

## ABSTRACT NATURE OF THE ON-DEMAND GUARANTEE

The judgment of the Spanish Supreme Court dated 5 April 2019 sheds some light on our understanding that an on-demand guarantee should in no way appear to be associated with the underlying contractual relationship.

### Supreme Court judgment of 5 April 2019

The judgment refers to a guarantee that secured the obligations undertaken by a vehicle rental company (in insolvency proceedings), as lessee of the fleet. Months after the guarantee was granted, the lessee ceased its business activities. When, due to certain discrepancies arising surrounding the return of the vehicles, the lessor threatened to enforce the guarantees, the Insolvency Receivers filed a complaint in which they requested that the Court order that the guarantees be released, because the insolvent party had fulfilled its obligations.

Thus, a discussion arose regarding the enforcement of the guarantee and its nature as an on-demand guarantee. The discussion began in the reverse order to what usually occurs in these cases: the complaint did not reach the Court after the beneficiary had enforced the guarantees, but rather beforehand, because the Insolvency Receivers filed the complaint so as to avoid the enforcement.

The judgment in the first instance upheld the complaint, finding that the guarantees were not actually of the type that were enforceable "upon request". Both the Court of Appeal and the Spanish Supreme Court confirmed the first instance judgment.

In its judgment, the Supreme Court declared that the reference in the guarantee to the underlying causal relationship is incompatible with an on-demand guarantee. The guarantee in question, although it was called an "on-demand guarantee", was not actually that.

The text of the guarantee, which the judgment transcribes in full, since it was decisive to the Decision, read as follows:

*"to secure the obligations undertaken by ACHH [the lessee] based on the vehicle lease agreement signed by and between the parties on 29 December 2010, a copy of which is appended to this guarantee, including all expenses (i.e. both court costs and non-court costs) arising in the collection of the amounts pending payment, upon the mere and prior request addressed to Caja Duero [the Bank] by the beneficiary".*

The Supreme Court concluded that the guarantee was more similar to a bond.

One can only wonder what the Court would have decided if the reference to the underlying agreement contained in the guarantee had been more concise, or if the text of the guarantee had not been appended to it: would the Court have reached a different conclusion? The fact that the judgment expresses, in such emphatic terms, the Court's findings regarding the abstraction requirement leads one to believe that its decision would be the same, provided that the text of the guarantee associates it with the contractual relationship that serves as its basis.

The judgment refers, first of all, to the enforcement: the on-demand guarantee is characterised as such because it can be effected merely at the debtor's request, without needing to prove non-compliance (as the judgment recalls, it is not even necessary for non-compliance to exist). The text transcribed above fulfilled this requirement, since it simply left it up to the beneficiary when to enforce the guarantee.

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But the judgment goes further than that: it states that by nature, an on-demand guarantee gives rise to an obligation to provide immediate security, which loses its nature of being ancillary to the main relationship, so that the obligation of the guarantor becomes completely autonomous.

Thus, the judgment deduces that the wording of the agreement may invalidate the abstract nature of the guarantee: "*guarantees provided by the Bank do not merely establish the abstract and separate enforceability inherent in an on-demand guarantee, but rather they express the reason for the guarantee, **by specifically associating it with the agreement of 29 December 2010**, a copy of which is included together with the guarantees*".

The judgment concluded that the guarantee was an ordinary bond and not an on-demand guarantee.

The Supreme Court reasoned that "*the terms in which this type of guarantee is worded are of paramount importance, given its autonomy*".

In practice, we can see a certain trend towards including a description, or even just so much as an outline, in on-demand guarantees, of the underlying contractual relationship. It seems that the parties involved start to get dizzy when the guarantee is disassociated from the agreement it secures. However, this practice can invalidate the on-demand guarantee.

In light of recent case law regarding on-demand guarantees, it was already known that, in order for a guarantee to be considered an on-demand guarantee, the mechanics of its enforcement cannot be linked to non-compliance with the underlying agreement. According to this latest judgment, it seems that any allusion to that legal relationship contained in the text of the guarantee could potentially undermine the guarantee. Best to avoid any such association.

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