

ACCELERATION CLAUSES FOLLOWING THE SUPREME COURT JUDGMENT OF 11 SEPTEMBER 2019: A BRIEF EXPLANATION OF A COMPLEX ISSUE

This note explains the scenario resulting from the Supreme Court judgment of 11 September 2019 (the "**Judgment**"), regarding early acceleration clauses ("**EACs**").

To what agreements does the Supreme Court Judgment refer?

The Judgment refers exclusively to mortgage loans with consumers.

Outside of the sphere of consumers, the parties are free to establish any EACs as they see fit, provided the effects of the agreement are not left at the discretion of the creditor.

Why are EACs inserted into mortgage loans?

EACs allow the creditor, in the event of a breach by the debtor, to accelerate the loan and demand payment of the entire debt.

In principle, in the absence of an AC, the creditor can only claim the amounts that are unpaid at any given time.

How have EACs included in loan agreements traditionally been worded?

In Spain it has been traditional to include very broad EACs in loan agreements, enabling the creditor to accelerate the loan in the event of any kind of breach by the debtor, even if trivial.

How has case law in relation to EACs evolved?

The courts have come to consider that traditional EACs (those triggered by any breach) are abusive and therefore null and void.

The courts apply the doctrine of abusiveness in abstract terms, based on the wording of the clause, without looking at the circumstances of the case.

For example, if a creditor declares acceleration following several years of non-payment, the judge will just examine the wording of the clause: if it entitles the debtor to declare the loan to have matured with just one non-payment, the judge will declare the clause null and void.

What is the practical effect of the declaration of nullity of the AC contained in an agreement?

If the AC is declared null and void (as abusive), it will not be possible to accelerate the loan. The creditor will only be able to claim the amounts unpaid, and not the total of the principal.

How has legislation on EACs evolved?

On 14 May 2013 (Act 1/2013) article 693 of the Civil Procedure Act was amended to establish that mortgage foreclosure would only be possible if the debtor has failed to make at least three repayments.

Article 24 of the Real Estate Credit Agreement Act (Ley de 15 de marzo de 2019, de Contratos de Crédito Inmobiliario or "LCCI") sets out the requirements for validity of the EACs contained in residential mortgage loans, establishing what breach will justify acceleration: i) during the first half of the loan, non-payment of more than three percent of the capital or a number of repayments equivalent to twelve months; ii) in the second half, non-payment of more than seven per cent of the principal or a number of repayments equivalent to fifteen months.

Moreover, the LCCI requires that the AC allow the debtor to remedy the breach in order to avoid acceleration.

What is the effect of the LCCI in relation to agreements that predate its entry into force and that contain an abusive clause?

In the event the creditor has declared acceleration, this declaration will be affected by the nullity (whether or not foreclosure has commenced).

If the creditor has not yet declared acceleration, it will be able to do so provided that the parameters for the seriousness of the breach envisaged in the LCCI, mentioned above, are met.

How does the nullity of the AC affect foreclosure procedures already in progress?

Following the entry into force of the LCCI, there was a large number of suspended foreclosures waiting for the Court of Justice of the European Union ("ECJ") to decide on the effects of the nullity of the AC.

However, the ECJ judgment of 26 March 2019 returned the matter to the Spanish Courts.

In view of the ECJ Judgment, the Supreme Court Judgment of 11 September 2019 sought to offer guidance for the courts when dealing with the procedures that were already underway.

The Judgment establishes the following criteria:

The proceedings in which the loan was declared to have matured prior to the entry into force of Act 1/2013 must be discontinued.

The proceedings in which the loan was declared to have matured after the entry into force of Act 1/2013 may continue if the debtor's breach meets the requirements of seriousness set out above.

In both cases, the discontinuance will not prevent the creditor declaring acceleration thereafter based not on the AC envisaged in the agreement, but on the power attributed to it in article 24 LCCI.

What point in time will be used to determine the seriousness of the breach: that when acceleration was declared or when the Court has to decide on the continuation of the proceedings?

On 19 September 2019, the Madrid Provincial Court published Resolutions in relation to a variety of matters, addressed to the courts within its territorial sphere. The Provincial Court considers that the seriousness of the offence must be determined at the time acceleration was declared.

However, this solution runs contrary to basic procedural economy: when the creditor is going to be able to declare acceleration once again, in order to reach the same point of the foreclosure, what is the point of shelving the existing proceedings?

Are the criteria set out by the Supreme Court applied to all foreclosures in progress, including those in which the asset was adjudicated and all that is pending is transfer of possession?

The Supreme Court Judgment clarifies that the criteria of the LCCI will apply to foreclosures in which the handover of possession to the acquirer has not taken place.

The Madrid Provincial Court has interpreted that the Supreme Court is referring to the eviction, that is, the handover of the keys.

Thus, in order to consider the foreclosure concluded (so that the debtor can no longer invoke the abusiveness of the clause) it will not be sufficient for the asset to be adjudicated, it will also be necessary for possession to have passed to the acquirer. The Madrid Provincial Court has assumed that the only way of handling possession is via eviction. However, this will only be necessary if the foreclosed party remains in possession. Otherwise, it would be logical to understand that possession was handed over when the asset was adjudicated.

Does this mean that, until the keys are handed over, the debtor can allege that the AC is null and void as abusive?

The criteria of the Supreme Court have taken into account the possibility that Act 1/2013 offered the foreclosed debtor to file an extraordinary opposition motion based on the existence of abusive clauses, immediately before eviction.

This procedure can only be used in certain circumstances (essentially, the debtor must have not had the opportunity to make the allegations before). This normally occurs in foreclosures initiated prior to the entry into force of Act 1/2013.

When the consumer no longer has the option of the extraordinary opposition motion, there are no other procedures for declaring the AC null and void, meaning that the foreclosure will continue until handover of possession to the awardee.

If the foreclosed debtor files an extraordinary opposition motion at that time and the judge declares the AC abusive, what happens to the asset?

The Madrid Provincial Court interprets that the foreclosure will have to be discontinued due to the effect of the nullity of the AC. Insofar as the declaration of acceleration is of no effect, it is logical to assume that the title of ownership also lapses.

This situation generates innumerable problems that the LCCI and the Supreme Court have not resolved. If the adjudication of the asset, declared to be of no effect, has been recorded at the Land Registry, the registration can only be cancelled by means of an order sent by the Court to the Registry to return the asset to its previous situation (the property of the debtor, with the mortgage guarantee). No provision is made for how this should be done (whether ex officio or at the request of a party), or regarding the notarial and registry fees and taxes paid in the interim.

In spite of the attempts made by Spanish Courts, there are still a number of issues which remain unclear. We will have to wait and see what happens in practice, as it cannot be discarded that Courts will adopt more practical interpretative criteria to protect juridical safety and avoid greater chaos in ongoing foreclosure proceedings.

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