Personal guarantors and refinancing arrangements under the 4th Additional Provision of the Insolvency Act

Ángel Carrasco Perera
Professor of Civil Law, Universidad de Castilla-La Mancha
Academic Counsel, Gómez- Acebo & Pombo

*Below we will explore several problems that arise in connection with para. 9 of the 4th Additional Provision ("**AP**") of the Insolvency Act ("**LCon**") when there are personal guarantors – or collateral-providers for third party debt – within refinancing arrangement 'homologation' (court-sanctioning) proceedings under said 4th AP.*

1. Contingent claim against the guarantor who refinances under the 4th AP.

In this case, it is the guarantor who refinances and seeks homologation. It is clear that he can do so, despite the fact that the 4th AP is posited – not sure whether rightly so – on the premise that the guarantor stands outside the proceedings. Such premise has been brought to the limelight as a result of the homologation decisions in respect of *Abengoa* and *FCC*. Despite the analogy that could be found in art. 87 LCon (contingent claims would count towards majorities and quorum, but would not have a vote), these rulings have concluded that claims against the party seeking the homologation, inasmuch as personal guarantor, are contingent provided such secondary obligation is not triggered (it must be noted that a joint and several guarantee is also contingent, according to the Supreme Court's case law). As such, they do not count as "financial debt" and, therefore, do not have a vote in respect of the arrangement. It is evident that this view prevailed so as to make it easier to obtain the majorities required in each case under the 4th AP, reducing the relevant financial debt. The result is almost perverse: the creditors holding these contingent claims would not be subject to the arrangement even if such claims crystallized in such a way as to allow them to proceed against the debtor party to the homologated arrangement. One way or another, creditors are permitted to make strategic choices within the refinancing proceedings: either they make a direct loan or they extend a guarantee, with very different consequences. The only way to counter this is to request a group arrangement where there are intra-group guarantors whose debt would also be adjusted (i.e., restructured).

2. The guarantor's repayment claim against the refinancing debtor.

To be consistent with the above, these claims for contribution should also be characterised as contingent when the surety has not yet paid off the refinancing debtor's debt. It is doubtful whether this should be so even when the homologation affects a group of companies and the guarantor of the parent company is also included within the scope of the arrangement (e.g., the *Isolux* case). Note that this would affect the consequence provided in para. 9 of the 4th AP. Where the surety is not a party to the proceedings, he will be liable for the whole of the debt when the creditor has not signed the arrangement, and where the creditor has signed the arrangement, the action against the surety will depend on "what would have been agreed in the respective legal obligation". If the guarantor also adjusts his debt, the contribution will be in accordance with the homologated arrangement; and if he is a party to the proceedings, the effect will occur regardless of whether the guarantor's debt and his action for contribution are characterised as contingent and prima facie as non-financial debt. In this case it is financial debt.

3. Contribution for the surety who pays the full amount of the debt guaranteed and refinanced.

The creditor who has not signed the refinancing arrangement or has disagreed with the same, but is affected by the homologation, keeps intact his rights against the guarantor. This is evident because it is postulated by para. 9 of the 4th AP. Less evident but equally true is that the surety has a right to contribution for the whole of his payment and the debtor is unable to raise as a defence the homologation arrangement, because art. 1840 of the Civil Code ("**CC**") is not applicable. This would be otherwise if the surety had counted/voted as holder of financial debt. In my opinion, in this case he would be subject to the terms of the arrangement by way of contribution.

4. The guarantor's subrogation to the creditor's rights, subject to composition.

The foregoing paragraph could be contradicted arguing as follows. According to art. 87.6 (by analogy here), the guarantor subrogates to the claim of the principal creditor when he pays, with the characterisation and rank that this claim has (with the exception stated in the provision). For the same reason it could be said that the guarantor who pays the entire debt does so taking on the characterisation of the debt "adjusted" by the 4th AP, and only to that extent could he proceed against the debtor. But it is not so, nor does it seem that art. 87(6) contains an exclusive solution by way of contribution. The non-"adjusted" guarantor can always proceed for contribution *iure propio*. However, we believe that in this particular hypothesis, the guarantor who claims repayment of the whole cannot benefit from any guarantees and privileges belonging to the adjusted debt. This view has its importance and is not a logical consequence of the rule that the choice of one route excludes the other, because the relationship between arts. 1838 and 1839 CC is that the guarantor can always seek contribution and take advantage of guarantees and privileges of the paid claim. The 4th AP would thus be, according to what has been said, an exception to this possibility.

5. Creditor voting in favour of the arrangement.

In this case, according to the aforementioned provision, "the maintenance of his rights against the other obligors, sureties or guarantors, will depend on what would have been agreed in the respective legal relationship". We assume that the surety does not adjust equally. Little can be extracted from para. 9 of the 4th AP as it is likely that nothing has been agreed in this regard between the guarantor and the creditor. However, where there is an express agreement in practice, it is always a non-release agreement, with the creditor retaining his rights as if he had voted against the arrangement. But let us stick to those cases where nothing has been agreed. The legal relationship in question cannot be the arrangement that is homologated. That is, the arrangement cannot impose (it is not even subject matter of the composition) that creditors retain their rights against the outsider surety, even if the surety holds debt that is part of the countable and voting financial debt. Consequently, the question must be settled in accordance with the national civil law of guarantees.

6. The national civil law of the guarantor-creditor relationship.

The CC does not offer a solution outside insolvency proceedings to the problem concerning the fate of the claim against the guarantor when the creditor votes in favour of debt adjustment. In my opinion, an agreed payment deferral entails the termination of the guarantee; a forgiveness of debt (haircut) entails an appropriate reduction of the guaranteed debt; a payment in kind (*datio in solutum*), though not an assignment of recourse debt (up to the applicable shortfall), terminates the surety (art. 1849). This would be so at least when the guarantor was a third party not especially related to the debtor. In the case of joint and several co-debtors, the arrangement would be a settlement (art. 1835 and 1839 CC) that would allow the remaining co-debtors to take advantage of the same to the extent that a deferral or forgiveness has been agreed, which they could raise against the creditor as a "defence stemming from the nature of the obligation" (art. 1148 CC).

7. Congruence between refinanced debt and guaranteed debt.

We return to the case where the creditor retains his rights against the surety, by application of the 9th para., by contract with the guarantor or by application of national civil law. But can they be retained totally independent of the agreed measure to refinance the loan? No. Between the underlying relationship derived from refinancing and the "untouched" guarantee relationship there must be *congruence*. If congruence cannot be maintained, the claim against the guarantor cannot be preserved. There is congruence in the event of deferral and forgiveness, and also (however doubtful) in transfers with or without recourse; but not when the creditor, whether he voted for or against, has become the holder of a participating loan or has capitalized the loan. There is, however, another solution: congruent or not, the creditor can resort to the guarantee and forget the adjustment measure. In order to overcome the situation, the creditor must in these cases refrain from adjusting his claims, forfeiting any right against the debtor and keeping the original right against the guarantor. And that can be done even if the creditor voted in favour of the arrangement.