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Guarantees: The guarantor's commitment must not be grossly disproportionate to his/her assets

In a decision dated January 26, 2016, the Commercial Chamber of the *Cour de Cassation* (French Supreme Court) provided clarification on the conditions in which Article L.341-4 of the French Consumer Code should be applied. Specifically, it ruled that "*the shares and the current account receivable held by the guarantor in the company that is the beneficiary of the guarantee must be taken into account in the assessment of the guarantor's assets and income at the time he/she delivered the guarantee*".

Pursuant to Article L.341-4 of the French Consumer Code (the "FCC"): "*A professional creditor may not rely on a personal guarantee granted by a natural person if the latter's commitment was, at the time the guarantee was granted, grossly disproportionate to his/her assets and income, unless the guarantor's estate, considered at the time the enforcement of the guarantee is sought, enables the latter to fulfill his/her obligation*".

Article L.341-4 of the FCC applies to any and all natural persons, including the manager of a company who stands as surety to guarantee the debts of the company towards a professional creditor[1] .

As such, this Article applies regardless of whether the guarantor is a discriminating individual or not[2].

Proportionality is assessed on the basis of the guarantor's assets and income[3], his/her financial capacity[4], taking into account his/her overall indebtedness[5].

Trial judges often take into consideration the tax returns filed by the guarantor in order to assess the proportionality of his/her commitment[6].

If there are several guarantors for the same debt, the disproportionate nature of the commitment is assessed individually, on the basis of the assets and income of each guarantor[7].

Lastly, the disproportion must be assessed on the basis of the guarantor's assets and income, as they exist on the date on which the guarantee is granted, as per Article L.341-4 of the FCC.

In its decision dated January 26, 2016, the *Cour de Cassation* provided clarification on the conditions in which the disproportion between the guarantor's assets and income and the guarantee must be assessed.

In the commented case, two shareholders, natural persons, decided to act as joint guarantors for the reimbursement of two loans granted by the bank *Caisse de crédit mutuel Bas Chablais* (the "Bank") to the company for the acquisition of its business going concern.

One of the two shareholders also became joint guarantor for a bank overdraft.

The company entered into judicial receivership and then judicial liquidation. The Bank decided to sue the guarantors and to seek the enforcement of the guarantee. The guarantors claimed that their guarantees were disproportionate to their assets and income.

In a judgment dated October 24, 2013, the Court of Appeals of Aix-en-Provence ruled that the shares and the current account receivable held by a guarantor in the company to which the guarantee had been granted should not be taken into account in the assessment of the guarantor's assets and income prescribed by Article L.341-4 of the FCC. Consequently, it dismissed the Bank's claim.

The Court of Appeals of Aix-en-Provence considered that this was the appropriate solution since "*the guarantee commitment is precisely designed, in case of default by the company, to enable the creditor to turn to a solvent debtor, who cannot possibly value the shares of a company that has suspended its payments*".

This judgment was then reversed by the *Cour de Cassation* which preferred to make a literal application of the law rather than an application that takes into account pragmatic reasons and good business sense, as applied by the Court of Appeals of Aix-en-Provence.

The *Cour de Cassation* thus recalled that for Article L.341-4 of the FCC to be relied upon to defeat the action brought by creditors against the guarantor, the guarantee commitment must have been "*at the time the guarantee was granted, grossly disproportionate to his/her assets and income*".

The words "*at the time the guarantee was granted*" set forth in Article L.341-4 of the FCC require that consideration be given to "*the assets and income*", as valued on the date on which the guarantor delivers the guarantee, not on the date on which an action for enforcement of the guarantee is brought against the guarantor.

As such, the *Cour de Cassation* elected to include in the guarantor's property referred to under Article L.341-4 of the FCC, assets that will necessarily be worthless on the date of enforcement of the guarantee since these assets are "*shares of a company that has suspended its payments*", as pointed out by the Court of Appeals of Aix-en-Provence.

By doing so, the *Cour de Cassation* applied L.341-4 of the FCC in the strictest sense, and remains consistent with the line of decisions it has issued in the past in relation to this matter.

The *Cour de Cassation* had already ruled that "*the proportionality of the guarantor's commitment may not be assessed on the basis of the revenues expected from the secured transaction*"[8].

[1] Court of Appeals of Paris, January 25, 2008: RJDA 2008, no 575

[2] Commercial Chamber of the *Cour de Cassation*, July 10, 2012: D. 2012. AJ 2020

[3] Commercial Chamber of the *Cour de Cassation*, June 22, 2010, n°09-67814

[4] Commercial Chamber of the *Cour de Cassation*, July 10, 2010, n°11-16355

[5] Commercial Chamber of the *Cour de Cassation*, May 22, 2013 n°11-24812

[6] Court of Appeals of Paris, June 1, 2007, RJDA 2007, N°1280

[7] Cf. in particular Commercial Chamber of the *Cour de Cassation*, May 22, 2013, n°11-24812

[8] Commercial Chamber of the *Cour de Cassation*, September 22, 2015, n°14-22.913 and Commercial Chamber of the *Cour de Cassation*, January 27, 2015 n°13-25.202