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The impact of mergers on guarantees

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Introduction

Any company, regardless of its legal form or the activities it carries out, may participate in a merger (whether through absorption or through the establishment of a new company), through which all assets or activities of two or more companies are pooled.

A merger has several legal effects, which include the dissolution without liquidation of the absorbed company and the transfer of its net assets to the absorbing company or to the company established through the merger. This automatic transfer of assets and liabilities is known under French law as *'transmission universelle de patrimoine'* (TUP).(1) The TUP mechanism allows not only for the transfer of all assets and liabilities without any need to list them in the merger agreement, but also for the transfer of all accessories of those assets and liabilities. In other words, all securities given by or received by the absorbed company should in principle be transferred to the absorbing company.(2) However, there are certain exceptions to this principle, as the rules governing mergers may conflict in certain instances with the rules governing guarantees.(3)

Article 2292 of the Civil Code states that guarantees must not be extended beyond the limits within which they were contracted. Moreover, the guarantee agreement has an *intuitu personae* nature, which implies that the guarantee was granted by the guarantor in consideration of a specific contracting party. A merger will thus affect the guarantee rules. The French courts have tried to reconcile these conflicting rules in their decisions.

An analysis of French case law reveals that the impact of a merger on a guarantee agreement will differ depending on whether the merging company is the creditor, the debtor or the guarantor, and on whether the company is the absorbed company or the absorbing company.

Merger of debtor

Debtor is absorbed company

A guarantee agreement concluded between a guarantor and a debtor is strongly characterized by its *intuitu personae* nature. The guarantor agrees to secure the debtor's liabilities because the parties have a specific relationship of trust. The guarantor appreciates the scope and limits of its commitment in consideration of the person of the debtor.

If a merger results in the absorption of the debtor, the debtor is wound up and all its assets and liabilities are automatically transferred to the absorbing company. The guarantee agreement should also be transferred. However, this transfer would lead to the guarantor securing the debts of the absorbing company, with which it may have no special relationship and without its express consent. The protection of the guarantor provided by Article 2292 of the Civil Code and the *intuitu personae* nature of the contract would thus be compromised. In such situation and through established precedent,(4) the courts have found an intermediate solution which both protects the guarantor and complies with the TUP principle.

In order to comply with the guarantee rules and not extend the guarantee beyond the limits within which it was contracted, the Court of Cassation validates the transfer of the guarantee agreement, but limits the scope of the guarantee. The guarantor is thus liable only for debts that accrued before the merger (ie, those debts of the absorbed debtor, which was the counterparty to the guarantee). Liabilities accruing after the merger date are unsecured, unless the guarantor explicitly asserts its willingness to guarantee them. Through this limitation of the obligation to guarantee, known as *'obligation de couverture'*, the guarantor is relieved of all liabilities accruing to the absorbing company.

However, the guarantor must pay the creditor if the latter claims for liabilities that accrued before the merger after the transaction has taken place. Therefore, the obligation to pay - known as *'obligation de réglement'* - remains intact even after the merger.

Debtor is absorbing company

In this case the debtor is not directly affected by the merger, as it survives after the transaction. The courts infer from this survival of the debtor that the merger has no impact on the guarantee agreement. They conclude that the guarantor shall remain responsible for liabilities accruing both before and after the merger date, as the contracting party has not changed. The TUP fully applies, as the courts consider that it does not conflict with guarantee rules.

However, this solution involves some risk for the guarantor. As a result of the TUP, the absorbing company may inherit significant liabilities from the absorbed company. Then, the economic situation of the absorbing company might be negatively affected by the merger, thus preventing the absorbing company from paying its debts. Creditors might thus seek to claim on the guarantee.

As the courts afford no protection to the guarantor in this situation, the guarantor might wish to protect itself by specifying in the guarantee agreement that should the debtor absorb another company, any liabilities accruing after the merger date will be secured only if the guarantor expressly agrees to do so.

Merger of creditor

Creditor is absorbed company

This issue has been the subject of much debate, in particular following a 2005 Court of Cassation decision which further complicated the situation. Thanks to recent case law, however, the applicable solution is now clear.

Before 2005, the Court of Cassation gave the same answer for an absorbed creditor as it did for an absorbed debtor: (i) the extinguishment of the guarantee for liabilities accruing after the merger date, unless the guarantor explicitly agrees to commit itself to the new legal entity; and (ii) enforcement of the guarantee for the debts existing on the merger date.(5)

This approach was once more based on the *intuitu personae* argument. However, it was challenged on the grounds that while the *intuitu personae* nature of the debtor-guarantor relationship is obvious, the same cannot be said of the creditor-guarantor relationship. Indeed, in 2004 the courts established that this relationship is not of an *intuitu personae* nature.(6)

Accordingly, on November 8 2005(7) the Court of Cassation changed its approach. Optibail, the owner of a building which it rented out, merged and wound up to become Selectibail. The payment of rent was secured by a guarantor. Following the bankruptcy of the tenant, Selectibail issued a third-party notice to the guarantor. The appellate court ruled that the guarantor did not have to guaranty to the new creditor any debts accruing after the merger date. The Court of Cassation rejected this decision, however, and ruled in favour of the absorbed creditor. It concluded that the guarantee securing the payment of rent should be fully transferred to the absorbed creditor, unless otherwise specified. In other words, the rules that govern mergers should prevail over those applicable to guarantees.

Some scholars(8) viewed this solution as a reversal of precedent which should largely apply to all cases in which the creditor is absorbed. Others pointed out that the decision related to a specific situation (guarantee of the payment of rent), and thus should not have a wider application.

On June 30 2009(9) the Court of Cassation ended the debate. In this case a bank had granted credit and had obtained a guarantee for repayment. Following the absorption of the bank and the bankruptcy of the debtor, the absorbing company gave the guarantor notice to pay. The Court of Cassation reverted to its previous position and held that the guarantor should be liable only for debts that accrued before the merger. It must cover debts accruing after the merger only if it has explicitly agreed to do so. This is now the applicable solution.

Creditor is absorbing company
When the creditor is the absorbing company, the courts consider that the merger has no impact on the guarantee agreement. The guarantor is responsible for debts accruing both before and after the merger date.(10)

Merger of guarantor

Guarantor is absorbed company
There appears to be no case law on the situation where the guarantor is absorbed. On the traditional basis of the *intuitu personae* nature of the guarantee agreement, the solution could be the same as that for an absorbed debtor or creditor. However, this solution is not in fact appropriate, as it would allow the guarantor to reduce its commitment at its convenience.(11) This position would encourage the guarantor to merge in order to limit its commitment and would create uncertainty for the creditor.

Arguably, therefore, in such case the guarantor (ie, the merged entity) should remain responsible for debts accruing before and after the merger date.

Guarantor is absorbing company
As the guarantor is not wound up, a merger has no consequence on the guarantee agreement. The guarantor shall continue to secure debts accruing both before and after the merger date.

Summary

	Absorbed company	**Absorbing company**
Debtor	• Transfer of guarantee agreement by means of TUP. • Guarantor secures debts accruing before merger. • Guarantor does not secure debts accruing after merger (unless it expressly agrees to do so).	• Transfer of guarantee agreement by means of TUP. • Guarantor secures debts accruing before and after merger.
Creditor	• Transfer of guarantee agreement by means of TUP. • Guarantor secures debts accruing before merger. • Guarantor does not secure debts accruing after merger (unless it expressly agrees to do so).	• Transfer of guarantee agreement by means of TUP. • Guarantor secures debts accruing before and after merger.
Guarantor	• Transfer of guarantee agreement by means of TUP. • Guarantor secures debts accruing before merger and should also guaranty liabilities accruing after merger.	• Transfer of guarantee agreement by means of TUP. • Guarantor secures debts accruing before and after merger.

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Endnotes

(1) Article L 236-1 of the Commercial Code.

(2) Article 1692 of the Civil Code; Cass com, December 18 1984; Cass com, March 25 1997.

(3) This update focuses on the most popular type of French security: the '*cautionnement*' (herein referred to as 'guarantee'), governed by Articles 2288 and following of the Civil Code.

(4) Cass com, October 25 1983; Cass com, January 21 2003, *Banque Populaire du Sud-Ouest c/ Blain*.

(5) Cass com, January 20 1987.

(6) Cass Ass Plén, December 6 2004, 2004-026032.

(7) Cass com, November 8 2005, 2005-030656.

(8) A Lienhard, "*Sort du cautionnement en cas de fusion-absorption*", *Receuil Dalloz* 2005, p 2875.

(9) Cass com, June 30 2009, 08-10719, *Makk c/ Barclays Bank PLC*.

(10) Cass com, November 5 2003.

(11) *Comité juridique ANSA*, September 10 2003, 04-004.