CLIENT GUIDE
KNOWLEDGE MANAGEMENT

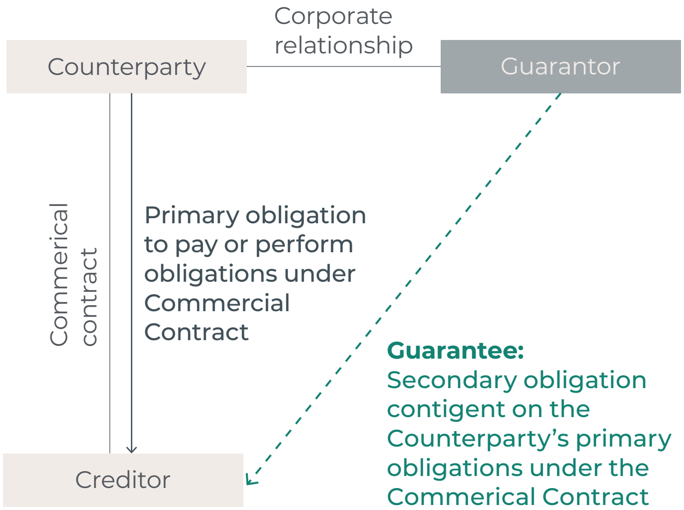
CLIENT GUIDE TO TRADE FINANCE DISPUTES: GUARANTEES AND INDEMNITIES

Guarantees and indemnities are common credit support instruments in trade and commodity transactions which operate in fundamentally different ways. This guide outlines the key features of each, highlights legal and practical risks under English law and identifies areas where disputes can arise.

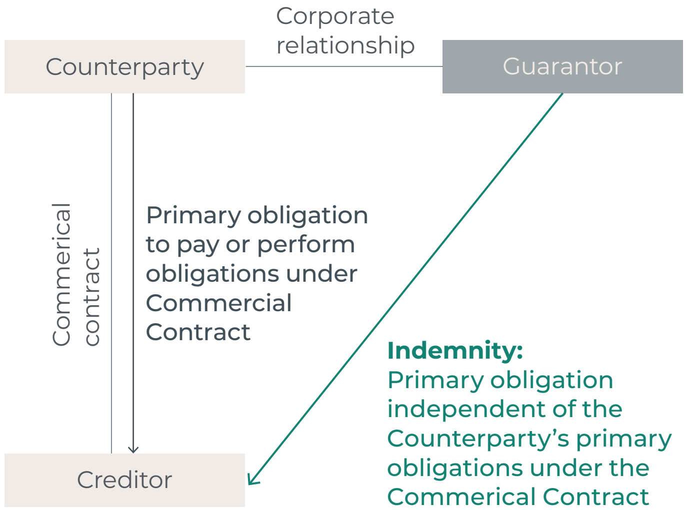
What is the difference between guarantees and indemnities?

In English law, guarantees and indemnities are frequently deployed in trade and corporate finance to provide creditors with additional comfort beyond the primary obligor's creditworthiness. Whilst often conjoinved in documentation, guarantees and indemnities are distinct constructs with materially different legal consequences. It is therefore imperative for parties to understand the differences between the two and to ensure that they are giving and receiving the benefits and protections they require in any transaction. If both a guarantee and an indemnity are required, this should be specifically requested.

GUARANTEES



INDEMNITIES



A guarantee is a *secondary* obligation. The guarantor undertakes to discharge the liabilities of a principal debtor in the event of default. This can be an all-encompassing performance guarantee or limited in nature to a payment guarantee. A guarantee's enforceability is contingent on the validity and subsistence of the underlying obligation and may also be discharged if the principal obligation is varied without the guarantor's consent.

By contrast, an indemnity is a *primary* obligation, making it more robust than a guarantee. The indemnifier promises to make good the creditor's loss, often phrased as a liability "*as principal obligor*". This obligation by the indemnifier is independent of the counterparty's own primary obligations under a commercial contract and this distinction is critical: indemnities are not caught by the Statute of Frauds 1677 (see below) and are less susceptible to discharge through creditor conduct or variations to the underlying contract.

An "on-demand guarantee" blurs this distinction and could actually be considered as a form of indemnity. They are typically issued by banks and are payable on receipt of a compliant written demand. Provided that the demand complies with the terms of the guarantee, it is immaterial whether the principal is actually in default, absent fraud of which the surety has knowledge (which is rare in practice).

Key legal issues to note — where can disputes arise?

Disputes inevitably arise either where a guarantor or indemnifier does not want to pay out and seeks legal justification for refusing to do so. Typical areas for challenge include the following:

- **Contractual formalities:** The Statute of Frauds 1677 requires that guarantees must be evidenced in writing and signed, failing which they are unenforceable. Indemnities, being primary, do not ordinarily attract this requirement.
- **Capacity:** A company must have capacity under its constitution and the Companies Act 2006 to give a guarantee or indemnity. For this reason, a legal opinion from the relevant jurisdiction confirming capacity is typically required. If a company is found to have been acting beyond its capacity or "ultra vires" any such acts risk being void or voidable.
- **Caps and Variations:** Guarantees are vulnerable if any changes are made to the underlying agreement. Any amendments to the underlying contract, after the giving of the guarantee, will discharge the guarantor's liability under the guarantee unless either the guarantor consents to the variation, or the variation is patently insubstantial or incapable of adversely affecting the guarantor.

  For example, the following could (wholly or partly) discharge the guarantor from its liabilities:

  - Granting the contractual counterparty more time to perform.
  - Material variation of the guaranteed obligation, e.g., amending payment terms.
  - Release/discharge of co-sureties, security held for the obligation.

  Where the underlying primary obligations pertaining to a guarantee are varied or the overall exposure of a creditor is increased, creditors should always obtain the guarantor's acknowledgement that the original guarantee will cover the changes and/or obtain a new guarantee from the guarantor to cover the increased exposure of the creditor.
- **Vitiating factors:** Duress, undue influence or misrepresentation can render guarantees and indemnities voidable. Creditors must avoid oppressive conduct and, in certain circumstances, disclose material facts to prospective guarantors.
- **Insolvency:** Guarantees and indemnities may be vulnerable to challenge under insolvency legislation, for example as transactions at an undervalue or preferences. The risk is heightened in intra-group contexts where consideration to the guarantor is unclear.
- **Upstream and cross-stream guarantees:** Guarantees provided by subsidiaries for parent or sister company liabilities raise accounting and corporate benefit concerns and may constitute unlawful financial assistance under Part 18 CA 2006 if linked to share acquisitions.
- **Guarantees in favour of directors:** These raise fiduciary duty and related party transaction issues,

particularly regarding disclosure and shareholder approval.

- **Assignment:** Guarantees and indemnities may be assignable, but only where expressly permitted or where rights are sufficiently severable from personal obligations.
- **Enforcement:** From a practical perspective, enforcement can be an issue: if the guarantor (and/or their assets) are based in a difficult jurisdiction, the security provided by the guarantee can be limited.

Example cases

Primary or secondary obligation?

In a 2025 judgment,[1] the Court commented that "*suretyship is an area of law bedevilled by imprecise terminology, where it is important not to confuse the label used by the parties with the substance of the obligation*".

Disputes frequently arise as to whether an obligation to pay is a primary or secondary one and there is a considerable body of case law offering guidance on how this should be decided. The use of the term "indemnity" or "guarantee" is not determinative. Whether a document is a guarantee or an indemnity depends upon "*the true construction of the actual words in which the promise is expressed.*"[2] This can lead to lengthy litigation.

In *Shanghai Shipyard Co Ltd v Reignwood International Investment (Group) Company Limited*,[3] a case in which HFW represented Shanghai Shipyard, the Court of Appeal found that even where issued by a company rather than a bank, the language of a performance guarantee made it a primary, demand guarantee rather a secondary, "see to it" guarantee. Reignwood had provided a separate payment guarantee (the "Guarantee") to Shanghai Shipyard in relation to a shipbuilding contract (the "Contract"). By a novation agreement, all of Reignwood's rights and obligations under the Contract were transferred to Opus, but not the Guarantee. Shanghai claimed the final instalment due from Opus under the Contract and when Opus failed to pay, issued a demand to Reignwood under the Guarantee. When Reignwood failed to pay, Shanghai commenced proceedings under the Guarantee in the English Commercial Court.

A key issue for the Court to decide was whether the Guarantee was a demand guarantee (and therefore a primary obligation) or a "see to it" guarantee (and therefore a secondary obligation). At first instance, the Court found that it was a "see to it" guarantee. Shanghai appealed. The Court of Appeal overturned the first instance decision and held that the Guarantee was a "demand bond", entitling Shanghai to payment on demand, not a traditional "see to it" guarantee imposing only a secondary liability on Reignwood. In reaching its decision, the Court of Appeal gave primacy to the words used in the Guarantee, notwithstanding the judgment in a previous case, which had established that outside the banking context, there is a presumption against interpreting such instruments as demand bonds.[4]

Contractual formalities

Despite the fact that the Statute of Frauds 1677 has been in existence for a very long time, the requirement that a guarantee be in writing and signed by the guarantor can cause issues surprisingly often. Applying this ancient statute in a modern context in *Golden Ocean Group Ltd v Salgaocar Mining Industries PVT Ltd & Anor*,[5] the Court of Appeal confirmed that a chain of emails using electronic signature were sufficient to meet the Statute of Frauds requirements that a guarantee be in writing and signed by the guarantor. In *WS Tankship II BV v The Kwangju Bank Ltd and another*,[6] the Court held that a guarantee issued and sent by SWIFT message also met the requirements.

Form of demand

In *Barclays Bank v Price*,[7] a demand for payment was rejected on the grounds that it exceeded the specified maximum amount of the guarantee. Based on the facts of the case, the Court rejected this argument.

Legality

In a judgment handed down earlier this year,[8] the Court was required to decide whether a "letter of comfort" constituted both a guarantee and an indemnity – it concluded that it did. Nevertheless, the guarantor tried to resist payment on the basis that it had not sought the required permission under local (Indian) law to provide the guarantee in the first place. Based on Indian law expert opinion, the English Court ruled that although permission was required, this could be obtained retrospectively and that the guarantee was enforceable.

HFW Comment:

The number of cases relating to guarantees indicates the care required, both at the time of drafting and during the course of the underlying transaction, to maintain this form of security successfully.

In practical terms, forewarned is forearmed. Particular care should be taken over the issues which frequently give rise to disputes. Clear and express drafting can avoid the need to litigate over whether the security is an indemnity or a guarantee. Ensuring that a guarantee is in writing and signed and that a legal opinion as to capacity has been obtained will limit the scope for a challenge based on form or capacity.

In practice, corporate guarantee instruments are frequently drafted to combine both a guarantee and an indemnity, thereby mitigating issues as to formalities and preserving enforceability in the face of underlying contractual changes. From the creditor's perspective, this dual structure maximises protection. From the surety's perspective, however, it underscores the importance of scrutinising scope, capacity and corporate benefit before execution.

Companies asked to give guarantees or indemnities should ensure that board approvals are carefully documented, that the commercial benefit is demonstrable and that any caps, duration limits or release mechanisms are clearly negotiated. This approach not only reduces the risk of unenforceability but also provides a clearer framework for managing exposure and avoiding disputes.

HFW is able to advise clients with queries about drafting guarantees and indemnities, understanding their rights and obligations and on enforceability.

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Endnotes

1 NatWest Market NV and anor v CMIS Nederland BV and anor [2025] EWHC 37 (Comm)
2 (Moschi v Lep Air Services Ltd [1973] AC 331)
3 [2021] EWCA Civ 1147
4 Marubeni Hong Kong and South China Ltd v Government of Mongolia [2005] 1 WLR 2497,
5 [2012] EWCA Civ 265
6 [2011] EWHC 3103
7 [2018] EWHC 2719
8 IDBI Bank Ltd v Axcel Sunshine Ltd & Anor [2025] EWHC 442