

An arguable Supreme Court decision on a bank guarantee relating to a SPA

Madrid, December 2019

The Spanish Supreme Court ("**SC**") recently issued a judgment on a bank guarantee of the deferred part of the purchase price resulting from a sale and purchase agreement ("**SPA**") of a company¹.

The background of the case is as follows.

Following completion, the purchaser informed the bank about serious breaches of the SPA by the seller due to the emergence of certain hidden contingencies in the purchased company.

A few days later the seller requested payment of the deferred part of the price to the bank; the bank informed the purchaser about the seller's payment request; the purchaser, in its turn, opposed payment by the bank given its claim *vis-à-vis* the seller. As a result, the bank did not pay.

The seller then brought an action against the purchaser and the bank seeking a declaration that both were jointly and severally liable to pay the deferred part of the price.

The first instance court found that the seller had breached the SPA and dismissed the claim against the purchaser and the bank. The decision was challenged and the court of appeals overturned it in relation to the breach of the SPA, but confirmed the dismissal of the action against the bank on the grounds that the latter had rightly rejected payment because the purchaser had previously filed a claim against the seller for breach of the SPA. The seller challenged the court of appeals decision before the SC.

The SC analysed the bank guarantee and concluded that, clearly, it was not a first demand, independent guarantee. In addition, the SC found, rather surprisingly, that the court of appeals decision was *manifestly illogical, irrational and arbitrary* because, in its opinion, the burden to judge whether the purchaser's claim for a breach of the SPA was or was not correct laid on the bank. In other words, according to the SC, it was for the bank to run the risk to determine the correctness of the purchaser's claim under the SPA, and, given that the bank had not paid despite the fact that (only subsequently) the purchaser's claim for breach of the SPA had been dismissed, the former should bear the consequences.

The SC decision is probably the result of an unfortunate hindsight bias. In any case, it shows the importance of drafting guarantees as accurately as possible, specifying with the utmost detail the conditions in which the guarantor is obliged to pay.

¹ Judgment number 494/2019, dated September 9, 2019 [ECLI ES:TS:2019:2916].