

Provisions of Standard Commercial Guarantee Agreements

Technical Guide

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Rocks joined the firm in 1980 and became counsel in 1990. She received a J.D. degree in 1979 from Columbia University, where she was a member of the Law Review, and received an undergraduate degree, *summa cum laude*, from Susquehanna University in 1975.

Introduction

Loan guarantees can help borrowing microfinance institutions (MFIs) obtain loans that otherwise are unavailable to them. An MFI typically seeks to facilitate a (third-party) loan guarantee to obtain a bank loan that would not be possible without the guarantee. Thus, the guarantee can help an MFI gain access to commercial funding markets and provide support for the MFI's creditworthiness in the eyes of potential lenders. The expectation is that a guarantee will also ease future borrowing for the MFI by increasing the bank's willingness to lend to the MFI again, perhaps without requiring another guarantee so long as the MFI complies with the terms of the loan agreement. In addition, MFIs that already have access to commercial funding markets may still benefit from loan guarantees because they can use the guarantee as a structuring tool, enabling the MFI to obtain a loan under conditions more favorable than those applicable to a typical unguaranteed loan (for example, by obtaining a lower interest rate).

With these benefits of a guarantee in mind, this Technical Guide introduces MFIs to the principal provisions of a standard commercial guarantee agreement, while offering general guidance and tips for drafting and negotiating standard clauses. It is not intended to be, nor does it provide, an exhaustive description of the contents of a guarantee agreement. MFIs should use this Guide to help them understand the risks associated with some of the important provisions of a guarantee agreement. This Guide can also help MFIs identify departures from generally accepted provisions that may negatively affect their interests.

It is also important to note that this Guide addresses only standard commercial guarantee agreements governed by common law legal systems, with specific emphasis on New York law, the U.S. Bankruptcy Code, and the Restatement (Third) of Suretyship and Guaranty, unless otherwise noted. The type of legal system that applies to the loan guarantee is critical, because common law and civil law legal systems involve different approaches to the respective rights of creditors and debtors, may use different legal terms, may offer different types of self-help remedies to creditors, and may apply, through local courts, different interpretations to terms and conditions. **MFIs should consult with local legal counsel to determine whether the law governing the loan agreement follows common law or civil law principles and what the implications of this may mean for them.** Indeed, MFIs should consult with local counsel to understand the local laws related to guarantees, as well as how the local legal system addresses other issues highlighted throughout this guide.

A third-party loan guarantee, the main topic of this Guide, is an agreement that is entered into by the **guarantor** (typically, a **development agency** or **investor**) and directly affects the rights of the **primary obligor** or **obligor** (the **borrowing MFI**), the **beneficiary** (the **lender**, typically a **local bank**), and the guarantor. Under a guarantee the guarantor agrees to pay the beneficiary the money owed to it by the primary obligor if the primary obligor defaults on the loan. In a loan guarantee agreement, the borrowing MFI is typically referred to as the primary obligor because it is the party to the underlying **primary obligation agreement** (the main underlying loan), with the primary obligor's obligations under that agreement being guaranteed (for the benefit of the beneficiary) by the guarantor. The borrowing MFI is the primary party responsible for the obligation on the primary obligation agreement or loan agreement (thus, the "primary obligor"), and the guarantor is, in effect, the secondary obligor because in the event the MFI fails to pay, the guarantor has an obligation to pay the amount owed under the loan agreement. Generally, the guarantor is not required to make any payment unless the primary obligor fails to pay. It is worth noting that if a reimbursement agreement is entered into between the MFI and the guarantor, in that reimbursement agreement the MFI will be referred to as obligor, rather than primary obligor, because with respect to the direct contractual relationship between the MFI and the guarantor set out in the reimbursement agreement, the MFI is the only obligor.

A loan guarantee can help an MFI, which may otherwise lack access to commercial funding sources, to obtain a loan. In this way, the guarantee serves as a type of credit enhancement to reduce the lender's perception of the MFI's risk of default. Other types of credit enhancements that MFIs can use to reduce their lenders' exposure to default risk include collateral security, letters of credit, and the inclusion of co-guarantors:

- **Collateral security.** The MFI may pledge assets as security for a loan. Such an arrangement often involves only two parties: the borrower (the MFI) and the beneficiary (the bank).
- **Letters of credit.** In this context, a letter of credit involves the borrowing MFI (the applicant), the lending bank (the beneficiary, or recipient of the letter of credit), the bank that issues the letter of credit (issuing bank). A letter of credit is a promise by the issuing bank to pay a specified amount to the beneficiary when the borrowing MFI defaults

on the loan. The letter of credit basically substitutes the creditworthiness of the issuing bank for that of the borrowing MFI. **Banks organized in the United States often cannot issue guarantees, but they can issue letters of credit and other “independent undertakings to pay against documents.”** Although U.S.-organized banks often cannot issue guarantees except in support of certain affiliate obligations or where the issuing bank otherwise has an interest in the transaction, this limitation is not shared by all jurisdictions. In any event, there is a need to consult with local counsel to determine the legal authority of the relevant guarantor to issue the guarantee. (See annotation 44 for further discussion). **In many jurisdictions, however, banks are permitted to issue guarantees.**

- **Co-Guarantors.** In some cases the beneficiary may require more guarantee coverage of the primary obligation than any one guarantor will agree to provide. In such a case there may be two or more guarantees of one loan. It is likely that in such a case the beneficiary will want the freedom to call on any guarantee if there is a default under the primary obligation. Although by definition the primary obligor will have already defaulted before any guarantee is called on, the guarantors may need to have arrangements in place to allocate any exposure among themselves. The primary obligor will, of course, remain obligated to reimburse **each** guarantor, and any multiple-guarantor arrangement will need to ensure that the primary obligor is never at risk of paying more, in the aggregate, than the amount of the primary obligations guaranteed. Attention will also need to be paid to what sorts of guarantor-related defaults could constitute a default under the primary obligation, as the presence of multiple guaranties would increase the chances of such an occurrence.

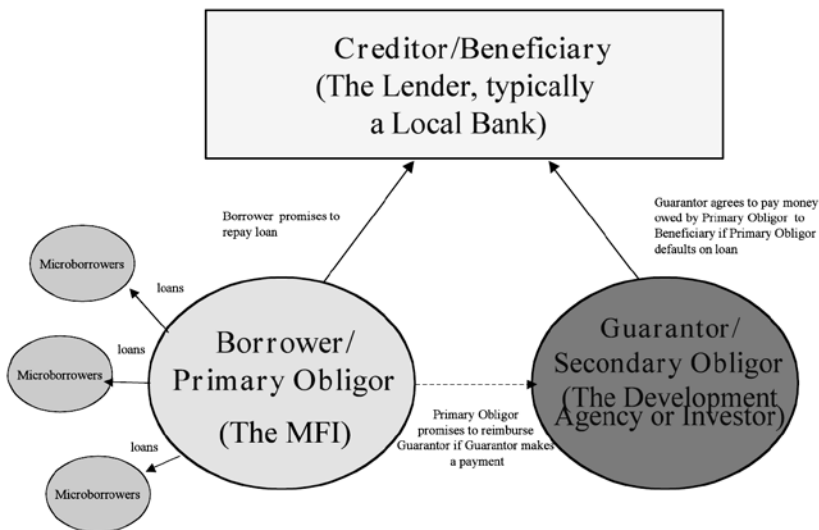
In practical terms, letters of credit, third-party loan guarantees, and the existence of multiple or co-guarantors help to ensure that the lender will receive prompt payment of amounts owed to it under the underlying loan, even if the borrowing MFI encounters financial difficulties and fails to pay when due an amount owed under the primary obligation agreement. The more confident the beneficiary is that it will be repaid, the more likely it is to make the loan, and on better terms. A primary obligor may choose to use more than one of the abovementioned credit enhancements at a time. In the event a primary obligor uses multiple credit enhancements, the primary obligor must address several issues that arise when multiple credit enhancements are in use, such as the following:

- **Relationship among credit enhancements.** When there are multiple sources of credit enhancement, the relationship among these enhancements must be addressed. In particular, any limitations on the amounts, timing, or order with which the different credit enhancements are and can be exercised will need to be determined.

- **Order of exercising credit enhancements.** Generally, the beneficiary will seek to proceed in any manner it decides, exercising its rights in respect of the available credit enhancements in any order it sees fit. On the other hand, a guarantor may seek to limit its liability under the guarantee by allowing the beneficiary to exercise its rights under the guarantee only in circumstances in which all other enhancements have been exhausted.

The remainder of this document will focus solely on loan guarantees.

Figure 1. Key Players in a Loan Guarantee.



Structurally, most guarantee agreements adhere to a similar format, which begins with a preamble. The agreement’s preamble (an opening statement) contains the names of the parties and may define key terms, such as “guarantor”, “beneficiary”, “primary obligor”, and “primary obligation agreement”. After the preamble, a typical loan guarantee contains various recitals (“WHEREAS” clauses, further described in annotation 1). The document’s eight main sections follow these recitals: (1) the guarantee, (2) representations and warranties, (3) subrogation of rights, (4) binding effect, (5) notices, (6) governing law, (7) amendment, and (8) transfer. Each of these sections is described in more detail in the annotations that follow.

Key Issues/Concepts to Consider

As MFI managers seek to make use of this Guide, it will be useful to keep a few important concepts related to guarantees in mind:

Loan guarantees may cover the entirety of a loan or only parts of a loan.

- **Complete guarantees** cover the entire loan amount, which will include all payments that come due under the loan agreement, including principal, interest, and fees.
- **Partial guarantees** cover only a specified amount of the loan, such as just interest, or just principal amounts, or even only certain (often later) payment installments, such as the last principal payments due.

A loan guarantee may be a guarantee of payment or a guarantee of collection.

- Under a **guarantee of payment**, if the primary obligor defaults, the beneficiary can proceed directly against the guarantor, without first seeking to enforce its claims against the primary obligor. In other words, the beneficiary of the guarantee is not required to seek to enforce its claims against the primary obligor before proceeding against the guarantor.
- Under a **guarantee of collection**, the beneficiary must seek to enforce its claims against the primary obligor (or other source of credit enhancement for the loan) before being able to enforce its claims against the guarantor. In other words, there is a condition precedent that must be satisfied before the beneficiary is able to turn to the guarantor for payment.

Regardless of which type of loan guarantee (of payment or of collection) is used, it usually comes at a cost, with the guarantor requiring the MFI to pay an initial and/or annual fee for the guarantee. Typically, the amount of the guarantee fee is based on the length of the loan and the amount of the guaranteed portion, and it may range from 0 percent to 4.5 percent of the guarantee amount. The estimated fee amount is based on a study, jointly supported by CGAP and the U.S. Agency for International Development (USAID), that draws on data provided by guarantee agencies, publicly available financial information reported by MFIs, and telephone and email exchanges conducted with selected MFI managers and guarantee agency staff (Flaming 2007). The study found that the guarantor agencies' unweighted average fee was just over 2 percent.

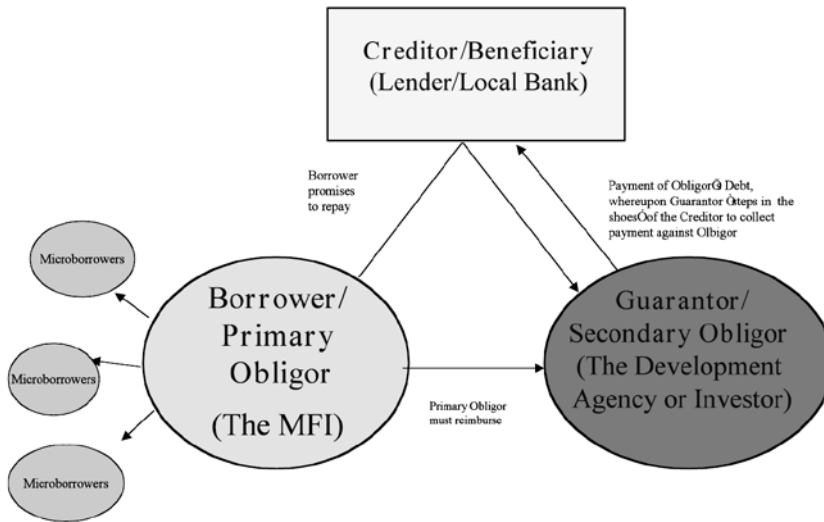
For a loan guarantee to have effect, **the guarantor must have authority to enter into the agreement**. Indeed, the guarantor's power to "execute and deliver" the guarantee is an essential legal prerequisite and is necessary for the guarantee to be valid. As such, it is standard practice for the guarantor, under the representations and warranties section, to

affirm that it has such authority and is a duly organized and validly existing organization. It is also customary for the guarantor to represent that entering into the guarantee does not contravene any of its incorporation provisions or bylaws, or any law, regulation, rule, or other contractual restriction that is already binding on it.

Another key provision of the guarantee concerns **subrogation**. **Subrogation provides for one party (in this case the guarantor) to stand in the shoes of another (the beneficiary), giving the substitute the same legal rights as those of the original party.** For example, subrogation allows the guarantor to “stand in the shoes” of the beneficiary, allowing the guarantor to assume and exercise the beneficiary’s legal rights against the primary obligor (or other sources of credit enhancement for the loan). (See Figure 2.) Subrogation occurs automatically, without any further action by the parties and has the same effect as if the beneficiary had assigned those rights to the guarantor directly. Thus, if the primary obligor defaults on its obligations under the primary obligation agreement, the guarantee provides that the guarantor will pay such amounts that (1) are covered by the guarantee and (2) that the primary obligor has failed to pay. If the guarantor’s payment of the amount owed completely satisfies the underlying obligation, the guarantor becomes subrogated to the rights of the beneficiary with respect to the underlying obligation and, standing in the shoes of the beneficiary, is entitled to receive payment from the primary obligor. If the guarantor has guaranteed only part of a debt, the guarantor will not be “subrogated” to the beneficiary’s claim against the primary obligor until the underlying obligation has been completely satisfied. Thus, a guarantor is likely to want to have a reimbursement agreement in place with the primary obligor to set out the terms that will govern repayment, even though the primary obligor is required (as a matter of law) to reimburse the guarantor for any payment made by the guarantor.

If a guarantor finds the prospect of stepping into the beneficiary’s shoes in the event of subrogation to be inadequate, a guarantor may seek to have the primary obligor’s reimbursement obligation **secured** (supported by collateral). Beneficiaries, however, are unlikely to favor such an arrangement. If the beneficiary itself has required collateral from the primary obligor, it is unlikely that it will permit another (even if subordinated) security interest in favor of the guarantor. In the event a guarantor does obtain a security interest for its reimbursement obligation, generally the beneficiary will require the guarantor to agree not to exercise any right to exercise remedies against any such collateral until the beneficiary is fully satisfied. Nevertheless, having such collateral would make the guarantor a secured, rather than an unsecured, creditor of the primary obligor, which typically has advantages in the event of a decline in the primary obligor’s creditworthiness or even insolvency or bankruptcy. Because the collateral is likely to

Figure 2. Subrogation: If Primary Obligor Defaults, Relationships Shifts



be located in the local jurisdiction of the primary obligor, any such arrangement will require **consultation with local counsel** regarding how to provide any such security interest and the costs and other complications that may be involved. Among other potential concerns, if the collateral includes the primary obligor’s loan portfolio, legal hurdles might prevent granting permission to the guarantor to make collections on such loans after the primary obligor’s default.

One final preliminary issue—**consideration**—has its roots in contract law. Guarantees are contracts entered into between the guarantor and the beneficiary, thus consistent with a basic principle of contract law, a guarantee like any other contract must be supported by consideration. Consideration need not flow directly to the guarantor, so there is no legal requirement that a guarantee fee be paid as consideration, although third-party guarantees are likely to require a guarantee fee. So long as the guarantee is executed at the time of the primary obligation agreement, consideration sufficient to support a guarantee will be found to exist if (1) the primary obligor received consideration from the beneficiary under the primary obligation agreement and (2) the guarantee is required as part of that loan transaction. If the guarantee is entered into after the primary obligation agreement is entered into, however, an issue may arise regarding the adequacy of consideration to support the guarantee. To prevent the guarantor from claiming that the guarantee was given without consideration, the guarantee document should recite

the consideration received or state that the guarantee is provided “for value received.” Guarantees governed by New York law have the benefit of Section 5-1105 of the New York General Obligations Law, which provides that a promise in writing is effective even if the consideration for the promise is past or executed, so long as the consideration is expressed in writing, is proved to have been given, and would have been valid consideration but for the time when it was given.

As discussed, loan guarantees can be helpful—providing primary obligors with access to capital it otherwise may not be able to obtain. However, loan guarantees come with costs that primary obligors must consider. The following is a summary of some of the chief advantages and disadvantages of using a loan guarantee.

The advantages of a loan guarantee include the following:

- A guarantee offers primary obligors some of the same protections as a letter of credit (for example, a primary obligor can use a loan guarantee to avoid the risks associated with keeping cash collateral on deposit with a local bank).
- A guarantee may provide a primary obligor with the advantage of access to capital that it otherwise would be unable to obtain or may provide a more legally enforceable claim where perfected security interests in collateral are unavailable or problematic. If the primary obligor does not have cash to offer as collateral for a local loan or if the pledge laws of the country where the primary obligor is located do not provide for mechanisms to perfect security interest in pools of intangible assets (such as microcredit portfolios), a guarantee from a development bank or from an organization (such as USAID) may be an acceptable substitute.
- In cases where unsecured financing is available to a primary obligor, the guarantee, like other credit enhancements, typically allows the primary obligor to borrow at a lower interest rate than that charged for an unguaranteed, unsecured loan. Of course, the cost of the guarantee (including fees), if any, must be considered in weighing this advantage.

There are several disadvantages to using a guarantee as a credit enhancement:

- The guarantor may require the primary obligor to pay an initial and/or annual fee for the guarantee.
- The guarantor may place certain restrictions on how the primary obligor may use the loan proceeds, such as prohibiting the primary obligor from engaging in any lending that the guarantor considers high risk.
- The guarantor may impose rigorous know your customer, anti-money laundering or counter-financing of terrorism laws on the primary obligor that may restrict the primary obligor’s lending capacity in its primary place of business and with which the primary obligor may not be able to comply.

- The interest rate available to a primary obligor that uses a guarantee may be higher than the interest rate available to that primary obligor on a loan secured with cash collateral deposited directly with the beneficiary. This is because the beneficiary is able to realize on letters of credit or cash collateral with much less effort and cost.
- The primary obligor will be obligated to reimburse the guarantor for any amounts paid under the guarantee, for which the guarantor may require collateral as security, even if the beneficiary did not require collateral.

The primary obligor, along with local counsel, needs to consider these advantages and disadvantages before deciding whether a loan guarantee is in its best interests. This Guide explains important terms and describes what language is helpful, neutral, or harmful to a primary obligor. Although the primary obligor is not a party to the guarantee, the primary obligor should closely observe the negotiations between the beneficiary and the guarantor. If the guarantor decides to enter into a reimbursement agreement with the primary obligor, the terms and conditions of the guarantee will affect the rights and obligations of the primary obligor under the reimbursement agreement.

Bracketed text in the guarantee indicates either transaction-specific terms or optional text, which, if considered desirable, should be replaced with the specific text applicable to the context.

ANNOTATED CORPORATE GUARANTEE

GUARANTEE¹ (as the same may be amended, supplemented, or otherwise modified from time to time, Guarantee), dated as of [date]² of [name of the Guarantor entity] (Guarantor), a [corporation] duly organized under the law of [Guarantor's state of organization],³ in favor of [name of the Beneficiary entity], a [corporation] duly organized under the laws of [Beneficiary's state of organization], its successors and assigns (Beneficiary);

WHEREAS, [name of the Primary Obligor entity] a [corporation] duly organized under the laws of [Primary Obligor's state of organization] (Primary Obligor)⁴ has entered into the [describe the transactions and the document creating primary obligation] (Primary Obligation Agreement) with the Beneficiary;

WHEREAS, in consideration of the foregoing and for other good and valuable consideration receipt of which is hereby acknowledged, the Guarantor has agreed to guarantee the payment of amounts under the Primary Obligation Agreement;

1. Most guarantee agreements begin with a preamble (an opening statement), followed by various recitals ("WHEREAS" clauses). The recitals are an often overlooked part of the agreement that serve as a useful, nontechnical summary of the goals and structure of the agreement and serve as an expression of the intent of the parties. The recitals are especially useful if the parties end up in court. Although recitals are not legally enforceable, the guarantor (and also the primary obligor) should nonetheless take care that the recitals are not more limiting than the terms of the agreement itself. Additional recitals could be used to express the intent of the parties or any other relevant background to the transaction.
2. If the guarantee is entered into after the main loan agreement or primary obligation document is signed, an issue may arise regarding the adequacy of **consideration** to support the guarantee, at least with respect to transactions taking place prior to the guarantee's execution. Consideration will be found where the existence of the guarantee is part of the exchange bargained for by the lender to induce it to extend credit to or contract with the primary obligor, but actual creation of the guarantee is delayed until after initial loan agreements have been entered into, even if no separate consideration supports the guarantee.

3. The preamble should state the name, legal organizational form, and the jurisdiction of the guarantor, beneficiary, and the primary obligor, as the case may be. Examples include a corporation, a limited liability company, a nonprofit company, a bank, and so forth. Some contract forms use the location of the registered office of the parties, which may not necessarily be the principal office of the parties. The parties should agree upon this.
4. The MFI is the primary obligor and is the party to the underlying agreement or primary obligation agreement, whose obligations under that agreement will be guaranteed by the guarantor, typically a development agency or investor.

NOW, THEREFORE, the Guarantor hereby agrees:

Section 1. The Guarantee. (a) The Guarantor hereby irrevocably,⁵ absolutely and unconditionally⁶ guarantees to the Beneficiary, with effect from the date of the Primary Obligation Agreement, the due and punctual payment⁷ (and not merely collection)⁸ [in currency in which the guaranteed obligation has to be paid]⁹ of all present and future¹⁰ amounts,¹¹ whether absolute or contingent, and whether for principal, interest, fees, breakage costs, expenses, indemnification, or otherwise, owing by the Primary Obligor under the Primary Obligation Agreement, as and when such amounts become due and payable, whether at their scheduled due dates, upon acceleration or otherwise (or would otherwise be owing, due or payable under the Primary Obligation Agreement but for the commencement of any bankruptcy, insolvency, or similar proceeding¹² in respect of the Primary Obligor) (such obligations, Guaranteed Obligations) and the performance of all delivery and other obligations of the Primary Obligor under the Primary Obligation Agreement¹³ in accordance with the terms of the Primary Obligation Agreement. All capitalized terms not otherwise defined herein shall have the respective meanings assigned to them in the Primary Obligation Agreement.

5. The term “irrevocable” means that the guarantee cannot be terminated unilaterally (this is implied in any event insofar as identified obligations are concerned). As explained below, complete irrevocability is not possible if the guarantee purports to relate to all future obligations between the primary obligor and the beneficiary, whether or not documented and identified in the guarantee. In an open-ended guarantee, the use of the term “irrevocable” simply means that the guarantor is prevented only from revoking its guarantee for any transactions

already entered into by the primary obligor. The guarantor may revoke its guarantee of future transactions not yet entered into by the primary obligor even though the guarantee is stated to be irrevocable. If the guarantor purports to terminate the guarantee while obligations under the underlying primary obligation agreement remain outstanding, this may constitute an event of default under the terms of the primary obligation agreement.

6. The term “absolute and unconditional” means that no condition need be satisfied, and no remedy need be pursued against the primary obligor, before any rights against the guarantor under the guarantee become enforceable. Because it is unclear whether, by the simple reference to “absolute and unconditional,” the guarantor will be viewed as having waived its right to defenses that the guarantor might have to performance (known as “**suretyship**” defenses, described in annotation 19 in greater detail) including where the primary obligor and the beneficiary have changed or waived the underlying obligations, the beneficiary will typically want the guarantee to contain further language that clarifies this point as this guarantee does in Section 1(c) of the text.
7. This is a guarantee of payment (whereby if the primary obligor fails to pay under the primary obligation agreement, the beneficiary of the guarantee is not required to seek to enforce its claims against the primary obligor before proceeding against the guarantor) as contrasted with a guarantee of collection (whereby the lender or beneficiary would be required to seek enforcement of its claims against the primary obligor first, before being able to turn to the guarantor for payment). Generally, in the United States, if the guarantee is silent on the issue of which type of guarantee it is, the guarantee will be considered a guarantee of payment. The rule that a guarantee that is silent as to whether it is a guarantee of payment or guarantee of collection is specific to U.S. law. Local counsel should be consulted to determine if nonspecified guarantees are automatically deemed guarantees of payment in the applicable jurisdiction.
8. This parenthetical strengthens the notion that this is a guarantee of payment (although this is implied without so stating).
9. This clause should be added to limit uncertainty in the context where it would be appropriate to agree on the desired currency of payment or of judgment settlement. Because the primary obligation is often payable in local currency, exchange controls and exchange rate fluctuations could have a negative impact on the primary obligor if any guarantee (and related reimbursement

obligation) is payable in a nonlocal currency (such as U.S. dollars) and the guarantor is not willing to assume such an exchange risk (for example by committing to make a payment in “then equivalent” funds). It might be possible for the primary obligor to acquire some sort of contingent currency fluctuation protection, although this could be expensive. Unless the loan to the primary obligor is in a different currency than the loan portfolio the primary obligor used to fund its repayment of the primary obligations there would not seem to be a need for an ongoing currency swap or similar hedge to be in place, since the primary obligor intends to make payment on the primary obligation and would therefore not need to make a reimbursement payment to the guarantor in a different currency. Foreign exchange controls could, however, prevent the primary obligor from making a repayment in the expected currency, in which case the primary obligor would face currency exchange rate risk. The beneficiary will want to ensure that no matter what the circumstances, the full amount of its loan is paid in either local currency or the then-U.S. dollar (or other relevant currency) equivalent. One approach a beneficiary might take would be to require interim loan prepayments by the primary obligor to ensure that the size of the guarantee is always sufficient to cover, at then-current rates, the requisite amount of the loan. This would be a very disadvantageous position for the primary obligor, as it could then require demanding earlier-than-expected repayment on its own loan portfolio.⊗

10. Adding the concept “present and future” strengthens the notion that this is a continuing guarantee that can cover future (even unidentified) obligations under the primary obligation. A continuing guarantee is a contract that is a continuing offer to guarantee the primary obligor’s debts and applies to transactions already entered into by the primary obligor (unless a provision is included that the guarantee does not apply or it is limited by its terms).

Even though a guarantee may provide that it is continuing, whether through the use of the words “present or future” or by referring to the guarantee as “continuing,” the guarantor may still act to terminate it by notice to the beneficiary revoking the guarantor’s liability for obligations that are incurred subsequent to such notice.

11. This is an unlimited guarantee, as contrasted with a limited guarantee. Under an unlimited guarantee, the guarantor is obligated to answer for all debts of the primary obligor in respect of the guaranteed obligations, whereas a limited guarantee limits the dollar amount of the liability assumed by the guarantor. If the guarantee is intended to be a limited guarantee, the parties may choose to include language such as “not in excess of \$[fixed amount],” or “limited to \$[fixed amount].” USAID’s Development Credit Authority, for example, guarantees loans up to 50 percent of a lender’s net loss on the guaranteed portion of the identified loan. This provision should be tailored to the type of guarantee intended.
12. The clause “but for the commencement of any bankruptcy, insolvency or similar proceeding” is included because any bankruptcy by the primary obligor may halt the accrual of further interest under the primary obligation agreement. This clause is intended to include within the scope of the guarantee, interest that would have accrued had a bankruptcy not occurred.
13. A guarantee can cover not only payment but also performance obligations, although guarantors often prefer to limit their obligations to those of payment, since they may not be in a position to perform other types of obligations.

Guarantor hereby agrees to pay all costs, fees, and expenses (including, without limitation, reasonable fees of outside counsel) incurred by any Beneficiary in enforcing this Guarantee. Each payment by the Guarantor under this Guarantee shall, except as required by law, be made without withholding or deduction for or on account of any taxes. If any taxes are required to be withheld or deducted from any such payment, the Guarantor shall pay such additional amounts as may be necessary to ensure that the net amount actually received by the Beneficiary after such withholding or deduction is equal to the amount the Beneficiary would have received had no such withholding or deduction been required, provided, however, that no such additional amounts shall be payable in respect of any taxes imposed on the net income of the Beneficiary and franchise taxes imposed on the Beneficiary by the jurisdiction under the laws of which the Beneficiary is organized or has its principal place of business or where its applicable lending office is located.¹⁴

14. It is standard practice for guarantors to be required, when the beneficiary enforces the guarantee, to pay all costs, including reasonable fees of outside counsel, incurred by the beneficiary. Additionally, the guarantor’s jurisdiction

may impose a tax on payments made under guarantee, which such jurisdiction collects by requiring the guarantor to withhold or deduct the amount of the tax from payments to the beneficiary. It is customary for the guarantor to agree to a tax “gross-up” clause to shift to the guarantor the risk that a withholding tax might be imposed on payments due under the agreement. The provision requires the guarantor to gross-up its payments to ensure that the beneficiary receives the payment amount it would have received had there been no withholding tax.

(b) In no event shall the Beneficiary be obligated to take any action, obtain any judgment, or file any claim prior to enforcing this Guarantee.¹⁵

15. This sentence clarifies and strengthens the unconditional nature of the guarantee and confirms that it is a guarantee of payment, not of collection.

Upon failure of the Primary Obligor punctually to pay the Guaranteed Obligation, the Guarantor agrees to pay such amounts [upon written demand by the Beneficiary to the Guarantor];¹⁶ *provided that* delay by the Beneficiary in making a demand for payment shall in no event affect the Guarantor’s obligations under this Guarantee. The rights, powers, remedies, and privileges provided in this Guarantee are cumulative and not exclusive of any rights, powers, remedies, and privileges provided by any other agreement or by law.¹⁷

16. While some guarantees provide for specific notice to the guarantor once the primary obligor has failed to pay or perform, other guarantees simply provide that the guarantor is obligated to pay or perform if the primary obligor is required to and fails to do so, without the requirement of any additional notice. This clause is relatively benign from the primary obligor’s standpoint, but guarantors typically ask for written notice provisions.

17. This sentence makes clear that enforcing any of the rights under the guarantee will not preclude the exercise of any other rights, such as rights against collateral provided by the primary obligor.

(c) The Guaranteed Obligations shall not be discharged except by complete payment of the amounts payable under the Primary Obligation Agreement¹⁸ irrespective of:¹⁹

18. The guarantor can always claim that the guaranteed obligations have been paid or performed. The beneficiary is not entitled to be paid more than once.

19. What follows are waivers by the guarantor of suretyship and other defenses. As mentioned in annotation 6, **suretyship defenses** are defenses that the guarantor would have to performance (in whole or in part) relieving the guarantor of its obligations to perform, where the primary obligor or the beneficiary have altered the underlying obligations of the loan agreement or have taken certain other actions that may affect the rights of the guarantor. Actions of the primary obligor or beneficiary that may entitle the guarantor to a suretyship defense may include release of the underlying obligation, extension of the deadline for performance, modification of the underlying obligation, or impairment or loss of collateral securing the underlying obligation. Typically, the beneficiary requires that the guarantor waive such suretyship and other defenses. The waivers are intended to establish the guarantee as a freestanding, separately enforceable agreement, regardless of circumstances affecting the primary obligor or the primary obligation agreement. Waivers of such defenses are generally enforceable. As a general rule, these conditions are of most importance to the guarantor and the beneficiary, with the guarantor wanting to ensure, via a narrowing of the waiver, that it has set the limits on the obligation it is covering and the beneficiary wanting the broadest waiver possible.

Note, however, that even in the absence of any waiver of defenses, under U.S. law there are some defenses that the guarantor may not claim. For example, two defenses that the guarantor can never claim (and thus, need not waive) are those regarding bankruptcy of the primary obligor and lack of capacity of the primary obligor.

On the other hand, certain defenses can never be waived. For example, concepts such as good faith and fair dealing, mistake, and fraud apply to a guarantee just like any other contract. The guarantor may always raise these defenses (if the facts warrant such a claim), even if it waives the suretyship defenses described in this section.

(1) any claim as to the validity, regularity, or enforceability of the Primary Obligation Agreement or this Guarantee [or any other agreement related to the Primary Obligation Agreement or this Guarantee];²⁰

20. The beneficiary could ask that the guarantor waive any objection to the validity, regularity, and enforceability of the underlying agreement and the guarantee. Adding mention of the guarantee to this section may prevent the claims by the guarantor that the guarantee was delivered based on duress or fraud to induce the guarantor to enter into the guarantee.

(2) the lack of authority of Primary Obligor to execute or deliver the Primary Obligation Agreement;²¹

21. Beneficiaries often ask guarantors to waive any objection related to a lack of authority of the primary obligor to execute or deliver the primary obligation agreement. Such a waiver helps to ensure that the validity of the guarantee will not be affected by defenses related to the primary obligation agreement itself.

(3) any change in the time, manner, or place of payment of, or in any other term of, or amendment to the Primary Obligation Agreement;²²

22. Here, the guarantor waives as a defense to the enforcement of the guarantee any alterations to the underlying agreement. Absent such a waiver, if the underlying obligation were amended without the guarantor's consent, the guarantor would be able to argue that it should be released, at least in part, from the guarantee obligation since it did not bargain for the increased risk embodied in the changed underlying obligation. As noted in annotation 19, a guarantor is likely to be reluctant to accept such an open-ended waiver without limiting certain aspects of the scope of the guarantee, such as maturity date and the amount of the obligation guaranteed.

(4) any waiver or consent by the Beneficiary with respect to any provisions of the Primary Obligation Agreement²³ or any compromise or release of any of the obligations thereunder;²⁴

23. Although the inclusion of this waiver is a neutral issue for the primary obligor, since any change in the underlying primary obligation agreement would typically be effective only with the primary obligor's consent, beneficiaries often ask that it be included. Requiring the waiver of claims that the guarantor might make based on any waiver or consent made by the beneficiary in connection with the underlying primary obligation agreement enables the beneficiary to modify, extend, and police the primary obligation agreement without jeopardizing its guarantee. See also annotations 19 and 22.

24. Beneficiaries also generally ask for a general waiver of defenses because such a waiver is enough to prevent a guarantor from being discharged by virtue of the primary obligor's release from liability. Specific language in the guarantee waiving the defense of release of the primary obligor is not necessary. A guarantor is unlikely to agree to the waiver unless the guarantor has a reimbursement agreement in place with the primary obligor. See also annotations 19 and 22.

(5) the absence of any action to enforce the Primary Obligation Agreement, to recover any judgment against the Primary Obligor, or to enforce a judgment against the Primary Obligor under the Primary Obligation Agreement;²⁵

25. In addition to making more explicit the fact that the guarantee is one of payment and not of collection, this waiver addresses the circumstance in which the beneficiary fails to pursue the primary obligor for payment and such failure extends beyond the time legally permitted for the beneficiary to enforce its rights under the primary obligation agreement. Although this waiver has no direct impact on the primary obligor, the presence of such a waiver is likely to shape the demands that a guarantor will make in a reimbursement agreement. This waiver ensures that the guarantor cannot claim it has been discharged where, for example, the beneficiary has failed to timely pursue the primary obligor or the statute of limitations (the maximum period of time, after certain events, that legal proceedings based on those events may be initiated) has

lapsed. When this waiver is present, causing the guarantor to waive the ability to claim failures to act or the running of the statute of limitations on the underlying obligation as a defense to payment on the guarantee, the guarantor may, with respect to its right of subrogation, be left vulnerable to the primary obligor's use of this defense.

(6) the occurrence of any event of default or potential event of default under the Primary Obligation Agreement;²⁶

26. While it is technically not necessary to include this waiver, this specific waiver may be included to clearly state that the guarantor is not entitled to claim an event of default or potential event of default—even if in existence at the time the guarantee was executed—as a defense.

(7) the existence of any bankruptcy, insolvency, reorganization, or similar proceedings involving the Primary Obligor;²⁷

27. As discussed in annotation 19, under U.S. law it is not necessary to include this waiver relating to bankruptcy.

(8) any setoff,²⁸ counterclaim, or defense of any kind or nature that may be available to or asserted by the Guarantor or the Primary Obligor against the Beneficiary or any of its affiliates;
 (9) any impairment, taking, furnishing, exchange, or release of²⁹ or failure to perfect or obtain protection of any security interest in, collateral securing the Primary Obligation Agreement;

28. In this context, the right of **set-off (set-off right)** is the right of the guarantor to reduce the amount of its obligation to the beneficiary by the amount of the beneficiary's obligation to either the guarantor or the MFI under other agreements. Depending on the jurisdiction it is typically the guarantor's right to net out *mutual* obligations between the parties. This provision waiving setoff rights prevents the guarantor from claiming the right to set off against its obligations under the guarantee any claims that the guarantor or the primary obligor may have against the beneficiary, including those that are unrelated to the transactions giving rise to the guarantee.

29. This waiver prevents the guarantor from claiming that release or reduction in the value of the collateral is a valid defense to the guarantor's obligations under the guarantee. Without this waiver, it is possible that the guarantor's obligations may be discharged to the extent that any release of collateral (through, for example, failure of the beneficiary to properly perfect its interest in the collateral or reduction in the value of the collateral) increases the guarantor's exposure to loss. In general, any actions by the beneficiary that "impair" the value of any collateral pledged by the primary obligor could also, in the absence of this waiver, constitute defenses available to the guarantor.

(10) any change in the laws, rules, or regulations of any jurisdiction;³⁰

30. This may appear in some guarantees as an attempt to address possible legal limitations, particularly in cross-border situations. For example, this waiver prevents the guarantor from asserting that changes in laws (e.g., those related to foreign currency limitations imposing difficulty in accumulating or transferring foreign currency) are defenses against the guarantor's obligations under the guarantee.

(11) any present or future action of any governmental authority or court amending, varying, reducing, or otherwise affecting, or purporting to amend, vary, reduce, or otherwise affect, any of the obligations of the Primary Obligor under the Primary Obligation Agreement or of Guarantor under this Guarantee;³¹ or

31. This may appear in some guarantees as an attempt to address possible legal limitations imposed by legal proceedings or judicial actions that reduce or restructure the debts of the primary obligor (e.g., bankruptcy proceedings).

(12) any other circumstance (other than payment or performance) that might otherwise constitute a legal or equitable discharge or defense of a Guarantor generally.³²

32. This is a catch-all provision designed to capture any unspecified event or action that may release the guarantor from its obligations. It may also have the benefit of deflating any defense argument by the guarantor that it was fraudulently induced into giving the guarantee. This provision is intended to serve as a supplement to, and not a replacement of, previous provisions.

(d) Guarantor hereby waives diligence, presentment, demand on the Primary Obligor for payment or otherwise, filing of claims, requirement of a prior proceeding against the Primary Obligor and protest or notice,³³ except as provided for in the Primary Obligation Agreement with respect to amounts payable by the Primary Obligor.

33. Waiver of these requirements ensures that the guarantor is not inadvertently released. For example, the law of guarantees has traditionally provided that the guarantor is entitled to notice of the primary obligor's default. Such waiver allows the beneficiary to proceed immediately against the guarantor without any delay caused by arguments regarding the proper dispatch of notice, the adequacy of notice, or whether other proceedings must be completed or other actions taken beforehand. As noted in the introduction, in a guarantee of collection, any conditions to proceeding against the guarantor would need to be spelled out and the waiver relating to proceeding against the primary obligor would not be included.

If at any time (including any time after termination or expiration of this Guarantee) payment under the Primary Obligation Agreement is rescinded or must be otherwise restored or returned by the Beneficiary upon the insolvency, bankruptcy, or reorganization of the Primary Obligor or Guarantor or otherwise, the Guarantor's obligations hereunder with respect to such payment shall be reinstated upon such restoration or return being made by the Beneficiary, all as though such payment had not been made.³⁴

34. This is a reinstatement clause. Bankruptcy and similar laws in some jurisdictions may provide for a return (a clawback) to a primary obligor of certain kinds of payments made by it, typically, if such payments are made within specified periods before the filing or commencement of bankruptcy or similar proceedings. The reinstatement clause provides for the guarantee to be reinstated if all or part of any payment by the primary obligor on the guaranteed obligations to the beneficiary must be returned or is rescinded under such circumstances or otherwise.

Section 2. Representations and Warranties. Guarantor represents and warrants to the Beneficiary on the date hereof and during the duration of this Guarantee that:³⁵

35. The main purpose of the representations and warranties is to elicit information to enable the beneficiary to make an informed credit decision. The guarantor makes representations and warranties with respect to facts that the beneficiary relies on when agreeing to extend credit to the primary obligor. These representations and warranties are similar to those typically made by the primary obligor in the primary obligation agreement. One difference between these representations and warranties and those in the primary obligation agreement is that if there is a breach of representations or warranties in the guarantee, such breach could trigger a default under the primary obligation agreement, whereas a breach in the primary obligation agreement may not trigger default under or otherwise affect the guarantee. It is important for the primary obligor to note, therefore, that a breach of representations or warranties in the guarantee would likely be considered a breach of the guarantee, which could, in turn, potentially trigger a default under the primary obligation agreement as well.

(a) it is duly organized and validly existing under the laws of the jurisdiction of its incorporation and has full power and legal right to execute and deliver this Guarantee and to perform the provisions of this Guarantee on its part to be performed;³⁶

36. The representation regarding the organization and existence of the guarantor is very common. The power to “execute and deliver” is an essential legal prerequisite to the extension of a guarantee.

(b) its execution, delivery, and performance of this Guarantee have been and remain duly authorized by all necessary corporate action and do not contravene any provision of its certificate of incorporation or bylaws, any law, regulation, rule applicable to it or contractual restriction binding on it, or its assets;³⁷

37. Like the representation in Section 2(a) regarding the organization of the guarantor, it is customary to include a representation in which the guarantor represents that it has taken all necessary steps to consummate the agreement

(e.g., authorization of the guarantor by its board of directors) and perform its obligations hereunder. If certain requirements can be accomplished only after the guarantee is signed (e.g., obtaining a waiver releasing the guarantor from particular binding contractual obligations), a covenant or promise to undertake particular future actions should be included to reflect the commitment of the guarantor to undertake such obligations.

(c) no notice to, consent, authorization or approval by, or filing with, any governmental authority having jurisdiction over the Guarantor or its property is required for its execution, delivery or performance of this Guarantee;³⁸ and

38. It is customary for the guarantor to represent that no governmental or regulatory authorization is necessary to authorize the guarantee or the guarantor's use of its property in performance of the guarantee. Any future action required should be reflected in the guarantee as a covenant. For example, registration of the guarantee itself with exchange control authorities in the guarantor's jurisdiction, if necessary, should be explicitly identified as being excluded from the relevant representation, and the guarantor should be willing to add a covenant to complete such post-signing requirements promptly.

(d) this Guarantee is its legal, valid, binding obligation.³⁹

39. Again, it is customary for the guarantor to represent that the guarantee is legal, valid, binding, and enforceable on the guarantor. Guarantees can vary in the way in which this representation is phrased. For example, the word "legal" is sometimes not included on the theory that such a term is directed at whether the guarantee violates a provision of law, typically addressed in a representation specifically referring to that situation. In general, some combination of "valid", "binding", and "enforceable" is used, and the different approaches are generally understood to convey the same meaning—that is, that the guarantor can be held responsible for its failure to perform under the guarantee.

Section 3. Subrogation. By accepting this Guarantee and entering into the Primary Obligation Agreement, the Beneficiary agrees that the Guarantor shall be subrogated to all rights of the Beneficiary against the Primary Obligor in respect of any amounts paid by the Guarantor pursuant to this Guarantee, *provided that* the Guarantor shall be entitled to enforce or to receive any payment arising out of or based upon such right of subrogation only when all amounts payable by the Primary Obligor under the Primary Obligation Agreement have been paid and any commitment to extend further credit under the Primary Obligation Agreement has been terminated.⁴⁰

40. As noted in the introduction, **subrogation** (the guarantor's stepping into the place of the beneficiary with respect to the primary obligor) occurs automatically by the operation of law once a guaranteed obligation has been paid in full. When a guarantor is subrogated to the rights of the beneficiary with respect to an underlying obligation, the effect is the same as if the beneficiary had assigned those rights to the guarantor. The guarantor would thus have the right to any collateral securing the underlying obligation if the primary obligation was secured with collateral and may recover its expenses associated with performing under the guarantee, in addition to the actual amount that it paid the beneficiary. In enforcing its subrogation rights, however, a guarantor would be subject to the primary obligor asserting whatever defenses the primary obligor had against the beneficiary under the primary obligation agreement or guarantee. This would not be the case if the guarantor had an independent right against the primary obligor to reimbursement through a separate reimbursement agreement.

The Guarantor unconditionally waives any rights that may now have or hereafter acquire against the Primary Obligor that arise from the existence, payment, performance, or enforcement of the Guarantor's obligations under or in respect of this Guarantee or any other agreement in connection therewith, including without limitation, any right of subrogation, reimbursement, exoneration, contribution, or indemnification, including without limitation, the right to take or receive from Primary Obligor, directly or indirectly, in cash or other property or by set-off or in any other manner, payment or security on account of such claim, remedy or right, unless and until all of the Primary Obligations and all other amounts payable under this Guarantee shall have been previously paid in full in immediately available funds. If any amount shall be paid to the Guarantor in violation of the preceding sentence at any time prior to the payment in full in immediately available funds of

the Primary Obligations and all other amounts payable under this Guarantee, such amount shall be received and held in trust for the benefit of the Beneficiary, shall be segregated from the other property and funds of the Guarantor, and shall forthwith be paid or delivered to the Beneficiary in the same form as so received (with any necessary endorsement or assignment) to be credited and applied to the Primary Obligations and all other amounts payable under this Guarantee, whether matured or unmatured, or to be held as collateral for any Primary Obligations or other amounts payable under this Guarantee thereafter arising.⁴¹

41. Beneficiaries often ask that this covenant be included to ensure that the guarantor does not commence an action against the primary obligor for reimbursement, or based on the guarantor's subrogation rights (although this is adequately covered by the proviso in the text to which annotation 40 relates), prior to the time of payment in full of the primary obligor's guaranteed obligations. Without this waiver, and with a separate reimbursement agreement in place that includes the relevant provisions, the guarantor would have the right to pursue reimbursement against the primary obligor whenever any payment was made under the guarantee, even a partial payment. Moreover, where the guarantor is an affiliate of the primary obligor, this sentence provides a basis whereby the beneficiary can prevent the guarantor from using its affiliated status to better its position with respect to the primary obligor after a payment under the guarantee has been made, but prior to payment in full of the primary obligor's guaranteed obligations. In some cases, the beneficiary will seek to obtain the guarantor's agreement that it will not seek any payment from the primary obligor in respect of any obligation owed by the primary obligor to the guarantor prior to payment in full of the primary obligation and will often try to ensure that no primary obligor assets are diverted to the guarantor until all amounts payable under the primary obligation agreement are paid in full. The primary obligor should note that if this broad prohibition is included, it could have a negative effect on the willingness of the guarantor to enter into additional relationships with the primary obligor, since its ability to exercise rights against the primary obligor (including for any payments owed) would not be exercisable in accordance with the terms of the applicable agreements until the guaranteed obligations were first completely satisfied.⊗ Given the important implications of this provision for the primary obligor with respect to the timing of repayments under a reimbursement agreement and the relationship between the primary obligor and the guarantor, the primary obligor will want to pay close attention to this provision.

Section 4. Binding Effect. This Guarantee shall be binding upon the Guarantor, its successors and assigns and shall inure to the benefit of the Beneficiary, its successors and assigns.⁴²

42. This sentence confirms both that the obligations under the guarantee remain effective even if the guarantor merges into another entity and that the obligations of the guarantee follow the primary obligation and will automatically transfer to any successors or assigns of the beneficiary, without the beneficiary being required to enter into a new guarantee with such successors or assigns to ensure continued validity of the guarantee.

Section 5. Notices, Severability. Any notice to the Guarantor or Beneficiary hereunder and any copy to the Guarantor of any notice delivered by the Beneficiary to the Primary Obligor under the Primary Obligation Agreement shall be in writing and mailed, postage prepaid, or sent by facsimile transmission to the following address and person or to such other address or person's attention as the Guarantor or Beneficiary shall notify each other from time to time.

[address]

[address]

Any notice addressed as provided above shall be deemed given three days after the date when deposited in the United States mail, postage prepaid, or when transmitted in the case of a facsimile notice. Any notice given in accordance with this provision shall not affect the obligations of the Guarantor under this Guarantee incurred before the termination date stated in the notice.⁴³ Wherever possible, each provision of this Guarantee shall be interpreted in such manner as to be effective and valid under applicable law, but if any provision of this Guarantee is held illegal or unenforceable, the validity of the remaining provisions shall not be affected.⁴⁴

43. This section sets forth the addresses and contacts of record for all exchanges of documents, information, and negotiations under this agreement, as well as the method by which information may be transmitted or delivered.

44. This sentence is intended to allow the parties to ignore any specific provision in the guarantee that is illegal or unenforceable and enables them to continue to observe all other provisions, rather than invalidating the entire agreement if one or more provisions are illegal or unenforceable.

Section 6. Governing Law; Submission to Jurisdiction. This Guarantee shall be governed by, and construed in accordance with, the law of [the State of New York].⁴⁵

45. New York law is typically selected because New York has a substantial body of law dealing with complex financial matters. The parties' desire for convenience and predictability as to the applicable law usually leads the parties to select the law of the guarantor's own jurisdiction or the law of New York or England (whose commercial law is well established). Even if the parties choose to specify their choice of law in such a clause, in some cases a court may decide to apply some other law to govern a matter deemed to have a strong public policy content, such as usury. Furthermore, any security interests (such as a lien or a mortgage) created to secure the loan to the primary obligor may be governed by the law of a separate jurisdiction, often the jurisdiction where the collateral is located.

An important purpose of this clause is to afford predictability as to which country's (or state's) law will apply in case a dispute erupts between the parties. If the agreement contains no express choice of law, a court might apply one of the following:

- (i) the law of the guarantor's country
- (ii) the law of the beneficiary's country
- (iii) the law of the primary obligor's country
- (iv) the law of the jurisdiction where suit is brought
- (v) the law of the jurisdiction with the most contacts with the transaction
- (vi) the law of the place where the guarantee is signed
- (vii) the law of the place where the guarantee is to be performed
- (viii) the law of the place with the greatest "interest" in the transaction
- (ix) under the "principle of validation," a law that the court deems will give effect to the intent of the parties

If parties to this guarantee wish to apply New York law to govern all conflicts relating to transactions entered into under this guarantee, the choice of law provision should be drafted broad enough to encompass extra-contractual disputes, such as fraud, misrepresentation, or other tort claims. One such formulation could be "This Guarantee and, to the fullest extent permitted by applicable law, all matters arising out of or relating in any way to this Agreement (whether arising in contract or tort), shall be governed by the law of the State of New York."

When a guarantor is organized under the laws of a jurisdiction other than New York, it is important to review with local counsel in the guarantor's jurisdiction the circumstances in which that local law may be held to override the contractual choice of law. In addition, the effect of such local law on guarantees should be investigated and this form of guarantee adapted if necessary.

The Guarantor irrevocably submits to the jurisdiction of the courts specified in [section reference] of the Primary Obligation Agreement [to resolve any controversy or claim arising out of or relating to this Guarantee][for purposes of any action or proceeding relating to this Guarantee]⁴⁶ and irrevocably appoint(s) the Process Agent identified in [section reference] of the Primary Obligation Agreement as its agent to receive service of summons or any other legal process in connection with any action or proceeding relating to this Guarantee brought in any such court.

46. This clause is designed to ensure that proceedings can be conducted in a particular jurisdiction—very often New York if New York law is chosen to govern the guarantee. A proper submission to jurisdiction is necessary to obtain a New York forum that will enforce the New York governing law clause included in Section 6 that might not be enforced by courts of other jurisdictions. This clause does not, however, provide for exclusive jurisdiction—actions may still be brought in another forum if there is jurisdiction.

The Guarantor irrevocably waives, to the fullest extent permitted by law, any defense or objection it may have that any such action or proceeding in any such court has been brought in an inconvenient forum.⁴⁷

47. In the event the beneficiary must enforce its rights under the guarantee in a court of law, this sentence, along with the previous sentence, will enable the beneficiary to bring suit against the guarantor in a court in its choice of jurisdiction.

Section 7. Amendment. This Guarantee shall not be amended, supplemented, or otherwise modified except by a writing signed by both the Guarantor and the Beneficiary.⁴⁸

48. In many jurisdictions, a written agreement that expressly states it can be modified only in writing cannot be modified orally. Under New York law, with certain exceptions, a written agreement that includes a clause stating that it cannot be changed orally, such as the clause above, cannot be changed by an agreement unless that agreement is in writing and is signed by the party against whom enforcement of the change is sought. In this context, although the beneficiary does not need to sign the guarantee, the beneficiary wants to

make explicit that the guarantor cannot change any term of the guarantee without getting the beneficiary's consent in writing.

Section 8. Other Agreements; Cumulative Rights. This Guarantee constitutes the entire agreement between the parties relating to the subject matter hereof and supersedes all prior or simultaneous agreements, written or oral.⁴⁹ All rights under this Guarantee and other documents delivered in connection with this Guarantee are cumulative and in addition to any other rights under applicable law.

49. **Other Agreements/Integration:** An “integration” or “merger” clause is meant to preclude disputes over whether an agreement is the final expression of the parties' agreement on its subject matter by establishing that this agreement is final and includes all the terms the parties agreed to include. This clause establishes that this written agreement is and should be understood to be the final agreement of guarantor and the beneficiary. Without this clause, in the event of a dispute over the content of this agreement, New York's parol evidence rule would apply to such agreement (governed by New York law). This rule would normally preclude consideration of evidence of the subject matter of the agreement—such as a conversation or letter between the guarantor and beneficiary dated before the agreement was executed—if that evidence is not consistent with the agreement. However, an exception to this rule exists when the written agreement does not appear to reflect the entire agreement of the parties (for example, if the parties forgot to include a provision that they had previously agreed to include). In that case, extrinsic evidence that is consistent with the loan agreement may be admissible to explain ambiguities or omissions. This type of clause, although not uncommon, is by no means universal.

[GUARANTOR]

By _____

Name:

Title:

ANNOTATED REIMBURSEMENT AGREEMENT

INTRODUCTION

The Annotated Guarantee addressed the basics of a commercial loan guarantee agreement and the relationships among the primary obligor (the microfinance institution [MFI] that receives the loan), the beneficiary (the lender, typically a local bank, that extends the loan to the MFI), and the guarantor (the development agency or investor that guarantees repayment in the event of default). The expectation is that the MFI will repay the loan itself, but if it fails to do so, the guarantor agrees to pay on the MFI's behalf. Under the laws of many countries, the guarantor has a legal right to be repaid as though it were the lender (known as a “subrogation right”^a) by the MFI for any amounts paid by the guarantor on the MFI's behalf. Additionally, under such laws, the MFI is generally required to reimburse the guarantor directly.

It is typical, however, for a guarantor to want its legal rights against the MFI for repayment of any funds paid on behalf of the MFI to be set out in a separate agreement—a reimbursement agreement—between the guarantor and the MFI rather than to depend on generally available legal principles. Once the guarantor covers a missed payment that should have been made by the MFI, the guarantor itself becomes a creditor of the MFI to the extent of that payment.

Even if the formal understanding between the guarantor and the MFI is that the MFI will promptly reimburse any drawing under the guarantee, in practice this is unlikely to happen. The MFI probably will not have the ready cash to effect that reimbursement, otherwise it would have paid the local bank directly and thereby avoided any need to draw under the guarantee in the first place. Accordingly, the reimbursement agreement is the document in which the guarantor will set out the terms—such as the interest rate applicable to any unreimbursed drawings—that will govern its relationship to the MFI if and when that relationship becomes one of creditor/debtor.

This section provides a basic guide for navigating the negotiation and drafting a reimbursement agreement should the parties choose to undertake such an agreement.

^aAs discussed in the Annotated Guarantee, subrogation is sometimes referred to as providing for one party (in this case, the guarantor) to “stand in the shoes of” another (the beneficiary).

Note that whereas the borrowing MFI is typically referred to as the primary obligor in the guarantee, the reimbursement agreement typically refers to the borrowing MFI as the “obligor” because, in the context of the direct relationship between the borrowing MFI and the guarantor set forth in the reimbursement agreement, the concepts of primary and secondary obligor are no longer relevant.

Bracketed text in the reimbursement agreement indicates either transaction-specific terms or optional text, which, if considered desirable, should be replaced with the specific text applicable to the context.

ANNOTATED SAMPLE REIMBURSEMENT AGREEMENT

This REIMBURSEMENT AGREEMENT¹ (Agreement) is dated as of [date] and made by and between [name of Guarantor entity], a [corporation] duly organized under the law of [Guarantor’s state of organization] (Guarantor) and [name of Obligor], a [corporation] duly organized under the laws of [Obligor’s state of organization] (Obligor).

WHEREAS, Obligor has entered into a [describe the transactions and the document creating the primary obligation] (Primary Obligation Agreement) with [name of Beneficiary entity], a corporation duly organized under the laws of [Beneficiary’s state of organization] (Beneficiary); and

WHEREAS, Guarantor entered into an irrevocable guarantee (Guarantee) to secure the obligations of Obligor to Beneficiary under the Primary Obligation Agreement.

NOW, THEREFORE, in consideration of the issuance of the Guarantee substantially in accordance with the terms and conditions provided by the Obligor as requested by Obligor in writing, Obligor unconditionally agrees as follows:

1. **Recitals.** Like guarantees and similar agreements, a typical reimbursement agreement begins with a preamble (an opening statement), followed by various recitals (“WHEREAS” clauses). The recitals are an often overlooked part of the agreement that serve as a useful, nontechnical summary of the goals and structure of the agreement and as an expression of the intent of the parties. The recitals are especially useful if the parties end up in court. Although recitals are not legally enforceable, the guarantor (and also the obligor) should nonetheless take care that the recitals are not more limiting than the terms of the agreement itself. Additional recitals could be used to express the intent of the parties or any other relevant background to the transaction.

1. *Reimbursement.*² The Obligor agrees, on the terms and conditions set forth in this Agreement, to reimburse Guarantor for any and all amounts paid by Guarantor under the Guarantee (Guarantee Amounts) immediately following any such payments.

2. **Purpose.** This section sets forth the MFI's basic obligation to reimburse the guarantor for the amounts it paid under the guarantee to the beneficiary of the guarantee.

2. *Commission, Fees, Charges, and Expenses.*³ For so long as the Guarantee is outstanding, the Obligor agrees that it will pay to the Guarantor a quarterly guarantee fee (Guarantee Fee) equal to [●]% of the undrawn principal amount of the Guarantee. The Guarantee Fee shall be calculated on the basis of the actual number of days elapsed and shall be payable quarterly in arrears on March ____, June ____, September ____, and December ____ of each year, commencing on the first such date to occur after the effective date of the Guarantee. [variants: [⊖ commissions, fees, and other charges on the Guarantee (for so long as Guarantor shall be obligated under the Guarantee in accordance with applicable law) at such rates and times as Obligor and Guarantor may agree in writing] or, in the absence of such an agreement [⊕ in accordance with the Guarantor's commission, fees, and other changes then in effect, payable on demand].

3. Typically, the guarantor charges fees as compensation for assuming the risk of the MFI's default on its loan and providing the service of issuing and maintaining the guarantee. The first negotiation point is the amount of the fees, which can range as high as 4.5 percent of the guarantee amount and average 2 percent (Flaming, 2007). A variant of the first clause above relating to a guarantee fee may be acceptable, but the MFI will wish to ensure that its separate agreement with the guarantor concerning the fees covers the entire period during which the guarantee will be outstanding, and does not provide the guarantor with discretion either to charge additional fees (unless such fees are clearly defined and acceptable to the MFI) or to change the applicable fee without the MFI's consent. In particular, the bracketed language within the second alternative version of the clause above allows the guarantor, in the absence of a separate written agreement, to change its fees at any time and should be avoided.

3. *Payments; Interest on Past Due Amounts; Computations.* All amounts due from Obligor shall be paid to Guarantor to such account as Guarantor may designate in writing, without defense, set-off, cross-claim, or counterclaim of any kind, and in immediately available funds, *provided, however*, that if any such amount is denominated in a currency other than United States Dollars, Obligor will pay the equivalent of such amount in United States Dollars computed at Guarantor's selling rate for cable transfers to the place where and in the currency in which such amount is payable, or such other currency, place, form, and manner acceptable to Guarantor in its sole discretion. Any amount not paid when due shall bear interest until paid in full at a daily fluctuating interest rate per annum equal to [two percent (2.00%) per annum]⁴ above the rate of interest announced publicly for each such day by [●] Bank.⁵ Unless otherwise agreed in writing as to the Guarantee, all computations of commissions, fees, and interest shall be based on a 360-day year and actual days elapsed.

4. **Applicable Interest Rate.** The expectation is that the MFI will reimburse the guarantor immediately upon payment, but given the possibility the MFI may not be able to pay right away, or that the beneficiary (lender) will not be permitted to let the MFI pay (if, e.g., the loan has not yet been paid in full) the amount outstanding will accrue at a certain rate of interest, which typically includes a penalty margin. The size of the penalty margin of that interest rate is a subject of frequent negotiation. One percent or 2 percent above the guarantor's pricing^b is typical, but banks sometimes ask for much more. In some countries, penalty interest is prescribed or limited by statute.
5. **Interest for Repayments Not Paid When Due.** Many reimbursement agreements specify that the interest rate on overdue reimbursement payments will be higher than the interest rate applicable to a loan for the same amount of principal. The purpose of this increase is to compensate the guarantor for the additional risk and administrative expense involved in a reimbursement obligation that is, by definition, in default. The higher interest rate is designed to give the MFI an added financial incentive to cure the payment default, if possible.

^bPricing may also be referred to as a "base rate" if the agreement follows U.K. terminology conventions.

4. *Taxes.*⁶ All payments made to Guarantor shall be made free and clear of and without deduction for any present or future taxes, levies, imposts, deductions, charges, or withholdings, and all related liabilities^c imposed by the Government of [●] or any political subdivision or taxing authority thereof or therein or any other jurisdiction from or through which the Obligor makes payment hereunder⁷ (all such taxes, levies, imposts, deductions, charges, withholdings, and liabilities are called “Taxes”). If any Taxes shall be required by law to be deducted from or in respect of any sum payable under this Agreement, (a) the sum payable under this Agreement shall be increased as may be necessary so that, after making all required deductions, Guarantor receives an amount equal to the sum Guarantor would have received had no such deductions been required, (b) Obligor shall be responsible for payment of the amount to the relevant taxing authority, (c) Obligor shall indemnify Guarantor on demand for any Taxes paid by Guarantor (other than Taxes for which no additional amounts are payable pursuant to this Section 4) and any liability (including penalties, interest, and expenses) arising from its payment or in respect of such Taxes, [☺ if] [☹ whether or not] such Taxes were correctly or legally asserted,⁸ and (d) Obligor shall provide Guarantor with the original or a certified copy of the receipt evidencing each Tax payment within 30 days of the tax payment date;⁹ [optional language: provided, however], that no such additional amounts shall be payable in respect of¹⁰ [☺ (i) any Taxes imposed on the Guarantor by reason of any connection between the Guarantor and the taxing jurisdiction other than entering into this Agreement and receiving payments hereunder]¹¹ [☺ or (ii) any Taxes imposed by reason of the Guarantor’s failure to comply with any certification, identification, information, documentation, or other reporting requirement if (A) such compliance is required by law, regulation, administrative practice, or an applicable treaty as a precondition to exemption from, or reduction in the rate of, deduction or withholding, and (B) at least [30 days] prior to the first payment date with respect to which the Obligor shall apply this subsection (ii), the Obligor shall have notified the Guarantor that the Guarantor will be required to comply with such requirement.¹² [☺ Notwithstanding the foregoing, in the event of an assignment and delegation by the Guarantor of its rights and obligations under this Agreement, the Obligor shall not be required to pay to such assignee or successor any amount greater than that which the original Guarantor would have been entitled to receive with respect to the rights assigned.]¹³

^cThe MFI might also consider getting a representation or covenant from the guarantor if the MFI is relying on an exemption from withholding based on the guarantor’s status.

6. **Purpose.** The MFI's or the guarantor's jurisdiction may impose a tax on payments made under the agreement, which such jurisdiction collects by requiring the MFI to withhold or deduct the amount of the tax from payments to the guarantor. It is customary for the MFI to agree to a tax gross-up clause to shift to the MFI the risk that a withholding tax might be imposed on payments due under the agreement. The provision requires the MFI to gross-up its payments to ensure that the guarantor receives the payment amount it would have received had there been no withholding tax. If the withholding tax is 20 percent and the gross-up amount itself is not subject to the tax, the MFI will have to pay \$120 (\$100 plus a gross-up amount of \$20) in respect of each \$100 payment due the guarantor. If the gross-up amount is also subject to the 20 percent withholding tax (which is typically the case), then the MFI will have to pay \$125 in respect of each \$100 payment due the guarantor, calculated by dividing \$100 by $(100\% - 20\%)$. Only by paying the guarantor \$125 will the guarantor receive the \$100 payment due (after 20 percent of the \$125 is withheld).
7. **BEWARE!** Although it may be fair for the guarantor to seek a gross-up for taxes imposed by the jurisdiction where the MFI is organized, a gross-up clause that purports to shift to the MFI the risk of any tax being imposed anywhere in the world on payments due under the loan agreement is unreasonable, and the MFI should avoid it. The model clause above is limited to taxes imposed by (i) the jurisdiction in which the MFI is organized and (ii) any other jurisdiction from or through which the MFI makes payment. The rationale for having a gross-up for taxes imposed by the jurisdiction through which the MFI makes payment is that the MFI will be able to control the method by which it makes payments and should therefore accept liability for any taxes imposed by a jurisdiction through which such payments are made.
8. **BEWARE!** The guarantor may propose a version of this clause (c) that is inappropriately broad. The parenthetical exclusion of indemnity payments for amounts that are excluded under Section 4 is necessary to ensure that the indemnity clause does not supersede the exceptions set forth in Section 4 by requiring that the MFI reimburse the guarantor for taxes that otherwise would be excluded (for example, the guarantor's normal income taxes). In addition, guarantors frequently include the "whether or not such Taxes were correctly or legally asserted" language, although the MFI should take the position that

it should not be required to indemnify the guarantor for taxes that clearly are incorrectly imposed. (Note that, because the guarantor will expect to be indemnified in respect of such taxes, it will have no incentive to challenge even the most frivolous tax claims.)

9. **BEWARE!** The provision of a receipt for payment of taxes within 30 days may not be practicable in all jurisdictions. The MFI should be careful to agree to a time restriction that it will be able to meet.
10. The MFI should consider proposing one or more of the following exceptions listed below to its obligation to gross-up payments in respect of taxes, in each case after considering the withholding and other tax laws in the applicable jurisdictions to assess the risk of such taxes being imposed on payments under the agreement.
11. **Tax Gross-up, First Optional MFI-Friendly Clause.** This clause carves out (excludes) from the MFI's gross-up obligation any taxes the guarantor would otherwise be responsible for, such as income taxes imposed by the guarantor's taxing jurisdictions. This formulation is a MFI-favorable provision. A more guarantor-favorable provision would specifically carve out income and franchise taxes imposed on a guarantor by the guarantor's taxing jurisdiction, thus leaving the MFI (obligor) responsible for any other taxes imposed on the guarantor by the taxing jurisdiction, even those not connected to the agreement. An example of such a clause would be as follows: "provided, however, that no such additional amounts shall be payable in respect of any Taxes imposed by the jurisdiction of guarantor's head office or the office issuing the guarantee or any of its political subdivisions."
12. **Tax Gross-up, Second Optional MFI-Friendly Clause.** Clause (ii) carves out from the MFI's gross-up obligation any taxes imposed due to a failure of the guarantor to provide certification that would reduce or eliminate the withholding tax applicable to payments made by the MFI. The MFI should not be obligated to gross up for withholding tax at the maximum rate, when the rate can be reduced or eliminated if the guarantor complies with certification requirements. Many jurisdictions require certification as a precondition to a reduction or elimination in the rate of withholding.
13. **Tax Gross-up, Third Optional MFI-Friendly Clause.** This provision limits the obligation of the MFI so that it pays no amount to a subsequent guarantor (the transferee, assignee, or successor, in this case) that is greater than the

withholding tax rate of the original guarantor (the transferor or assignor, in this case). An alternative way of protecting the MFI from paying additional amounts as a result of an assignment is to include language that restricts the assignment rights of the guarantor completely or subjects it to the consent of the MFI.

5. *Indemnification.*¹⁴ Obligor will indemnify and hold Guarantor and its officers, directors, affiliates, employees, attorneys, and agents harmless from and against any and all claims, liabilities, losses, damages, costs, and expenses including, without limitation, reasonable fees and disbursements of [© special] counsel,¹⁵ other dispute resolution expenses (including fees and expenses in preparation for a defense of any investigation, litigation, or proceeding) and costs of collection that arise out of or in connection with or by reason of the enforcement of this Agreement.¹⁶

14. **Indemnification.** It is customary for the MFI (obligor) to agree to “indemnify” the guarantor for costs associated with any need to enforce the agreement. Two potentially significant sources of indemnification by the MFI under this section are the following (annotations 15 and 16).

15. **Special Counsel.** The MFI should resist paying the fees of the guarantor’s “in-house” (as opposed to “special” or “outside”) counsel.

16. **Enforcement Proceedings.** In some jurisdictions (the United States, for example), a party’s expenses incurred in enforcing a contract through litigation are not automatically recoverable even if that party wins the lawsuit. This explains the guarantor’s desire to have the agreement contain a separate undertaking by the MFI (obligor) to pay such enforcement expenses. Under this clause, the guarantor is entitled to indemnification for costs and expenses incurred in enforcing the agreement. Therefore, if the guarantor alleges that the MFI has defaulted under the agreement and initiates legal proceedings, the MFI will have to reimburse the guarantor’s costs and expenses in connection with that action (including attorneys’ fees).

6. *Obligations Absolute: Limitations of Liability.*¹⁷ Obligor's obligations under this Agreement (Obligations) shall be unqualified, irrevocable, and payable in the manner and method provided for under this Agreement irrespective of any one or more of the following circumstances: (i) any lack of validity or enforceability of this Agreement, the Guarantee, or any other agreement, amendment, guaranty, document, or instrument relating thereto, (ii) any change in the time, manner, or place of payment of or in any other term of all or any of the Obligations of Obligor or the obligations of any person or entity that guarantees the Obligations, or (iii) the existence of any claim, set-off, defense, or other right that Obligor may have at any time against any beneficiary or any transferee of the Guarantee (or any person or entity for whom any such beneficiary or transferee may be acting), Guarantor, or any other person or entity, whether in connection with any transaction contemplated by this Agreement or any unrelated transaction, or any claim by Guarantor or Obligor against the beneficiary of the Guarantee for breach of warranty.¹⁸

17. **Purpose.** In this section, the guarantor is asking the MFI (obligor) to waive or limit a number of rights the MFI might otherwise have.

18. This clause provides that the MFI will be required to reimburse the guarantor under the terms of the agreement even if the MFI has the various defenses listed above, including "set-off rights," to payment of the beneficiary under the primary obligation agreement. This clause is standard in guarantee reimbursement agreements, and from the guarantor's perspective, this clause is necessary because the guarantor typically waives its defenses under the guarantee.

7. *Representations and Warranties of Obligor.*¹⁹ Obligor represents and warrants that (a) it is validly existing and in good standing under the laws of the jurisdiction in which it is organized and is duly qualified to do business and is under good standing under the laws of each other jurisdiction that requires such qualification, [except where failure to qualify or be in good standing would not have a material adverse effect on the financial condition, earnings or business affairs of the Obligor];²⁰ (b) its execution, delivery, and performance of this Agreement are within its powers, have been duly authorized, do not contravene any contract binding on or affecting it or any of its properties, do not violate any applicable law or regulation, and do not require any notice, filing, or other action to or by any governmental authority;²¹ (c) this Agreement constitutes a valid and legally binding obligation of the Ob-

ligor enforceable against the Obligor in accordance with its terms, [except as such enforceability may be limited by applicable bankruptcy, insolvency, reorganization, moratorium, or other similar laws now or hereafter in effect affecting the enforcement of creditors' rights generally and except as such enforceability maybe limited by general principles of equity (whether considered in a proceeding at law or in equity)];²² (d) there are no proceedings or investigations pending against the Obligor²³ before any court, regulatory body, administrative agency, or other tribunal or governmental instrumentality (i) asserting the invalidity of this Agreement, the Guarantee, or any transaction related to the Guarantee or (ii) seeking any determination or ruling that could materially and adversely affect²⁴ the performance by the Obligor of its obligations under this Agreement or the validity or enforceability of this Agreement.

19. **General Explanation of Representations and Warranties.** The main purpose of the representations and warranties is to elicit information to enable the guarantor to make an informed decision. The MFI makes representations and warranties with respect to facts that the guarantor relies upon when agreeing to issue the guarantee to the beneficiary. If any representation or warranty is determined to be inaccurate before the guarantee is issued, the guarantor may withhold the guarantee. For more information, see CGAP (2006, pp. 25–28).

BEWARE! The MFI should review the representations and warranties to ensure that they do not conflict with and are no more onerous than those in the loan agreement.

20. **Valid Existence and Good Standing.** The representation as to the organization and good standing of the MFI is very common, as is the “materiality” qualifier.

21. **Power to Execute the Agreement.** Like the representation regarding the organization of the MFI, it is customary to find a representation in which the MFI represents that it has undertaken all necessary steps to execute the agreement (e.g., authorization of the guarantee application and the agreement by its board of directors). If certain requirements can be accomplished only *after* the agreement is signed, those requirements should be explicitly identified as not falling within the language of the relevant representation, and the MFI should be willing to add a covenant to complete such post-signing requirements promptly.

22. **Valid and Binding Agreement.** Like the representations before it, this representation is customary. The MFI represents that the agreement has been executed and delivered properly and that the agreement is legal, valid, and binding on the MFI, subject to certain events that may affect that enforceability, notably insolvency proceedings.
23. **No Material Actions.** The main purpose of this representation is to require the MFI to investigate and fully disclose information about pending and threatened litigation, because financial statements include only limited disclosure on this subject. It is appropriate and important that the MFI include “knowledge” and “materiality” qualifiers with respect to threatened lawsuits and other contingencies to (i) prevent the guarantor from [declaring a default under the agreement or] escaping from its commitment because the MFI does not disclose threatened litigation of which it was not aware and (ii) avoid having to list irrelevant litigation matters.
24. **Optional Language.** If any claim or dispute (whether or not currently being litigated or arbitrated) might have a material adverse effect on the agreement, it should be addressed in a schedule (a separate section typically included in legal agreements to list items too lengthy to include in the body of the agreement), including a statement that the schedule contains a complete and accurate description of each claim or dispute. The guarantor may also request a letter from the MFI’s counsel describing outstanding litigation and gauging the likelihood of the opposing party’s success in each case.

8. *Covenants of the Obligor.*²⁵ The Obligor covenants and agrees that, so long as the Guarantee or this Agreement shall remain in effect, unless the Guarantor shall otherwise consent in writing, where such consent is not to be unreasonably withheld, the Obligor will:

(a) preserve and maintain its existence, rights, franchises, and privileges as a [name of jurisdiction of incorporation] [type of business entity], in the jurisdiction of its organization, necessary for the conduct of its business, and qualify and remain qualified as a [type of business entity] in each jurisdiction in which such qualification is necessary or desirable in view of its business and operations or the ownership of its properties.

(b) pay and discharge all taxes, assessments, and governmental charges or levies imposed upon it or upon its income or profits, or upon any properties belonging to it, prior to the date on which, if unpaid, any such tax, assessment, governmental charge, or levy might become a lien or charge upon any properties of the Obligor, provided that the

Obligor shall not be required to pay any such tax, assessment, governmental charge, or levy that is being contested in good faith and by proper proceedings;²⁶

(c) not merge or consolidate with any other corporation, limited liability company, or partnership unless the Obligor is, or upon consummation of the merger or consolidation will become, the surviving entity.

25. **General Explanation of Covenants.** “Covenants” are promises about the future. In this context, covenants deal with the conduct and financial situation of the MFI *after* the guarantee is issued. Failure to abide by a covenant is one possible basis for the guarantor’s declaration of default under the agreement. Covenants in loan agreements are usually heavily negotiated, because they can impose significant constraints on the borrower’s conduct of its business. Covenants, particularly covenants that impose certain financial soundness requirements on the MFI (obligor), are seen as important by lenders, because repayment of the loan depends on maintenance of the borrower’s creditworthiness on an ongoing basis after the loan is issued. The covenants should be carefully reviewed by the MFI to ensure that they do not impose requirements that would be difficult or costly for the MFI to meet given its particular circumstances. In addition, if the guarantor is also the lender under a hard currency loan agreement, the MFI should request that any similar covenants in both agreements be harmonized so as to avoid duplicative requirements. For a fuller discussion of the principal types of covenants encountered by MFIs, see CGAP (2006, pp. 28–31).

BEWARE! The MFI should review the covenants to ensure that they do not conflict with and are no more onerous than those in the loan agreement.

26. Because governmental claims for unpaid taxes often have priority over claims of other creditors in the event of the MFI’s insolvency, guarantors include covenants like the one above. Generally, guarantors resist agreeing to a grace period for breach of such a covenant, but they may agree to a grace period that is shorter than that accorded to breaches of other covenants.

9. *Set-off.*²⁷ Subject to the limitations set forth in Section 3 of the Guarantee, if any default under the Agreement shall occur and be continuing, Guarantor may set-off any and all of the Obligations, irrespective of whether or not Guarantor shall have made any demand under this Agreement and although such obligations may be unmatured or contingent.²⁸ Guarantor's rights under this Section are in addition to other rights (including other rights of set-off) that Guarantor may have under this agreement or applicable law.

27. See note 28 in Annotated Guarantee (p. 20) for discussion of set-off rights.

28. **Negotiation Point.** In some instances, the set-off provision may contain broader language allowing the guarantor to offset the MFI's obligations against other deposits with the guarantor and/or other obligations of the guarantor to the MFI. The impact of such a provision depends on the MFI's other relationships with the guarantor: Does the MFI have deposits at the guarantor? Does the guarantor owe the MFI money under other contracts or transactions? Does the MFI expect that the guarantor will owe it money in the future? If so, will the guarantor's set-off rights over these other deposits and obligations interfere with the MFI's ability to respect its obligations under the relevant transactions or reduce their economic benefits to the MFI? The MFI should carefully consider these questions and, where appropriate, require that other transactions be excluded from the guarantor's right of set-off under this provision and applicable law.

10. *Waiver of Immunity.*²⁹ Obligor acknowledges that this Agreement is, and the Guarantee will be, entered into for commercial purposes and, to the extent that Obligor now or later acquires any immunity from jurisdiction of any court or from any legal process with respect to itself or its property, Obligor now irrevocably waives its immunity with respect to the Obligations [☺ to the fullest extent permitted by applicable law].³⁰

29. **Purpose.** Some legal entities, like governments and government officials, are granted different levels of immunity (sometimes only temporary or partial) from lawsuits. Different countries have different rules about who gets immunity and under what conditions, but often, immunity from lawsuits can be waived by the beneficiary of such immunity. This section is meant to ensure that the guarantor will still have a legal remedy against the MFI even if the MFI were immune from lawsuits presently or were to somehow benefit from an immunity law in the future.

30. **Negotiating Point.** Although the guarantor may ask the MFI (obligor) to waive any and all of its immunity from lawsuits, the law in the MFI's home jurisdiction may not permit the MFI to waive certain types of immunity. The MFI may attempt to negotiate a limitation on the waiver such as the phrase "to the fullest extent permitted by applicable law" to acknowledge this possibility.

11. *Notices; Interpretation; Severability.*³¹ Notices shall be effective, if to Obligor, when sent to its address indicated below the signature line and, if to Guarantor, when received at _____, or as to either, such other address as either may notify the other in writing. If this Agreement is signed by two or more persons or entities, (i) each such person or entity shall be deemed an "Obligor" hereunder, (ii) each Obligor shall be jointly and severally liable for all the Obligations hereunder,³² and (iii) notices from Guarantor in connection with this Agreement or the Guarantee to either Obligor and notices from, or the consent of, either Obligor in connection with this Agreement or the Guarantee shall be sufficient to bind all Obligors. Headings are included only for convenience and are not interpretative. The term "including" means "including without limitation." Wherever possible, each provision of this Guarantee shall be interpreted in such manner as to be effective and valid under applicable law, but if any provision of this Guarantee is held illegal or unenforceable, the validity of the remaining provisions shall not be affected.³³

31. **Notices.** This section sets forth the addresses and contacts of record for all exchanges of documents, information, and negotiations under this agreement, as well as the method by which information may be transmitted or delivered.

32. **Joint and Several Liability.** Joint and several liability is a legal term of art that refers to the method of apportioning money damages in a civil suit between two or more defendants. This term is relevant in this section of the agreement only if more than one MFI signs as an obligor. If there are multiple MFI obligors and if more than one MFI fails to live up to its obligations under the agreement, the guarantor can potentially sue (in a civil, not a criminal, case) just one of the MFIs for *all* of the money damages the guarantor suffered even though the particular MFI sued may have been only *partially* responsible for those damages. If the guarantor is successful in its lawsuit, it is up to the MFIs to apportion the damages more equitably among themselves, either through a negotiated settlement or another lawsuit.

33. **Severability.** This clause is intended to allow the parties to ignore any specific provision in the agreement that is illegal or unenforceable and enables them to continue to observe all other provisions, rather than invalidating the entire agreement if one or more provisions are illegal or unenforceable.

12. *Successors and Assigns.*³⁴ This Agreement shall be binding upon and inure to the benefit of Obligor and Guarantor and their respective successors and permitted assigns. Obligor shall not voluntarily transfer or otherwise assign any of its obligations under this Agreement. Guarantor may transfer or otherwise assign its rights under this Agreement, in whole or in part, and shall be forever relieved from any liability with respect to the portion of Guarantor's rights transferred or assigned. Obligor acknowledges that information pertaining to Obligor as it relates to this Agreement or the Guarantee may be disclosed to (actual or potential) transferees or assignees. This Agreement shall not be construed to confer any right or benefit upon any person or entity other than Obligor and Guarantor and their respective successors and permitted assigns.

34. **Successors and Assigns.** This clause binds any successors in interest to the MFI or to the guarantor to the terms of the agreement ("successors in interest" are institutions or individuals that may take over the interests of the MFI or the guarantor through a sale, acquisition, merger, or other transfer of the rights and responsibilities under an agreement). This is especially helpful to the guarantor in situations where the control and/or ownership of the MFI may be in question, or where the MFI has historically changed ownership frequently. Note, however, that an assignment by the guarantor may subject the MFI to additional tax risk, unless Section 4 appropriately excludes such additional taxes. See Annotation 13.

13. *Modification; No Waiver.* None of the terms of this Agreement may be waived or amended except in a writing signed by the party against whose interest the term is waived or amended.³⁵ Forbearance, failure, or delay by Guarantor in the exercise of a remedy shall not constitute a waiver, nor shall any exercise or partial exercise of any remedy preclude any further exercise of that or any other remedy. Any waiver or consent by Guarantor shall be effective only in the specific instance and for the specific purpose for which it is given and shall not be deemed, regardless of frequency given, to be a further or continuing waiver or consent.³⁶

35. See note 48 in Annotated Guarantee (p. 29) for discussion of modification of terms.
36. **No Waiver.** These clauses establish that, even if the guarantor does not seek to enforce a right (or remedy) under this agreement immediately, or does not completely exercise such a right (or remedy), it does not give up that right (or the ability to seek that remedy later).

14. *Other Agreements; Rights Cumulative; Delivery by Facsimile.* This Agreement constitutes the entire agreement between the parties relating to the subject matter hereof and supersedes all prior or simultaneous agreements, written or oral.³⁷ All rights under this Agreement and other documents delivered in connection with this Agreement are cumulative and in addition to any other rights under applicable law. Delivery of a signed signature page to this Agreement by facsimile transmission shall be effective as, and shall constitute physical delivery of, a signed original counterpart of this Agreement.³⁸

37. **Other Agreements/Integration.** An “integration” or “merger” clause is meant to preclude disputes over whether an agreement is the final expression of the parties’ agreement on its subject matter by establishing that this agreement is final and includes all the terms the parties agreed to include. This clause establishes that this written agreement is and should be understood to be the final agreement of the MFI (obligor) and the guarantor. Without this clause, in the event of a dispute over the content of this agreement, New York’s parol evidence rule would apply to such agreement (governed by New York law). This rule would normally preclude consideration of evidence of the subject matter of the agreement—like a conversation or letter between the guarantor and MFI dated before the agreement was executed—if that evidence is not consistent with the agreement. However, an exception to this rule exists when the written agreement does not appear to reflect the entire agreement of the parties (for example, if the parties forgot to include a provision that they had previously agreed to include). In that case, extrinsic evidence that is consistent with the loan agreement may be admissible to explain ambiguities or omissions.
38. **Delivery by Fax/Counterparts.** A counterpart is an original, signed copy. This clause enables multiple copies of the agreement to be signed by different parties with the signature pages then put together to form a single agreement. This

provision is especially helpful in situations where the parties are geographically separated and is also helpful to ensure that the signing progresses quickly. It also may be called the “separability” clause. Copies of the entire executed agreement should be maintained by the MFI and by the MFI’s counsel.

15. *Termination; Surviving Provisions.* This Agreement shall be terminated only upon payment in full to Guarantor of all obligations hereunder. Restrictive provisions in this Agreement, such as indemnity, tax, immunity, and jurisdiction provisions shall survive termination of this Agreement.³⁹ If the Guarantee is issued in favor of any bank or other financial or commercial entity in support of an undertaking issued by such bank or entity on behalf of Obligor or Guarantor, Obligor shall remain liable under this Agreement (even after expiry of the Guarantee) for amounts paid and expenses incurred by Guarantor with respect to the Guarantee or the undertaking until Guarantor is released by such other bank or entity.⁴⁰

39. **Termination.** The obligations of the MFI under the agreement will terminate when it has repaid the guarantor in full for any payments by the guarantor of guarantee amounts under the guarantee.
40. **Surviving Provisions.** This clause states that the provisions relating to indemnification, the payment of taxes, immunity, and jurisdiction will last even after the obligations under the agreement have been completely repaid.

16. *Governing Law.*⁴¹ This Agreement and the rights and obligations of Obligor and Guarantor hereunder shall be governed by and subject to the laws of [the state of New York and applicable UNITED STATES federal laws].

41. **Governing Law.** See note 45 of the Annotated Guarantee (p. 28).

17. *Submission to Jurisdiction; Service of Process.* Obligor now irrevocably submits to the nonexclusive jurisdiction of any state or federal court sitting in New York, New York, for itself, and in respect of any of its property and, if a law other than New York, U.S.A., has been chosen to govern the Guarantee, Obligor also now irrevocably submits to the nonexclusive jurisdiction of any state or federal court sitting in such jurisdiction. Obligor agrees not to bring any action or proceeding against Guarantor in any jurisdiction not described in the immediately preceding sentence. Obligor irrevocably waives any objection to venue or any claim of inconvenience.⁴² Obligor agrees that any service of process or other notice of legal process may be served upon it by mail or hand delivery if sent to, at _____ which Obligor now designates its authorized agent for the service of process in the courts in the State of New York.⁴³ (If no authorized agent is designated in the space provided above, Obligor agrees that process shall be deemed served if sent to its address given for notices under this Agreement). Obligor agrees that nothing in this Agreement shall affect Guarantor's right to serve process in any other manner permitted by law or to commence legal proceedings or otherwise proceed against Obligor in any other jurisdiction. Obligor agrees that final judgment against it in any action or proceeding shall be enforceable in any other jurisdiction within or outside the United States, by suit on the judgment, a certified copy of which shall be conclusive evidence of the judgment.

42. **Jurisdiction.** If the agreement provides for submission to a foreign jurisdiction (such as a state of the United States), the agreement may provide that the guarantor may also bring and enforce a proceeding in the local jurisdiction, or any other jurisdiction where the MFI or any of its property may be found.
43. **Agent for Service of Process.** An MFI would typically hire a company (there are several that provide this as a standard service) to receive legal notices on the MFI's behalf in a jurisdiction like New York—this is what is meant by an “agent for service of process.” Such an agent would then transmit those legal notices to the MFI. In this case, the MFI will likely already have an agent for service of process in that particular jurisdiction, because the hard currency loan agreement will typically require the appointment of such an agent.

18. JURY TRIAL WAIVER.⁴⁴ THE OBLIGOR AND GUARANTOR EACH IRREVOCABLY WAIVES ITS RIGHT TO A JURY TRIAL OF ANY CLAIM, COUNTERCLAIM OR CAUSE OF ACTION BASED UPON OR ARISING OUT OF THIS AGREEMENT, GUARANTEE, OR ANY DEALINGS WITH ONE ANOTHER RELATING TO THE SUBJECT MATTER OF THIS AGREEMENT.

44. **Waiver of Jury Trial.** It is common for the guarantor to seek to require that the MFI waive any right it might have to jury trials in the agreement. This clause assumes that the agreement is enforceable in a jurisdiction that provides a right to a trial by jury, such as New York. If the agreement is to be enforced in a jurisdiction that does not provide for a right to trial by jury, this section is unnecessary. Counsel should be consulted as to the enforceability of such waivers in the relevant jurisdictions, and as to whether a waiver in any particular form is more likely to be enforced.

19. *Counterparts.* This Agreement may be signed in counterpart with all of such counterparts constituting one and the same instrument.

Signed,

Obligor: _____
(Company Name)

By: (Authorized Signer):

(Signature)

(Print Name)

(Title)

Address: _____

[Co-Obligor (if any):

By (Authorized Signer):

(Signature)

(Print Name)

(Title)

Address: _____
_____]

(For Guarantor Use only)

Approval to Issue

[Guarantor Office/Representative] (Signature & Stamp)

(Other required Signature & Stamp)

References

CGAP. 2006. *Commercial Loan Agreements: A Technical Guide for Microfinance Institutions*. Washington, D.C.: CGAP.

Flaming, Mark. 2007. "Guaranteed Loans to Microfinance Institutions: How Do They Add Value?" Focus Note 40. Washington, D.C.: CGAP.

