Banking - Austria

Interest rate adjustment and calculation under business loan agreements

Contributed by **Binder Grösswang Rechtsanwälte GmbH**

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Introduction

In a recent judgment the Supreme Court dealt with interest rate adjustment clauses and interest rate calculation methods under business loan agreements. This judgment provides important guidance for banks and their advisers.

In business loan agreements, the parties are free to insert an interest rate adjustment clause that entitles the bank to step up interest rates following an increase in refinancing costs. This right is limited only by a corresponding obligation to reduce interest rates when refinancing costs drop, and by the principle of reasonability. Interest payments under business loan agreements that do not provide for a specific method of interest calculation are calculated pursuant to the 30/360-day count convention which, according to the Supreme Court, constitutes a trade custom in Austria.

Facts

The plaintiff entered into several business loan agreements with the defendant bank. These agreements included clauses pursuant to which the bank was entitled unilaterally to amend the terms of the loan, including the applicable interest rate, in accordance with the prevailing money, credit or capital market situation. However, the loan agreements did not contain a provision on the method of calculating the interest amounts.

In its claim, the plaintiff sought reimbursement of excess interest payments, arguing that:

- the interest rate adjustments applied by the bank had exceeded the changes in the secondary market yield and the Euro Interbank Offered Rate during the relevant period; and
- interest payments should have been calculated on the basis of actual days elapsed rather than on the basis of a 360-day year.

The bank argued that it was entitled to adjust the applicable interest rates in accordance with its own equitable discretion. Furthermore, it was entitled to calculate interest amounts on the basis of a 360-day year, since this calculation method was customary in the Austrian loan market.

Decision

The Supreme Court confirmed the permissibility of interest rate adjustment clauses, based on Section 1056 of the General Civil Code. This provision permits contractual arrangements between entrepreneurs under which one of the parties to an agreement (or an unrelated third party) is authorised unilaterally to determine the commercial terms of the agreement. The Supreme Court acknowledged that banks have a legitimate interest in providing for the adjustment of interest rates in accordance with changes in refinancing conditions and the relevant money and capital markets.

According to established case law, such arrangements do not permit adjustments that are evidently or grossly unreasonable. An adjustment of interest rates is considered evidently unreasonable if an unrelated expert would immediately be able to identify the adjustment as unjustified. However, abuse by a lender of the right to adjust the interest rate would not lead to the automatic invalidity of the interest rate so adjusted; instead, the adjusted interest rate would remain subject to *ex-post* review by the courts.

The Supreme Court also confirmed earlier case law under which interest rate adjustment clauses (even in business loan agreements) must operate both ways - that is, the contractual arrangement must provide for a reduction of interest rates when the bank's refinancing costs decrease.

In relation to the interest calculation method applied by the defendant bank, the Supreme Court acknowledged, on the basis of an expert opinion obtained by the court of first instance and a corresponding provision of the Banking Act on the calculation of interest on deposits, that the 30/360-day count convention constitutes an established trade custom in the Austrian loan market. Such trade customs are directly applicable in the absence of an explicit contractual provision on interest calculation.

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