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Guarantee of subsidiaries' commitments under French law

Parent companies are often asked to guarantee the commitments of their subsidiaries towards third parties. The guarantee can take various forms, but the most frequently used ones are the joint and several guarantee (*cautionnement*), the independent guarantee (*garantie autonome*) and the letter of intent (*lettre d'intention*).

The conditions of validity of a guarantee will vary depending on the type of company issuing the guarantee, i.e., limited liability company or unlimited liability company. Furthermore, joint-stock companies are specific in that the prior authorization of the board of directors, or supervisory board as the case may be, is required for the granting of any sureties, endorsements and guarantees. Other limitations may result from the nature of the guarantee itself.

Joint and several guarantees, independent guarantees and letters of intents are defined as follows under French law:

- Joint and several guarantees (*cautionnements*), provided for in Article 2288 *et seq.* of the French Civil Code, according to which the guarantor, as co-debtor of the principal, shall pay to the beneficiary any sums which have not been paid on due date by the principal to the beneficiary. In this case, the guarantee is considered from a legal standpoint as an ancillary element of the contract between the principal and the beneficiary, and the guarantor is entitled to raise objections in certain circumstances

to differ payment or to refuse to pay the beneficiary;

- Independent guarantees (*garanties autonomes*), provided for in Articles 2321 *et seq.* of the French Civil Code, according to which the guarantor undertakes to irrevocably pay any sum due under the guarantee upon first demand of the beneficiary, without any possibility to differ payment or to raise any kind of objections. The guarantee is legally independent from the contract/relationships between the principal and the beneficiary;
- Letters of intent (*lettres d'intention*), defined by Article 2322 of the French Civil Code as “*the commitment to act or not act with the purpose of supporting the debtor in the performance of his obligation towards his creditor*”.

The conditions of validity of a guarantee will vary depending on the type of company issuing the guarantee, i.e., limited liability company or unlimited liability company (1). Furthermore, joint-stock companies are specific in that the prior authorization of the board of directors, or supervisory board as the case may be, is required for the granting of any sureties, endorsements and guarantees (2). Other limitations may result from the nature of the guarantee itself (3).

1. Conditions of validity of a guarantee depending on the type of company issuing the guarantee

Under French law, the conditions of validity of a guarantee will vary depending on the type of company issuing the guarantee, namely unlimited liability companies (1.1) or limited liability companies (1.2)

1.1 Unlimited liability companies

Unlimited liability companies^[1] are not bound by actions/instruments which do not fall within the scope of their corporate purposes as defined in their by-laws. For this reason, the compliance of the guarantee with the corporate purpose of unlimited liability companies has given rise to a substantial amount of court decisions.

Besides, according to French case law, to be valid, the guarantee issued by an unlimited liability company must not conflict with the corporate interest of the guarantor^[2]. Although no precise definition of “corporate interest” has been provided by case law, French courts usually refer to a convergence of interests between the guarantor and the debtor to establish the existence of the “corporate interest”. As an example, French courts have ruled that the lack of expected benefit for the guarantor, or a guarantee creating an imbalance between the commitment of the guarantor and the benefit the guarantor may derive therefrom, or a guarantee exceeding the financial capacity of the guarantor, would be deemed contrary to the guarantor’s corporate interest.

1.2 Limited liability companies

In French limited liability companies^[3], actions/instruments done/signed by the corporate bodies of the company shall be binding upon it even if those actions/instruments do not fall within its corporate purpose, unless it proves that the third party knew that the relevant action/instrument was outside its corporate

purpose or could not, in view of the circumstances, have been unaware of it^[4].

This legal principle has given rise to a well-established case law regarding the validity of guarantees whereby the guarantor shall be bound by a guarantee even if said guarantee is contrary to its corporate interest and/or corporate purpose. This being said, and notwithstanding the well-established case law recalled above, the number of disputes concerning the nullity of actions/instruments done/signed by limited liability companies with third parties on the grounds that such actions/instruments are allegedly contrary to the company's interest has still not dried up and continues to result in numerous court decisions^[5].

2. Specific case of joint-stock companies (*sociétés anonymes*): Prior authorization of the board of directors/supervisory board

if the guarantor is a French joint-stock company (*société anonyme*), other than a banking or financial institution, the terms of any sureties, endorsements and guarantees must be, prior to its conclusion, formally and expressly authorized by the company's board of directors (or supervisory board as the case may be). Please note that said prior authorization shall only be given to the general manager of the company.

The authorization is only required to guarantee commitments made by third parties and not those of the company itself^[6]. However, it is settled case law that a subsidiary is considered a third party^[7].

If the sureties, endorsements and guarantees have been given without prior authorization of the board, the commitment is not binding on the French joint-stock company and may not result in any obligation being imposed on it^[8]. No subsequent ratification can take place.

Please note that the terms of this prior authorization shall vary depending on whether the guarantee relates to commitments made by a company which is "controlled" by the guarantor (2.1.) or not (2.2).

2.1 Guarantee of commitments made by a "controlled" company

With respect to the guarantee of commitments made by a company "controlled"^[9] by the guarantor, the board of directors (or supervisory board as the case may be) of the French joint-stock company guarantor may authorize sureties, endorsements and guarantees as a whole and without limitation as to their amounts. It may also authorize the general manager to grant guarantees to the same controlled company without limitation as to their amounts, provided that the general manager reports to the board at least once a year^[10].

The board of directors (or supervisory board as the case may be) of the French joint-stock company guarantor may give its authorization either annually or for an indefinite period, provided that the general manager reports to the board at least once a year.

2.2 Guarantee of commitments made by a third party other than a "controlled" company

With respect to the guarantee of commitments made by any third party other than a company "controlled"^[11] by the French joint-stock company guarantor, the authorization must be given for a limited amount. The

sureties, endorsements and guarantees shall then be freely granted by the general manager until the cap set by the board is reached. However, the board of directors (or supervisory board as the case may be) of the French joint-stock company guarantor may also, within the overall cap that has been set, require its prior authorization for any individual surety, endorsement and guarantee exceeding a specific amount.

3. Limitations resulting from the nature of the guarantee

Other limitations related to the nature of the guarantee in question may prevent its implementation.

3.1 Unenforceability of personal guarantees (cautionnements) under French law

Under a personal guarantee (*cautionnement*), the guarantor, is obliged to fulfil the obligation towards the creditor, if the debtor does not fulfil it himself.

The personal guarantee is as an ancillary element of the contract between the principal and the beneficiary, which has the following consequences:

- The personal guarantee may not exceed what is owed by the debtor, nor be contracted under more onerous condition;
- The guarantor is entitled to raise certain objections derived from the underlying contract, which the principal debtor could itself raise against the beneficiary of the guarantee, with a view to delaying payment or refusing to pay the beneficiary (e.g.: non-performance by the beneficiary of its obligations under the underlying contract or nullity of the underlying contract);
- The guarantor is discharged if the beneficiary causes him to lose his right of subrogation in the beneficiary's rights and security interests (for example, when insolvency/bankruptcy proceedings are initiated against the debtor, in the absence of a declaration by the beneficiary of the secured claim, the guarantor is discharged from his obligation, regardless of the nature of the claim, if he would have been able to derive an effective benefit from the right to be entitled to the distributions and dividends resulting from the debtor's insolvency/bankruptcy proceedings and likely to be transmitted to him by way of subrogation^[12]);
- The guarantor is discharged if the principal debt is extinguished.

3.2 Unenforceability of independent guarantees (*garanties autonomes*) under French law

3.2.1 Manifestly abusive or fraudulent enforcement request or fraudulent collusion

Under French law, with respect to independent guarantees (*garanties autonomes*), the guarantor can only decline payment in case of a manifestly abusive or fraudulent enforcement request or fraudulent collusion of the beneficiary with the principal debtor^[13].

Manifestly abusive or fraudulent enforcement requests or fraudulent collusion can, for example, result from:

- Request for payment from the guarantor by the beneficiary although the principal debtor has already

fulfilled its obligations;

- Production of falsified documents by the beneficiary to the guarantor in order to obtain payment;
- Request for payment from the guarantor by the beneficiary although the beneficiary has breached the contract;
- Any collusion agreements between the principal debtor and the beneficiary to deliberately adversely affect the guarantor.

3.2.2 Spin-off/merger of the beneficiary company

It should be finally noted that an independent guarantee (*garantie autonome*) under French law can only be enforced by the designated beneficiary. Unless otherwise agreed, it does not follow the secured claim. As a result, an independent guarantee (*garantie autonome*) will not be assigned to the company that results from a spin-off or merger of the beneficiary company and to which the secured claim has been transferred [14].

The reform of French security law, enshrined in Ordinance 2021-1192 of September 15, 2021, with an effective date on January 1, 2022, aims to simplify and modernize French legal provisions governing security interests[15]. That being said, and although the regime applicable to personal guarantees (*cautionnements*) has been substantially amended by Ordinance 2021-1192, it would appear that the new features brought about by the reform have no real impact on the legal framework applicable to guarantees of subsidiaries' commitments under French law.

[1] Under French law, the following forms of companies are unlimited liability companies: general partnerships (*sociétés en nom collectif*), limited partnerships (*société en commandite simple*), civil companies (*sociétés civiles*)

[2] Commercial Chamber of the *Cour de Cassation* (French Supreme Court), November 8, 2011, No. 10-24.438

[3] Under French law, the following forms of companies are limited liability companies: joint stock companies (*sociétés anonymes*), simplified joint-stock companies (*sociétés par actions simplifiée*), limited liability companies (*sociétés à responsabilité limitée*), partnership limited by shares (*sociétés en commandite par actions*)

[4] For limited liability companies (*sociétés à responsabilité limitée*): Article L.223-18 of the French Commercial Code; for joint stock companies (*sociétés anonymes*): Article L.225-35 of the French Commercial Code; for simplified joint-stock companies (*sociétés par actions simplifiée*): Article L.227-6 of the French Commercial Code

[5] Solutions for limited liability companies (*sociétés à responsabilité limitée*): Commercial Chamber of the *Cour de Cassation*, May 12, 2015, No. 13-28.504 ; Commercial Chamber of the *Cour de Cassation*, February

14, 2018, No. 15-24.146; Commercial Chamber of the *Cour de Cassation*, October 16, 2019, No.18-19.373; Solutions for simplified joint-stock companies (*sociétés par actions simplifiée*): Commercial Chamber of the *Cour de Cassation*, September 19, 2018, No. 17-17.600; Commercial Chamber of the *Cour de Cassation*, February 14, 2018, No. 16-16.013

[6] Commercial Chamber of the *Cour de Cassation*, February 11, 1986; Commercial Chamber of the *Cour de Cassation*, January 15, 2013

[7] Commercial Chamber of the *Cour de Cassation*, February 25, 2003

[8] Commercial Chamber of the *Cour de Cassation*, October 15, 1991; Commercial Chamber of the *Cour de Cassation*, January 15, 2013, No. 11-27.648

[9] “Exclusive control” as defined by Article L.233-16, II of the French Commercial Code

[10] Article L.225-35 §4 of the French Commercial Code

[11] “Exclusive control” as defined by Article L.233-16, II of the French Commercial Code

[12] Commercial Chamber of the *Cour de Cassation*, February 19, 2013, No. 11-28.423

[13] Art. 2321 of the French Civil code

[14] Commercial Chamber of the *Cour de Cassation*, January 31, 2017, No. 5-19.158

[15] See article entitled [Reform of French legal provisions governing security interests: Simplification and modernization](#) published on our Blog in August 2021

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