

Beneficiary's repayment obligation following bank guarantee by consumer securing third-party debt

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Introduction

Information obligations for security provided by consumers for third-party debts

Merits of the case

Comment

Introduction

In a recent decision,⁽¹⁾ the Supreme Court extended the scope of the sections of the Consumer Protection Act⁽²⁾ that protect consumers that accede to a third party's obligation without any economic interest of their own. The Supreme Court broke with previous case law and held that Section 25c of the Consumer Protection Act must be applied analogously (ie, "beyond its wording") if a consumer does not personally join a third-party liability as a joint debtor, surety or guarantor, but provides a bank guarantee securing such liability. Although the Supreme Court returned the case to the first-instance court, the guidelines drawn up in this decision will apply to any type of collateral provided in similar situations for the account of a consumer.

Information obligations for security provided by consumers for third-party debts

In 1985 the Austrian legislature introduced provisions into the Consumer Protection Act⁽³⁾ aiming to protect spouses jointly liable for a loan. Since then, financial institutions asking for security granted by the spouse of the principal borrower must provide information on the legal consequences of such joint and several obligations in general and in the event of divorce, provided that the spouse qualifies as a consumer.

In 1997 the then-newly introduced Section 25c of the Consumer Protection Act further extended this information obligation to situations where a creditor was or should have been aware that the principal borrower, due to its poor financial situation, was likely to (partially) fail to fulfil its repayment obligations. In order to ensure a wide scope of application of the intended 'warning function', the information obligation under Section 25c applies to all types of creditor (eg, the scope is not limited to loans granted by a financial institution) and to consumers in general.

The legal consequence of failing to meet the information obligation pursuant to Section 25c is that a consumer will not be liable towards the creditor, unless it would have consented to granting the security even if the creditor had provided adequate information.

Merits of the case

In the case at hand, the plaintiff – an experienced businessman active in the facility management business – was requested by his cousin to personally provide a bank guarantee serving as a security for a bridging loan to be granted by the defendant, an Austrian bank, to his cousin's company (the borrower). The plaintiff agreed. The bank requested such a guarantee as a condition precedent for providing the bridging loan. A purchase contract for machines totalling the amount of the bank guarantee was entered into by the plaintiff and the borrower with the intention of providing the plaintiff with some kind of security for providing the bank guarantee. The cousin, in his capacity as managing director and majority shareholder of the borrower, neither informed the defendant about

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the economic situation of the borrower nor about the fact that the bank had already obtained ownership over the machines subject to the purchase contract by way of security. Further, the cousin did not inform the defendant about the entry into the purchase contract.

However, the bank was aware of the family relationship between the plaintiff and his cousin. The plaintiff refused to grant a mortgage (as initially requested by the defendant) but agreed to instruct his bank to issue a bank guarantee. The terms of the bank guarantee were agreed between the plaintiff's bank and the defendant. The defendant did not address the economic situation of the borrower during discussions with the plaintiff.

The defendant drew the bank guarantee in the insolvency of the borrower.

In the present procedure, the plaintiff sued the defendant for reimbursement of the principal and costs charged by the plaintiff's bank for meeting its obligations under the bank guarantee. The plaintiff based his claim on the defendant's failure to meet its obligations under Section 25c. The defendant objected by arguing that, among other things, the provision of a bank guarantee does not constitute the granting of a security within the meaning of Section 25c – in particular, considering the fact that the obligation to pay under the guarantee was with the plaintiff's bank and not the plaintiff (in his capacity as a consumer).

The first-instance court denied the applicability of Section 25c and held that the drawing of the bank guarantee qualified as a payment under the purchase contract. The appellate court confirmed this decision and held that by instructing the bank guarantee, the plaintiff primarily pursued his own economic interests (ie, purchasing the machines) and held that there was no claim for damages because the defendant had not been informed of the purchase contract.

The Supreme Court reversed these decisions based on the following assessment of the merits of the case:

- The plaintiff had acted as a consumer towards the defendant, as the provision of the bank guarantee was in no way connected with the plaintiff's own entrepreneurial activity.
- The plaintiff did not pursue his own economic interests (ie, purchasing the machines), as the purchase contract solely served as some kind of security and was invalid due to the pre-existing transfer of title to the bank.
- The purchase contract itself had no significance in the relationship between the defendant and the plaintiff, since:
 - the defendant had not known of the contract; and
 - the plaintiff had acted towards the defendant exclusively as the party willing to ensure the bridging loan to be granted to the borrower.

Based on this assessment, the Supreme Court dismissed the lower-instance courts' legal assessment and held that a person who provides a bank guarantee for a third-party debt is also financially burdened by the guarantor's claim for reimbursement if the bank guarantee is drawn. According to the Supreme Court, this obligation to reimburse the guarantor is precisely the type of risk that Section 25c wants to protect consumers against, as they assume a liability for a principal debtor without their own economic interests. Therefore, the Supreme Court referred the case back to the first-instance court in order to establish whether:

- the borrower's lack of ability to repay the loan had to be recognised by the defendant when extending the loan; and
- Section 25c was therefore violated.

Comment

Although the merits of the case – as summarised in the decision – seem exceptional, the analogous application of Section 25c in cases where the collateral is provided for the account of a consumer is fully correct – in particular, considering that the consumer must reimburse the guarantor. The Supreme Court correctly emphasised that the purpose of Section 25c is to warn and protect consumers that provide security for third-party liabilities, particularly in cases where the recourse of the consumer to the principal debtor may already be jeopardised from the outset due to the

borrower's poor economic situation.

The form of the collateral provided does not matter as long as it triggers the consumer's personal liability for all of their assets. Thus, the guidelines set out in this decision not only apply to bank guarantees, but also to any type of security interests provided on account and at the expense of a consumer. The reasoning behind this decision is that consumers are liable (with all of their assets) for the reimbursement of expenses incurred by the guarantor. It remains to be seen whether the Supreme Court will further apply these guidelines to security *in rem* (eg, like mortgages). Until now, the Supreme Court has denied the analogous application of Section 25c by holding that the liability arising from a mortgage is limited to the respective plot of land and does not constitute an (unrestricted) liability of the consumer with all of its assets.

As the case was referred to the first-instance court, the Supreme Court did not explicitly address the legal consequences of the applicability of Section 25c. In particular, with respect to the reversal of the payments made and claims triggered by the drawing of the bank guarantee. However, the decision may be read in such a way as to infer that the Supreme Court's intended solution for cases in which the defendant (in its capacity as beneficiary of the bank guarantee) fails to inform the consumer adequately is that the defendant will be liable to reimburse the plaintiff (ie, the consumer) for principal and costs charged by the plaintiff's bank for extending the bank guarantee.

This pragmatic approach also fits with established case law on the various legal relationships arising under bank guarantees. Undoubtedly, limitations arising from Section 25c in relationships between a consumer and creditor must not affect the (abstract and unconditional) obligations of the guarantor towards the creditor as beneficiary under the bank guarantee. In accordance with settled case law, the plaintiff's bank had to pay the defendant, which then had a valid claim against the plaintiff for reimbursement.

From an enrichment perspective, the payment received by the defendant is similar to an unlawful drawing of a bank guarantee (eg, where a secured claim was not due at the time of drawing the bank guarantee). In such cases, established case law provides the party instructing the bank guarantee with a claim for reimbursement against the beneficiary drawing the bank guarantee.

The flipside of this solution is that consumers instructing a bank guarantee must bear the costs triggered by the drawing of the bank guarantee until they are reimbursed by the beneficiary. Further, consumers must bear costs and risks (including the insolvency risk of the beneficiary) relating to reimbursement claims.

In the standard case provided for by Section 25c, a consumer which joined the (third-party) liability as a joint debtor, surety or guarantor would simply not be liable unless it would have undertaken such liability despite adequate information on the poor financial situation. Thus, consumers providing a bank guarantee or other type of security granted by third parties on their account face greater risks.

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Endnotes

(1) OGH 26.04.2017, 1 Ob 40/17i.

(2) *Bundesgesetz vom 8. März 1979, mit dem Bestimmungen zum Schutz der Verbraucher getroffen werden (Konsumentenschutzgesetz – KSchG) idgF.*

(3) BGBl 1985/481, Federal Act of 24 October 1985 establishing provisions for the protection of spouses jointly liable for a loan.

