Enforcement of bank guarantees in Spain

Marina Bugallal and Mariano Jiménez discuss what happens when a debtor or guaranteed party goes insolvent

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What happens if the beneficiary of a bank guarantee or other surety decides to enforce it against a payment default by a debtor who has been declared insolvent? This is a crucial question not only for the beneficiary of the guarantee but also the granter thereof – in many cases a financial institution. Neither one nor the other should be unaware of the consequences if their debtor and guaranteed party, respectively, are declared to be insolvent.

In the interests of the utmost clarity the guarantor will be called herein "the guaranteeing party". The debtor involved in the insolvency proceedings, for its part, will be called "the secured debtor", while the surety beneficiary will be called the "the creditor with guarantee".

1. The general rule of article 87.6 of the Spanish Insolvency Proceedings Act (Ley Concursal, LC)

This article lays it down that "*the credits in which the creditor enjoys a third-party surety will be recognised at their face value with no limitation whatsoever and regardless of any change in the credit holder in the event of payment by the guarantor*".

This means that, after declaration of the insolvency, the guaranteeing party will remain the bound party vis-à-vis the creditor with guarantee, benefited by the remaining term until the obligation falls due. Should this term run its course during the insolvency proceedings and the creditor with guarantee hold the guaranteeing party to its surety obligation, then the latter, i.e., the guaranteeing party, will then, by virtue of the payment, become the holder of the credit against the secured debtor, being entitled to take over the original creditor's payment demand right.

Royal Decree Law (*Real Decreto-ley*) 2/2009 of 27 March has added the following rider to said article 87.6: "Whenever the payment-driven subrogation should occur, these credits will then be classified in such as a way as may be least onerous for the insolvency proceedings, between those corresponding to the creditor or guarantor".

2. The case of only partial credit payment by the guaranteeing party after enforcement of the guarantee

Article 87.7 of the LC runs as follows: "*at the behest of the creditor that has received payment of part of its credit from a guaranteeing party, guarantor or joint and several debtor of the insolvency proceedings, the list of creditors may include in its favour not only the rest of the unpaid credit but also the total sum corresponding to whoever made the partial payment, by reimbursement or the part corresponding to a joint and several debtor …*"

This precept, for the credit recognition phase, enshrines the general principle that the right of the creditor with guarantee to be compensated for the unpaid part of the credit overrides the right of the guaranteeing party that has made a partial payment vis-à-vis the same debtor.

Pursuant to this provision (article 87.7 of the LC), the original creditor has the possibility of recovering in the insolvency proceedings the rest of its unpaid credit against payment of the credit as corresponding to the guaranteeing party. Bearing out this idea, article 160 of the LC, in the section dealing with payment to creditors, lays it down that "any creditor that, before declaration of the insolvency proceedings, has received part payment of the credit from a guarantor or guaranteeing party or from a joint and several debtor will be entitled in the insolvency proceedings to receive the payments corresponding to the former until such time as they add up to the total sum of the latter".

3. Relationship of the arrangement with creditors and the secured credit

The doubt now crops up of whether, in the event of the approval of an arrangement with creditors involving corresponding debt reductions and postponements, the guaranteeing party would be able to pay the creditor with guarantee by applying the debt reductions and postponements authorised by said arrangement.

The LC rules as follows on this point: "creditors that have not voted in favour of the arrangement will not be bound thereby in terms of the full subsistence of their rights vis-à-vis those joint and severally bound with the insolvent party and vis-à-vis its guarantors or guaranteeing parties, who will not be entitled to invoke the approval or effects of

the arrangement to the detriment of the former" (article 135.1).

This is without detriment to whether the guarantee in question constitutes a first-demand bank guarantee. In such a case, it is our opinion that the guaranteeing party could never invoke against the creditor with guarantee the debt reductions and/or postponements of the arrangement with creditors, not even if the latter had voted in favour of said arrangement. Along these lines the LC lays it down that "the liability of those joint and severally bound, guarantors or guaranteeing parties of the insolvency proceedings against the creditors that have voted in favour of the arrangement will be governed by the rules applicable to the obligation they may have taken on or by such arrangements as may have been made thereon" (article 135.2).

4. Guarantee in favour of the creditor specially related to the debtor

Special mention must be made of the situation where the creditor with guarantee is considered to be a "person especially related with the insolvent party". Pursuant to article 93.2 of the LC, when the secured debtor is a company, the following persons will be deemed to be specially related thereto:

- Shareholders that, pursuant to the law, are personally liable without limit for company debts and those others that, at the moment when the credit right arises, are holders of at least 5% of the share capital, if the company declared to be insolvent has securities trading on an official secondary market, or 10% otherwise.
- The directors, the liquidators and generally empowered agents of the company plus those who may have been any of the above within the two year period running up to the declaration of the insolvency proceedings.
- The companies forming part of the same group as the company declared to be insolvent and the shareholders thereof, provided these meet the same circumstances as under paragraph 1 hereof.

Along these lines article 97.2 of the LC runs as follows:
"*If the creditor classified in the list of creditors as especially related with the debtor does not challenge this classification in due time and form, the insolvency-proceedings judge, as soon as the deadline for doing so has passed, and without any other requisite, will dictate an order* ***declaring any guarantees of any sort furnished in favour of the former's credits to be extinguished****, ordering, as the case may be, the possessory restitution and cancellation of the entries in the corresponding registries*".

The practical importance of this provision is clear: does it mean that if I have a debt security from a company of which I am a shareholder (or of its group of companies) and this is declared insolvent, I will forfeit my guarantee? Will I forfeit it too if I am the CEO (general empowered agent) of a company that owes me several sums secured by a bank guarantee?

A strict reading of article 97.2 would disfavour the creditor with guarantee especially related to the debtor, since it would mean that in every case the insolvency-proceedings judge "without any other requisite" will dictate an order declaring the guarantee granted in its favour to be extinguished. Some writers have criticised the mercantile judges' tendency to such "strict interpretations" and claim that, pursuant to article 97.2, the judge should weigh up the circumstances of the case before adopting the drastic measure of extinguishing the guarantee.

Unfortunately, the current wording of article 97.2 is not conducive to this discretionary interpretation by the judge, so there is a high risk of the judge simply extinguishing the guarantee in question without a second thought.

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