Guarantees and Suretyships – Can you ever really be sure of your surety?

June 1, 2016

Recent revisions to the Russian Civil Code broaden the range of entities able to issue Russian law independent guarantees and introduce the concept of indemnities. These developments further complicate the decision on the most suitable form of suretyship contract when dealing with sureties/guarantors incorporated in Russia. This article sets out some key issues for consideration when making a selection.¹

Background and terminology

Terminology can be one of the biggest obstacles in discussing the various options. This is particularly true where terms relating to Russian law concepts are translated into English but are not wholly aligned with the equivalent English law concept. The technicalities of English law also blur the lines between various terms. For instance, the document that is commonly referred to as “an English law guarantee” is usually in fact a combination of a guarantee and a separate indemnity. Both the guarantee and this particular type of indemnity can be considered to be “contracts of surety”² under English law.³ In fact, it is not uncommon for these documents to be renamed "Suretyship Agreements" in some CEE jurisdictions to make them more palatable to the local market. There are, however, a number of differences between these English law agreements and Russian law governed suretyships.

To cut through the jargon, this article will use the following terms:

- English Guarantee: an English law⁴ guarantee and supporting indemnity (which applies if the underlying obligations of the primary debtor become unenforceable, invalid or illegal).⁵ It is not relevant what name is given to the document containing these provisions or if they are incorporated within another document (such as a facility agreement). The “guarantee” portion of the English Guarantee is a secondary and contingent liability which will lapse or be unenforceable if the underlying obligation being guaranteed is discharged or terminated or itself becomes unenforceable. It is precisely for this reason that the supporting indemnity portion of the English Guarantee is included: This is a primary obligation which survives the underlying obligation being discharged or terminated or becoming unenforceable. English Guarantees can be given by corporate entities and individuals.⁶

- Russian Suretyship: a Russian law suretyship (poruchitel’stvo). Like an English law "guarantee" this is a secondary, contingent liability. A Russian Suretyship is a contractual security instrument, and the surety is liable for the performance of certain obligations of the principal debtor. Therefore, if the principal debtor's obligations cease to exist, so too do the surety's. However, if the underlying contract between the beneficiary and the principal debtor becomes invalid, the principal debtor has an obligation under Russian law to return any funds advanced and not yet repaid. Any surety would also still be required to cover this obligation. Although currently not general practice and still untested in the Russian courts, in B2B transactions it should be possible to include a Russian Indemnity (see definition below) as part of the document containing the Russian Suretyship (in a similar manner to the inclusion of a supporting indemnity in an English Guarantee). Russian Indemnities require a specified amount or a method of

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calculation to be effective. For example, to protect against circumstances where the underlying obligations of the primary debtor become invalid, a Russian Indemnity could be included to cover the amount of the accrued interest on the principal debt as the interest can easily be calculated. It was previously thought that it would be more problematic to extend the scope of Russian Indemnities to cover the liabilities of the primary debtor for costs, expenses or losses, etc. However, a recent clarification from the Supreme Court of the Russian Federation\(^7\) seems to allow the amount to be specified simply as the full amount of losses (or a certain part of them). If this position is accepted by the lower courts and prevails in court practice, it will be possible to include Russian Indemnities into Russian Suretyships which have a broadly similar effect to the supporting indemnity in an English Guarantee. At the moment, in the absence of court practice and given the relatively recent development of the indemnity in Russian law, it is not yet clear to what extent the inclusion of Russian Indemnities will be effective. Nevertheless, it may very well be prudent to include such provisions for the time being. Where granted in respect of specified underlying documents ("specific monies"), Russian Suretyships can be given by corporate entities and individuals. However, only a corporate entity may grant a Russian Suretyship in respect of all present and future liabilities of a certain debtor to a certain creditor (under unspecified documentation) ("all monies").\(^8\)

- Independent Guarantee: a Russian law independent guarantee (nezavisimaya garantiya). This is an independent primary obligation under which the grantor is required to make payment upon the fulfillment of the conditions specified therein. This obligation applies irrespective of the validity of any other documentation or obligations of any other party.\(^9\) It is similar in nature to the English law "on demand bond" (adding to the confusion, these English law instruments are also known as demand guarantees, performance bonds and performance guarantees). Independent Guarantees can only be granted by commercial legal entities.

- Russian Indemnity: an indemnity (vozmeshchenie poter') within the meaning of the Civil Code of the Russian Federation given in a document governed by Russian law (a Relevant Agreement) in B2B transactions only. A Russian Indemnity may be granted by a party to any type of agreement to compensate/indemnify the other party for losses incurred upon the occurrence of certain circumstances (specified in the Relevant Agreement). However, these losses must not occur as a result of a failure by the party granting the Russian Indemnity to perform its other obligations under the Relevant Agreement (i.e., such losses should be caused by the actions of a third party or events outside the control of either party). According to the Civil Code, the Relevant Agreement must set out a specified amount of compensation. As noted above, a conservative interpretation of this requirement would require a fixed figure or a method of calculation for the amount of compensation. However, after the clarification from the Supreme Court (mentioned above) it may now be acceptable for the parties to indicate only whether the whole amount of losses will be compensated or a certain portion. This position is still to be confirmed by court practice.

Scope and limitations

Having considered the basic nature and terminology of these instruments, there remain the relative advantages and disadvantages of each in respect of certain scenarios. The first consideration is the possible scope. English Guarantees can be given in an "all monies" format or a "specific monies" format. In the "all monies" format, all liabilities of one or more persons to the beneficiary under any and all agreements (which are not in any way specified and may be in existence or entered into at a future date) are covered. In the "specific monies" format only specified agreements are covered and, although this can include contracts to be entered into in the future, care must be taken a suitable mechanism is in place to allow for this. Both types can cover the entire amount of the relevant obligations of the principal debtor or, if commercially agreed, be limited to a cap on the amount recoverable. Limitations on the period of the guarantee are also possible but, likewise, are not necessary. Care must be taken with "all monies" guarantees as the guarantor typically has the right to terminate the guarantee at any time with respect to new liabilities of the primary debtor. Additionally, "all monies" guarantees are not suitable for use with syndicated facilities.
Russian Suretyships and Independent Guarantees, in contrast, must always be limited to a specific amount, even when a Russian Suretyship is given in the newly available “all monies” format. For Independent Guarantees, the limit can be set as the outcome of a calculation. With respect to Russian Suretyships given in the “specific monies” format, the limitation by amount need not be an express figure; reference to amounts outstanding under specified documentation is sufficient. In contrast to English Guarantees, a “specific monies” Russian Suretyship will only cover the liabilities of those primary debtors and under those agreements which can be “identified” at the time of entering into the Russian Suretyship. This requirement that the primary debtors are “identified” means they must be listed by name or fall within an identifiable group of persons. In respect of the underlying obligations covered, these must be “identified” by specifying the subject and the object of the relevant agreements. Therefore, liabilities of new obligors, or under new transaction documents, brought into the transaction at a later date are unlikely to be covered by an existing Russian Suretyship (without any amendment thereto). This will still be the case even if there is a mechanism in the primary documentation for accession or the designation of additional transaction documents (unless the relevant provisions are especially specific).

In addition, Independent Guarantees must always be for a certain specified period. Although Russian Suretyships need not specify any particular term, certain rules apply in the absence of any explicit “contractual” term: it will only be valid for 1 (one) year after the final maturity date specified in the primary documentation, or, if no final maturity date is specified in the underlying agreement (such as where payment is “on demand”), for 2 (two) years from the date of entry into the Russian Suretyship.

“Future proofing”

The next significant area for comparison is the issue of “future proofing." This tends to be primarily the ease with which the obligations of the primary debtor can be amended, or extended, without requiring the involvement of the surety or impacting the validity of the surety’s obligations. As already mentioned above, the "all monies" format English Guarantee (if appropriately drafted) will cover all liabilities of the underlying debtor however documented. Therefore, any amendment to any document between the beneficiary of an "all monies" English Guarantee and the primary debtor can be undertaken without the need for consent from the guarantor. However, where a "specific monies" format is used for an English Guarantee, it is far more likely that the guarantor will need to be involved in the amendment process to prevent the discharge of the English Guarantee. Although most English Guarantees will contain provisions by which the guarantor purports to give consent to future amendments to the underlying contract, great care should be taken before relying on any such provisions as the amendments would still need to be in the "purview" or general scope of the original guarantee. Prudent English legal counsel will advise that confirmation from the guarantor should be obtained in all cases other than: for very minor amendments; or in circumstances where it is absolutely clear there can be no suggestion the variation is capable of adversely affecting the guarantor. In some circumstances confirmation from the guarantor may not be sufficient. Where extensive, fundamental amendments have (in substance) produced new primary obligations (rather than amended primary obligations), it may be necessary to take a new guarantee to cover these new primary obligations.

Under an “all monies” Russian Suretyship, any amendment to any document between the beneficiary of the Russian Suretyship and the primary debtor can be undertaken without the need for consent from the surety so long as the guaranteed amount is not exceeded.

Under a "specific monies" Russian Suretyship, any increase in the liabilities of the principal debtor requires the consent of the surety to ensure the Russian Suretyship covers the increased obligations. It is possible to include such consent in advance in a Russian Suretyship provided a limit for any possible increase in liability is specified. This being the case, it is common practice to include a proportionate extension limit in Russian Suretyships.
Interestingly, if the surety's consent to an amendment is not obtained (either in advance or at the time of the amendment), the Russian Suretyship will not be discharged in full, but will cover the liabilities of the principal debtor on the original terms of the underlying agreement. The application of this principle is very clear where the amendments relate to any easily discernible amounts (such as increases in interest rate, principal, fees, etc.). However, it is less clear how this principle would apply where the amendments introduce additional undertakings or tighten up any financial covenants. Theoretically, a failure to comply with such new restrictions by the principal debtor may potentially lead to an earlier acceleration. As such, the surety may claim that the amendments are detrimental to its position. If acceleration does occur in such circumstances, it is unclear how a Russian court would apply this "original terms" rule.

Independent Guarantees are not usually impacted by amendments to the underlying obligations, and so the consent of the guarantor should not normally be required. However, consent would be required for an extension to the amount recoverable under the Independent Guarantee (as this would be an amendment to the Independent Guarantee itself). No consent would be necessary if the documentation contained specific wording that provided for an increase in the guaranteed amount in the relevant circumstances.

Another future proofing concern arises where the beneficiary may wish to transfer the underlying debt of the primary debtor to another entity. In this case, the beneficiary will need to be sure it can also assign it rights under any relevant guarantees/suretyships as well. For each of the English Guarantee (broadly), Russian Suretyship or Independent Guarantee no consent from the guarantor/surety should be required if relevant drafting is included in the documentation. Strictly speaking, under English law, it is not always necessary for an English Guarantee to include express provisions that it is freely assignable, but it is prudent for the beneficiary to ensure such language is included.

The last major area of consideration when looking at future proofing these instruments is the circumstances in which they may be discharged or in which certain defenses may be raised by the guarantor/surety. Needless to say, the list is very long. Proper drafting can mitigate the risks in some circumstances, but it cannot by any means remove the risk entirely. There are two points that are particularly worthy of note when deciding between these types of instrument: The first is that both English Guarantees and Russian Suretyships may be subject to challenge (in part or in full) if a co-guarantor/surety, or any security in respect of the relevant obligations, is released. The second is that the liability of the guarantor/surety under these same two instruments is limited to the amounts that are owing by the underlying debtor. Either of these two particular concerns applies to Independent Guarantees.

Enforcement

A final and very important consideration is, of course, enforcement. Although it does not always have to be the case, it is usually advisable to have disputes heard in the jurisdiction of the governing law of the relevant agreement. When considering a Russian surety or guarantor, however, one must take into account that any final judgment or arbitral award will usually need to be enforced in Russia. This means that for English Guarantees, international arbitration (usually LCIA) will often be selected; arbitral awards can be enforced through the Russian courts if necessary, whereas English court judgments, as a general rule, cannot. This adds an additional layer of procedure to the enforcement of English Guarantees against Russian guarantors. On the other hand, Russian law governed documents can be pursued directly through the Russian courts. Although this would appear to be a drawback with English Guarantees, the fact that the merits of a dispute would be heard by an arbitral tribunal made up of English law experts is often viewed as being advantageous as the outcome is arguably more predictable.

Summary
A table summarizing the main issues considered in this article is set out below. Neither the table nor this article are, of course, exhaustive, but seek only to give an overview of some of the more important factors. In short, when comparing these factors, there are many similarities between Russian Suretyships and English Guarantees, primarily due to their nature as secondary, contingent liabilities. Steps can be taken to reduce the impact of their contingent nature, and in this respect English Guarantees perhaps have the advantage. This is primarily due to the indemnity concept being significantly more established under English law. It remains to be seen whether the incorporation of a Russian Indemnity in Russian Suretyships will prove to be as effective.

A further disadvantage of Russian Suretyships is the requirement for limits on both amount and duration, but in many transactions the commercial terms will require this in any case. Russian Suretyships' advantage over English Guarantees is that amendments to the underlying debt documents without the requisite consent do not carry the risk of the Russian Suretyship being discharged in full. In these circumstances, the Russian Suretyship would cover only those liabilities envisaged prior to the amendment. Clearly, the risk of discharge in respect of English Guarantees can be removed by ensuring the correct formalities are observed at the time of the relevant amendment, but this is sometimes overlooked.

In contrast to both English Guarantees and Russian Suretyships, Independent Guarantees are less susceptible to changes to the obligations of the primary debtor or the overall security package. However, given the strict requirement to make payment on the fulfillment of the relevant conditions, without reference to the underlying obligations of the primary debtor, it is unlikely general commercial companies will be willing to provide these without a significant incentive. Previously, this type of guarantee could only be provided by banks under Russian law, and the banks' primary inducement is their fees, which tend to be quite substantial (this being one reason Russian bank guarantees are not widely used in finance transactions). It remains to be seen whether Independent Guarantees will be used in the Russian market in any markedly different manner to that of on demand bonds in the English market.

<table>
<thead>
<tr>
<th></th>
<th>Russian Suretyship</th>
<th>Independent Guarantee</th>
<th>English Guarantee</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Scope</strong></td>
<td>Specific monies</td>
<td>All monies</td>
<td>Specific monies</td>
</tr>
<tr>
<td>Possible providers</td>
<td>Corporates/Individuals</td>
<td>Corporates only</td>
<td>Corporates only</td>
</tr>
<tr>
<td>Effect of invalidity of the primary obligation</td>
<td>Secure return of the amounts received by the primary debtor together with interest at the rate applicable in accordance with Russian law. It may be possible to incorporate a Russian Indemnity in B2B transactions which extends this to interest and, potentially, other losses and expenses.</td>
<td>No impact</td>
<td>Supporting indemnity remains in force (if appropriately drafted)</td>
</tr>
<tr>
<td>Term</td>
<td>If not specified in the documentation, set by legislation</td>
<td>For a specified period</td>
<td>Unlimited but typically the guarantor may give notice preventing guarantee covering new...</td>
</tr>
</tbody>
</table>

17 Secure return of the amounts received by the primary debtor together with interest at the rate applicable in accordance with Russian law.
<table>
<thead>
<tr>
<th>Limit on liability</th>
<th>Specific monies</th>
<th>All monies</th>
<th>Specific monies</th>
<th>Specific monies</th>
<th>All monies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Russian Suretyship</td>
<td>Subject to any express drafting, limited only by the amounts due under the primary obligations</td>
<td>Express cap required</td>
<td>Limited by the cap expressed as a fixed figure or a method of calculation</td>
<td>Subject to any express drafting, limited only by the amounts due under the primary obligations</td>
<td></td>
</tr>
<tr>
<td>Independent Guarantee</td>
<td>Additional Transaction Documents covered but limited to the liabilities of those obligors which are identified at the time of entering into the Suretyship</td>
<td>Limited to the liabilities of the principal under specific agreement(s)</td>
<td>Yes, if covered by drafting in original documentation</td>
<td></td>
<td></td>
</tr>
<tr>
<td>English Guarantee</td>
<td>Additional Transaction Documents Covered. Additional Obligors can be covered by drafting in original documentation</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

- **Additional Obligors/Transaction Documents covered**
  - Russian Suretyship
  - Independent Guarantee
  - English Guarantee

- **Amendment of the primary obligations increasing liability of primary debtor**
  - Russian Suretyship
  - Independent Guarantee
  - English Guarantee
<table>
<thead>
<tr>
<th>Change of the beneficiary</th>
<th>Russian Suretyship</th>
<th>Independent Guarantee</th>
<th>English Guarantee</th>
</tr>
</thead>
<tbody>
<tr>
<td>No consent is required unless otherwise agreed between the parties.</td>
<td>Consent is required unless otherwise agreed between the parties (can be given in original documentation).</td>
<td>Consent to assignment of rights may be required unless otherwise agreed between the parties (can be given in original documentation).</td>
<td></td>
</tr>
</tbody>
</table>

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<thead>
<tr>
<th>Release of other security/guarantee</th>
<th>Russian Suretyship</th>
<th>Independent Guarantee</th>
<th>English Guarantee</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>In B2B transactions</strong>: discharged (partially or in full) unless the surety gives confirmation to the lender that its suretyship is provided irrespective of any other security instrument and the surety does not rely on getting reimbursement via any other security instrument.</td>
<td>Not impacted</td>
<td>May be discharged depending on specific circumstances – prudent to seek guarantor's consent</td>
<td></td>
</tr>
<tr>
<td><strong>If the surety is an individual</strong>: may be discharged (partially or in full) depending on the specific circumstances and no confirmation to the contrary (as in B2B transactions) is permitted.</td>
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<tr>
<th>Dispute resolution and enforcement</th>
<th>Russian Suretyship</th>
<th>Independent Guarantee</th>
<th>English Guarantee</th>
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</thead>
<tbody>
<tr>
<td>International arbitration or Russian courts can be specified in the documentation. If a dispute is heard by an arbitral tribunal, enforcement in Russia will need to be made separately through the Russian courts.</td>
<td>Russian courts are usually specified in the documentation, since an Independent Guarantee is a unilateral transaction. However, a separate agreement could be entered into between the guarantor and the beneficiary agreeing to resolve disputes under the Independent Guarantee via international arbitration. If a dispute is heard by an arbitral tribunal, enforcement in Russia will need to be made separately through the Russian courts.</td>
<td>International arbitration is often specified in the documentation as arbitral awards can be enforced through the Russian courts if necessary, whereas English court judgments, as a general rule, cannot. If a dispute is heard by an arbitral tribunal, enforcement in Russia will need to be made separately through the Russian courts.</td>
<td>It is generally not advisable to have a dispute in relation to an English law document</td>
</tr>
</tbody>
</table>
1. The author wishes to express her sincere thanks to her Dentons Moscow colleague Anna Nekhodtseva for invaluable assistance on matters of Russian law.

2. “Surety” when used in the context of English law documents does not have a particularly precise meaning, and the more modern term “credit support” is perhaps now more commonly used.

3. An English law indemnity will only be a “contract of surety” to the extent it is given by one party in respect of the performance of an obligation by a person other than that party. It is also possible under English law, among other things, for one counterparty to an agreement to give an indemnity in respect of certain losses or expenses of the other counterparty, which would not constitute a contract of surety.

4. The relative merits of similar documentation governed by the laws of other jurisdictions are beyond the scope of this article but may be worth considering depending on the circumstances.

5. This is the most common format for these documents in debt financing transactions. Variations on this format are possible but beyond the scope of this article.

6. Depending on the relationship between the guarantor and principal debtor (and other entities and individuals connected to them), certain additional formalities may be required in respect of individuals to mitigate against claims that the guarantee was entered into under “undue influence.”


8. A cap on the liability of the surety will be necessary in these circumstances. See further details below.

9. There are certain defenses that may be raised indirectly as a result of issues concerning the underlying obligations in certain circumstances, such as intentional abuse of rights.

10. The term can only be specified by way of reference to a calendar date or period of time (such as month, year, etc.), or by way of reference to an event which will inevitably occur (therefore “until all primary obligations are discharged in full” would not be valid for an Independent Guarantee).

11. Provided of course the English Guarantee in question is a true “all monies” guarantee and the drafting of the guarantee or the circumstances of the specific transaction cannot be interpreted as showing an intention for the guarantee to be read in conjunction with a specific obligation entered into at the same time (Bank of Baroda v Patel [1996] 1 Lloyd’s Reports 391).


13. It is also prudent to include in such consent amendments to the undertakings and/or financial covenants, which are detrimental to the position of the debtor (non-compliance with which may potentially lead to an event of default and acceleration of the loan (or any similar applicable consequences)).

14. An English law guarantee is subject to the principal of co-extensiveness. In addition, the beneficiary cannot claim under a supporting indemnity where the principle debtor has performed the guaranteed obligations because, to claim...
under an English Indemnity, the beneficiary must have suffered an indemnified loss. Pursuant to article 364 of the Russian Civil Code, a surety under a Russian Suretyship can raise the same defenses to any claim as the underlying debtor.


17. The interest rate is set in accordance with Article 395 of the Civil Code of the Russian Federation. The rate varies for the different regions of the Russian Federation and can change each month (for the period beginning 15 April 2016 the rate is 8.14% on amounts in rubles).

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