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## RANKING OF A SECURED GUARANTOR UPON PAYMENT OF CLAIM OF UNSECURED CREDITOR

*On the ruling of Commercial Court No. 1 of Oviedo, dated 25 May 2011  
(Article 87.6 of the Spanish Insolvency Act)*

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The case: In this case a creditor holds an unsecured and unsubordinated claim against an insolvent debtor. A guarantor had provided a guarantee to the creditor and taken security on assets of the debtor to secure repayment of the debt in the event of enforcement of the guarantee.

The court ruling decided on the ranking of the claim of the guarantor upon payment of the amounts owed by the debtor to the original creditor.

The law applicable: Article 87.6 of the Spanish Insolvency Law:

*Article 87. Special Cases of Acknowledgement [of claims against the estate of the insolvent debtor]*

1.- [...]

2.- [...]

3.- [...]

4.- [...]

5.- [...]

6.- The claim of a creditor [against an insolvent debtor] holding a personal guarantee provided by a third party shall be acknowledged in full without prejudice to the substitution of the holder of the claim in case of payment of the debt by the guarantor. Provided subrogation [by

the guarantor] for payment of the debt takes place, in the acknowledgement of the claim [of the guarantor] the ranking of that which is less onerous to the insolvent's estate shall prevail, by comparing the seniority of the original creditor with that of the guarantor.

Background: Article 87.6 of the Spanish Insolvency Act foresees that in those circumstances where the debt of a company is guaranteed by a third party (guarantor), if the claim is satisfied by the guarantor, the recovery rights of the guarantor shall rank, in the case of insolvency of the debtor, with the seniority which is least onerous to the insolvent's estate, by comparing the seniority of the original creditor with that of the guarantor.

This article had been heavily criticized for its potentially indiscriminate scope as this could be applied in many types of cases well beyond what academics and practitioners assumed to be the mischief towards which it was directed (i.e. where a party related to the debtor provides a guarantee to an unrelated creditor).

In order partly to clarify the meaning of the rule contained in article 87.6, and to avoid the use of the downgrade mechanism against an unrelated creditor prior to the satisfaction of the claim by a guarantor, Real Decreto Ley 3/2009 introduced the requirement underlined above. Accordingly, under this reform, the above rule would only apply where the guarantor had honored the debt; the original creditor had been paid out, and hence

the guarantor became the new holder of the claim.

In the opinion of legal writers, despite the above reform, many other cases not theoretically addressed by article 87.6, were still strictly speaking going to be captured such as the one discussed in this court ruling; that is to say, a secured guarantor paying and subrogating in an unsubordinated claim.

#### The arguments of the parties:

On the one side, the guarantor requested the acknowledgement of its recovery rights against the insolvent's estate as a secured claim because it held a mortgage over real estate property of the debtor. In support of this request the guarantor used the arguments of the majority legal doctrine in Spain, which restricts the application of the rule in article 87.6 of the Insolvency Act to those circumstances where at least one of the claimants (original creditor and guarantor) is a party especially related to the debtor, and hence a subordinated creditor.

On the other, the receivers in bankruptcy (*administración concursal*) argued for the literal wording<sup>1</sup> of article 87.6 of the Insolvency Law

to apply and since the less onerous ranking of the claim against the insolvent's estate was that of the original creditor (unsecured and unsubordinated), they maintained that the guarantor's claim should be deprived of the benefit of the mortgage and be merely acknowledged as an unsecured and unsubordinated claim.

#### The court resolution:

Following other minor<sup>2</sup> court resolutions<sup>3</sup>, the Commercial Court of Oviedo has held that the recovery rights of any secured guarantor should maintain the privilege provided by the security, whatever remedies for reimbursement available to it may be triggered (e.g. subrogation in the claim of the original creditor under article 1838 of the Civil Code and reimbursement of payments made by guarantors under article 1838 of the Civil Code).

Furthermore, the court held that in the absence of the subordination of a claim on the grounds of the holder's relationship with the debtor (i.e. equitable subordination), there is no reason to downgrade a guarantee arrangement which had been executed to assure a preferred ranking of its recovery rights in the case of insolvency of the debtor.

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1 Although some legal writers use the literality of the rule in exactly the opposite direction.

2 Rulings of first instance tribunals.

3 Commercial Court No. 1 of Madrid, 5 July 2005.