Lender's liability in case of borrower's insolvency

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Recent case law from the Supreme Court(1) demonstrates once again that lenders can be held liable by creditors of an insolvent borrower under certain conditions. In particular, a lender may be held liable where it has significant influence over the borrower's management. However, only a few cases have met the necessary level of influence. The case discussed below shows that total disregard of this risk can have severe consequences for lenders.

Facts

The debtor was an insolvent fuel trader and producer. The plaintiff was the debtor's fuel supplier. The purchase price for the fuel was normally paid within 14 days of delivery. Both parties had been doing business with one another for quite some time, and there had never been a problem with the payments to the plaintiff until the debtor became insolvent. However, as the debtor's economic situation gradually deteriorated, it was eventually compelled to file for insolvency. Consequently, it was unable to pay for the last deliveries and the plaintiff had to accept a significantly lower recovery rate in respect of its outstanding liabilities.

The plaintiff sued the debtor's main bank for recovery of the losses that it had incurred due to the insolvency. The plaintiff argued that the defendant had used its influence over the debtor in order to delay the insolvency filing for its own benefit. In doing so, it had induced the plaintiff and other creditors to supply the debtor – something which they would not have done had they been aware of the true circumstances. The plaintiff argued that the defendant was therefore responsible for the subsequent losses.

The plaintiff's allegations proved true in the ensuing proceedings. The evidence suggested that the debtor's insolvency had been caused by a failed search for investors. Not only had the debtor's main bank been aware of the failed search before the other creditors, but it also played a significant part in attempts to restructure the debtor, assuming an active and leading role in the insolvency procedure.

When it became clear that the debtor would have to file for insolvency, the defendant used its influence to choose a date for the insolvency application which would minimise its own losses. It was discovered that the defendant had already arranged for the assignment of the debtor's receivables from customers before the insolvency in order to secure its own claims, thereby using the assigned receivables in order to mitigate its own losses.

According to the approach developed together with the borrower, the insolvency application had to be filed when the maximum income from the assigned receivables was available. Until that point, the defendant continued the credit relationship with the debtor, which led the suppliers to believe in the debtor's continued creditworthiness. This allowed the plaintiff to withdraw money from the debtor's account even after the date of the insolvency application, although these bookings were later reversed. The defendant's approach was ultimately successful and it was able to cover its receivables from the assigned receivables. However, this course of action also resulted in correspondingly high losses to the plaintiff and other creditors.

Decision

The court considered that the debtor would have had to file for insolvency at a much earlier date without the defendant's involvement. Because the defendant continued to grant the debtor credit, the latter was able to continue to do business in order to file for insolvency at the planned date. Without the defendant's involvement, the debtor would have been unable under any circumstances to convince the creditors to continue to supply it over this extended period.

According to the court, the defendant had induced the plaintiff to supply fuel to the debtor despite the imminent threat of insolvency, with full knowledge that it (or its officers) would reap economic benefits from these supplies in the case of insolvency. The defendant thereby deliberately accepted the risk of harming the other creditors, which it eventually did. The defendant's unfair conduct entitled the plaintiff to compensation.

The actual damage suffered by the plaintiff included the deliveries which it had been induced to make due to the defendant's involvement. According to the court, compensation had to be paid for the time during which the debtor was already insolvent and able to continue to do business only because of the defendant's assistance, as the plaintiff would not have made these deliveries without the defendant's unfair influence.

Comment

Although Austrian case law has addressed similar cases in which a lender was liable to other creditors of an insolvent borrower, the courts have always strictly interpreted the crucial condition of the lender's 'qualified substantial' influence over the debtor's management. As such, lenders have been found liable to creditors only in specific cases – for example, where the lender acquired shares in the debtor.

Although the court applied a somewhat lower standard in respect of the lender's influence in the case at hand, this is likely to be an exceptional ruling. The lender's influence was significant enough to influence when the insolvency application was filed. Thus, the case law on this issue is unlikely to change. However, the case serves as a reminder that lenders' risk of liability is more than an abstract possibility. Lenders should thus be aware of their risk of liability whenever they exercise influence over a borrower that is likely to become insolvent.

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Endnotes

(1) Supreme Court, December 15 2015, Case 4 Ob 128/15z.