Providing Security
Austrian Legal Aspects

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The authors of this article provide an overview on common types of security in Austria and introduce the key legal issues of importance from the perspective of lenders and their international counsel.

As in many other jurisdictions, loans may either be secured by providing security in personam, whereby a third (legal or natural) person enters into a contractual obligation by agreeing to pay the creditor (beneficiary of security) for the debtor’s obligation upon the occurrence of certain defined events, or by providing a security in rem, whereby the creditor (beneficiary of security) is granted preferential enforcement into certain assets to recover claims.

Austrian civil law is codified law; the Austrian Civil Code (Allgemeines Bürgerliches Gesetzbuch) sets out the basic provisions of interest. The Austrian Civil Code, however, recognises the principle of contractual freedom so that contractual arrangements regularly prevail over the provisions of law unless in conflict with certain mandatory provisions. Mandatory rules exist, in particular, for the benefit of third party creditors (especially under corporate law), were agreements are against bonos mores or in relation to transactions involving consumers who enjoy particular protection.

In addition to codified law, cases formerly decided by the Austrian Supreme Court are of importance in practical terms. Also published articles or comments on court cases by learned legal commentators are traditionally of importance as they may (and regularly do) affect future court decisions.

Major Types of Austrian Security in personam

Personal Guarantee: In case of a personal guarantee (suretyship; “Bürgschaft”) the guarantor undertakes to pay certain obligations of a debtor in case of the latter’s default to effect payment when due. The personal guarantee is a security in personam and accessory, i.e. the guarantor’s liability is conditional upon (i) the debtor’s failure to fulfil his obligation and (ii) the existence of the debtor’s obligation (in terms of legal grounds as well as in terms of amount).

Accession to joint liability: Such type of security is quite similar to a personal guarantee whereby the acceding person agrees with either the debtor or the creditor to accede to the obligation of the debtor. Such accession may be in addition to or instead of the original debtor (replacement only following consent of creditor).

Abstract Guarantee: By means of such guarantee, the guarantor undertakes – similar to a documentary letter of credit – to pay a certain amount of money upon the beneficiary’s formal request without reviewing the merits of the request. The guarantor’s payment obligation is abstract (as opposed to accessory) in the sense that it is independent of the underlying legal relationship between the beneficiary as creditor and his debtor. Accordingly, the guarantor may not raise any defence against a request for payment by the beneficiary resulting from the underlying commercial transaction. The guarantor may only allege an abuse of rights by the beneficiary. In order to be successful with such defence, the guarantor has to succeed to be awarded an interim court order preventing the calling of the guarantee by the beneficiary. Abstract guarantees, in particular abstract bank guarantees, are of prime commercial relevance in Austria (due to stamp duty reasons – see below).

Comfort Letter: These are no specific type of security although they are frequently used when dealing with groups of affiliated companies. Depending on its wording and from case to case a comfort letter may in legal terms be a mere declaration of intent without creating any binding obligation or amount to an abstract guarantee.

Recourse: In each case where the provider of security in personam has to effect payment to the creditor (beneficiary of security), he has a claim of recourse to the original debtor based on legal relationship between such parties. In addition, there are also statutory claims of recourse. As an example, if the guarantor under a personal guarantee has to effect payment he is by operation of law assigned the claim against the debtor if and to the extent that he satisfies the creditor (including any security interests).

Major Types of Austrian Security in rem

With respect to the acquisition and perfection of security rights in rem, the Austria Civil Code requires a twofold procedure: a contractual agreement on the provision of security and a public act of transfer (act of publicity) to perfect the acquisition of a security right in rem which is deemed to manifest the preferential interest to the public. The necessary act of publicity varies from case to case, depending on the asset involved.

Pledge: Traditionally, the most common security right in rem is the right of pledge (“Pfandrecht”). It is a right granted to the creditor to obtain satisfaction of its due and unpaid claim by means of preferential enforcement into the pledged asset. A pledge is accessory and thus dependent on a valid claim of the pledgee.

In Austria, a pledge is not subject to registration in a public register except in respect of land mortgage (registration in land register) and the pledge of
intellectual property rights such as trademarks and patents. In respect of other types of assets, the perfection of a pledge requires an act of publicity which in case of movables usually requires physical delivery of the pledged asset to the pledgee. Rights may also be subject to a pledge whereby the required act of publicity for perfection is either notification of the debtor or the annotation of the pledge in the pledgor’s accounting ledgers.

In respect of the pledge of shares, the type of entity the shares in which shall be pledged is of importance for the correct act of publicity. In case of certificated shares (in particular, applying to a stock corporation – “Aktiengesellschaft”) an actual physical transfer is required which is effected by means of physical transfer (bearer shares) or endorsement of share certificates and physical delivery (registered shares). In case of a limited liability company (Gesellschaft mit beschränkter Haftung-GmbH) there are no certificated shares and the share is in legal terms only a right to a quota in the company. Thus, the rules in respect of rights apply and perfection basically requires notification of the company. Also interests in partnerships are deemed a right rather than a physical asset.

Assignment of Receivables: Receivables are in legal terms rights. They are, however, regularly not pledged but assigned for security as the assignment provides for additional protection to the creditor: further to notification of the assignment to the respective debtor the latter may effect payment with discharging effect only to the notified new creditor. The assignment is accessory. Austrian law allows for the assignment of (i) all a person’s current and also of (ii) future receivables provided the relevant receivables are sufficiently defined and identifiable. A person may thus assign by means of a general assignment agreement (Globalzessionsvertrag) all current and future receivables whereby such assignment becomes binding and effective already when the agreement is effective and not only when the respective future receivable enters into existence. The act of publicity required for the perfection of an assignment of receivables is the same as required in case of a pledge of receivables.

Syndicated Loans/Accessoriness Issues

In international syndicated loan transactions involving Austrian entities, legal issues in relation to Austrian security regularly pop up due to the accessoriness of the most popular types of Austrian security (such as the pledge of assets or shares, assignment of receivables or personal guarantees). The concept of accessoriness is not in line with structures used under common law facility agreements whereby creditor rights are transferred by novation (rather than assignment) and security is held by a security trustee as common law trustee for the benefit of the lenders, who is no creditor or only one of several creditors and thus not (fully) entitled to the secured claims. Both issues may be taken care of by certain contractual provisions. The pledgor may agree that the security interest created shall remain in place when the creditor transfers his claim by means of novation to new creditor thus allowing for the transfer of participations in the loan. Further, accessoriness is regularly handled by means of introducing an independent and separate parallel debt resulting in the security trustee being a creditor of the entire outstanding amount so that security held by such trustee may secure all claims.

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Corporate Benefit

The provision of security by a corporation for a shareholder’s liability occurs rather frequently in practical terms. Especially in the context of group financing and leveraged (management) buy-outs such security arrangements are desired. In turn, it is also common that a parent company provides security for obligations of affiliated companies down-stream. While the latter procedure does not raise particular issues under Austrian corporate law for lenders, the provision of security by a corporation securing obligations of its (indirect) corporate parent up-stream or other affiliated entities side-stream is in potential conflict with mandatory rules and thus a threat to both local management and creditors.

As a basic rule, a corporation must not distribute funds (or other benefits) to its (indirect) shareholders by means other than the formal distribution of a dividend further to a respective shareholder vote. Such mandatory rule is for the benefit of third party creditors and extends to all dealings between the company and its (indirect) shareholders which need to be at arm’s length in order to be admissible. Cases formally decided by the Austrian Supreme Court and learned legal literature have introduced the following major restrictions on the provision of security up- or side-stream by an Austrian corporation:

- adequate fee: the provider of security needs to receive an adequate fee for extending security as would an independent third party.
- corporate benefit: as most companies are no commercial banks, they would not extend security for the benefit of third parties (even if for an adequate fee) unless they derive certain additional corporate benefit from the transaction. Thus an additional corporate benefit is required. In case of group financing transaction such benefit may be given if and to the extent that funds drawn under the loan facility are made available to the Austrian subsidiary internally.
- risk assessment: the corporation’s management needs to make its own assessment of the risk that the security is called upon and/or that the subsequent claim of recourse is fully collectible. Further, the provisions of security shall be in line with the financial position and must not result in a risk of insolvency for the company. If such criteria are not met the transaction is void in the legal relationship between company and (indirect) shareholder; the
shareholder is liable for returning any undue benefit obtained. If the corporation incurs any damage as a result of such transaction, the company’s management may be personally liable to the corporation for damages. A third party beneficiary (creditor) is not necessarily affected by the ineffectiveness of the provision of security between corporation and shareholder. Ineffectiveness extends to a third party beneficiary only if it knew or ought to have known that the provision of security was unlawful. This will, however, likely be the case and lenders run material risk of their security being ineffective when not paying due attention to the involved legal issues.

An Austrian Particularity: Stamp Duty

When dealing with loan and security arrangements, major attention needs to be paid to an Austrian particularity, stamp duty ("Rechtsgeschäftsgebühr"). The Austrian Stamp Duty Act ("Gebührgesetz") imposes stamp duties on certain types of agreements, provided they are concluded in writing or evidenced in writing. So the Stamp Duty Act provides for stamp duty on loans (0.8% to 1.5% of loan amount depending on term), personal guarantees and accessions to joint liability (1% of obligation), mortgages (1% of secured amount) and the assignments of rights (0.8% of consideration or secured claim). Certain exemptions exist (e.g., an exemption from stamp duty applies to loans extended by banks exclusively to Austrian non-residents). Further, there is an exemption in relation to the provision of security were the underlying loan is subject to stamp duty.

The Stamp Duty Act contains very detailed definitions of the cases triggering stamp duty and there is no particular general logic behind the individual provisions. Hence, it is indispensable to engage legal expert advice on a case-by-case basis, also advising on potential methods to lawfully avoid stamp duty altogether. Such methods may be the execution and keeping of signed originals and legalised copies outside Austria, oral or factual acceptance of a written offer and the conclusion of an agreement orally evidenced by “lawyers’ correspondence”.

Care must be taken to avoid alternative triggers for stamp duty also following the initial conclusion and execution of agreements, as abundant case-law shows. Any written correspondence in Austria evidencing the concluded agreement and its parties may constitute such alternative trigger. Further, according to the Stamp Duty Act references to other documents incorporate the content of such referenced document. Thus, an Austrian security document itself not triggering stamp duty may trigger stamp duty for other loan documents if it incorporates such documents by way of reference (e.g., for purposes of definitions).

Stamp duty considerations are in practical terms of high importance as they may render certain financial transactions unfeasible. Stamp duty considerations are also the background to the popularity of abstract guarantees in Austria: an abstract guarantee is not subject to stamp duty while e.g. a personal (conditional) guarantee triggers stamp duty.