

## Corporate Finance/M&A - Austria

### Is There a Future for Callable Bonds in Austria?

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In recent times corporate bonds have proved to be an alternative to traditional bank loans. However, a recent Higher Regional Court of Vienna decision,<sup>(1)</sup> which is pending before the Supreme Court,<sup>(2)</sup> may cause callable bonds as a means of raising money for corporate activity to disappear.

The Austrian consumer information association alleges that a typical provision in the general terms and conditions of bond issuers, according to which the bond issuer has the right to redeem the corporate bond under certain conditions before its maturity date, violates Austrian consumer protection law. Consequently, the association filed a class action against an Austrian limited liability company which issued bonds for a fixed term of six years. The general terms and conditions of the bonds granted the bond issuer a termination right which was exercisable after two years. The bond holders had no such termination right.

At both first and second instance the courts declared that the bond issuer's early termination rights grossly discriminated against the bond holder in terms of Section 879(3) of the Civil Code. In their reasoning the courts referred to the hypothetical case of a bond issuer that, having maximized its profits through the proceeds raised by the issue, terminates and redeems the issued bonds before the bond holders can benefit from higher interests.

However, the courts did not consider that a termination right is usually reflected in the pricing structure. In other words, the bond issuer must pay to exercise the option of a termination right. The courts can resort to a variety of established practices to appraise the value of such options. From an economic point of view, the issuance of corporate bonds is a financing instrument in the hands of companies in need of cash. Once bonds have been issued, it is at the sole discretion of the bond issuer to redeem the bond by way of exercising its early termination right at any time that it deems fit. A bond holder usually assumes the risk of solvency in consideration of yields that are higher than those attainable by conservative investments.

It remains to be seen whether the Supreme Court will consider this perspective in its final judgment. An affirmation of the consumer information association's assertion could possibly cease the issuance of not only corporate bonds, but also callable bonds in general in Austria.

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#### Endnotes

(1) OGH 9 Ob 81/08i (not yet available).

(2) Higher Regional Court of Vienna, OLG Wien 5R 63/08h.

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