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NEWSLETTER

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UNILATERAL DISENGAGEMENT OF GUARANTEES ON BLANK PROMISSORY NOTES

1) CONTEXT

On January 8th, 2025, the Ruling of the Supreme Court of Justice no. 1/2025 ("**Ruling**") was published in the 1st Series, no. 5 of the Official Gazette, which standardized court decisions and answered a question recurrently raised within commercial and financial relations: can the a shareholder or director who endorsed a blank promissory note to guarantee an obligation of a company disengage from that obligation following the loss of quality of shareholder or director? The Ruling provides a clear answer to this question and admits such disengagement, by means of termination (although with the limitations mentioned below).

In a market and in a period in which banks and other credit institutions rarely finance companies without requiring personal guarantees, such as guarantees provided form shareholder or directors, this decision is especially relevant because it can facilitate the moment of departure of a shareholder or director from a company that, until now, proved to be problematic, given the difficulty associated with the disengagement or replacement of such guarantees.

In addition, this Ruling reverses the decision taken in 2013 by the Supreme Court of Justice, in Ruling no. 4/2013, of the 21st of January, which prohibited the said possibility of disengagement.

2) CONDITIONS

Under the terms of the Ruling, the main basis for exercising the right to terminate is the absence of a term in the bond, which means that termination will only be possible if the bond has been entered into (i) without a term or (ii) with a renewable term, provided that the initial period has elapsed.

The termination is also governed by the following conditions:

- It must be effective before the creditor fills out the title;
- Although no justification is required, the termination must be made in good faith, under penalty of abuse of right. In this regard, the Ruling states that the loss of the status of shareholder or director does not constitute grounds for termination, but is merely an indicator that the termination is in accordance with good faith;
- It is only effective for the future, that is, it is only effective in relation to amounts that may be requested after the termination, and the guarantor is obliged to guarantee the liabilities incurred up to the date of the termination; and
- It only applies to bank financing in which the financial flow that determines the guaranteed debt depends on the requests made by the company at any given time (such as the opening of simple credit or current account), and is not applicable to cases in which the secured debt is previously determined, such as, for example, financial leasing or bank loan - in these cases, the guarantors are aware of the maximum amount for which they may have to respond and the maximum term of the underlying contract.

3) ARGUMENTS

The Supreme Court of Justice supported its position of free termination on the following main arguments:

- A guarantee provided on a blank promissory note, with an agreement for completion of the promissory note, does not correspond to an exchange obligation until the moment it is filled in, as opposed to an exchange guarantee. This is a mere legal bond and the regime of exchange obligations, which would prevent free termination, is not applicable;

- The principle of inadmissibility of perpetual bonds or bonds of indefinite duration, arguing that such bonds are null and void, as they are contrary to public order, if they are not subject to free termination;

- The legitimate interests of the guarantors are not safeguarded without the possibility of free termination, since, when they were bound for the guarantee, they did so in their capacity of shareholders and it is not reasonable for a former shareholder or director, without any control over the management of the assets of the company in question, to guarantee his obligations in perpetuity;

- The creditor bank maintains all its guarantees regarding the credit granted until the termination, since any termination will only be effective for the future and has alternative mechanisms to defend its interests, such as invoking the refusal to release capital if the counterparty's obligations are not fulfilled, the termination of the agreement or the change of circumstances.

4) FUTURE

The Supreme Court of Justice considers this to be the most balanced solution, and it is notorious that it benefits the guarantors, who are now granted a right to extinguish the guarantee regardless of justification and regardless of the will of the financing entity. It remains to be seen how creditors will react, whose willingness to contract was based on guarantees that can now be unilaterally terminated.

Finally, it should be noted that this Ruling does not exclude the possibility of negotiation between the guarantor and the creditor, by agreement, to change the contracted conditions and possibly replace the guarantees provided, which seems to be, in most cases, the most balanced solution.

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