G A _ P

Gómez-Acebo & Pombo

Surety bond to secure the repayment of merged or divided company debts

Angel Carrasco Perera
Professor of Civil Law, Universidad de Castilla-La Mancha
Academic Counsel, GA_P

This paper discusses the legal position of a surety, in the various configurations thereof, when the secured debtor is a company merging or dividing.

1. Old issue, new perspectives

One of the most uncertain parts of company law remains that of the fate of external creditors
and non-corporate rights holders against a commercial company merging or dividing under
the terms of the Structural Changes (Commercial Companies) Act ('LME'). Something new can
always be revealed if you take more time than usual to reflect on the matter, and such deeper
(1) reflection is encouraged by the latest book by the notary Segismundo Álvarez Royo Villanova,
Sucesión universal en las modificaciones estructurales (2018). The aforementioned work
provides a comprehensive overview of this subject. But I am only interested now in addressing
a particular issue, such being the consequences for a surety of a merger or division of a debtor
company. The merger or division of the surety or obligee creditor will not be considered here.

Reading Segismundo Álvarez's pages has advised me to expand on some points I made in the
(2) third edition of the *Tratado de los Derechos de Garantía I*, page 316, whilst inviting me at
the same time to go beyond said author's views, which do not as a whole convince me.

According to my previous opinion, the debtor's merger gives rise, as a matter of law, to a subrogation under art. 22 LME; the surety is not released, even if the debtor company is absorbed. The surety for present and future debts (general surety) would also be bound by
(3) post-merger debts, unless the surety bond was such that, because of its indefinite nature, it would allow the surety to withdraw *pro futuro*. An "objection" by the surety under art. 44 LME would amount to withdrawal. Finally, termination of the surety bond by a change of circumstances caused by the change of debtor or (I add now) by a novation of art. 1847 of the Civil Code ('CC') should not be accepted.

According to Segismundo Álvarez (pp. 222 and 223), a merger would not result in any change in the status quo as a result of the succession *in universum ius* effect of art. 22 LME, but the surety would have a right to object if its claim to contribution had arisen and had not lapsed[1], which can only occur if it has been sued and has not yet paid or when the principal debt has become due, by analogy with art. 1843 CC (action for release of surety bond). In the case of a general surety bond, the surety may withdraw if the surety bond has an indefinite term. Even if definite,
(4) it could withdraw for just cause in application of art. 1705 CC [sic, probably art. 1707], although he finds it preferable to "extend" the solution proposed by the Supreme Court ruling of 23 March 1988 and to advocate the termination of the surety bond for successive debts. I note here that, unless I am very much mistaken, the above-mentioned judgement did not deal with this matter *per se*, but rather with the non-perfection of the surety agreement when the offeror (surety) died before acceptance of the offer by the creditor.

2. Solution based on the interests at stake

(5) I shall now try to transcend my own position and that of the author I have glossed over, and whose views, as will be seen, I share only to a limited extent.

2.1 Five contentions

— *First*. With regard to the effects on the surety bond, a distinction should only be made between the absorbed (debtor) company and the absorbing (debtor) company when there is a *material reason for this distinction due to the volume of adventitious risks*,
(6) or when the rule in question is so misguided (for example, art. 32 of the Urban Tenancy Act: transfer by merger) that it is reasonable to minimize the scope of the rule. Otherwise, it would make no difference whether the main debtor has been absorbed or has absorbed (in the division, the transferor or the transferee).

[1] Art. 44 indeed grants this right to "the creditors of each of the merging companies whose claim arose before the date on which the draft terms of merger were posted on the company's website or filed with the Register of Companies and had not become due then".

— *Second*. The position of the surety is not that of a mere creditor under art. 44 LME. The rejection of the aforementioned provision is also aided by the fact that it is deficient and that in its most usual interpretation (but not that of Segismundo Álvarez, which I share) it means leaving the relevant guarantee in the hands of directors. In the surety bond, it is not the position of creditor (for contribution) of the surety that is essential, but the position of the contingent debtor of this surety; in fact, it may be the case that the action for contribution against the debtor is not appropriate for various reasons. In
(7) addition, the contribution does not occur in terms of the transactional *causa* (purpose) of the surety bond, but in terms of the underlying mandate (or business management) contract under which the surety undertook to provide the debtor with a surety bond. The surety bond as a whole (including the action for contribution) is a complex legal position, unrepeatable in the system due to its business scheme, which, of course, is not reduced to that of a simple claim against the secured debtor, as are, among other things, the positions of the rightholder of (person entitled to enforce) a non-compete agreement, a right to confidentiality, a bilateral continuing performance contract, a purchase option on merged shares, etc., which have no place under art. 44 LME.

— *Third*. It is a *petitio principii* to prefer a dubious interpretation simply on the grounds that *structural changes in the company must be encouraged* and that for starters this is stated in European legislation. It is not acceptable to play with such arguments in private law, which serve only to disregard the wise rule of commutative justice of *fiat iustitia, pereat mundus*. At least when the price to be given to the creditor for this expropriation is as unsubstantial as that of art. 44 LME. For the same reason, it could
(8) then be said that capital increases should be encouraged, regardless of whether the dissenting shareholder's expectations are minimally met or not or whether commercial companies should be capitalised above all, even if this means not distributing dividends indefinitely to minority shareholders. When it comes to mergers (divisions), it is only particular interests that should be weighed up: those of the shareholders, the creditors, the workers; not the macroeconomic magnitudes or the alleged systemic strengths.

— *Fourth*. The proposals on the fate of the surety bond in the merger or division operation now under consideration should take into account *only material considerations*. These material considerations are in any case *expectations of risk*. There are three types: 1) That the operation produces an increase in the *risk of non-payment from the debtor to the creditor* greater than the surety could have taken into account when
(9) contracting. Although a merger appears at first sight to essentially exclude this risk and a division excludes it by virtue of art. 80 LME, this is a *petitio principii*. In practice, this increase may occur not only because the transaction costs for making the payment are increased, but also because the operation changes the compliance strategies of the new or old directors. 2) The operation results in an increased *risk of non-payment of the surety's action for contribution against the merged or divided debtor*. Similar

reflections can be made here. 3) That the result of the merger or division quantitatively
increases the risk of successive indebtedness of the debtor when the creditor has
a general surety bond. Here too, it is a matter of fact whether or not the increased
risk will occur and whether or not it will materialise once it does. As a summary of
(9) the three cases, it could be argued, but only *ceteris paribus*, that an appreciable
increase in risk would give the surety a right to release himself from this surety bond in
accordance with this increase in risk and in the corresponding amount; we would apply
arts. 1835, 1851 and 1852 CC analogously and accept that there would then have been
a "novation" under art. 1847.

— *Fifth*. Where the surety has the precious mechanism of right to withdraw *pro futuro*
in a general surety bond, it cannot be proposed that the right to object under
(10) art. 44 of the Law LME may be used for this purpose, nor that an automatic *pro futuro*
termination of the surety bond may occur in accordance with the increase in risks or
the absence of *intuitu personae* with the new debtor.

2.2 Four types of surety bonds

Both Segismundo Álvarez and I have in the past been misguided on a fundamental point,
(11) namely that not all sureties are of the same class. But we have, at the very least, the
following:

— *First*. The surety is an insider of the debtor company in any of the relevant ways in
which this capacity may be exercised. A typical insider does not deserve, in principle
(marginal exceptions must always be left open), the protection derived from arts. 1851
and 1852 CC, as the Supreme Court has rightly held, although the same may be said
of other conflicts. Like that of a structural change. Simply, the amount of successive
(12) risk is irrelevant, as is whether the debtor company has lost its legal personality by
absorption. Not even a right to object under art. 44 LME lies. As always, there remains
the right to withdraw *pro futuro* in a general surety bond, which is not conditioned in
any way by a structural change operation. We believe that there is no withdrawal for
just cause in a general surety bond with a limited term.

— *Second*. The surety is a company of the group of the merged or divided debtor.
(13) The same consideration applies as above. The succession *in universum ius* effect is
complete, with no ancillary consequences. With regard to the right to withdraw *pro
futuro*, the above applies.

— *Third*. The surety is a credit institution that secures third-party transactions. The surety
(14) bond remains in force, and there will be no right to object as a rule because the
surety will always be suitably counter-secured in his expectation of contribution

(14) against the debtor, even for the purposes of art. 44 LME[2]. The same applies to the right to withdraw.

— *Fourth*. The surety is a person (not necessarily a natural person) who does not have the status of insider of the debtor company, but has family ties with the debtor or with the debtor's director. For instance, the spouse of the director secured the debt of his spouse's company, who is an insider, or secured the debt of the family company, which is the source of the production of marital community property. Even less involved with the business, the case of the parents of the director or insider shareholder. This type of surety is not marginal, nor are the 'family' companies that merge or divide. In these cases, *the personal basis is fundamental* and the application of art. 44 LME is not appropriate. This personal basis is a matter of fact and is not necessarily related to the 'family' company being the absorber, the absorbed, the transferor of the division or the transferee of the division. Let us not, however, draw any hasty conclusions. We should distinguish between debt pre-existing the structural operation and successive debts contracted by the debtor company. In the first, the structural operation cannot have been an influence; the debt is consummated and only the risk of contribution remains.
(15) But in a surety bond of this kind *it is rational to assume that the family surety never had from the outset the realistic option of contribution*, so its current worsening will be an ordinarily untenable excuse. There is no increased risk. There remain the successive debts from the general surety bond. The family member has a right to withdraw which eliminates the subsequent risk. And, as he is surely also a consumer, he can request the voidness of the general clause for lack of transparency if it was not made very clear to him when entering the agreement that he had this possibility which he could use at his discretion. It may also be proposed that, quite simply, the surety should not be liable for these successive debts, establishing a material rule to this effect, such as the one created by the Supreme Court judgment of 29 April 1992, in the event that the general surety expires before the new debts covered by the guarantee are contracted. This solution seems to us to be particularly convincing - operators must be deterred from requiring consumers to provide surety bonds for business debts in any case - and irrespective of whether the general surety bond had or not a fixed term.

2.3 *The residual case*

In our opinion the above list of cases exhausts the subjective spectrum of surety bonds that may be given in a structural change operation. However, lest there still be cases not covered
(16) directly or by analogy by any of the above descriptions, although I honestly cannot imagine what such circumstances might be, I propose the following: 1) to disregard, in accordance with the foregoing, art. 44 LME; 2) to take the succession *in universum ius* as the rule of production; 3) to apply what has been said regarding the right to withdraw *pro futuro* in

[2] "Creditors whose claims are already sufficiently secured shall have no right to object."

(16) general surety bonds with an indefinite term; 4) to otherwise leave the resilement for just cause under art. 1707 open if there is a significant increase in subsequent indebtedness, and 5) to apply art. 1852 CC and to propose a full or partial release of the surety if the operation has significantly increased the risk of contribution.