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A first demand guarantee is not transferrable when the beneficiary of such guarantee is split-up

In a decision dated January 31, 2017, the Commercial Chamber of the *Cour de Cassation* (French Supreme Court) held that "*unless otherwise agreed upon between the parties, the first demand guarantee, that does not follow the guaranteed obligation, is not transferred in case of a split-up*".

This position has already triggered many comments and conflicting views. It deserves special attention given that, in particular, first demand guarantees are an essential issue for businesses and supposed to ensure legal certainty for their beneficiaries.

In this specific case, the lessee-manager of a hotel-restaurant business had deliver to the company that owned the business a first demand guarantee in order to secure the proper performance of the lease-management agreement. During the term of agreement, the owner was split-up and the business that formed the subject matter of the lease-management agreement was transferred to another company. Later on, the lessee-manager failed to perform its obligations under the lease-management agreement and the transferee of the business sought the enforcement of the guarantee and asked the issuing bank to perform payment.

The question was: How could the spun-off company invoke a first demand guarantee that had not been initially granted to it?

On appeal, the Court considered that the spun-off company was entitled to claim the benefit thereof because, unless otherwise agreed upon, the universal transfer of assets and liabilities that result from a merger or split-up had the effect of transferring to the spun-off company the relevant line of business in its entirety as well as the first demand bank guarantee that had been issued under the lease-management agreement and that was

associated with such line of business.

The *Cour de Cassation* disagreed with the rationale of the Court of Appeals and recalled that, as per Article L. 236-3 of the French Commercial Code and Article 2321 of the French Civil Code, "*unless otherwise agreed upon between the parties, the first demand guarantee, that does not follow the guaranteed obligation, is not transferred when beneficiary of the guarantee is split-up*".

It should be recalled that pursuant to Article L. 236-3, I of the French Commercial Code "*The merger or split-up shall lead to the dissolution without winding-up of the companies which are disappearing and to the universal transfer of their assets and liabilities to the receiving companies, in the state in which they are on the date on which the transaction is completed*".

Concerning first demand guarantees, Article 2321 of the French Civil Code stipulates that "*unless otherwise agreed upon, this guarantee does not follow the guaranteed obligation*".

This is exactly what has been pointed out by the *Cour de Cassation* to support its ruling that the first demand guarantee had not been transferred.

This position seems quite consistent in case of a first demand guarantee – the guarantor does not undertake to pay the guaranteed debt but enters into a separate and distinct obligation that does not follow the primary obligation for which the guarantee has been issued – but it does however, conflict with the principle laid down by Article L. 236-3, I of the French Commercial Code (cf. above) that governs the universal transfer of assets and liabilities.

This position is supported by some legal writers[1] who consider that a guarantee, and even a first demand guarantee, should be included in the transferred assets and liabilities, arguing that Article 2321 of the French Civil Code should apply wherever a guaranteed debt is subject to a specific distinct transfer (i.e. an isolated transfer) and that the first demand guarantee should not therefore be excluded from the universal transfer of assets and liabilities.

Lastly, one can wonder whether the principle of non-transferability of first demand guarantees laid down by the *Cour de Cassation* undermines the efficiency of first demand guarantees, the independent nature of which is much appreciated by beneficiaries who are sure to have an independent security over the guaranteed debt that they can enforce without any restriction[2].

Mergers, split-ups and acquisitions involving commercial companies or banking institutions acting as guarantors are common practice in the business world and the treatment of first demand guarantees issued by such guarantors and in force on the date of the transaction must henceforth be anticipated by the parties who draft the deed of guarantee or the agreement that provides for the transfer of the relevant business line.

[1] Cf. Philippe Simler – Semaine Juridique Edition Générale n°12, March 20, 2017, 310

[2] Except in case of abusive enforcement or manifest fraud (Article 2321 §2 of the French Civil Code)

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