



NAVIGATING COMPLEXITIES. DELIVERING RESULTS

## Bank Guarantees Are a Thing of the Past

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If someone had told us three or four years ago that we'd be writing an article about the decline of bank guarantees in EPC projects, we would have laughed. But life, as always, had other plans.

Why is a bank guarantee no longer an effective tool for converting to cash for an Employer in a construction project under an EPC structure—or, frankly, under any other structure—not just in Russia but, dare we say, globally?

There are several reasons:

### **1. Shift toward national protectionism for issuing banks**

Unscrupulous foreign contractors have discovered a new way to block payments under bank guarantees: they apply to a domestic court in their country to prohibit the issuing bank from paying the guarantee to the beneficiary (the Employer under the contract).

For decades, the core legal principle behind bank guarantees remained unquestioned: *payment on first demand*. This meant that the issuing bank would first pay the beneficiary and only then deal with any objections from the principal.

Let's recall the **UN Convention on Independent Guarantees and Stand-by Letters of Credit** (New York, December 11, 1995) (the "Convention"). The Russian Federation did not accede to the Convention, although its neighbor Belarus did so in 2002. The United States also ratified it.

Under Article 19 of the Convention, there are limited exceptions when payment may be withheld, namely:

- (i) a document is forged;
- (ii) the payment is not due on the grounds stated in the demand;
- (iii) based on the nature of the obligation, there is clearly no right to payment.

Thus, only clear-cut fraud used to be a valid reason for refusing payment, including under the URDG (Uniform Rules for Demand Guarantees). [Source.]

However, since 2022, the situation has shifted, and there have been cases where a foreign contractor successfully obtained a court order in their home country preventing the issuing bank from making payment to the beneficiary. These are no longer outlier cases—they're becoming part of the new normal.

## **2. Sanctions restrictions**

Even if the contractor isn't abusing the legal system, there may be another risk: the Employer could find themselves on an SDN list or under secondary sanctions. In such cases, the issuing bank may be technically unable to process the payment in favor of the sanctioned party. This would require a special license from the relevant U.S. regulator—a process that is often slow and not always successful.

### **So what can be done?**

To mitigate these risks, we strongly recommend that Russian Employers in EPC projects avoid relying on bank guarantees where the contractor is a foreign legal entity—even from a so-called “friendly” country.

Instead, **retention mechanisms through escrow accounts** can be effectively integrated into the EPC Agreement. As for corporate guarantees—caution is advised. The jurisdiction in which the contractor is incorporated matters significantly, as this affects the enforceability of such instruments.

A similar warning applies to **suretyships**: neither Russian nor English law treats them as fast-track instruments for obtaining cash. If the surety refuses to pay, the Employer will face lengthy litigation before any funds can be recovered.

In short, be vigilant in today's global environment.

#bankguarantees #EPC #sanctions #industrialconstruction

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