94} usually with the purpose of preventing the financial consequences of identity theft, such as use of a false identity when one is applying for credit.^{*95} A reason for such a credit-data-register entry need not be given, and the register provider must allow the entry upon receiving the application. Conversely, the register entry may be removed at any time. This register entry is intended to constitute additional information for the purpose of greater prevention of the risk of identity theft.

From the legal perspective, the 'own credit stoppage' does not cause invalidity of credit agreements or other contracts. Consumer creditors are, however, obliged to comply with good lending practices overall with regard to the consumer-credit relationship and the credit-granting process. From this perspective, the creditor's reasonable obligation would be that the consumer's identity must be protected and, therefore, verified with a caution commensurate with the best practices generally available. In practice, some consumer creditors tend not to grant loans via electronic means when the consumer has an 'own credit stoppage'.^{*96}

The retention periods for credit-data-register entries are 2–5 years, depending on the type of the credit-data-register entry.^{*97} Register entries are generally not removed upon the debt's repayment, but the debtor may submit a notification in the form of supplementary information.^{*98} The debtor may also submit additional relevant information pertaining to debts—for instance, detailing the reasons for a payment default. In some cases, the debt's repayment may shorten the retention period.

Use of a private person's credit information is limited to only specific situations. In consumer lending, the main situations in which this is permissible are credit-granting, credit control, and debt-collection planning.^{*99} Outside these purposes, using any credit-data information—including credit-data registers and other credit details—is not possible. The consumer must be informed of the use of a credit-data register in advance of the application for credit.^{*100}

5. Regulation of the consumer's payment difficulties

5.1. Responsible lending and good debt-collection practice

As is mentioned in Subsection 3.2, above, good lending practice requires the creditor to provide information and advice in situations of payment difficulty, and it requires the creditor to approach payment arrangements in a responsible manner.

Firstly, good lending practice requires creditors to advise consumers and disclose additional information related to payment difficulties. It has been stated in the legislative history that it is required that the creditor encourage the consumer to contact the creditor in situations of payment delay and supply relevant information about the authorities that provide debt counselling. In addition, the creditor must provide information about the arrangements for debts, along with the possible consequences of delayed payment, such as termination of the credit agreement, late-payment interest, debt collection, and payment-default entries in credit-data registers. In practice, this information can be provided, for example, in connection

⁹² CIA, Section 14.

⁹³ CIA, Section 12.

⁹⁴ CIA, Section 12.

⁹⁵ In practice, it is usual that 'own credit stoppage' is also used to prevent over-indebtedness.

⁹⁶ A. Makkonen (see Note 48), pp. 157–158.

⁹⁷ CIA, Sections 17–18.

⁹⁸ CIA, Section 13, Subsection 2.

⁹⁹ CIA, Section 19.

¹⁰⁰ CIA, Section 29, Subsection 2.

with payment reminders. Nonetheless, information about possible consequences of payment delays must not be misleading or exaggerated. Guidelines on good debt-collection practice require that the consumer be informed only of the likely consequences of certain payment-default situations.^{*101}

Secondly, good lending practice requires the creditor to maintain a responsible approach to payment arrangements. According to materials forming part of the legislative history, this does not oblige the creditor to agree to all of the proposed arrangements for payment, but the systematic refusal of payment arrangements should be considered contrary to good lending practices. Possible debt arrangements might be, for instance, a new due date for the payments, reduction of the monthly payments, extension of the loan term, aggregation of several separate loans, instalment-free periods, and the reference rate's modification to reduce the interest rate. The creditor is still allowed to assess whether the arrangement is reasonable under case-specific circumstances and is encouraged, when possible, to seek a conciliatory solution in collaboration with the consumer.^{*102}

In addition to good lending practice, the creditor is obliged to comply with **good debt-collection practice**, which also includes an obligation to approach the payment arrangements in a responsible manner. During the debt-collection process, false or misleading information on the consequences of payment delays is prohibited, as is causing unreasonable or unnecessary costs or harm or jeopardising the debtor's right to privacy. It is contrary to good debt-collection practice to attempt to collect a time-barred or otherwise invalid debt.^{*103}

5.2. Financial and debt counselling

In Finland, financial and debt counselling is a government-based, charge-free service for private persons that is based on certain legislative acts and overseen by the Competition and Consumer Agency. Financial and debt counselling is intended to prevent over-indebtedness of private persons by providing advice on payment difficulties and assisting them in solving their various debt problems. The Regional State Administrative Agencies entitle service providers—which can be public authorities such as municipalities, social and health departments, and religious congregations, along with private (profit or not-for-profit) organisations, to provide these services. Financial advisers who work for certified financial- and debt-counselling providers are entitled to assist their clients in a private person's debt-adjustment process when there has been a court filing.^{*104}

5.3. Adjustment of private debts

The adjustment of private debts is a court process applied for by the insolvent private person. It can be characterised as among **general insolvency proceedings**, as it encompasses all of the debtor's debts and other outstanding financial commitments, such as guarantees. After the court has determined that the debtor fulfils the requirements for debt adjustment, the court is entitled to confirm a new payment schedule for the outstanding debts, which may include, for instance, making reductions in the total amount of the debt (except in cases of secured loans); reducing interest rates, and adjusting the provisions for liquidating the debtor's assets and possessions.^{*105} Usually the payment schedule for the debt adjustments covers 3–5 years, depending on the debtor's situation.^{*106} If the debtor's income increases during this time, the debtor is obliged to pay an additional amount correspondingly.^{*107} Once the debtor successfully fulfils the obligations set forth in the payment schedule, the debts and financial commitments specified through the debt adjustment no longer apply.^{*108}

¹⁰¹ CPA, Chapter 7, Section 13; government bill HE 24/2010 vp, pp. 33–36; DCA, Section 4; government bill 199/1996, Chapter 2.1; Competition and Consumer Authority guidelines 'Good Debt-Collection Practice in Consumer Relations' (i.e., *Hyvä perintätapa kuluttajaperinnässä*), p. 5.

¹⁰² CPA, Chapter 7, Section 13; government bill HE 24/2010 vp, pp. 33–36.

¹⁰³ DCA, Section 4.

¹⁰⁴ Laki talous- ja velkaneuvonnasta (Act on Financial and Debt Counselling), 4.8.2000/713, as amended.

¹⁰⁵ DAA, Section 34.

¹⁰⁶ DAA, Section 30.

¹⁰⁷ DAA, Section 35 a.

¹⁰⁸ DAA, Section 40.

The requirements of a private debt adjustment are judged from need and social circumstances. The first requirement is that the applicant be **permanently** insolvent, which means permanent inability to fulfil the financial commitments.^{*109} The debt-adjustment process is not possible in cases of temporary payment difficulties that are due, for instance, to short-term unemployment. The second requirement for debt adjustment is the debtor's social circumstances: illness, inability to work, long-term unemployment, or other change in circumstances that fundamentally reduces payment ability.^{*110} It must also be proved that the over-indebtedness is not primarily the debtor's own fault.^{*111}

However, there are circumstances that may prevent the approval of the private debt-adjustment process. These may involve criminal or improper behaviour of the debtor, such as an irresponsible approach to financial commitments; arrangements that have weakened the position of creditors; false or misleading information given in credit-granting or insolvency proceedings; hiding of assets, property, or income; or crime-based over-indebtedness.^{*112} Notwithstanding the above-mentioned factors, private debt adjustment can be exceptionally granted for weighty social reasons.^{*113}

A debt-adjustment procedure can later be cancelled by court decision. Reasons for cancelling debt adjustment include significant breach of the payment schedule by the debtor without justifiable reason, a pre-existing reason for denying the whole debt-adjustment process, the debtor endangering the payments by taking on new debt that is not based on need, and the debtor otherwise failing to co-operate in the debt-adjustment procedure. Once the debt-adjustment procedure is cancelled, the original terms and amounts of the debts will revert to the form they would have had originally without the debt adjustment. Interest on late payment does not accumulate during the duration of the debt adjustment, unless the court orders otherwise.^{*114}

A reform of the Act on the Adjustment of the Debts of a Private Individual is currently pending. The working group, appointed by the Ministry of Justice, suggests that a creditor's actions must also be taken into consideration in determination of the requirements for the debt-adjustment process.^{*115} The especially key issues would be good lending practice and the obligation to generate a creditworthiness assessment.^{*116} For instance, if the creditor is responsible for aggressive credit-marketing, has otherwise operated contrary to good lending practice, or has neglected the obligation of a creditworthiness assessment, entry into a debt-adjustment procedure may be granted as a result. This reform would likely encourage creditors to be careful to comply with good lending practice and the creditworthiness assessment obligation. On the other hand, the proposal can be criticised in cases wherein only some members of a group of creditors have acted counter to the responsible lending provisions, thus placing an undue burden upon those creditors who did comply with the applicable legal requirements.

6. The limitations to credit costs and the accessibility of credit

6.1. Regulation of credit prices

The provision pertaining to the maximum total cost for consumer credit—a so-called **interest-rate cap**—entered into force in June 2013 and is included in the CPA's Chapter 7. In cases wherein the consumer credit amounts to less than EUR 2,000, the actual annual percentage rate of interest must not exceed the reference rate under Section 12 of the Interest Act plus 50 percentage points.^{*117} When calculating the annual percentage interest rate, one must take into account the interest on the credit and the other credit costs

¹⁰⁹ DAA, Section 9.

¹¹⁰ *Ibid.*

¹¹¹ *Ibid.*

¹¹² DAA, Section 10.

¹¹³ DAA, Sections 9 and 10 a.

¹¹⁴ DAA, Section 42.

¹¹⁵ Ministry of Justice (Oikeusministeriö). Velkajärjestelylain tarkistaminen ['The revision of [the] Debt Adjustment Act']. Reports of the Ministry of Justice (or 'Oikeusministeriö, mietintöjä ja lausuntoja') 59/2013, pp. 84–85 (in Finnish).

¹¹⁶ *Ibid.*

¹¹⁷ CPA, Chapter 7, Section 17 a.

charged to the customer.^{*118} The interest-rate cap applies to all types of credit, including both running-account credit and lump-sum credit, with the exception of goods-or-services-related credit.

The reference rate under the IA's Section 12 is semi-annual and uses the European Central Bank (ECB)'s main refinancing-operations rate, rounded up to the nearest half-point. The Bank of Finland regularly publishes the reference rate.^{*119} As of this writing, the reference rate (for the period 1 January–30 June 2014) is 0.5% and the interest-rate cap is 50.5%.

6.2. Interest for late payment

The Interest Act includes provisions on the maximum interest for late payment in cases wherein the debtor is a consumer or the debt has to do with housing rent. Higher interest for late payment, along with commissions, fees, or similar payments that are intended to act as a substitute for the interest on late payment, cannot be applied under the law.^{*120}

The annual interest rate for late payment shall not exceed the reference rate referred to in the Interest Act's Section 12 plus seven percentage points,^{*121} which is the **statutory late-payment interest**. At the time of the writing of this article, the statutory maximum late-payment interest rate (for 1 January to 30 June 2014) is a total of 7.5%.

For many types of unsecured consumer loans, the original interest rate is well above the maximum interest allowed for late payment. In these cases, the creditor is still entitled to collect interest at the original rate and costs agreed upon in the credit agreement instead of the statutory late-payment interest. However, the original interest rate and costs may only be charged for up to 180 days after the total debt is fully due, and the maximum statutory late-payment interest thereafter. If the creditor has claimed the debt through a court process, the creditor is entitled only to the statutory late-payment interest from the court decision onward.^{*122}

6.3. Regulation of debt-collection costs

Pre-judicial-procedure debt-collection actions, by, for example, a debt collection agency, shall be carried out under the Debt Collection Act. The DCA includes provisions for limits to debt-collection costs, because excessively high costs have been determined to exacerbate consumers' over-indebtedness problems.^{*123} Debt collection is an essential part of instant-lending activities, especially on account of the large proportion of payment defaults. Some of the debt-collection agencies are part of the same financial entity (such as a corporate group) as the creditor.^{*124} A reform to the regulation of debt-collection costs took place in March 2013, when the legislator significantly decreased the maximum costs allowed for debt collection. The main reasons for the reform were the greater cost-efficiency now possible in debt-collection processes (thanks to, for example, development of data systems) and problematically high debt-collection costs.^{*125} Furthermore, high debt-collection costs have been widely noted by various media.^{*126}

The maximum limit for the debt-collection costs depends on the amount of the debt. For the same debt, the creditor—or the debt-collection agent—is allowed to charge the consumer no more than EUR 60 for debt amounts up to EUR 100, EUR 120 when the amount of the debt is at least EUR 100 but not less than EUR 1,000, and EUR 210 if the amount of the debt is more than EUR 1,000.^{*127}

¹¹⁸ CPA, Chapter 7, Section 6.

¹¹⁹ IA, Section 12 a.

¹²⁰ IA, Section 2.

¹²¹ IA, Section 4.

¹²² *Ibid.*

¹²³ Government bill HE 57/2012 vp, Chapter 3.5.

¹²⁴ *Ibid.*, p. 18.

¹²⁵ Research into debt-collection costs indicated that in many cases the debt-collection agencies did not comply with the recommended maximum total collection costs specified in the guidelines for good lending practice. See government bill HE 57/2012 vp, p. 28.

¹²⁶ Debt-collection costs have even been a topic of the popular television documentary series *MOT* ('Rahastusta velkakierteellä'), presented on the television channel YLE TV1 on 8.9.2008 and available also at http://yle.fi/elavaarkisto/artikkelit/rahas-tusta_velkakierteella_35891.html#media=35897 (most recently accessed on 12.4.2014) (in Finnish).

¹²⁷ DCA, Section 10 d.

However, the debtor is allowed to collect the actual costs in exceptional cases. This basically applies to situations in which the debt collection has been difficult, with consideration for the fact that the debt-collection acts undertaken would not be considered disproportionate, particularly with regard to the total amount of the debt in question. In these situations, it is required that the debtor discloses a detailed calculation of the debt-collection costs and the reasons for the higher costs.^{*128}

A court procedure is an obligatory phase before the legal-enforcement process. The maximum total court costs (in addition to debt-collection costs) that the creditor is able to claim from the debtor in summary procedures are—depending on the circumstances—usually EUR 115–166 (when the capital amount of the debt is up to EUR 300), EUR 145–206 (when the capital amount of the debt is at least EUR 300 but does not exceed EUR 1,000), or EUR 175–246 (if the amount of the debt is more than EUR 1,000).^{*129}

6.4. Usury

Levying of clearly disproportionate costs for credit is sanctioned as **usury** under the Criminal Code. The provision pertaining to usury was reformed in the first instant-loan regulation package, coming into force on February 2010. According to the Criminal Code, a person shall be sentenced for usury:

who takes or requires for himself or herself or another, an interest or other economic benefit that is clearly disproportionate to the performance of the creditor, taking into consideration:

- (1) the amount of credit granted, the period of credit and the other terms of the credit agreement;
- (2) the credit risk involved in the credit that has been granted;
- (3) the expenses incurred by the creditor that are part of the careful procedure for the granting of credit;
- (4) the ordinary expenses incurred in the financing of the credit;
- (5) the ordinary general expenses in credit granting services. (Chapter 36, Section 6)

As the wording of the Criminal Code indicates, even clearly disproportionate costs of credit fulfil the essential elements of usury—exploiting the debtor's predicament is not required. It is stated in the legislative history that all costs of the credit shall be taken into consideration, including the interest rates, fees, and commissions, along with other than monetary economic benefits, such as objects and possessions that have financial value.^{*130} However, corporate criminal liability does not apply in cases of usury. Only the management may be convicted.

It has been stated that the reform of the usury statute would have reduced the costs of instant loans. Some of the instant-loan companies were noticed to have changed their credit-cost policy in line with the examples articulated in the legislative history.^{*131} Moreover, an observation was made that the obligation to verify customers' identity and the regulation pertaining to the actual percentage rate were put into practice among creditors. Comprehensive studies have not been done, however. The examples cited above are mainly from random observations.^{*132}

Sentencing for usury in credit-granting situations is very rare in Finland—the most recent cases related to usury that came before the Supreme Court were in the 1950s.^{*133} However, after the renewal of the usury provision, the Consumer Ombudsman filed a report of an offence involving alleged usury in an instant-loan business, which recently led to prosecution of the chief executive officer of the creditor company.^{*134} In fact, the provision pertaining to usury can be considered unclear, especially in its definition of **clearly dispro-**

¹²⁸ DCA, Sections 10 a, 10 c, and 10 d.

¹²⁹ Ministry of Justice decree 14.12.2001/1311, as amended; government decree 19.12.2013/1058.

¹³⁰ Government bill HE 64/2009 vp; proposal of the Penal Code, Chapter 36, Section 6.

¹³¹ *Ibid.*

¹³² See J. Tapani. Kiskontarikokset: luottokiskonta ['Criminal usury: Credit usury']. – *Lakimies* 2010/4, p. 528 (in Finnish).

¹³³ *Ibid.*, p. 518.

¹³⁴ Bulletin of the Consumer Agency 'Poliisille tutkintapyyntö koronkiskonnasta' ['A report of an offence related to usury'], available at <http://www.kuluttajavirasto.fi/fi-FI/arkisto2010/verkkolehti-7-2010/poliisille-tutkintapyynto-kiskonnasta> (most recently accessed on 6.4.2014) (in Finnish); 'Pikavippifirman pomo saa kiskontasyytteen' ['A boss of an instant-loan company accused of credit usury'], an article on the Web site of the newspaper *Helsingin Sanomat*, available at <http://www.hs.fi/talous/a1363834412174> (most recently accessed on 6.4.2014) (in Finnish). The district court dismissed the charges in late July 2014 (at the time of writing, however, the decision may still be appealed).

portionate costs of credit. This may be one reason that prosecution and sentencing for usury are very rare. On the other hand, it would seem that the existence of a usury-related provision in the first place has had some preventive effects in the credit business.

6.5. Limitations on night-time credit accessibility

The first regulative package related to instant loans, which came into force in February 2010, included provisions for limitations to night-time credit-granting. This is purely national, non-harmonised legislation. Night-time granting of instant loans was considered a potential risk for imprudent loan applications, causing more indebtedness problems for consumers.^{*135} However, prior to the legislative actions, night-time lending was regarded as being against the general provisions on consumer marketing and consumer relations under the CPA's chapters 2 and 3, based on the decision of the Market Court in 2009.^{*136}

When credit is both applied for and granted between 11pm and 7am Finnish time, the amount of credit is not permitted to be dispensed to the consumer until 7am following the loan's approval.^{*137} Accordingly, if the credit had been applied for before 11pm, the amount of the credit is permitted to be dispensed to the consumer also during the night without restrictions. The law does not restrict submission of a loan application in such a manner; the consumer is permitted to apply for credit regardless of the time.

The restriction to dispensing of the credit amount applies only to new credit agreements, not to credit limits. According to the legislative history, this exception was seen as appropriate so as not to prohibit increasing a credit-card limit when the consumer is abroad in another time zone.^{*138} Moreover, the law does not set any restrictions to the use of credit cards, credit accounts, or other credit limits.^{*139}

7. Supervision

7.1. Supervisory authorities

Several authorities supervise the consumer-credit business. According to the CPA, the Consumer Ombudsman monitors compliance with the general provisions for consumer marketing and the terms and conditions of business-to-consumer-related agreements.^{*140} Furthermore, the Consumer Ombudsman and the Finnish Competition and Consumer Authority, along with its subsidiary Regional State Administrative Agencies, supervise compliance with the CPA's Chapter 7.^{*141} The Finnish Financial Supervision Authority supervises banks and other credit institutions.

In practice, the Consumer Ombudsman and the Competition and Consumer Authority can be considered a single authority, because the Consumer Ombudsman acts as director-general of consumer affairs for the Competition and Consumer Authority.^{*142} The Consumer Agency and the Competition Authority merged into the Competition and Consumer Authority at the start of 2013. Because of the merger of these authorities, the law expressly provides an independent position for the Consumer Ombudsman in a consumer-protection-related supervisory capacity.^{*143}

The Regional State Administrative Agency of Southern Finland, which maintains the consumer-creditor register, is also an important supervisory authority for consumer creditors. The agency's duties are to make decisions pertaining to consumer-creditor registration and to supervise consumer creditors' compliance with the provisions of the Registration Act. As was mentioned in Section , above, consumer creditors are required under the RA to have a legal right to conduct business in Finland, sufficient reliability, and the

¹³⁵ Government bill HE 64/2009 vp, p 17.

¹³⁶ Case MAO (referring to the Market Court) No. 257/09.

¹³⁷ CPA, Chapter 7, Section 19.

¹³⁸ Government bill HE 64/2009 vp, p. 18.

¹³⁹ *Ibid.*, p. 25.

¹⁴⁰ CPA, Chapter 2, Section 20 and Chapter 3, Section 4.

¹⁴¹ CPA, Chapter 7, Section 51.

¹⁴² Laki Kilpailu- ja kuluttajavirastosta (Act on the Competition and Consumer Authority), 30.11.2012/661, Section 3.

¹⁴³ Act on the Competition and Consumer Authority, Section 4.

necessary knowledge of consumer lending. In addition, the Registration Act expressly requires that the consumer creditor comply with good lending practice and with other legal requirements related to consumer lending.^{*144} In point of fact, this widens the supervisory duties of the agency toward general supervision of the lending business—such supervisory duties are not limited to only registration requirements. The supervision conducted by the agency actually overlaps with that of the consumer authorities.

The division of supervision between the Regional State Administrative Agency of Southern Finland and consumer authorities (the Consumer Ombudsman and the Competition and Consumer Authority) is not clear from the law, on account of a lack of provisions clearly specifying which body is the primary supervision authority. According to the Registration Act, the supervisory role of the Regional State Administrative Agency of Southern Finland can be considered independent, but in the governmental structure, the regional administrative agencies in Finland operate under the national authorities, such as the Competition and Consumer Authority. However, Chapter 7 of the CPA requires that all of the supervisory authorities operate in appropriate co-operation with one another.^{*145} Still, it is worth noting that neither of the authorities has promulgated mutually agreed upon guidelines regarding the division of supervision between the authorities, which would serve to clarify the situation from both the consumer creditors' and consumers' perspective.

Consumer lending can also be considered an **information process**, because of the large volume of financial and identity-verification information gathered from the consumer in the creditworthiness assessment. From this perspective, the consumer creditor must comply with personal-data and credit-data regulations, which are supervised by the Data Ombudsman.^{*146} However, the CPA requires the consumer creditor to assess the consumer's creditworthiness from the consumer-protection perspective, with the result that the consumer authorities and the Regional State Administrative Agency of Southern Finland also supervise the lending process in determination of whether the creditor is in compliance with the consumer-protection regulation.

The focus of supervision as conducted by the authorities is on the consumer creditor's consumer lending business **as a whole**. In essence, the authorities are not entitled to intervene in separate consumer relations or agreements, nor are they allowed to resolve disputes between creditors and consumers.^{*147} Any such disputes shall be filed in the court system or through alternative dispute-resolution organs, such as the Consumer Disputes Board. This notwithstanding, the Data Ombudsman is entitled to issue decisions and legal orders to the consumer creditor in individual cases with regard to the customer's right to inspect the data concerning him or her, or rectification of false information.^{*148}

Authorities, however, receive customer feedback that is utilised for various supervisory means as well as in guidance for consumer creditors. The main role of the feedback is, therefore, to inform the authority of a grievance in consumer lending rather than to settle disputes. The authorities also follow the praxis of courts and alternative dispute-resolution organs in order to stay up to date on current, relevant problems.

7.2. Sanctions

Each consumer lending supervisory authority is entitled to impose sanctions independently. As was stated in the previous section, the supervisory authorities are not entitled to intervene in separate consumer relationships or agreements, and sanctions shall be imposed only on the basis of the consumer creditor's practices as a whole.

The Regional State Administrative Agency of Southern Finland shall prohibit operation of a consumer-credit business if the consumer lending activities are conducted without an appropriate registration or licence required by the law.^{*149} A prohibition can also be issued, for special reasons, with respect to a person who works for or on behalf of the creditor—for example, as an agent. In addition, a person who

¹⁴⁴ RA, Section 9.

¹⁴⁵ CPA, Chapter 7, Section 51.

¹⁴⁶ CIA, Section 33; Personal Data Act, Section 38.

¹⁴⁷ This is expressly stated in the legislative history for the law pertaining to the Finnish FSA (see A. Makkonen (see Note 48), p. 213).

¹⁴⁸ Personal Data Act, Section 40.

¹⁴⁹ RA, Section 11.

operates a consumer lending business without registration or a licence as required by law can be deemed to have committed a **creditor offence** entailing a fine or imprisonment for up to six months.^{*150}

The Regional State Administrative Agency of Southern Finland may also put in place a partial or complete temporary prohibition of consumer lending activity in circumstances wherein the creditor has seriously ignored the obligations required under the law, or where the creditor continues unlawful practices despite prior notices and warnings.^{*151} In this respect, all types of obligations set forth by law—not only requirements based on the CPA's Chapter 7 but also other regulations, such as other provisions in the CPA's chapters 2 and 3 and in relation to a creditor's obligation to submit necessary information to the relevant supervisory authorities—are taken into consideration. The agency is entitled to impose a conditional fine on the creditor, if necessary, as a punitive action.^{*152}

The most severe sanction the Regional State Administrative Agency of Southern Finland is able to impose is removal of a consumer creditor from the creditor register. Removal from the register would be as a result of the creditor or its senior management seriously and consistently neglecting obligations of operation and conduct as required by law, and, in addition, the creditor would have been previously made subject to a lending prohibition. Moreover, a creditor may be removed from the register if found to be merely a front organisation, conducting the consumer lending business on another's behalf. Also, when a creditor no longer meets the requirements for law-based registration, such as reliability and the necessary knowledge of consumer lending, that creditor shall be stricken from the register.^{*153}

The Consumer Ombudsman (CO) and the Market Court are also entitled to impose sanctions. The CO is entitled to prohibit a practice temporarily if that prohibition is not significant from the perspective of legal praxis or otherwise and may also issue a prohibition for special reasons in urgent cases.^{*154} In other cases, any prohibition is imposed by the Market Court.^{*155} The prohibition can be supplemented by a conditional fine in either of these instances.^{*156}

The sanction power of the CO and the Market Court is based not on consumer-credit provisions in the CPA's Chapter 7 but on the general provisions on consumer marketing and consumer relations found in the CPA's chapters 2 and 3. However, the scope of these general provisions is very wide, which results in the *de facto* large-scale sanctioning powers of the CO and the Market Court. Consequently, the sanction powers are much wider than the consumer-credit provisions of Chapter 7 of the CPA on their own indicate.

8. How consumer-credit regulations affect contractual obligations

A relevant question is whether consumer-credit regulations (such as provisions in the CPA's Chapter 7 and the Registration Act) affect separate credit agreements. In other words, if the creditor does not comply with, *inter alia*, good lending practice, the creditworthiness assessment obligation, the identity verification obligation, credit price regulations, or the limitations on night-time lending or conducts consumer lending business without consumer-credit registration, how do these unlawful practices affect the consumer's contractual obligations? Can the loan amount, interest rate, or credit costs be nullified or reduced in these cases? This section explores some associated perspectives, without attempting to provide a complete overview.

As was stated in the previous chapter, the supervision authorities are entitled to impose sanctions when a creditor neglects these obligations fundamentally or repeatedly but not on the basis of only a single case. Furthermore, while supervisory authorities are entitled to sanction only the creditor, these sanctions do not affect credit agreements.

¹⁵⁰ RA, Section 13.

¹⁵¹ RA, Section 11.

¹⁵² *Ibid.*

¹⁵³ RA, Section 12.

¹⁵⁴ Act on the Competition and Consumer Authority, Section 10.

¹⁵⁵ CPA, Chapter 2, Section 17.

¹⁵⁶ Act on the Competition and Consumer Authority, Section 10.

Some of the consumer-credit provisions are very efficient in their direct effects on credit agreements. According to the CPA,^{*157} a consumer-credit agreement must be made in writing or electronically—if not, the consumer is obliged to pay back only the capital amount of the loan. In addition, the consumer is obliged to pay only those credit costs that have been agreed on in a written or electronic agreement.^{*158} Also, the provisions pertaining to maximum credit costs (a ‘rate cap’), interest for late payment, and debt-collection costs have a direct effect on credit agreements. They determine the maximum costs that the creditor or the debt-collection agency is allowed to collect from a consumer.^{*159} Since the creditor is obliged to specify the basis of the claim—such as the capital amount, costs, and interest—in the application for summons, these cost restrictions are generally applied by the courts *ex officio* if this is possible.^{*160}

There are no precise regulations on the contractual consequences of neglecting the provisions on responsible lending—such as those for good lending practice, creditworthiness assessment, and identity verification. The consumer-credit regulation expressly states neither the contractual consequences of granting loans to non-creditworthy consumers nor those for neglecting the ban on night-time lending. It is somewhat unclear whether these legal rules are only supervisory means for authorities or they also have some effect on contractual obligations. Regardless, these circumstances do not usually arise in court proceedings related to debt collection, since the creditor is not obliged to provide information on these issues in the summons application. Consequently, the court cannot apply the above-mentioned legal rules *ex officio*.

The most obvious consequences are basically credit losses for the creditor. If the debtor fulfils the requirements for a private person’s debt adjustment,^{*161} all of the debts will be settled via the debt-adjustment procedure. Reform of provisions for private persons’ debt adjustment is currently pending. The working group suggests that a creditor’s actions—such as having complied or not with good lending practice and the creditworthiness assessment obligation—must also be taken into consideration in determination of the requirements for the consumer in the debt-adjustment process.^{*162} Consequently, neglecting the obligations related to responsible lending may lead to reduction of credit amounts and credit costs via the debt-adjustment process in future.

The consequences may arise in application of the general principles of contract law, such as the unreasonableness doctrine that is included in the Contracts Act^{*163} (CA): ‘If a contract term is unfair or its application would lead to an unfair result, the term may be adjusted or set aside. In determining what is unfair, regard shall be had to the entire contents of the contract, the positions of the parties, the circumstances prevailing at and after the conclusion of the contract, and to other factors.’^{*164} Thus far, there is no case law applying unreasonableness doctrine to instant loan agreements.^{*165} It is more likely that a case can be made for revisiting the guarantee given by a private individual on the basis of special rules in the law pertaining to guarantees.^{*166} However, the debtor receives the funds and therefore a benefit, unlike the guarantor, who receives no benefit. For this reason, mediation for credit agreements differs markedly in nature from mediation related to guarantees. This suggests that unreasonable credit agreements will generally be mediated only with regard to the cost of credit. In addition, the Interest Act includes a certain adjustment

¹⁵⁷ CPA, Chapter 7, Section 17: ‘A consumer-credit agreement shall be made in writing and the consumer shall be provided with a copy of the agreement. The agreement may also be made electronically in a way that allows the unchanged reproduction and storage of the information by the consumer.’

¹⁵⁸ CPA, Chapter 7, Section 17. See also A. Makkonen (see Note 48), p. 215.

¹⁵⁹ CPA, Chapter 7, Section 17a; DCA, Sections 10 a, 10 c, and 10 d.

¹⁶⁰ A court procedure is an obligatory phase before the legal-enforcement process. See Subsection 4.2 (‘The information provided by credit-data registers’) and Note 88. In practical terms, it is impossible in many cases to determine whether the creditor has complied with the ‘rate cap’ provision, because the ‘rate cap’ is not based on exact maximum amounts (as the maximum debt-collection costs are); instead, it is based on complex calculation of the actual percentage rate, and the creditor is not required to submit the credit agreement in its entirety to the court in summary procedures.

¹⁶¹ See Subsection 5.3, on adjustment of private debts.

¹⁶² See Subsection 5.3 of this article.

¹⁶³ Laki varallisuusoikeudellisista oikeustoimista (Contracts Act), 228/1929, as amended.

¹⁶⁴ CA, Section 36.

¹⁶⁵ However, in 1996 the Supreme Court held that total credit costs consisting even 50% of the capital amount (original capital amount was 218,000 mk and credit costs around 124,000 mk) were not unreasonable in short-term bank financing since these costs did not differ from the general short-term financing price range in the banking sector in the beginning of 1990s and the price level of short-term financing was generally known. In addition, most of these credit costs were caused by extending the original repayment period. See case KKO (referring to the Supreme Court) 1996:90.

¹⁶⁶ Laki takauksesta ja vierasvelkapanttauksesta (Act on Guarantees and Third-Party Pledges), 361/1999, as amended.

provision for late-payment interest on private debts.^{*167} This provision applies mainly to long-lasting over-indebtedness and when the amount of the interest for late payment has increased to beyond the level that the debtor is able to overcome.^{*168}

By a recent decision of the Turku Court of Appeals,^{*169} a consumer-credit agreement was declared invalid because the creditor did not hold appropriate registration as a provider of consumer credit. The creditor was an Estonian loan company that had conducted instant-loan business in Finland for several years.^{*170} The decision of the district court indicates that the Estonian company had transferred the credit agreements to a Finnish debt-collection company immediately after granting the loans. In addition, the debt-collection agency did not hold a licence to conduct debt-collection business.^{*171}

Since the creditor and the debt-collection agency did not fulfil the registration or licensing obligation, the activities of the companies were seen as unlawful and *contra bonos mores* by the court. Furthermore, the loan agreement itself was seen as unlawful and non-binding. The main principle of Finnish contract law is that where a contract is invalid, the parties must return the consideration.^{*172} Still, the district court and the court of appeals applied the **principle of non-interference** (*puuttumattomuusperiaate*)^{*173}, which means that in cases of unlawful and *contra bonos mores* acts a party is not obliged to fulfil its obligations or provide reimbursement: the consumer debtor was not obliged to pay back the loan amount, interest, or other costs. However, the court justified its decision only on the basis of the lack of registration as a consumer-credit provider and debt-collection licence—no other unlawful actions or delinquencies were pointed out, such as neglect of good lending practice, the identity verification obligation, or creditworthiness assessment obligation.^{*174} At the time of writing, this judgement is not yet final.

9. New regulations—new problems?

It can be stated that instant-loan regulation has been amended ‘step by step’—first by softer means, such as identity verification, supervision, disclosure obligations, and the focus on good lending practice. The first amendments have been criticised as only ‘technical adjustment’ of the legal norms.^{*175} Although many important enhancements to consumer protection—especially the identity verification obligation—were made, in fact, no research or statistics give any indication that these regulations in themselves have been effective against the indebtedness problems accompanying instant loans.

Some of the new regulations were a result of very active political discussion^{*176}, alongside the implementation of the Consumer Credit Directive. Even the majority of the members of the Finnish Parliament—regardless of their political affiliation—agreed in 2011 that the indebtedness problems caused by instant

¹⁶⁷ IA, Section 11.

¹⁶⁸ Case KKO (referring to the Supreme Court) 2006:66.

¹⁶⁹ Turku Court of Appeals (Turun hovioikeus) case 209, of 12.2.2014. The decision was not yet final at the time of writing; it may be appealed.

¹⁷⁰ The company claimed that it conducted consumer-loan business in Finland only temporarily, for which reason it was not obliged to be registered as a consumer-credit provider (see Section 2, ‘Registration of consumer-credit providers’). The Court found that the practice was ongoing and not, as claimed by the company, temporary.

¹⁷¹ Debt-collection business is subject to a licence in Finland. See Laki perintätoiminnan luvanvaraisuudesta (the Act on Licensing of Debt Collection Businesses), 517/1999, Section 2. A debt-collection agency that is part of the same corporate group as the creditor, however, is not required to be licensed. In the case mentioned, the collection agency claimed to be part of the same corporate group as the creditor but was not able to provide any proof of that claim.

¹⁷² M. Hemmo. *Sopimusoikeus I* [‘Contract Law I’]. Jyväskylä, Finland 2003, pp. 320–322 (in Finnish).

¹⁷³ The principle of non-interference has previously been seen as related to, *inter alia*, false transactions (see M. Hemmo (*ibid.*), pp. 429–431), illegal gambling (*ibid.*, pp. 436–437), and prostitution (KKO case 2005:72).

¹⁷⁴ The Consumer Agency published a bulletin on 14.9.2012 wherein the agency warned customers about the inappropriate and misleading practices of the same consumer creditor and debt-collection agency and advises consumers to consider appealing to the reasons for which the amount of, or basis for, the debt is unclear. See the bulletin entitled ‘Neljän pikaluottoyhtiön perinnässä epäselvyyksiä’ [‘Obscurities observed in debt collection of four instant-loan companies’], available at <http://www.kuluttajavirasto.fi/fi-FI/Uutiset/2012/tiedote/tiedotteet-2012/neljan-pikaluottoyhtiön-perinnassa-epaselvyyksia> (most recently accessed on 6.4.2014) (in Finnish). This argument did not arise in the case considered here.

¹⁷⁵ P. Lämsineva. Pikaluottojen sääntely ja perusoikeudet [‘Instant-loan regulation and the fundamental rights’]. – *Lakimies* 2010/6, p. 1055 (in Finnish).

¹⁷⁶ N. Jakobsson. Pikaluotot – Hämää markkinointia, kohtuuttomia sopimusehtoja ja koronkiskontaa? [‘Instant loans—unclear marketing, unreasonable terms and usury?’] – *Helsinki Law Review* 2008, pp. 147–148 (in Finnish).

loans are so severe for consumers that either instant loans should be totally banned or the consumer-credit legislation must be otherwise reformed.^{*177} This led to legal limits on the costs of consumer credit under EUR 2,000.

The new laws may solve some of the ‘traditional’ problems related to instant loans—in particular, high credit costs, unclear marketing, excessively easy access to loans, and granting of credit in the absence of ability to pay. The statistical information indicates that the legislative changes in 2013—in particular, the limitation on credit costs—may have caused some decrease in the size and number of loans granted and in credit costs, but at the same time the average payment period has significantly increased. One third of consumer-loan companies closed down their consumer lending business in 2013. The number of payment defaults (court decisions on outstanding loans) continued to increase in 2013, but this may be explained by payment defaults being usually established in the credit-data registers several months after the due date of the loan.

Key figures for instant loans in 2008–2013:

	2008	2009	2010*	2011	2012	2013**
New instant loans ^{*178} granted (thousands of euros)	187,711	226,259	244,051	322,188	394,357	322,912
Number of new instant loans granted	1,027,706	1,130,783	1,183,335	1,410,304	1,552,586	1,013,878
Outstanding instant loans ^{*179} (thousands of euros)	28,062	45,227	56,167	98,447	134,067	116,065
Average amount (euros)	182	200	206	228	254	318
Average payment period for new loans (Q4 only) (days)	28	29	32	33	38	96
Costs for new loans (percentage)	23.7%	26.7%	26.1%	24.5%	23.0%	19.1%
Total number of payment defaults ^{*180} for private persons	N/A	228,430	237,447	280,767	334,795	343,530
Total number of instant-loan payment defaults ^{*181} and their percentage of all payment default	N/A	54,762 23%	49,117 21%	81,735 29%	109,852 33%	115,718 34%
Number of registered consumer-loan companies ^{*182}	—	—	—	86	87	55

* Laws entering into force in February 2010, on the obligation to verify a consumer’s identity (see Subsection 3.4), limitations on night-time credit accessibility (see Subsection 6.5), and amendment of usury laws (see Subsection 6.4), and December 2010, on registration of consumer-credit providers, good lending practice, the obligation to assess the consumer’s credit-worthiness, and reform of the supervision system (see Sections 2, 3.1–3.3, 5.1, and 7).

** Laws entering into force in March 2013, on reform of debt-collection costs’ regulation (see Subsection 6.3), and June 2013, on credit prices’ regulation (see Subsections 3.2 and 6.1) and renewal of the creditworthiness assessment obligation (see Subsection 3.3).

¹⁷⁷ Parliament members’ initiatives LA 58/2011 vp (signed by 116 out of 200 MPs) and LA 59/2011 vp (signed by 127 out of 200 MPs). In addition, the Social Democrats introduced a motion in 2007 for the supervision of instant-loan companies to be handled by the Finnish FSA (LA 103/2007 vp).

¹⁷⁸ Official Statistics of Finland (OSF): Outstanding credit [e-publication]. ISSN=2342-2661. Helsinki: Statistics Finland. Available via http://www.stat.fi/til/lkan/tup_en.html (most recently accessed on 22.3.2014).

¹⁷⁹ *Ibid.*

¹⁸⁰ Credit-data register of Suomen Asiakastieto Oy, with the registered court decisions related to all consumer debts (including also other debts than credit agreements, such as unpaid bills). I would like to thank Suomen Asiakastieto Oy for supplying statistical information for this article.

¹⁸¹ Credit-data register of Suomen Asiakastieto Oy. Instant-loan payment default is defined as a court decision pertaining to lump-sum consumer credit (based only on a credit agreement) of under EUR 300.

¹⁸² Source: Administrative Agency of Southern Finland, January 2014. The Registration Act, which entered into force in 1.12.2010, specifies that a consumer-credit provider is obliged to apply for registration—unless it holds a credit-institution licence. See Section 2, on registration of consumer-credit providers.

However, this statistical information should be subjected to a critical eye. From examination of the consumer-credit-provider register, 44 Internet-based consumer-loan services were found and analysed in April 2014. In consequence, three totally new types of instant-loan product were discovered.

Firstly, 23 of the companies provide consumer loans amounting to, at **minimum**, EUR 2,000. As the credit price regulations pertain to consumer loans of less than EUR 2,000,^{*183} the creditors are clearly tending to raise the minimum amount of the loans. Of these loan services, 16 provided only credit limits, and in eight of these cases, the terms and conditions of the credit included significant restrictions on the use of credit limits, which means in effect that the credit limit is only formal and the consumer is able to use only a part of it.

Secondly, 13 consumer-credit services required a guarantee as security for the loan. Both personal guarantees and credit guarantees (granted by an affiliate of the creditor) were usually accepted, but in practice, the credit guarantee is the only option for instant granting of the credit. The commission fees for the credit guarantee varied from 22 to 33 per cent of the loan amount, which is calculated neither in the actual percentage rate nor in the scope of the credit price regulations. An alarming observation was that none of the credit services disclosed this information clearly on their Web sites. Only in five of these cases was the commission fee for the credit guarantee revealed in the terms and conditions of the credit on the publicly facing Web site. In the other eight cases, these costs were impossible to find without registration for the consumer-loan service.^{*184}

Thirdly, three of the consumer-credit services required the loan amount to be transferred to a pre-paid payment card without the possibility of withdrawing the money. This way, the consumer credit can be considered a goods-or-services-related credit and beyond the scope of credit price regulation.

Moreover, although there are obligations of identity verification, creditworthiness assessment, and the credit agreement being made in written or electronic form, SMS lending is not totally deceased. In 18 consumer-credit services, after the creditworthiness assessment and identity verification are conducted via customer registration, application for new loans and use of the credit limit is possible via SMS messages through a personal PIN code or similar verification.

According to a report of the Finnish Tax Administration (from April 2013)^{*185} that considered instant-loan businesses between 2007 and 2011, some 35% of the registered consumer creditors or the persons in charge thereof were indicated as lacking financial reliability. In this report, financial reliability was determined on the basis of previous bankruptcies, negative equity, unprofitable accounting periods, debt-recovery proceedings, and significant (i.e., over EUR 5,000) outstanding tax debt. Almost a third of the instant-loan companies were indicated to have outstanding tax debt, which proportion is double the average across all Finnish businesses. However, consumer creditors' **financial** reliability is not expressly mentioned in the provisions pertaining to the requirements related to the registration of consumer-loan providers.

10. Conclusions

The Finnish legislator has developed national legislation as a solution to the problems related to instant loans. **Flexible** provisions, such as good lending practice and creditworthiness assessment, were intended to prevent all types of inappropriate practices in consumer lending. Still, only **specific** restrictions have had a notable influence in responding to the problems faced in the country in recent years: according to the statistics, credit costs and the number of new loans have decreased. Unfortunately, it seems that the purpose of the legislator has become somewhat watered down. There have been remarkable side effects, such as tripling of the average payment period, higher loan amounts, and more complex loan products—some of them with the same level of costs as before the legislative changes. In fact, the definition of an **instant loan** is no longer as exact as it used to be: it is not only a small-amount lump-sum loan with a short payment period, but it also can be a sort of credit limit amounting to thousands of euros or a consumer loan with a

¹⁸³ See Subsection 6.1, 'Regulation of credit prices'.

¹⁸⁴ At the moment, there is a case pending with the Market Court that has to do with the commission fees linked to an instant loan's credit guarantee.

¹⁸⁵ The report entitled 'Selvitys pikalainayrityksistä' ['Report on instant-loan companies'] by the Finnish Tax Administration (Verohallinto), 10.4.2013, available at [http://www.vero.fi/fi-FI/Tietoa_Verohallinnosta/Tiedotteet/Tietoa_harmaasta_taloudesta_Selvitys_pik\(26905\)](http://www.vero.fi/fi-FI/Tietoa_Verohallinnosta/Tiedotteet/Tietoa_harmaasta_taloudesta_Selvitys_pik(26905)) (most recently accessed on 6.4.2014) (in Finnish).

credit guarantee. All in all, this development introduces many new challenges not only for consumers but also in collecting of statistical information.

There are two essential perspectives related to credit price regulation that should be taken into more thorough consideration. Firstly, it seems that a maximum actual percentage rate for consumer loans' total costs is too easily avoidable, by means such as lengthening the payment period or inventing new loan products. Instead, enacting a maximum nominal amount for consumer-loan costs, including costs of credit-related ancillary services, would be worthy of consideration. Secondly, the scope of the credit price regulation should be expanded to include all types of credit and also goods-or-services-related credit products, because of the rapid development of new payment methods.

On the other hand, it has also been suggested that a compulsory waiting period ('cooling-off period') be instituted between granting and dispensing of the credit to the customer, as an alternative to price regulation. This solution has been seen as a way to help people avoid becoming indebted imprudently.^{*186}

Another notable issue seems to be the supervisory system in place for consumer creditors. As was stated in Section 7, several authorities are involved in consumer creditors' supervision. The legislation does not define which one of these supervisory authorities takes overall responsibility for the supervision or even a division of authorities' supervisory duties. The CPA only requires that the supervisory authorities **co-operate with each other as is appropriate**.^{*187} It should be taken into consideration whether the tasks of individual supervisory authorities should be specifically defined in the law. Alternatively, one solution may be for the authorities to resolve the question independently, by, for instance, announcing guidelines for the division of supervisory duties among the authorities.

Consolidating the supervision of consumer lending regulation with a single authority might also be worth considering, for several reasons. Such a solution would, in particular, clarify the supervision, which would be a benefit for consumers and creditors alike. Furthermore, it would prevent the diverging interpretations of law that might be possible in dealing with various authorities. Consolidated supervision might also be justified on the basis of efficiency, as public-sector effectiveness is currently a very topical issue in Finland.

The present legislation does not provide extensive requirements for financial reliability for consumer-loan providers, regardless of the fact that consumer-loan business is economically significant activity. The reliability of the consumer creditor is evaluated basically in terms of crime history. The Finnish Tax Administration has suggested reforming the requirements related to consumer lending business in such a way that especially the financial reliability and financial background of the creditor and its persons in charge could be taken into consideration more particularly.^{*188}

Finnish law includes two essential rules related to responsible lending—on good lending practice and the obligation of creditworthiness assessment—which should be utilised more, for instance, through self-regulation or public guidelines set forth by the authorities. Qualified examples of this include good banking practice, formulated via the banking sector's self-regulation, and the guidelines on good debt-collection practice, which resulted from co-operation among consumer-protection authorities, debt-collection agencies, and consumer associations. However, a practical challenge is that consumer creditors are not fully organised, for example, with a union of their own, with the result that such self-regulation cannot yet be expected.

If providing instant loans were to be restricted by legislative means, what would replace them? About 30 municipalities in Finland provide social lending services for their residents who, because of their low income and scant financial means, are unable to obtain credit on reasonable terms elsewhere.^{*189} Social lending is based on special legislation that includes provisions pertaining to granting of credit, terms and conditions for social credit agreements, and financial counselling.^{*190} The maximum interest rate for social credit is the reference rate under the Interest Act's Section 12^{*191}. An essential element of the social credit

¹⁸⁶ O. Juurikkala (see Note 10), pp. 30–31; O. Juurikkala. *Pikavippien sääntely: Ei korkokattoa, vaan erityinen harkinta-aika* [Instant-loan regulation: Not a rate cap but a special waiting period]. – *Oikeus* 2012/3, pp. 458–459 (in Finnish).

¹⁸⁷ CPA, Chapter 7, Section 51.

¹⁸⁸ See the report of the Finnish Tax Administration (see Note 185).

¹⁸⁹ For instance, see the position paper of *Mun talous* (the My Economy Network). Helsinki 3.2.2014 (in Finnish). Available at <http://www.takuu-saatio.fi/@Bin/494977/Kannanotto+sosiaalinen+luototus.pdf> (most recently accessed on 12.4.2014) (in Finnish).

¹⁹⁰ *Laki sosiaalisesta luototuksesta* (Act on Social Lending), 20.12.2002/1133, as amended.

¹⁹¹ See Subsection 6.1, 'Regulation of credit prices'.

is fee-free financial counselling, which must be provided for the consumer if needed.^{*192} Municipalities are entitled to determine the credit-granting policy independently.^{*193} Although the Act on Social Lending came into force in 2003, social credit is still a very rare financing 'product': the latest survey, from 2010, indicates that there were only 780 cases of social credit being granted in 2010.^{*194} The majority of municipalities do not provide social lending services.^{*195} It has been widely stated that social lending services should be expanded nationwide, however, since smaller consumer loans with low costs and financial advising services are not a sensible combination for businesses.^{*196}

¹⁹² Act on Social Lending, Section 9.

¹⁹³ Act on Social Lending, Section 2. For example, the City of Oulu grants social credit only for purposes of undertaking studies.

¹⁹⁴ National Institute for Health and Welfare (Terveystieteiden tutkimuskeskus). Sosiaalinen luotto 2010 – kuntakyselyn osareportti ['Social lending in 2010 – a survey report']. Available at http://www.thl.fi/tilastoliite/tilastotiedotteet/2011/Tr40_11.pdf (most recently accessed on 12.4.2014) (in Finnish).

¹⁹⁵ According to the Act on Social Lending (Section 2), municipalities are not obliged to provide social lending services.

¹⁹⁶ For instance, see O. Juurikkala (see Note 186), p. 459.



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Legal Problems and Regulations related to Easy-access Non-secured Consumer Loans in Estonia^{*1}

1. Introduction

Easy-access non-secured consumer loans (instant loans) are a fairly new phenomenon in the Estonian credit market. Providers of this variety of product do not have to follow any specific regulations. Instant loans typically have a short maturity term, the amount generally does not exceed EUR 1,000, and the loans are provided by private enterprises not registered as credit institutions.

On account of the rapid advances of technology in recent years, instant-loan providers have been able to make it exceptionally easy for anyone to apply for such loans. The providers are open for applications for long hours, and often one can apply for a loan simply by sending a text message (SMS) from a previously identified mobile phone. In contrast to operations involving a commercial bank, wherein responding to a loan application may take up to five days, providers of instant loans give their answer in minutes. For example, in the case of instant-loan provider Credit24^{*2}, the offices are open from 8am to 10pm, and a potential client who does not have access to electronic channels can simply fill in a form in a Maxima supermarket.

The market for instant loans is continuously and rapidly growing, so there are insufficient statistics describing the current situation. In addition, the overall debt of Estonian households is continuously growing. Households in Estonia generally do not have experience from previous recessions of how to handle debt-servicing problems, as household debt was modest until the economic boom of 2004–2007.^{*3} According to the annual survey conducted by TNS Emor, debt-servicing payments by Estonian households increased from 2006 to 2009, when 23% of indebted households had a debt-servicing level higher than 30% of their disposable income.^{*4} There are some indirect statistics also, according to which approximately three per cent of the total population took out an SMS loan in 2008–2009. One of the debt advisers explained that in

¹ This article is prepared within the framework of the project EMP205, Topical Issues of Consumer Credit in Estonia and Norway. The authors are indebted to Heili Püümann, *stud. iur.*, without whom the publication of this article would not have been possible.

² See its Web page at <http://www.credit24.ee/> (most recently accessed on 31.1.2014).

³ K. Staehr, M. Kukk. The over-indebtedness of European households: Updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact. – *Country Report Estonia*, 19.12.2012, p. 27.

⁴ *Ibid.*, p. 24.

2008–2009 roughly a third of the debt-counselling cases involved clients who had accumulated arrears on SMS loans.^{*5} The Ministry of Finance, however, estimates that at least 100,000 residents (out of Estonia's population of 1.3 million) have obtained instant loans.^{*6} According to information from the register of 'payment disorders' supplied to the Ministry of Economic Affairs and Communications in October 2013, there are 34,047 individuals who have a payment disorder resulting from an instant loan or other consumer credit.^{*7} It has been reported that the number of clients of instant-loan providers is continuously growing (mainly in the north-eastern part of Estonia and among the 25–30 and 55–60 age brackets).^{*8}

Regardless of the absence of precise statistical data, one can state that consumer over-indebtedness connected with instant loans is currently a very topical matter in Estonia.

This article analyses the current market situation involving instant loans in Estonia and social problems related to them. Firstly, the authors provide an overview of the legal issues that have not yet seen full harmonisation via the European consumer-credit legislation and that are specific to this particular type of credit product in Estonia. Furthermore, the article covers the market situation and estimates related to the credit products active in the market and possible numbers of creditors. Because there is no direct supervision of instant-loan providers, the authors are able to provide only unofficial and estimated figures characterising the problems. Then, the second part of the article provides a legal and institutional overview of the instant-loan market. The third and fourth parts describe the consumer-protection measures currently in force in Estonia and assess whether those measures have been functioning efficiently in practice. Finally, the ongoing discussions of further legislative measures are described and the associated legislative proposals evaluated.

2. The market situation and statistics

2.1. Overview of the creditors and consumers

Instant-loan providers are not supervised by Estonia's Financial Supervision Authority (FSA). The FSA monitors only credit institutions—that is, entities whose main activities are to give out loans and to accept deposits.^{*9} Since the instant-loan providers do not accept deposits, they are not regarded as credit institutions and hence are not subject to supervision by the FSA.

The providers of instant loans are regarded as private creditors, and there is no special supervision provided by law. They are subject only to the monitoring of the Estonian Consumer Protection Board (CPB). The CPB follows the Consumer Protection Act^{*10} (CPA), which, in general, regulates the provision of services or sale of products to customers. The CPB has only general supervisory power with respect to loan providers, and it does not have the right to intervene in the relationship between the parties to the loan contract. Therefore, eventually it is for the courts to decide whether a particular contract between a consumer and a lender is valid or not and whether the lender has the right to claim for payment of the related penalties, interest, and additional costs from the customer.

The problems related to instant loans became increasingly topical for the Estonian public in 2004–2007, when there was a considerable upturn in the instant-loan-provision market. It is remarkable that over 2006–2007 the total marketing costs of SMS-loan providers were comparable to the total marketing costs of the commercial banks active in Estonia. The extensive promotion of instant loans stopped in 2008, once default on debts had started to increase amidst global financial crisis. The instant-loan market

⁵ *Ibid.*, p. 26.

⁶ Ministry of Economic Affairs and Communications (Majandus- ja Kommunikatsiooniministeerium). Kiirlaenu- turg – analüüs ja ettepanekud ['The instant-loan market – analysis and proposals'], p. 8. Available at http://www.mkm.ee/public/kiirlaenu_turg_analyys_ja_ettepanekud.pdf (most recently accessed on 24.4.2013) (in Estonian).

⁷ Chancellery of the Riigikogu, department of law and analytics (Riigikogu kantselei õigus- ja analüüsiosakond). Kiirlaenu- olemus, probleemid ja reguleerimisvõimalused ['Fast loans – their nature, problems, and options for regulations']. – *Riigikogu kantselei õigus- ja analüüsiosakond*, 21.10.2013 (No. 21). Available at <http://www.riigikogu.ee/doc.php?177395> (most recently accessed on 31.1.2014) (in Estonian).

⁸ Kiirlaenu- turg – analüüs ja ettepanekud (see Note 6), p. 8.

⁹ Credit Institutions Act (Krediitiasutusteseadus). – RT I, 23.12.2013, 30 (in Estonian).

According to §3 (1) of the Credit Institutions Act, a credit institution is a company the principal and permanent economic activity of which is to receive cash deposits and other repayable funds from the public and to grant loans for its own account and provide other financing.

¹⁰ Consumer Protection Act (Tarbijakaitseadus). – RT I, 31.12.2013, 7 (in Estonian).

resumed its expansion in 2012–2013. According to publicly available financial reports from the loan providers, the annual growth of the market has been as great as 50%.^{*11} Working from data from the register of payment disorders, the Ministry of Economic Affairs and Communications assesses the size of the market to be approximately EUR 118 million per year and concludes also that the last two years have seen the size of that market increase by approximately 30% per year.^{*12}

Because there is neither a registration obligation nor official statistical information about the exact number of borrowers, it is only possible to provide some estimated values. The share of electronic retail lenders in the retail lending market as a whole is estimated at about 16%.^{*13} In the assessment of the Ministry of Finance, the number of loan providers is approximately 100, but almost 90% of the loans are provided by 30 companies.^{*14} This leads one to conclude that the instant-loan market is heavily concentrated with a few major players. During the period 2010–2012, the six biggest instant loan providers were SMSLaen AS, Placet Group OÜ (SMS Money), Folkia AS Eestifiliaal (Monetti), MCM Finance Estonia OÜ (Credit24), Hüpoteeklaen OÜ, and MiniCredit AS. In that period, the highest net profit reported by an instant-loan company was EUR 1.5 million.^{*15} Characteristic of the loan products of the leaders active in this market are high interest rates and a high annual percentage rate of charge (APRC); for example, for lending of EUR 300 to a regular customer of Yes Credit for one month, the APRC is 1355.19%. For lending of the same amount from Monetti for a month, the APRC is 791.61% and from SMS-Laen it is 544.64%. In comparison, the APRC for a 2,000-euro loan for four years from the bank SEB is approximately 18.54%.

The Ministry of Economic Affairs and Communications has conducted interviews with debt counsellors in order to create a profile of an average instant-loan client. Consumer-credit debt is a problem mostly for people who have a lower level of education; debtors with a higher education are a very rare phenomenon. The majority of the debtors are unemployed, beneficiaries of subsistence funding, or persons receiving pension due to incapacity for work. The main reasons for taking out an instant loan are need to cover subsistence expenses, need to buy necessities, and need to cover other debts. As an alarming trend the debt counsellors note many young people applying for instant loans while in an intoxicated state at parties.^{*16}

2.2. Products on the market

Instant-loan providers offer several distinct credit products: instant loans, SMS loans, loans for small sums, and other consumer loans. These other consumer loans too, such as those involving traditional credit cards, qualify as non-secured loans, but some of the requirements involved in application for those traditional products differ from those applicable for the other products mentioned. An 'instant loan' is characterised by its short duration and small amount. Often, an application for an instant loan can be submitted via the Internet.

An SMS loan is a type of instant loan that can be applied for through sending of a message by SMS to the provider.^{*17} Until the beginning of 2008, instant-loan providers in Estonia were allowed to identify customers without direct contact with them (for example, through a bank link). Since concerns about malpractice were serious, the law was amended in early 2008^{*18}; under the regulations now in effect, the applicant has to be identified by the lender at least once in person^{*19}. This amendment to the law was a first step toward more responsible practices in electronic retail lending. After its adoption, most lenders implemented some changes of procedure, usually arranging things such that the first-time identification is done either in the

^{*11} M. Kukk. What do we know about SMS loans / fast loans in Estonia? Tallinn University of Technology, 17.9.2013.

^{*12} Kiirlaenu – analüüs ja ettepanekud (see Note 6), p. 3.

^{*13} *Ibid.*, p. 7.

^{*14} *Ibid.*

^{*15} *Ibid.*, p. 5.

^{*16} *Ibid.*, pp. 13–14.

^{*17} See further discussion of these modern credit products in K. Saare *et al.* Protection of consumer rights in SMS loan agreements. – *European Review of Private Law*, 2010/18, pp. 129–131.

^{*18} I. Ulst. *Balancing the Rights of Consumers and Service Providers in Electronic Retail Lending in Estonia*. Tartu Ülikooli Kirjastus 2011, p. 21.

^{*19} The Money Laundering and Terrorist Financing Prevention Act (Rahapesu ja terrorismi rahastamise tõkestamise seadus). – RT I, 8.5.2012, 5 (in Estonian).

office of the lender or by means of a courier service.^{*20} The government has now recommenced discussion regarding possible additional amendments to the regulations, and various analyses are being carried out by individual ministries.

Several instant-loan providers offer some unusual kinds of credit products, such as a loan that a person can be granted in cash. Getting the amount in cash has two 'advantages'. Firstly, if the creditor pays out the loan in cash, there will be no record of it on the consumer's bank statement. That element is very important with regard to confidentiality. Under the usual bank practices^{*21} in Estonia, it is difficult for a person to get credit from a commercial bank if having taken out an instant loan. Before the 'loan in cash' product appeared on the market, some consumers were hesitant to obtain an instant loan because they were aware of the problems that could occur in the future upon application for a loan from a bank. In contrast, there were no problems related to signing the 'loan in cash' contract: the product offers full confidentiality and allows clients to get an instant loan 'without consequences'. Secondly, a loan of this type can be taken out even by a person whose bank account has been seized by the bailiff, with all the payments to that account being applied directly for repayment of previous debts. If the loan is paid out in cash, the person receives it regardless of bank-account status.

On account of the number of instant-loan providers in Estonia, a Web site^{*22} has been developed in a commercial initiative to allow clients to obtain a better overview of the various creditors. That site offers a possibility to get acquainted with all possible creditors and the loan products on the market. The Web site also gives potential clients an opportunity to submit requests to all of the creditors and compare the offers before choosing one. On one hand, this gives potential clients the opportunity to get a comprehensive overview of all possible products and to find the best offer; on the other hand, Web sites of this sort are another way for instant-loan providers to advertise their products and promote the understanding that credit is easily available.

3. Legal and institutional overview

3.1. Legal overview

The framework regulation that is binding for consumer credit can be divided into administrative measures and contractual measures. Supervision of administrative measures is exercised by the CPB and, in cases of disagreement, by administrative courts. The contractual measures can be implemented by the parties through actions in civil courts.

The administrative measures are regulated mainly by the Consumer Protection Act (CPA) and the Advertising Act (AA).^{*23} The CPA regulates the offering, sale, and marketing of goods or services to consumers by traders; specifies the rights of consumers as purchasers or users of goods or services in general; and provides for the organisation and supervision of consumer protection and liability for violations. The aim with the AA is to restrict the advertising activity of the creditors and reduce the likelihood of the loan providers creating an illusion of easy money. If consumer credit is granted by a credit institution, the provisions of the Credit Institutions Act (CIA) too are binding for the relevant creditor.

The contractual aspects of credit transactions are regulated by the Law of Obligations Act (LOA)^{*24}, among them the norms implementing the EU Consumer Credit Directive (CCD)^{*25}. The unconscionability doctrine under which usurious credit contracts are restricted can be found in the General Part of the Civil Code Act (GPCCA)^{*26}. The procedural aspects of enforcing the claims arising from consumer-credit contracts are to a great extent set forth in the Civil Procedure Code (CPC).^{*27} It must be stressed that the order-for-

²⁰ I. Ulst (see Note 18), p. 21.

²¹ For example, leading banks in Estonia SEB and Swedbank.

²² See <http://www.parimintress.ee/> or <http://www.heaintress.ee/> (most recently accessed on 26.2.1014).

²³ Advertising Act (Reklaamiseadus). – RT I, 11.6.2013, 6 (in Estonian).

²⁴ Law of Obligations Act (Võlaõigusseadus). – RT I, 8.7.2011, 21 (in Estonian).

²⁵ 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 133/66, 22.5.2008.

²⁶ General Part of the Civil Code Act (Tsiviilseadustiku üldosa seadus). – RT I, 6.12.2010, 12 (in Estonian).

²⁷ Civil Procedure Code (Tsiviilkohtumenetluse seadustik). – RT I, 22.3.2013, 16 (in Estonian).

payment procedure is used extensively by creditors^{*28}. It is common practice for instant-loan providers to use this procedure for asserting their claims against consumers: according to the statistics of the Ministry of Economic Affairs and Communications, 80% of all claims related to instant loans are asserted via the order-for-payment procedure.^{*29} It is a faster and less expensive procedure for the claimant than others, as it is implemented without court hearings. Notification about the claim and a debt-repayment proposal are sent to the debtor by post. If the debtor does not respond, the court decides on the debt-enforcement measures to be applied, without the debtor's involvement. The amounts that are claimed in court can substantially exceed that of the initial loan.

A third group of relevant regulations come into play, to do with the results of consumer over-indebtedness. In the event of insolvency of a private person or a household, there is a possibility for bankruptcy proceedings or restructuring of debts. In 2011, the Debt Restructuring and Debt Protection Act (DRDPA)^{*30} entered into force, with the intent being to offer alternatives to bankruptcy for indebted individuals. The DRDPA stipulates that natural persons can turn to the courts to apply for restructuring of personal debts for purposes of overcoming the solvency problems and avoiding bankruptcy. The debtor has to provide a sustainable debt-restructuring plan demonstrating ability to pay at least some of the debt due. The debtor has to cover all the associated costs, including the court fees and the costs of the advisory service. The aim with the DRDPA was to offer natural persons with temporary payment issues a possibility to restructure the debt and to help them through solvency problems^{*31}; however, in practice, the protection provided by the DRDPA seems not to be sufficient. According to the statistics of the Ministry of Justice, from April 2009 to November 2013 only 102 restructuring applications were filed with the courts, 92 of which have proceeded to processing. Of the applications processed, only seven were fully or partially approved by the court.^{*32}

The Bankruptcy Act^{*33} (BA), from 2004, provides a possibility for natural person to commence bankruptcy proceedings and eventually be released from the debts.^{*34} In general, the rules of bankruptcy proceedings for a natural person are similar to those applicable to the equivalent proceedings for legal persons^{*35}, with the main difference being that for natural persons the law provides for debt-release procedure. At the request of a debtor, the court can decide on the release of said debtor from his or her obligations that were not performed during the bankruptcy proceedings by a ruling five years after commencement of proceedings for the release of the debtor from his or her obligations (see §175 (1) of the BA). Taking into account the circumstances the court may release a debtor who has been performing his or her obligations duly from his or her obligations of even earlier but not before three years have passed from commencement of the proceedings (again, see §175 (1)¹ of the BA).

3.2. Institutional overview

Since instant-loan providers are not credit institutions, their business practices are neither standardised nor regulated as those of credit institutions are. They are not obliged to disclose any specific information describing their activities to a supervisor, and they are bound only by general business regulations.

The majority of the instant-loan providers do not fall under the jurisdiction of the FSA. Therefore, the only relevant supervisory authority is the CPB, under whose jurisdiction falls supervision of the fulfilment of the CPA and the AA. According to the AA, the CPB has the right to supervise the compliance of

²⁸ Section 481 *et seq.* of the Civil Procedure Code. The procedure is similar to the order-for-payment procedure under Regulation (EC) No 1896/2006 of the European Parliament and of the Council creating a European order for payment procedure. OJ L 399, 30.12.2006, pp. 1–32.

²⁹ Kiiralaenuturg- analüüs ja ettepanekud (see Note 6), p. 13.

³⁰ Debt Restructuring and Debt Protection Act (Võlgade ümberkujundamise ja võlakaitse seadus). – RT I, 6.12.2010, 1 (in Estonian).

³¹ Võlgade ümberkujundamise ja võlakaitse seaduse eelnõu seletuskiri [‘Explanatory memorandum on the Debt Restructuring and Debt Protection Act’]. Available at <http://www.riigikogu.ee/?page=eelnou&op=ems2&emshelp=true&eid=1004095&u=20140130162250> (most recently accessed on 31.1.2014) (in Estonian).

³² Statistics provided by the Ministry of Justice that are related to implementing of the Debt Restructuring and Debt Protection Act. Statistics as of 2013 (the above-mentioned statistics are in the possession of the authors).

³³ Bankruptcy Act (Pankrotiseadus). – RT I, 23.12.2013, 54 (in Estonian).

³⁴ Chapter 11 of the BA.

³⁵ M. Varusk. Füüsilise isiku pankrotimenetlus [‘Bankruptcy proceedings for natural persons’]. Available at <http://www.just.ee/49515> 31.01.2014 (most recently accessed on 26.2.2014) (in Estonian).

advertising with the requirements specified by law. In its supervision, the CPB has the right to check the compliance of advertising with the requirements set by the law (see §31 (1) 1) of the AA), issue oral warnings to the person who commissioned certain advertising and the advertiser or the producer of the advertisement in question, and draw said persons' attention to any failure to comply with the requirements of the AA (see §31 (1) 5) of the AA).

The CPB is also entitled to issue guidelines of an advisory nature—i.e., non-binding recommendations. In 2012, the CPB issued advisory guidelines for consumer-credit providers,^{*36} in which it explained the obligations of responsible lending and laid down some rules for implementation of the reasonable lending principle.

4. Measures

4.1. Administrative measures

4.1.1. Licensing

There are currently no licensing measures or regulations in place for instant-loan providers under Estonian law, as the licensing system and supervision by the FSA are applicable only to credit institutions. However, during recent discussions the question has been raised of whether imposing licensing requirement could have a positive influence on the instant-credit market. Even the Supreme Court has stressed that the legislator should introduce more stringent administrative control requirements for the consumer-credit providers^{*37} and currently the Ministry of Finance is working on a legal proposal introducing licensing requirements also to creditors other than banks.

Indeed, if instant-loan providers were obliged to have a licence, it would be possible to exercise more efficient supervision of them. This would aid in getting a better overview of the situation with instant-loan providers and statistics on them. Licensing measures could also offer the possibility to establish minimum requirements for operation (e.g., a minimum threshold for equity capital and requirements for members of the management board). Last but not least, the possibility of losing the licence would motivate the creditors to comply with the requirements for responsible lending practices.

4.1.2. Marketing restrictions

Estonian law sets some specific restrictions on advertising of financial services and some general requirements for marketing that also have an impact on the instant-loan market. In 2013, the legislator introduced additional provisions to the AA on advertising of financial services. One of the major problems connected with instant loans (and non-secured consumer credit in general) is that in their advertisements creditors create an illusion that lending is extremely easy and will even resolve personal financial problems.^{*38} Recently, one of the most common commercial practices among many instant-loan creditors has been marketing the first loan as 'free': if taking out a loan under certain conditions (amount limits and conditions as to the time period), the consumer is obliged to repay only the principal amount of the loan later. The main purpose of that kind of practice is to attract new clients and to create a positive experience of the service.

The advertising restrictions—both general ones and those specific to financial services—are regulated in the AA. Under a general principle of the AA, advertising that in any way misleads or is likely to mislead the persons to whom it is directed or whom it reaches and that, by reason of its misleading nature, is likely to affect their economic behaviour or that, for those reasons, injures or is likely to injure a competitor of the person placing the advertising is prohibited. In accordance with the AA, therefore, an advertisement that

³⁶ Tarbijakaitseamet (Consumer Protection Board). Juhend tarbijakrediidi pakkujatele ja vahendajatele [‘Advisory guidelines for consumer-credit providers and retailers’], 22.11.2012 Available at http://www.tarbijakaitseamet.ee/sites/default/files/failid/dokumentid/juhend_krediidiandjatele_vastutustundlik_laenamine_.pdf (most recently accessed on 30.1.2014) (in Estonian).

³⁷ CCSCd 5.3.2014, 3-2-1-186-13, paragraph 25 (in Estonian).

³⁸ For example, the advertisement from the Web page <http://www.parimintress.ee/> ‘After a long postponement of visiting the dentist, I decided to borrow the absent money and finally got my teeth repaired. Thanks to the Web site parimintress.ee, I found a very favourable loan, and I am truly grateful to them for that’.

creates an impression that the non-secure easy-access loan is an easy solution for financial problems and has no serious consequences is prohibited.

In May 2013, an amendment was made to §29 (1) of the AA such that the rules on advertising by credit institutions are now extended to non-secured easy-access loan creditors. According to §29 (2) of the AA, an advertisement of financial services must include an invitation to examine the terms and conditions of the financial services and to consult an expert, if necessary. Any advertisement in which consumer credit is offered or the arrangement of consumer-credit contracts is offered must indicate the annual percentage rate of charge by way of a representative example (under §29 (3) of the AA). Further, an advertisement offering credit to a consumer has to be responsible, and the advertiser is not allowed to create an illusion that taking out consumer credit is risk-free and an easy solution to financial problems. Any advertisement in which consumer credit is offered or the arrangement of consumer-credit contracts is offered has to be responsible and balanced, and it may not suggest that consumer credit is a risk-free and simple opportunity to solve financial problems or induce consumers to ill-advised borrowing (see §29 (7) of the AA). The information shall be presented in such a typeface and font size as, given ordinary attention, make it noticeable, understandable, and clearly distinguishable from other information.

According to the explanatory memorandum on the above-mentioned amendments to the AA, their goal is to prevent financial services from being advertised in a way that leads the consumer to take out credit unwisely.^{*39} Responsible and balanced advertising also means that information about possibilities and purposes of using the loan should not overshadow the information on the obligations and responsibilities that follow from using the consumer credit.

In a general requirement under the CPA, unfair and misleading commercial practices are prohibited (see §12, items 2 and 3 of the CPA). An unfair commercial practice is a practice that is contrary to good commercial usage. A commercial practice is misleading if it employs false information or if presentation of factually correct information deceives or is likely to deceive the average consumer and, in consequence of it, the average consumer makes a transaction decision that he or she would not have made otherwise or is likely to do so. So far, there is no Supreme Court case law related to misleading or unfair commercial practices in relation to credit transactions.

The CPB has the right to issue, within the limits of its competence, advisory guidelines on compliance with the requirements arising from legislation for consumer protection. In 2013, the CPB exercised this right and issued guidelines for application of the financial-service advertisement requirements that were designed to specify the definition of advertisement and financial services. For example, in a situation wherein the client has not asked for an offer of financial services, a 'personal offer' is to be considered an advertisement.^{*40} Another aim with the guidelines is to specify the law's restrictions on the advertisement of financial services^{*41}, such as the obligation to publish a representative example. The service provider, when preparing a representative example through application of its best professional skills on the basis of the statistics and/or practice of the company, is responsible for classification of credit contracts and the authenticity of the data used.^{*42}

According to the statistics provided by the CPB, that board has conducted 54 sets of proceedings in 2011 related to advertisement of financial services. Violation of the law has been asserted 24 times. In 2010, the board carried out 38 sets of proceedings related to advertisement of financial services and violations were asserted in 17 cases.^{*43}

One can conclude that restrictions related to advertisements are relatively efficient measures against the illusion of 'easy money'. It is more doubtful, however, whether the obligatory information in

³⁹ Võlaõigusseaduse ja reklaamiseaduse muutmise seletuskiri ['Explanatory memorandum on the Act Amending the Law of Obligations Act and Advertising Act]. Available at <http://www.riigikogu.ee/?op=ems&page=eelnou&eid=7df3d370-3b77-4c0b-be6b-c73fffd0242b&> (most recently accessed on 18.1.2014) (in Estonian).

⁴⁰ Tarbijakaitseamet (Consumer Protection Board). Guidelines for compliance with the requirements arising from legislation for consumer protection, 12.9.2013. Available at http://www.tarbijakaitseamet.ee/sites/default/files/failid/dokumendid/guidelines_for_application_of_the_financial_service_advertisement_requirements-enters_into_force_01_12_2013.pdf (most recently accessed on 4.6.2014), p. 5.

⁴¹ *Ibid.*, p. 6.

⁴² *Ibid.*, p. 8.

⁴³ Tarbijakaitseamet (Consumer Protection Board). *Tarbijakaitseameti aastaraamat 2012* ['Yearbook of the Consumer Protection Board 2012']. Available at <http://www.tarbijakaitseamet.ee/en/node/304> (most recently accessed on 30.1.2014) (in Estonian).

a financial-service advertisement really is able to ensure that an average reasonable person actually can understand the possible risks of an instant-loan contract. Recently during the political debate the question has been raised whether to ban the advertising of consumer loans in TV and radio all in all but the debate is still ongoing.

4.1.3. The system of debt-counselling

Debt-counselling as a public social service is not generally available in Estonia. However, there are three types of debt-counselling systems.

On the Web page created by the FSA, there is an interactive 'debt-counselling' application that helps a debtor to analyse his or her situation.^{*44} The problem with Internet counselling is that it is not direct, it does not take into account the person's actual situation, and many people may not have access to the Internet.

The second category of debt-counselling involves NGOs offering counselling services on their own initiative and on their own conditions. There is no state supervision of these organisations, and the network of institutions is developed arbitrarily.

In a very limited extent, there are also debt-counselling services offered by the state and by the local governments. The Estonian Unemployment Insurance Fund offers personal counselling for unemployed persons with the purpose of helping the unemployed back to the labour market.^{*45} One part of their personal counselling encompasses debt-counselling if necessary. In order to obtain such debt-counselling, the person has to be unemployed. In a one-time programme, the Ministry of Social Affairs also has carried out debt-counselling for persons who are not recorded as unemployed, but such programmes are rather exceptional.

Some local governments too provide debt-counselling as a part of their social services. One of the most successful of these is the local government of Tallinn, which has created the Tallinn Social Work Centre, whose services include debt-counselling. The service is aimed at individuals who have their registered domicile in Tallinn, and the counselling is offered free of charge. Since 2008, the Social Work Centre has been offering debt-counselling also to persons who are not residents of Tallinn, but in those cases the fee for the service is 19 EUR.^{*46} If the debtor is directed to the Tallinn Social Work Centre by some other local government, the cost might be covered by that local government.

In conclusion one can state that debt-counselling service is not available as a general social service in Estonia. Therefore, the system of debt-counselling is not harmonised and is case-specific. The most accessible route to help is to use interactive debt-counselling Web sites. The indebted person also has the opportunity to utilise the help of NGOs, but there is no actual public supervision of these institutions. Debt-counselling organised by the state or local government is not systematic.

4.1.4. The credit register

Only a privately held negative credit register exists in Estonia. The register is maintained by a public limited company, AS Krediidinfo, as one of its publicly available business services (the register of payment disorders). Under Estonian law, apart from general data-protection rules^{*47}, there is no special regulation on dissemination of debtors' data.

The register of payment disorders was created back in 2001 as a co-operation project of commercial banks in Estonia with the aim of offering creditors the possibility to make reasonable and appropriate credit decisions and also to help creditors to apply the reasonable lending principle. The register contains data of both natural persons and legal persons. The data are obtained from the users of the register or from other creditors. Information about when and on what grounds the debt arose, when the obligation ended, and the approximate amount of the debt is held in the register.

⁴⁴ Völanõustaja ['Debt counsellor']. Available at <http://volanoustamine.minuraha.ee/files/v6lan6ustamine.pdf> (most recently accessed on 31.1.2014) (in Estonian).

⁴⁵ Tööturuteenused ja toetused ['Labour market services and benefits']. Available at <http://www.sm.ee/tegevus/too-ja-toime-tulek/tooturuteenused-ja-toetused.html> (most recently accessed on 31.1.2014) (in Estonian).

⁴⁶ The Tallinn Social Work Centre on the Internet: <http://www.swcenter.ee/> (most recently accessed on 18.1.2014) (in Estonian).

⁴⁷ Personal Data Protection Act (Isikuandmete kaitse seadus). – RT I, 30.12.2010, 11 (in Estonian).

A payment disorder is entered in the public register when debt has arisen from breach of contract and not been settled within 45 days. The amount of the debt has to be at least EUR 30, inclusive of interest and the penalty for late payment. If a person has many separate debts, the register shows the balance of the debts. The balance of a debt is updated in line with the actual amount of debt. An active payment disorder will be removed from the register when all obligations that have arisen in relation to the contract are fulfilled, but information about previous debts entered in the register remains there after the debt is paid. The information on previous payment disorders remains available for seven years in cases of legal persons and three years for natural persons.^{*48} Exceptionally, the payment disorders of natural persons that are entered in the register by banks will, according to the internal rules of the register, be available for five years.^{*49} Inserting data in the Krediidinfo database presumes that the creditor has a contract with AS Krediidinfo and that the contract that is the basis for the debt allows the lender to forward the data to the register of payment disorders. The consumer's consent is usually obtained via the standard terms. The information about legal persons is publicly available for everyone, but obtaining access to the information about private persons requires one to have a legitimate interest.^{*50}

There has been some discussion about the need for creating a positive credit register—i.e., a register that would include all the credit information, total income of private persons, and obligations that are officially registered. It is argued that a positive credit register would offer a possibility to focus on actual creditworthiness and its sustainability by the applicant.^{*51} The greatest impact of use of a positive credit register would probably be a decrease in the credit risk for creditors. It would also aid in implementation of the principle of responsible lending. It is suggested that a positive credit register would help to decrease the amount of unpaid loans: surveys by the World Bank Group and comparison of Estonia with other countries suggest that a positive credit register could decrease unpaid loans by 50% and consumer loans' interest by about 30%.^{*52} On the other hand, creation of a positive register raises privacy concerns, and there has not yet been a political decision on this issue

4.1.5. The principle of responsible lending

The principle of responsible lending and the obligations arising therefrom are mostly a result of implementation of the Consumer Credit Directive, although for credit institutions an obligation to assess a prospective borrower's creditworthiness was introduced back in 2007 in §83 (3) of the CIA. The main obligations related to the responsible lending principle are provided by the LOA and AA. The principle of responsible lending is not defined in Estonian law but can be described in terms of the various obligations of the creditor in the pre-contractual phase. The main obligations related to responsible lending are the obligation to acquire information that gives the creditor the possibility of assessing the creditworthiness of the customer, judge creditworthiness, and give the consumer sufficient information to enable him or her to assess whether the proposed consumer-credit contract corresponds to his or her needs and financial situation (under §403² (1) of the LOA). The burden of proof of compliance with those obligations lies with the creditor (see §403² (7) of the LOA).

In assessment of the creditworthiness of a consumer, the creditor should adhere to due diligence and take into consideration all the circumstances known to the creditor that may have an impact on the consumer's ability to repay the credit under the terms and conditions agreed upon in the contract, including the consumer's financial situation, regular income, other financial obligations, performance of earlier payment obligations, and the impact of a potential increase in the financial obligations arising from the consumer-credit contract, by means of determining the extent of the required assessment operations in light of the

⁴⁸ *Ibid.*, §6 (11).

⁴⁹ Erasiku maksehäirete sisestamine ['Recording of the payment disorders of private persons']. Available at <http://www.krediidinfo.ee/index.php?m=365> (most recently accessed on 25.2.2014) (in Estonian).

⁵⁰ Erasiku maksehäirete vaatamine ['Examining the payment disorders of private persons']. Available at <http://www.krediidinfo.ee/index.php?m=301> (most recently accessed on 25.2.2014) (in Estonian).

⁵¹ K. Saar. Positiivne krediidiregister teeb laenud odavamaks ['The positive credit register decreases the cost of credit']. – Äripäev, 15.10.2013. Available at http://www.aripaev.ee/?PublicationId=31503ED6-39D4-4163-9D98-74AA1E3959CE&p_aperarticleid=BBA4330D-3E54-433F-A3A9-2C0FCE5350AF (most recently accessed on 25.2.2014) (in Estonian).

⁵² *Ibid.* See also: Krediidinfo. Erasikute krediidiregistri võimalikkusest Eestis ['On the possibility of a credit register for private persons'], 12.11.2012. Available at <http://blog.krediidinfo.ee/2012/11/erasikute-krediidiregistri-voimalikkusest-eestis/> (most recently accessed on 25.2.2014) (in Estonian).

terms and conditions of the consumer-credit contract, the consumer data available, and the amount of the financial commitment undertaken (see §403² (2) of the LOA).

Both the FSA and the CPB have issued guidelines on implementation of the responsible lending principle. According to the guidelines of the FSA, the credit institution should assess whether the customer would be able to repay the loan from his or her income/salary and whether the customer's income will be viable in the future. Viability of repaying the loan means that the customer is able to pay back the loan out of his or her salary or savings without the need to liquidate the collateral.^{*53} The CPB too has emphasised the importance of viable lending. According to the CPB's guidelines, the creditor has to take the credit decision primarily on the basis of the viability of paying.^{*54}

In 2010, the CPB received 692 consumer complaints related to consumer credit. The number for 2011 was 572.^{*55} The main reason for an injunction on consumer-credit providers was related to hardly understandable legal language in the standard terms and unreasonably high fees for premature termination of the contract. Statistics show that the complaints received by CPB in 2010 related to the principle of responsible lending and has detected 30 financial-service providers who failed to meet the responsible lending requirements.^{*56}

In the explanatory memorandum on the act implementing the Consumer Credit Directive, it is stated that the lender has the obligation to assess the client's financial situation during the counselling on the loan.^{*57} In §403² (1) of the LOA, the legislator has clearly connected Subsection 6 and Article 8 of the Consumer Credit Directive with each other, as a result of which it can be presumed that the legislator has foreseen the consumer's counselling in accordance with his or her creditworthiness.^{*58} In Estonian law, the obligations of the parties arising from the responsible lending principle are regulated as part of the pre-contractual obligations, with the goal of minimising the information asymmetry between the parties.^{*59}

It has to be taken into account that, according to the law, the consumer has to receive enough explanations. What is enough is not defined in the law and has to be determined case-specifically. The extent of the explanations is dependent upon the consumer, the conditions of the offer, and the complexity of the terms and conditions.^{*60} According to the guidelines of the Consumer Protection Board, the scope of the explanations depends on the specific credit product and on the previous experience of the consumer. The creditor is obliged to clarify the consumer's need and wish to get more information about the contract. It is not allowed for the creditor to encourage the consumer not to submit information that is necessary for the process of evaluating consumer creditworthiness. Also, the possibility of asking questions and getting sufficient answers from the creditor has to be ensured for the client.^{*61}

If the credit provider does not honour the obligations specified by law, the Consumer Protection Board can issue a prescription as to how the practice of the creditor should be changed (see §41 (1), item 1 of the CPA). According to § 23 (4) of the Law Enforcement Act^{*62} that is in force since 01 July 2014 the upper limit of possible penalty payment is 9600 euros. This is remarkably higher than the 640 euros that was the upper limit until the recent amendments.

⁵³ Finantsinspektsiooni soovituslik juhend ['Recommended guidelines of the Financial Supervision Authority'], Vastutustundliku laenamise nõuded ['Requirements on responsible lending'], p. 5. Available at http://www.fi.ee/public/Soovituslik_juhend_Vastutustundlik_laenamine.pdf (most recently accessed on 18.1.2014) (in Estonian).

⁵⁴ Tarbijakaitseamet (see Note 36).

⁵⁵ Tarbijakaitseamet (the Consumer Protection Board). *Tarbijakaitseameti aastaraamat 2011* ['Yearbook of the Consumer Protection Board 2011'], p. 10. Available at <http://www.tarbijakaitseamet.ee/en/node/304> (most recently accessed on 30.1.2014) (in Estonian).

⁵⁶ Tarbijakaitseamet (see Note 43), p. 14.

⁵⁷ Võlaõigusseaduse ja teiste seaduste muutmise seaduse seletuskiri ['Explanatory memorandum on the act implementing the Consumer Credit Directive'], p. 26. Available at <http://www.riigikogu.ee/?page=eelnou&op=ems&emshelp=true&id=1033413&u=20110306003000> (most recently accessed on 18.1.2014) (in Estonian).

⁵⁸ *Ibid.*, p. 26.

⁵⁹ K. Koll. Vastutustundliku laenamise põhimõte ['The principle of responsible lending']. Available at <http://www.just.ee/orb.aw/class=file/action=preview/id=55659/Kristiina+Koll.+Vastutustundliku+laenamise+p%F5him%F5te.pdf> (most recently accessed on 18.1.2014) (in Estonian).

⁶⁰ Võlaõigusseaduse ja teiste seaduste muutmise seaduse eelnõu seletuskiri (see Note 57), p. 26.

⁶¹ Tarbijakaitseamet (see Note 36), Section 7.

⁶² Law Enforcement Act (Korrakaitseadus) - RT I, 22.03.2011, 4 (in Estonian).

In the legal literature, it is argued that the principle of responsible lending does not oblige the creditor to refrain from giving credit to a non-creditworthy consumer.^{*63} Neither does such an obligation follow from the wording of §403² of the LOA. However, the Supreme Court has referred in a recent decision to the creditor being obliged to refrain from giving credit in cases wherein 'it should have been obvious to the creditor that extension of the loan term for an additional fee would only increase the debt'.^{*64} The Supreme Court stated that 'if the creditor had implemented the principle of responsible lending, the plaintiff would have not entered into contract with the creditor and could have avoided the increase of debt'.^{*65} Accordingly, it seems that the interpretation of the Supreme Court moved beyond the wording of the LOA with the conclusion that the creditor must refrain from granting credit in situations wherein the non-creditworthiness of the consumer is obvious.

5. Contractual measures

5.1. The unconscionability doctrine and relative APRC restrictions

In 2009, the Estonian legislator tried to solve the problems arising out of usurious practices of instant-loan providers through a legislative amendment setting forth a relative APRC cap in combination with the unconscionability doctrine. Before that, the prevailing view in court practice was that the parties are free to agree upon the interest rate of a loan and, therefore, an unproportionally high interest rate does not, in itself, entail violation of 'good morals'.^{*66} Thus a usurious credit contract could not be considered automatically void under §86 of the GPCCA. The position taken by the Supreme Court before 2009 was that such a contract can, as a rule, only be avoidable under §97 of the GPCCA if the consumer is able to prove that 1) he or she concluded the agreement under extremely unfavourable conditions, 2) he or she did so because of gross disparity (inexperience, urgent needs, etc.), and 3) the other party benefited from the gross disparity.^{*67} In the legal literature one could also find the view that in electronic credit transactions wherein the creditor does not assess the creditworthiness of the borrower, there should also be a possibility to consider a usurious credit contract void through breach of 'good morals' under §86 of the GPCCA.^{*68} In practice, though, this norm was never applied and credit agreements with high interest costs were held to be valid by the courts.

In February 2009, the Estonian Parliament passed a legislative amendment, affecting §86 of the GPCCA, with a purpose of 'reducing the social problems related to the rapid development of the instant-consumer-credit market'.^{*69} It was admitted that the legal rules in effect at the time were not able to solve those problems in accordance with the social needs and the society's sense of justice.^{*70} The amendment entered into force on 1 May 2009 and changed the notion of a transaction violating 'good morals'. The aim with the new wording of §86 of the GPCCA was to ensure that usurious credit contracts can be considered to be against good morals and hence void.

The new §86 (2) of the GPCCA stipulates that a transaction is deemed contrary to good morals if, *inter alia*, one party knew or had to know that the other party entered into the transaction because of urgent needs, said person's dependence or inexperience, or similar circumstances and if 1) the transaction was made on grossly unfair terms for the other party or 2) imbalance in the value of the mutual obligations of the

⁶³ K. Sein. Protection of consumers in consumer-credit contracts: Expectations and reality in Estonia. – *Juridica International* 2013, p. 37.

⁶⁴ CCSCd 19.02.2014 3-2-1-169-13, paragraph 21 (in Estonian).

⁶⁵ *Ibid.*

⁶⁶ See CCSCd 22.10.2002 3-2-1-108-02; CCSCd 16.10.2002 3-2-1-80-02; CCSCd 29.01.2007 3-2-1-137-06. See also K. Saare *et al.* (see Note 17), pp. 136–137.

⁶⁷ CCSCd 22.10.2002 3-2-1-108-02, paragraph 11 (in Estonian).

⁶⁸ P. Varul *et al.* *Võlaõigusseadus II. Kommenteeritud väljaanne* ['Law of Obligations Act II: Commented Edition']. Tallinn: Juura 2007, pp. 391–392.

⁶⁹ Tsiviilseadustiku üldosa seaduse ja võlaõigusseaduse muutmise seaduse eelnõu seletuskiri ['Explanatory memorandum on the Act Amending the General Part of the Civil Code Act and Law of Obligations Act']. Available at <http://www.riigikogu.ee/?page=eelnou&op=ems2&emshelp=true&eid=420369&u=20130411155159> (most recently accessed on 10.4.2013) (in Estonian).

⁷⁰ *Ibid.*

parties exists and can be deemed contrary to good morals. In order to ease the consumer's burden of proof, the second sentence of §86 (3) of the GPCCA stipulates that in the case of consumer-credit contracts it is assumed that the value of the parties' mutual obligations is disproportionate and contrary to good morals if, *inter alia*, at the time of issuing of the loan the APRC payable by the consumer is more than three times the average APRC charged on consumer credit by credit institutions according to the latest statistics of the Estonian Central Bank.^{*71}

The matter of the burden of proof under the new rule was initially not clear, however. A view was expressed in the literature that if the APRC of a credit agreement exceeds three times the average APRC, it is presumably void and it is for the creditor to prove the opposite—i.e., not having known or been required to have known of the existence of gross disparity.^{*72} Such a burden of proof would have been fairly complicated for the creditor to meet, as it would have meant the proof of absence of a circumstance. Therefore, the Estonian Chancellor of Justice went so far as to take the position that §86 of the GPCCA might violate the fundamental freedom of free entrepreneurship guaranteed by the Estonian Constitution.^{*73} The issue was finally clarified in 2011 in Supreme Court case 3-2-1-49-11. The Supreme Court stated that, for the credit contract to be held to be against 'good morals' and, accordingly, void under §86 of the GPCCA, it has to be ascertained, firstly, whether there is a gross imbalance in value in the mutual obligations of the parties and, secondly, whether the consumer concluded the contract in consequence of his or her urgent needs, dependence, or inexperience.^{*74} Most importantly, the Supreme Court stressed that it is the consumer who has to plead and prove the existence of the second of these elements, i.e. that he or she concluded the contract due to gross disparity.^{*75}

Such division of the burden of proof means that §86 of the GPCCA, providing for the voidness of a usurious credit contract, cannot be applied *ex officio* by the court, particularly if the consumer is not present in the proceedings, which is often the case in Estonia.^{*76} This is probably one of the most important reasons for which the unconscionability doctrine has proved to be ineffective against the usurious practices. The fact that it is the consumer who must plead and prove that he or she concluded the credit contract due to urgent needs or inexperience has created a situation in which there are practically no cases wherein the voidness of a usurious credit contract has been established by the court.^{*77} It is interesting to note, however, that in a judgement of the Tallinn District Court the court held that asserting claims arising from a consumer-credit contract with an APRC of 441% is not compatible with the principle of good faith.^{*78} The court explicitly did not apply the unconscionability doctrine of §86 of the GPCCA, although the arguments put forward in the judgement were, in fact, essentially the same as what can frequently be found in assessment as to the usurious nature of a credit contract. The court was probably trying to avoid the problem of the consumer having not established the existence of gross disparity and, rather, applying the principle of good faith, which could be applied *ex officio* and without any issues of the burden of proof.

One of the further reasons for which §86 of the GPCCA is very seldom applied in the case law is that usurious consumer-credit contracts are often enforced not in ordinary court proceedings but through the use of debt-collection agencies. This has psychological background as consumers tend to pay voluntarily after receiving a payment reminder from the debt collectors.^{*79} Firstly, they are not sure of their legal rights and often find the pressure from the agency intimidating. Secondly, many of them are afraid of the

^{*71} As of 1 March 2014, the annual interest rate published by the Bank of Estonia for short-term credit (granted in Estonian kroons) (at <http://www.eestipank.info/>) was 33.96%. As a result, the contractual APRC is deemed to be contrary to good morals if it amounts to more than about 100%.

^{*72} K. Saare *et al.* Laenusaja õiguste kaitse SMS-laenulepingute puhul ['Protection of consumers in SMS loan agreements']. – *Juridica* 2010/1, p. 47 (in Estonian).

^{*73} For further information on this issue, see the work of I. Ulst (see Note 18), pp. 44–77.

^{*74} CCSCd 17.06.2011 3-2-1-49-11, paragraph 8 (in Estonian).

^{*75} *Ibid.*, paragraph 9. The standard of proof may be lower, however, in those cases in which the disproportion between the parties' obligations is extreme.

^{*76} For more information, see K. Sein (see Note 62), p. 34, along with I. Ulst (see Note 18), p. 75.

^{*77} M. Vutt. Tehingu heade kommete vastas TSÜS § 86 alusel ['Transactions contrary to good morals under §86 of the GPCCA'], pp. 6–18, 25–26. Available at http://www.riigikohus.ee/vfs/1352/TehinguHeadeKommeneVastanus_MargitVutt.pdf (most recently accessed on 3.4.2013) (in Estonian). See also K. Sein (see Note 62), p. 34.

^{*78} Judgement of the Tallinn District Court 2-11-60438, of 3.1.2012 (in Estonian).

^{*79} K. Sein (see Note 62), p. 34.

creditor reporting their default to the credit information registry, which would result in their stigmatisation throughout the credit market.

The ordinary court proceedings are avoided also through the use of the order-for-payment procedure. If the creditor uses this procedure and the defaulting consumer does not file a timely statement of opposition to the claim, the court issues a payment order in accordance with §489 of the Civil Procedure Code. Such a payment order can be enforced without any other formalities, and thereby the creditor can avoid assessment of the validity of the claim by a court. The fact that the interests of consumers are not adequately protected in the order-for-payment procedure has been repeatedly stressed in the Estonian legal literature.^{*80} It is also the Estonian reality that most debtors in cases of usurious consumer loans tend to be persons who are not ready to assert their rights in the courts. Their situation is further complicated by the fact that consumer-credit norms are highly complex and consumers are, as a rule, not able to resort to them^{*81}, at least not without professional legal aid.

The norms banning usurious contracts have further been avoided via use of abstract acknowledgements of debt. It is common practice in Estonia that when a consumer defaults, the creditor (or the debt-collection agency hired by the creditor) offers him or her the option of signing an abstract acknowledgement of debt according to which the consumer acknowledges owing the creditor a certain sum of money. In other words, the capital of the debt, the interest, penalty interest, and other costs of the initial contract are added together and constitute the new capital owed under the acknowledgement of debt.^{*82} These acknowledgements of debt are then enforced either in the order-for-payment procedure or in ordinary court proceedings, which makes it impossible or at least very difficult to determine whether the underlying credit contract could be considered usurious and therefore void under §86 of the GPCCA.

All in all, one can draw the conclusion that in reality the unconscionability doctrine and the relative APRC restrictions in §86 of the GPCCA have not fulfilled their purpose of effectively limiting the usurious practices of electronic-consumer-loan providers. The same view has been expressed by the Estonian Consumer Protection Board.^{*83} Therefore, a plea has been made in the legal literature to abandon the unconscionability doctrine and to introduce APRC caps in its place.^{*84} Not all Estonian legal scholars favour APRC restrictions, though. Instead of limitations to the cost of credit and stricter information, disclosure, and prudent marketing requirements are proposed by I. Ulst in her doctoral thesis.^{*85} She also doubts the constitutionality of APRC or interest-rate restrictions, asserting that 'the APRC limit disproportionately restricts the constitutionally protected right of entrepreneurship freedom of service providers. In weighing the proportionality of the restriction, an important issue is the conflict between the principle of social state and the fundamental right of entrepreneurship freedom'.^{*86}

This far, the Estonian legislator has been unwilling to introduce APRC or interest-rate caps^{*87} and has instead favoured milder measures such as advertising restrictions or more detailed requirements for responsible lending. As the problem persisted, very recently the Supreme Court intervened and stated that the legislator should foresee APRC caps as a more efficient consumer-protection measure.^{*88} In the same decision, the Supreme Court partly amended its earlier position, ruling that if the APRC is more than six times the average market consumer-credit APRC, the consumer-credit agreement is presumably in violation of good morals and should, on that basis, be considered void.^{*89} At the end of March 2014, the Ministry

^{*80} K. Saare *et al.* (see Note 71), p. 49; M. Vutt (see Note 76), p. 6; V. Kõve. Tsiviilkohtumenetluse kiirendamise võimalused ja nendega seotud ohtud ['Possibilities for expediting civil proceedings and dangers thereof']. – *Juridica* 2012/9, pp. 670–671 (in Estonian); K. Sein (see Note 62), pp. 34–35, 39–40.

^{*81} V. Kõve (see Note 79), p. 668.

^{*82} J. Ots. Intressilt viivise arvutamise keeld [Prohibition of calculating penalty interest on interest]. – *Juridica* 2010/2, p. 422 (in Estonian).

^{*83} Tarbijakaitseamet (Consumer Protection Board). *Tarbijakaitseameti aastaaruanne 2010* ['Yearbook of the Consumer Protection Board 2010'], p. 55. Available at http://www.tarbijakaitseamet.ee/public/Aastaaruanne_2010.pdf (most recently accessed on 11.4.2013) (in Estonian).

^{*84} K. Sein (see Note 62), pp. 35–36.

^{*85} I. Ulst (see Note 18), p. 81. Other authors, however, are of the opinion that the regulation of APRC limits is justified for protection of consumers, especially in consideration of the fact that in various European countries similar or even more restrictive interest limits exist; see K. Saare *et al.* (see Note 71), pp. 141–142.

^{*86} I. Ulst (see Note 18), p. 79.

^{*87} A proposal for a legislative amendment presented by the opposition party to Parliament was rejected in September 2013.

^{*88} CCSCd 5.03.2014, 3-2-1-186-13, paragraph 25 (in Estonian).

^{*89} *Ibid.*, paragraph 22.

of Justice presented a draft for introduction of APRC caps, which would add a new §406² to the Law of Obligations Act. According to the newly drafted §406² of the LOA, a consumer-credit agreement would be void if its APRC exceeds triply the average APRC for consumer credit according to the latest statistics of the Estonian Central Bank. At the time of completion of this article, the draft has not yet been adopted, but if it does enter the law, it would probably mean a considerable reduction in usurious credit practices in Estonia.

5.2. Civil law sanctions for breaching the principle of responsible lending

In addition to the sanctions in administrative law, breach of the principle of responsible lending can have civil-law consequences in Estonia. Firstly, it has to be stressed that such breach does not render the credit agreement void.^{*90} But a creditor who is in breach of the responsible lending obligation may be liable for damages calculated on the basis of reliance interest. In late 2012, the Estonian Supreme Court stated that the obligation of the creditor to assess the creditworthiness of the borrower constitutes a pre-contractual obligation under §14 (1) of the LOA, according to which persons engaged in pre-contractual negotiations or other preparations for entering into a contract shall take reasonable account of one another's interests and rights.^{*91} If the creditor breaches this pre-contractual obligation, the borrower—and also the person who has given a surety for the borrower—may have a right to damages under Sections 14 and 115 of the LOA. The amount of damages should be assessed on the basis of the negative interest. The borrower should be thus compensated for all negative consequences of the credit—the Supreme Court explicitly names interest for late payment, penalty for breach of contract, and decrease in assets—and can offset the associated claim for damages with the repayment claim of the creditor.^{*92} Whether the contractual interest should also be considered worthy of compensation as damages is less clear, but the question should still be answered in the affirmative.^{*93}

It is yet to be decided in court practice whether breach of the responsible lending obligation can also lead to the avoidability (due to mistake or fraud) of the credit contract.^{*94} Most probably, this should be possible. In 2013, the Tallinn District Court established the legality of avoidance of a mortgage agreement by reason of fraud of the creditor under §95 of the GPCCA.^{*95} The court held that the failure of the creditor to assess the creditworthiness of the borrower constituted fraud in the circumstances of the case—the creditor was aware of the over-indebtedness of the borrower—and entitled the mortgagor to avoid the mortgage agreement. The creditor tried to bring the case to the Supreme Court but failed: the Supreme Court decided not to hear the case. The refusal of the Supreme Court to decide on that case indicates that the Tallinn District Court had applied the substantive law correctly: breach of the responsible lending obligation can indeed lead to the avoidance (on account of fraud) of a mortgage agreement.^{*96} But if the avoidance of a mortgage or suretyship agreement is held to be possible (there has even been talk of the principle of responsible surety-taking to go along with the principle of responsible lending), the same should apply to the possibility of avoidance of the credit contract in the first place.

All in all, the civil-law sanctions for breaching the responsible lending obligation can be described as relatively far-reaching under Estonian law: the consumer is, in principle, entitled to avoid the credit contract and claim damages for reliance interest. Further, the legislative amendment of §403² (7) of the LOA dating from 1 July 2013 clarified the issue of the burden of proof, specifying that it is the creditor who has to prove having complied with the responsible lending obligations. It is yet to be seen, however, whether those private-law sanctions will prove to be effective in case law or whether their application will be impeded by procedural issues. Thus far, we have found only one judgement in which a court has actually held the

⁹⁰ CCSCd 19.02.2014 3-2-1-169-13, paragraph 18 (in Estonian).

⁹¹ CCSCd 27.11.2012 3-2-1-136-12, paragraph 24 (in Estonian).

⁹² *Ibid.*, paragraph 25 (in Estonian).

⁹³ In the legal literature this was held to be possible already in 2007, before the adoption and implementation of the CCD. See P. Varul *et al.* (see Note 67), p. 383.

⁹⁴ See also K. Sein. Transposition of the new Consumer Credit Directive in Estonia. – *European Review of Private Law* 2012/2, pp. 439–440.

⁹⁵ Judgement of the Tallinn District Court 2-10-48441, of 30.5.2013.

⁹⁶ The Supreme Court has also held that the avoidance of a personal suretyship agreement for reasons of fraud or mistake is possible; see CCSCd 27.11.2012 3-2-1-136-12, paragraph 26.

creditor to be in breach of the responsible lending obligation.^{*97} In all other civil cases wherein the issue was considered, the court held that there was no breach of responsible lending, in some cases even stressing that the borrower must be able to assess his or her own creditworthiness.^{*98}

5.3. Party autonomy restrictions: Interest for late payment and claims for damages

5.3.1. Interest for late payment

The Estonian legislator and the Supreme Court have tried to improve the position of the consumer by restricting party autonomy in several respects. Mostly, the restrictions on party autonomy are related to interest for late payment and a creditor's claim for damages. Some of the restrictions apply to standard terms only, but most of them are relevant also for individually negotiated contracts.

When the consumer is in default on payment, the creditor is entitled to claim interest for late payment under §113 of the LOA. At first, after the passing of the LOA in 2002, there was no unanimity in views as to whether the creditor may demand interest plus penalty interest in the event of the consumer's default. The clarification came with the judgements of the Supreme Court ruling that the contractual interest can only be claimed until the sum for repayment is due—i.e., only for the time that was originally agreed upon for the use of the creditor's money. If the loan or part thereof is not repaid in time, from this point on the creditor is only entitled to interest for late payment and, as the case may be, for additional damages resulting from the delay. Thus the general rule under Estonian law is that interest for late payment cannot be claimed in combination with contractual interest for the time of default on repayment of the loan.^{*99} This rule is, in principle, dispositive in nature, so the parties can agree in the contract that the lender is entitled to claim the contractual interest alongside interest for late payment.^{*100} The party autonomy ends, however, at the point when the creditor has withdrawn from the contract because of the consumer's default: on account of the mandatory provisions of §416 (3) of the LOA, the creditor is then only entitled to interest for late payment and cannot claim the lost contractual interest as damages.^{*101} All in all, the general rule under Estonian law is that in the case of default, the creditor may claim—in addition to specific performance—only interest for late payment.

The restrictions place great weight on how the rate of interest for late payment is calculated. Usually, it is stipulated in the credit contract. Here again, party autonomy is somewhat restricted: according to §415 (1) of the LOA, the rate of interest for late payment in consumer-credit agreements may not exceed the statutory rate provided for in §113 (1) of the LOA. This too has created some controversy in past case law, as §113 (1) of the LOA actually covers two methods for calculating the statutory interest rate for late payment. According to the first sentence of §113 (1) of the LOA, the statutory penalty rate is calculated by adding eight per cent to the statutory interest rate specified in §94 of the LOA.^{*102} For credit agreements, an alternative calculation method is provided for in the third sentence of §113 of the LOA: if a contractual interest rate exceeds the statutory rate of interest for late payment, then the contractual interest rate constitutes the rate of interest for late payment. Therefore, if the contractual interest rate as of today exceeds 8.25%, the contractual interest rate will be applied as the rate of interest for late payment.^{*103}

⁹⁷ Judgement of Pärnu County Court 2-10-51549, of 7.6.2013. The Supreme Court found the creditor in breach of the responsible lending obligation also in case 3-2-1-169-13 but dismissed that argument due to procedural reasons.

⁹⁸ See, for example, Harju County Court judgements 2-12-32459, of 22.4.2013, and 2-12-22941, of 28.2.2013.

⁹⁹ CCSCd 29.01.2007 3-2-1-137-06, paragraph 17 (in Estonian); CCSCd 5.11.20018 3-2-1-89-08, paragraph 15 (in Estonian).

¹⁰⁰ P. Varul *et al.* (see Note 67), p. 394.

¹⁰¹ CCSCd 14.01.2009 3-2-1-120-08, paragraph 11 (in Estonian).

¹⁰² According to Section 94 (1) of the LOA, the interest rate shall be applied on a half-year basis and shall be equal to the last interest rate applicable to the main refinancing operations of the European Central Bank before 1 January or 1 July of the year, unless the law or the contract provides otherwise. The statutory interest rate referred to in Section 94 of the LOA is published on the Web site of the Estonian Central Bank at <http://www.eestipank.ee/pub/en/yldine/ekp/> and may change every six months.

¹⁰³ This was affirmed in Supreme Court judgement 14.01.2009 3-2-1-120-08, paragraph 12.

There is a further restriction on claiming interest for late payment; according to the mandatory §113 (6) of the LOA, no interest for late payment may be claimed for delay in the payment of interest.^{*104} While this does not preclude or restrict the right of the creditor to claim compensation for damage caused by a delay in the payment of interest (see the LOA's §113 (7) and §415 (1), second sentence), here the creditor bears the burden of proof as to the existence and amount of his or her damages. And, as we saw earlier, the Supreme Court does not allow the creditor to claim lost contractual interest as damages.^{*105}

Since the financial crisis in 2008, disputes on so-called refinancing agreements have become common. Refinancing agreements are usually concluded in a situation wherein the consumer is not able to pay back the original loan and his or her unpaid debts under the original credit agreement are 'refinanced'; i.e., the payment period is extended. It is common practice that in this situation the unpaid interest (and sometimes also the accrued interest for late payment) is capitalised; i.e., it is added to the capital of the loan. Thus, under the refinancing agreement, the consumer is obliged to pay interest also on the interest accrued under the original credit contract.

Controversy has arisen in case law as to whether such a refinancing agreement constitutes a new credit agreement or should be viewed only as an agreement to change the original credit agreement (to extend the payment period). There was also no common view on whether the practice of capitalising the interest is legal or not. This issue was cleared up by the very recent Supreme Court judgement 3-2-1-169-13. Here, the Supreme Court stated that the legal nature of such agreements should be evaluated on the basis of their economic content and that they should rather be considered modification of the original loan agreement.^{*106} Secondly, the Supreme Court considered capitalisation of interest (including interest for late payment) unacceptable: such practice is contrary to the prohibition expressed in §113 (6) of the LOA.^{*107} The Supreme Court emphasised that this provision shall not be avoided merely by replacing one agreement with another. Accordingly, it is only allowed to calculate the agreed interest and interest for late payment on the original capital of the loan.^{*108}

Estonian law also entitles the court to reduce the interest for late payment: according to §113 (8) of the LOA, a person required to pay interest for late payment may claim for a reduction of the fine pursuant to the provisions of §162 of the LOA.^{*109} However, the court may not do so on its own initiative; the debtor must so request.^{*110} When deciding upon reduction, the court must consider circumstances such as the extent to which the obligation has been performed by the debtor, the legitimate interests of the creditor, and the economic situation of the parties (see §162 (1) of the LOA). If the amount of interest for late payment exceeds the capital of the claim, then the creditor has to prove having suffered loss in a larger amount.^{*111}

As we have seen, claims for interest for late payment are restricted in several ways in Estonian law: firstly, when agreeing upon its rate, the parties must follow the restrictions of §415 (1) of the LOA; secondly, the creditor may not claim contractual interest in parallel with the interest for late payment; thirdly, no interest for late payment may be claimed for delay in the payment of interest; and, finally, the court is entitled to reduce the interest for late payment if the consumer so requests.

5.3.2. Contractual penalties and claims for damages

Restrictions to party autonomy exist also with respect to liquidated damages claims and contractual penalties. The lead here has been taken by the Supreme Court, who have acknowledged the dangers associated with absolute party autonomy and declared void several abusive clauses in consumer-credit contracts. At

¹⁰⁴ This has been criticised by P. Varul *et al.* See *Võlaõigusseadus I. Kommenteeritud väljaanne* ['Law of Obligations Act I: Commented Edition']. Tallinn: Juura 2006, p. 382; J. Ots (see Note 81), pp. 418–426. In 2009, the Ministry of Justice even presented a draft for elimination of this restriction. However, in the time of financial recession this was politically undesirable, and the law has remained unchanged thus far.

¹⁰⁵ CCSCd 14.01.2009 3-2-1-120-08, paragraph 11.

¹⁰⁶ CCSCd 19.02.2014 3-2-1-169-13, paragraph 17 (in Estonian).

¹⁰⁷ *Ibid.*, paragraphs 28–30.

¹⁰⁸ *Ibid.*, paragraph 29.

¹⁰⁹ The court may also reduce the statutory interest for late payment calculated in accordance with the third sentence of Section 113 (1) of the LOA. See CCSCd 3-2-1-120-08 (see Note 98), paragraph 12.

¹¹⁰ P. Varul *et al.* (see Note 103), p. 383; CCSCd 14.06.2005 3-2-1-66-05, paragraph 15 (in Estonian).

¹¹¹ CCSCd 14.06.2005 3-2-1-66-05, paragraph 18.

least once, the position taken by the Supreme Court has brought about amendments to the Law of Obligations Act. Namely, before 2008, it was common practice for creditors offering usurious electronic consumer credit to provide for a contractual penalty for late payment and for this to be claimed in addition to the interest on late payment.^{*112} In 2008, such clauses were declared void by the Supreme Court in case 3-2-1-120-08 as being contrary to the mandatory provisions of the consumer-credit contract law (§§ 416 and 421 of the LOA).^{*113} After this judgement, in 2011, a provision was added to the LOA precluding such contract terms: according to the new third sentence of §415 (1) of the LOA, agreements that allow claiming payment of earnest money or a contractual penalty from the consumer in the event of late payments are void.

Very often, the position of consumers who are in default is worsened by the high debt-collection and payment-reminder fees that they are bound to pay under the standard terms of the creditors. In the above-mentioned groundbreaking case, 3-2-1-120-08, the Supreme Court tried to stop the practice of creditors charging unreasonably high fees for debt collection and payment reminders as liquidated damages. The Supreme Court ruled that clauses according to which consumers have to compensate for debt-collection and payment-reminder fees as fixed in the standard terms of the creditor can be deemed unfair under §42 (3), item 5 of the LOA if they are unreasonably high.^{*114} However, there remains no common understanding in the case law of when such collection costs can be considered unreasonably high and the clauses, for this reason, void.^{*115} One can find decisions wherein the courts have found such costs to be unreasonably high and, accordingly, unfair, with the consequence that the consumer does not have to bear them or has to compensate for them to only a reduced extent.^{*116} In the majority of the cases, however, courts have held the clauses to be valid, ordering the consumers to pay relatively large amounts of collections costs.^{*117}

The absence of uniform case law on debt-collection fees stems from the fact that Estonian law does not provide for clear criteria in decisions on the possible unfairness of the liquidated-damages clauses pertaining to debt-collection fees. Therefore, there has been discussion of whether one should follow the example of several European countries (such as the Nordic countries or Holland) where maximum amounts of debt-collection costs are specified by law. The Ministry of Justice has done preliminary research on the issue and put forward a proposal to the legislature, but this proposal has not yet been adopted by the Parliament.

6. Penal measures

There are no measures in penal law in the Estonian law that could be applied in cases of usurious credit contracts or of breach of the responsible lending obligation. Usury is not considered a criminal offence under the Estonian Penal Code.

7. Conclusions

Instant loans are a fairly new phenomenon in the Estonian credit market. Regardless of the absence of statistical data of any precision, it is obvious that the problem of over-indebtedness is a very topical question.

Instant-loan providers are currently neither supervised by the Financial Supervision Authority in Estonia nor subject to a licensing system. Therefore, there are no official statistics on the exact number of borrowers; one can provide only some estimates. The market share of electronic retail lenders is about 16% of

¹¹² K. Sein (see Note 62), p. 38.

¹¹³ CCSCd 14.01.2009 3-2-1-120-08, paragraph 15.

¹¹⁴ *Ibid.*

¹¹⁵ K. Saare, K. Sein. Amtsermittlungspflicht der nationalen Gerichte bei der Kontrolle von missbräuchlichen Klauseln in Verbraucherverträgen [‘Obligation of national courts to act ex officio by unfair terms control in consumer contracts’]. – *Zeitschrift für Europäisches Unternehmens- und Verbraucherrecht* 2013/1, p. 24 (in German).

¹¹⁶ E.g., Tartu County Court decisions 2-08-14356 and 2-11-19661, wherein the Court considered 3,100-kroon (approx. 199 EUR) and 166.14 EUR debt-collection fees to be unreasonably high. Collection costs of 126 EUR were deemed unreasonably high also in a recent decision of Pärnu County Court (2-13-765, of 13.9.2013).

¹¹⁷ See, for example, decision of Harju County Court 2-07-3204, in which the creditor was awarded EUR 86.92 in debt-collection fees.

the whole retail lending market. However, according to various assessments, there might be approximately 100,000 customers of instant-loan providers, with their number continuously growing.

Estonian law provides some specific restrictions on advertising of financial services and some general requirements for marketing that have an impact on the instant-loan market. In 2013, the legislator set forth additional requirements in relation to advertising of financial services. Also, the responsible lending principle and expanded information obligations were added in the transposition of the EU Consumer Credit Directive. In addition to the administrative-law sanctions, breach of the principle of responsible lending can have civil-law consequences in Estonia—loan providers may be liable for damages calculated on the basis of reliance interest.

Debt-counselling as a social service is not generally available in Estonia. However, there is access to some privately organised debt-counselling systems. Only a privately held negative credit register exists in Estonia, but there is some discussion of the possibility of introducing a positive credit register.

In 2009, the Estonian legislator attempted to solve the problems arising out of usurious practices of instant-loan providers by means of a legislative amendment setting forth a relative APRC cap in combination with the unconscionability doctrine. In reality, the latter doctrine and the relative APRC restrictions have not fulfilled their purpose of effectively limiting the usurious practices of electronic-consumer-loan providers. Thus far, the Estonian legislator has been unwilling to introduce APRC or interest-rate caps. Rather, it has favoured lighter measures such as advertising restrictions or more detailed requirements for responsible lending. With the problem not having gone away, very recently a draft was presented by the Estonian Ministry of Justice with proposed introduction of an APRC cap, which should be triply the market average APRC. Should this proposal be accepted, it might lead to a considerable reduction in usurious credit practices in Estonia. Its effectiveness might, on the other hand, be reduced in consequence of use of the order-for-payment procedure remaining possible for consumer credit regardless of the APRC of a given contract. Other positive developments are the proposals for specified ceilings to debt-collection costs, for introducing licensing requirements for creditors and for additional restrictions on advertising.



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A Strict Regulatory Framework for SMS Credit and Its Effectiveness in Latvia

1. Introduction

In Latvia, SMS creditors conquered their market share at the end of 2008 as, in response to the various financial crises, the banks reviewed their credit policy, setting stricter requirements. In consequence, SMS credit became more readily accessible than bank credit and there was no necessity to secure the latter. Since then, SMS credit has become very popular among consumers. For example, in the first half of 2013, non-bank creditors issued SMS credit for, in total, EUR 97 million.^{*1} At the time of writing, there are 54 licensed non-bank creditors in Latvia. Of these, 20 are distance creditors (SMS creditors), 19 are creditors against pledges (pawnshops), 16 are consumer creditors (providing payments by instalment for goods or services), 15 handle leasing, and 12 are mortgage credit providers.^{*2}

The SMS credit industry is strictly regulated in Latvia; however, as is explained below, the creditors create new business strategies and tactics and, therefore, are usually a few steps ahead of the legislator. Moreover, the legislation process is long and complicated, so the problems in the industry are not solved on the spot. Accordingly, the aim of this article is to provide an overview of the legal framework regulating SMS credit in Latvia, to assess its effectiveness, and to analyse the relevant case law.

2. Legal and institutional overview

The Consumer Rights Protection Law^{*3} sets forth Latvia's general rules on consumer credit (in Article 8). With this law, also Directive 2008/48/EC^{*4} was implemented in Latvia; however, even though that directive excludes from its scope those credit agreements involving a total amount of credit less than EUR 200 (in Article 2, part 2 (c)), the Consumer Rights Protection Law does apply to such agreements (see Article

¹ Pārskats par ne-banku patērētāju kredītēšanas sektoru 2013. gada I. pusgadā ['Market summary for non-bank financial service providers, first half of 2013']. Consumer Rights Protection Centre. Available at http://ptac.gov.lv/upload/2013_parskats_par_nebanku_kredit_sekt_1_01_2013_-30_06_2013.pdf (most recently accessed on 1.3.2014) (in Latvian).

² *Ibid.*

³ Patērētāju Tiesību aizsardzības likums (Consumer Rights Protection Law). – *Latvijas Vēstnesis* ['Latvian Herald'] 1999, No. 104/105; 2013, No. 193 (in Latvian). English text available at http://www.vvc.gov.lv/export/sites/default/docs/LRTA/Likumi/Consumer_Rights_Protection_Law.doc (most recently accessed on 1.3.2014). Please note that not all translations of Latvian legal acts are updated in line with the latest amendments.

⁴ 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 133/66.

8, part 4³ (1)). On the basis of the latter law, numerous regulations of the Cabinet of Ministers have been adopted: Regulations on Consumer Credit^{*5}, Regulations Regarding Distance Contracts for the Provision of Financial Services^{*6}, and regulations on the licensing of consumer creditors.^{*7}

In addition, the Unfair Commercial Practice Prohibition Law^{*8} lays down the main principles for commercial practices in business-to-consumer relations, also affecting the consumer-credit landscape. In 2012, Parliament adopted the Law on Extrajudicial Recovery of Debt^{*9}, providing for, *inter alia*, the rights and duties of creditors and debt-recovery service providers in the recovery process. It was on the basis of this law that the Cabinet of Ministers issued Regulations on Licensing of the Debt Recovery Service Providers^{*10} and Regulations on Allowed Amount of the Debt Recovery Expenses and Non-Compensable Expenses.^{*11}

There are also other laws applicable to consumer-creditor relationships. For example, the Civil Law^{*12} sets forth the main principles of contract law, including those pertaining to legal penalties, legal amounts of interest, etc.

According to the Consumer Rights Protection Law, supervision and control of consumer rights' protection is implemented by the Consumer Rights Protection Centre (see Article 24).^{*13} The Consumer Rights Protection Centre assesses complaints and other submissions received from consumers, supervises markets for unfair commercial practices, controls the consumer-credit market, and issues special licences for consumer-credit service providers. The centre has issued guidelines on evaluation of consumers' ability to repay credit to non-bank creditors^{*14}, on fair commercial practice for consumer credit^{*15}, and on drafting of fair consumer-credit agreements.^{*16} Those guidelines state the general principles related to consumer credit but do not constitute an official interpretation of the legal norms, even though in practice creditors

⁵ Ministru kabineta noteikumi Nr. 1219: Par patērētāju kredīvēšanu (Cabinet of Ministers Regulations, No. 1219: Regulations on Consumer Credit). – *Latvijas Vēstnesis* ['Latvian Herald'] 2011, No. 2; 2013, No. 188 (in Latvian). English text available at http://www.vvc.gov.lv/export/sites/default/docs/LRTA/MK_Noteikumi/Cab_Reg_No_1219_-_Regulations_On_Consumer_Credit.doc (most recently accessed on 1.3.2014).

⁶ Ministru kabineta noteikumi Nr. 1037: Par distances lġumu par finanšu pakalpojumu sniegšanu (Cabinet of Ministers Regulations, No. 1037: Regulations Regarding Distance Contracts for the Provision of Financial Services). – *Latvijas Vēstnesis* ['Latvian Herald'] 2004, No. 209 (in Latvian). English text available at http://www.vvc.gov.lv/export/sites/default/docs/LRTA/MK_Noteikumi/Cab_Reg_No_1037_-_Regs_re_Distance_Contracts_etc..doc (most recently accessed on 1.3.2014).

⁷ Ministru Kabineta noteikumi Nr. 245: Noteikumi par kārtību, kādā izsniedz, pārrēģistrē, aptur un anulē speciālo atļauju (licenci) patērētāju kredīvēšanas pakalpojumu sniegšanai un maksā valsts nodevu par speciālās atļaujas (licences) izsniegšanu un pārrēģistrāciju, kā arī prasībām kapitālsabiedrībai speciālās atļaujas (licences) saņemšanai (Cabinet of Ministers Regulations, No. 245: Regulations Regarding the Procedures by Which a Special Permit (Licence) for the Provision of Consumer Credit Services Shall Be Issued, Re-registered, Suspended and Cancelled and the State Fee for the Issue and Re-registration of a Special Permit (Licence) Shall Be Paid, As Well As the Requirements for a Capital Company for the Receipt of a Special Permit (Licence)). – *Latvijas Vēstnesis* ['Latvian Herald'] 2011, No. 53; 2013, No. 202 (in Latvian). English text available at http://www.vvc.gov.lv/export/sites/default/docs/LRTA/MK_Noteikumi/Cab_Reg_No_245_-_Special_Permit_for_the_Provision_of_Consumer_Credit_Services.doc (most recently accessed on 1.3.2014).

⁸ Negodīgas komercprakses aizlieguma likums (Unfair Commercial Practice Prohibition Law). – *Latvijas Vēstnesis* ['Latvian Herald'] 2007, No. 199 (in Latvian). English text available at http://www.vvc.gov.lv/export/sites/default/docs/LRTA/Likumi/Unfair_Commercial_Practice_Prohibition_Law.doc (most recently accessed on 1.3.2014).

⁹ Parādu ārpusietas atgūšanas likums (Law on Extrajudicial Recovery of Debt). – *Latvijas Vēstnesis* ['Latvian Herald'] 2012, No. 186 (in Latvian). English text available at http://www.vvc.gov.lv/export/sites/default/docs/LRTA/Likumi/Law_On_Extrajudicial_Recovery_of_Debt.doc (most recently accessed on 1.3.2014).

¹⁰ Ministru kabineta noteikumi Nr. 64: Parāda atgūšanas pakalpojuma sniedzēju licencēšanas kārtība (Cabinet of Ministers Regulations, No. 64: Regulations on Licensing of the Debt Recovery Service Providers). – *Latvijas Vēstnesis* ['Latvian Herald'] 2013, No. 22 (in Latvian).

¹¹ Ministru kabineta noteikumi Nr. 61: Par parādu atgūšanas izdevumi pieļaujamo apmēru un izdevumiem, kuri nav atlīdzināmi (Cabinet of Ministers Regulations, No. 61: On Allowed Amount of the Debt Recovery Expenses and Non-compensable Expenses). – *Latvijas Vēstnesis* ['Latvian Herald'] 2013, No. 22 (in Latvian).

¹² Civillikums (Civil Law). – *Valdības Vēstnesis* ['Government Herald'] 1937, No. 41; 2013, No. 188 (in Latvian).

¹³ Patērētāju Tiesību aizsardzības centrs (Consumer Rights Protection Centre). Web site: <http://www.ptac.gov.lv/> (most recently accessed on 1.3.2014).

¹⁴ Vadlġnijas Nr. 7: Patērētāja spējas atmaksāt kredġtu novērtēšana kredġtu devējiem, kas neatbilst kredġtiestādes statusam (Guidelines No. 7: On Evaluation of the Consumer Ability to Repay the Credit for Non-bank Creditors). Patērētāju Tiesību aizsardzības centrs (Consumer Rights Protection Centre) 16.8.2013 (in Latvian).

¹⁵ Vadlġnijas Nr. 8: Godīgas komercprakses īstenošanai patērētāju kredīvēšanas jomā (Guidelines No. 8: On Drafting Fair Consumer Crediting Agreements). Patērētāju Tiesību aizsardzības centrs (Consumer Rights Protection Centre) 3.9.2013 (in Latvian).

¹⁶ Vadlġnijas taisnīga patērētāja kredīvēšanas lġuma sastādġšanai (Guidelines on Drafting Fair Consumer Crediting Agreements). Patērētāju Tiesību aizsardzības centrs (Consumer Rights Protection Centre) 2010 (in Latvian).

should follow those guidelines since they express the views of the supervising institution, the Consumer Rights Protection Centre. Moreover, the guidelines usually are accepted long before the relevant changes in the law are made, so they bridge the legislative gaps and set detailed rules specific to the field of credit. The clear tendency on the Latvian legal scene is for the law to regulate all situations in detail, with it not being deemed sufficient to endorse recommending or explanatory documents.

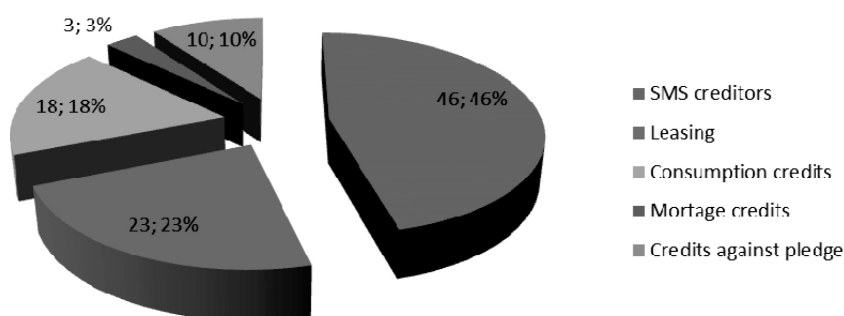
In general, it must be admitted that the legal foundation for regulation of SMS credit is fragmented and subject to frequent amendments. Accordingly, the body of related laws becomes immense and difficult to perceive. Furthermore, the amendments are adopted *post factum*—i.e., after events have aroused public interest or discussion in this field, as described below.

Statistics

Licensed creditors are obliged to submit information on the consumer-credit agreements concluded, the total sum of the credit issued, and default payment amounts, along with other information, to the Consumer Rights Protection Centre twice per year—by 1 March and 1 September.^{*17} According to statistics gathered by the Consumer Rights Protection Centre, creditors issued credit to consumer in the total amount of EUR 209.595 million in the first six months of 2013, with EUR 97 million, or 46%, of that taking the form of SMS credit (see Figure 1).^{*18} This is 59.38% more than the amount of credit issued in 2012.

It has been established that 77.53% of consumers repay the credit without delay; however, 7.92% delay by up to 30 days and 14.55% are in default on payment for more than 30 days.^{*19}

Figure 1. Total amount of issued credits 1st half of year 2013^{*20}



The statistics show that SMS creditors are still playing an important role in the market; only a small decrease in the amounts issued can be observed as public discussion of the problems related to SMS credit continues and stricter rules on evaluation of the creditworthiness of the relevant consumers are adopted.

3. Measures

3.1. Administrative measures

Licensing

In 2010, there were around 316 companies providing consumer credit in Latvia.^{*21} With the purpose of facilitating more effective supervision of the consumer-credit market, to introduce unified criteria for such companies, and to protect consumers, the authorities introduced a licensing scheme for providers of consumer

¹⁷ Article 28 of Regulations on Consumer Credit. See Note 5, above.

¹⁸ Pārskats par ne-banku patērētāju kreditēšanas sektoru 2013. gada I. pusgadā ['Market Summary of Non-bank financial service providers, first half of 2013'] (see Note 1, above).

¹⁹ *Ibid.*

²⁰ Figure reprinted from 'Pārskats par ne-banku patērētāju kreditēšanas sektoru 2013. gada I. Pusgadā' (*ibid.*).

²¹ Annotation to Regulations on Consumer Credit. See Note 5, above.

credit, in 2011. The consumer-credit providers had to increase the share capital of their companies to EUR 425,000^{*22} and had to obtain a special licence, for a fee of EUR 71,140. Consumer creditors shall re-register every year, and the state fee for this re-registration is EUR 14,255. The Consumer Rights Protection Centre grants a licence if the company in question has been registered with respect to its processing of personal data in line with the terms set forth by the Data State Inspectorate^{*23}, the capital company has developed internal procedures for the provision of consumer-credit services and evaluation of the creditworthiness of the relevant consumers, it does not have tax debts, etc.

The licence can be suspended if, for instance, the company does not provide this information, and the requested documents; does not co-operate with the Consumer Rights Protection Centre in order to rectify violations of consumer rights; or does not comply with the requirements of the regulations in force with respect to the protection of consumer rights (see Article 38 of the Regulations on Licensing the Consumer Creditors^{*24}). If the company rectifies the violations, the centre renews the licence within 10 working days (according to the terms of Article 40).

Also, the licence can be cancelled if the company significantly violates consumer and personal data protection etc. (under Articles 42 and 43). If its licence is cancelled, the company may file a submission for the receipt of a new special licence no sooner than three years later (see Article 48). No cases of suspension or cancelled have been reported yet.

It must be acknowledged that the licensing, firstly, has made the SMS credit market more transparent; *inter alia*, the creditors shall submit information about their business activities. Secondly, uniform requirements for creditors were introduced with the licensing system. Before the issuance of a licence, the Consumer Rights Protection Centre evaluates whether the relevant creditor can fulfil all legal requirements related to consumer protection, such as ensuring that any unfair contract terms have been eliminated; thus creditors are forced to have their contracts, internal regulations, and processes in order. For instance, *prima facie* illegal terms are excluded from the credit contracts, as the Consumer Rights Protection Centre evaluates the standard contracts before issuing a licence; thus, the centre effectively and actively supervises SMS credit.

Marketing/advertising restrictions and unfair commercial practices

In their first form, the Regulations Regarding Consumer Credit Agreements provided that credit advertisements^{*25} shall not encourage irresponsible borrowing and that all advertisements shall contain information warning consumers to borrow responsibly and to evaluate their ability to repay the credit (see Article 14).^{*26} In practice, as established by the Consumer Rights Protection Centre, the warning about responsible lending shall not be in a smaller font size than other text in the advertisement; otherwise, the warning does not fulfil its aim.^{*27}

However, the new Regulations on Consumer Credit^{*28} provide instead that the advertisement shall not encourage irresponsible borrowing (see Article 11). For determination of whether an advertisement encourages irresponsible borrowing, the overall content and the way it is presented, its design, and the information

²² Komerclikuma spēkā stāšanās kārtības likums (Law on Procedures for the Coming into Force of the Commercial Law). – Latvijas Vēstnesis [‘Latvian Herald’] 2001, No. 188; 2013, No. 193, Article 21 (3) (in Latvian). English text available at http://www.vvc.gov.lv/export/sites/default/docs/LRTA/Likumi/Law_on_Procedures_for_the_Coming_into_Force_of_The_Commercial_Law.doc (most recently accessed on 1.3.2014).

²³ Datu Valsts Inspekcija (Data State Inspectorate). Web site at <http://www.dvi.gov.lv/> (most recently accessed on 1.3.2014).

²⁴ Regulations on Consumer Credit. See Note 5.

²⁵ ‘Advertisement’ is any form or mode of announcement or endeavour associated with economic or professional activity, where intended to promote the popularity of or demand for goods or services, (including immovable property, rights, and obligations), according to Article 1 of the Advertising Law (Reklāmas likums). – Latvijas Vēstnesis [‘Latvian Herald’] 2000, No. 7; 2012, No. 169 (in Latvian). English text available at http://www.vvc.gov.lv/export/sites/default/docs/LRTA/Likumi/Advertising_Law.doc (most recently accessed on 1.3.2014).

²⁶ Ministru kabineta Noteikumi Nr. 692: Par patērētāja kredītēšanas līgumu (Cabinet of Ministers Regulations, No. 692: Regulations Regarding Consumer Credit Agreements). – Latvijas Vēstnesis [‘Latvian Herald’] 2008, No. 134 (in Latvian). English text available at http://www.vvc.gov.lv/export/sites/default/docs/LRTA/MK_Noteikumi/Cab_Reg_No_692_-_Regulations_Regarding_Consumer_Credit_Agreements.doc (most recently accessed on 1.3.2014). This has; not been in force since 2011.

²⁷ Consumer Rights Protection Centre decision E03-PTU-P65-7, of 2.3.2012. Available at http://www.ptac.gov.lv/upload/ptac_lemumi/2012/lemums_nr-e03-ptu-p65-7.pdf (most recently accessed on 1.3.2014) (in Latvian).

²⁸ Regulations on Consumer Credit. See Note 5, above.

provided in the advertisement on the credit service that enables the consumer to take an informed and economically justified decision shall be taken into consideration.

The new regulations do not directly require inclusion of a warning related to responsible lending. Nonetheless, the creditors still use this warning in their advertisements, and it plays an important role in evaluation of the content of the advertising, as is proved by the case of an advertisement with the slogan 'So easy!'. The latter advertisement was acknowledged as not conforming with professional diligence, as it promoted irresponsible lending even though it did also present a phrase reminding the reader to borrow responsibly.^{*29} The Consumer Rights Protection Centre concluded that the overall content of the advertisement and its presentation established the notion that the credit could be taken out easily and quickly, and that undertaking the credit obligations is hassle-free and not connected to any risks.

In another case, the consumer creditor's advertising spread stated that a client who borrows at least LVL 150 (~ EUR 214) gets an invitation to the concert Love in the Right Moment as a gift.^{*30} It was promised that the most well-known musicians would participate in the event, and concert tickets could not be bought on the open market. Firstly, the Consumer Rights Protection Centre established that advertising is part of consumer creditor's commercial practice.^{*31} Then, the centre decided that, since tickets were distributed to many consumers, this advertisement influenced consumers' economic behaviour. Furthermore, the advertisement did not indicate that the consumer undertakes financial obligations by receiving the credit and that the credit should be paid back with interest. Accordingly, such advertisement facilitates irresponsible lending, with consumers not evaluating whether such credit is necessary at that point and whether the credit can be paid back on time, without creating financial problems. In this case, the credit company argued that the new regulations do not mandate that advertisements include a warning about responsible lending. The Consumer Rights Protection Centre agreed that the warning is indeed not mandatory, after accepting new amendments; however, even if such a warning is included, the advertisement in question can facilitate irresponsible lending—Article 11.1 of the new regulations states that, for determination of whether there is facilitation of irresponsible lending, all information on the credit service provided in the advertisement that enables the consumer to take an informed and economically justified decision shall be taken into consideration. As the above-mentioned advertisement motivated consumers to take out credit irresponsibly, the company's commercial practice was misleading. The centre imposed a monetary penalty on the relevant SMS creditor.

The cases described above show that creditors use powerful advertisement tricks that often can be considered aggressive commercial practice or misleading advertisement. Additionally, most likely in consequence of the above-mentioned cases and similar ones, further amendments to Regulations on Consumer Credit were adopted.^{*32} Those amendments describe *prima facie* examples of advertisement that promotes irresponsible borrowing. For example, an advertisement that calls on the reader to take out credit without considering its necessity and regardless of the consumer's finances or implies that there is no risk when one takes out credit shall be considered to be advertising of irresponsible borrowing (under Article 11.1). The regulations state that encouragement of irresponsible borrowing in advertising occurs also when the creditor offers, in addition, goods, services, or other preferences besides the credit itself. If the creditor violates such rules, the Consumer Rights Protection Centre, taking into consideration the character and nature of the violation, can require the creditor to ensure the conformity of its advertising, with adverts in full accordance with the law^{*33}, or can apply administrative sanctions. For example, the administrative fine for legal persons distributing an advertisement not conforming to the requirements of regulatory acts can range from EUR 70 to 14,000.^{*34}

²⁹ Consumer Rights Protection Centre decision E03-PTU-F213-1, of 2.2.2014. Available at http://ptac.gov.lv/upload/02.01.2014_lemums_izraksts_as_bigbank.pdf (most recently accessed on 1.3.2014) (in Latvian).

³⁰ Consumer Rights Protection Centre decision E03-PTU-F47-7, of 1.7.2013. Available at http://ptac.gov.lv/upload/2013.07.01.lemums_apk_izraksts-2.pdf (most recently accessed on 1.3.2014) (in Latvian).

³¹ 'Commercial practice' refers to an act (course of conduct, representation, commercial communication, or marketing) or failure to act (omission) that is directly connected with the promotion of trade, sale of goods (physical or non-physical objects), or provision of a service to a consumer, according to Article 1, part 2 of the Unfair Commercial Practice Prohibition Law. See Note 8, above.

³² Grozījumi Ministru kabineta noteikumos Nr. 1219: Par patērētāju kredītēšanu (Amendments to Cabinet of Ministers Regulations No. 1219: Regulations on Consumer Credit). – *Latvijas Vēstnesis* ['Latvian Herald'] 2013, No. 127 (in Latvian).

³³ Article 15, part 4 of the Unfair Commercial Practice Prohibition Law. See Note 8, above.

³⁴ Latvijas Administratīvā Pārkāpuma kodekss (Latvian Administrative Violations Code). – *Ziņotājs* ['Herald'] 1984, No. 51; 2014, No. 51, Article 16613. English text available at http://www.vvc.gov.lv/export/sites/default/docs/LRTA/Likumi/Latvian_Administrative_Violations_Code.doc (most recently accessed on 1.3.2014).

The system for debt collection

Out-of-court recovery

Taking into consideration the number of consumer complaints about the methods and costs of out-of-court debt recovery, Parliament adopted the Law on Extrajudicial Recovery of Debt^{*35} in 2012. This law is applicable to creditors and licensed out-of-court collection companies (see Article 1). The aim of the law is to provide fair, proportional, and reasonable debt collection (Article 2). For example, it sets general rules for the culture of communication with the debtor—aggressive and offensive communication is forbidden; the debtor shall not be visited at his or her place of employment or residence without prior consent; and communication shall not be performed on Sundays, public holidays, or between 9pm and 8am (see Article 10).

Out-of-court collection companies shall be required to obtain a licence issued for a three-year term by the Consumer Rights Protection Centre (under Article 5), and the state fee for the issuance of this special licence is EUR 3,555, with renewal costing EUR 1,420 per year.^{*36} Before adoption of the law, there were 67 companies in the collection business^{*37}, whereas now there are only 22 companies so licensed.^{*38}

New regulations also limit collection costs.^{*39} Collection companies shall not collect more than seven euros for the written announcement of the debt and invitation to the consumer to pay the debt and not more than EUR 10 for other collection activities (under Article 2). The actual costs incurred in debt collection, however, are much higher than the cap set by the legislator.

Positive changes can be identified that have arisen from licensing of this sector. Creditors and debt-recovery companies are required to follow the quality standards that are set forth by law, and the collection costs borne by the consumer have significantly decreased. However, the law still does not cover questions related to the secondary collection process—for example, when the creditor moves the collection case from one collection company and forwards it to another.

In-court debt collection

Many disputes with consumers were resolved in arbitration until 2006. Then, with the implementation of the Unfair Terms in Consumer Contracts Directive^{*40} and in line with European Court of Justice practice^{*41}, the arbitration clause of many consumer contracts was acknowledged as unfair. Accordingly, most such disputes cannot be handled via arbitration anymore.^{*42}

Even though creditors can use court proceedings of various types for purposes of recovering the debts from their clients, court proceedings are not effective, in general, and they are time-consuming and rather expensive.

For example, the Civil Procedure Law^{*43} provides for special procedure—the compulsory execution of obligations in accordance with a warning procedure (the national equivalent of a European Order for Payment). This procedure shall apply only in those cases wherein the declared address of the debtor is known and the contractual penalty and interest together do not exceed the initial debt (see Article 406¹). The procedure is based on standard forms, it is a written process, and no court hearings are held. If the respondent does not submit objections to the claim but has received the warning, the court decides in favour of the claimant

³⁵ Law on Extrajudicial Recovery of Debt. See Note 9.

³⁶ Regulations on Licensing of the Debt Recovery Service Providers, Articles 39–40. See Note 10, above.

³⁷ Anotācija likumprojektam (Annotation to the Draft Law). See Note 9, above.

³⁸ Parādu atgūšanas pakalpojumu sniedzēji, kuri saņēmuši speciālo atļauju (licenci) parāda atgūšanas pakalpojumu sniegšanai [‘Debt collection providers that have received a special permit (licence) for debt collection’]. Consumer Rights Protection Centre. Available at <http://www.ptac.gov.lv/page/590> (most recently accessed on 1.3.2014) (in Latvian).

³⁹ Article 2 of Regulations on Allowed Amount of the Debt Recovery Expenses and Non-compensable Expenses. See Note 11, above.

⁴⁰ Council Directive 93/13 EEC of 5 April 1993 on Unfair Terms in Consumer Contracts. OJ L 095, 21/04/1993 P. 0029–0034.

⁴¹ ECJ Judgment C-168/05, of 26.10.2006, *Elisa María Mostaza Claro v. Centro Móvil Milenium SL*, 2006 I-10421; ECJ Judgment 6.10.2009 C-40/08, *Asturcom Telecomunicaciones SL v. Cristina Rodríguez Nogueira*, 2009 I-09579.

⁴² I. Kačevska. Piezīmes par šķirējtiesas nolēmuma piespiedu izpildes procesu [‘Notes on compulsory enforcement of arbitral awards’]. – *Jurista Vārds* [‘Lawyer’s Word’] 3.9.2013, No. 36.

⁴³ Civilprocesa likums (Civil Procedure Law). – *Latvijas Vēstnesis* [‘Latvian Herald’] 1998, Part 50¹, No. 326/330; 2014, No. 2 (in Latvian). English text available at http://www.vvc.gov.lv/advantagecms/docs/LRTA/Likumi/Civil_Procedure_Law.doc (most recently accessed on 1.3.2014).

and the decision is forwarded directly for compulsory enforcement. This procedure is quicker and less expensive—with a state fee of two per cent of the debt but not more than EUR 498.01—than other available procedures. However, it is not very effective, as in most cases the debtor responds to the claim and disputes it; therefore, the case should be dismissed, because Article 406⁷ of the Civil Procedure Law specifies that debtor objections submitted within the prescribed time period with respect to the validity of the payment obligation shall be the basis for termination of court proceedings related to compulsory execution of obligations in accordance with warning procedures. In these cases, the creditor can then apply the ordinary procedure.

In 2011, a small-claims procedure was introduced in the Civil Procedure Law.^{*44} The aim with this procedure was to expedite and simplify the resolution of small claims (claims for up to EUR 2,100), by means of a standard-form-based and mostly written procedure; however, the case materials available to the author of this article indicate that resolution of the disputes usually takes more than a year and that oral hearings are held in most cases. Therefore, the initial aim with the procedure is not met.

The ordinary civil procedure is seldom used for recovery in cases of consumer credit: it is even more time-consuming than the small-claims procedure. Moreover, the court fee is the same as for the small-claims procedure; i.e., if the claim is up to EUR 2,134, the court fee is 15% of the claim but not less than EUR 71.44 (under Article 34 of the Civil Procedure Law). Clearly, both procedures are very expensive for recovery of small debts. Moreover, compulsory enforcement of the judgement is not always successful, since the debtors may not have any income or may become insolvent. Accordingly, creditors use mostly the services of collection companies in their attempts at recovery from their clients.

Positive- and negative-credit registers

Until 2012, credit databases were not regulated by Latvian law; however, the Law on Extrajudicial Recovery of Debt^{*45} introduced special requirements applicable to negative-credit databases. According to that law, the debtor shall be included in a negative-credit database only if having delayed payment for more than 60 days. The information may be stored in the database for three years from the moment at which the debt is paid; otherwise, the information is stored in keeping with the statute of limitations, for 10 years (see Article 13).

A third party may receive information from such a database if there is an agreement concluded between the creditor and the third party and also if the debtor has indicated acceptance in accordance with the Personal Data Protection Law.^{*46}

In practice, each SMS creditor and debt-recovery company keeps its own credit database. In parallel, the Bank of Latvia maintains its own credit register.^{*47} Consequently, there is no single uniform register of negative and positive credit, so highly objective information can not always be received about a prospective client.

Responsible lending obligations

As is indicated above, creditors shall not encourage irresponsible lending in their advertising, and regulations provide for a non-exhaustive blacklist of advertisers that *prima facie* promote irresponsible lending. The list covers the following situations: inviting a consumer to take out credit without considering its necessity and reasonability or without regard for his or her financial situation; creating the impression that receipt of the credit is without risk or that credit can solve all of one's financial problems; and influencing the consumer's decision to take out credit by offering additional services, goods, or other benefits.^{*48} Also, the Consumer Rights Protection Centre can impose administrative fines for such violations.^{*49}

⁴⁴ Grozījumi Civilprocesa likumā (Amendments to Civil Procedure Law). – *Latvijas Vēstnesis* ['Latvian Herald'] 2011, No. 148 (in Latvian).

⁴⁵ Law on Extrajudicial Recovery of Debt. See Note 9, above.

⁴⁶ Fizisko personu datu aizsardzības likums (Personal Data Protection Law). – *Latvijas Vēstnesis* ['Latvian Herald'] 2000, No. 123–124; 2012, No. 104 (in Latvian). English text available at http://www.vvc.gov.lv/export/sites/default/docs/LRTA/Likumi/Personal_Data_Protection.doc (most recently accessed on 1.3.2014).

⁴⁷ Kredītu reģistra likums (Consumer Rights Protection Law). – *Latvijas Vēstnesis* ['Latvian Herald'] 2012, No. 92; 2013, No. 187 (in Latvian).

⁴⁸ Article 11.1 of Regulations on Consumer Credit. See Note 5, above.

⁴⁹ Latvian Administrative Violations Code. See Note 34, above.

Referring to materials from the European Commission^{*50}, the Consumer Rights Protection Centre indicates in its guidelines^{*51} that the target group of credit advertising is composed of vulnerable consumers. These consumers are more susceptible to a commercial practice or product because they are credulous; therefore, they readily believe in offers of quick and risk-free credit. The author of this article argues that, thanks to awareness and publicity of the issues associated with consumer credit and the experience of large numbers of consumers, the target group of such advertisement shall be identified as average consumers. Moreover, the consumer too should take responsibility in the process.

The obligation to assess creditworthiness

Pursuant to Article 8, part 4¹ of the Consumer Rights Protection Law, the creditor is obliged to assess the creditworthiness of the consumer before conclusion of a credit agreement.^{*52} When evaluating the creditworthiness of a consumer, the creditor shall take into account, firstly, the sufficiency of the information provided by said consumer. Such information includes income, employment, other characteristics (such as age, education, and civil status), etc. as indicated in the guidelines issued by the Consumer Rights Protection Centre.^{*53} If the credit is for less than EUR 427 and monthly payments do not exceed EUR 71, the creditor is permitted to rely only on the information given by the consumer. However, if the amount is greater, the SMS credit provider shall, secondly, evaluate the relevant credit history in credit databases or in other databases. If refusal to issue credit is grounded in the data obtained from databases, the creditor shall inform the consumer immediately of the result of said consultation and of the particulars of the database(s) consulted, without charge. The creditor's failure to assess the consumer's creditworthiness constitutes an unfair commercial practice and non-conformance with professional diligence.^{*54} The Consumer Rights Protection Centre may impose fines on legal persons in this connection, from EUR 70 to 14,000, in accordance with the Latvian Administrative Violations Code.^{*55}

One reason for introduction of the obligation to assess the consumer's creditworthiness was the aim of restricting the possibility of issuing SMS credit immediately after application by the consumer. For example, it is suggested that 15 minutes is too little time for full evaluation of the consumer's creditworthiness.^{*56} Nonetheless, SMS credit can be received very quickly.

In practice, the argument that the creditor has not completed an evaluation of creditworthiness is the justification most often used by consumers in default. In the debtor's mind, the deal should, in consequence, be considered void. However, many of the consumers in this category have, firstly, supplied their employment records and salary amounts when registering for the credit, so that the creditor can assess the creditworthiness of the prospective client on the basis of the information provided. Secondly, most of these consumers have previously taken out credit with the same provider and, more importantly, paid back the sums on the required date or even earlier. Therefore, consumers cannot rely on the argument that the creditor has not evaluated their creditworthiness.^{*57}

⁵⁰ Commission Staff Working Document 'Guidance on the Implementation/Application of Directive 2005/29/EC on Unfair Commercial Practices', SEC (2009) 1666, 3 December 2009, available at http://ec.europa.eu/justice/consumer-marketing/files/ucp_guidance_en.pdf (most recently accessed on 1.3.2014).

⁵¹ Guidelines No. 8: On Drafting Fair Consumer Crediting Agreements. See Note 6, above.

⁵² See also, Consumer Rights Protection Centre's decision No. E03-PTU-F94-10 dated 18 July 2013. Available at http://ptac.gov.lv/upload/leemums_4finance.pdf (most recently accessed on 1.3.2014) (in Latvian).

⁵³ Guidelines No. 7: On Evaluation of the Consumer Ability to Repay the Credit for Non-bank Creditors. See Note 14, above.

⁵⁴ See Article 4 of Regulations Regarding Distance Contracts for the Provision of Financial Services (Note 6, above).

⁵⁵ Latvian Administrative Violations Code. See Note 34, above.

⁵⁶ L. Dārziņa. Ātro kredītu biznesu liks stingrākos normu rāmjos ['Quick credit will be put in a stricter framework']. From the portal 'Latvijas Vēstneša portāls' and available at <http://www.lvportals.lv/print.php?id=254090> (most recently accessed on 6.5.2014) (in Latvian).

⁵⁷ See, for example, Rīgas pilsētas Vidzemes priekšpilsētas tiesas (Riga City Vidzemes Suburb Court) case C30555113, of 27.2.2014, unpublished.

3.2. Contractual measures

Regulations Regarding Distance Contracts for the Provision of Financial Services^{*58} is a set of rules prescribing the information to be included in a distance agreement for the provision of financial services, specifically SMS credit. Namely, the agreement with the consumer shall include precise description of the services provided; the total sum to be paid, including all expenses and commission fees; the payment terms; the obligations and rights of the parties; etc. In general, almost all SMS creditor offer very similar contract terms, except with regard to the fees, APRC, contractual penalties, and interest.

Contractual penalty

The issue of contractual penalties is one of the most topical questions in the Latvian legal environment, so it is appropriate to describe the historical evolution of the legal norms related to penalties.

Initially, the Civil Law did not set any limits as to the amount of contractual penalties, stating that the contracting parties themselves shall determine the amount of these and that it is not limited to the amount of the losses expected as a result of non-performance of the contract (see Article 1717).^{*59} In practice, creditors and collection companies were collecting penalties from debtors not only for the delayed payments but also for other breaches of the credit contract. Consequently, the amounts of the penalties were excessive in many cases. For example, someone concluded a credit agreement for EUR 213 on 6 May 2004 and the contractual penalty for delayed payments as of the moment when the consumer submitted a complaint to the Consumer Rights Protection Centre (on 18 December 2006) was EUR 7,466.^{*60}

The special law—in the form of the Consumer Rights Protection Law—provides that terms of contract that impose disproportionately large contractual penalties or other compensation for non-performance or unacceptable performance of the contractual obligations shall be deemed unfair and shall not be in force from the moment of entry into the contract (under Article 6, parts 3.4 and 8). Accordingly, the Consumer Rights Protection Centre has always paid special attention to the calculation of penalties under credit contracts. The centre has stipulated that, to establish whether a penalty is proportionate and grounded, one shall take into account the following criteria: the payments and their amounts (for example, whether the penalty is calculated from the debt sum or the total value of the agreement); the significance of the consumer's breach of contract (for example, the penalty being imposed if the client has not informed of a change of address), whether the contract provides for a ceiling to the contractual penalty and whether or not penalties are imposed doubly for the same breach (for example, for delayed payment and for a reminder letter about delayed payment).^{*61}

However, even though most SMS credit contracts provided a reasonable formula for calculation of the contractual penalties, consumers received debt computations with contractual penalties in the same amount as the initial debt or even more. Because of lack of the knowledge, time, or money necessary, most consumers did not turn to the courts for the protection of their rights and did not object to the excessive penalties. Many complaints still were received by the Consumer Rights Protection Centre^{*62}, though. Consequently, more changes were made in the relevant article of the Civil Law, in 2009. The legislator adopted a new Article 1724¹, providing that the courts shall reduce the penalty to a reasonable amount if it is excessive. In applying this provision of the law, the case law suggested that a contractual penalty is reasonable if it does not exceed the main debt.^{*63} However, the debt recovery was done primarily by collection companies,

⁵⁸ Cabinet of Ministers Regulations, No. 1037: Regulations Regarding Distance Contracts for the Provision of Financial Services. See Note 6, above.

⁵⁹ *Civillikums* (Civil Law). – *Valdības Vēstnesis* [‘Government Herald’] 1937, No. 46; 2013, No. 188 (in Latvian). English text available at http://www.vvc.gov.lv/export/sites/default/docs/LRTA/Likumi/The_Civil_Law.doc (most recently accessed on 1.3.2014).

⁶⁰ Regional Administrative Court judgement in case A42574607, dated 12 November 2009. Available at http://www.tiesas.lv/files/AL/2009/11_2009/12_11_2009/AL_1211_raj_A-1117-09_16.pdf (most recently accessed on 1.3.2014) (in Latvian).

⁶¹ Guidelines on Drafting Fair Consumer Crediting Agreements, pp. 14–21. See Note 16, above.

⁶² Reports on consumer complaints and consultations, information from the Consumer Rights Protection Centre. Available at <http://ptac.gov.lv/page/195> (most recently accessed on 1.3.2014) (in Latvian).

⁶³ *Tiesu prakse līgumsodu piemērošanā* [Courts' practice in applying contractual penalties']. Civil Department of the Supreme Court's Senate 2013, p. 5. Available at http://at.gov.lv/files/uploads/files/6_Judikatura/Tiesu_prakses_apkopojumi/Apkopoj_ligumsodi_5.11.2013.doc (most recently accessed on 1.3.2014) (in Latvian).

not the courts (the latter having the power to assess the reasonableness of the penalties), so still the companies calculated contractual penalties that exceeded the original debt.

Therefore, proposed changes related to contractual penalties were again put before Parliament for consideration. Article 1717 of the Civil Law was amended to state that a contractual penalty for delayed or incomplete obligations shall not exceed 10% of the initial debt or the total value of the contract.^{*64} Remarkably, despite the fact that this norm entered force on 1 January 2014, it is to be applied also to those contracts concluded before that date and executed on or after 1 January 2014 and if the claim regarding the contracts is not submitted to the court until 31 December 2014.^{*65} Moreover, these legislative changes pertain also to the order of debt extinguishment. Namely, a creditor previously could offset the debtor's payment first in terms of interest and contractual penalties, then with regard to the original debt, but with the latest changes, the contractual penalty shall be the last debt extinguished (see Article 1843).^{*66}

Three important consequences emerge from the latest amendments to Article 1717 of the Civil Law. Firstly, the amendments apply not only to consumer-to-business but also to business-to-business relations. This is regrettable. Restriction of contractual penalties could be more explicitly regulated in the special consumer laws, thereby allowing the possibility for free and unlimited agreement in business-to-business contracts as to the amount of penalties. Secondly, consumer-credit providers started to change the clauses on contractual penalties into late-payment interest clauses in their credit contracts, since the amount of late-payment interest is not as limited as that of contractual penalties (see the next section of this article). Thirdly, the courts reduce contractual penalties to 10% even for those consumer contracts concluded before the amendments were introduced, yet such decisions are not in line with European Court of Justice case law, which specifies that national courts shall render the unfair clause invalid and that the national courts are precluded from actually modifying the relevant contract by revising the terms' content.^{*67}

Interest

According to the general norm incorporated into Article 1753 of the Civil Law, interest is compensation either to be given for the use of a sum of money or to be submitted in consequence of late payment. The idea of interest as set forth in the Civil Law is to provide the important equivalence of the market economy—i.e., capital shall bring forth additional capital. Interest is not meant as punishment. Unlike a contractual penalty, it is encouragement to settle one's obligations in an expeditious manner.^{*68}

In practice, however, interest is also used as the price for default, especially with SMS credit. As is indicated above, after the amount of contractual penalties was limited to 10% of the basic debt under the Civil Law, most of the SMS creditors changed their terms on contractual penalties into late-payment-interest clauses in the contracts because the Civil Law provides that interest for late payment stops growing only upon reaching the amount of the capital (see Article 1763), so the creditors can claim more in interest than in penalties. This problem has been acknowledged by the courts.^{*69} Consequently, the new changes in the law provide that inadequate interest and also interest that contravenes the principle of fair dealing shall be illegal (see Article 1764).^{*70} Therefore, if the court considers the interest inadequate, it may exercise its initiative and declare this clause of the contract to be void.

As can be seen from the foregoing discussion, diverse questionable practices in the consumer-protection field ended with the introduction of stricter rules in the body of general laws, and, furthermore, the rules shall apply not only to consumer contracts but also to commercial agreements, of whatever sort.

⁶⁴ Grozījumi Civillikumā (Amendments to the Civil Law). – *Latvijas Vēstnesis* ['Latvian Herald'] 2013, No. 128.

⁶⁵ Par atjaunotā Latvijas Republikas 1937. gada Civillikuma saistību tiesību daļas spēkā stāšanās laiku un piemērošanas kārtību (On Force and Application of the Renewed Contract Part of [the] 1937 Civil Law of the Republic of Latvia). – *Ziņotājs* ['Rapporteur'] 1993, No. 1; 2013, No. 2, Article 21.

⁶⁶ Civil Law. See Note 12, above.

⁶⁷ European Court of Justice case C-618/10, *Banco Español de Crédito SA v. Joaquín Calderón Camino*, 13.7.2012, not yet published.

⁶⁸ K. Torgāns. *Saistību tiesības, I. daļa* ['Contract Law, Part I']. Rīga 2006, p. 145 (in Latvian).

⁶⁹ Latvijas Republikas Augstākās tiesas Senāts (Supreme Court's Senate of the Republic of Latvia) judgement C20392609, of 10.10.2013. Available at <http://tiesas.lv/nolemumi/pdf/118342.pdf> (most recently accessed on 1.3.2014) (in Latvian).

⁷⁰ Article 1764 of the Civil Law. See Note 12, above.

APRC

An appendix to the Regulations on Consumer Credit^{*71} provides a formula for calculation of annual interest rates; however, the law does not actually restrict this rate. According to information provided by the Ministry of Economics, each creditor sets its own limits and some of them have rates that even start at 120% and reach 1552% (except for the first credit).^{*72} There have been legislative initiatives to limit the total amount of annual interest, but so far these have been without any success.

3.3. Penal measures

The Criminal Law^{*73} stipulates the general criminal responsibility of consumer-targeting service providers with respect to services that do not correspond with the quality standards set (see Article 202). Article 201 of the Criminal Law bans usury, specifying that any kind of lending activities performed by taking advantage of the borrower's difficult material situation and by setting excessively burdensome conditions shall be penalised with short-term detention (up to three months) or forced labour or with a monetary penalty. However, there are no cases reported yet of application of this norm.

4. Conclusions

Latvia not only introduced harmonisation of the Directive on Credit Agreements for Consumers^{*74} in accordance with the scope set forth in Recital 10 of its preamble but also enacted stricter rules pertaining to consumer credit. However, almost every outburst in the sphere of regulation of SMS credit results in amendment of the law. Thereby, the legal framework is changed too often and rules addressing SMS credit can be found in many, quite different laws, regulations, and guidelines.

In Latvia, SMS creditors are required to be licensed, and currently there are 20 SMS creditors so licensed by the Consumer Rights Protection Centre. The licensing scheme for SMS creditors has facilitated the adjustments of the SMS credit sector, since the creditors are required to follow strict rules and guidelines. The system includes unification and improvement of consumer contracts, along with limitations to advertisement content and the use of collection services. Moreover, SMS creditors shall submit statistics and other information related to credit twice per year, thereby rendering it possible to estimate the market share of SMS creditors, numbers of borrowers, and their level of payment discipline.

Latvian law sets in place specific restrictions to the advertisement of SMS loans; for example, advertisements may not encourage irresponsible borrowing, and a non-exhaustive list of examples of advertisement types that encourage irresponsible borrowing is provided in the law. Also, SMS creditors' activities are subject to rules aimed at prohibition of unfair commercial practices.

Debt-collection services too are subject to licensing in Latvia, so a strict set of rules is in place, providing a standard for communication between creditors, collection agencies, and debtors. The law also specifies rules for the establishment and maintenance of negative-credit databases and sets forth maximum limits to the costs that may be claimed from the consumer for collection services.

The legislator has amended the Civil Law so as to impose a cap on contractual penalties (10%) for all kinds of contracts, including consumer contracts, and setting limits to the interest rates. However, there are still no restrictions as to APRC or on the amount of the commission for the issuing of credit. Whether stricter is better only the future will show us...

⁷¹ Regulations on Consumer Credit. See Note 5, above.

⁷² G. Litvins. Augļošana un ētika ['Usury and ethics']. *Jurista Vārds* ['Lawyer's Word'] 12.2.2013, No. 6.

⁷³ Krimināllikums (The Criminal Law). – *Latvijas Vēstnesis* ['Latvian Herald'] 8.7.1998, No. 199–200; 27.3.2013, No. 61 (in Latvian).

⁷⁴ Directive 2008/48/EC (see Note 4, above).



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The Future of Consumer Credit in Lithuania: *Quo vadis*, Consumer Credit?

1. Introduction

The recent financial crisis raised a number of issues related to whether the Lithuanian state did everything it could to avoid dire financial consequences not only for individuals but also for society as a whole. The question was asked—and is still being raised—at both national and EU level of the steps that should be taken to ensure that avoidance of such crisis or mitigation of its consequences.

Consumer credit is one of the financial services provided not only by the banks but also by other parties: both credit institutions and legal persons that are not credit institutions. In consequence of the financial crisis, banks have tightened their conditions for the provision of consumer credit; therefore, the establishment of new companies providing consumer credit has been affected, as has the expansion of the consumer-credit market beyond the banks. Today's statistics, as will be shown below, clearly substantiate the fact that consumer loans are granted in a reckless manner, regardless of whether or not the consumer will be able to repay the loan.

In recent years, consumer credit (especially in the form of 'quick loans') has been intensively and aggressively marketed on television, in magazines, and via the Internet. Usually, attractive slogans are used to promote consumers' activeness in the consumer-credit market. The marketing advertisements for consumer credit create the impression that consumer credit is the cure for all diseases and the easiest solution, a way to balance the consumer's finances, while also highlighting the speed of granting a loan and the around-the-clock nature of the service, along with the fact that the consumer credit can be applied for via text messages or Web sites. Furthermore, the client may be attracted by the allure of the first consumer credit being free of charge etc.

The situation in Lithuania with respect to the consumer-credit market clearly reveals that the market is rapidly developing and some statistical data are thought-provoking here with respect to the question of whether the state should take any measures (via tighter regulatory measures or other actions). The 2012 overview of the consumer-credit market, along with the presentation on this topic¹, announced by the Bank of Lithuania (hereinafter 'the supervisory institution') in July of 2013 revealed some important facts, which served as the basis for the supervisory institution's proposal of some amendments to the consumer-credit regulations. According to the supervisory institution's comparisons with 2011, in 2012 i) there were

¹ See Vartojimo kredito rinkos apžvalga, 2012 ['The overview of the 2012 consumer-credit market'] and the presentation on this topic, available at https://www.lb.lt/vartojimo_kredito_rinkos_apzvalga_2012_m and <https://www.lb.lt/n21596/skaidres.pdf> (most recently accessed on 30 April, 2014) (in Lithuanian).

70% more consumer-credit agreements signed, in an increase from 366,000 to 621,000 agreements; ii) the total amount of consumer credit granted was 32% greater, rising from 653.97 million litai (~189.56 million euros) to 862.31 million litai (~244.97 million euros); and iii) a 2.5 times increase was seen in the portfolio of small-sum consumer credit: from 83.18 million litai (~24.11 million euros) to 206.91 million litai (~59.97 million euros). At the end of 2012, payment was overdue by more than 60 days for about 20% of consumer credit (with 29% of the cases involving small-sum consumer credit), 40.7% of the outstanding amount of consumer credit was accounted for by small-sum consumer credit wherein the repayment period had been extended after the borrower paid an extension fee, 35% of the clients for small-sum consumer credit were below age 25, and the average annual percentage rate of charge (APR) for small-sum consumer credit was 177%. However, only 44 consumer complaints had been made in 2012 to the supervisory institution regarding consumer credit. The supervisory institution announced this March its overview of the consumer credit market for 2013^{*2}. According to the supervisory institution's comparison with 2012, in 2013 i) there were 17.19% more consumer-credit agreements signed (722,000 agreements); ii) the total amount of consumer credit granted was 16.67% higher, at 1,002.71 million litai (~290.64 million euros); iii) and there had been a 2.5 times increase in the portfolio of small-sum consumer credit, from 83.18 million to 206.91 million litai (~24.11 million euros to ~59.97 million euros). At the end of 2013, 23.6% of the consumer credit had its payment overdue by more than 60 days (32.7% of the associated credit being small-sum consumer credit), 36.81% of the outstanding amount of consumer credit came from small-sum consumer credit for which the repayment period had been extended after the borrower paid an extension fee, 39.21% of the clients for small-sum consumer credit were under 25, and the average APR for small-sum consumer credit was 164% (the APR has fallen by more than 10%). Despite the fact that the number of consumers filing complaints about consumer credit with the supervisory institution rose from 2012 to 2013, rising from 44 to 63, it seems—and the supervisory institution has arrived at the same conclusion—that this number is still relatively small. The conclusion of the supervisory institution in its evaluation of the 2013 consumer-credit market was that the consumer-credit market is growing further.

Therefore, it would be meaningful to mention that the number of lenders clearly shows as well that the consumer-credit market is very much growing in Lithuania. The number of lenders (at least those that are included in the official lists of lenders) rose in the span of six months (from 31 December 2012 to the start of July 2013) to almost 300%: the number of lenders rose from 56 to 146. Despite the fact that at the time of this writing (30 April 2014), the number of lenders remains at a similar level (147 lenders are on the list of consumer-credit lenders), there is no reason to believe that the consumer-credit market has not created even more issues for society.

The main aim of the present article is to show how the legal norms of Lithuania regulating consumer credit are dealing with the issue of easy access to non-secured consumer loans, especially via electronic means. The article also presents the proposals of the Bank of Lithuania pertaining to measures for improvement of the consumer-credit market situation with the aim of precluding ill-considered conduct and incautious decisions of consumers, along with additional measures for control of the consumer-credit market.

However, it should be noted that neither the 2012 overview of the consumer-credit market and presentation on this topic nor the statistics on consumer credit in 2013^{*3} released by the supervisory institution pay particular attention to the non-secured consumer credit that lenders provide via electronic means. However, as has been mentioned above, the supervisory institution in March released its overview of the 2013 consumer-credit market^{*4}, in which it indicated that, just as in the previous year (2012), most of the small-sum credit was provided by distance means (by phone or over the Internet). The supervisory institution indicated that 87.22% of the cases of small-sum credit were handled by distance means. However, the supervisory institution has not provided any information on whether and how the lenders follow the requirements of the laws on provision of information to consumers or other legal requirements, let alone examination of the factual situation.

This article addresses several aspects of the consumer-credit landscape: it i) provides a general overview of the regulation of consumer credit in Lithuania; ii) examines the particular fields of regulation of

² See Vartojimo kredito rinkos apžvalga, 2013 [“The overview of the 2013 consumer-credit market”], available at https://www.lb.lt/n20287/vartojimo_kredito_rinkos_apzvalga_2013.pdf (most recently accessed on 30 April, 2014) (in Lithuanian).

³ See https://www.lb.lt/vartojimo_kredito_rinkos_apzvalga_2012_m. (see Note 1) and https://www.lb.lt/n20287/vartojimo_kredito_rinkos_apzvalga_2013.pdf (see Note 2).

⁴ See https://www.lb.lt/n20287/vartojimo_kredito_rinkos_apzvalga_2013.pdf (see Note 2).

consumer credit, taking into account, where applicable, the provisions specific to control of easy-access non-secured consumer loans extended via electronic means; ii) and offers analysis of the proposed amendments to the regulations on consumer credit that are now under discussion at the ministerial level.

2. Overview of the regulation of consumer credit in Lithuania

2.1. A general legal overview of the regulation of consumer credit in Lithuania

Consumer credit is regulated by public and private legal norms. The regulation of consumer credit consists, in essence, of the regulation of particulars of consumer-credit contracts, the conditions imposed for lender (including credit intermediary) activity, and the responsibilities in cases of infringement of the requirements of the law. The legal basis for consumer credit has been influenced mostly by European Union law. Therefore, the relevant legal rules related to consumer credit were brought into the Civil Code of the Republic of Lithuania (hereinafter ‘the Civil Code’)⁵ with the transposition of the old Consumer Credit Directive (CCD)⁶ (articles 6.886–6.891 of the Civil Code, regulating the specifics of consumer-credit contracts, were included in the chapter ‘Loan Agreement’). However, the method of transposition of the new Consumer Credit Directive (hereinafter ‘Directive 2008/48/EC’)⁷ into Lithuanian law was different: the separate Law on Consumer Credit⁸, regulating private- and public-law matters, was adopted, and the provisions of the Civil Code regulating consumer credit were revoked accordingly (only Article 6.886, which specifies just the definition of a consumer-credit contract, the obligation of a consumer-credit lender to ensure that the principle of responsible lending is followed, the definition of ‘consumer-credit lender’, and reference to regulation by other laws). It should be noted that, in general, the wording of the Law on Consumer Credit corresponds with the wording of Directive 2008/48/EC. It should be taken into account also that the draft of the law was subject to very lively discussion in the Parliament of the Republic of Lithuania and there were some proposals to establish stricter provisions than are set forth in Directive 2008/48/EC.

The Law on Consumer Credit was changed—new wording, adopted on 17 November 2011, came into force on 1 January 2012. The essence of the changes of the law involved, firstly, institutional changes, with the functions related to the public administration of the consumer-credit market being assigned to the Bank of Lithuania (before that, the State Consumer Protection Authority was responsible for the supervision of the consumer-credit market). The supervisory function, functions related to imposition of sanctions and the alternative dispute-resolution mechanism in particular, were assigned to the Bank of Lithuania as the supervisory institution. The institutional changes caused some changes in the penalisation procedure accordingly. It may be concluded that it was the right decision to move the supervisory functions related to the consumer-credit market to the Bank of Lithuania, as this institution is more closely linked to the market itself and, therefore, able to assess the consumer-credit market in a more general way, taking into account the whole financial market. That has enabled it to gain a better understanding of the problems that consumers might face. Secondly, there was a quite important modification in relation to the maximum APR, which was reduced from 250 to 200 per cent. It should be noted that the maximum APR set forth by law is presumed to be the fair annual percentage rate of charge, and an APR greater than 200% is considered unfair. Therefore, it can be concluded that the change in the law was generally in the interests of consumers. More detailed analysis is provided further on in the article.

⁵ Lietuvos Respublikos civilinis kodeksas [‘Civil Code of the Republic of Lithuania’]. – *Official Gazette* 2000/74-2262 (in Lithuanian).

⁶ Council Directive 87/102/EEC of 22 December 1986, on the approximation of the laws, regulations, and administrative provisions of the Member States concerning consumer credit (OJ L 042, 12.2.1987).

⁷ 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 2008 133), also known as the Consumer Credit Directive.

⁸ Lietuvos Respublikos vartojimo kredito įstatymas [‘Law on Consumer Credit of the Republic of Lithuania’]. – *Official Gazette* 2011/1-1 and 2011/146-6830 (in Lithuanian). The new law was adopted on 23 December 2010 and came into force on 1 April 2011.

It should be mentioned that some secondary legal acts that are important in the field of consumer credit were adopted also. The Bank of Lithuania, as the institution responsible for supervision of the consumer-credit market, approved the rules for calculation of the annual percentage rate of charge⁹, the principles associated with responsible lending and evaluation of consumer creditworthiness¹⁰, the rules for lenders' inclusion on the list of providers of credit¹¹ (the latter rules were adopted by the State Consumer Rights Protection Authority and were not revised by the Bank of Lithuania), the guidelines on the advertisement of financial services¹², and rules on the provision of the obligatory information to the Bank of Lithuania¹³. The new wording of the principles for responsible lending and evaluation of a consumer's creditworthiness was adopted in 2013 (and came into force on 1 July of that year) (hereinafter, 'the Principles'), receiving a very negative reaction from consumer-credit lenders. The document was sharply criticised by some stakeholders (especially consumer-credit lenders and the association for small-sum consumer credit) in the media. They argued that this document had been adopted without thorough examination of the situation, that people will lose the possibility of receiving credit, that the new requirements will create a 'black economy' in this field, that the Principles are ambiguous, and that the document would be complicated to apply in practice. However, the banks welcomed the Principles and argued that they protect the client no matter who the lender is—a bank or another lender.

As has been illustrated above, the number of consumer-credit contracts has increased in recent years in Lithuania. The consumer-credit lenders have used aggressive marketing tactics; however, paradoxically, despite the fact that the Law on Consumer Credit has been in force for three years already, only a few cases related to consumer credit have reached the Supreme Court of the Republic of Lithuania (hereinafter 'the Supreme Court'). Moreover, there are no cases that would be related to the issues of easy obtaining of non-secured consumer loans via electronic means. Since the rules provided by the Law on Consumer Credit have not yet been tested and have not been verified in court practice (at least Supreme Court practice); therefore, it is difficult to judge what particular problems might arise in the application and interpretation of the Law on Consumer Credit in the existing consumer-credit market.

The regulation of consumer credit could be discussed in detail in terms of the following aspects: i) the particulars of the consumer-credit contract, ii) the duty of disclosure (the obligation to provide information to the consumer) and requirements for the information to be provided to the consumer, iii) the obligation of the lender to evaluate the creditworthiness of the consumer, iv) regulation of the activity of the lenders of credit, v) the state institutions responsible for the consumer-credit market, and vi) responsibility related to infringement of the provisions of the law.

The *ratione personae* of the Law on Consumer Credit is defined by application to the B2C relationship. The parties to the consumer-credit contract are the consumer (or consumer-credit borrower) and the lender of consumer credit. The consumer (or consumer-credit borrower) is, according to the law, a natural person who is aiming to conclude a consumer-credit contract for personal, family, or household purposes, not business or profession needs. The notion of the consumer reflects the definition in Directive 2008/48/EC. Although some proposals were made by the association of small and medium-sized enterprises for inclusion in the definition of a consumer not only natural persons, with the definition expanded to cover small and medium-sized enterprises too, the Lithuanian legislator decided not to extend the personal scope

⁹ Lietuvos banko 2012 m. lapkričio 29 d. nutarimas Nr. 03-245 „Dėl Bendros vartojimo kredito kainos metinės normos skaičiavimo taisyklių patvirtinimo“ [‘Resolution of the Bank of Lithuania of 29 November 2012, No. 03-245, on the rules for calculation of the annual percentage rate of charge’]. – *Official Gazette* 2012/140-7230 (in Lithuanian).

¹⁰ Lietuvos banko 2013 m. kovo 19 d. nutarimas Nr. 03-62 „Dėl Vartojimo kredito gavėjų mokumo vertinimo ir atsakingojo skolinimo nuostatų patvirtinimo“ [‘Resolution of the Bank of Lithuania of 19 March 2013, No. 03-62, on the principles for responsible lending and evaluation of consumer creditworthiness’]. – *Official Gazette* 2013/30-1519 (in Lithuanian).

¹¹ Valstybinės vartotojų teisių apsaugos tarnybos direktoriaus 2011 m. kovo 14 d. įsakymas Nr. 1-32 „Dėl Vartojimo kredito davėjų įrašymo į viešąjį vartojimo kredito davėjų sąrašą tvarkos aprašo patvirtinimo“ [‘Order of the director of the State Consumer Rights Protection Authority of the Republic of Lithuania of 14 March 2011, No. 1-32, on the rules for inclusion of lenders in the list of credit-lenders’]. – *Official Gazette* 2011/32-1528 (in Lithuanian).

¹² Finansinių paslaugų reklamos gairės, patvirtintos Lietuvos banko Priežiūros tarnybos direktoriaus 2012 m. rugsėjo 5 d. sprendimu [‘Decision of the director of the Supervisory Office of the Bank of Lithuania of 5 September 2012 on the guidelines for the advertisement of financial services’]. Available at https://www.lb.lt/finansiniu_paslaugu_reklamos_gaires (most recently accessed on 30 April, 2014) (in Lithuanian).

¹³ Lietuvos banko 2012 m. gruodžio 6 d. nutarimas Nr. 03-248 „Dėl Vartojimo kredito davėjų privalomos informacijos teikimo Lietuvos bankui taisyklių patvirtinimo“ [‘Resolution of the Bank of Lithuania of 6 December 2012, No. 03-248, on the rules on the provision of the obligatory information to the Bank of Lithuania’]. – *Official Gazette* 2012/145-7501 (in Lithuanian).

of Directive 2008/48/EC. The consumer-credit lender is a person, though not a natural person, who grants or promises to grant consumer credit in the course of his business. As the definition of the consumer-credit lender is not fully harmonised and the Member States have discretion to decide on expansion of the definition of who is a credit lender, the legislator of Lithuania decided that the lender here should be defined as only a legal person. Therefore, a natural person may not provide consumer-credit services.

The material scope of the Law on Consumer Credit in general is the same provided in Directive 2008/48/EC. However, as Directive 2008/48/EC allows some deviations from the provisions of the CCD with regard to scope, the legislator has decided not to exclude those credit agreements wherein credit is granted free of interest and without any charges and credit agreements under the terms of which the credit has to be repaid within three months and only insignificant charges are payable. Accordingly, the law provides no exceptions for credit involving a total amount of credit less than 200 euro (defined as credit above a 200-euro limit). The reason for the deviations mentioned was to include quick credit within the scope of the law.

2.2. The duty of disclosure and requirements as to the information provided to the consumer

The regulation of the duty of disclosure covers three stages in the agreement process, and its regulation reflects the provisions of Directive 2008/48/EC: i) the obligation to provide information in the advertising, ii) the obligation to provide information before conclusion of the contract (i.e., pre-contractual information), and iii) the obligation to provide information by implementation of the contract (that is, in the contractual stage). It should be noted that, according to Directive 2008/48/EC, the disclosure of information in the advertising or some details in the pre-contractual stage should be implemented through a representative example; however, the Law on Consumer Credit where it addresses the advertising stage refers only to standard information. It does not stipulate the requirement that the standard information provide illustration by means of representative example¹⁴. In general, the regulation of the duty of disclosure reflects the regulation by Directive 2008/48/EC. The only difference is that the Law on Consumer Credit establishes the *onus probandi* rule, according to which proving of the provision of the information to the consumer rests with the credit-lender. Moreover, no particular regulation exists in the area of the duty of disclosure related to the control of easy access to consumer loans via electronic means¹⁵, and neither the Law on Consumer Credit nor the Law on Unfair Commercial Practice makes any particular provisions in this area.

From the factual situation and the proposals issued by the supervisory institution (which will be discussed later in the article), it seems that one of the important issues for effective implementation of control of the consumer-credit market is the relationship between the provisions of the Law on Consumer Credit and the Law on Unfair Commercial Practice¹⁶, especially as relevant for separation of the competence of the supervisory institution from that of the other institutions responsible for the application of the Law on Unfair Commercial Practice. This issue proceeds from European Union law and is linked to the relationship between Directive 2008/48/EC and the Unfair Commercial Practices Directive (UCPD)¹⁷. As the European Commission has explained, the relationship between the UCPD and the CCD should be resolved through

¹⁴ As was indicated by the European Commission in its guidelines on the application of the Consumer Credit Directive in relation to costs and the annual percentage rate of charge (Commission Staff Working Document: Guidelines on the application of Directive 2008/48/EC (Consumer Credit Directive) in relation to costs and the Annual Percentage Rate of charge (8.5.2012; SWD (2012) 128 final), p. 9), the representative example should reflect not market conditions in general. It should instead be an attempt to reflect the exact characteristics of the credit to be obtained by the consumer from the creditor. This means that a specific consumer-credit product/case should be chosen rather than an abstraction of the general market. Moreover, the European Commission, taking into account the requirements of the Unfair Commercial Practice Directive, pointed out that the creditor should determine the content of the representative example on the basis of reasonable expectations related to the offer.

¹⁵ It should be noted that the requirements associated with information provided in the advertising stage are subject to full harmonisation and may not be changed by national legislation.

¹⁶ See Lietuvos Respublikos nesąžiningos komercinės veiklos vartotojams draudimo įstatymas [‘The law on prohibition of unfair business-to-consumer commercial practices of the Republic of Lithuania’]. – *Official Gazette* 2008/6-212 (in Lithuanian).

¹⁷ 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 and Amending Council Directive 84/450/EEC, Directives 97/7/EC, 98/27/EC and 2002/65/EC of the European Parliament and of the Council and Regulation (EC) No 2006/2004 of the European Parliament and of the Council (‘Unfair Commercial Practices Directive’) (OJ L 2005 149).

the application of the principles of *lex generalis* and *lex specialis*¹⁸. Although the UCPD, regardless of its full-harmonisation nature, allows Member States to provide specific regulation of financial services, the Lithuanian legislation does not state any specific provisions in the Law on Unfair Commercial Practice with respect to consumer credit. Part 3 of Article 4 of the Law on Consumer Credit indicates that the provisions of the Law on Unfair Commercial Practice related to the advertisement of consumer credit are applied where the rules of the Law on Consumer Credit are not. However, it seems that this rule does not help very much: firstly, as will be addressed below, the supervisory institution has indicated that ‘at this time, the supervising of advertising of consumer-credit contracts is limited to checking the criteria of Article 4 (1) of the Law; therefore, it means in practice that this rule is rarely applied: the consumer-credit lenders do not state any credit-related costs in advertisements, and advertising is limited to general resounding phrases’¹⁹. It should be noted that three institutions have competence related to the control of provision or non-provision of such information to the consumer, these being the supervisory institution (responsible for the control of the requirements under the Law on Consumer Credit), the Competition Council (generally responsible for the control of misleading advertisement according to the Law on Unfair Commercial Practice and the Law on Advertising²⁰), and the State Consumer Rights Protection Authority (responsible for the control of unfair commercial practices and of advertising that does not fall within the competence of the Competition Council). It becomes obvious from reviewing the practice of the Competition Council that the last of these institutions has not applied the provisions of the Law on Unfair Commercial Practice to misleading advertising with respect to consumer credit. The same is true of the Consumer Rights Protection Authority²¹. The supervisory institution has applied liability in accordance with the Law on Consumer Credit in only a handful of cases²². That means that said institution has not effectively applied the penalties related to infringement of the rules on the duty of disclosure in line with the Law on Consumer Credit. Such a situation is very interesting and strange, because the above-mentioned state institutions were, in the cases described by the supervisory institution, able to apply the provisions of the Law on Consumer Credit by imposing sanctions for infringement of the obligation to provide information to the consumer or the provisions of the Law on Unfair Commercial Practice by imposing sanctions for misleading actions or omissions. As has been stated by the European Commission, ‘the assessment of this compliance with the CCD and UCPD should be carried out, on a case-by-case basis, by the national authorities of the Member States which are primarily competent for investigating the conduct of individual companies in the light of EU legislation’²³. It is obvious that it may be hard in practice to separate the competence of three state institutions dealing with the enforcement of the provisions of the two laws. However, all of the problems (or, rather, at least most of them) could be solved via effective co-operation among these state institutions. Therefore, it is likely that the reason for the ineffective control of the consumer-credit market is not a problem with the sufficiency of the legal norms (at least there is no evidence that the legal norms preclude the

¹⁸ Guidelines on the Application of Directive 2008/48/EC (Consumer Credit Directive) in Relation to Costs and the Annual Percentage Rate of Charge (see Note 14), pp. 2, 3, 9, 12. The EC states therein that where there is ‘a conflict between the provisions of the UCPD and other EU rules, such as the CCD, it follows from the *lex specialis* principle in Article 3(4) of the UCPD that the more specific rules, and in this case the rules included in the CCD, prevail. In the CCD, reference to the relationship between the UCPD and the CCD with regard to the information requirements at the advertising stage is made in Article 4(4) and Recital 18, which confirms the *lex specialis* principle’.

With respect to the areas and/or elements not covered by the CCD, the UCPD applies and completes the framework by filling the gaps. However, according to Article 3(9) of the UCPD, in relation to financial services as defined in Directive 2002/65/EC, and to immovable property, the UCPD establishes minimal harmonisation only. This means that Member States may go beyond the requirements of the UCPD and impose requirements that are more restrictive or prescriptive in the areas and/or with respect to aspects not covered by the CCD.

¹⁹ See Lietuvos Respublikos vartojimo kredito įstatymo pakeitimo ir papildymo įstatymo aiškinamasis raštas [‘The explanatory note on the draft of the amendments to the Law on Consumer Credit’] prepared by the supervisory institution, p. 2. Available at http://www.lb.lt/n22037/aiskinamasis_rastas.pdf (most recently accessed on 30 April, 2014) (in Lithuanian).

²⁰ Lietuvos Respublikos reklamos įstatymas [‘Law on Advertising of the Republic of Lithuania’]. – *Official Gazette* 2000/64-1937 and 2013/57-2854 (in Lithuanian).

²¹ At least it is not very clear whether the sanctions have applied to lenders of consumer credit, because the decisions of the State Consumer Rights Protection Authority have neither given a description of the infringement nor indicated the business’s area of activity. The decisions are available at <http://www.vvtat.lt/index.php?2127023073> (in Lithuanian).

²² Information about some example cases wherein the supervisory institutions have applied the sanctions are available at http://www.lb.lt/uz_netinkama_reklama_75_tukst_lt_bauda_ukio_banko_lizingui_1 (most recently accessed on 30 April, 2014) and http://www.lb.lt/uz_teises_aktu_pazeidimus_vienam_vartojimo_kredito_davejui_bauda_du_ispeti_1 (most recently accessed on 30 April, 2014) (all in Lithuanian).

²³ *Ibid.*

state institutions' application of the laws mentioned) but the inefficient co-ordination of activities among the individual institutions responsible for control of the implementation of the Law on Consumer Credit and the Law on Unfair Commercial Practice. Undoubtedly, the effective application of the latter law could prevent unfair practices in the consumer-credit market and could be one of the measures used to control the ease of access to non-secured consumer loans, including via electronic means.

2.3. Regulation of the consumer-credit contract

As has been mentioned above, the Law on Consumer Credit regulates the particulars of the consumer-credit contract and, in its manner of doing so, generally reflects the provisions of Directive 2008/48/EC. There are, however, several elements added in the Lithuanian legislation.

Firstly, the Law on Consumer Credit (in its Article 10) sets in place some provisions related to consumer-credit contracts concluded by distance means (it should be noted that these provisions are additional to the national regulation stipulated in the Law on Consumer Protection^{*24} with respect to the distance marketing of consumer financial services, which reflected the regulation in the EU directive on distance marketing of consumer financial services^{*25}). The law refers to two conditions for the conclusion of a consumer contract by distance means: firstly, the law specifies the obligation of the consumer-credit lender to ensure that the consumer wants to conclude the contract by distance means; secondly, the contract shall be concluded only if the lender has ascertained the identity of the consumer. This provision of the law should be one of the measures used to prevent easy access to consumer credit and to preclude incautious decisions by consumers as to whether or not to enter into a credit agreement. However, it is not clear how this legal norm functions in practice and whether the consumer-credit lenders follow the associated requirements of the law in the process of conclusion of their consumer-credit contracts. It seems, when one considers the discussion that has appeared from time to time in the media about persons whose names were used by others taking out consumer credit, that this obligation is not fulfilled in the correct manner. As can be concluded from the publicly available information, the supervisory institution has not punished any of the consumer lenders for such practices.

Secondly, additionally to the provisions of Directive 2008/48/EC, Lithuanian regulation establishes certain contractual remedies for application if the obligation to provide information to the consumer is breached by the consumer-credit lender; i.e., if the lender provides misleading or inaccurate information and this information formed the basis for the decision taken by the consumer, the consumer has the right i) to withdraw from the contract after 30 days' notice or ii) to repay the credit in accordance with the conditions of the contract but without paying interest and any other fees. That is, the consumer has an obligation to pay only the principal of the loan, not any other amounts. The current content of the norm corresponds in essence with the regulation set forth in Article 6.888 of the Civil Code as it existed until the transposition of Directive 2008/48/EC. However, despite the fact that the above-mentioned norms have existed for almost 13 years now, there is no court practice of the interpretation of this regulation. Therefore, the practical effectiveness of the regulation is highly doubtful. One could conclude that consumers have not relied on this regulation and have not attempted to protect their rights on the basis of it. The rule mentioned appears at first glance to be very similar to the regulation of the consumer's right to withdraw from the consumer-credit contract as specified by Directive 2008/48/EC. However, thorough analysis shows that the regulation is of a different nature, especially in its consequences for the consumer-credit lender. Firstly, the consumer's right to withdraw from the consumer-credit agreement is not bounded by any particular amount of time. The fact of the provision of incorrect information to the consumer may be revealed at any time, whereupon the consumer may exercise his right to withdraw. Secondly, the right of withdrawal is related to reasons indicated by the law; that is, the grounds for exercise of the right of withdrawal consist of breach of the obligation of the consumer-credit lender to provide information to the consumer. Thirdly, the regulation of the right of withdrawal means the imposition of sanctions of some kind on the consumer-credit lender because

²⁴ Lietuvos Respublikos vartotojų apsaugos įstatymas ['Law on Consumer Rights Protection of the Republic of Lithuania']. – *Official Gazette* 1994/94-1833, 2000/85-2581, and 2007/12-488) (in Lithuanian).

²⁵ Directive 2002/65/EC of the European Parliament and of the Council of 23 September 2002 Concerning the Distance Marketing of Consumer Financial Services and Amending Council Directive 90/619/EEC and Directives 97/7/EC and 98/27/EC ('Distance Marketing of Financial Services Directive') (OJ L 2002 271).

the consumer has the right to pay only the principal and not pay any other fees. Moreover, the consumer is obliged to pay the amount of the principal only in parts, as provided for by the contract (according to the schedule referred to therein). However, it is not clear whether these consequences are to be applied only after withdrawal from the contract or whether they influence payments made before the withdrawal as well. The analysis provided above shows that the regulation pertains to the right of the consumer to terminate the contract; however, the regulation is not very consistent, because this right is associated not with breach of obligations under the contract but with the obligations that existed in the pre-contractual stage. Moreover, this regulation is not co-ordinated with the regulation of control of unfair terms: where there exist circumstances in which misleading information was provided to the consumer, it suffices to conclude that unfair terms existed in the contract and the contract is null and void, with there being no necessity of terminating the contract explicitly.

Thirdly, the law establishes a maximum rate of interest on default, which shall not be higher than 0.05% for each day of default. Moreover, the law states the imperative norm that any other interest or fees for default shall not be paid by the consumer in the event of non-fulfilment of obligations under the consumer-credit contract. Therefore, in this case, the law restricts the liability of the consumer in what corresponds with the general principle of civil liability set forth in Part 1 of Article 6.251 of the Civil Code. Moreover, according to Part 2 of Article 6.73 of the Civil Code, the court has discretion to reduce the interest on default²⁶, though the amounts of interest already paid on default cannot be reduced.

Fourthly, the law gives an exhaustive list of conditions in which the lender is able to terminate the contract. These conditions must all exist in order for termination to apply. The lender is able to terminate a consumer-credit contract only if i) the consumer has been informed about the payment related to default, ii) payment is delayed by more than one month and in the amount of not less than 10% of the total amount of the credit or delayed for longer than three consecutively months, and iii) the relevant payment has not been made within two weeks from additional notification to the debtor.

Fifthly, the law establishes a prohibition of a lender of consumer credit accepting bills of exchange, cheques, and debt instruments as payment. In the event of breach of this prohibition, the lender shall indemnify the debtor from all damages related to further use of such means. However, the consumer-credit lender is allowed to accept bills of exchange, cheques, and debt instruments as the means for security of the fulfilment of the obligation.

A sixth element has to do with one of the most important aspects of regulation of the consumer contract, related to regulation of consumer-credit prices and the maximum limit for the annual percentage rate. Firstly, the law specifies a set of principles applicable to the total cost of the credit to the consumer. According to the law, the total cost of the credit for the consumer has to be reasonable, justified, and in line with the fair dealing principle, and it must not infringe the balance between the interests of the consumer-credit lender and the consumer. Secondly, the law establishes the presumption that the total cost of the credit to the consumer does not correspond with the above-mentioned principles if the APR at the time of conclusion of the contract exceeds 200%. That means that the law regulates limits to the APR (via a cap on the APR). Setting of a maximum APR usually is used as a measure under anti-usury legislation²⁷. It should be noted that many countries in the European Union have regulations according to which the price associated with a consumer-credit contract is restricted by one or another method²⁸. Several issues could be mentioned in this connection with respect to Lithuanian regulation. Firstly, it is not clear enough what consequences are to be applied if the mentioned requirements of the law are infringed. It is clear that the law provides for only one consequence—with the presumption of the unfairness of the consumer price if the conditions of the law are not met. However, it should be noted that the control of unfair terms is not applied to the main terms of the agreement, with the exception of application of the transparency test (i.e., Lithuanian regulations

²⁶ Part 2 of Article 6.73 provides: 'The amount of penalty stipulated may be reduced by the court when it is manifestly excessive, or if the creditor has already benefited from partial performance of the obligation, though the sum may not be reduced below the damages payable for the failure to perform the obligation or for defective performance thereof. No reduction of the penalty paid shall be allowed.' Moreover, it should be taken into account that the penalty clause is not allowed under Lithuanian law.

²⁷ A correct credit interest and usury rate for consumers: Harmonisation of cost elements of the annual percentage rate of charge, APR, pp. 28–31. Available at http://www.iaclaw.org//APR_Interestrates_Europe_iff_1.pdf (most recently accessed on 30 April, 2014).

²⁸ Study on Interest Rate Restrictions in the EU, Final Report, Project No ETD/2009/IM/H3/87. Available at http://ec.europa.eu/internal_market/finservices-retail/docs/credit/irr_report_en.pdf (most recently accessed on 30 April, 2014).

establish the principle set forth in the Unfair Terms Directive). Therefore, there is not any basis in the general rules of the Civil Code for control of the main terms of the agreement or for declaring them unfair. That means that the regulation setting an APR cap is not co-ordinated with the Civil Code's provisions and is not complete. Secondly, it is not clear what state body would have the competence to indicate whether a contract term is fair or not and what price is fair in any given situation. Presumably, the courts would have competence to decide on this matter. However, in this case, one could debate what legal grounds exist for the court to interfere in the private (contractual) relationships and to decide on the contract price in particular, taking into account the principle that the court is able to intervene in the contractual relationship only in the cases specified by the law. However, such particulars are not described by the Civil Code. One might consider whether Article 6.228 could be applied in this situation²⁹ or whether general grounds for nullity of the transactions could be applied—e.g., declaring the contract null and void because it is counter to public order and good morals. The regulation of APR limits could lead to very different consequences under the above-mentioned articles of the Civil Code; therefore, it is not clear what kinds of consequences were intended upon the legislator's inclusion of the mentioned provision in the Law on Consumer Credit. Moreover, as has been mentioned above, there is a lack of court practice addressing this matter and it is difficult to predict how the law might be applied and interpreted by the court.

As has already been mentioned, besides special provisions of the Law on Consumer Credit, general provisions of the Civil Code regulating contract law and, in particular, the legal norms regulating the control of unfair terms are applied to consumer-credit contracts. Obviously, aggressive advertising practices should in practice be deemed to lead to the use of unfair contract terms. Accordingly, there should be a presumption of a need to apply the rules on unfair terms; however, again, there is practically no associated case law. In one of the most recent court decisions—the decision of 3 January 2014³⁰ in which the Supreme Court dealt with the terms of a contract with regard to the fairness of contractual interest—the court, stating that the applicant did not challenge the interest rate and contested only the contract term dealing with determination of interest, addressed the fairness of the contract solely in this respect. It should be noted that the court did not take into consideration the principle that it itself had developed in line with the practice of the European Court of Justice (ECJ) according to which the court must *ex officio* determine the matter of unfair terms of consumer contracts³¹. For the following reasons, the court did not declare the relevant term of the contract unfair: Firstly, in the court's opinion, the clause in question could not have been a surprise clause, in view of its content, wording, and method of expression (its content was expressed not only in the standard terms but also in the part of the contract discussed case-specifically, which covered the following: the yearly interest rate on the amount of the credit, the total amount of the credit, and the payment schedule (which reflected the monthly amount of credit to be repaid and the interest rate for the amount of credit granted); the method of calculation was indicated unambiguously, in clear verbal expression, and the method of payment was specified in a prominent place). Secondly, the court took into account

²⁹ Article 6.228 of the Civil Code states the following:

Article 6.228. Gross disparity of parties

1. A party may refuse from the contract or a separate condition thereof if at the time of the conclusion of the contract, the contract or its condition unjustifiably gives the other party excessive advantage. In such cases, among other circumstances, regard must also be paid to the fact that one party has taken unfair advantage of the other's dependent position, or of the other party's economic difficulties, [or] urgent needs, or of the latter's economic weakness, lack of information or experience, [or] inadvertence or inexperience in negotiations; regard shall also be taken of the nature and purpose of the contract.
2. Upon the request of the party entitled to claim for invalidity of a contract or a separate condition thereof on the grounds established in the preceding Paragraph of this Article, a court may revise the contract or its condition and adapt them respectively in order to make the contract or its separate condition meet the requirements of fairness and reasonable standards of fair dealing practices.
3. The court may modify the contract or separate conditions thereof also on the request of the party who has received a notice of the refusal from the contract if this party upon receiving the notice has immediately informed the other party about his request into the court, and the latter still has not refused from the contract.

It seems that a similar principle is applied in Estonia, through Article 86 of the General Part of the Civil Code Act. For a detailed explanation, please see the work of Karin Sein. Protection of consumers in consumer-credit contracts: Expectation and reality in Estonia. – *Juridica International* 2013(XX).

³⁰ Lietuvos Aukščiausiojo Teismo Civilinių bylų skyriaus 2014 m. sausio 3 d. nutartis civilinėje byloje Nr. 3K-3-114/2014 *BIG-BANK AS v. A.P.R.* [Decision of the Supreme Court of 3 January 2014 in civil case 3K-3-114/2014, *BIGBANK AS v. A.P.R.*] (in Lithuanian).

³¹ Joined Cases C-240/98 and C-244/98, *Oceano Grupo Editorial SA v. Rocío Murciano Quintero* and *Salvat Editore SA v. Jose M. Sanchez Alcon Prades et al.*, 27 June 2000 [2000] ECR I-4941 and other cases of the ECJ.

the specific personal characteristics of the debtor, including the fact that the person had a higher education and, therefore, could be deemed legally educated and aware that, in consideration of the opportunity to get a loan rapidly, a higher interest rate is charged³².

2.4. The lender's obligation to evaluate the creditworthiness of the consumer

The Law on Consumer Credit establishes the obligation of the consumer-credit lender to evaluate the creditworthiness of the consumer. The law does not indicate any particular rules for individual types of consumer credit—for example, credit by text message (SMS credit) or quick credit. Although the principle of responsible lending is stated in the law, the content of that principle is not described there. However, the content is elaborated upon in the Principles. Accordingly, each lender has an obligation to adopt the rules on the evaluation of the consumer's creditworthiness. Each lender of credit has an obligation to collect information (documents) proving its fulfilment of the obligation to evaluate consumer creditworthiness. The *onus probandi* lies with the lender for proving that it follows the requirements of the law.

The Consumer Credit Law regulates the consequences in the event that the credit-lender does not properly evaluate the creditworthiness of the consumer. In that case, the interest rate applied for late payment and any charges payable for default do not apply if the delay in payment arises from circumstances that were not properly evaluated. In the manner that this article examines below, the supervisory institution has suggested harsher consequences of the credit-lender breaching the obligation to evaluate the creditworthiness of the consumer properly.

As has been mentioned above, the principle of responsible lending has been elaborated upon by the supervisory institution. Under the Principles, responsible lending is understood as a lending activity of the lender during which consumer credit is granted in observance of certain provisions that create preconditions for the proper assessment of the consumer-credit borrower's creditworthiness and precluding the consumer's possible assumption of the burden of excessive financial obligations. Therefore, though the principle of responsible lending might be treated very broadly even at the level of the business culture, the content of this principle under Lithuanian legislation is reasonably specific. The content of the principle of responsible lending as set forth in the Principles has four aspects, which are now described in summary.

Firstly, the Principles specify an obligation of the lender to assess the creditworthiness of the consumer. The lender has to make this assessment on the basis of sufficient information. The lender must examine all material factors objectively expected to be relevant, in consideration of the information provided by the consumer and available to the lender that might affect the consumer's creditworthiness—in particular, the sustainability of the consumer's income, the credit history of the consumer, and potential changes (growth or reduction) in income. Accordingly, the Law on Consumer Credit and the Principles establish the obligation of the consumer to provide information to the lender. The lender is not responsible for consequences of a consumer's provision of misleading or inappropriate information; under the Law on Consumer Credit and the Principles, the lender is obliged to check all information from the data sources available to it in observance of the requirements of the law, including the requirements of data protection. It should be noted that there is no official register of debtors or debts in Lithuania. Only private persons have managed such registers, which are negative registers. In addition to the general regulation in the area of data protection, there are no special rules on the collection of data about consumer credit, debts, or debtors in the Law on Consumer credit or in the Principles.

Secondly, the lending shall be based on the debt-to-income principle. In its evaluation of the consumer's income, the lender should take into account the income of the consumer's entire household, including current and future income. The core element for evaluation is sustainable income, which is described as the income of the consumer that can be reasonably expected throughout the time for which the consumer credit is granted.

Thirdly, the Principles refer to the debt-to-income ratio. Upon conclusion of the contract, the consumer's average instalment for repayment of the principal and payment of interest, which is calculated by division of the sum of all repayments of the principal amount and of interest by the number of instances of payment during the credit period, shall not exceed 40% of the sustainable income of the consumer. This

³² Case 3K-3-114/2014 *BIGBANK AS v. A.P.R.* (see Note 30).

ratio covers all obligations to financial institutions. As has been mentioned above, this ratio has been much criticised by credit-lenders.

Next, the creditworthiness of the consumer should not be assessed in only an abstract way. The aim of the assessment is to judge the ability of the consumer to assume the specific financial responsibility that, jointly with other financial responsibilities, the consumer would be able to fulfil. Therefore, the lender shall assess to some extent whether the financial product in question in any given case corresponds to the consumer's needs and interests.

The Principles, though the law itself does not, state accordingly that promotion of irresponsible lending is forbidden.

When one considers the definition of responsible lending provided and the key foundations specified for 'responsible lending', one can conclude that, in the Lithuanian regulatory environment, responsible lending encompasses provision of advice rather than provision only of information and/or explanations to the consumer. As the European Commission stated in the Public Consultation on Responsible Lending and Borrowing in the European Union³³, providing advice is distinct from providing information. The purpose of the provision of information is to describe the product, whereas the purpose behind providing of advice is to give a recommendation to the consumer in account of the particular circumstances of the consumer. Obviously, the Principles empower the credit-lender to assess the situation of the relevant consumer, considering not only information related to him but objective factors such as economic matters as well. Moreover, a negative result of the assessment leads to the lender's obligation not to grant credit to the consumer. That means that the lender to some extent takes responsibility for the decision of the consumer. However, it is not clear how the Principles can work in practice, because the lender of consumer credit cannot, in principle, be an objective adviser, since that company is very much interested in the provision of service. At present, it is difficult to judge what kinds of consequences would be applied in court practice if, despite a negative assessment, a lender takes into account the consumer's wishes by granting the credit and the consumer, because of insolvency, proves unable to repay that credit, especially in addition to the consequences discussed later in this article.

2.5. Regulation of the activity of lenders

The Consumer Credit Law established some requirements for activity of lenders of credit and credit intermediaries. These persons are allowed to provide consumer-credit services only after inclusion on an official list. Two separate such lists exist in Lithuania—one of credit-lenders and the other of intermediaries. The supervisory institution is responsible for the management of these lists and has the obligation to delete persons from the lists if the circumstances described below exist. However, it should be noted that the conditions for inclusion on a list are not strict and are rather more general than very specific in relation to *ex ante* control of the activity of the lender or intermediary. A legal person wanting to be included on the list shall submit to the supervisory institution the relevant request, information about public registers in which the supervisory institution will be able to check information about that legal person, the rules to be used for evaluation of the creditworthiness of consumer-credit borrowers, the rules to be used in the examination of complaints from consumer-credit borrowers, and information about the databases wherein the creditworthiness of consumers will be checked, along with the list of consumer-credit intermediaries to be used, if the consumer-credit lender intends to use the services of any.

Persons can be deleted from the list only if it later becomes clear that the person has provided inaccurate data or has not provided the information required by law. In summary, the regulation of credit-lenders' activities does not seem to create much added value for control of the credit market.

There is no specific legislation in the area of debt collection. Therefore, it remains for the agreement between the lender and the collection company to determine how much the services should cost and what conditions for the provision of the services should be applied. Accordingly, it is up to the consumer-credit lender to decide whether he is willing to pay the costs related to debt collection.

³³ Public consultation on responsible lending and borrowing in the European Union (2009), available at http://ec.europa.eu/internal_market/finances-retail/credit/responsible_lending_en.htm (most recently accessed on 30 April, 2014).

2.6. The state institutions responsible for the consumer-credit market and their responsibility

In general, three state institutions can be distinguished as responsible for management (that is, supervision) of the consumer-credit market: i) the supervisory institution; ii) the Consumer Rights Protection Authority, and iii) the Competition Council.

The supervisory institution shall monitor the entire financial sector and, as has been noted above, has since 2012 been responsible for consumer protection in the consumer-credit market. This institution is responsible for the control of the implementation of the requirements of the Law on Consumer Credit. Moreover, according to Lithuania's laws, the supervisory institution implements also the functions related to the alternative dispute-resolution mechanism. The main regulations for the alternative resolution procedure are established by a separate law regulating the activities of the Bank of Lithuania. Therefore, the Law on Consumer Credit does not specify detailed rules for the alternative dispute-resolution procedure; it only provides reference to the procedure regulated by the Law on the Bank of Lithuania. In summary, the following functions of the supervisory institution can be distinguished with regard to the consumer-credit market: i) supervision (management) of the entire financial market, ii) the control of the requirements of the Law on Consumer Credit; iii) the regulatory function, iv) the application of the penalties addressed in the Law on Consumer Credit, and v) the function of the body for the alternative dispute-resolution scheme.

The responsibility of the Consumer Rights Protection Authority is focused on the protection of consumer interests. This responsibility encompasses both the general function of co-ordination of the consumer-protection policy (along with the activity of the institutions active in the field of consumer protection) and particular functions related to some specific aspects of consumer protection. Two of the latter functions are relevant to the control of the consumer-credit market—namely, the Consumer Rights Protection Authority's competence to control unfair terms and the competence to control unfair commercial practices and the advertising used. The latter competence is shared between the Consumer Rights Protection Authority and the Competition Council.

The Competition Council is responsible for controlling misleading advertising in accordance with the Law on Unfair Commercial Practice and the Law on Advertising.

One could conclude that the responsibility in the area of finance and credit matters has been divided among several institutions; however, the main role is assigned to the Bank of Lithuania. Moreover, it is more than clear that smooth co-operation among the three institutions is the main prerequisite for effective control of the consumer-credit market. However, as this article makes explicit, it is obvious that this co-operation is not ensured in Lithuania.

2.7. Regulation of the responsibility for handling infringement of the provisions of the law

The Consumer Credit Law specifies the economic sanctions (public-law sanctions) for the breach of requirements of the law (which regulates penalisation procedure). According to the law, the following sanctions can be imposed: i) warning for minor infringements of the law, ii) a penalty of 1,000 to 30,000 litai (~290 to ~8,700 euros), or iii) a penalty for repeated infringement within the span of one year—up to 120,000 litai (~34,800 euros). However, the law does not state criteria for the application of the sanctions. It employs only very general language, stating that 'for the infringements of the provisions of this law the penalty is applied'. Therefore, the supervisory institution has the discretion to decide what sanctions shall be applied for particular infringements of the law. Moreover, as the law has not described the particular disposition of the infringement, sanctions could be applied for various types of breach of the law on Consumer Credit—for infringement of the duty to disclose, the obligation to assess the consumer's creditworthiness, etc.

2.8. Enforcement related to consumer credit

The supervisory institution has indicated, in its 2012 and 2013 overviews of the consumer-credit market, discussed earlier in the article, that the most popular means of security for the consumer obligation is the bill of exchange. That means if the consumer has not repaid the debt, a simplified procedure is applied

for the enforcement of the debt (the consumer-credit lender is able to refer the matter to a notary and the notary's deed is the enforceable document that can be presented to a bailiff for the enforcement procedure). Therefore, the courts are not involved in this simplified procedure. In this case, the consumer does not have a practical opportunity to contest the debt.

It should be noted that the possibility has existed in Lithuania to apply simplified procedures in court for the enforcement of the debt (the procedure for issuing of a court order and the documentary proceedings). The same procedure can be used in the case of enforcement of the debt arising from a consumer-credit agreement. However, there are no publicly available statistics on how many disputes related to consumer credit have been resolved via the simplified procedure³⁴.

3. The future of the regulation of consumer credit in Lithuania: *Quo vadis*, consumer credit?

The supervisory institution, relying on the analyses mentioned in the introduction to this article, has determined that the reasons for growth in consumer indebtedness are i) insufficient evaluation of consumer creditworthiness, ii) aggressive and misleading advertisements, and iii) non-responsible lending (lack of consumer education). Therefore, it has proposed certain measures for improvement of the situation: firstly, regulatory measures (which will be described below) and, secondly, educational measures—i.e., further development of the consumer-education system in the field of consumer credit. However, the supervisory institution has not suggested any particular measures related to education of consumers that could address the situation in the consumer-credit market today.

In October 2013, the supervisory institution submitted a draft to the Ministry of Finance for amendments to the Law on Consumer Credit³⁵ (hereinafter 'the Draft Law'). The essence of the proposed amendments is described below.

Firstly, the supervisory institution has proposed tightening the regulation of the control of advertisement of consumer credit. As the quote above shows, the supervisory institution stressed in the explanatory note to the Draft Law³⁶ that consumer-credit lenders have not indicated the expenses related to their consumer credit in the advertisements of that credit and have usually used only resonant rhetoric. The Draft Law stipulates several amendments addressing this situation: i) there is an added requirement that the information be provided in a representative example (actually, this amendment involves correct transposition of the CCD); ii) the right to flesh out the requirements for advertisements of consumer credit is assigned to the supervisory institution; and iii) the supervisory institution is given the right to forbid misleading, ambiguous, and wrong advertising and, if necessary, the right to oblige the lender to deny of the credit advertised. However, it is very doubtful whether this additional regulation can achieve its aim, because, as noted above, the current issue is related rather more to inefficiency in the activity of the state institutions than to inefficiency of the legal norm.

Secondly, the supervisory institution has suggested shifting from 'soft regulation' to mandatory evaluation and has proposed inclusion of an obligation for the consumer-credit lender to check the consumer's creditworthiness against databases (e.g., the social security database, SODRA) or other sources. The supervisory institution has indicated that current regulations allow lenders to rely on the information provided by the consumer—that is, information not supported by any evidence. The supervisory institution has suggested stricter consequences for breaching the above-mentioned obligation of the credit-lender: if the lender does not properly evaluate the creditworthiness of the consumer and if the circumstances that were not properly evaluated cause late payment, not only the interest on late payment and any charges payable for default shall not apply; neither shall the contractual interest charges apply. In that case, the consumer-credit lender would be allowed to require only that the consumer repay the principal sum of the

³⁴ The statistical data from the National Courts Administration—available at <http://www.teismai.lt/dokumentai/civilines.xls> (most recently accessed on 30 April, 2014) in Lithuanian—address only some categories of cases. According to the statistics, 11,848 cases related to consumer credit were examined in the courts of first instance in 2013. Of these, 11,649 (i.e., almost all) were examined within six months. Therefore, it is likely (especially in consideration of the fact that not many cases were examined further in the Supreme Court) that the simplified procedure was used for the disputes related to consumer credit.

³⁵ See the explanatory note on the draft of the amendments to the Law on Consumer Credit (see Note 19).

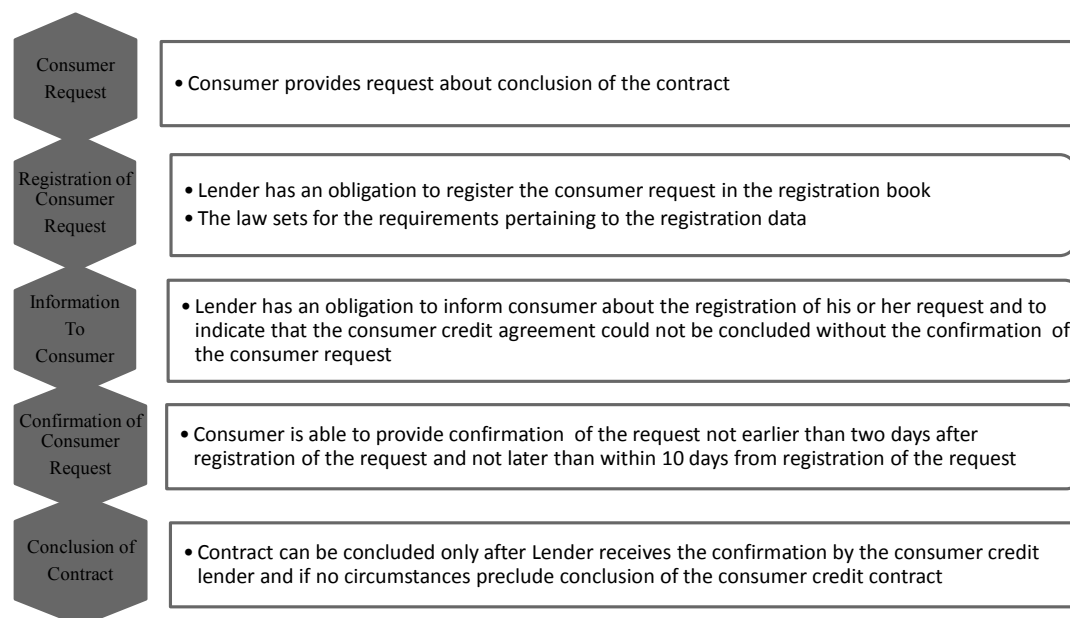
³⁶ *Ibid.*, p. 2.

credit. This proposed legal norm creates several problems. Firstly, the wording of the norm has not been drafted in a precise manner³⁷. The reference to the contractual interest charges is not very precise, and the wording gives the impression that it covers penalty interest for breach of contractual obligations rather than contractual interests. The conclusion that the regulation addresses the contractual interest charges and not other type of interest can be drawn only from the clarification provided in the explanatory note, not from the language itself. Secondly, the Draft Law stipulates a very different type of consequences for breach of the obligation of properly evaluating the creditworthiness of the consumer. The non-application of the interest on default should be treated as particular grounds for exemption from liability of the consumer as provided by law (Part 9 of Article 6.253 of the Civil Code of Lithuania stipulates that other grounds for exemption from civil liability or for non-application thereof may be established by law or by agreement between the parties). However, the consequence linked to non-application of the contractual interest and other fees is not related to the liability of the credit-lender. The nature and essence of said consequence and what kind of private-law rules shall be applied for this consequence should be considered. Undoubtedly, both the interest under the consumer-credit contract and the loan principal are a matter of the agreement between the credit-lender and the consumer. The contractual interest is the monetary price (compensation to the lender) to be paid by the consumer for the product—i.e., for the loan. The consequence mentioned above would result in the service of consumer credit becoming free for the consumer. It must be noted that, while at first glance it would seem that the regulation establishes a consumer-credit lender's liability for failing to assess consumers' creditworthiness, the consequences specified are not related to the damages for the debtor, because it is not required that the consumer prove any damages and it is not clear whether the law requires that any even have been incurred. In such a case, the possibility of not applying the contractual interest proposed in the draft legislation should be interpreted as an exemption from fulfilment of part of the principal obligation. However, the Civil Code does not establish the option of regulation by other laws the ways of exempting the debtor from fulfilment of the principal obligation. Article 6.129 of the Civil Code only establishes the right of the creditor to decide on the exemption of the debtor. On the other hand, the legislator's intervention with the principal obligation would mean interference with freedom of contract and, to some extent, with the regulation of the price of the contract. It is clear that applying such a consequence for inaccurately assessing the creditworthiness of a consumer would cause the consumer-credit lender to incur losses. Thereby, the regulations establish certain sanctions for the consumer-credit lender. With the norm interpreted in such a way, the question arises of whether the sanctions established by the legislator and the intervention in contractual relations are adequate and proportional, particularly in light of the fact that in this case a situation exists wherein there is no reason to consider the main content of the contract unfair³⁸ (if there were grounds to apply control of unfair terms, the relevant term of the contract would be considered unfair and thus be rendered void, such that there would be no basis for applying the consequences detailed in the norm analysed). Thirdly, the mechanism for application of the norm is completely unclear—it is unclear whether it must be applied from notification of the consumer onward or retrospective too (e.g., is there a right to enforce the interest paid?) or whether the decision on this is left to the court's discretion. Such uncertainty implies without doubt that either the norm will not be applied in practice or it will create uncertainty in case law applying and interpreting it. Either way, the norm is toothless, since i) it would be difficult to protect consumers' interests and ii) even if they could be protected, this would take a marathon of court proceedings. The fact that such a norm is unclear and difficult to apply in practice can be seen also from the above-mentioned norm dealing with the consequences for not properly disclosing information to the consumer. Accordingly, it must be assumed that norms of this kind should be re-evaluated and either eliminated or revised into clear and consistent rules that would take into account basic civil-law norms and that could be properly applied in practice.

³⁷ This legal norm states that interests, forfeit and taxes do not apply to the consumer credit debtor in cases of late payments, if the consumer credit lender improperly assessed the creditworthiness of the consumer credit debtor without any fault of the consumer credit debtor ("6. Palūkanos, netesybos ir mokesčiai pavėluoto įmokų mokėjimo atvejais vartojimo kredito gavėjui netaikomi, jeigu vartojimo kredito davėjas ne dėl vartojimo kredito gavėjo kaltės netinkamai įvertino vartojimo kredito gavėjo mokumą"). See the Part 6 of the Article 8 of Lietuvos Respublikos vartojimo kredito įstatymo pakeitimo ir papildymo įstatymas ["The draft of the amendments to the Law on Consumer Credit] prepared by the supervisory institution. Available at <http://www.lb.lt/n22037/projektas.pdf> (most recently accessed on 30 April, 2014) (in Lithuanian).

³⁸ It should be noted that the definition of the main subject matter of the contract and determination of the adequacy of the price and remuneration are under the control of the unfair term if the transparency principle is not breached—i.e., if these terms are drafted in plain, intelligible language. If these conditions in the contract are drafted in plain and intelligible language, the state has no grounds to interfere with a private contractual relationship.

Thirdly, the supervisory institution has reconsidered the rules on conclusion of a consumer-credit contract. The Draft Law provides for a ‘cooling-off period’ before conclusion of the contract—two days at minimum and up to 10 days (a time frame designed for informed decision by the consumer). That means that a consumer-credit contract may be concluded only after confirmation of the request of the consumer to conclude the contract, given only after two days have elapsed from registration of the consumer’s request by the consumer-credit lender but not later than 10 days from registration of the consumer’s request to conclude the contract. If the Draft Law gets adopted, conclusion of a consumer-credit contract will consist of several stages. These are depicted in the diagram below.



The cooling-off period in consumer-protection law means that the consumer is able to withdraw from the contract within a particular period of time without any consequences arising for him. The cooling-off period introduced in the Draft Law has different consequences, though the aim of both is the same—to enable the consumer to change his mind within the time specified by law. Several issues related to the above-mentioned new rule can be highlighted. Firstly, it is not clear what the purpose is behind the maximum 10-day period set forth for confirmation of the consumer’s request to conclude the contract. Secondly, the Draft Law does not specify the consequences of the contract not being concluded by way of breach of the above-mentioned rule. Two types of consequences could be considered: the first interpretation involves considering the contract not to have been concluded in this situation, and the second way of interpreting matters is to argue that the contract was concluded but is null and void because it was concluded in breach of the imperative rule (see Article 1.80 of the Civil Code). In view of the general rules of contract law (including rules in the Civil Code that pertain to transactions), there is more justification for the first interpretation.

Undoubtedly, the proposed regulation related to formalisation of the procedure for the conclusion of a consumer-credit contract and the cooling-off period set forth by law will influence the speed of the process of the conclusion of consumer-credit contracts and, therefore, restrict consumers’ abilities to conclude the contract in an especially easy way. It is very likely that these new rules will create additional conditions aiding the consumer in rethinking the decision, and it is probable that in many cases the consumer will not confirm his wish to conclude the contract. However, the ultimate influence on the market for consumer credit will depend very much on the control of the implementation of this rule by the supervisory institution and on the rule’s application in court practice.

Fourthly, there is a proposal to reduce the APR from 200% to 50%. It should be noted that several members of the Parliament of the Republic of Lithuania proposed reduction of the APR to 36%. In late 2013, the Government offered its opinion³⁹ on the draft amendments to Article 21 of the Law on Consumer Credit, indicating that the complexity measures shall be used to solve the problems related to the

³⁹ Lietuvos Respublikos Vyriausybės 2013 m. gruodžio 18 d. nutarimas Nr. 1205 „Dėl Lietuvos Respublikos vartojimo kredito įstatymo 21 straipsnio pakeitimo įstatymo projekto Nr. XIIP-636“ [‘Resolution of the Government of the Republic of Lithuania

consumer-credit market and that the Government would issue a draft set of amendments to the Law on Consumer Credit at the beginning of 2014. However, at the time of this writing, the Government still has not provided the Parliament with such a draft. Also worthy of mention is that an interesting opinion on the above-mentioned draft has been provided by the European Law Department of the Ministry of Justice. That department indicated that the proposed legal norm raises doubts with respect to conformity with articles 56–62 of the Treaty on the Functioning of the European Union⁴⁰; it stressed that stating a maximum APR, which encompasses all fees related to issuing of credit and its administration, restricts a person's right to free movement of services. Such *ex ante* control may be justified only by public interests such as consumer protection. Moreover, it should be ascertained whether such a control system is relevant and strictly proportionate to the aim to be achieved and whether that aim cannot be reached by less restrictive means. On one hand, attention should be paid to the arguments of the European Law Department. Although the ECJ in *SC Volksbank România SA v. Autoritatea Națională pentru Protecția Consumatorilor—Comisariatul Județean pentru Protecția Consumatorilor Călărași (CJPC)*⁴¹ decided that restrictions to the number of bank charges do not fall into the category of restriction to free movement of services, it may be concluded that such a conclusion would not apply if the restrictions were of such a nature that the amount of charges or the interest rates were limited. Therefore, it might be that limitations to the APR would be considered by the European Court of Justice to restrict the free movement of services. On the other hand, as has been mentioned elsewhere in this article, the fact that many member states of the European Union have one or another restriction to the prices of consumer credit should be taken into account accordingly.

Fifthly, the supervisory institution has proposed regulation of the restrictions applied to conclusion of consumer-credit contracts: firstly, a consumer can restrict his rights himself by submitting a request to the state institution for prohibition of concluding a consumer-credit contract. This request would be registered in a specific register, and consumer-credit lenders would be obliged not to conclude a contract with people whose requests are included in the register; secondly, the law would enable the courts to take a decision on restrictions/prohibition of a person's capability of concluding a consumer-credit contract.

The above-mentioned proposals raise many legal doubts and questions regarding the adequacy and proportionality of the proposed measures. First of all, from a legal point of view, the nature of the proposed restriction is unclear. If this restriction is considered a limitation to a natural person's active civil capacity, then such restriction does not comply with the mechanism for restricting active civil capacity that is established in the Civil Code of the Republic of Lithuania. It must be noted that Lithuania's civil code does not permit establishment of only certain (specific) restrictions to a natural person's active civil capacity, whether in whole or in part (in other words, the content of the rights is determined by law and applies in all cases equally). In addition, in the event of incapacity of a natural person, the guardian conducts transactions on behalf of the incapacitated person, and if there are restrictions to a person's active legal capacity, that person may conclude legal transactions only with the consent of his guardian (with certain transactions permitted without the consent of the guardian). The proposed restrictions, in contrast, establish an absolute prohibition of concluding only one type of transactions—that of a consumer-credit contract. Secondly, the bases and criteria for such a restriction's application are unclear. The proposed amendments establish a single, abstract criterion for application of the prohibition—abuse of the right to conclude consumer-credit contracts—and the prohibition does not establish any other criteria for application, including criteria for determining whether there is an abuse of rights and what evidence could confirm the existence of such abuse. It must be noted that the general provisions establishing restrictions to active legal capacity imply application of criteria whereby both legal circumstances and facts must be determined on the basis of opinions of medical experts. With the restriction at issue here, it is doubtful that medical experts could ascertain a person's abuse of the right to conclude consumer-credit contracts. Thirdly, the consequences of breaching

of 18 December 2013 No. 1205 on the Draft of the Amendments of Article 21 of the Law on Consumer Credit of the Republic of Lithuania, No. XIIP-636']. – *Official Gazette* 2013/133-6778) (in Lithuanian).

⁴⁰ The Treaty on the Functioning of the European Union, available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2012:326:0047:0200:EN:PDF> (most recently accessed on 30 April, 2014).

⁴¹ Judgment of the Court of 12 July 2012 in *SC Volksbank România SA v. Autoritatea Națională pentru Protecția Consumatorilor—Comisariatul Județean pentru Protecția Consumatorilor Călărași (CJPC)*, Case C-122/10. The court stated in this decision that 'whilst the national legislation at issue in the main proceedings limit[s] the number of bank charges that can be included in credit agreements, it does not impose requirements curbing the rate of charge, since no limit is laid down as regard[s] the amount of charges that are authorised by the national provisions at issue in the main proceedings or as regards interest rates in general'.

this prohibition are unclear: would the contract concluded after abuse has been determined be void, or it could be later approved in some way?

As has already been noted, such restrictions raise doubts with respect to their proportionality. It is worth mentioning that even in cases of such activities as gambling and lotteries, there are no restrictions this strict established under Lithuanian legislation. Moreover, although it is obvious that the restrictions proposed by the supervisory institution reflect the proposals of the consumer organisations⁴², it seems clear that proposals made by the supervisory institution not only must be more measured and better reasoned from the legal point of view but also must be adequate for addressing the actual situation of the consumer-credit market. Additionally, it must be determined whether the situation in the consumer-credit market is temporary (such assessment processes were not observed); the court proceedings for restriction of natural persons' active civil capacity would definitely take time, so doubts could be raised as to whether the restrictions would be relevant after a certain amount of time. In addition, the practice of using specific legislation to establish grounds for restriction of natural persons' active civil capacity is defective since it may cause a situation wherein the government proposes restrictions of one's rights related to specific transactions in the event of even the slightest market failure (in analogy, from a historical point of view, ought the government to have restricted rights to conclude mortgage transactions in order to minimise the consequences of the financial crisis?). With respect to the above-mentioned circumstances, the utility of the proposed amendments to the Law on Consumer Credit (in particular, with regard to the courts' rights to prohibit conclusion of a consumer-credit contract) is highly debatable.

Sixthly, the supervisory institution has proposed the stipulation of additional condition on the activity of consumer-credit lenders—the chief executive officers and all natural or legal persons or related persons who, directly or indirectly, own 20% or more of the voting rights or authorised capital, along with all others who, in light of the articles of association or contracts concluded with the consumer-credit lenders or otherwise in the opinion of the supervisory institution may have a decisive influence in the operations of the consumer-credit lender, have to be of impeccable reputation. If the supervisory institution considers any of the above-mentioned persons not to be in compliance with this requirement, it shall have the right not to include the consumer-credit lender in question on the list of creditors or to remove it from the list. As is mentioned above, the current regulation of consumer-credit lenders' operations and of the conditions under which a creditor may be included on the creditor list is laconic and does not create unnecessarily restrictive conditions to the operations of consumer-credit lenders. However, there is no doubt that the proposed amendments establish tighter restrictions. If the truth be told, it is not entirely clear whether the above-mentioned norms would apply to those consumer-credit lenders that were on the creditor list before the amendments come into force. If such restrictions were not to be applied retroactively, they would have almost no consequences, since the second half of 2013 and the start of 2014 saw the number of consumer-credit lenders remain nearly constant, as was noted in the introduction to this article.

Seventhly, the supervisory institution has suggested increasing the penalties for infringement of the Law on Consumer Credit (for infringement, 5% and then for repeated infringement 10% of the organisation's income from the consumer-credit services and deletion from the list of service providers).

In light of the above-mentioned insights into the Draft Law, there is only one major question that begs to be raised—*quo vadis*, consumer credit? The proposals made in the Draft Law reflect a quite clear tendency toward more extensive regulation of the consumer-credit market. It seems that this regulation is not being used understandably as the last resort; it is only one option for the resolving of issues related to the consumer-credit market, and proper justification of such regulations remains absent. Moreover, as has already been mentioned, some of the proposals are extremely drastic. The author of this article is quite convinced that the problems of the consumer-credit market cannot be remedied through purely legislative means anyway. Therefore, it is time to ask ourselves what the role of the state should be and where the boundaries for the consumer-credit market's regulation should lie. Should the state be an active regulator, or should it shift its activity toward education measures or other actions, such as further development of a financial advisory services system or creation of alternative means allowing poor people to receive credit (e.g., 'social credit')? One might argue that the state should be only a passive observer and should not interfere in a market; however, this author does not suggest such an approach. Rather, the state should not concentrate purely on regulation measures in its activity (especially, regulation of a prohibitive nature);

⁴² It should be noted that the consumer organisations have argued in the media that consumer-credit market conditions should be stricter and that consumer credit should be equated to such products as tobacco products or alcoholic beverages.

before that, it should take coherent extensive and systemic measures that could help to increase consumers' conscientiousness, financial awareness, and financial literacy, with particular attention paid to young people who do not have enough experience in the management of their finances. The state should not shift the full burden of responsibility to the consumer lenders; it needs to take a very active role itself, especially in the field of consumer education. It is quite clear that the prohibitions and regulatory measures suggested cannot yield positive results if the society's level of financial awareness and financial literacy remains relatively low. The necessity of increasing financial literacy has been stressed by the Organisation for Economic Co-operation and Development (OECD). The OECD has pointed out that consumers' difficulties with making long-term informed financial decisions and selecting financial products that match their needs may have negative consequences not only for individuals' and households' future financial well-being but also for the long-term stability of entire financial and economic systems⁴³. To be fair, one should point out that the National Consumer Protection Strategy for 2011–2014⁴⁴ indicated that it takes a long time to nurture consumers' capabilities in this regard and, therefore, in order to foster these capabilities among Lithuanian consumers and for them to know their rights and be able to defend them, educational institutions' curricula are to encompass economic and financial matters (this applies to secondary-school curricula and subjects). However, how the latter measure has been implemented and whether enough attention was paid to it are not very clear.

Secondly, the state should be active enough in its implementation of actions protecting the collective interests of consumers, especially the mechanism for controlling unfair commercial practices and the penalisation mechanism under the law implementing the Consumer Credit Directive.

Finally, if thorough analyses properly identify the problems in the consumer-credit market and prove that there are serious reasons and suitable justification for strict regulation measures, the state should ask itself how balance among the various interests should be achieved and what level of 'average' consumer the regulatory measures should target. This author at least is not convinced that the law should protect a consumer who does not want to exercise care himself.

3. Conclusions

Analysis of existing consumer-credit regulation in Lithuania reveals that, on one hand, even now there are some norms regulating the consumer-credit market that could protect the interests of consumers and prevent excessively easy access to non-secured consumer loans via electronic means—if applied effectively. On the other hand, there are some norms that remain unclear and that do not comply with the general provisions of civil law. Most of these norms' practical application has not been tested; therefore, it is unclear what precisely is behind the ineffectiveness of these norms. It is also obvious that there has been no research into why certain legal norms do not reach their goals and what legal measures are most effective for resolving the issues specific to the consumer-credit market; i.e., it is not clear what particular market failure should be addressed and what regulatory measures might be adequate for the correction of such failure. The amendments to the Law on Consumer Credit that have been proposed by the supervisory institution, the Bank of Lithuania, imply that the national institutions see only one solution for the issues in the consumer-credit market—stricter (tighten) regulation—and in some cases specify drastic measures not only with respect to business but also with respect to consumers. In addition, the proposed amendments to the regulations pertaining to the consumer-credit market clearly imply that the proposals have been made without comprehensive analysis of the legal consequences and, with the result that they are not worded properly from a legal point of view. This means that, although most of them will probably be incorporated into existing legislation, it is most likely that they will not reach their goals.

What is more, in efforts to resolve the issues seen in the consumer-credit market, there are no systemic measures that are designed to correct the market failure itself, as opposed to merely the consequences of that market failure. In addition, the lack of analysis preparatory to adoption and application of state-level

⁴³ Available at <http://www.oecd.org/daf/fin/financial-education/financialliteracyandconsumerprotection-overlookedaspectsofthecrisis-oecdrecommendation.htm> (most recently accessed on 30 April, 2014).

⁴⁴ Lietuvos Respublikos Vyriausybės 2011 m. liepos 7 d. nutarimas Nr. 848 „Dėl Valstybinės vartotojų teisių apsaugos 2011–2014 metų strategijos patvirtinimo“ [“Resolution No. 848 of the Republic of Lithuania of 7 July 2011 on Approval of the National Consumer Protection Strategy for 2011–2014”]. – *Official Gazette* 2011/89-4274 (in Lithuanian).

measures, such as adoption of a social-credit system or development of a system of consulting services that addresses financial services, can be clearly seen. It is obvious too that there is a lack of clear government policy with respect to development of consumer—in particular, youth—financial education. There are only general statements referring to proposals of better financial education of consumers, without any specific programmes at present, including special measures and financing, for increasing financial literacy. It is more than clear—and the financial crisis has demonstrated as much—that these are the sorts of measures that should be taken before others by the state. Because they take root over time, they can create far greater positive consequences than regulatory measures can. Only a conscientious, financially literate society can be a counterbalance to the unfair commercial practices employed by many financial service providers. It is clear that supply quickly follows wherever demand exists, and the same can be said with regard to unfair commercial practices. Accordingly, what is the future of consumer credit? *Quo vadis*, consumer credit?

Abbreviations

RT	<i>Riigi Teataja</i> ('State Gazette')
OJ	Official Journal of the European Union
CCSCd	Decision of the Civil Chamber of the Supreme Court