

Banking - Austria

Supreme Court restricts contractually agreed pledgee's rights of realisation

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[Introduction](#)

[Section 1371 of the Civil Code](#)

[Supreme Court decisions](#)

[Impact on acquisition financings](#)

Introduction

In the context of secured financings, lending banks often require a pledgor to issue a sale power of attorney for the asset pledged (ie, shares, real property or other assets). This sale power of attorney is to facilitate realisation of the pledged asset in the event of default, without any involvement required on the side of the pledgor.

However, in recent decisions (the latest dated February 11 2010), the Austrian Supreme Court has held that such a sale power of attorney may be considered an illegal circumvention or breach of Section 1371 of the Civil Code.

Section 1371 of the Civil Code

Under Section 1371, all conditions and side agreements that are contrary to the nature of pledge agreements are void. In particular, the section arguably requires a pledgee to take into account the pledgor's interests when realising pledged assets. Provisions stipulating a minimum sales price and a 'best efforts' clause are not considered sufficient protection of the pledgor's interest. Furthermore, any provisions granting the pledgee the right to sell the pledged object at its arbitrary will, or at a pre-fixed price, are void. The effect of a violation of this section is nullity, normally not of the entire pledge agreement, but only of the respective condition or side agreement.

Supreme Court decisions

In each case presented to the Supreme Court, the court decided on the validity of a sale power of attorney issued by the pledgor for the sale of pledged real property in the context of a financing secured by such real estate. In each case, the court held that a comprehensive sale power of attorney granted to a bank in order to act on behalf of the owner of the pledged real estate indicates an illegal circumvention or violation of Section 1371. The scope of rights granted to the bank under the sale powers of attorney was decisive for the outcome of these cases. Each time it was argued that the pledgee was able to shape the sales process at its discretion and thus the pledgor did not have effective opportunities to optimise the sales price of the pledged asset.

The rationale underlying the decisions applies not only to financing involving real property, but presumably to any financing involving a sale power of attorney for a pledged asset.

Impact on acquisition financings

In the context of acquisition financings, lending banks typically require the borrower to grant comprehensive security interests. Sale powers of attorney are often used to facilitate realisation of pledges of shares and other assets.

The decisions of the Supreme Court create uncertainty as to the validity and enforceability of such sale powers of attorneys.

However, the Supreme Court did not rule that sale powers of attorney are prohibited in general. Pursuant to the court's rationale, sale powers of attorney that provide the pledgor with an opportunity to influence the sales process, and especially the sales price, should still be considered valid. Hence, provisions enabling the pledgor to optimise the sales process - such as the right to name an expert to determine the sales price or prospective buyers - work to the benefit of the pledgee if the sale power of

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attorney is challenged in court.

In future, sale powers of attorney will therefore need to be drafted carefully to include certain protections of the pledgor's interest during realisation of the pledged asset. In particular, provisions should be included that require the pledgee not to sell below market price and offer the pledgor an opportunity to ensure that an appropriate price for the pledged asset is received. This may help to avoid the sales power of attorney being held void.

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