

Comparative analysis of Russian law and English law regarding the impact of changes in the underlying obligation on the guarantee (suretyship)

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A suretyship under Russian law is in many ways similar to a guarantee under English law. These are accessory obligations that are linked to the principal (underlying) obligation. This means, among other things, that the guarantor's liability is secondary to the liability of the principal debtor. However, the application of such criteria may result in increased guarantor's liability, if the lender and the borrower agree to vary the principal obligation. Given that, variation of the guarantor's liability without its consent violates its rights, certain measures aimed at protecting the guarantor's rights have been developed in Russian law and English law.

There is a generally accepted English law equitable principle which states that any substantial variation in the terms of the underlying obligation, which could prejudice the guarantor's rights, will discharge the guarantor [1, 2]. This can be avoided if the guarantor has provided its prior or subsequent consent to such variation. The prior guarantor's consent can be included in the guarantee. For example, the guarantor may expressly confirm that the guarantee will cover the underlying obligations subject to any changes (no matter how extensive they may be). Also, the guarantee may provide for a waiver of defences that the guarantor may have as a result of amendments to the guaranteed contracts. If such provisions are not incorporated in the guarantee or other contracts to which the guarantor is a party, or the variation of the principal obligation at hand is not covered by these contractual provisions, then in order to preserve the guarantee, the guarantor may issue a confirmation under which it agrees with the relevant changes to the main contract and confirms the effectiveness of the previously issued guarantee.

However, even if guarantee contains such anti-discharge wording, the court may conclude that by agreeing on substantial amendments to the principal obligation, the parties actually created a new principal obligation, and the old one was terminated [3]. Therefore, there is a real risk that the previously issued guarantee will be ineffective. Taking this into account, it may be necessary to re-issue a guarantee in order to cover such new principal obligation [4]. The main disadvantage of this approach is that the English courts have not developed any precise criteria for determining which substantial changes to the main contract create a new contract and which do not. This entails a risk that any restructuring of the guaranteed obligation may not be covered by the existing guarantee (even if the guarantor's prior consent is in place).

The LMA's standard documentation addresses this risk. It contains language stating that the "replacement" or "restatement" of any financial instrument does not relieve the guarantor from liability under the guarantee. Nevertheless, the parties must examine in each case whether the respective amendment to the finance documents is covered by the provisions of the guarantee. In case there are any doubts it is recommended either to issue a new guarantee or to obtain the guarantor's written confirmation that it agrees to secure the newly created principal obligation.

In contrast to English law, Russian law provides for other consequences when the principal obligation is modified (in the absence of the surety's consent). As a result of the 2014 civil law reform, it was decided to abandon the rule on termination of suretyship in case the principal

obligation was amended without the surety's consent (if it entailed increased liability or other unfavorable consequences for the surety). Instead, it was provided that the surety continues to be liable on the same terms as were agreed prior to the variation of the principal obligation. This regulation is preferable both for the lenders and the surety, since the borrower's debt to the lenders remains secured (in initially agreed amount), and the surety does not bear the negative consequences of changing the principal obligation without its consent. Drawing a parallel with English law, we note that changing the principal obligation for the benefit of the guarantor (surety) also does not require its consent.

The surety's consent under Russian law may also be prior or subsequent. A prior consent is given to cover any subsequent changes in the underlying obligation that the parties may agree upon. It is imperative that the prior surety's consent must contain the maximum limits within which the underlying obligation can be varied. The surety's liability limits rule is a balanced solution. It takes into account the interests of all parties to the loan transaction. The lenders and the borrower are given the opportunity to modify the principal obligation without the guarantor's consent within predetermined limits. At the same time the surety is protected from the lenders' abuse, which could have happened if the surety had given "abstract" preliminary consent to any changes [5].

In our view, Russian law and English law provide effective measures to protect the guarantor (surety) when the principal obligation is modified without its consent. The guarantor's prior consent with regard to future changes is often incorporated in the finance documents due to the high probability of subsequent changes in the terms of the principal obligation. It is our understanding that the mechanisms provided for in Russian law regarding the preservation of suretyship are more balanced in comparison with the English law, since they take into account the interests of all parties to the transaction in the best possible way.

References

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