

Banking - Austria

Bank guarantees – abuse of rights when demanding payment?

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Introduction

Bank guarantees are the financial security instrument of choice in the international and Austrian business sectors. To use this instrument effectively, it is crucial to have in-depth knowledge of the advantages and strategic use of abstract claims arising from bank guarantees, as well as an understanding of the pitfalls triggered by poorly drafted guarantees and underlying commercial agreements.

The Supreme Court recently⁽¹⁾ dealt with a situation that is likely to occur in the lifespan of a bank guarantee – in particular, when claims secured by a bank guarantee become due after the guarantee period expires.

Facts

The plaintiff had hired the defendant to build a house, which was to be completed by the end of November 2012. The parties agreed that partial invoices would be issued once pre-defined construction phases were completed. The invoices were due and payable within seven days of receiving the receipt. As security for the payments, the parties agreed on an abstract revocable bank guarantee to be provided by the plaintiff. In order to invoke the guarantee, the defendant had to provide the invoice and a confirmation issued by a civil engineer that, among others things, the respective construction phase was completed. The civil engineer was not responsible for assessing whether any defects existed. The contract did not provide for a mandatory extension of the bank guarantee's time limit in case the construction works were delayed. The plaintiff provided a bank guarantee which expired on November 30 2012. The defendant accepted the bank guarantee without objecting to the guarantee period.

During the course of the project, construction was delayed and disputes arose among the parties. On November 28 2012 the defendant issued two partial invoices and requested that the plaintiff extend the guarantee period of the bank guarantee to March 1 2013. The new guarantee had to be provided by noon on November 30 2012. The plaintiff agreed to make its best efforts to provide the new guarantee, but failed to deliver it in time.

The defendant claimed payment under the bank guarantee on November 30 2012, even though he knew that the claims under the two partial invoices were not due and would not be due during the guarantee period. The defendant's request for payment complied with formal requirements under the contract and the terms of the bank guarantee. Accordingly, the bank agreed to pay the defendant by December 6 2012.

In early December 2012 the plaintiff provided the new bank guarantee with an extended guarantee period. The terms of the bank guarantee were amended (ie, the previously required confirmation by a civil engineer was replaced by a confirmation to be made by the plaintiff).

On the plaintiff's request, a preliminary injunction was issued which prohibited the bank from paying the defendant under the initial bank guarantee. In the underlying complaint, the plaintiff requested revocation of the defendant's request for payment because the defendant had committed an abuse of rights and violated the contract by requesting payment of invoiced amounts that were not yet due. The defendant argued that it was not an abuse of rights to request payment under a guarantee for claims that are outstanding during the guarantee period but due after it expires. Further, the defendant argued that he had acted not with intent to cause damage, but rather in the plaintiff's interests. Had he not invoked the bank guarantee, the construction work would have stopped, resulting in serious harm to the plaintiff's interests.

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The first and second-instance courts rendered judgments in favour of the plaintiff on the basis that the defendant had abused his rights by invoking the bank guarantee before the secured claims were due. Further, the courts held that there was no 'extend or pay' call or indication that the bank guarantee was actually made in the plaintiff's interest.

Past Supreme Court decisions

Austrian precedent on bank guarantees is casuistic and characterised by the principle of 'strict formality', which means that all of the conditions set forth in the bank guarantee for making a demand must be complied with precisely.

A beneficiary's claim under an abstract bank guarantee is not based on the commercial relationship between the beneficiary and the instructing party. As a guarantee is non-accessory, the bank cannot object to any matter that arises from the respective underlying contractual relationship. According to the Supreme Court, this "corresponds to the spirit and purpose of a bank guarantee to ensure an immediate payment to the beneficiary without further examination of alleged objections". Such allegations should be reviewed only after payment under the bank guarantee has been made.

Regarding the question of whether demanding payment under a bank guarantee is an abuse of rights purely on the grounds that the underlying obligation was not due or payable, no clear-cut answer exists.

In the past the Supreme Court has held⁽²⁾ that in such cases no abuse of rights is committed because, pursuant to Section 1434 of the Civil Code, "the payment of a valid and unconditional debt cannot be reclaimed only because the payment period has not yet expired". However, in more recent rulings, the Supreme Court has held⁽³⁾ that in such cases, the instructing party of a guarantee may demand repayment from the beneficiary on the grounds of unjust enrichment based on an analogous application of Section 1431. It may therefore be assumed that invoking a guarantee constitutes an abuse of rights when the underlying secured claim is not due or payable.⁽⁴⁾

However, in another recent ruling⁽⁵⁾ the Supreme Court confirmed the rulings of the first and second-instance courts by holding that demanding payment does not constitute an abuse of rights solely on the grounds that the underlying secured claims were not due or payable. The Supreme Court held that the court of appeal – in its individual case assessment – acted in accordance with the principles developed by case law⁽⁶⁾ and referred to the aforementioned older rulings.⁽⁷⁾ In addition, it follows from the Supreme Court's well-established case law⁽⁸⁾ that no abuse of rights is committed as long as the beneficiary invokes the guarantee on reasonable grounds.

Decision

In the case at hand, the Supreme Court rejected the defendant's revision. In its reasoning, the court confirmed that the defendant had committed an abuse of rights, since he claimed payment under the bank guarantee, even though it was clear that he had no claim due against the plaintiff when he filed the request for payment. The Supreme Court based its decision on the fact that the defendant knew his claim was not yet due and that it would not be due within the guarantee period. In addition, the court held that the defendant invoked the bank guarantee in order to extend its securing function beyond the agreed guarantee period.

Based on the above, the Supreme Court summarised that no reasonable grounds justified the invoking of the guarantee. In doing so, the court avoided answering the question of whether demanding payment under a bank guarantee constitutes an abuse of rights purely on the grounds that the underlying invoice or obligation was not due or payable.

The Supreme Court further held that this was not an 'extend or pay' case, where the beneficiary makes a demand for payment according to the terms of the bank guarantee near its expiry date and permits the guarantor to extend the validity of the bank guarantee as an alternative to immediate payment. According to Austrian precedent, this requires that:

- the invoking of the guarantee be made by the beneficiary clearly and unequivocally in the client's interests; and
- the beneficiary request that the bank not pay the amount requested until it is ascertained whether the bank guarantee will be extended.

Since the defendant did not meet these prerequisites, his revision was ultimately rejected.

Comment

Irrespective of the importance of bank guarantees in the Austrian business sector, the Supreme Court's decision neither streamlined casuistic Austrian precedent nor provided clear guidelines for beneficiaries on how to proceed when:

- the end of the guarantee period is approaching;
- the contract does not provide for an obligation to extend the guarantee period or renew the bank guarantee; and
- there are claims outstanding which will be due after the guarantee period ends.

The Supreme Court appears to accept the 'extend or pay' procedure. However, even if a beneficiary

closely adheres to the requirements developed by courts, there is still a risk that an abuse of rights defence will succeed.

For further information on this topic please contact [Stephan Schmalzl](#) or [Norbert Amlacher](#) at Graf & Pitkowitz by telephone (+43 1 401 17 0), fax (+43 1 401 17 40) or email (schmalzl@gpp.at or amlacher@gpp.at). The Graf & Pitkowitz website can be accessed at www.gpp.at.

Endnotes

(1) OGH March 25 2014, 10 Ob 14/14b.

(2) OGH January 16 1992, 8 Ob 645/91; OGH November 9 1993, 5 Ob 540/93; OGH January 15 1998, 6 Ob 293/97z.

(3) OGH November 15 2000, 7 Ob 108/00h; OGH June 7 2011, 5 Ob 103/11z; OGH April 19 2012, 7 Ob 7/12y.

(4) This view is supported by *Apathy/Iro/Koziol*, Austrian Banking Law V² Rz 3/106.

(5) OGH July 7 2011, 5 Ob 95/11y; RS0016948.

(6) The Supreme Court may reject revisions for lack of a substantial legal issue. In connection with an abuse of rights, the Supreme Court regularly argues that the respective prerequisites must be evaluated in the light of the circumstances of each particular case. The Supreme Court must rule on the substance of the matter only where there is apparent misinterpretation or misjudgment by the lower courts.

(7) See Endnote 2.

(8) OGH July 23 2014, 3 Ob 113/14k; RS0017997.

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