Letters of comfort: a comparative law and trans-systemic analysis of chameleonic instruments

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LETTERS OF COMFORT: A COMPARATIVE LAW AND TRANS-SYSTEMIC ANALYSIS OF CHAMELEONIC INSTRUMENTS

By

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Submitted in fulfilment of the requirements for the degree of

Doctor of Philosophy

From the University of New South Wales

Law School
University of New South Wales
Year of submission: 2010
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Over the last few decades, banks throughout the world have found it increasingly difficult to obtain outright guarantees from companies to cover loan or other financial facilities to subsidiaries. Consequently, various third party credit support devices or comfort instruments, generally known as letters of comfort, have developed to provide an alternative to traditional forms of security. It is necessary for a proper understanding of these instruments to investigate their origin, to delineate them, and to consider their use in corporate group and banking practice.

The typical comfort letter transaction involves the parent-subsidiary-lender trinity and at least three different, but inter-related relationships which may be regulated by different legal regimes - first, between a lender and the subsidiary; secondly, between a lender and the parent company; and thirdly, between the parent company and the subsidiary. When the relationship between a lender and the subsidiary breaks down or the latter becomes insolvent, the courts are usually asked to determine the contractual effect of the letter of comfort as between the lender and the parent company.

Letters of comfort are predominantly used in international business transactions. The issue of comfort letter enforceability is considerably more complex within an international context than in one’s own legal system. Courts in different jurisdictions and in disparate legal systems have adopted distinct approaches to determine the contractual enforceability of letters of comfort. Accordingly, a trans-systemic view of the contractual effect of letters of comfort is necessary to be aware of the way in which such letters are treated in other legal systems, and to facilitate a consistent treatment of an instrument of international use in one’s domestic law.

Over the years, letters of comfort have become more detailed in content. The result is more litigation about the enforceability of letters of comfort and, because of courts undertaking more contractual analysis of such letters, a doctrinal foundation for the assessment of liability against a parent company has started to be developed by courts in some jurisdictions. Legal liability based on a letter of comfort is a real possibility. Like a boomerang, a letter of comfort is potentially a dangerous instrument when it returns to its unsuspecting originator.

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THIS SHEET IS TO BE GLUED TO THE INSIDE FRONT COVER OF THE THESIS
“An earthworm expects to find a law, a printed law, for every circumstance. Even have laws for private matters such as contracts. Really, if a man’s word isn’t any good, who would contract with him? Doesn’t he have a reputation?”¹

“The law of contract exercises a particularly powerful grip on the imaginations of lawyers. What Voltaire said about God could equally be said of contract law: if it did not exist, then it would certainly be necessary for us to invent it!”²

¹ Argues Manuel in Robert Heinlein’s science fiction novel, The Moon is a Harsh Mistress (1966), which describes a legal culture on the moon different from the one we are accustomed to "downside".
To Jeanne - *mea uxor extraordinaire*
I would like to thank the following persons for assistance in the preparation of this thesis:

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- My father-in-law, professor Andries Cilliers, for providing me with copies of some Dutch law texts;
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- My daughters, Stefanie and Liesel, for their understanding and being a reminder that there is a lot more to life than the law.

Any mistakes are mine, and the opinions expressed in this thesis and conclusions arrived at are mine and should not be ascribed to any other person.
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1 INTRODUCTION

1.1 Raison d’être for the dissertation

This dissertation deals with so-called comfort instruments\(^1\) in the Australian legal context, and more particularly with the contractual effect of letters of comfort\(^2\)—informed by a comparative law and trans-systemic analysis of letters of comfort in Common Law and other jurisdictions.\(^3\) It has as its subject one of the instruments\(^4\) commerce developed in the area of commercial lending to provide an alternative to the traditional security instruments, and is used to clarify or supplement loan documents.\(^5\) It is about the letter of comfort, one of the principal forms of financial accommodation available within a corporate group,\(^6\) by facilitating the opening of a line of credit for the benefit of a subsidiary of the corporation issuing the letter of

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\(^{2}\) In this dissertation, I will use the terms "letters of comfort" and "comfort letters" interchangeably. See annexure 1 for examples of letters of comfort, as well as D Deschrijver, A Gutermann and M Taeymans, Standard Business Contracts under Belgian Law (Lacier, Gent, 2006) 195 to 200; JA Nilsson, Ready Drafted Legal and Business Letters (Director Books, Hemel Hempstead, 1989) 38 to 44.

\(^{3}\) See paragraph 1.4.

\(^{4}\) T Mann (gen ed), Australian Law Dictionary (Oxford University Press, Australia & New Zealand, 2010) 309 defines an instrument, in its primary sense, as "a document by which some legal purpose is achieved."

\(^{5}\) Comfort letters that enhance debt transactions are distinct from, and should not be confused with, other forms of comfort, for example, legal opinions, comfort letters from accountants for issuers of securities, and "no action" letters from governmental authorities, which are beyond the scope of this dissertation – see AM Christenfeld and SW Melzer, "Comfort Letters - How Comforting Are They?" in New York Law Journal, Volume 222 number 26, Thursday, 3 June 1999; BL Resnik, "Understanding comfort letters for underwriters" [1980] Securities Law Review 153.

\(^{6}\) J O'Donovan, "Grouped Therapies for Grouped Insolvencies" in M Gillooly (ed), The Law Relating to Corporate Groups (Federation Press, Sydney, 1993) 46 at 47. The other forms of financial accommodation are loans, guarantees and accommodation bills. Inter-company loans from the holding company to its subsidiaries or vice versa are a direct source of capital. Letters of comfort and guarantees by the parent company provide indirect support for the members of the group. See also L Lanoye, "Patronaatsverklaring: What’s in a name?" in E Dirix (ed), Borgtocht en garantie persoonlijke zekerheden (Kluwer Rechtswetenschappen, Belgium, 1997) 151 at 157; SDN Belcher and PJ Lewarne, “Corporate Guarantees as a Form of Financial Assistance: The Banker’s View” (1990) 5 Banking and Finance Law Review 1; N La Corte, Die harte Patronatserklärung (Duncker & Humbolt, Berlin, 2006) 21.
comfort. It deals with a legal hybrid, an instrument cynically viewed by some as “a lawyer’s cover-up of a disagreement”, but by others as one of the “most interesting forms of security”, and more aptly described by Staughton J in Chemco Leasing Spa v Rediffusion Plc as a “compromise between, on the one hand, a guarantee by the parent company of the debts of its subsidiary and, on the other hand, a placebo which gives no undertaking at all by the parent company.”

One may justifiably ask why any business person would provide or why any bank would accept such a “Clayton’s guarantee”, when there are traditional security instruments such as guarantees or indemnities available? Indeed, it is a truism that the words, ascribed to Groucho Marx - “If a man tells you that his word is as good as his bond, take his bond” - are not only an apopthegm, but is also sound advice. For a variety of reasons, however, in commercial lending and commercial transactions - from the Orient to the Occident, and the Nordic countries to the Antipodes - there has been a proliferation of comfort instruments containing a statement or statements which can vary in scope, intended to provide “comfort” to one of the parties with a view to

11 (19 July 1985, unreported, QBD); on appeal [1987] 1 FTLR 201 (hereinafter also referred to as Chemco Leasing).
12 Colloquially, the adjective “Clayton’s”, means “serving as a substitute, imitation”. It comes from the trademark “Clayton’s” which referred to a non-alcoholic drink which was advertised in Australia as “the drink you have when you’re not having a drink”.
13 Generally speaking, a guarantee is the promise of one person to be answerable for the debt or obligation of another person if that other person defaults - see Bank of New South Wales v Permanent Trustee Co of New South Wales Ltd (1943) 68 CLR 1; Sunbird Plaza Pty Ltd v Maloney (1988) 166 CLR 245.
14 Generally speaking, a contract of indemnity is a contract by one party to keep the other harmless against loss. In contrast to contracts of guarantee, contracts of indemnity involve the creation of a primary liability on the part of the indemnifier and the indemnifier’s liability is accordingly generally unaffected by problems with the validity or enforceability of the principal contract and is not contingent upon the principal debtor’s default.
15 They may be mere expressions of goodwill, vary through representations or statements giving rise to potential liabilities or be enforceable undertakings by way of guarantee or indemnity.
induce the latter into concluding a contract or provide credit facilities, or into maintaining an existing contractual relationship between the latter and a third party. In the commercial world one of the parties contemplating a transaction, or the continuation of a contractual relationship, may not always be in a position to insist that the other party, or someone on behalf of the other party, provide it with a traditional legal instrument\(^\text{17}\) to secure the other party's obligations.\(^\text{18}\) The contractual negotiations, or the contractual relationship, may be in jeopardy unless the party is assured, or provided with "comfort", that the other party will perform its obligations.\(^\text{19}\) Moreover, as Staughton J observed when dealing with a letter of comfort in *Chemco Leasing*,\(^\text{20}\) when business people want to do business or close a deal but find that on some particular aspect of it they cannot agree, it is not –

"uncommon for them to adopt language of deliberate equivocation so that the contract can be signed and their main object achieved. No doubt they console themselves with the thought that all will go well, and that the terms in question will never come into operation or encounter scrutiny; but if all does not go well, it will be for the courts or arbitrators to decide what those terms mean."\(^\text{21}\)

\(^{16}\) In this context, the word "comfort" describes some level of assurance given by one person as to the financial capability of another, and the assurance can be anywhere in the range between a guarantee and a vague expression of opinion, depending on the words used – see *British and Commonwealth Holdings plc v Quadrex Holdings Inc* [1995] CLC 1169 at 1178.\(^\text{17}\)

\(^{17}\) For example, mortgage, charge, indemnity or guarantee.\(^\text{18}\)

\(^{18}\) MS Kurkela, *Letters of Credit and Bank Guarantees Under International Trade Law* (Oxford University Press, New York, 2008) 7 and 8 remarks, however, that: "Sometimes the parties are financially strong enough, or foolish enough, to take a risk, or to justify an expectation that no security, or only a more or less 'cosmetic' security, suffices."

\(^{19}\) As E Herzfeld, "Comfort letters before the courts" (1988) 132 Solicitors' Journal 1549 observes, a "letter of comfort may not provide real comfort – at least not to both parties."

\(^{20}\) (19 July 1985, unreported, QBD). EA Farnsworth, "'Meaning' in the Law of Contract" (1967) 76 Yale Law Journal 939 at 954 similarly remarked that "one or both [of the parties to an agreement] may have foreseen the problem but deliberately refrained from raising it during the negotiations for fear that they might fail – the lawyer who 'wakes these sleeping dogs' by insisting that they be resolved may cost his client the bargain ... Or both may have foreseen the problem but chosen to deal with it only in general terms, delegating the ultimate resolution of particular controversies to the appropriate forum." See also G McMeel, *The Construction of Contracts: Interpretation, Implication and Rectification* (Oxford University Press, Oxford, 2007) 6.

\(^{21}\) *Chemco Leasing* (19 July 1985, unreported, QBD). See also Prenn v Simmonds [1971] 1 WLR 1381 at 1385, where Lord Wilberforce remarked, albeit in a different context, that: "The words used may, and often do, represent a formula which means different things to each side, yet may be accepted because that is the only way to get 'agreement' and in the hope that disputes will not arise."
The vagaries of the law are not necessarily their primary concern. This is especially true when business people contemplate repeated interactions or ongoing relationships. Even sophisticated parties in business transactions often prefer not to invoke legal documents for fear of souring the business relation and creating an additional obstruction to the completion of a deal, or resort to side letters or agreements which fall in the shadow of judicial non-enforcement. Lawyers, in particular litigators, invariably have difficulty in believing that the business community has such a lax attitude to the legal enforceability of their agreements. The use of letters of comfort may appear to be anathema to the eyes of a cautious lawyer. However, as Hedley aptly observed:

22 It has been remarked that a great many legal requirements are considered by business generally as red tape and it is only when involved in litigation that they are seriously considered – see MH Jones, “Presidential Address” (1934-35) 8 American Law School Review 880 at 881.
27 TL Stark, “Thinking Like a Deal Lawyer” (2004) 54 Journal of Legal Education 223 aptly points out that “doing deals is fundamentally different from litigating, in terms of both the skills used and the substantive knowledge required.”
28 It is not surprising for lawyers, as observed in Balmoral Group Ltd v Borealis [2006] EWHC 1900 (Comm) at [339], to think that there are two parallel universes: the “real world’ in which the parties move and have their being, and an “artificial world” created for them by their lawyers if, but only if, a dispute arises.
"As a result of their training, lawyers have selectively morbid imaginations. Professionally, they are concerned with agreements only when they are broken ... Their perception of when people do or do not contemplate litigation is distorted by their own knowledge of when litigation actually occurs."31

A comfort letter is usually drafted because the parties cannot agree.32 The middle ground is the letter of comfort33 - often containing wording that conjures up an image of a "compromise emerging from a smoke-filled room"34 - so one should not expect le mot juste (exact word) in a letter of comfort.35 Thus, by nature and design, letters of comfort are "hypocritical instruments intended to serve two masters"36 often containing imprecise, diffuse, uncertain or unreliable words or expressions, suggesting yet evading a promise or commitment, rendering the real intention of the parties unclear.37 Common-Law lawyers38 invariably view with scepticism Delphic instruments

31 Business people are said, however, to be more optimistic, have different personalities and have different priorities – see RM Lloyd, "Making Contracts Relevant: Thirteen Lessons for the First-Year Contracts Course" (2004) 36 Arizona State Law Journal 257 at 260.
32 For hypothetical examples of how letters of comfort are used and obtained, see M Antoine, Ph Billot and J Terray which form part of M Antoine, "La Lettre de Patronage Enseignement Jurisprudentiel Recent" (1990) 6 International Business Law Journal 771 at 783 to 806; P Spector, "Comfort letters – How to get support from your customer’s parent company" (1995) 16 Credit Control 6.
33 See AL Tyree, Banking Law in Australia (Butterworths, Sydney, 2008) 450.
35 H Ominsky, "Counseling the Client on 'Gentleman’s Agreements'" (1990) 36 The Practical Lawyer 25 at 26 has also remarked that the commitments in a letter of comfort reflect the ambivalence of the draftsman.
37 G McBain, "Comfort Letters, Contractual or Moral Obligations?" 1986 (October) International Banking Law 69. In Corson v Rhuddlan Borough Council (1990) 59 PP&CR 185, the court explained this type of instrumental ambiguity and the courts’ responsibility in its resolution: "Businessmen often record the most important agreements in crude and summary fashion; modes of expression ... clear to them in the course of their business may appear to those unfamiliar with the business far from complete or precise. It is accordingly the duty of the court to construe such documents fairly and broadly without being too astute or subtly at finding defects."
which contain such “weasel words”.39 Letters of comfort are therefore said to occupy the rather barren judicial ground between the field of enforceable guarantees and the sea of insolvency with lenders naturally trying to interpret them as enforceable guarantees or contracts and comfort givers offering to acknowledge the existence of a transaction but denying responsibility if anything goes wrong.40

Letters of comfort are often the subject of intense negotiations41 and are the products of the negotiation that precedes their creation.42 A letter of comfort may provide a critical incentive for the lender to enter into the transaction with the subsidiary and may result in a reduction of the cost of borrowing.43 While a comfort letter may not necessarily improve the lender’s legal position, it hardly does the lender any harm.44 If all goes well, none of the parties involved usually pays much attention to the comfort letter after it had been issued. However, if the financial fortunes of the borrower change for the worse and there is a possibility that the loan may not be repaid - 45

- the lender, usually a bank (and its legal representatives) being the beneficiary under the letter of comfort,46 looks at the letter of comfort in its possession with renewed interest and endeavours to enforce it against the parent company. It will maintain that the letter of comfort is a contractual document from which a claim for damages relating to non-payment of the loan may arise.

39 Referring to eggs that when sucked dry by weasels keep their shape but are drained of their content; attributed to Stewart Chaplin’s story Stained Glass Political Platform (1990): “Why, weasel words are words that suck the life out of the words next to them, just as a weasel sucks an egg and leaves the shell.”
46 In this dissertation, I refer to this party as the bank, or comfortee or recipient of the comfort letter.
the parent company, invariably the issuer of the letter of comfort,\textsuperscript{47} maintains that the comfort letter was not intended to be legally binding and that, at most, it was a matter of honour or a “gentlemen’s agreement”;\textsuperscript{48} that is, in the words of Sachs J in \textit{Goding v Frazer},\textsuperscript{49} a transaction “which experience shows is only too often a transaction in which each side hopes the other will act like a gentleman and neither intends so to act if it is against his material interests”. Often, the other party does not turn out to be as much of a “gentleman” as you think you are.\textsuperscript{50}

- the borrower or debtor, usually associated with the issuer of the letter of comfort such as a subsidiary company,\textsuperscript{51} maintains a neutral position, not being in a position to do anything.\textsuperscript{52}

Thus, the typical comfort letter transaction involves the parent-subsidiary-lender trinity\textsuperscript{53} and at least three different, but related relationships\textsuperscript{54} which may be

\textsuperscript{47} In this dissertation, I refer to this party as the parent company, the comfortor or the issuer of the comfort letter.


\textsuperscript{49} [1966] 3 All ER 234 at 239.

\textsuperscript{50} See H Ominsky, “Counseling the Client on ‘Gentleman’s Agreements’” (1990) 36 \textit{The Practical Lawyer} 25 at 39.

\textsuperscript{51} In this dissertation, I refer to this party as the subsidiary or the debtor.

\textsuperscript{52} The position is different where the parent company has issued a keep-well letter in respect of its subsidiary – see \textit{Gate Gourmet Australia Pty Ltd (in liquidation) v Gate Gourmet Holding AG} [2004] NSWSC 19 (hereinafter also referred to as \textit{Gate Gourmet}) as discussed in paragraph 7.5 where a subsidiary instituted proceedings against the parent company to avoid falling foul of the insolvent trading provisions of the \textit{Corporations Act 2001} (Cth). See also \textit{Atco Controls Pty Ltd (in liquidation) v Newtronics Pty Ltd (receivers and managers appointed) (in liquidation)} (2009) 78 ACSR 375 (hereinafter also referred to as \textit{Atco Controls}).


regulated by different legal regimes — first, between a lender and the subsidiary; secondly, between a lender and the parent company; and thirdly, between the parent company and the subsidiary. When the relationship between a lender and the subsidiary breaks down or the latter becomes insolvent, the courts are usually asked to determine the legal status of the comfort letter as between the lender and the parent company. However, on at least one occasion, the Banco Ambrosiano scandal, divine intervention obviated the need for judicial determination, even though there were still secular aspects to what was referred to as: “A tale of two deaths, twelve investigations and missing millions”. It involved, “God’s banker”, Roberto Calvi, and the Instituto per le Opere di Religione’s (or Vatican Bank’s) denial of responsibility deriving from two comfort letters (lettere di patronage) signed by the head of the Vatican Bank, Archbishop Marcinkus, in respect of alleged illegal transactions. There were also a so-called “liberating letter”, or a “letter of discomfort”, written by Roberto Calvi to the Vatican Bank five days before the comfort letters were issued (in respect of a loan made by Banco Ambrosiano Andino in Peru, Ambrosiano Group Banco Commercial in Managua, Banco Ambrosiano Holding in Luxemburg, and Banco Ambrosiano Overseas Ltd in Nassau) which purported to negate the comfort letters and relieved the Vatican Bank of any responsibility under the comfort letters. The “liberating letter” was not, however, disclosed to the recipients of the comfort letters. The Vatican Bank, nevertheless, reached an out of court settlement of $250 million.

55 MA Jagmetti, “Letters of Responsibility: Switzerland” (1978) 6 International Business Lawyer 320 has observed that very often the three parties involved are companies from different countries, so that the first issue usually is to determine which law governs the legal relationship which may be created by the letter of comfort.
59 The Association of Corporate Treasurers, Letters of Comfort: A Practical Guide (London, April 2007) at 22 points out that letters of discomfort are in practice letters which state that the parent company has no intention to consider support for its subsidiary and that the bank must make its own enquiries, investigations and analyses and do its own fact checking to ascertain the credit risks involved. Parent companies rarely make statements of non-support or non-guarantee of subsidiary debt, preferring to leave their intentions ambiguous — see RJ Clayton and W Beranek, “Disassociations and Legal Combinations” [1985] Financial Management 24 at 25.
The issue of comfort letter enforceability is considerably more complex within an international context than in one’s own national legal system. Various questions arise, such as –

- what is the applicable law in light of the fact that the parties are in different countries?
- what is the nature of the letter of comfort?
- is the comfort letter a contract or a guarantee or an indemnity or only a gentleman’s agreement?
- does it contain moral obligations only as initially thought by academics and commercial players alike?

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62 Letters of comfort do not normally include jurisdictional or governing law clauses, even where cross-border financing is involved. The applicable law will be determined according to conflict of laws rules which are outside the scope of this dissertation. In view of Bonyngham v Commonwealth [1951] AC 201 and Mendelson-Zeller Co Inc v T&C Providers Pty Ltd [1981] 1 NSWLR 366, an Australian court will look for the system of law with which the transaction has its closest and most real connection – see also MJ Rigotti and JR Schembri in The Laws of Australia (Thomson Reuters (Professional) Australia Limited, online) at [18.8.108]. In most jurisdictions, however, the law that will be applied to a letter of comfort, if it does not contain a choice of law clause, is the law of the jurisdiction of the parent company or issuer, or where performance is to occur. See, in general, SA Kruisinga and L Leber, "A letter of comfort: does it offer any comfort?" 2010(7) Vermogensrechtelijke Analyses 1 at 22 to 28; JV Boonacker and ED Drok, De Mogelijke Rechtsgevolgen van de Letter of Comfort volgens Nederlands, Engels, Duits en Frans Recht (Nederlands Instituut voor het Bank- en Effectenbedrijf, Amsterdam, 1992); A Mourre, "Survey of Private International Law Applied to Business" (2001) 9 Tilburg Foreign Law Review 89 at 109 to 110; L du Jardin, "Lettre de patronage et droit international privé" (2000-01) 2 Euredia: European Banking and Financial Law Journal 366 for a discussion of ING Bank NV Paris v Société Mantel Holland Beheer BV (Cour de Cassation dated 30 January 2001); B Volders, "Patronaatsverklaringen en toepasselijk recht" 2008(2) Rechtspraak Antwerp, Brussels, Gent 115 for a discussion of SA Remafer v Trust Capital Partners NV (Hof van Beroep Gent dated 4 April 2007); the decisions of the Rechtbank Rotterdam in Plaid Enterprises Inc v Plaid Beheer BV (dated 21 May 2008, 251581/HA ZA 05-3439 and HA ZA 05-3449) and Plaid Enterprises Inc v Plaid Nederland BV (dated 21 May 2008, 251581/HA ZA 05-3445 and HA ZA 05-3447), and the discussion in [2008] Journaal Insolventie, Financiering & Zekerheden 273.

• if it is not a contract or security, does it have any legal effect at all whether in
tort or otherwise?

• which law should be applied, and in which forum should the legal
proceedings be instituted?  

Indeed, it has been remarked that “a veil of mystery tends to shroud Letters of
Comfort (LoC). Any attempt to pierce the veil and look closely at this instrument seeks
to raise more questions than solve the mystery.” Moreover, the inconsistency of the
many judicial decisions both within a given jurisdiction and by comparison across
countries is also testimony to the intricacies of letters of comfort. In dealing with
letters of comfort, Anglo-common law courts have relied on academic writings, a
practice a long way from the old view that it was not acceptable to cite the writings of
living authors as part of an argument in court, but in line with the modern practice to
encourage legal scholars to explore areas of law for future cases and developing the
law.

It is neither possible nor desirable to deal with all the aforementioned issues in this
dissertation: it would be a work of ennui. The focus of my dissertation is the

64 See P Wautelet, “De patronaatsverklaring in het international privaatrecht” (1996-97) 33 Jura Falconis
317; A Verbeke and D Blommaert, “De patronaatsverklaring: Een persoonlijke zekerheid met vele
gezichten” (1994) 31 Ondernemingsrecht 71; J Erauw and C Clijmans, Handbook Belgisch international
privaatrecht (Kluwer, Mechelen, 2006) 515.

65 See MJ Bernard, “The Seven Commandments for Letters of Comfort” 2003 (March/April) Banking
Today 6.

66 See B Rudden, “The Gentleman’s Agreement in Legal Theory and in Modern Practice” (1999) 2
European Review of Private Law 199 at 217.

67 See, for example, Banque Brussels Lambert SA v Australian National Industries Ltd (1989) 21 NSWLR
502 at 520 and 521 (hereinafter also referred to as Banque Brussels); Australian European Finance
Corporation Ltd v Sheahan (1993) 60 SASR 187 (hereinafter also referred to as Australian European
Finance); WS Weerasooria, Bank Lending and Securities in Australia (Butterworths, Sydney, 1998) 276.

68 See Kekewich J in Union Bank v Munster (1887) 37 Ch D 51 at 54: “It is to my mind much to be
regretted, and it is a regret which I believe every Judge on the bench shares, that text-books are more
and more quoted in Court – I mean of course text-books by living authors – and some Judges have gone
so far as to say that they shall not be quoted.”

69 See Lord Browne-Wilkinson in Linden Gardens Trust Ltd v Lenesta Sludge Disposals Ltd [1994] 1 AC 85
at 112: “I am reluctant to express a concluded view on this point since it may have profound effects on
commercial contracts which effects were not fully explored in argument. In my view the point merits
exposure to academic consideration before it is decided by this House.”
contractual effect of letters of comfort in Anglo-common law and certain Civil Law jurisdictions.  

1.2 A preliminary general delineation of letters of comfort – chameleonic instruments defined

While the term “letter of comfort” is used to denote a variety of instruments in diverse contexts in practice, as mentioned at the start of this dissertation, it is most commonly employed in the context of commercial bank lending. In this regard, it is clichéd to say that “[C]omfort letters, despite their name, are not letters containing statements of commiseration sent by bankers to companies suffering from financial and other problems.” A generally accepted definition of the letter of comfort has, however, proved to be elusive. Over the years, courts and commentators have proffered a variety of definitions of the letter of comfort in an attempt to identify its nature, characteristics, enforcement and consequences. The letter of comfort is not dealt with in legislation in the Anglo-common law jurisdictions and accordingly there is no statutory definition of the concept. As discussed in paragraph 9.2, the French legislature has, however, defined the letter of comfort. Similarly, the study group on a European Civil Code or a Common Frame of Reference, which seeks to advance the process of “Europeanisation” of private law by drafting a set of common European principles which are especially relevant for the functioning of the common market, has also defined the letter of comfort as discussed in paragraph 9.2.

Various definitions of the letter of comfort will be discussed in this dissertation because it is clear from a perusal of judgments, books and articles dealing with letters of comfort that the concept is usually defined so as to best meet the needs of the

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70 See paragraph 1.4 for the scope of the investigation.
author in question. At this early stage and for purposes of this dissertation, it is, however, apposite to give a general common delineation of the letter of comfort – it is “a letter written usually by a parent company ... to ... the lender giving comfort to the lender about a loan made to a subsidiary”.

It is important to note that all communications in whatever medium to a bank could be interpreted as including content which would normally be found in a letter of comfort. So, it is prudent to be wary when engaging in seemingly innocuous communication, and especially in the negotiation of credit and credit based services, because one has to assume that nothing is off the record with a bank and that someone employed with the latter will make a contemporaneous note.

1.3 Origin and international dimension of letters of comfort

Letters of comfort have been used for a very long time - indeed before the term came into common use – for example, during the period of expansion overseas, especially into the then British Empire, of British companies in the inter-war years. Some commentators have even endeavoured to trace the origin of letters of comfort back

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76 In Autocar Equipment Ltd v Motemtronic Ltd and Searle (unreported, 20 June 1996, CAT No 656 of 1996), quoted in GM Andrews and R Millet, Law of Guarantees (Sweet & Maxwell, London, 2008) 543, the English Court of Appeal held that an oral statement by the chairman and majority shareholder of Motemtronic Ltd, that he would “make sure” that the money was there to repay a substantial sum of money to Autocar Equipment Ltd if the agreement was cancelled, was a mere “comfort”. See also T Vollans, “You Sitting Comfortably?” (1996) 17 Business Law Review 232.
77 See PJ Ho, Letters of "Dis"comfort: An Examination of the Legal Effect of Letters of Comfort (unpublished thesis in part fulfilment of the degree of Bachelor of Law, Monash University, 1994) 5 who has remarked that comfort letters could be constituted by oral communication. However, it is preferable to limit letters of comfort, as comfort instruments, to written communications.
78 For example, e-mails are often sent unchecked, or oral comments are made over lunch by Chief Executive Officers or Chief Financial Officers, or thank-you notes are sent after such a luncheon – see The Association of Corporate Treasurers, Letters of Comfort: A Practical Guide (London, April 2007) 6.
79 Credit based services include, for example, provision of automated payment services, foreign exchange services, and letters of credit, where the bank has a credit exposure prior to settlement.
80 The Association of Corporate Treasurers, Letters of Comfort: A Practical Guide (London, April 2007) at 6 remarks that banks “are inveterate record keepers and have been known to produce twenty or thirty year old, badly worded letters at inconvenient times”.
82 See, for example, J Horn, Patronatserklärungen im common law und im deutschen Recht (Peter Lang, Frankfurt am Main, 1999) 14 and 15; T Hantke, Die Besicherung von Konzernkrediten über so genannte
to Roman times, and in particular the position of the *patronus* in Roman law.\textsuperscript{83} It appears, however, that the historical link is founded on the etymology of the German expression used for letters of comfort, namely *Patronatserklärungen*, the Dutch equivalent *patronaatsverklaringen*, or the English alternative, letters of patronage.\textsuperscript{84}

Interesting as that may be, letters of comfort in contemporary use in commercial lending and business - and in particular in the context of corporate groups - only made their appearance almost half a century ago, after the Second World War,\textsuperscript{85} as an improvisation of the banking industry which grew out of the increased competitiveness between banks,\textsuperscript{86} and have since then been cultivated by the law in practice.\textsuperscript{87} The origin of the letter of comfort has to be viewed against the background of the phenomenon and expansion of multi-national corporations ("MNCs") and groups of companies in the 1960s,\textsuperscript{88} the unstable business climate at the start of the 1970s,\textsuperscript{89} and the change in, and transposition of, the model financing transaction which was established in Western Europe in the nineteenth century.\textsuperscript{90} American\textsuperscript{91} MNCs and corporate groups in particular responded increasingly to those changes in

\textit{Ausstattungsverpflichtungen und andere Patronatserklärungen} (Peter Lang, Frankfurt am Main, 2004) 16 and 17.

\textsuperscript{83} During the Principate there were numerous liberated slaves who occupied influential positions. The effect of the liberation of a slave was that he acquired a new status in the Roman community, depending upon the way in which he acquired his freedom. However, as a freedman (*libertines or libertus*) he usually maintained a relationship of dependence in respect of his previous master, now referred to as his *patronus* – DH van Zyl, History and Principles of Roman Private Law (Butterworths, Durban, 1983) 84. See also P Nobel, "Patronatserklärungen und ähnliche Erscheinungen im nationalen und internationalen recht" in W Wieglend (ed), Personalsicherheiten (Stämpfli Verlag AG, Bern, 1997) 55 at 56.

\textsuperscript{84} See paragraph 2.3 for a discussion of the different terminology to refer to letters of comfort used in practice.

\textsuperscript{85} See RIVF Bertrams and FGB Graaf, "Letters of comfort en rechtspraak" (1990) 68 De Naamloze Vennootschap 75.

\textsuperscript{86} Toronto Dominion Bank v Leigh Instruments Ltd (Trustee of) (1998) 40 BLR (2d) 1 at 7 (hereinafter also referred to as Toronto Dominion Bank).

\textsuperscript{87} See PR Altenburger, Die Patronatserklärungen als "unechte" Personalsicherheiten (Schulthess, "Schweizer Schriften zum Handels-und Wirtschaftsrecht" number 40, Zürich, 1979) 15.

\textsuperscript{88} See the comments of Rogers CJ in Banque Brussels (1989) 21 NSWLR 502 at 520.

\textsuperscript{89} See K Wolfs, Patronaatsverklaringen (Verhandeling voorgedragen tot het bekom van het licentiaat in de Toegepaste Economische Wetenschappen (Oriëntatie Internationaal Zakenwezen), Universiteit Antwerpen, 1992-1993) 3.


\textsuperscript{91} In this dissertation, I use "America", "United States of America", "United States", and "US" interchangeably.
the market by (a) decentralising their international financial management in order to utilise local opportunities, (b) arranging local, company-external funding for their overseas subsidiaries in order to minimise the financial and political risks associated with foreign investments, and (c) shifting the risk of the subsidiaries’ failure towards their creditors. Due to the capital basis of such subsidiaries invariably being insufficient, local banks increasingly sought personal securities from the MNCs or other members of the corporate group. Although there used to be a customary tendency either of parent companies to guarantee – formally or informally – that they would meet their subsidiaries’ obligations, or of all the companies in the group to guarantee each other’s obligations by way of cross-guarantees, there was also an increasing application of limited liability in the parent-subsidiary context to limit the financial exposure of the parent towards the creditors of its subsidiary. Frequently, the parent company, in particular American parent companies, did not want to provide a formal guarantee, but were prepared to informally support their subsidiaries or to give side letters or collateral undertakings, or implied guarantees mainly because of financial accounting reasons.

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94 JM Smits, Bronnen van verbintenissen (Kluwer, Deventer, 2003) 44.

95 See C van Wyneersch, “Contexte économique et financier des lettres de patronage” in M Bellis et al, Les lettres de patronage (Travaux de la Faculté de droit de Namur et Fediuc, Namen, 1984) 1 to 11.


99 PK Nevitt and FJ Fabozzi, Project Financing (Euromoney Books, London, 2000) 307: “Implied guarantees are not really guarantees at all. They are merely undertakings or sets of circumstances which make it likely, from the lender’s standpoint, that the guarantor will provide support to the transaction. Implied guarantees are popular with guarantors because they are non-binding and do not have to be reported on financial statements.”

100 The primary reason for the reluctance to give guarantees was the fact that guarantees had to appear as contingent liabilities in the parent company’s accounts – see S McCracken and A Everett, Everett and McCracken’s Banking and Financial Institutions Law (Lawbook Co, Sydney, 2009) 523. PK Nevitt and FJ Fabozzi, Project Financing (Euromoney Books, London, 2000) at 307 succinctly comment that: “In the past, in the United States, comfort letters included undertakings to provide funds to a project company
Since then, letters of comfort have evolved.\textsuperscript{101} Until the mid-1970s, parent companies essentially provided so-called letters of awareness which contained statements of awareness of the financing of their subsidiaries and often a commitment to maintain their ownership interest in the subsidiaries,\textsuperscript{102} but thereafter the scope of the letters was enhanced by statements expressing the degree of support required by the lender, resulting in the so-called letters of responsibility.\textsuperscript{103} Today, letters of comfort usually encompass both letters of awareness and responsibility, their content has become more detailed and standardised,\textsuperscript{104} and their use in international business and finance transactions has become commonplace.\textsuperscript{105} However, because of this expansion of the use of letters of comfort, banks and parent companies have started to place detailed requirements on the format and contents of such letters,\textsuperscript{106} and consequently a trap has developed:

“The more that is stated and assured in the comfort letter, the less flexibility it retains and the more likely it is that the courts will be willing to enforce the representations contained in these letters. Simply stated, the more ‘comfort’ the parent gives the lender, the greater the chance of legal enforceability.”\textsuperscript{107}

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or subsidiary if it got into difficulty. Sometimes this was expressed as an agreement to maintain the working capital at a certain level, which was tantamount to a full guarantee. Until several years ago, when the accounting rule was changed in the United States, such undertaking in a comfort letter was not considered a guarantee for financial accounting purposes. However, today such an undertaking is regarded as a guarantee.”


\textsuperscript{102} It was therefore not surprising that the French Banking Association in a circular dated 2 July 1975 on letters of comfort warned that such devices were of questionable validity and effectiveness – see A Pierce, Demand Guarantees in International Trade (Sweet & Maxwell, London, 1993) 217.

\textsuperscript{103} The evolution is apparent from a review of the various definitions of letters of comfort discussed in Chapter 2 paragraph 2.2.


\textsuperscript{105} See J Koch, Die Patronatserklärung (Mohr Siebeck, Tübingen, 2005) 3 and 4.


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The origin of its birth and the nature of its use, however, have caused confusion in terminology, and inherent uncertainty surrounding letters of comfort. It forced letters of comfort right from the time of their introduction into a legal twilight zone.\(^{108}\) The terminology is confused by the US background of letters of comfort.\(^{109}\) American corporations, for all the usual reasons,\(^{110}\) often preferred not to give banks guarantees or indemnities to support subsidiary activities, but preferred rather to give collateral undertakings or warranties, or to make representations in the form of letters.\(^{111}\) Indeed, in its basic form a letter of comfort was “a written statement by one party (comforter) who, while carefully refraining from expressly guaranteeing a debt, undertaking or obligation of a second party, does prepare, sign and deliver a document to a third party (comfortee) with the intention of soothing, relieving or encouraging the third party to enter into, or continue with, a business relationship with the second party.”\(^{112}\) These collateral undertakings were given the descriptive moniker, “letters of comfort”, rather than being referred to by a more suitable name or term. The term has become so entrenched in both business and legal practice that, \textit{faute de mieux},\(^{113}\) the terminology has been retained. Although letters of comfort are of American origin,\(^{114}\) they soon achieved a strong international character and became popular in Anglo-common law jurisdictions as well as the Continental law jurisdictions, particularly in Germany, France and the Benelux countries.\(^{115}\) Moreover, in the Anglo-common law

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\(^{109}\) The term “letter of comfort” is frequently used in the United States to denote a letter containing collateral warranties from the parent company – see K Rose, "Introductory Notes" in \textit{Australian Encyclopaedia of Forms and Precedents} (LexisNexis, on-line) at [2705]. Ironically, as R Sacasas and D Wiesner, "Comfort Letters: The Legal and Business Implications" [1987] \textit{Banking Law Journal} 313 at 334 points out, it appears that internationally letters of comfort are more familiar to the legal systems other than in the United States.

\(^{110}\) See the discussion in paragraph 3.2.2.


\(^{113}\) This may be translated as “for the lack of anything better”.


\(^{115}\) H Laga and R Tas, “Enkele bijzondere problemen met betrekking tot het sluiten van (samenhangende) overeenkomsten met een vennootschap die deel uitmaakt van een groep” in J Perilleux, V Van Houtte-
jurisdictions the confusion has been exacerbated by the fact that, unlike the position in those jurisdictions, reliance plays a central role in American contract law so that the enforceability of the contractual effect of letters of comfort is more reliance based than promise based.\textsuperscript{116}

Since the advent of letters of comfort, they have attracted more than mere passing attention from Continental lawyers. This is especially true of Germany where some of the earliest mentions of, and commentaries on, letters of comfort are found.\textsuperscript{117} Letters of comfort have been the subject of numerous dissertations and books published in German-speaking jurisdictions.\textsuperscript{118} To a lesser extent this is also true of France,\textsuperscript{119}


\textsuperscript{118} See, for example: In Germany - J Koch, Die Patronatserklärung (Mohr Siebeck, Tübingen, 2005); R Stecher, “Harte” Patronatserklärungen, rechtsdogmatische und praktische Probleme (Bankrechtliche Sonderveröffentlichungen des Instituts für Bankwirtschaft und Bankrecht an der Universität zu Köln, Cologne, 1978); W Mosch, Patronatserklärungen deutscher Konzernmuttergesellschaften und ihre Bedeutung für die Rechtsprechung (Gieseking, Bielefeld, 1978); A Gerth, Atypische Kreditsicherheiten: Liquiditätsgarantien und Patronatserklärungen deutscher und ausländischer Muttergesellschaften (Fritz Knapp Verlag, Frankfurt am Main, 1980); I Seiler, Die Patronatserklärung im internationalen Wirtschaftsverkehr (aus bankrechtlicher Sicht, und zwar im Wirtschaftsverkehr mit England, Frankreich und der Schweiz) (Fachbereich Rechtswissenschaft der Westfälischen Wilhelms – Universität, Münster, 1981); K Rippert, Patronatserklärungen im deutschen und französischen Recht Ihre Verwendung im deutsch – französischen Rechtsverkehr (Fachbereichs Rechts – und Wirtschaftswissenschaften der Johannes-Gutenberg- Universität, Mainz, 1982); D Hoffmann, Die Patronatserklärung in deutschen und österreichischen Recht (Peter Lang GmbH, Frankfurt am Main, 1989); J Fried, Die weiche Patronatserklärung (Duncker & Humblot, Berlin, 1998); J Horn, Patronatserklärungen im common law und im deutschen Recht (Peter Lang, Frankfurt am Main, 1999); T Hantke, Die Besicherung von Konzernkrediten über so genannte Ausstattungsverpflichtungen und andere Patronatserklärungen (Peter Lang, Frankfurt am Main, 2004); CU Wolf, Die Patronatserklärung (Nomos, Baden-Baden, 2005); C Schnellecke, Wirksamkeit und Inhaltskontrolle harter Patronatserklärungen (Peter Lang, Frankfurt am Main, 2005); M Rüssmann, Harte Patronatserklärungen und Liquiditätszusagen (Nomos, Baden-Baden, 2006); N La Corte, Die harte Patronatserklärung (Duncker & Humbolt, Berlin, 2006); S Thiekötter, Die Patronatserklärung ad incertas personas (Peter Lang, Frankfurt am Main, 1999). In Austria – A Frick, Patronatserklärungen – Motive, Sicherheitenwert und Ausweispflicht (unpublished Doctoral dissertation, Karl-Franzens-Universität Graz, Graz, 1989); E Hiebling, Ausgewählte Problemstellungen der weichen
Belgium and Italy. There are also books and dissertations on letters of comfort published in the Scandinavian countries, as well as in The Netherlands and Portugal.


See, for example, J-L Medus, La Lettre de Comfort (Dissertation, University of Paris XII – Val de Marne, 1992); X Barre, La Lattre D’Intention (Economica, Paris, 1995).


Although letters of comfort were briefly discussed by some lawyers in the Anglo-common law countries,\textsuperscript{125} it was not until 1984\textsuperscript{126} that they enjoyed the attention of the English courts in \textit{Compagnie Generale D’Industrie et de Participations v Solori Societe Anonyme.}\textsuperscript{127} Although the issue of the contractual enforceability of comfort letters were not central to the decision of the court, the case made it clear that such instruments were not innately unenforceable.\textsuperscript{128} A year later, letters of comfort also surfaced in \textit{Chemco Leasing}\textsuperscript{129} and in \textit{Re Augustus Barnett & Sons Ltd.}\textsuperscript{130} Comfort letters remained in relative obscurity in common law until 1988, when, in the aftermath of the international tin market collapse,\textsuperscript{131} they were thrust into the judicial spotlight in England. A lively debate among lawyers\textsuperscript{132} in the Anglo-common law


\textsuperscript{124} See, for example, AN de Noronha, \textit{As cartas de conforto} (Coimbra Editore, Coimbra, 2005); AM Cordeiro, \textit{Das cartas de conforto no direito bancário} (LEX, Lisbon, 1993); M Lopes, “Cartas de conforto conceito, natureza e regime” (1996) 25 \textit{Revista do Tribunal de Contas} 121. See also the discussion about comfort letters in Macau, a jurisdiction influenced by Portuguese law, by A Vilhena, “As cartas de conforto na supervisão bancária a experiência de Hong Kong e sua influência na legislação de Macau” (1996) 3 \textit{Revista Jurídica de Macau} 59.


\textsuperscript{127} \textit{Compagnie Generale D’Industrie et de Participations v Solori Societe Anonyme} (unreported, Queen’s Bench, 18 June 1984); 134 NLJ 788. Hirst J held that French law was applicable.


\textsuperscript{130} \textit{Re Augustus Barnett & Sons Ltd} [1986] BCLC 170 (hereinafter also referred to as \textit{Augustus Barnett}). See paragraph 4.5.2.


countries followed the English Queen’s Bench decision in *Kleinwort Benson Ltd v Malaysia Mining Corporation Berhad*\(^{133}\) where a letter of comfort was held to be contractually binding and to impose liability on the entity which provided the letter of comfort.\(^{134}\) The debate became even livelier, transcending the Anglo-common law jurisdictions,\(^{135}\) when the English Court of Appeal overruled this decision and concluded that the letter of comfort in that case was not sufficiently promissory to create a legal obligation because it referred merely to the policy of the holding company in respect of its subsidiary.\(^{136}\)

The debate continued following a number of Australian decisions on letters of comfort with auditors, lawyers and bankers airing their views trans-continentally.\(^ {137}\) The Supreme Court of Victoria in Commonwealth *Bank of Australia v TLI Management Pty Ltd*,\(^ {138}\) and the South Australian Supreme Court in *Australian European Finance Corporation Ltd v Sheahan*,\(^ {139}\) followed the approach of the English Court of Appeal in

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133 *Kleinwort Benson Ltd v Malaysia Mining Corporation Berhad* [1988] 1 WLR 799 (hereinafter also referred to as *Kleinwort Benson at first instance*). See paragraph 5.3. That debate also occurred in non-common law countries - see, for example, G Radesich and A Trichardt, "Comfort Letters: Are They Binding Under South African Law?" [1988] De Rebus 795.


136 *Kleinwort Benson Ltd v Malaysia Mining Corporation Berhad* [1989] 1 WLR 379 (hereinafter also referred to as *Kleinwort Benson on appeal*). See paragraph 6.1 and also A Ivison and J Naccarato, "Comfort letters: are they legally binding?" 1989 (November) Chartered Surveyor Weekly 114.


Kleinwort Benson. The judicial cat was set among the commercial pigeons by the decision of the New South Wales Supreme Court in Banque Brussels, where Rogers CJ’s approach to the interpretation and construction of letters of comfort was different from that of the English Court of Appeal in Kleinwort Benson - and a comfort letter in substantially similar terms was held to be promissory in effect and the provider of the letter was liable for breach of contract or, in the alternative, for contravention of section 52 of the Trade Practices Act 1974 (Cth) and was estopped from denying legal effect to statements in the letter. However, in Esanda Finance Corporation Ltd v Wordplex Information Systems Ltd, Giles J remarked that: "There is no gulf between the courts in England and the courts in New South Wales concerning letters of comfort whereby one party would be materially disadvantaged by litigation in the courts of the other forum." Although it is possible to reconcile the decision in Kleinwort Benson on appeal and the decision in Banque Brussels by attributing the difference in outcome to differences in the wording of the comfort letters and the pleadings, to do so would be to overlook the difference in approach followed by the courts in England and Australia. The English Court of Appeal in Kleinwort Benson, recently confirmed in Associated British Ports v Ferryways NV, adopted a traditional analytical approach whereas Rogers CJ in Banque Brussels, followed in Gate Gourmet, adopted a commercial (common sense) approach.

In New Zealand, the English Court of Appeal’s approach in Kleinwort Benson was followed in Bank of New Zealand v Ginivan and Genos Developments Ltd v Cornish.

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140 Banque Brussels (1989) 21 NSWLR 502. See paragraph 7.3.
143 Esanda Finance Corporation Ltd v Wordplex Information Systems Ltd (1990) 19 NSWLR 146 (hereinafter referred to as Esanda Finance).
144 See Esanda Finance (1990) 19 NSWLR 146 at 157. P Jeffares, "Letters of Comfort: The ANI Case" (1989-90) 5 Australian Banking Law Bulletin 203 at 204 is also of the view that the conclusion to be drawn from Banque Brussels and Kleinwort Benson on appeal, albeit their results are opposite, is similar – it is important for parties to clearly express their intentions.
146 [2009] 1 Lloyd’s Rep 595 (hereinafter also referred to as Associated British Ports).
Jenner and Christie Ltd.\textsuperscript{149} However, the New Zealand Court of Appeal in Bank of New Zealand v Ginivan\textsuperscript{150} did not follow Kleinwort Benson on appeal. In Re Atlantic Computers plc (in administration); National Australia Bank Ltd v Soden,\textsuperscript{151} the English Chancery Division (Companies Court) considered the Banque Brussels decision but declined to follow it since “the test prescribed by the law of Australia to determine whether a statement is promissory or only representational is different from that in England.” Then, with some exceptions,\textsuperscript{152} the debate lost most of its momentum in the Anglo-common law countries since comfort letters seem to attract the attention of lawyers in these jurisdictions only after problems concerning their judicial nature arise in the context of litigation. Towards the end of the previous century and the beginning of the present century, the judicial silence was broken by a number of decisions from superior courts in Australia,\textsuperscript{153} Canada,\textsuperscript{154} Singapore,\textsuperscript{155} Hong Kong,\textsuperscript{156} and England\textsuperscript{157}

\begin{thebibliography}{999}
\bibitem{149} (unreported, Master Towle, High Court of New Zealand, Auckland, 10 July 1990, CP 556/90) (hereinafter also referred to as Genos Developments). See paragraph 6.6.
\bibitem{150} [1991] 1 NZLR 178 (hereinafter also referred to as Bank of NZ on appeal).
\bibitem{151} Re Atlantic Computers plc (in administration); National Australia Bank Ltd v Soden [1995] BCC 696 (hereinafter also referred to as Atlantic Computers). See paragraph 6.2.
\bibitem{153} Gate Gourmet [2004] NSWSC 149; and recently in Newtronics Pty Ltd (rec and mgs apptd)(in lia)(ACN 061 493 516) v ATCO Controls Pty Ltd (in lia) (ACN 005 182 481) (2008) 69 ACSR 317 (hereinafter referred to as Newtronics), and ATCO Controls (2009) 78 ACSR 375. See paragraphs 7.5 and 7.6 for a discussion of these three decisions. Letters of comfort, although not discussed, were also involved in, for example, Helco Pty Ltd v O’Haire (1991) 109 Australia and New Zealand Conveyancing Reports 8; Tasman Group Services Pty Ltd v Federal Commissioner of Taxation (2008) 69 ATR 257; BHP Billiton Direct Reduced Iron Pty Ltd v Deputy Commissioner of Taxation (2007) 67 ATR 578; The Commissioner of Taxation of the Commonwealth of Australia v BHP Billiton Finance Ltd [2010] FCAFC 26; Kellogg Brown & Root Pty Ltd v Australian Aerospace Ltd [2007] VSC 200.
\bibitem{157} Associated British Ports [2009] 1 Lloyd’s L Rep 595. See paragraph 6.3.
\end{thebibliography}
following either Banque Brussels or the English Court of Appeal’s approach in Kleinwort Benson.

As early as 1979, it was stated that letters of comfort “are a fact of life in the banking business” and, in 1982, commentators and bankers observed that letters of comfort had gained a wide degree of use and acceptance by banks and companies. Frequent use of letters of comfort in commercial transactions was confirmed by surveys conducted in 1990 and in 2002. Indeed, fin de siècle it was observed that letters of comfort are used in more than two thirds of international financing transactions in company groups. Moreover, in 2007, The Association of Corporate Treasurers in the United Kingdom stated that advice on comfort letters has been one of the most frequent requests it has received.

Although comfort letters have been and are used in purely domestic transactions, they are far more prevalent in international commerce. Accordingly, the international nature of letters of comfort necessitates an understanding of the international and trans-systemic dimensions of letters of comfort and an awareness of judicial decisions on the subject by foreign courts. It is therefore opportune to review a selection of the foreign decisions and to reflect on the approaches followed by the courts and discuss the possible legal pitfalls associated with the use of letters of comfort.

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161 I conducted a similar but more extensive survey to that of Kelly mentioned in the previous footnote. My survey included both Australian banks and foreign banks, particularly banks in the United Kingdom, France, Germany, Belgium and The Netherlands. Due to the requests for confidentiality, the limited value of the results in considering the contractual effect of comfort letters, and having regard to length considerations applicable to this dissertation, I have not included or discussed the results of the survey.
162 J Horn, Patronatserklärungen im common law und im deutschen Recht (Peter Lang, Frankfurt am Main, 1999) 12; JM Smits and GJ Scholten, Bronnen van verbintenissen (Kluwer, Deventer, 2003) 44.
1.4 Scope of investigation

There are two major legal systems in the Western world,\textsuperscript{166} the Common Law system and the Civil (or Continental European)\textsuperscript{167} Law system.\textsuperscript{168} In this dissertation, I will compare and analyse the nature and contractual effect of letters of comfort in –

- the Common Law\textsuperscript{169} by reference to Australian law informed by a review of case law in England, Canada, New Zealand, Hong Kong, and Singapore,

\textsuperscript{166} The law school of the University of Ottawa has prepared a detailed study of the world legal systems, available at http://www.juriglobe.ca/eng/index.php. According to this study, there are three major legal systems in the world, namely the Civil Law system, the Common Law system and the Religious Law system, but there are combinations of the systems, or the so-called pluralistic systems; for example, Civil and Common law systems, Civil and Religious law systems, and Common and Religious law systems. See, in general, P de Cruz, Comparative Law in a Changing World (Routledge-Cavendish, London, 2007) 3.

\textsuperscript{167} According to JA Jolowicz, “Development of Common and Civil Law Contrasts” [1982] Lloyds Maritime and Commercial Law Quarterly 87, the Civil Law, generally speaking, refers to the law of the countries of continental Europe which have a close connection with Roman law and an affinity for codes. See also DH van Zyl, Beginsels van Regsvergelyking (Butterworths, Durban, 1981) at 56 et seq; FH Lawson, A Common Lawyer Looks at the Civil Law (The Thomas Cooley Lectures, Fifth Series, University of Michigan Law School, Ann Arbor, 1953) at 2.

\textsuperscript{168} According to the University of Ottawa study on world legal systems referred to in footnote 167, the Civil Law system can be divided into three distinct groups, namely the French Civil Law group: France, the Benelux countries, Italy, Spain and the former colonies of those countries; the German Civil law group: Germany, Austria, Croatia, Switzerland, Greece, Portugal, Turkey, Japan, South Korea, China; Scandinavian Civil law group: Denmark, Norway, Sweden, Finland, and Iceland, although they do not have complete systematic codes – see J Cartwright, Contract Law: An Introduction to the English Law of Contract for the Civil Lawyer (Hart Publishing, Oxford, 2007) 8.

referring to all these jurisdictions as the "Anglo-common law jurisdictions";\(^{170}\) and

- the Civil Law by reference to the legal doctrine and case law in France, a Romanistic legal system\(^ {171}\) and quintessential example of the Civil Law.

In addition to the comparative law analysis of the Anglo-common law systems and French law, brief trans-systemic comments on and references to comfort letters are given in respect to the position in the other Romanistic jurisdictions\(^ {172}\) (such as Belgium, The Netherlands, Spain, Portugal and Italy), as well as in the Germanic legal system of the Civil Law\(^ {173}\) (represented by Germany, Austria, and Switzerland), and in the Nordic legal system (represented by Norway, Sweden and Denmark). I refer to all these jurisdictions as the “Continental law jurisdictions”.\(^ {174}\) The trans-systemic analysis does not, however, cover any of the Oriental law jurisdictions.\(^ {175}\)

The Continental law jurisdictions cover about two-thirds of the world’s geographic area, while the Anglo-common law jurisdictions represent, if the United States is

\(^{170}\) As J Cartwright, *Contract Law: An Introduction to the English Law of Contract for the Civil Lawyer* (Hart Publishing, Oxford, 2007) 10 points out, there are significant differences between, for example, English and Australian law on some points of detail and even in respect of more fundamental questions about the nature of contracts and the role of the law in regulating particular relationships. It is not the purpose of this dissertation to discuss those differences.


included, only about 6.5% of the world's population.\textsuperscript{176} Although English has become the lingua franca of business, the internationalisation of commerce and finance has increased the need for flexibility and mutual understanding of the two legal systems.\textsuperscript{177} It has aptly been remarked that: “Europeans and South Americans are coming aware of the necessity to have a view of the law which is trans-systemic, to appreciate the value of being able to bring to bear a perspective, obtained from familiarity with other legal systems, upon domestic legal questions. Indeed, it is increasingly being recognized that today’s lawyer must have such a perspective.”\textsuperscript{178} Unfortunately, in Australia the comparative law and trans-systemic approach to the study of law and legal questions is still in its infancy and legal writing with such perspective is practically non-existent.

A trans-systemic approach to the study of letters of comfort is fitting, because it brings to the fore not only the differences in the judicial treatment of letters of comfort in the Anglo-common law,\textsuperscript{179} Continental law and Oriental law jurisdictions, but it also demonstrates the influence and potential confusion that can result when Continental legal drafting is anglicised\textsuperscript{180} and Common Law concepts are introduced into classical

\textsuperscript{179} JGJ Rinkes and GH Samuel, Contractual and Non-contractual Obligations in English Law (Ars Aqui Libri, Nijmegen, 1992) 5 have pointed out that Auslandsrechtshand (international legal studies) may be the threshold of comparative law, but nowadays the appreciation of the differences of the legal families is set in the context of searching for similarities and cross-fertilisation.
\textsuperscript{180} For example, contracts in the Continental law jurisdictions were traditionally short, because the draftsman felt no need to repeat the provisions of the civil code. In contradiction, as a corollary of the absence of codification, the drafting philosophy in the Anglo-common law jurisdictions, anticipates as many situations as possible, leaving as little as possible to the appreciation and discretion of the judge, and describing the will of the parties in great detail, which leads to very long agreements – see PF de Ravel d’Esclapon, “Relative Competitiveness of Different Legal Systems: The Point of View of an American Practitioner” in J-F Gaudreault-DesBiens, E Mackaay, B Moore and S Rousseau (eds), Convergence, Concurrence et Harmonisation des Systèmes Juridiques - Les Journées Maximilien – Caron 2008 (Thémis, Montreal, 2008) 58 at 59.
Continental Law constructions. Moreover, such approach highlights factors that may lead to unintended contractual liability for Australian business persons involved in international transactions. Hence this dissertation, apart from discussing letters of comfort in Anglo-common law jurisdictions, also presents an introduction to letters of comfort in French law, Common Law style.

Letters of comfort are encountered in all jurisdictions and are frequently used in international business transactions. The letter of comfort is therefore considered in a comparative law context, meaning, in this context “the tracing of an identical or similar idea or institution through all of many systems, with a view to discovering its differences and likenesses in various systems, the reasons for those variations, and the nature and limits of the inherent and invariable idea, if any – in short, the evolution of the idea or institution universally considered.”

When the problem of the nature and enforceability of letters of comfort is considered in the Australian context, the decisions of the courts in England, Canada, New Zealand, Singapore and Hong Kong are instructive and important. This is so because of their international significance and the desirability of uniform treatment by courts dealing with disputes involving litigants from different jurisdictions, especially other Anglo-common law jurisdictions.

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181 See PF de Ravel d’Esclappon, “Relative Competitiveness of Different Legal Systems: The Point of View of an American Practitioner” in J-F Gaudreau-DesBiens, E Mackaay, B Moore and S Rousseau (eds), Convergence, Concurrence et Harmonisation des Systèmes Juridiques - Les Journées Maximilien – Caron 2008 (Thémis, Montreal, 2008) 58 at 60, for example, in contact drafting practice, it is customary to use "best efforts" or "commercially reasonable efforts" clauses. If a contract thus drafted on the basis of a Anglo-common law precedent is governed by Continental law, in particular the French civil law group, there may be uncertainty as to the nature of the obligations so contracted – are they obligations of means (best efforts obligations) or obligations of results (results obligations) as discussed in paragraph 8.6.1.

182 I refer to the French decisions on letters of comfort in the way case law is referred to in the Anglo-common law jurisdictions, but the usual Continental convention is followed when referring to other Continental law decisions.


1.5 Limitation of topic

Letters of comfort are used in many spheres of industry, commerce, regulated and state-controlled activities, government and regulation. However, the Anglo-common law cases which have considered the enforceability of letters of comfort appear to fall into one of two groups. Lowe points out that comfort letters are encountered: “(1) when a parent company provides a comfort letter to a lender, when that lender makes a loan to the subsidiary; or (2) when the letter of comfort is given by a parent to the directors or auditors of its subsidiary to enable the directors of an insolvent or potentially insolvent company to continue to allow the subsidiary to trade without incurring potential liability for wrongful trading.” However, Gordon J has pointed out in BHP Billiton Finance Limited v Commissioner of Taxation different fact patterns:

“The first common fact pattern is: (1) subsidiary seeks debt financing; (2) outside bank (not in-house financier) agrees to lend provided that comfort letter is given by parent; (3) letter is given to the bank; (4) subsidiary fails to pay; and (5) bank sues parent.”

“The second common fact pattern in the comfort letter cases is: (1) entity enters into transaction or publishes financial statements; (2) independent financial or legal adviser issues a comfort letter to the entity stating that it is satisfied that the financials are correct, preconditions for transactions are

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188 BHP Billiton Finance Limited v Commissioner of Taxation [2009] FCA 276 at [126] (hereinafter also referred to as BHP Billiton Finance).
met or something along those lines; (3) letter contains disclaimer saying it is for the benefit of the addressee only and should not be relied upon by anyone else; (4) third party enters into transaction or purchases shares; and (5) it turns out preconditions are not met or financials were false; and (6) third party sues independent adviser, claiming estoppel or tortuous misrepresentation”.\textsuperscript{189}

The first common fact pattern identified by both Lowe and Gordon J is the so-called “original classic context of a letter of comfort”.\textsuperscript{190} In light of the fact that the popularity of letters of comfort in contemporary use as a form of financial accommodation is intimately linked with the emergence of groups of companies and their overseas expansion, as mentioned in paragraph 1.3, this dissertation deals with letters of comfort which are addressed by private sector parent or holding companies\textsuperscript{191} or group members to providers of credit or of credit based services\textsuperscript{192} (that is, banks), to encourage them to grant credit facilities to a subsidiary or fellow subsidiary or incorporated joint venture.\textsuperscript{193} However, as Pagone J has pointed out in Newtronics,\textsuperscript{194} the decided cases concerning letters of comfort in the “original classic context” are relevant and applicable to enforceability of comfort letters in other contexts.

This dissertation deals with the Australian law on letters of comfort and the approach to be adopted in Australia in resolving the problem of the nature and contractual

\textsuperscript{189} BHP Billiton Finance [2009] FCA 276 at [127].
\textsuperscript{190} Newtronics (2008) 69 ACSR 317 at [2].
\textsuperscript{191} A survey conducted in 1989 indicated that an estimated 95\% of letters of comfort were from parent companies in support of loans extended to their subsidiaries or affiliates – see J Evans, “British Court Warns Lenders not to rely on letters of Comfort” (1989) 154 American Banker 7; L Thai, “Letters of Comfort: A Comparative evaluation of Australian, United States and English Jurisdictions” (2000) 7 Current Commercial Law 1 at 11.
\textsuperscript{192} Credit based services include, for example, provision of automated payments services, foreign exchange services, and letters or credit where the provider has a credit exposure prior to settlement – see The Association of Corporate Treasurers, Letters of Comfort: A Practical Guide (London, April 2007) 4.
\textsuperscript{193} See H Laga and R Tas, “Enkele bijzondere problemen met betrekking tot het sluiten van (samenhangende) overeenkomsten met een vennootschap die deel uitmaakt van een groep” in J Perilleux, Y Van Houtte-Van Poppel, F Walschot (eds), L’interdépendance de contrats: Onderlinge afhankelijkheid van overeenkomsten (Vlaams Pleitvennotschap, Ghent, 1997) 133 at 154.
\textsuperscript{194} (2008) 69 ACSR 317 at [6].
effect of letters of comfort. In this regard, a few observations should be made. Since Australian law, like the law in the other Anglo-common law jurisdictions, has been founded upon and heavily influenced by English law, liberal use has been made of the judicial pronouncements and legal writings in England and these other common law jurisdictions. The reasoning of the courts in the various Anglo-common law jurisdictions is important for and facilitates a balanced discussion of letters of comfort. Where differences exist in the law pertaining to letters of comfort in such jurisdictions and that of Australia, these have been noted.

This dissertation does not purport to be a detailed study of all aspects of letters of comfort in all the jurisdictions. This is not possible within the scope of a dissertation. I only deal with those aspects which are necessary to place the law into context and to deal with the nature and contractual enforceability of letters of comfort.195 The contractual enforceability of letters of comfort is significant primarily for three reasons.196 First, the contractual effect of letters of comfort is of “considerable practical importance to those involved in financing transactions”.197 This so because lenders or bankers, it is said, usually believe that letters of comfort have legal effect, and that a parent company has a legal duty to pay a subsidiary company’s debt.198 Parent companies, it is said, usually believe that letters of comfort do not have legal effect, but only moral effect, and accordingly that they only have a moral duty to pay a subsidiary company’s debt.199 Secondly, it is “of great importance for the banking world, having regard to the generality of the current practice on occasions to rely on similar documents by way of security for the granting of financial facilities”200 such as letters of comfort, honour clauses, letters of commitment, letters of intent, and heads or agreement. Indeed, the enforceability of letters of comfort is not only a question of

law, but of providing some guidance for banking and business practice.\textsuperscript{201} Thirdly, it has been said that “[p]erhaps two of the most difficult areas in commercial negotiations are what to reduce to writing and to distinguish between contractually binding terms and ‘letters of comfort’.”\textsuperscript{202}

In this dissertation, I do not discuss the circumstances in which non-contractual remedies\textsuperscript{203} may arise, or may feature in legal proceedings.\textsuperscript{204} In Australia, the possibility that a letter of comfort may attract legal liability is increased by three possible lines of argument as canvassed by Rogers CJ in Banque Brussels\textsuperscript{205} and by Einstein J in Gate Gourmet,\textsuperscript{206} and succinctly stated by Seddon and Ellinghaus:\textsuperscript{207}

“First, the High Court has shown a marked tendency to adopt standards of fair dealing in connection with commercial relationships, as shown by Walton Stores (Interstate) Ltd v Maher\textsuperscript{208} (estoppel), Commercial Bank of Australia Ltd v Amadio\textsuperscript{209} (unconscionability) and Taylor v Johnson\textsuperscript{210} (mistake). It may of course be argued that fair dealing has nothing to do with letters of comfort because the people involved are not in need of any protective doctrines. But the notion that commercial people amongst themselves should adhere to such standards is more evident in Australia than it is in England. Second, the

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\textsuperscript{201} P Gilker, "Taking comfort in certainty: to enforce or not to enforce the letter of comfort" [2004] Lloyd’s Maritime and Commercial Law Quarterly 219 at 220.


\textsuperscript{203} That is, the possibility of reliance based liability resulting from the use of letters of comfort – for example, in tort or for unjust enrichment, promissory estoppel.

\textsuperscript{204} Some courts are sometimes confused as to the nature of comfort letters and consequently do not clearly distinguish between liability based on breach of contract or in tort. For example, the Hungarian Arbitration Court of the Chamber of Commerce and Industry held that the issuer of a comfort letter was tortiously (non-contractually) liable, but its reasoning was based on the fact that the issuer breached the obligations contained in the letter – see the discussion by P Gárdos, "Comfort Letters Unenforceable, But May Give Rise to Damages" dated 25 September 2009 at \url{http://www.internationallawoffice.com/Newsletters}.

\textsuperscript{205} (1989) 21 NSWLR 502 at 526 to 530.


\textsuperscript{208} (1988) 164 CLR 387.

\textsuperscript{209} (1983) 151 CLR 447.

\textsuperscript{210} (1983) 151 CLR 422.
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expanded doctrine of estoppel ... has to some extent transcended contract in that the existence of a contract is no longer necessary for contract-like obligations to arise.211 Third, a letter of comfort, or the conduct of the person giving such a letter, could be seen as misleading so as to attract liability under the Trade Practices Act s 52212 or its equivalents.”213

I also do not discuss corporation law issues such as the consequences if a parent company honours a non-legally binding obligation in a letter of comfort in order to protect its reputation.214 Suffice it to say, a parent company ought to realise the outcome if it is to honour a morally binding comfort letter. For example, the parent

211 In the US, courts are likely to either enforce comfort letters on a contract or promissory estoppel theory depending on the circumstances – see Lasalle Bank National Association v Citicorp Real Estate Inc 2003 US Dist LEXIS 1204.
212 Section 52 of the Trade Practices Act of 1974 (Cth) provides that: “A corporation shall not, in trade or commerce, engage in conduct that is misleading or deceptive or is likely to mislead or deceive.” It is important to note the definition of “conduct” in section 4(2) of the Trade Practices Act 1974 (Cth) and the decision of the Full Federal Court in Accounting Systems 2000 (Developments) Pty Ltd v CCH Australia Ltd (1993) 114 ALR 355. Section 4(2) of the Trade Practices Act of 1974 (Cth) defines the terms “conduct” and “engaging in conduct” broadly to mean the doing or refusing to do any act, making a contract or arrangement giving effect to a provision of a contract or arrangement, arriving at an arrangement, giving effect to a provision of an understanding, and giving or acquiring a covenant. The effect of section 4(2)(a) is to make warranties in contracts “conduct” for the purposes of the Trade Practices Act, with the consequent effect that, if false or misleading, the warranties will breach section 52. See D Skapinker and JW Carter, “Breach of Contract and Misleading or Deceptive Conduct in Australia” (1997) 113 Law Quarterly Review 294; D Harland, “The Statutory Prohibition of misleading or Deceptive Conduct in Australia and Its Impact on the Law of Contract” (1995) 111 Law Quarterly Review 100.
213 See also RI Milliner, “Comfort Letters – How Much Comfort Are They For Lenders and Auditors?” (unpublished paper, University of Western Australia, Law Summer School, 1990) at [10.2], J Lipton, “Good Faith and Letters of Comfort” (1999) 28 University of Western Australia Law Review 138 at 148 and 149 points out that courts have to date identified six main mechanisms of potential enforcement of the terms of comfort letters, all underpinned by the notions of good faith and morality – namely, enforcement (1) of the comfort letter as a guarantee; (2) of one or more discrete contractual obligations contained in the letter, giving rise to the usual contractual remedies for breach (including, damages based on the injured party's expectation loss); (3) of one or more specific representations contained in the letter under the equitable principles of promissory estoppel; (4) based on the law of restitution, particularly if it can be established that the bank has suffered detriment as a result of accepting the comfort letter which corresponds with an associated "unjust enrichment" of the parent company; as well as (5) reliance upon remedies relating to torts (negligent or fraudulent misrepresentation); and (6) actions under statutory prohibitions against misleading or deceptive conduct (for example, section 52 of the Trade Practices Act 1974 (Cth), its State statutory equivalents (section 9 of the Fair Trading Act of 1999 (Vic); section 42 of the Fair Trading Act of 1987 (NSW); section 38 of the Fair Trading Act of 1989 (Qld); section 56 of the Fair Trading Act of 1987 (SA); section 10 of the Fair Trading Act of 1987 (WA); section 14 of the Fair Trading Act of 1990 (Tas); section 12 of the Fair Trading Act of 1992 (ACT); and section 42 of the Consumer Affairs and Fair Trading Act of 1990 (NT)) and section 12DA of the Australian Securities and Investments Commission Act 2001 (Cth)).
company may ensure that its subsidiary’s business is sufficiently viable in order to meet loan commitments to the bank. If compliance with the moral obligation necessitates the transfer of funds from the parent to the subsidiary, consideration is needed of the potential liabilities that may arise, as well as their implications. As Hawke215 points out, “the directors of the parent authorising that transfer of funds may well be in breach of their fiduciary duty to that company. Of course there may be no immediate circumstances in which that breach of duty will be enforced. On the other hand, if the shareholders or, ultimately, a liquidator should decide to enforce such a breach of fiduciary duty the parent company’s financial liability may be considerable.” Furthermore, payment under an unenforceable comfort letter may be ultra vires the parent company and if the parent company is insolvent, the payment may be attacked as preference or voidable disposition.216

German law and legal doctrine on comfort letters are extensive and have been influential internationally. However, due to word limit considerations and because of the unique and technical nature of German law on letters of comfort, the German law on letters of comfort or Patronatserklärungen is not discussed or extensively referred to.217 In any event, looking at some of the portmanteau words encountered in the discussions on comfort letters such as Ausstattungsverpflichtungen,218 Geschäftspolitikklausel,219 and Beteiligungs-oder Stillhalteklausel220 (to mention but a few) expressed in words of such length, the familiar tale of the lady who stated that she had abandoned the study of German comes to mind – upon being asked why, she

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217 See SA Riesenfeld and WJ Pakter, Comparative Law Casebook (Transnational Publishers, Ardsley NY, 2001) 391 to 396 for translations of some German court decisions.
218 See J Horn, Patronatserklärungen im common law und im deutschen Recht (Peter Lang, Frankfurt am Main, 1999) 169. This refers to the undertaking in a comfort letter that the parent company will make available to its subsidiary the financial means necessary to enable it to meet its commitments.
219 See J Horn, Patronatserklärungen im common law und im deutschen Recht (Peter Lang, Frankfurt am Main, 1999)147. This refers to the undertaking in a comfort letter that it is the parent company’s policy or practice to ensure that its subsidiary will at all times be in a position to meet its obligations.
220 See J Horn, Patronatserklärungen im common law und im deutschen Recht (Peter Lang, Frankfurt am Main, 1999) 125. This refers to the undertaking in a comfort letter that the parent company will maintain its shareholding in the subsidiary.
replied” “When I discovered that 'pin' was 'stechnadel', I lacked the courage to keep on until I came to elephant.”

1.6 Roadmap

This dissertation is divided into four parts. Part 1 consists of chapter 1, the introduction, which delineates the scope of the investigation and adumbrates the substance of the investigation in the remaining chapters. Chapters 2 and 3 also fall within Part 1. Chapter 2 consists of a delineation of the concept of comfort letters and includes a discussion of the various definitions of such letters, the terminology used in respect of comfort letters, a typology of letters of comfort and classification of such letters in various jurisdictions, the potential legal nature of comfort letters, and a brief comparison with traditional securities. Chapter 3 entails a discussion of the use of comfort letters in corporate group and banking practice. In particular, there is a discussion of the reasons for the use of comfort letters, an economic explanation for the use of letters of comfort, and the banking practice of the grading of such letters.

Part 2 consists of chapters 4 to 7 inclusive and deals with the contractual effect of letters of comfort in the Anglo-common law jurisdictions and the different approaches adopted by the courts. Chapter 4 is an inquiry into the aspects of contract law relevant to the discussion of the contractual effect of comfort letters, namely consideration, certainty, and intention to create legal relations. There is also a discussion of the early English case law on comfort letters and a delineation of the different approaches adopted by the courts in the Anglo-common law jurisdictions to determine the contractual effect of such letters. Chapter 5 reviews the so-called "presumption of intention to create legal relations" approach adopted in Kleinwort Benson at first instance.221 Chapter 6 is a discussion of the so-called "literal construction" approach222 first adopted in Kleinwort Benson on appeal223 as well as its off-shoot, the so-called "lack of certainty" approach first adopted in TLI Management.224 Chapter 7 analyses

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222 Also known as the "constructionist" or "analytical" approach.
the so-called “commercial (common sense) interpretation” approach first adopted in Banque Brussels\textsuperscript{225} and followed in Gate Gourmet\textsuperscript{226} and Newtronics.\textsuperscript{227}

Part 3 consists of chapters 8 and 9, and deals with letters of comfort in French law, a Romanistic jurisdiction. In chapter 8, there is an overview of the general principles of contract law applicable to the consideration of comfort letters in French law, as well as discussion of the early French case law on letters of comfort. In chapter 9 there is a discussion of letters of comfort in French law.

Part 4 contains chapter 10 which is the concluding chapter. In this chapter, the Anglo-common law decisions are compared with each other as well as with the case law on comfort letters in France and other Continental law jurisdictions. In fine, “ten commandments” of letters of comfort are stated.

\textsuperscript{225} (1989) 21 NSWLR 502.
\textsuperscript{226} [2004] NSWSC 149
\textsuperscript{227} (2008) 69 ACSR 317. See Atco Controls (2009) 78 ACSR 375 where Gate Gourmet and Newtronics were distinguished on their facts.
2 THE CONCEPT OF THE LETTER OF COMFORT AND ITS DELINEATION

2.1 Introduction

At the frontier of contractual obligation are instruments, found in most areas of business and finance, which are imbued with an internal repugnancy. They have no recognisable nomenclature, no universally accepted definition, and are generally considered to be outside the field of contractual liability, but, for a want of a better term, have been coined comfort instruments. Comfort instruments are generally given to support a commercial deal or to encourage another party to enter into a contractual obligation by providing “comfort” in the form of an assurance to one of the parties contemplating a commercial transaction in general, and commercial finance in particular. Their objective is credit value or exchange enhancement by way of compromise in order to salvage a business transaction. They are all meant to record an agreement or intention on the part of the comfort provider to do or not to do certain acts which will give comfort to the addressee of the comfort letter.

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1 LA DiMatteo, “The Norms of Contract: The Fairness Inquiry and ‘The Law of Satisfaction’ – A Nonunified Theory” (1995) 24 Hofstra Law Review 349: “One way to examine a subject is to study it at its fringes. In order to understand the beginning of the universe, scientists have studied its expansion by looking out to far off galaxies. It is the technique of examining the remnants of the ‘big bang’ in order to reverse in theory and reconstruct the moment of creation. Alternatively, in the words of Judge Posner, it is at the fringes of the law that new ‘discoveries’ are incorporated into the law so as to ‘cause the least perturbation in the system.’ So, in order to understand the essence of contract we need to look at the frontier of contract law, that area of the law where contractual certainty is at its weakest. The law of ... quasi-contractual instruments or ‘comfort letters’ are among the areas”.


6 See RI Milliner, “Comfort Letters – How Much Comfort Are They For Lenders and Auditors?” (unpublished paper, University of Western Australia, Law Summer School, 1990) at [1.1]. In this regard, comfort instruments fit neatly into the French approach to obligations, namely that a contract involves a party giving, doing or not doing something (that is, obligations de faire) – see paragraph 8.6.
The potential for contractual liability lies in the internal inconsistency, or inherent dichotomy, of many of the comfort instruments – the prototypical comfort instrument has a “bipolar nature,” trying to provide a guarantee-type of assurance without the resultant guarantee-type of liability. DiMatteo has stated that these instruments “seem to exist in a doctrinal gray area between inchoate expectation and legally enforceable reliance. From a theoretical and doctrinal basis, this line between contract and noncontract remains ambiguous.” A letter of comfort, often containing ambiguous assurances under various different guises and designations, is a prime example of a comfort instrument.

The amorphous world of comfort letters lies somewhere between a full-service downstream guarantee and simply suffering the adverse effects on one’s business reputation. Accordingly, a lack of familiarity with the concept, its nature and terminology, and the indiscriminate use of letters of comfort, especially in the context of their international business dealings, can create a legal minefield for the unwary. In this chapter, I discuss the delineation of the concept of comfort letters and some definitions of such letters. I also discuss the terminology used in respect of comfort letters, as well as a typology of letters of comfort, the classification of such letters in various jurisdictions, the potential legal nature of comfort letters, and I briefly compare comfort letters with traditional securities.

2.2 Definitions

The term "comfort letters" or "letters of comfort" is a generic term used to denote a wide variety of promises, representations, declarations or statements made by a person or legal entity to assure or reassure a creditor or creditors of another person or legal entity of his or their chances of satisfaction of his or their claim to payment of debt. A letter of comfort is neither a distinct type of legal document nor is it necessarily a legally enforceable document. Accordingly, letters of comfort are not readily identifiable as a separate type of legal document in the same way as, for example, guarantees, charges or mortgages. It has been stated that a letter of comfort is not a formal guarantee, but a "surrogate ... for [a] formal guarantee", an "implied guarantee", a "poor person’s guarantee", a "pseudo-waarborg (guarantee)", a "semi-guarantee", a "soft alternative to a guarantee", 

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14 See, in general, M Bellis, "Définition et typologie" in M Bellis, M Coipel, J Le Brun, Y Poullet and C van Wyneersch (eds), Les Lettres De Patronage (Feducl, Paris, 1984) 16 to 19.
16 See A Hargovan, A Comparative Analysis on the Enforceability of Comfort Letters in England and the Asia-Pacific Region (Draft copy of conference paper presented at Asian Law Institute Conference, Faculty of Law, Chulalongkorn University, Bangkok, May 2005) 1. I wish to thank Mr Hargovan for providing me with a copy of the draft paper and his consent to refer to it.
20 See PK Nevitt and FJ Fabozzi, Project Financing (Euromoney Books, London, 2000) 307 remark that a “comfort letter which carries implication of support is the most common form of an implied guarantee.”
“collateral sui generis”,25 an atypical security,26 a “pious platitude”,27 “a financial security of doubtful legal efficacy”,28 a “quasi-security”,29 or a “different method to soothe, relieve, and encourage others”.30 In short, a letter of comfort is an ersatz guarantee,31 neither a true guarantee nor scrap paper.32 Thus, it is not surprising that there is a variety of definitions of a letter of comfort.33

As mentioned in paragraph 1.2, a generally accepted definition of a letter of comfort is that it is "a letter written usually by a parent company ... to ... [a] lender giving comfort to the lender about a loan made to a subsidiary".34 This definition does not, however, indicate whether such letter could give rise to any legal liability to the person or company issuing it. Vedenkannas similarly describes a letter of comfort as "a document issued to a creditor (the receiver) as collateral for a loan. In the letter the issuer of the document (the supporter) asserts that the supporter is ready to finance the debtor if necessary. This kind

30 A Pierce, Demand Guarantees in International Trade (Sweet and Maxwell, London, 1993) 216.
of a document is normally issued to the receiver of the letter (the creditor) in lieu of a guarantee. The supporter is usually the parent company of the debtor (the subsidiary company).”

O’Donovan and Phillips define a letter of comfort as a “document that contains various statements of fact and intention addressed to a lender by, for example, a parent company in respect of one of its subsidiaries or by a government in respect of a public entity.”

Although the definition is broad and refers to letters issued by parent companies and government bodies like Wood’s definition, it is accurate and different from most definitions of a letter of comfort in that it highlights the fact that comfort letters invariably consist of both statements of fact and intention.

Rudden refers to a letter of comfort as a letter written by a third party to encourage the creation or renewal of a legal relationship between two others, stating that often “a parent company writes such a letter in order to encourage the grant of credit facilities to its subsidiary by a bank or a supplier.”

Bradgate and White describe a letter of comfort as “a means of reassuring potential creditors that their loan or credit facilities will be repaid without actually guaranteeing repayment.”

Bernstein and Zekoll similarly defines a letter of comfort very broadly as “an instrument written by a third party and is designed to encourage the creation of an agreement between two other parties.” The aim of this definition is to cover four different scenarios

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40 H Bernstein and J Zekoll, “The Gentleman’s Agreement in Legal Theory and in Modern Practice: United States” (1998) 46 American Journal of Comparative Law 87 at 98 and 99. This definition was accepted in Lasalle Bank National Association v Citicorp Real Estate Inc 2003 US Dist LEXIS 12043 at 21 and 22. The definition is also similar to the definition of R Feltkamp and J Stoop, “Patronaatsverklaring” in A van Oevelen
where instruments known as comfort letters are used: First, where the letter is written by a third party to assure a potential creditor that the prospective debtor is creditworthy. Secondly, to cover instruments such as the “validity agreement” in asset-based financing, letters of intent or understanding in real estate leasing and business purchases, and “black box letters” used in the transfer of intellectual property. Thirdly, where a professional opinion is expressed, such as a “due diligence” letter used by accountants in the securities industry. Lastly, to apply to a lawyer’s letter designed to assure a potential purchaser that a particular document is enforceable. As stated before, this dissertation deals only with letters of comfort drafted by a parent company and which are aimed at encouraging a lending institution or bank to issue credit to a subsidiary.

In the Butterworths Australian Legal Dictionary, a letter of comfort is defined as a “formal but non-contractual assurance from a third party to a lender which represents that a particular fact is true, or that the third party is aware of the loan, or intends to act in a certain way in the future.” This definition is almost identical to the definition suggested by Tyree, and only relates to letters of comfort properly so called as discussed in paragraph 2.5.

After a review of literature, articulated business policy statements and case law on letters of comfort, Sacasas and Wiesner concluded that “comfort letters are written: (1) by

(ed) Bestendig handboek vennootschap en aansprakelijkheid (Kluwer rechtswetenschappen, Antwerp, loose leaf 2001) at [7050].
46 AL Tyree, Banking Law in Australia (Butterworths, Sydney, 1998) 402 defined a letter of comfort as “some form of assurance from a third party, usually a parent company, to a lender which represents that some fact is true, that the third party is aware of the loan or that the third party agrees to a certain conduct in the future.”
parent companies to financial institutions or other creditors seeking to support a credit request by a subsidiary or affiliate or, (2) to anyone else where the writer expects to assure or influence others.47 A letter of comfort has also been defined as an instrument,48 usually a letter written by a parent or holding company, to induce a lending institution, usually a bank, to extend credit to its related entity, usually a subsidiary, or in support of a loan extended to its subsidiary and to give comfort (that is, acknowledging a liability) about the loan made or credit facilities extended, to its subsidiary.49 This latter definition is similar to the definition proposed by Thai who has observed that a comfort letter is "a letter written by a parent company (or holding company)50 and given to a potential lender for the purpose of inducing the lender to advance a loan to a subsidiary of the parent company."51 The key element of this latter definition is the fact that a letter of comfort is primarily aimed at inducing or encouraging a lender to provide a loan or credit facility to a third party related to the author of the letter thereby emphasising the concept reliance.52 By emphasising reliance, the influence of American law on these three definitions of letters of comfort is evident, and may be indicative that, generally speaking, letters of comfort may be more susceptible to reliance, rather than promissory, liability.53

Solomon and McMillan broadly define a letter of comfort as "a letter written, generally by a parent company to a potential financier of its subsidiary, containing various statements

48 Generally speaking, a "comfort letter" can be any communication in whatever medium. See also The Association of Corporate Treasurers, Letters of Comfort: A Practical Guide (London, April 2007) 6.
50 Usually banks prefer not to receive a letter of comfort from a holding company, but prefer rather a letter from a trading company – see paragraph 3.2.1.
53 See paragraph 1.5.
of fact and intention with respect to the subsidiary.”54 Fontaine describe a letter of comfort as an instrument “intended to reassure a party contracting with a subsidiary as to the support that the parent company is prepared to give its subsidiary in the event of it falling into difficulties.”55 Similarly, Smits defines a letter of comfort as “een verzamelbegrip voor gevallen waarin een ‘patroon’ jegens derden (meestal kredietverschaffers) aangeeft een bedrijf te zullen steunen teneinde de kredietwaardigheid van dat bedrijf te bevorderen (an omnibus term for situations where a patron indicates to third parties (mainly financiers) that it would support a business in order to advance the creditworthiness of the business)”.56

Smith, Tuxen and Mann57 define comfort letters very broadly and vaguely as a document “typically given by a holding company of a company undertaking obligations and often contains statements regarding the intentions and policy of the holding company with regard to the subsidiary.”58 Apart from being very general, this definition refers to a “holding company”, and not a “parent company”, as the provider of the comfort letter which is unusual because banks invariably insist on a comfort letter from a trading company rather than holding company because holding companies, generally speaking, have no assets other than the shareholding and are not as sensitive about its reputation compared to a trading company.59

56 See JM Smits, Bronnen van verbintenissen (Kluwer, Deventer, 2003) 43.
57 A Smith, S Tuxen and L Mann, Guarantees, Indemnities & Letters of Comfort (paper delivered at the Fourth Annual Mallesons Stephen Jaques Finance Law Summer School, Melbourne, 25 and 26 February 1991) at [1.2.4].
58 This definition is identical to the definition of I Solomon and G Stander, “Guarantees” in Mallesons Stephen Jaques, Australian Finance Law (Lawbook Co, Sydney, 2008) 608 at 614.
According to Collins' delineation, "[A] letter of comfort is typically given by a parent company to a creditor containing a promise to support the liquidity of its subsidiary that is seeking to raise capital from the creditor, without the letter or assurance itself amounting to a legally enforceable guarantee of the debt."\(^\text{60}\) Friel briefly defines letters of comfort as "promises made by people that they hope to keep but which they do not wish to be legally bound by".\(^\text{61}\)

Andrews and Millett do not define letters of comfort but rather describe them: "The situation sometimes arises in which a third party is unable or unwilling to provide a guarantee for a loan made to a borrower, but is prepared to give a written assurance to the lender of its continued support for, interest in, or dealings with, the borrower.\(^\text{62}\) These written assurances are known as letters of comfort, because they are intended to afford 'comfort' to the lender by indicating to him that the borrower is likely to be able to repay the loan. Although the use of letters of comfort is not confined to banking transactions, they are perhaps most prevalent in this area, and are often given by parent companies in respect of prospective loans to their less affluent subsidiaries."\(^\text{63}\) This description of letters of comfort clearly encompasses only letters of comfort properly so called,\(^\text{64}\) or what has been generally referred to in Continental law jurisdictions as weak or soft letters of comfort,\(^\text{65}\) which do not involve legally enforceable obligations.

Lennox defines a letter of comfort by reference to Wood's description of the components of letters of comfort as "typically a letter given by a parent company to a financier intending to grant financial accommodation to the parent's subsidiary which provides: (a) a statement of awareness of the financing transaction; (b) a statement as to the parent's


\^\text{62}\) This corresponds to a certain extent with the statement by MH Whincup, *Contract Law and Practice: the English System and Continental Comparisons* (Kluwer Law international, the Hague, 1996) 23: "A 'letter of comfort' is evidently intended to reassure another party that he may safely act in a certain way, but it may not amount to a binding promise to that effect."


\^\text{64}\) See paragraph 2.5.

\^\text{65}\) See paragraph 2.5.
ownership interest in the subsidiary; and (c) a statement concerning the conduct of the subsidiary’s business and the support (if any) to be provided to that business.”

Mulcahy has delineated comfort letters as “representations by one party which reassures the other about their commitment to the contract or ability to carry it out” and then continued to state that their purpose “is to increase confidence in pre-contractual negotiations but the question has arisen of whether they carry sufficient intention to be bound to form part of the contract.” This delineation of letters of comfort is confusing and is clearly contrary to what is generally understood in commercial lending to be a letter of comfort which involves a tripartite relationship as set out in paragraph 1.1. Mulcahy’s definition of comfort letters appears to place them as instruments used in the pre-contractual phase and include them as a type of letter of intent. This is wrong as Lake and Draetta has pointed out – a comfort letter is not really a letter of intent since, in addition to not being so-called, it is not a tentative step toward a contract, but is a putatively non-obligatory substitute for a guarantee in financial transactions. For them, a comfort letter is a document falling short of a formal guarantee which is given by a parent company to secure a loan for its subsidiary company.

In Chemco Leasing Spa v Rediffusion plc, Staughton J described a letter of comfort as “a compromise between, on the one hand, a guarantee by the parent company of the debts of its subsidiary, and, on the other, a placebo which gives no undertaking at all by the

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67 See L Mulcahy, Contract Law in Perspective (Routledge-Cavendish, Abingdon, 2008) 78.
68 See also M Fontaine, “Les lettres d’intention dans la négociation des contrats internationaux” (1977) 3 Droit et Pratique Commerce International 73 at 90. M Lutter, Der Letter of Intent (Heymann, Cologne, 1982) 12 lists letters of intent and letters of comfort as distinct types of Absichtserklärungen (declarations of intent to participate or assurance letter of intent). See J Horn, Patronatserklärungen im common law und im deutschen Recht (Peter Lang, Frankfurt am Main, 1999) 113 for a discussion of Absichtserklärungen.
69 See RB Lake and U Draetta, Letters of Intent and Other Precontractual Documents (Butterworths Legal Publishers, Boston, 1989) 13. Where third parties present putatively non-obligatory pre-contractual documents to provide some form of assurance to one or both parties to a contract under negotiation, it is not a pre-contractual situation so much as a non-contractual one.
70 See RB Lake and U Draetta, Letters of Intent and Other Precontractual Documents (Butterworths Legal Publishers, Boston, 1989) 175.
parent company". In *Toronto Dominion Bank v Leigh Instruments Ltd (Trustee of)*, Winkler J of the Ontario Court of Justice, General Division (Commercial List), described a letter of comfort as "a letter provided by a parent company to a bank concerning the borrowings of a subsidiary intended to give to the bank a degree of comfort about the transaction but also intended to fall short of a guarantee to repay the debts of the subsidiary."

### 2.3 Terminology

Internationally, a variety of terminology is used to describe the phenomenon under discussion, which often leads to confusion and mystification of the concept. In the Anglo-common law jurisdictions and the United States of America, it is usually denoted by the terms "comfort letter", "letter of comfort", "letter of responsibility", "letter of awareness", "letter of introduction", "keep well letter", "letter of patronage", "assurance letter", "letter of recognition", "letter of willingness", "commitment letter", "support letter", "letter of recommendation", "letters of maintenance", or even "love

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71 (19 July 1985, unreported, Queens Bench Division).
72 (1998) 40 BLR (2d) 1 at 7.
77 Particularly in Argentina where it is also known as a carta de recomendación – see AL Rovira and LA Allende, “Argentina” in WE Moojen and M Ph van Sint Truiden (eds), *Bank Security and Other Credit Enhancement Methods* (Kluwer Law International, The Hague, 1995) 1 at 10.
letter". Some commentators are of the view that, whilst the words used in combination with the word “letter” (for example, “awareness”, “support”, “assurance” and “comfort”) can connote different degrees of commitment on the part of the issuer, it is more correct not to attach any material weight to the terms, as the legal effect of the letter is ultimately a question of construction of the content thereof. However, in the context of Australian law as stated in *Banque Brussels Lambert SA v Australian National Industries Ltd*, apart from construing the words or the letter, evidence of other matters, including surrounding circumstances, is important in determining the contractual effect of a letter of comfort. The different names given to a letter of comfort may be an implication that comfort is given to a lender by the assumption not of a legal responsibility but, rather, of a moral responsibility only, or *vice versa*. Moreover, the indiscriminate and inconsistent use of these terms is conducive to confusion and frustrates the proper classification of these comfort instruments. In Attorney General v Blake, albeit a case not involving letters of comfort, Lord Steyn commenced his speech by stating that “in law classification is important. Asking the right questions in the right order reduces the risk of wrong decisions.” Classification changes nothing, but it promotes understanding. A neglect of classification leads to errors and confusion. An absence of classification results in a chaos of unsorted information, or, as Wood commented on the state of English law in 1722, “a

81 (1989) 21 NSWLR 502 (hereinafter referred to as *Banque Brussels*).
82 See also paragraph 6.1.3 and 7.3.4.
84 [2001] 1 AC 268 at 290.
heap of good learning." To a certain extent this is true of the law in respect of comfort letters in Anglo-common law jurisdictions.

In Belgium, the term *patronaatsverklaring* is consistently used in the Dutch legal doctrine, while the French speaking Belgian jurists use the French variant of the term, namely, *lettre de patronage* or *lettre de parrainage*, but they also use the terms *protocol d’accord, lettre de soutien or lettre de support*. Bellis, a French speaking Belgian jurist, makes a distinction between letters of comfort addressed to specific persons, coined *lettre de patronage*, and similar declarations or statements addressed to indefinite persons, coined *annonces de patronage*. In the Belgian banking sector, the term *lettre d’intention* or *intentieverklaring* or letter of intent is commonly used. Although the

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87 A Triest, “De patronaatsverklaring” (2003-04) 40 Jura Falconis 817 at [3] points out that the term *patronagebrief* is also occasionally used in practice, while JM Smits and GJ Scholten, *Bronnen van verbintenissen* (Kluwer, Deventer, 2003) 43 also uses the term “geruststellende verklaring”.


terms lettre d’apaisement or sterkmakingsverklaring\(^\text{94}\) are occasionally used, use of the latter term should be avoided because the concept of sterkmakingsverklaring connotes a stipulation pursuant to which a parent company commits itself to ensure that a subsidiary agrees to incur an obligation, while a parent company which issues a letter of comfort incurs itself an obligation.\(^\text{95}\)

In Germany, the term Patronatserklärung is most often used,\(^\text{96}\) while in Austria that term as well as the term Loyalitätserklärung are used.\(^\text{97}\) In Sweden, the term “letter of comfort” and stödbrev\(^\text{98}\) appear to be used invariably by the legal commentators,\(^\text{99}\) while in Denmark the terms "comfort letter", "letter of awareness", "letter of intent", "letter of responsibility", støtteerklæring and hensigtskerlæring are used interchangeably.\(^\text{100}\) In Greece, commentators have used terms which translated are “letters declaring intent” and “patronic statements”.\(^\text{101}\)

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\(^{95}\) C Cauffman, De Verbindende Eenzijdige Belofte (Intersentia, Antwerp, 2005) 337.


Although the terms lettre de soutien, lettre d’apaisement, lettre de patronage, lettre d’appui, declaration de patronage and lettre de confort are used in French legal doctrine, the customary term is lettre d’intention as a result of the 1987 decision of the French Cour de Cassation, or Supreme Court. Since lettre d’intention is the terminology used in section 2322 of the French Civil Code, the term has now become entrenched in French law and the terms lettre de patronage and lettre de confort ought not to be used any longer. The use of lettre d’intention or letter of intent to refer to letters of comfort is unfortunate, because it may cause the concept to be confused with the letter of intention, often encountered during the pre-contractual phase of negotiations, and which is, for an Anglo-common law jurist interchangeable with a memorandum of understanding or MOU. Houtcieff, however, is of the opinion that in France the practice will progressively be to do away with the use of the expression “letters of intent” in pre-

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103 Viuda de José Toira v Société de développement régional du Languedoc-Roussillon1988 II Juris-classeur périodique. La semaine juridique number 21113, conclusion by Advocate-General M Montannier. See paragraph 9.3.1.

104 This section was introduced into the French Civil Code by Ordinance No 2006-346 of 23 March 2006, and coin the letter of comfort as a lettre d’intention or letter of intent and defined it as an undertaking to do or not to do, having as its object the support given to a debtor in the execution of its obligations towards its creditor. For a discussion of section 2322 of the French Civil Code, see paragraph 9.2.

105 See paragraph 9.2.


107 See, for example, A van Oevelen, “Juridische verhoudingen en aansprakelijkheid bij onderhandelingen over (commerciële) contracten” (1990) 14 Het Ondernemingsrecht 57.

contractual situations,\textsuperscript{109} which will cause French law to be out of step with all the other jurisdictions.

In Portugal, the terms cartas de conforto,\textsuperscript{110} cartas de patrocínio, and declarações de patrocínio are used,\textsuperscript{111} while in Spain the terms carta de confort, cartas de patrocinio, and declaraciones de patrocinio are commonly used.\textsuperscript{112} The terms lettere di gradimento, lettere di padronaggio, lettere di patronato, lettere di patrocinio and lettere di conforto are used in Italy.\textsuperscript{113}

The use of such a multiplicity of terminology, especially when some of the terms are themselves imprecise and susceptible to a variety of meanings, is very confusing and is not conducive to accurately define, or clarify the nature of, the letter of comfort. By consistently using clear and precise terminology, it is possible to facilitate not only an accurate classification of letters of comfort, but also a better conceptualisation and understanding of the instrument.

\textsuperscript{109} D Houtcief, “Les sûretés personnelles” 2006 (May) Juris-classeur périodique. La semaine juridique (supplement) 7 at 10.

\textsuperscript{110} This is a literal and erroneous translation of the English “letters of comfort”, but has become common usage. The better expression for a letter of comfort is either carta de abono or carta de recomendação.

\textsuperscript{111} See A Menezes Cordeiro, Das cartas de conforto no direito bancário (Lex Edições Jurídicas, Lisbon, 1993); AM Pereira and M Ferreira, “Portugal” in WE Moojen and M Ph van Sint Truiden (eds), Bank Security and Other Credit Enhancement Methods (Kluwer Law International, The Hague, 1995) 325 at 335. These terms are also used in the other Portuguese speaking jurisdictions such as Brazil and Macau – see, for example, A Vilhena, “As cartas de conforto na supervisão bancária a experiência de Hong Kong e sua influência na legislação de Macau” (1996) 3 Revista Jurídica de Macau 59; C Lopes, “Cartas de Conforto Conceito, Natureza e Regime” (1996) 25 Revista do Tribunal de Contas 121 at 125.


2.4 The typology of letters of comfort

It is apparent from the definition of the letter of comfort that one is not dealing with a uniform concept. The concept encompasses a wide variety of declarations or statements or undertakings with different legal effect or consequences. There is no single instrument that one can call the letter of comfort, because every letter of comfort consists of more than one statement or declaration, usually three or four. It is the combination of the declarations or statements or undertakings contained in a particular letter of comfort which determines the enforceability of the letter, and to what extent the parent company will be bound thereby. To put it differently, the specific wording, and thereby the legal effect, of a letter of comfort can run the gamut from a vague introduction or acknowledgment of the proposed transaction to a fairly precise obligation tantamount to a guarantee.

Needless to say, it is impossible to analyse each letter of comfort on an ad hoc basis. The wide use of comfort letters in international financial transactions has, however, led to some standardisation of their contents. So, although in practice each letter of comfort which is the subject of litigation will be interpreted in context, analytically letters of comfort can be studied by reference to the various types of constituent declarations or statements or undertakings usually found in letters of comfort. Internationally, 

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117 See, in general PR Altenburger, Die Patronatserklärungen als "unechte" Personalsicherheiten, (Schultess "Schweizer Schriften zum Handels-und Wirtschaftsrecht" no 40, Zurich, 1979) 30.
commentators have tried to classify the various letters of comfort and put them into different categories. Early on, commentators on letters of comfort in the Continental law jurisdictions busied themselves mainly with the issue of classification of letters of comfort based on their scope and legal enforceability. It should be noted, however, that even though the commentators classify “letters of comfort”, it is clear that, a single comfort letter may contain paragraphs of different types. It is not possible to discuss all the different classifications since they are inherently arbitrary. Moreover, although cases on letters of comfort tend to turn very much on their particular facts, the cases discussed in chapters 5 to 7 and 9 are interesting illustrations of letters of comfort frequently encountered in practice.

2.4.1. Classification of letters of comfort in Belgian law

In Belgium, both Bellis and Schollen distinguish four types of letters of comfort. They differ, however, from each other in respect of the letters of comfort that fall into each of the categories. According to Bellis, letters of comfort can be categorised according to those containing declarations or statements (a) referring to the credit agreement between the subsidiary and the bank or credit provider; (b) pertaining to the participation

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of the parent company in its subsidiary; (c) in respect of the management of the subsidiary; and (d) pursuant to which the parent company gives an assurance in respect of the sound financial structure of the subsidiary.\textsuperscript{126} Wolfs has adopted Bellis’ classification,\textsuperscript{127} and Dirix adopted a similar categorisation.\textsuperscript{128}

As stated before, Schollen’s classification also consists of four categories, but with a different categorisation:\textsuperscript{129} there are letters of comfort which do not amount to legally binding obligations; letters of comfort containing an obligation to do something irrespective of result (the so-called obligation de moyens or middelenverbintenis or inspanningsverbintenis);\textsuperscript{130} letters of comfort containing an obligation to obtain a result (the so-called obligation de résultat or resultaatverbintenis);\textsuperscript{131} and letters of comfort containing a genuine obligation to pay on behalf of the debtor.

Following the classification of Van Ryn and Heenen,\textsuperscript{132} some commentators distinguish between three types of letters of comfort: first, the purely informative letters of comfort (vrijblijvende informatieve verklaringen); secondly, the letters of comfort containing a negative obligation not to reduce participation in the debtor or referring to participation in the debtor (verklaringen tot behoud van een bepaalde kapitaalsparticipatie in de dochtervennootschap); and thirdly, letters of comfort containing a positive obligation or commitment (verklaringen houdende een positieve verplichting met betrekking to het

\begin{itemize}
\item \textsuperscript{126} The four categories are: (a) la lettre de patronage énonciative; (b) la lettre de patronage et la permanence d’investissement; (c) la lettre de patronage et la qualité de la gestion; and (d) la lettre de patronage et la qualité de la structure financière – see MAP Bellis, “Définition et typologie” in M Bellis, M Coipel, J Le Brun, Y Poulet and C Van Wymeersch (eds), Les lettres de patronage (Société d’Etudes Morales, Sociales et Juridiques, Namen, 1984) 16 at 18; M Bellis, “Typologie des lettres de patronage” (1982) 46 Bank- en Financiewezen 213 at 217.
\item \textsuperscript{127} K Wolfs, Patronaatverklaringen (Verhandeling voorgedragen tot het bekomen van het licentiaat in de Toegepaste Economische Wetenschappen (Oriëntatie Internationaal Zakenwezen), Universiteit Antwerpen, 1992-1993) 7
\item \textsuperscript{128} See E Dirix, "Gentlemen’s agreements en andere afspraken met onzekere rechtsgevolgen” (1985-86) 49 Rechtskundig Weekblad 2119 at 2144 to 2145.
\item \textsuperscript{129} See A Schollen, “Les lettres de parrainage ont-elles toujours de bonnes intentions?" [1994] Revue de droit des affaires internationals 793 at 795.
\item \textsuperscript{130} See paragraph 8.6.1.
\item \textsuperscript{131} See paragraph 8.6.1.
\item \textsuperscript{132} See J van Ryn and J Heenen, Principes de droit commercial IV (Bruylant, Brussels, 1988) 426 to 427.
\end{itemize}
belijden en/of de financiële situatie van de dochtervennootschap).\textsuperscript{133} Verbeke and Blommaert’s threefold classification is similar in that they distinguish between purely informative letters of comfort; letters of comfort containing declarations or statements pertaining to share capital maintenance in the debtor, and letters of comfort containing positive obligations in respect of the policy and financial position of the subsidiary.\textsuperscript{134}

Meinertzhagen-Limpens and Delierneux,\textsuperscript{135} as well as Byttebier and Feltkamp,\textsuperscript{136} propagate a twofold classification based on whether or not a contract was intended. Triest also adopts this classification.\textsuperscript{137} Cauffman similarly adopts a twofold classification, distinguishing between letters of comfort containing no precise obligation or undertaking and those containing a precise obligation or undertaking.\textsuperscript{138} She acknowledges that the


\textsuperscript{134} The three categories are: (a) de loutere informatieve patroonstaatsverklaring; (b) de verklaring tot behoud van participatie; and (c) de verklaring die een positieve verplichting inhoudt – see A Verbeke and D Blommaert, Patroonstaatsverklaringen (Kluwer, Antwerp, 1996) 7. See also A Verbeke, "De kameleont zekerheidsrechten: over interpretatie van patroonstaatsverklaringen", (note to the judgment of the Ghent Supreme Court dated 15 November 1994) 1994-5 Algemeen Juridisch Tijdschrift 512 to 513 and compare L Lanoye, "Patroonstaatsverklaring: What’s in a name?" in Borgtocht & garantie. Persoonlijke zekerheden – Actuaria, in Voorrechten en hypotheken. Grondige studies (Kluwer, Antwerp, 1997) 151 at 161 to 165.


\textsuperscript{137} See A Triest, "De patroonstaatsverklaring" (2003-04) 40 Jura Falconis 817 at [19].

boundaries of the two categories are not fixed or rigid. The first category encompasses letters of comfort pursuant to which the parent company acknowledges and approves of the existence of the financial facilities provided to its subsidiary, and whereby the parent company either declares that it is its policy to ensure that its subsidiary meets its obligations, or declares its shareholding participation in the subsidiary. The letters of comfort falling within the first category are the so-called zwakke patronaatsverklaringen, or “weak” comfort letters, weiche Patronatserklärungen, lettera di patronage debole, or cartas débiles which only give rise to non-contractual liability or aansprakelijkheid uit onrechtmatige daad (that is, delictual or tort liability) in Belgium, France and The Netherlands. In Germany, the “weak” letters of comfort, or weiche Patronatserklärungen may give rise to liability pursuant to the so-called doctrine of


Vertrauenshaftung, while in the Anglo-common law jurisdictions they may result in non-contractual liability based on misrepresentation, deceit, estoppel, or statutory misleading or deceptive conduct.

To Cauffman’s second category of letters of comfort belongs those pursuant to which the parent company commits itself not to change the share capital of its subsidiary, or not to change its shareholding in its subsidiary without prior notification to the bank or credit provider, or to ensure that its subsidiary will be in a position to meet its obligations or even to personally pay its subsidiary’s debts if the latter is not in a position to do so itself. The letters of comfort falling within the second category are the so-called harde patronaatsverklaringen, strong or hard letters of comfort, harte Patronatserklärungen, lettera di patronage forte, or cartas fuertes which give rise to contractual liability.

Konzernkrediten über so genannte Ausstattungsverpflichtungen und andere Patronatserklärungen (Peter Lang, Frankfurt am Main, 2004) at 45 also refers to “sehr weiche Patronatserklärungen” or very weak comfort letters.


See paragraph 1.5.


See, for example, in Australia section 52 of the Trade Practices Act 1974 (Cth), or section 9 of the Fair Trading Act 2002 (Vic).


The dividing line between “weak” (soft) and “strong” (hard) letters of comfort is not, however, drawn similarly in all jurisdictions because the extent of the responsibility defined in terms of “weak” (soft) to “strong” (hard) depends on the circumstances under which the letter of comfort was issued, the wording of the letter and the governing law. For example, in the Germanic civil law jurisdictions\(^{158}\) such as Germany and Switzerland, unlike the position in the Romanistic civil law jurisdictions\(^{159}\) such as Belgium, France and The Netherlands, some commentators\(^{160}\) categorise letters of comfort which contain a mere informative statement or declaration as a contract, thereby putting it into the second category of Cauffman.\(^{161}\) This difference is due to the fact that in the absence of a general provision dealing with the payment of damages in tort,\(^{162}\) the commentators in the Germanic legal systems more readily resort to contractual analysis of legal questions. Moreover, in German legal theory, a letter of comfort which is not addressed to a specific person, the so-called *Patronatserklärung ad incertas personas*, is not regarded as a juristic or legal act.\(^{163}\) In 1977, the *Landgericht* or Regional Court in Frankfurt\(^{164}\) decided that it can be inferred from the fact that a statement or declaration is addressed to an indeterminate group of persons (that is, not to a specified person)\(^{165}\) that it has no

\(^{157}\) See the decision of the Spanish Supreme Court (Civil Division, 1\(^{st}\) Section) in *Banco Zaragazano v Rusticas SA* (unreported, 30 June 1995).


\(^{159}\) See chapter 8.

\(^{160}\) See M Obermuller, "Die Patronatserklärung" 1975 *Zeitschrift für Unternehmens- und Gesellschaftsrecht* 1 at 5.


\(^{162}\) See sections 1382 and 1383 of the Belgium *Burgelijk Wetboek* (or Civil Code) and section 1382 and 1383 of the French Code Civil (Civil Code) which are identical.

\(^{163}\) See, in general, M Habersack, "Patronatserklärungen ad incertas personas" 1996 *Zeitschrift für Wirtschaftsrecht und Insolvenzpraxis* 256; S Thiekötter, *Die Patronatserklärung ad incertas personas: eine Untersuchung der Geschäftserlebnen der Großbanken* (Peter Lang, Frankfurt am Main,1999); J Koch, *Die Patronatserklärung* (Mohr Siebeck, Tübingen, 2005) 533 to 605 for a discussion of the so-called *Patronatserklärung ad incertas personas*; C Cauffman, *De Verbindende Eenzijdige Belofte* (Intersentia, Antwerp, 2005) 340. The reasoning is that the person issuing the letter of comfort could not have had the intention to bind itself to an indeterminate number of persons.


\(^{165}\) See the discussion under the heading "Letter of comfort properly so called or ‘weak’ (or soft) letter of comfort" in paragraph 2.5.
rechtsgeschäftlich verpflichtende Wirkung (legally binding effect), with no resulting Vertragliche Rechte (contractual rights). Effectively, such approach reduces what appears on the face of it to be a strong letter of comfort to a weak letter of comfort, so that liability, if any, can be found only if a person relied on what is conveyed by the letter of comfort.

Du Jardin has proposed a novel classification which is based on the classification of Byttebier and Feltkamp. First, he divides statements or declarations based on their object; that is, whether they merely contain information, or whether they embody obligations. The latter category is then subdivided into two categories by reference to the effect of the statements or declarations; that is, whether the obligation is a mere moral or a legal obligation. The latter sub-category is then further subdivided on the basis of whether the legal obligation is an obligation to do something irrespective of result (the so-called obligation de moyens or middelenverbintenis or inspanningsverbintenis) or an obligation to obtain a result (the so-called obligation de résultat or resulfaatverbintenis). According to Du Jardin, the last classification between obligation de moyens and obligation de résultat has to be considered on two levels; first, as between the confortor or parent company and the confortee or bank, and secondly, as between the debtor or subsidiary and the creditor or bank. At both levels one may be dealing with either

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166 See also C Cauffman, De Verbindende Eenzijdige Belofte (Intersentia, Antwerp, 2005) 340; Y Poullet, "La lettre de patronage" 1981 DPCI 680 at 682 to 684.
170 It appears that he is of the opinion that mere informative statements are the same as moral obligations insofar as their effect is concerned - L Du Jardin, Un confort sous-estimé dans la contractualisation des groups de sociéties: la lettre de patronage (Bruxlant, Brussels, 2002) 54. Thus, as A Triest, "De patroonaatsverklaring" (2003-04) 40 Jura Falcinis 817 at [19] points out, Du Jardin’s classification also boils down to whether or not a contract is intended.
obligations de moyens, or obligations de résultat, or a mixture of the two types of obligations.\footnote{171}

### 2.4.2. Classification of letters of comfort in French law

In France, Advocate-General Montanier has made a distinction between four different types of letters of comfort.\footnote{172} In the first category of letters of comfort are those containing declarations or statements confirming the parent company’s approval of the operations of its subsidiary; in the second category fall letters of comfort pursuant to which the parent company commits itself to maintaining its participation in the subsidiary until the financial facility granted to the subsidiary has been paid back in full; in the third category are the letters of comfort whereby the parent company gives an assurance that it will ensure that the subsidiary will be able to satisfy its obligations to the bank or credit-giver; and finally there is the fourth category of letters of comfort pursuant to which the parent company undertakes to substitute itself for the subsidiary in the event of the latter defaulting in its obligations to the bank.

Baillod opts for a two-category classification, whereby letters of comfort are categorised as falling either inside or outside the legal domain.\footnote{173} Simler and Delebecque distinguish between three types of letters of comfort, namely those which contain moral obligations or commitments only; those containing a genuine guaranty or surety; and those containing declarations or statements pursuant to which the parent company commits itself to do something.\footnote{174}

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\footnote{171}{L Du Jardin, \textit{Un confort sous-estimé dans la contractualisation des groups de societies: la lettre de patronage} (Bruylant, Brussels, 2002) 38 and 68.}

\footnote{172}{\textit{Viuda de José Tolra v Société de développement regional du Languedoc-Roussillon} 1988 II Juris-classeur périodique. \textit{La semaine juridique} number 21113, note by Advocate-General M Montannier.}


\footnote{174}{Ph Simler and Ph Delebecque, \textit{Droit civil. Les sûretés. La publicité foncière} (Dalloz, Paris, 1995) 221 to 226.}
2.4.3. Classification of letters of comfort in Dutch law

In The Netherlands, a threefold classification is also propounded by Boonacker and Drok, distinguishing between letters of comfort containing informative declarations or statements, those containing ambiguous promises, and letters of comfort containing unambiguous promises. Bertrams and Graaf propound a fourfold classification which is based on the potential legal ambit of the statements in the comfort letter: There are letters of comfort containing (1) a so-called "vrijblijvende verklaring" (non-committal statement) known as letters of awareness; (2) affirmative covenants, which are subdivided into those comprising of “resultaatverbintenissen” or obligations de résultat (obligations to achieve a result), those with “inspaceensverbintenissen” or obligations de moyens (obligations to use best endeavours), and those having “financiële ondersteuningsverbintenissen” (financial support statements); (3) statements about the parent company's policy in respect of its subsidiary; and (4) undertakings similar to guarantees. Van der Waals supports the distinction between “hard” and “soft” comfort letters. This distinction has been followed in the decision of the Rechtbank Utrecht.

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177 For example, the comfort letter contains a statement that the parent company is aware of the credit facility granted to its subsidiary.
178 For example, the comfort letter contains a statement that the parent company will maintain its shareholding in its subsidiary. See paragraph 8.6.1.
179 For example, the comfort letter contains a statement that the parent company will use its influence over the subsidiary so that the latter will meet its obligations. See paragraph 8.6.1.
180 For example, the comfort letter contains a statement that the parent company will support its subsidiary to comply with its obligations to the bank.
181 For example, the comfort letter contains a statement that it is the policy of the parent company to treat its subsidiary’s debts as if it is its own.
182 BK van der Waals, “Vermogensverklaringen, te verkiezen boven borgtocht?” 2004 (April) Vennootschap & Onderneming 69 at 70.
183 2003 Jurisprudentie Indermerning & Recht 125. The statement in the comfort letter read: “Indien het garantievermogen op enige tijdstip minder bedraagt dan 30% van het balanstotaal, zal/zullen ondergetekende(n) op eerste schriftelijk verzoek van de bank het garantievermogen aanvullen met een bedrag gelijk aan... (If at any time the financial means available for guarantee is less than 30% of the balance total, then the undersigned will supplement such means upon first demand)” The court, adopting a rather literal interpretation approach, has held it to be a “hard” undertaking with contractual effect. See BK van der
2.4.4. Classification of letters of comfort in German law

The best known classification in Germany is that of Obermuller, who distinguishes between seven different types of letters of comfort.\textsuperscript{184} A distinction is made between declarations or statements (a) providing information about the parent company's participation in the subsidiary; (b) stipulating a prohibition against asset stripping; (c) pertaining to changes in the parent company's participation in the subsidiary; (d) containing moral obligations only; (e) pursuant to which the parent company undertakes to exercise its influence over its subsidiary so that the latter meets its obligations; (f) whereby the parent company undertakes to maintain its subsidiary's solvency; and (g) pursuant to which the parent company commits itself to ensure that the subsidiary will be managed and financially supported to enable the subsidiary to meet its obligations.

Rümker\textsuperscript{185} distinguishes between three different types of letters of comfort.\textsuperscript{186} Schneider has also identified three categories; first, letters of comfort which impose a legal obligation on the parent company which is conceptually quite distinct from a guarantee, but the practical effects of which are comparable to those of a guarantee; secondly, letters of comfort which also impose some sort of legal obligation on the parent company, but which normally do not require the parent company to make good a loss incurred by the bank in the event that its subsidiary fails; and thirdly, letters of comfort which do not create legal obligations for the parent company at all.\textsuperscript{187} Roschmann\textsuperscript{188} categorises

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\textsuperscript{186} See also H Schneider, "Federal Republic of Germany" (1978) 6 International Business Lawyer 303 at 304.
\textsuperscript{187} H Schneider, "Letters of Responsibility: Federal Republic of Germany" (1978) 6 International Business Lawyer 303 at 304.
comfort letters into six types, while Mosch and Fried divide letters of comfort into 22 and 36 categories respectively. Wittuhn acknowledges that generally a distinction is drawn between weak and strong letters of comfort by reference to the expected degree of enforceability, but for practical purposes has based his classification on Obermüller, Rümker and his “personal experience” and distinguishes four basic types of comfort letters: (a) those containing declarations of knowledge, (b) those containing declarations of intent to participate, (c) those containing statements of policy, and (d) comfort letters that come close to a guarantee.

2.4.5. Classification of letters of comfort in Anglo-common law

In England, Wood points out that usually comfort letters covers three issues, namely a statement of awareness of the financing, a commitment to maintain ownership interest, and the degree of support required by the lender. Parsons distinguishes between nine

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189 See W Mosch, *Patronatserklärungen deutscher Konzernmuttergesellschaften und ihre Bedeutung für die Rechnungslegung* (Bielefeld, 1978).
191 In Austria, B Lindner, *Patronatserklärungen im österreichischen und deutschen Recht* (unpublished Doctoral dissertation, Universität Wien, Vienna, 2005) VIII and IX distinguished between 16 different types of comfort letters which he then divided into the weak (weiche) and strong (harte) categories of letters of comfort.
196 See P Wood, *International Loans, Bonds, Guarantees, Legal Opinions* (Sweet and Maxwell, London, 2007) 401. GD Cooper and JG Fox, "Commercial Morality – Enforceability of Letters of Comfort" [1990] *Journal of Banking and Finance Law and Practice* 66 also point out that a letter of comfort ordinarily contains: "(1) an acknowledgment by the parent company as to the awareness of the provision of financial accommodation and approval thereof; (2) a statement (to use a neutral term) by the parent company in relation to the maintenance of its ownership of, or other interest in, the subsidiary company; and (3) an indication (again using a neutral term) of ‘the degree of support required by the lender’".
different types of clauses found in letters of comfort. \(^{197}\) Lingard adopts a simple straightforward classification between letters of comfort containing either legally binding or legally non-binding declarations or statements. \(^{196}\)

Ellinger has classified letters of comfort into three basic types. \(^{199}\) At the one extreme, the parent company may give an undertaking to maintain its shareholding or other financial commitment in its subsidiary. A second type of letter calls for the parent company to use its influence to see that its subsidiary meets its obligation under the primary contract. The third type of letter of comfort is the weakest form of letter and is a confirmation that the parent is aware of the contract with its subsidiary, but without any express indication that the parent company will assume any responsibility for the primary obligation. \(^{200}\)

In Australia, Kelly \(^{201}\) adopted Ellinger’s trinomial classification dividing letters of comfort into “weak comfort letters”, “medium strength comfort letters”, and “strong comfort letters”. \(^{202}\) This classification also corresponds with the popular categorisation of letters of comfort in Sweden where a distinction is made between svaga (weak), mellanstarka (medium strong) and starka (strong) letters of comfort, \(^{203}\) and in Portugal where a similar distinction is made between conforto fraco (weak), conforto médio (medium strength) and


\(^{200}\) See also AL Tyree, Banking Law in Australia (Butterworths, Sydney, 2008) 450.


\(^{202}\) AMH Smart, “Letters of Responsibility: England” (1978) 6 International Business Lawyer 295 at 296 has divided letter of comfort into two main categories – those imposing no legal obligation and those imposing legal obligations – and then sub-divide the latter category into strong and weak letters of comfort.

conforto forte (strong).\textsuperscript{204} The classification is also similar to the classification mjuka (soft) and mellanvarianter (in between variants), and hårda (hard) by the Danish commentator, Bryde-Andersen.\textsuperscript{205}

In Canada, David\textsuperscript{206} is of the opinion that commitments in comfort letters fall into four general categories, namely affirmative covenants or undertakings, negative covenants, representations and warranties, and statements of intention.

2.5 Delineation

The expression “letter of comfort” is an extremely misused term,\textsuperscript{207} because the appellation is used for a range of instruments which at the one end of the spectrum merely contain assertions of fact not giving rise to contractual liability and on the other end which contain express promises giving rise to contractual liability.\textsuperscript{208} At its weakest, a letter of comfort is a mere introduction or an act of comity resting entirely upon business goodwill, and at its legal maximum a comfort letter contains the promise of a surety or guarantee.\textsuperscript{209} Its validity and enforceability depend upon the degree of comfort; that is, whether the letter is closer to being a guarantee or just a mere comfort with no contractual force in law.\textsuperscript{210}


\textsuperscript{205} See M Bryde-Andersen, Praktisk aftalteret (Copenhagen, 1988) 447.


\textsuperscript{208} The different forms of letters of comfort and the degree of enforceability have been noted by various commentators – see, for example, AL Tyree. “Southern Comfort” (1990) 2 Journal of Contract Law 279. See schedule A for some examples of letters of comfort.

\textsuperscript{209} See R Sacasas and D Wiesner, “Comfort Letters: The Legal and Business Implications” (1987) 104 Banking Law Journal 313 at 315, and 336 for the “Comfort Index” according to which letters of comfort are put on a scale ranging from 1 (guarantee/legally enforceable promise) to 10 (nothing).

Letters of comfort, a phenomenon that has developed in commercial practice, vary considerably in form, content and factual background, but generally, they contain one or more of the following –

(a) an acknowledgement by the parent company that it is aware of the provision of funds to its subsidiary;

(b) a statement or undertaking with respect to the parent company’s maintenance of ownership interest in the subsidiary; and

(c) a statement of support, indicating that the subsidiary will be maintained in a financial position to meet its commitments as and when they fall due, and in particular, its commitments to the intending financier or bank.  

Although this delineation taken from Wood correctly describes the components of letters of comfort usually encountered, it is unhelpful in enabling conclusions as to the strength of an individual comfort letter’s undertaking. Moreover, such delineation does not do justice to letters of comfort as a negotiated compromise in practice.

In practice, the decision whether a comfort letter in lieu of a guarantee from a parent company will be used to secure the credit facility granted by the bank to its subsidiary essentially involves a trade-off which will depend on, for example, the bargaining power of

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213 It appears that banks also adopt a similar approach to the categorisation of letters of comfort – see paragraph 3.3.
the parties, the financial condition of the borrower, the credibility of the parent company, the wish of the bank to extend credit facilities and to initiate, or continue, business with either the parent of the subsidiary companies. Moreover, the terms of the letter of comfort, which are crucial in determining its contractual effect, are usually also a compromise solution to the polarised negotiating positions of the parent company and the bank. On the one hand the bank endeavours to obtain a clear and legally binding commitment in the form of a strong letter of comfort; on the other hand the parent company tries to avoid any binding commitment and is prepared to give only a letter of comfort properly so called. A letter of comfort is consequently a compromise position. As a result, most frequently the negotiated letter of comfort is the medium strength letter of comfort.

Comfort letters fall into categories purely based on their content and the degree of comfort or enforceable promise made therein. Consequently, letters of comfort are customarily classified according to their “strength” or “weakness” from the bank’s point of view. So, it is submitted that a more useful framework is to define three classes of letters of comfort according to the extent of commitment entered into by the parent company; namely, letters of comfort properly so called, medium strength letters or comfort, and strong comfort letters.

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215 See paragraph 3.2.1.
216 See paragraph 3.2.2.
217 See AL Tyree, Banking Law in Australia (Butterworths, Sydney, 2008) 450.
2.5.1. Letter of comfort properly so called or “weak” (or “soft”) letter of comfort

A letter of comfort “properly so called”\(^{221}\) is an instrument that does not give rise to contractual liability, but only to moral obligations.\(^{222}\) It is merely a facet of the relationship between the bank and the corporate group in question, without collateral value. A letter of comfort properly so called should not contain anything enforceable as a guarantee or collateral warranty or representation or otherwise. Letters of comfort “properly so called” include, for example, statements in which the parent company declares to closely supervise the management of a subsidiary without assuming responsibility for the subsidiary to meet its contractual obligations, or general declarations of awareness\(^ {223}\) of the underlying transaction.\(^ {224}\) A declaration of awareness does not oblige the person giving the declaration to do anything directly. At most, it may be construed as prohibiting the parent company from draining the subsidiary excessively of its cash resources on grounds of equity, but a direct obligation towards the creditors of the subsidiary cannot be construed out of such a declaration.\(^ {225}\) Moreover, apart from the fact that the language used in the letter must not be able to be construed as any kind of promise,\(^ {226}\) the conduct of the issuer of the letter of comfort must be consistent with an intention of unenforceability.\(^ {227}\) The letter of comfort properly so called can be equated with the category “weak” or “soft” comfort letters, or letters of awareness. If a bank is seriously looking for a promissory obligation, a letter of comfort properly so called merely offers lip

\(^{221}\) Associated British Ports v Ferryways NV [2009] 1 Lloyd’s Rep 595 at [24].

\(^{222}\) See R Feltkamp and J Stoop, “Patronaatsverklaring” in Bestendig handboek vennootschap en aansprakelijkheid (Kluwer rechtswetenschappen, Antwerp, loose leave 2001) at [760].

\(^{223}\) Sometimes also referred to as “non-committal statements” or in Dutch, “vrijblijvende verklarings” – see BK van der Waals, “Vermogensverklaringen, te verkiezen boven borgtocht?” 2004 (April) Vennootschap & Onderneming 69 at 70.


\(^{226}\) Having regard to the international use of letters of comfort, the wording of the letter must survive scrutiny in all jurisdictions which may consider the letter, not just the issuer’s jurisdiction.

service in the form of encouragement or awareness. A soft letter of comfort is no comfort at all.\textsuperscript{228}

Letters of comfort properly so called usually have the following features\textsuperscript{229} and contain only one or two “comforts”:

(a) A specified addressee: The letter of comfort should be addressed to a specific recipient bank, but any language that attempts to make the letter personal to the bank should be avoided because that could be taken to be evidence of an intention to create legal relations.\textsuperscript{230}

(b) A specified user of credit service: The letter of comfort should be in relation to a specific company (subsidiary in a corporate group context), and should not be capable of being interpreted as applying to all the subsidiaries in a corporate group in a specific country, or to all related companies.\textsuperscript{231}

(c) A specified credit or credit based service: The letter of comfort should be in relation to provision in a specified country of credit or credit based services, and the particular line of credit or particular type of credit based service should be stipulated.\textsuperscript{232} It is undesirable to have one letter of comfort referring to more than one line of credit or type of credit based service, because potentially problems could arise about the currency of the letter of comfort if, for example, one of the lines of credit expires or a type of credit based service is withdrawn. Moreover, care should be taken when stating that the letter of comfort is provided as a condition precedent or requirement for use of the credit facility,

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\textsuperscript{228} See MJ Bernard, “The Seven Commandments for Letters of Comfort” 2003 (March/April) \textit{Banking Today} 6 at 7.

\textsuperscript{229} The letter of comfort may also include, for example, a confidentiality undertaking if the parent company does not want it to be known to third parties that it has provided a comfort letter – see The Association of Corporate Treasurers, \textit{Letters of Comfort: A Practical Guide} (London, April 2007) 16.


because this may be an indication of a legal commitment. A similar concern is raised if the letter of comfort has an expiry date – in any event, if the principal statement is an expression of awareness and goodwill, there really cannot be an end date.

(d) A statement of awareness: The principal "comfort" in the letter is an expression that the parent company is aware of the provision or renewal of the credit facility to its subsidiary, or of a debt incurred, or to be incurred, by a subsidiary company. It contains a statement of the fact of awareness, not a promise to act upon the awareness, and as such has no promissory effect. Thus, it has no legal effect. It creates no more than a moral obligation by the parent company to take the bank's position into account when dealing with the subsidiary. If this is the only statement in the letter of comfort, it is usually referred to as a letter of awareness and it is the weakest or softest form of a letter of comfort.

(e) A statement of holding: The letter of comfort often also includes a further "comfort" to the effect that the debtor company is a subsidiary of the issuer of the letter, or that the parent company holds a certain percentage of the shares in the subsidiary. It is important to state that the statement is true only at a

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234 PJ Ho, Letters of "Dis"comfort: An Examination of the Legal Effect of Letters of Comfort (unpublished thesis in part fulfilment of the degree of Bachelor of Law, Monash University, 1994) 6. It should be noted that letters of discomfort (non-recourse) have a particular meaning and have nothing to do with either the uncertainty surrounding letters of comfort, or with enforceable letters of comfort. As discussed in The Association of Corporate Treasurers, Letters of Comfort: A Practical Guide (London, April 2007) 22, a letter of discomfort is an instrument whereby a bank is formally and explicitly put on notice that the parent company will not consider any credit support at all to its subsidiary, and that the bank must make its own enquiries, investigations and analyses about the credit risks involved without in any way relying on the relationship between the parent company and its subsidiaries. These letters are uncommon for obvious reasons.

235 See K Wolfs, Patronaatsverklaringen (Verhandeling voorgedragen tot het bekomen van het licentiaat in de Toegepaste Economische Wetenschappen (Oriëntatie Internationaal Zakenwezen), Universiteit Antwerpen, 1992-1993) at 8; J Horn, Patronatserklärungen im common law und im deutschen Recht (Peter Lang, Frankfurt am Main, 1999) at 107.

particular time so that it is not interpreted as an undertaking to maintain the shareholding. 238

(f) A disclaimer: It is advisable to include this in the letter of comfort to negate any intention to create legal obligations and to place it into the category of deliberate no law. 239

2.5.2. Letter of responsibility or “strong” (or “hard”) letter of comfort

The strongest form of the letter of comfort is the letter of responsibility. A letter of responsibility (“hard” or “strong” letter of comfort), which also includes a statement that a parent company is aware of a debt incurred, or to be incurred, by a subsidiary company, means that the parent company may be responsible for the debt in particular situations. For example, where the letter of comfort states that the parent company will be responsible for the debt if it sells the subsidiary company to a third party, and the third party is not acceptable to the bank or lender, the parent company may be liable. 240 In such a situation, the letter of comfort has legal effect 241 close to that of a guarantee. 242 A strong letter of comfort may include all the features and “comforts” of a letter of comfort properly so called, except the disclaimer.

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Toegepaste Economische Wetenschappen (Oriëntatie Internationaal Zakenwezen), Universiteit Antwerpen, 1992-1993) at 15: J Horn, Patronatserklärungen im common law und im deutschen Recht (Peter Lang, Frankfurt am Main, 1999) at 116.

238 Needless to say, if the statement is not true when made a claim in tort for damages may lie, or even, for example, a claim under section 52 of the Trade Practices Act 1974 (Cth) – see paragraph 1.5.

239 See paragraph 4.4.1.


241 Chemco Leasing Spa v Rediffusion plc (unreported, Staughton J, Queen’s Bench Division (commercial Court), 19 July 1985); Chemco Leasing SpA v Rediffusion plc [1987] FTLR 201.

242 In fact, CH Wissum, “Comfort letters under Danish law” (1987) 6 International Financial Law Review 23 at 25 is of the view that it is inadvisable to make any major legal distinction between “strong” comfort letters and guarantees.
2.5.3. Medium strength letter of comfort or letter of comfort in ordinary vernacular

The legal status of the so-called “genuine”\textsuperscript{243} or medium strength or moderate\textsuperscript{244} letter of comfort is unclear. The medium strength letter of comfort, now referred to in common parlance as a "letter of comfort" with no descriptive qualification, is neither a letter of awareness or a letter of responsibility, but a letter of in-between character with terms that not only vary considerably but are often obscure.\textsuperscript{245} Indeed, as one commentator\textsuperscript{246} has remarked: "Letters of comfort remind one of that well known comment by a famous cricket commentator: they are neither one thing nor the other."\textsuperscript{247} Gulson is of the view that they "steer a course between the Scylla of a non-acknowledgment by the parent company on the one hand and the Charybdis of a legal commitment on the other".\textsuperscript{248} Hence, generalisations on legal enforceability of letters of comfort in this category are dangerous, necessitating a careful consideration of each letter’s individual terms and circumstances.

The case law internationally, and in particular in Anglo-common law jurisdictions as discussed in chapters 5 to 7, indicates that, while appropriate legal solutions can be deducted for letters of comfort which clearly fall within the categories of letters of comfort properly so called and strong comfort letters, medium strength letters of comfort have proven problematical for the courts, giving rise to divergent approaches to the

\begin{itemize}
  \item[\textsuperscript{243}] G Tierney, "Letters of Comfort – Are they worth the paper they’re written on?" (1988) 102 Australian Banker 161.
  \item[\textsuperscript{245}] PJ Ho, Letters of “Dis”comfort: An Examination of the Legal Effect of Letters of Comfort (unpublished thesis in part fulfillment of the degree of Bachelor of Law, Monash University, 1994) 6.
  \item[\textsuperscript{247}] This is a reference to BBC commentator and journalist, John Arlott, who once famously described the unimpressive bowling performance by Bob Cunis, a New Zealand medium pace bowler who played 20 tests between 1964 and 1972 and who had an unorthodox action which made it seem like he was bowling off the wrong foot, as follows; “Cunis’ bowling this morning has been rather like his surname ... neither one thing nor the other.”
\end{itemize}
contractual effect of such letters. Although legal solutions cannot be deduced for these letters of comfort by reference to case law, it is possible to identify the various approaches adopted by the courts to derive some guidelines to the contractual effect of letters of comfort.

Generally speaking, a letter of comfort usually contains two or more of three elements: informative facts, vague intention and unambiguous commitment. As well as stating that a parent company is aware of a debt incurred, or to be incurred, by a subsidiary company, and containing all the other features of a letter of comfort properly so called, except the disclaimer, it usually provides one or more of the following “comforts” to a bank or lender:

(a) that the parent company will not decrease its shareholding in the subsidiary company;\textsuperscript{249}

(b) that the parent company will not "asset strip” the subsidiary company;\textsuperscript{250}

(c) that the parent company will manage the subsidiary company;\textsuperscript{251}

(d) that the parent company will notify the bank of any change in its shareholding of the subsidiary;\textsuperscript{252}

(e) that the parent company will support the subsidiary company;\textsuperscript{253}

\textsuperscript{249} This comfort is also known as a statement of financial involvement.
\textsuperscript{250} K Wolfs, \textit{Patronaatserklärungen} (Verhandeling voorgedragen tot het bekom van het licentiaat in de Toegepaste Economische Wetenschappen (Oriëntatie Internationaal Zakenwezen), Universiteit Antwerpen, 1992-1993) at 43.
\textsuperscript{251} See K Wolfs, \textit{Patronaatserklärungen} (Verhandeling voorgedragen tot het bekom van het licentiaat in de Toegepaste Economische Wetenschappen (Oriëntatie Internationaal Zakenwezen), Universiteit Antwerpen, 1992-1993) at 36; J Horn, \textit{Patronatserklärungen im common law und im deutschen Recht} (Peter Lang, Frankfurt am Main, 1999) at 139.
\textsuperscript{252} This comfort is also known as an information undertaking. See The Association of Corporate Treasurers, \textit{Letters of Comfort: A Practical Guide} (London, April 2007) 16; K Wolfs, \textit{Patronaatserklärungen} (Verhandeling voorgedragen tot het bekom van het licentiaat in de Toegepaste Economische Wetenschappen (Oriëntatie Internationaal Zakenwezen), Universiteit Antwerpen, 1992-1993) at 17 and 21; J Horn, \textit{Patronatserklärungen im common law und im deutschen Recht} (Peter Lang, Frankfurt am Main, 1999) at 125.
\textsuperscript{253} See G Walker, ”Letter of Cold Comfort” (1989) 5 Banking Law Bulletin 120 at 121.
(f) that the parent company will use its influence to ensure that the subsidiary company repays the debts;

(g) that the parent company intends to ensure that the subsidiary repays the debt, or be in a position to fulfil its obligations to the bank;

(h) that the parent company has a policy of ensuring that the subsidiary company repays its debts;

(i) that the parent company will ensure that the continuing commercial relationship between it and its subsidiaries will be maintained; and

(j) that the parent company is responsible for the overall policy of its subsidiary.

These statements of comfort do not form a closed list of statements that can be incorporated in a letter of comfort, because the “variations used by lenders and parents of borrowing subsidiaries are numerous and are limited only by the extent of the innovation practised by the draftsperson and the requirements of the parties.” 254

2.6 The legal nature of letters of comfort

Any analysis of the legal status of comfort letters must proceed from a proper understanding of the nature of the transaction. There is a difference in approach in the various jurisdictions as to the basis for legal liability in respect of strong letters of comfort, and the debate is particularly lively in the civil law jurisdictions. 255 A strong letter of comfort is either viewed as a contract (offer and acceptance) or as a binding unilateral

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253 This comfort is also known as a statement of support.
255 A Vilhena, “As cartas de conforto na supervisão bancária a experiência de Hong Kong e sua influência na legislação de Macau” (1996) 3 Revista Jurídica de Macau 59 at 61.
promise. The distinction is not, however, clear-cut, because it appears that what some commentators regard as a binding unilateral promise is basically an offer.

2.6.1. Contract as basis for the letter of comfort

The French Cour de Cassation, or the Supreme Court, has viewed the letter of comfort as a contract. The contractual basis for the letter of comfort has also been confirmed by further decisions of the French Supreme Court on 18 April 2000 and 9 July 2002. In light of these decisions, French legal doctrine is predominantly of the view that the letter of comfort has a contractual basis, rejecting the binding unilateral promise approach. As Cauffman points out, however, these French decisions and doctrine evidence a liberal view of stilzwijgende aanvaarding (tacit acceptance) of an offer, because acceptance is, for example, assumed when the loan agreement in respect of which the letter of comfort is provided makes mention of it, or when the terms of the letter of comfort is agreed between the parties, or when the loan is only advanced after receipt of the letter of comfort.

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According to these French decisions and doctrine, the letter of comfort itself (usually in the form of a letter from a parent company) constitutes the offer. A similar approach is also adopted by the Dutch *Hooge Raad*, or Supreme Court, in its so-called "Albada Jelgersma I" decision, and the Dutch legal doctrine. Although the majority view in Belgium is that the basis for comfort letters is a binding unilateral promise, there are commentators favouring contract as the basis of such letters.

The majority view in Germany is similar: the *Patronatserklärung* constitutes the offer by the parent company, and the claim by the bank that the parent company complies with its promised performance results in the formation of the *Patronatsvertrag*. Thus, there has to be an offer and an acceptance, even though the acceptance is invariably not expressed, because pursuant to section 151 of the German *Bürgerliches Gesetzbuch* or BGB (Civil Code) it is not necessary to communicate an acceptance of an offer to the

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264 See, for example, JV Boonacker and ED Drok, *De mogelijke rechtsgevolgen van de letter of comfort volgens Nederlands, Engels, Duits en Frans recht*, in NIBE-Bankjuridische reeks (NIBE, Amsterdam, 1992) 12.
269 Section 151 of the BGB: *Der Vertrag kommt durch die Annahme des Antrags zustande, ohne dass die Annahme dem Antragenden gegenüber erklärt zu werden braucht, wenn eine solche Erklärung nach der Verkehrssitte nicht zu erwarten ist oder der Antragende auf sie verzichtet hat. Der Zeitpunkt, in welchem der Antrag erlischt, bestimmt sich nach dem aus dem Antrag oder den Umständen zu entnehmenden Willen des Antragenden* (translated as “Acceptance without declaration as against the offeror. A contract will come into existence by acceptance of an offer without acceptance needing to be declared to the offeror if such a declaration is not to be expected in accordance with custom, or if the offeror has renounced his right to it. The moment in time at which the offer lapses, is determined by the intention of the offeror which is to be deduced from the offer or the circumstances.”
offeror if it is not customary to communicate an acceptance in such circumstances, or if the offeror does not insist on the acceptance being communicated to him.270

It is clear from the case law discussed in chapters 5 to 7, that the Anglo-common law jurisdictions also opt for a contractual analysis of letters of comfort. Whether a letter of comfort is a legally binding promise depends on whether it is contractual in nature. Thus, major elements of formation of a contract have to be present, namely agreement (offer and acceptance), consideration, contractual intention or as it is also somewhat awkwardly known, “intention to create legal relations”, and certainty of terms.271

2.6.2. Binding unilateral promise as basis for the letter of comfort

Explanation A to article 2:107 of the Principles of European Contract Law ("PECL") 272 refers to comfort letters as an example of a binding unilateral promise. In Belgium, a binding unilateral promise as basis for a comfort letter is not only propounded by most commentators,273 but has also been accepted by the courts.274 In Brazil, letters of comfort are also considered to be unilateral transactions, conceived by the statement of intent of one single party.275 In France276 and Germany,277 the reverse is true in that the minority

271 See chapter 4.
272 Article 2:107: “A promise which is intended to be legally binding without acceptance is binding.”
274 See the judgment of the Rechtbank van Koophandel Gent dated 3 June 1993 discussed by A Verbeke and D Blommaert, "De patronatsverklaring: Een persoonlijke zekerheid met vele gezichten" (1994) 31 Ondernemingsrecht 71; L Du Jardin, Un confort sous-estimé dans la contractualisation des groups de sociéties: la lettre de patronage (Bruylant, Brussels, 2002) 102 is of the view, however, that the case is support for the view that agreement or contract is the basis for a letter of comfort.
view is that the basis for the letter of comfort is a binding unilateral promise. However, in respect to binding letters of comfort not addressed to any specific person, the unanimous view in Belgium\textsuperscript{278} and Germany\textsuperscript{279} is that such letters are based on unilateral promises.

2.6.3. Credit mandate as basis for the letter of comfort

In Spain the courts have applied to the letter of comfort the theory of the credit mandate, \textit{mandatum qualificatum}.\textsuperscript{280} Both "soft" and "hard" comfort letters are construed and interpreted as an order or mandate given by the parent company to the bank to provide credit facilities to its subsidiary, especially if the subsidiary is wholly-owned.\textsuperscript{281} According to the broadly diffused Roman law rule of \textit{mandatum},\textsuperscript{282} as applied in \textit{Banco Zaragozano},\textsuperscript{283} any person who requests another to advance credit to a third party whose financial worthiness is in some way supported by the requesting person, incurs liability as a personal guarantor.

2.7 Letters of comfort and traditional securities

Comfort letters resemble two other classic types of collateral: contracts of guarantees and indemnities. Normally, however, a letter of comfort falls short of a guarantee or

\textsuperscript{276} J Mestre, "Les conflits de lois relatives aux sûretés personnelles" [1986-87] \textit{Revue critique de droit international privé} 70.
\textsuperscript{277} See UH Schneider, Patronatserklärungen gegenüber der Allgemeinheit" [1989] Zeitschrift für Wirtschaftsrecht und Insolvenzpraxis 624.
\textsuperscript{278} See, in general, C Cauffman, De \textit{Verbindende Eenzijdige Beloftes} (Intersentia, Antwerp, 2005) 345 and 346.
\textsuperscript{279} See in general, M Habersack, "Patronatserklärungen ad incertas personas" [1996] Zeitschrift für Wirtschaftsrecht und Insolvenzpraxis 256 at 261.
\textsuperscript{280} See the decision of the Spanish Supreme Court (Civil Division, 1\textsuperscript{st} Section) in \textit{Banco Zaragozano v Rusticas} SA (unreported, 30 June 1995) ("Banco Zaragozano"); and A Carraso, Guarantees – Letters of Comfort" (2007) 22 Journal of International Banking law and Regulation N92.
\textsuperscript{282} For a discussion of the Roman law concept, see DH van Zyl, \textit{History and Principles of Roman Private Law} (Butterworths, Durban, 1983) 310 to 312.
A guarantee is an unconditional contractual promise that holds the guarantor liable for the performance of an obligation or debt, so that if the debtor fails to perform, the guarantor is liable to pay the full amount guaranteed on demand. An indemnity is a promise by the promisor that he or she will keep the promisee harmless against loss suffered through entering into a transaction with a third party. An indemnity differs from a guarantee in three respects. First, the statutory provisions based on the Statute of Frauds of 1677 which require certain types of contracts to be in writing (for example, the Victorian Instruments Act of 1958) apply generally to guarantors, but not to indemnities. Secondly, a guarantor’s liability may be affected by the discharge of the debtor, or by the fact that the principal contract is void or unenforceable, whereas an indemnifier’s liability either will not or may not be affected by those factors. Thirdly, the grounds on which a guarantor may be discharged by the conduct of the creditor are broader than the grounds on which an indemnifier may be so discharged.

There are mainly five apparent differences that distinguish comfort letters from contracts of guarantees and indemnities:

(a) Unlike a guarantee, a letter of comfort is not always a binding contract. In Needham v Television Australia Satellite Systems Ltd (Kirby P, Sheller and Cole JJA), an agreement to “stand behind”, “stand beside” or “take care of” the debtor was construed to be words of comfort, not a guarantee.
(b) Letters of comfort do not make the parent company directly liable to the bank of the subsidiary. The liability is intended to be limited, at most, to furnishing the subsidiary with the financial means to meet its obligations to the bank. Thus, the letter of comfort is collateral *sui generis.*

(c) The continuance or non-continuance of the obligation can be resolved only by interpreting the language used in the letter of comfort. Comfort letters may be restricted to a specific obligation to which it relates or refer to all existing and future obligations that may arise out of a legal relationship.

(d) As long as it is not expressly mentioned in the letter of comfort, the bank cannot insist on a specific form of support by the parent company to its subsidiary. At most, the parent company can state that it will provide the financial support for a subsidiary to meet its obligations under a specific credit arrangement. So, it may be that all creditors, and not just the bank, will benefit from payments by the parent company.

(e) Letters of comfort do not usually contain the protective clauses which typically appear in formal guarantees, such as negative pledges, guarantor’s warranties as to its authority and power to enter into the guarantee and confirmation of the unconditional nature of the parent company’s obligations.

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Letters of comfort are usually compared to guarantees and indemnities, mainly because general contractual principles apply to both.\textsuperscript{293} Although the wording of guarantees is more standard than the wording of letters of comfort, the courts have not, like with comfort letters, used a single consistent approach to the construction of guarantees.\textsuperscript{294}

\begin{footnotesize}
\textsuperscript{293} Andar Transport Pty Ltd \textit{v} Brambles (2004) 217 CLR 424 at [23].
\textsuperscript{294} See J O’Donovan, “Guarantees” in \textit{The Laws of Australia} (Legal Online, 2008) at [8.6.930].
\end{footnotesize}
3.1 Introduction¹

The problems pertaining to the contractual nature and enforceability of letters of comfort remind one forcefully of the shortcomings of Anglo-common law concerning groups of companies,² especially in the context of a subsidiary which is not sufficiently capitalised to enable it to carry on its proposed business.³ In the course of its activities, a subsidiary, like any other company, may incur or assume a variety of obligations, including obligations to repay capital borrowed from a financial institution or bank, as well as the interest thereon. Per definition the application of limited liability⁴ in the parent-subsidiary context⁵ limits the financial exposure of the parent towards this creditor of its subsidiary, allowing the subsidiary to be used as a convenient device for shielding a parent company against risk.⁶ Even in a wholly-owned subsidiary scenario the parent company has, generally speaking,⁷ no direct liability for the debts of its

¹ See, in general, C van Wy.meersch, ”Conte xte économique et financier des lettres de patronage” in M Bellis, M Coipel, J Le Brun, Y Poulet and C van Wymeersch (eds), Les Lettres De Patronage (Feduci, Paris, 1984) 1 to 15.
² AHH, ”A comfort letter may create a contractual obligation” 1988 (February) Business Law Brief 4. The problem is not, however, peculiar to Anglo-common law – see, for example, BG Bylund, ”Letters of Responsibility: Sweden” (1978) 6 International Business Lawyer 310 at 311.
⁴ Salomon v Salomon [1897] AC 22.
⁵ See, in general, chapter 9 (Liability Management) in N Hawke, Corporate Liability (Sweet & Maxwell, London, 2000) 163 et seq.
⁷ Exceptions are fraudulent or wrongful trading – see Re Augustus Barnett & Son Ltd (1986) 2 BCC 98,904; DD Prentice, ”Fraudulent Trading: Parent Company’s Liability for the Debts of Its Subsidiary” (1987) 103 Law Quarterly Review 11. In Augustus Barnett, a subsidiary had operated at a loss and its auditors had only agreed to certify its accounts on a going concern basis because the parent company had provided a letter of comfort, whereby it allowed this to be noted in the subsidiary’s accounts. The subsidiary went into liquidation. The attempts to hold the parent company liable were unsuccessful. See paragraph 4.2.5.
subsidiary beyond the amount of its investment in the subsidiary.\(^8\) Indeed, as Templeman LJ aptly remarked:

“English [and so too Australian] company law possesses some curious features which may generate some curious results. A parent company may spawn a number of subsidiary companies, all controlled directly or indirectly by the shareholders of the parent company. If one of the subsidiary companies, to change the metaphor, turns out to be the runt of the litter, and declines into insolvency to the dismay of its creditors, the parent company and the other subsidiary companies may prosper to the joy of the shareholders without a liability for the debts of the insolvent subsidiary”.\(^9\)

However, from an economic or financial point of view a subsidiary company in a reputable group of companies benefits from at least an appearance of enhanced creditworthiness due to group consolidated financial statements.\(^10\) This spectre of financial stability and limited credit risk often obscure the legal risks involved in making credit facilities available to the subsidiary.\(^11\) Thus, in corporate lending,\(^12\) the risk of the

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\(^9\) Re Southard \& Co Ltd [1979] 1 WLR 1198 at 1208. See J Dine, The Governance of Corporate Groups (Cambridge University Press, Cambridge, 2000) 44 who remarked that this corporate law approach was confirmed by the cavalier treatment by the court of comfort letters in Re Augustus Barnett \& Son Ltd (1986) 2 BCC 98,904, a decision discussed in paragraph 4.5.2.

\(^10\) See, in general, H Laga and R Tas, “Enkele bijzondere problemen met betrekking tot het sluiten van (samenhangende) overeenkomsten met een vennootschap die deel uitmaakt van een groep” in J Perilleux, V Van Houtte-Van Poppel, F Walschot (eds), L’interdépendance de contrats: Onderlinge afhankelijkheid van overeenkomsten (Vlaams Pleitvennootschap, Ghent, 1997) 133 at 134.

\(^11\) From the bank’s perspective having a customer company controlled by another non-customer company is an important factor, positive or negative, in the bank considering the credit relationship.

\(^12\) As RJ Clayton and W Beranek, “Disassociations and Legal Combinations” [1985] Financial Management 24 at 25 correctly observe: “Supporting subsidiary debt will tend to lower the cost of such debt at the sacrifice of increasing the parent’s financial risk, and hence its systematic risk. A parent that refuses to support its subsidiary debt, on the one hand will find the cost of its subsidiary debt to be higher but its own systematic risk lower.”
subsidiary’s failure is clearly shifted towards its financial creditor, the bank.¹³ The bank needs to deal with this risk-shifting not only by way of good bank lending practices,¹⁴ but also by way of traditional securities and letters of comfort.

The skill in lending money is to get it repaid safely along with an appropriate reward for the risk involved.¹⁵ The best security, in a general sense, against commercial risks is the success of the borrowing subsidiary company, and this can be monitored in several ways – for example, the bank can and ought to look for reliable predictions of feasibility and profitability;¹⁶ the bank can and ought to look at ensuring the preservation of net worth and the maintenance of assets,¹⁷ as well as adequate cash flows in appropriate currency to serve the debt; the bank can by means of assignment or charge intervene to intercept the proceeds of contracts of the subsidiary, the bank can and ought to monitor projects of the subsidiary and require regular updates of the financial position of the subsidiary; and the bank can and ought to impose borrowing limits on the subsidiary by way of financial ratio covenants such as minimum turnover target, profitability ratio and debt-equity ratio.¹⁸

In the context of company groups where the parent company controls a subsidiary, the bank’s customer, the control may be a positive or a negative factor in evaluating the

¹⁶ Banks consider, among other things, the following when receiving applications for credit facilities from companies: the liquidity of the company, the solvency of the company, the profitability of the company, the quality and morality of the management of the company, the nature and extent of the other securities provided by the company, the company’s credit record – see JV Boonacker and ED Drok, De Mogelijke Rechtsgevolgen van de Letter of Comfort volgens Nederlands, Engels, Duits en Frans Recht (Nederlands Instituut voor het Bank- en Effectenbedrijf, Amsterdam, 1992) 5.
¹⁷ If the subsidiary’s assets are unencumbered and the net-worth far exceeds the credit maximum, the bank may depend solely on the quality of the subsidiary’s management and on its bright market prospects.
risk of not getting repaid its loan - the credit risk. Banks and other creditors are not, however, always in a position to fully evaluate, and protect themselves effectively against, the risks which the limited liability of the parent shifts upon them. As Avgitidis observed:

“Like creditors of an independent company, creditors of a subsidiary are only sometimes protected, depending on the kind of their relationship with the company, the particular risk which they have to face, their ability to foresee it and their bargaining power to demand ex ante compensation. Only the creditors who are practically able to protect themselves, and, additionally, have sufficient resources, skills, experience and sophistication can be effectively protected; for the rest of them, limited liability transfer uncompensated risks.

In fact, creditors of a subsidiary are in a more difficult position than creditors of an independent company. They have to face not only the usual risks faced by a creditor of an independent company, but also, a number of additional difficulties arising out of the typical group structure and practices.”

If the bank has any concern either about that control or about the creditworthiness of its customer considered on its own, it may contemplate a hierarchy of possible risk mitigations. Especially if the unsecured credit risk is too high, a bank can secure the

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19 There are other types of risks involved in lending, for example operational, currency, interest, market, country and environmental risks, but the really big risk that most banks run is the credit risk in their lending books – see CN Rouse, Bankers’ Lending Techniques (Financial World Publishing, Canterbury, Kent, 2002) 3 to 8; RD De Lucia and J Peters, Commercial Bank Management (LBC Information Services, Sydney, 1998).


credit risk by way of the usual means,\textsuperscript{23} of guarantees (third party, intra-group, or parent company guarantees),\textsuperscript{24} indemnities, bonds, mortgages, debentures, charges,\textsuperscript{25} negative and positive pledges, by demanding ex ante compensation for the risk of loss that its bears, or by reserving for itself the right to monitor the riskiness of the subsidiary’s operations.\textsuperscript{26} Indeed, as far as commercial risks are concerned, a bank’s best security, in the narrower banking sense, lies in guarantees (secured if possible) from parent and related companies of the borrowing company with available assets.\textsuperscript{27} It is only in this way that the bank can be certain that assets of the group will be available to meet the obligations of the legal borrower.\textsuperscript{28} However, in commercial lending, like in project finance, there may be transactions which do not call for security in the form of hard assets\textsuperscript{29} or there may be occasions when “soft” credit support is

\textsuperscript{22} If possible the bank would seek “hard collateral” ; that is, mortgages on real estate, pledges on moveable property or fiduciary assignment of assets, including receivables.


\textsuperscript{24} See B Price, “Intra-Group Guarantees; Who benefits?” 1997 (May) Practical Law for Companies 15; A L Tyree, Banking Law in Australia (Butterworths, Sydney, 1998) 401 suggests that a guarantee should, if possible, be taken from all companies in the group.

\textsuperscript{25} Not being a charge because it does not give the bank an interest in any asset of the parent company, a letter of comfort does not require registration – see L Taylor, “What A Company Charge Does Not Reveal – The Financier’s Perspective” [1992] Company and Securities Law Journal 396 at 412.


\textsuperscript{28} See AL Tyree, Banking Law in Australia (Butterworths, Sydney, 2008) 450.

\textsuperscript{29} For example, where the credit decision is based upon the potential debtor’s financial statements, its general business reputation, and relationships with clients, customers and affiliates, but there are third parties with additional financial stability - R Sacasas and D Wiesner, "Comfort Letters: The Legal and Business Implications” [1987] Banking Law Journal 313 at 315; or where real security would be too costly or inflexible – K Wolfs, Patronaatsverklaringen (Verhandeling voorgedragen tot het bekomen van het licentiaat in de Toegepaste Economische Wetenschappen (Oriëntatie Internationaal Zakenwezen), Universiteit Antwerpen, 1992-1993) at 4.
the only support available. In such a milieu where the expression of goodwill and awareness of the credit facility may be acceptable, the comfort letter is one of the instruments used and serves a valuable role in promoting commercial transactions. In other words, for the lender, the letter of comfort acts not as security, but as a credit enhancement tool, which is backed by the parent company’s name and reputation.

In this chapter, I discuss the reasons for the use of comfort letters, analyse the economic explanation for the use of such letters, and review the banking practice of the grading of letters of comfort.

3.2 Reasons for the use of letters of comfort

3.2.1 Reasons for their acceptance by banks

The approach of a bank to securing its credit risk will greatly depend on whether the credit advanced to the subsidiary constitutes a short, a medium or a long term facility. Short term loans usually take the form of overdraft facilities, loans with maturity of not more than one year, repayment obligations arising out of letters of credit or guarantees issued by the bank at the subsidiary’s request and advances made

34 See RR Pennington, Bank Finance for Companies (Sweet and Maxwell, London, 1987) 71 et seq.
by a bank accepting, purchasing or discounting bills of exchange or promissory notes issued by the subsidiary.\textsuperscript{35} These transactions between a bank and a subsidiary are of a routine nature and the amounts as well as the length of maturity involved are often insignificant, and therefore it is unlikely that a bank will undertake a costly assessment of the financial standing of the subsidiary and it will bargain accordingly the terms of credit.\textsuperscript{36} In such circumstances, the most convenient and cost efficient way to deal with the credit risk is often to obtain a letter of comfort issued by a parent company.\textsuperscript{37} Although letters of comfort are usually encountered in respect of short term credit facilities, they are, despite their doubtful legal effect, also used to manage the credit risk of the bank for medium and long term financial facilities if the parent company, or another group company is, for a number of reasons, reluctant to guarantee formally the debts of its subsidiary.\textsuperscript{38} Almost always, banking practice is to confine the acceptance of letters of comfort to transactions involving large reputable local companies and MNCs,\textsuperscript{39} which are trading companies and not merely holding companies, with which the bank has a history of prior satisfactory dealings.\textsuperscript{40} Moreover, banks are usually reluctant to accept letters of comfort, unless the good standing of the debtor is supported by other evidence or the loan or credit is supported by other securities.\textsuperscript{41} Also, as a rule of thumb, especially in the Continental


\textsuperscript{37} It should be noted that comfort letters may also be given by an existing lender in order to encourage the injection of further capital into a borrowing company, or additional financial support – see Morgan Grenfell Development Capital Syndications Ltd v Arrows Autosport Ltd [2003] EWHC (Ch) 333 and GM Andrews and R Millet, Law of Guarantees (Sweet & Maxwell, London, 2008) 541.


\textsuperscript{39} See PW Blake, JW Brink, TS Link and DE Walsh "Four Perspectives on the Comfort Letter" [1979] Journal of Commercial Bank Lending 16 at 19.


\textsuperscript{41} See K Heller, "Letters of Responsibility: Austria" (1978) 6 International Business Lawyer 293 at 295.
law jurisdictions, a letter of comfort will be acceptable to a bank if it must be shown on
the parent company’s balance sheet.42

The commercial considerations which may impact on a bank’s decision to accept a
letter of comfort as opposed to insisting on a formal and legally enforceable guarantee
may include, for example43 –

(a) the overall relationship of the bank with the corporate group involved, its
genral reputation, the volume of business and profit margins that the bank
enjoys from them as well as the degree of risk inherent in the instant
transaction;44

(b) the moral obligation of a major company, which are sensitive to maintaining
their reputation for honest dealing and are reluctant to break their word,
even if legally they do not have to keep it;45

(c) some forms of wording in letters of comfort which could make them legally
binding and are seen as better than nothing when a guarantee cannot be
negotiated;

(d) competitive pressures among banks which may entice a bank into offering to
extend credit without requiring a guarantee, as a means of luring the

43 See CN Rouse, Bankers’ Lending Techniques (Financial World Publishing, London, 2002) 174; L Thai,
44 Toronto Dominion Bank v Leigh Instruments Ltd (Trustee of) (1998) 40 BLR (2d) 1 at 7 and 8
(hereinafter referred to as Toronto Dominion Bank).
and Financial Law 3 at 4 remarked that if the subsidiary defaults in repayment, it has been a rather
successful tactic, irrespective of the merit of the bank’s claim from a strictly legal point of view, to
produce the comfort letter and try to embarrass the parent company into honouring its commitment.
See also K Wolfs, Patronaatsverklaringen (Verhandeling voorgedragen tot het bekom van het licentiaat
in de Toegepaste Economische Wetenschappen (Oriëntatie Internationaal Zakenwezen), Universiteit
Antwerpen, 1992-1993) at 4 and 5 who points out that the insolvency of the subsidiary may have an
impact on the creditworthiness of the parent company, because banks tend to look at the financial
position of the group, and not the individual companies within the group.
borrower away from a competing institution, or to maintain and develop a long-standing and well-established business relationship.46

Indeed, as Winkler J has remarked in Toronto Dominion Bank,47 “the terms which comprises a letter of comfort will likely be negotiated individually, address some or all of the above issues and be somewhat idiosyncratic reflecting the respective bargaining power of the parties.”

3.2.2. Reasons for their provision by parent companies48

The management of liability in the context of a group of companies is essential for the existence and prosperity of not only the group, but for each company forming part thereof.49 Notwithstanding that their policy may be to support any subsidiary in financial difficulties, parent companies are usually reluctant to give formal guarantees, even though their motive “is not necessarily sinister”.50 Indeed, even a letter of comfort is “a device known to businessmen who do not always find it comforting”.51 In 1996, Avgitidis conducted a sample survey of 25

47 (1998) 40 BLR (2d) 1 at 8.
49 See chapter 9 in N Hawke, Corporate Liability (Sweet and Maxwell, London, 2000).
51 F Herzfeld, “Comfort letters before the courts” (1988) 132 Solicitors’ Journal 1549. The Association of Corporate Treasurers, Letters of Comfort: A Practical Guide (London, April 2007) 11 points out that there a number of reasons why parent companies usually seek to minimise the number of comfort letters they issue, for example: (1) they may be uncomfortable with the possible risk to their reputation if the comfort letter is not fully supported to the bank’s satisfaction; (2) they are concerned with the comfort letters being interpreted by courts as giving rise to legally enforceable obligations; (3) the issuing of a comfort letter may change the tax status of the parent company; (4) the issuing of comfort letters may defeat the purpose of project vehicles operating in foreign jurisdictions without recourse to the parent company; and (5) they wish to avoid the administrative burden of issuing and internally controlling the comfort letters.
companies which were either parent or subsidiary companies of a group.\textsuperscript{52} One of the questions was: "Are letters of comfort preferred over formal guarantees?" Board members responsible for legal or financial matters of thirteen of the companies responded as follows\textsuperscript{53} -

ICI plc, the overall parent company of the ICI group:

"Letters of comfort are preferred. We would never let a subsidiary default. Most people know that when they are dealing with one of our companies they should not be too worried, because they know effectively that we will stand behind it. We would never let a subsidiary company going into liquidation owing money because that would severely undermine our credibility with our other lending institutions. We do issue of letters of comfort. We try to avoid them actually if we can but we prefer them over formal guarantees for balance sheet reasons. But quite often you can get away without providing anything, especially for small overdraft facilities. But if we are raising big amounts on a foreign bond market, then inevitably we give a parent company guarantee. The institutions will insist on that."\textsuperscript{54}

(a) General Electric Company, the overall parent company of the General Electric Group:

"I do not like letters of comfort. In the normal course it does not make any difference because you stand by your subsidiary, but, on the other hand, the legal consequences of a letter of comfort are uncertain and changing according to the terms whereas guarantees require precise corporate actions with resolutions of the board and authority to enter into them. Letters of comfort are entered into much more easily without going to through the

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\textsuperscript{53} The group structures of the surveyed companies may have changed and the current world-wide financial and credit crisis will undoubtedly have an impact on corporate behaviour, but even if so, the responses provide a useful basis to analyse corporate views and use of letters of comfort.


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formalities. I think it is a matter of general corporate governance. Given our sort of financial situation, I prefer guarantees because at least you know what your obligation is and there is no misunderstanding. This is my view. I do not know whether my colleagues would agree on that.

Letters of comfort in the UK are different from letters of comfort in the Continental Europe where they are regarded as having binding effect. In the UK there are cases which make it clear that there is a certain amount of uncertainty. There is obviously a reluctance of some companies to give guarantees because it counts in relation to their borrowing limits and things of that sort, which problems we do not have.\textsuperscript{55}

(b) Unilever plc, one of the two parent companies of the Unilever Group:

"We tend for historical reasons and presentation reasons to expect our subsidiaries to present themselves as companies standing on their own feet. We do not expect them to be leaning too much on us for assistance. They are supposed to go and arrange supplies with their creditors and arrange leases of property. We are very disinclined to give parent company guarantees. Fortunately most of our subsidiaries are quite substantially on their own right so that by and large they do not need guarantees. We do not want to have big figures in the accounts for contingent liabilities and guarantees. We fortunately have such a good reputation that, to a very large extent, outsiders are very happy to do business with us without any form of comfort.

... Just occasionally, there will be a need for comfort letters which we in fact review from time to time. In some ways, we do not like comfort letters because they are morally binding. As recent case law indicates, they can be legally binding, as well. They are certainly ambiguous. So, the preferred legal

view is not to give letters of comfort. If we want to give a legal commitment we give a clearly enforceable guarantee. If we do not want, we do nothing. But the legal perfection is not always observed by our commercial and banking colleagues. So, there are occasions where letters of comfort are given. We try to make sure that they definitely do not have any legal effect.”56

(c) Philips UK Ltd, a subsidiary of Philips of Holland:

“We have often been asked for guarantees or letters of comfort for some of our subsidiaries. We have always in the past refused to take the step to provide guarantees or letters of comfort to Dutch companies. For various reasons we only gave guarantees within the UK. Our policy is to keep guarantees within the UK. Only occasionally we guarantee for foreign companies. It is not particularly banks which ask for guarantees; this happens only occasionally. If you are doing large contracts, particularly with a local authority, the local authority will want a guarantee from the parent. If it is a large project they prefer guarantee rather than letter of comfort.”57

(d) Shell UK Ltd, a subsidiary owned 60% by the Royal Dutch Petroleum Co and 40% by the English Shell Transport and Trading Co:

“We do not like formal guarantees. Certainly, at the level from holding company down to us, they do not like guarantees, probably they will not give guarantees. Down to the next levels, occasionally we give performance guarantees when dealing with local authorities. But by and large we do not guarantee subsidiaries and letters of comfort make us feel uncomfortable. So, the preferred course is that only in unusual circumstances we might give either a guarantee or a letter of comfort. It is the exception rather than the

rule. There is a number of reasons for not giving guarantees and letters of comfort."58

(e) BMW (GB) Ltd, a subsidiary of BMW AG of Germany:

“Letters of comfort are absolutely preferred over formal guarantees. Our parent company has never provided us with a guarantee of any form. They prefer to provide us with letters of comfort which may be different but they seem to work. We follow the same policy with our subsidiaries. We prefer to provide letters of comfort. This is because companies have autonomy and they are funded themselves. We want our subsidiaries to be commercially successful on their own right. It is not the fear that the guarantee is more easily enforceable than a letter of comfort, because at the end of the day we will not let a subsidiary go bust because of the damage of reputation that it might do to the group. You have a little bit more flexibility if you do not have a formal guarantee.”59

(f) Canon UK Ltd, a subsidiary of Canon of Tokyo:

“When we first started and we were financially not very strong, we needed very clear guarantees from our parent company. As we progressed, creditors and banks needed a softer and softer guarantee. So, we went from guarantee to letter of comfort but now we do not need anything. So, we have borrowing facilities now; we do not have guarantees in place, at all. The same applies to our subsidiaries. Sometimes, when they are very small, they will need guarantees from us. Gradually, as they get bigger and healthier, they need letters of comfort and then nothing.”60

(g) Mitsubishi Electric UK Ltd, a subsidiary of the Mitsubishi Electric Corporation of Japan:

“Letters of comfort are often used and not necessarily formal guarantees. But because we are such a huge group internationally we have ability to act on trust and understanding. I am not aware of any instance where a letter of comfort had to be enforced against the parent company.”61

(h) Ford Motor Co Ltd, a subsidiary of the American Ford Motor Co responded that nearly all the companies in the group are internally financed, so that there were no outside creditors.

(i) ITT Industries Ltd, an English subsidiary of the American ITT Corporation:

“It is unusual for the parent company to be approached for a letter of comfort or formal guarantee other than for any formal bank borrowings. My parent company is very reticent about giving letters of comfort or formal guarantees. Subsidiaries' creditors more often use retention of title clauses to protect their interest.”62

(j) Japanese parent company of a group in the automotive industry:

“Owing to the group's credit rating, providing a letter of comfort is usually sufficient for our creditors, though some of our subsidiaries' creditors require formal guarantees from the parent.”63

(k) Ciba-Geigy SA, the Swiss overall parent company of the Ciba-Geigy group:

“No general policy or statement can be made given the variety of the situation”, because sometimes letters of comfort are required, sometimes guarantees, and at other times nothing is asked for by the creditors of its subsidiaries.64

The responses of the surveyed companies provide an interesting perspective on letters of comfort in corporate group practice and correspond with the reasons given in the literature on comfort letters why a parent company prefers, or is compelled, to provide a letter of comfort instead of a traditional form of security such as a guarantee. The reasons, for example, are:65

(a) A parent company may generally for commercial reasons seek to avoid liability for the debts of subsidiaries; that is, it deliberately wishes to keep the subsidiary at arms length.66 For example: while it is unusual, a holding company may legitimately take the “stand alone” attitude to its subsidiaries generally, as a matter of policy;67 or, in some cases what is to be seen as a stand-alone project in a different jurisdiction may be carried on through a subsidiary, and in view of the risks involved, the parent company may take the view that the subsidiary must stand or fall, after initial or planned capitalisation, on its own cash flows or project finance so that external liabilities are without recourse to the parent company;68 or when considering subsidiaries or incorporated joint ventures in other jurisdictions, parent

companies commonly regard the exposure of banks, especially local banks, to the credit of the subsidiary or joint venture as a small measure of protection against expropriation, arbitrary loss of operating licences, or import/export licences as banks may have some influence locally to “help” in such circumstances – in other words, if the parent company issues guarantees it may remove the credit exposure to the potentially weakened customer and so also the incentive to help.69

(b) A formal guarantee may breach a limit in a parent company's Constitution, Articles or Memorandum of Association or borrowing instruments, or breach an agreement with its own bankers or lenders,70 for example, the parent company may have given undertakings by way of a negative pledge71 to others, usually other lenders, that they will not issue any third party guarantees or will do so only under certain defined circumstances.72 The parent company may also want not to reduce its own borrowing base.

(c) Comfort letters have accounting advantages, because the commitment may not necessarily appear as a contingent liability on the parent company's balance sheet.73 A formal guarantee may have to be disclosed as a contingent

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liability upon a parent company's financial statements, but the parent company may not want to disclose it for two reasons. First, the parent company may not want to disclose a guarantee for "balance sheet cosmetics" reasons, "for the purpose of impressing shareholders, competitors, business associates and potential lenders." Secondly, the provision of a guarantee may affect the parent company's own credit rating or minimum solvency requirement, or may affect the parent company's own ability to obtain credit facilities.

Apparently very few Australian companies used to disclose the existence of letter of comfort in their annual reports. The view has, however, been


For example, section 29 of the Insurance Act 1973 (Cth) provides for a minimum solvency requirement in respect of a parent insurance company.

See J van Ryn and J Heenen, Principes de droit commercial IV (Bruylant, Brussels, 1988) 425. J Kelly, Comfort Letters in Australian Banking Practice – A Moral Obligation or Contract? (unpublished thesis, Macquarie University, Sydney, 1990) 9 points out, however, that financial markets assess a parent company’s creditworthiness from a group perspective so there would be minimal advantage in avoiding a contingent liability on the parent company’s balance sheet. The group balance sheets are the relevant data the banks are interested in and the inter-group contingent liabilities effectively disappear on such statements. Accordingly, the accounting benefits are really a chimera conjured up by the parent companies’ misconception of the mechanics of the financial markets.

See B Walker, "UK Court Decision on Letters of Comfort offers little" New Accountant. 6 April 1989, who examined the financial statements of a hundred Australian companies in 1989. Arguably, internationally this practice may have change because it appears that although accountants do not treat
expressed that letters of comfort are an “extreme method of off balance sheet financing”\textsuperscript{80} and that “not only senior company accountants and auditors, but also directors, may have been placing themselves at risk of various breaches of the Corporations Law [now the Corporations Act 2001 (Cth)] and at risk of possible actions for breach of duty when companies engaged in significant off balance sheet financing schemes which resulted in misleading balance sheets.”\textsuperscript{81} However, it is not only the parent company officers who could be liable for breaching the Corporations Act, because the bank or lender could face a similar problem, and “if the lender knows that the parent intends to use the informality of the letter so as to evade disclosure, this illegal conspiracy may poison the entire letter and the lender’s rights.”\textsuperscript{82}

Although there used to be a practice that it was for the directors to decide the likelihood, as a matter of commercial judgment, to honour the intentions

\[\text{so-called enforceable comfort letters as guarantees, they acknowledge their enforceability by considering them contingent liabilities on issuers’ financial statements – see LA DiMatteo and R Sacasas, “Credit and Value Comfort Instruments: Crossing the Line from Assurance to Legally Significant Reliance and Toward a Theory of Enforceability (1995) 47 Baylor Law Review 357 at 370.}\]


\textsuperscript{81} M Markovic, “Off Balance Sheet Financing: The Legal Implications” (1992) 10 Company and Securities Law Journal 35 at 46. However, G Whittred, I Zimmer, S Taylor and P Wells, Financial Accounting (Thomson, Southbank, Victoria, 2004) at 164 who remark that the inclusion of contingent liabilities under guarantee in the debt/assets ratios included in loan covenants is at least partially responsible for the use of letters of comfort. After expressing the view that a letter of comfort has “no legal standing: it is not enforceable”, which is clearly too general and not in accordance with the recent case law in Australia as set out in chapter 7, they continue that it “has economic significance inasmuch as a failure to honour the commitment will cause the lending institution, and perhaps the debt market at large, to revise its assessment of the provider’s credibility and reputation. Nevertheless, the fact that the letter is not legally enforceable might allow the auditor to avoid classifying the commitment as a contingent liability for the purpose of debt agreement. A more prudent approach for accountants and auditors is, however, not to assume that a letter of comfort is not legally enforceable, and in any event, when faced with a letter of comfort they should not only carefully analyse it, but should also take legal advices to avoid legal pitfalls – see N Radesich and A Trichardt, “Comfort Letters in Australia: Some Pointers for South African Auditors and Lawyers” (1994) 6 South African Mercantile Law Journal 360 at 364; S Copp, “Comfort Letters: Some Not So Comforting Thoughts” (1990) 106 Accountancy 81 at 82.

\textsuperscript{82} See P Wood, Law and Practice of International Finance (Sweet and Maxwell, London, 1980) 309."
expressed in a letter of comfort, it has been suggested that in light of *Kleinwort Benson* accountants should adopt the following approach: “The first issue is to examine carefully the terms of the letter of comfort, and, if possible, the circumstances in which it came to be written, in order to determine whether it creates a legally binding liability. If it does, then it will be necessary to include the letter of comfort as a contingency in the financial statements. Only in the case where the directors are satisfied that the letter of comfort cannot give rise to any legal liability will the matter be one purely of commercial judgment.”

(d) In certain countries, like Germany, a subsidiary company’s debt guaranteed by a parent company used to incur a 2% capital investment tax. The capital investment tax in Germany was abolished in 1972, but “the advance of these instruments had gained its own momentum and was not to be stopped.” Giving guarantees of the subsidiary’s obligations without a receipt of a fee may cause problems for the parent company in the context of its own tax regulations on transfer pricing. Furthermore, from an international tax perspective, companies’ guarantee obligations, especially foreign companies, in the context of a parent/subsidiary relationship may change the tax status of those companies.

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90 The Association of Corporate Treasurers, *Letters of Comfort: A Practical Guide* (London, April 2007) 9 and 10 gives two examples from the tax notes issued in the United Kingdom: (1) OT220500 – Interest and Financing states that “in international tax matters the usual yardstick acceptable to OECD countries,
(e) A formal guarantee may be costly to provide because it may incur stamp duty or other levies, and may even be required to be disclosed in the official gazette.

(f) A formal guarantee may require exchange control authority.

(g) A formal guarantee may require board approval for it to be enforceable.

(h) An overseas parent company may have subsidiaries in countries in respect of which there are international sanctions or boycotts, like South Africa during the apartheid years. When a note on a parent company’s balance sheet indicated a contingent liability in respect of a subsidiary which was doing business with or in the Republic of South Africa, the parent company could have been subjected to boycotts or other intimidations, and was subject to state and local anti-South Africa legislation in the United States which, for example, prohibited or precluded state and local government superannuation including the UK, is the arm's length arrangement. That is, in looking at UK group subsidiaries with a common overseas parent it may be necessary to limit the interest deduction to the arm’s length level of interest charged on a total debt level no bigger than that which the relevant consolidated UK grouping would or could borrow from a third party without outside support. Outside support includes guarantees, back to back loans, external collateral, letter of comfort, etc ... provided by other UK groupings or overseas parts of the world-wide multi-national group"; and (2) DT1919 -Non-residents: UK income: returns and reports: enquiries by FICO- form 4450/1 part 2 states that "Sometimes the borrowing is from a bank etc. but the amount has been influenced by a guarantee given by an overseas parent. The influence can also be by way of a letter of comfort or a letter of awareness. International Division 4/5, Melbourne House would like to see any cases where excessive finance seems to have been obtained by such means." See also IJJ Burgers and HMM Bierlaagh, "Some Tax Aspects of Guarantees, Letters of Comfort and Keep-Well Agreements between Group Companies" (1998) 52(2) Bulletin for International Fiscal Documentation 81.


funds from investing funds in any company with links with companies doing business with or in South Africa.96

(i) Some parent companies regard the provision of a guarantee in respect of its subsidiary’s debt a “beneath the dignity of the parent company”.97 This reason is sometimes coupled with the explanation that most companies have a self-image of responsible behaviour so that in the event of a subsidiary in financial difficulty, the parent company will, without any obligation, prefer orderly closure and will settle all obligations as appropriate.98

(j) Another major reason that banks accept letters of comfort is competitive pressures among banks. Toronto Dominion Bank99 is a good example of how far a bank may depart from prudent practice in pursuit of a lucrative new account. Banks compete for business not only through loan pricing, but also by way of increased willingness to assess and assume credit risks,100 so that a bank which is prepared to lend money to a subsidiary without requiring a parent guarantee may have a competitive advantage over a bank that continues to insist on such a guarantee.101

It has been argued that because historically letters of comfort have been invented, and provided by parent companies instead of formal guarantees, not to avoid the legal

96 See, in general, AP Trichardt and GAM Radesich, Divestment, disinvestment, divestiture, disengagement: a survey of United States state and local anti-South Africa legislation (Transactions of the Centre for Business Law no 12, University of the Orange Free State, Bloemfontein, 1989).
98 However, as pointed out by The Association of Corporate Treasurers, Letters of Comfort: A Practical Guide (London, April 2007) 10 and 11, even responsible parent companies have been known to allow the subsidiary to be liquidated, because the parent company may itself experience financial issues, or the exposure in respect of the subsidiary may cause the parent company to go into insolvent liquidation, or there may be risk that the directors of the parent company may be acting outside their powers and authority and not in the interests of the parent company.
effect of guarantees but primarily for their accounting and tax opacity, the implication is that letters of comfort have legal effect.\textsuperscript{102} It is clear that the case law in the Continental law jurisdictions\textsuperscript{103} and in some Anglo common law jurisdictions\textsuperscript{104} have neither supported this economic importance of letters of comfort with certain, straightforward and rational decisions, nor given clear guidelines to enable the financial practice to work on a firm and predictable basis. Moreover, as Bertrams has pointed out, the accounting and tax considerations are no longer the primary considerations for the use of letters of comfort, and in any event, they are not determinative of the contractual effect of such letters.\textsuperscript{105}

3.2.3. An economic explanation for the use of letters of comfort when enforceable contracts are neither technically nor economically infeasible

According to socio-legal scholars, businesspeople and lawyers do not necessarily view contracts in the same way.\textsuperscript{106} There is a gulf between what businesspeople regard as necessary in the interests of flexibility and what the law regards as desirable in the interests of certainty.\textsuperscript{107} It is not uncommon for the former not to distinguish between an agreement and a contract, or between a discretionary and an enforceable contract. For lawyers a contract is a mixture of rights, obligations and remedies for breach\textsuperscript{108}

\textsuperscript{103} See chapter 9 for a discussion of the French case law.
\textsuperscript{104} See chapters 5 to 7 for a discussion of the Anglo-common law case law.
with the key issue being legal liability,\textsuperscript{109} while for businesspeople it is “primarily a facilitative device within an economic cycle which turns on such processes as the acquisition of materials, the production of finished goods, marketing and sales, finance and payment.”\textsuperscript{110} It is further said that for business people a contract, where made, serves the “a-legal” purpose of clarifying the exact nature of the deal rather than that of casting it in a particular mould.\textsuperscript{111}

Research suggests that “probably the majority of people in ongoing business relationships regulate their relationships in accordance with what they consider is fair and reasonable or commercially necessary at particular points in time rather than by reference to a priori rights and duties arising under a contract”.\textsuperscript{112} So, it is said that businesspeople believe that they need not insist on the rights associated with the contractual relationship if some other device or method can achieve their goals or deal with commercial uncertainty or contingency.\textsuperscript{113} Because commerce is founded on relationships with others,\textsuperscript{114} businesspeople keep their promises because they fear


business sanctions\textsuperscript{115} rather than legal sanctions,\textsuperscript{116} and are therefore prepared to accept comfort letters which deny any legally binding effect or contain only moral obligations, because they expect that, regardless of legal force, such a document obliges the other party to abide by what he or she has promised.\textsuperscript{117} Business is said to have withdrawn to a large extent from contract law particularly in so far as much greater reliance is placed on amicable negotiation and commercial arbitration, and not the courts, for the resolution of contractual claims.\textsuperscript{118}

When businesspeople make promises or agreements they are looking forward and seek to reduce uncertainty or contingency, and for them contracts and submitting disputes to a judge when there is a disagreement are only some ways of dealing with the contingency.\textsuperscript{119} It has been said that a reason why sophisticated parties use legally unenforceable comfort agreements, is that the "parties simply do not value judicial enforcement, even if they could have it."\textsuperscript{120} Contracts can thus be viewed as lying in a

\textsuperscript{115} See, for example, the comments by Winkler J in \textit{Toronto Dominion Bank}(1998) 40 BLR (2d) 1 at 157 that companies may pay on non-binding comfort letters based on “commercial considerations such as corporate reputation and concern that a refusal to honour a comfort letter may undercut the company’s relationship with the affected bank or become public knowledge and make future dealings with other banks difficult.”


\textsuperscript{118} J Tillotson, \textit{Contract Law in Perspective} (Cavendish Publishing Limited London, 1995) 25. B Irlenbusch, “Are Non-Binding Contracts Really Not Worth the Paper?” (2006) 27 \textit{Managerial and Decision Economics} 21 comments that legal sanctions are often unnecessary and may even have undesirable consequences, and that: “This is the case not only because of their costs but rather because reference to legal norms might be interpreted as a betrayal of trust or even a form of unkind action. It is argued that insisting upon a strict legal analysis of the relation or the dispute is likely to close down any further reference to norms of goodwill or cooperation” and furthermore that: “The fact that parties often abstain from using legal sanctions is closely related to the observation that most contracts are vague or silent on a number of key features, ie they are incomplete.”


\textsuperscript{120} JM Lipshaw, Contingency and Contracts: A Philosophy of Complex Business Transactions \texttt{http://law.bepress.com/expresso/eps/444} 20. See also RE Scott, “A Theory of Self-Enforcing
precision continuum, with illusory\textsuperscript{121} or non-binding assurances about future behaviour,\textsuperscript{122} and definite or legally enforceable\textsuperscript{123} promises as endpoints.\textsuperscript{124} In doing business, businessmen therefore have at least three choices: (1) enter into no contract at all; (2) enter into a contract which contain illusory promises or non-binding assurances about future behaviour, that is, a discretionary contract; or (3) enter into a contract which contain legally enforceable promises, that is, a definite contract.\textsuperscript{125}

I have discussed the reasons why banks accept and parent companies give letters of comfort in practice. I now briefly discuss, from an economic perspective and using the jargon of economists and game theorists, why financial instruments, like letters of comfort which do not contain legally enforceable promises\textsuperscript{126} and allow the issuer of the letter a measure of discretion as to whether to honour or repudiate them, are used in the area of commercial lending in circumstances where legally binding contracts are neither technically nor economically infeasible. In this regard, the letter of comfort is regarded as a contract, and in particular a so-called discretionary contract or non-
binding contract\textsuperscript{127} - that is, a contract containing undertakings that are illusory or illusory promises or not containing legally enforceable promises in the sense that they impose no legal obligation on the promissor, leaving him free not to render any performance.\textsuperscript{128} Illusory promises, being non-binding assurances, are unenforceable in the sense that there is no legal remedy for breach. Unlike a discretionary contract, a so-called definite or enforceable contract, like a guarantee, contains legally enforceable promises and imposes a legal obligation and leaves the promissor no discretion whether to render a performance. Thus, the lack of enforceability is the key difference between a discretionary and an enforceable contract.

Both the letter of comfort and the guarantee promise a future performance (payment or increased capitalisation or financial support) by the parent company in exchange for a payment made at the outset by the bank to its subsidiary. From an economic perspective, guarantees possess or represent both reputational and financial capital of the parent company, but with only the latter reflected on its balance sheet.\textsuperscript{129} The reputational capital reflects the market’s beliefs about the likelihood that the parent company will honour its guarantees - the better its reputation, the more the market should be willing to pay for its guarantees.\textsuperscript{130} If the parent company has issued a guarantee, it is legally bound, and if a claim eventuates, it will honour it to the full extent of its financial capital.\textsuperscript{131} However, if the parent company has issued a letter of comfort it can decide not to honour it with legal impunity. In deciding whether or not to honour its illusory promises, the parent company has to make a choice between

\textsuperscript{130} AW Boot, SI Greenbaum and AV Thakor, “Reputation and Discretion in Financial Contracting” (1993) 83 \textit{The American Economic Review} 1165 at 1166. In this regard, it should be noted that “pay for its guarantees” means, for example, that the bank will more readily provide credit facilities and also at lower interest rates.
\textsuperscript{131} AW Boot, SI Greenbaum and AV Thakor, “Reputation and Discretion in Financial Contracting” (1993) 83 \textit{The American Economic Review} 1165 at 1166.
augmenting its reputational capital by honouring the claim and accepting the
dissipative write-down of its financial capital, or it can conserve its financial capital by
repudiating the claim and accepting a dissipative charge against its reputational
capital.132 By allowing the parent company this discretion, the letter of comfort
provides the parent company with additional degrees of freedom in managing its
assets – it liquefies reputational capital and also facilitates reputational
enhancement.133 This interplay between financial and reputational capital, between
discretion and enforceability, is central to unenforceable contracts like letters of
comfort.134 Indeed, the letter of comfort causes the recipient to be “comfortable
because he feels that somehow moral reputation has been pledged, never to be
dishonoured, and the giver feels comfortable because moral honour is not an item
which has to appear on the balance sheet, let alone involve actual money.”135

From an economic perspective an unenforceable contract, providing contractual
discretion, may in certain circumstances be optimal even when enforceability is
feasible.136 The economists Boot, Greenbaum and Thakor explain the position on the
basis of the game theory which, in the context of a comfort letter, can be stated as
follows:137

The parent company, the informed agent, moves first by offering the bank, the
uninformed agent, a contract, which the bank can then either accept or reject. If the
contract is accepted, the parent company incurs an information-production cost, and

132 AW Boot, SI Greenbaum and AV Thakor, "Reputation and Discretion in Financial Contracting" (1993)
83 The American Economic Review 1165 at 1166.
133 AW Boot, SI Greenbaum and AV Thakor, "Reputation and Discretion in Financial Contracting" (1993)
83 The American Economic Review 1165 at 1166.
134 AW Boot, SI Greenbaum and AV Thakor, "Reputation and Discretion in Financial Contracting" (1993)
83 The American Economic Review 1165 at 1166.
136 See L Bernstein, "Opting out of the Legal System: Extralegal Contractual Relations in the Diamond
137 AW Boot, SI Greenbaum and AV Thakor, "Reputation and Discretion in Financial Contracting" (1993)
83 The American Economic Review 1165 at 1170. See also H Collins, Regulating Contracts (Oxford
in the future the bank may submit a claim against the parent company's financial
capital.

If a claim is made under an enforceable contract (a guarantee) and the parent
company refuses to honour the claim, a court of law will enforce liquidation of enough
of the parent company's assets to satisfy the claim. Since the parent company's
financial capital is not mutually verifiable, such forced liquidation will result in the
parent company surrendering more by refusing to honour a claim than it would by
honouring it if it is financially able. This ensures that the parent company will always
honour an enforceable contract (guarantee) when it is financially capable of doing so –
that is, the parent company will perform its obligations under a guarantee and pay the
bank the amount of the indebtedness guaranteed.

With a discretionary contract or non-binding contract (a letter of comfort) there is no
legal enforcement, and the parent company chooses whether or not to honour the
contract having regard to the information it has – a choice dependent upon the
interplay between financial and reputational capital.138 Thus, the parent company
moves first and last in this game, and its strategies involve the choice of contract and
whether or not to honour a claim if one eventuates. The parent company will have a
choice whether to perform under the letter of comfort, be it by paying the bank the
amount owed by its subsidiary, or increasing the capital of its subsidiary, or
maintaining its shareholding in its subsidiary. If there are effective non-legal sanctions
which would coerce the parent company into performing under the letter of comfort,
it would perform. In such circumstances, the benefit of legal sanctions available under

138 According to B Irlenbusch, "Relying on a man’s word? An experimental study on non-binding
contracts" (2004) 24 International Review of Law and Economics 299 at 301, the discretionary contract
is, in a game theoretic sense, "mere cheap talk; ie the contract is a non-binding, costless, nonverifiable
message that may affect the listeners' beliefs but not necessarily players' payoffs. Nevertheless, in
experiments two major roles of cheap talk are identified. On the one hand, cheap talk can be valuable
for signalling players' private information. On the other hand, cheap talk is found to be effective in
signalling players' intentions for future decisions." See also, B Irlenbusch, "Are Non-Binding Contracts
an enforceable contract compared to the non-legal sanctions under a letter of comfort would be negligible.\textsuperscript{139}

The game has another dimension; that is, the “no contract” scenario where the parent company has offered the bank neither an enforceable contract (guarantee) nor a discretionary contract (comfort letter). The “no contract” scenario is similar to the discretionary contract (comfort letter) scenario in so far as neither involves legally enforceable promises. There is, however, an important distinction – on the one hand, the discretionary contract (comfort letter) contains illusory promises which are publicly observable and often involve a document. On the other hand, the “no contract” scenario does not involve observable promises at all. Consequently, the performance or breach of a discretionary contract (comfort letter) will affect the parent company's reputation, whereas the “no contract” scenario lacks analogous reputational implications. Thus, the importance of the letter of comfort stems from the role that these publicly observable instruments play in reputation-formation.\textsuperscript{140} As a result of this reputation mechanism, the letter of comfort becomes a viable alternative to a guarantee, and is superior to the “no contract” alternative. Indeed, it has been said that the issuing of a letter of comfort to a bank by the parent company is a reputational signal that makes it self-enforcing.\textsuperscript{141} Depending on the reputation of the parent company, the letter of comfort is therefore treated as good security in a commercial sense\textsuperscript{142} - it constitutes moral and business commitments on behalf of the parent company in respect of its subsidiary.\textsuperscript{143} Indeed, the commercial comfort

provided by a letter of comfort is of value on the basis that “letting subsidiaries go bust is bad for group business.”

As Collins remarked, courts recognise “the possibility of the rationality of the exclusion of legal sanctions as a possible remedy where alternative non-legal sanctions are available or the risks of betrayal and disappointment are discounted on the basis of trust.” Indeed, the economic explanation for the use of letters of comfort was recognised by the Ontario Court of Appeal in Toronto Dominion Bank v Leigh Instruments Ltd (Trustee of) when it quoted with approval the following submission by one of the counsel in respect of the commercial value of comfort letters:

“In this marketplace, both parties have experience in situations where a parent, for reasons it deems appropriate, refuses to give a legally binding assurance and a bank, for reasons it similarly considers appropriate agrees to accept something less, perhaps believing that when, and if, ‘push comes to shove’, the parent would pay for any or all of the 'non-legal' commercial considerations of reputation, fear of adverse publicity, higher future borrowing costs and a myriad other reasons and possibilities depending on the circumstances.”

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544 C Stoakes, "I have here a piece of paper signed by ..." [1986] Euromoney 181. See also SL Schwarcz and GS Vargas, "Guaranties and Other Third-Party Credit Supports" in JJ Norton (ed), Commercial Loan Documentation Guide (Matthew Bender, 1993) at [16.06].


546 17B DLR (4th) 634 at [18]. See also Wake v Renault (UK) Ltd 15 Tr L 514, The Times 1 August 1996, where Robert Walker J remarked: “A comfort letter, even though not legally binding, may not be pointless since it may have important practical consequences: for instance in enabling a subsidiary to borrow on more favourable terms than might otherwise be available, or enabling auditors to sign off accounts on a going concern basis.”

Indeed, the use of letters of comfort which are legally worthless but morally binding only is not pointless. 148 The mere involvement of the parent company may make it worthwhile not to dispense with a comfort letter. 149 Letters of comfort properly so-called are effective in practice because both sides perceive that it is in their own long term interests to accept and fulfil the moral obligations stipulated in such letters. 150 Moreover, the strength of the moral obligation will depend upon the strength of the relationship between the bank and the parent company; the stronger the relationship, the easier it will be to find an acceptable commercial solution when the letter of comfort is relied upon. 151 However, it would be only natural for a bank to try and find a legally binding obligation even in such circumstances, and in particular if an acceptable commercial solution is not forthcoming, and there may be room to consider whether a legal obligation has arisen from the surrounding circumstances, or to consider non-contractual proceedings based on, for example, misrepresentation. But, perhaps “the most effective tool a bank can use is publicity: letting third parties know of the wrong done to it, or, alternatively, refusing further facilitation in the hope that this will force a compromise.” 152 No corporation should be under any illusions as to the consequences of failing to honour the perceived commitment in a letter of comfort – “access to any informal or flexible financing arrangements would be denied and perhaps even greater pressure applied; and the offender could be made a financial ‘pariah’.” 153 However, as can be seen from the Toronto Dominion Bank saga 154 that tool is not always effective.

148 See the comments of Robert Walker J in Wake v Renault (UK) Limited 15 Tr L 514, The Times, 1 August 1996.
149 RJ Clayton and W Beranek, “Disassociations and Legal Combinations” [1985] Financial Management 24 at 25 have observed that a parent company will support its subsidiary “either because the subsidiary may be important to parent-shareholder wealth generation or because failure to support may be perceived by the parent as tarnishing its ‘image’”.
154 (1998) 40 BLR (2d) 1. See paragraph 6.2.
3.2.4. Some comments

Although many contractual disputes end up in court each year, these disputes usually arise as a result of differing interpretations of what each party's obligations are under the contract, and whether a party has breached their obligations. Few contractual disputes arise over the issue of whether there is a contract at all. Litigation lawyers are rarely forced to deal with letters of comfort. This is basically so for two reasons.

First the need to litigate comfort letters only arises as a result of the superimposition of duties which override the necessity for continuing business - for example, a liquidator will not have the same view of a letter of comfort as the chief executive officer of the company issuing the letter.\(^{155}\) As Sauer and Marks\(^{156}\) have observed,

“in a continuing business situation, the absence of litigation is most likely explained by the simple fact that letters of comfort are honoured by the parties without question even if the terms of the written commitment are couched in a highly uncertain manner. The parties know what they really intended and do not need a judge to tell them. In the end, the self-enforcing commitment falling in the grey area somewhere between commercial practice and law must have substantial advantages over black letter legal rights.”

Secondly, the prospective costs of converting comfort letters into money are too high.\(^{157}\) Litigation on letters of comfort has been spasmodic, but when it does occur, their inherently vague and ambiguous nature invariably leads to protracted legal disputes.\(^{158}\) Although such litigation may be explained as a bank's last-ditch attempt to salvage an ill-fated transaction, such facile explanation ignores the fact that there “also exists a tangible and sanguine expectation that some legal consequences should attach


to assurances given by a parent company in support of its subsidiary’s obligations.”159 Moreover, as DiMatteo has observed, as more cases are brought involving comfort instruments, “it is increasingly likely that courts will find them legally binding.”160

If banks accept letters of comfort despite their legal ambiguities, it is because the underlying credit arrangements are believed to be sound.161 Lawyers will only become involved if the economic assumptions made by the banks proved to be incorrect.162 Although there have been a significant number of instances where companies have failed to honour letters of comfort, relatively few cases go to trial. Thus, it is important for banks to know when to rely on a letter of comfort rather than insist on a guarantee. Although it will ultimately be a matter of judgment, the following issues should be considered:163

(a) The management of the parent company giving the letter of comfort. Is the management of the company intrinsically honourable? Does the company actually have a reputation to lose and is the company likely to guard it jealously? Does the company have a track record in supporting its subsidiaries, and has it previously met obligations that legally it did not have to? In other words, as a rule of thumb, “je respektabler die Muttergesellschaft, desto ‘weicher’ ist die van ihr abgegebene Patronatserklärung” (the more reputable the parent company, the weaker is the comfort letter provided).164

164 See W Mosch, Patronatserklärungen deutscher Konzernmuttergesellschaften und ihre Bedeutung für de Rechnunglegung (Bielefeld, Gieseking, 1978) 3; K Wolfs, Patronaatsverklaringen (Verhandeling
(b) The size of the letter of comfort obligation in relation to the resources of the parent company giving the letter.\textsuperscript{165} It is much easier to meet a moral obligation if it is not material to the overall financial performance of a group. If the financial position of the group is at risk, or significantly financially damaging to the company, it is more likely that the management of the parent company will walk away in adversity.

(c) The key principle of lending, "know your borrower", is particularly applicable to letters of comfort. If a bank has any serious doubt about the subsidiary continuing in business, it should insist on lending to some stronger part of the group.\textsuperscript{166}

Although it is true that lawyers and business people view contracts differently, it is submitted that it goes too far to argue, as did one of the counsel in \textit{Balmoral Group Ltd v Borealis (UK) Ltd}, that “there were, in effect two parallel universes: the ‘real world’ in which the parties moved and had their being, and an artificial world created for them by their lawyers when, but only when, a dispute arose.”\textsuperscript{167} The different perspectives of contracts is rather, as Lord Devlin has cautioned, “a good illustration of the danger that besets the relationship between commercial lawyers and commercial men; that the commercial man’s vagueness of thought and happy-go-lucky phraseology may have to sustain a weight of logical argument which it was never constructed to bear.”\textsuperscript{168} Moreover, the sharp distinction, often made by socio-legal scholars, between a real world created by the parties (the real deal) and an artificial world created by contract law (the paper deal) cannot be drawn because commercial agreements, such as comfort letters, have to be understood as integrated phenomena, rather than


\textsuperscript{166} JR Lingard, "Comfort letters under English law" (1986) 5 \textit{International Financial Law Review} 36

\textsuperscript{167} [2006] EWHC 1900 at [339].

\textsuperscript{168} P Devlin, “The Relation Between Commercial Law and Commercial Practice” (1951) 14 \textit{Modern Law Review} 249 at 257.
wholly discrete aspects of contracting behaviour.\textsuperscript{169} Contracts are social, economic and legal phenomena, a fact brought to the fore by the adoption of the commercial (or common sense) interpretation approach to commercial instruments, such as comfort letters.\textsuperscript{170}

### 3.3 The banking practice of grading letters of comfort

There are some banks which follow the practice of grading letters of comfort in their business instruction manuals according to their presumed contractual binding effect.\textsuperscript{171} For example, in *Hong Kong and Shanghai Banking Corporation Ltd v Jurong Engineering Ltd*,\textsuperscript{172} the comfort letter grading practice of HKSBC set out in its Business Instruction Manual was discussed, but the court declined to follow HKSBC’s grading and stated that it was “only their subjective belief and knowledge, since [Jurong] were never privy to the contents of their Business Instruction Manual”.\textsuperscript{173} According to this manual:

(a) Grade 1 comfort letters indicated a very strong letter of comfort containing covenants regarding financial assistance, management control and retention of shareholding;\textsuperscript{174}

(b) Grade 2 comfort letters indicated a less strong letter of comfort which may include only two out of three covenants in a Grade 1 comfort letter;\textsuperscript{175}

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\textsuperscript{170} See chapter 7.


\textsuperscript{172} [2000] 2 SLR 54 at 76 (hereinafter referred to as *Jurong Engineering*).

\textsuperscript{173} *Jurong Engineering* [2000] 2 SLR 54 at 76.

\textsuperscript{174} *Jurong Engineering* [2000] 2 SLR 54 at 73. This grade of comfort letter is similar to the grade A letter of comfort mentioned in R Sacasas and D Wiesner, “Comfort Letters: The Legal and Business Implications” (1987) 104 Banking Law Journal 313 at 334.
(c) Grade 3 comfort letters indicated all other letters of comfort which are effectively no more than an acknowledgment that a financial facility had been granted.\textsuperscript{176}

HKSBC regarded Grade 1 and 2 letters of comfort as creating legally binding obligations. The HKSBC grading of letters of comfort is, however, not unique. It appears that other financial institutions similarly classify comfort letters. Wiesner refers to a financial institution that classified letters of comfort as Grade A, B or C.\textsuperscript{177} The “Grade C” letters of comfort acknowledge the credit, states the degree of ownership, and promises to notify the creditor of any ownership changes. When the parent company additionally states that it intends to give “support” to its subsidiary requesting the bank loan, for example, the letter is classified as “Grade B”. The strongest letter, “Grade A”, includes these phrases, and also contains a promise by the parent company to “use its best efforts in seeing to the performance” of the underlying credit obligation.\textsuperscript{178}

These bank grading or classification of comfort letters is reminiscent of the classification of comfort letters found in the discussions of the Continental European jurists as mentioned in chapter 2, and in particular, in German law where comfort letters are categorised from “hard” to “soft”, the former being legally binding and the latter merely evidencing an acknowledgment of a moral obligation.\textsuperscript{179} Although these bank grading or classification of letters of comfort cannot fully anticipate the range of


\textsuperscript{177} Jurong Engineering [2000] 2 SLR 54 at 73. This grade of comfort letter similar to the grade C letter of comfort mentioned in R Sacasas and D Wiesner, “Comfort Letters: The Legal and Business Implications” (1987) 104 Banking Law Journal 313 at 334.


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creative draftsmanship attempted in practice, it nevertheless fairly represents the
different levels of involvement encountered when dealing with letters of comfort.  

4 THE CONTRACTUAL EFFECT OF LETTERS OF COMFORT IN THE ANGLO-
COMMON LAW

4.1 Introduction

“A contract is a promise (or a set of promises) that is legally binding; by legally binding
we mean that the law will compel the person making the promise (‘the promisor’) to
perform, or to pay damages to compensate the person to whom it was made (‘the
promisee’) for non-performance.” Contract law focuses on breach of promise. It can,
as Ellinghaus observed, be viewed as “a polytheistic aggregate of doctrines setting out
the circumstances in which a legal sanction is available in respect of such breach. That
is, it amounts, as a whole, to a map of enforceability.”

The letter of comfort is a legal technique which originated in practice, that falls on or
near the borderline between morally and legally binding promises. Whether a letter
of comfort is a legally binding promise depends on whether it is contractual in nature,

94 Northwestern University Law Review 937 at 938. See, however, G MacCormack, “Some Problems of
2 P Clarke, J Clarke and M Zhou, Contract Law: Commentaries, Cases and Perspectives (Oxford University
Press, South Melbourne, 2008) 3 and 4; B Mescher, “Promise Enforcement by Common Law or Equity?”
J, as he then was, stated that a contract is an institution “by which parties are empowered to create a
charter of their rights and obligations.” NC Seddon and MP Ellinghaus, Cheshire and Fifoot’s Law of
Contract (LexisNexis, Sydney, 2008) 214 define a contract as a “legally enforceable agreement.”
the discrete contract the content comes from the promises of the parties, but the obligation comes from
the promise-enforcing external god.” See JGJ Rinkes and GH Samuel, Contractual and Non-contractual
Obligations in English Law (Ars Aqui Libri, Nijmegen, 1992) 104.
4 MP Ellinghaus, “Consideration Reconsidered Considered” (1975) 10 Melbourne University Law Review
267 at 269.
5 Toronto Dominion Bank v Leigh Instruments Ltd (Trustee of) (1998) 40 BLR (2d) 1 at 7 (hereinafter
referred to as Toronto Dominion Bank). See also paragraph 6.2.
7 Some promises are binding even though they are not contractual in nature. For example, a promise
that does not contain the element of a bargain may still give rise to legal rights and obligations if the
promise has relied upon that promise in circumstances in which it would be unjust to allow the promisor
to resile with impunity – see Walton Stores (Interstate) Ltd v Maher (1988) 164 CLR 387. Moreover, in
The Commonwealth of Australia v Verwayen (1990) 170 CLR 394 at 428 and 429, Brennan J said that “an
equitable estoppels yields a remedy in order to prevent unconscionable conduct on the part of the party
who, having made a promise to another who acts to his detriment, seeks to resile from the promise.”
because etymologically something that is contractual in nature is something that rises to the level of a legally binding obligation.\textsuperscript{8} The entire task of the Anglo-common law of contracts has been to find the appropriate dividing line between the morally binding and the legally binding promise\textsuperscript{9} – that is, the purpose of contract law is to draw a line between enforceable and unenforceable promises.\textsuperscript{10} Thus, although the letter of comfort is a legal construct \textit{sui generis},\textsuperscript{11} it is an agreement governed by the general principles of contract law\textsuperscript{12} and courts have had to resort to the familiar rules of contract to determine both the existence or otherwise of a valid and enforceable agreement as well as the nature of the obligations created by the agreement.\textsuperscript{13} The major elements of formation of a contract, or the requirements that must be fulfilled before a promise, or set of promises, will be enforceable as a contract\textsuperscript{14} are usually identified as the following:\textsuperscript{15} agreement (offer and acceptance), consideration,\textsuperscript{16}

\begin{itemize}
  \item \textsuperscript{9} LA DiMatteo, \textit{Contract Theory: The Evolution of Contractual Intent} (Michigan State University Press, East Lansing, 1998) 8. JGJ Rinkes and GH Samuel, \textit{Contractual and Non-contractual Obligations in English Law} (Ars Aequi Libri, Nijmegen, 1992) 104 point out that it is not the notion of convention or agreement, but the notion of \textit{pollicitation or promissum} or promise that forms the focal point of liability – “the English contractor is liable in damages at common law for breach of promise rather than non-performance of an agreement.”
  \item \textsuperscript{10} The position is the same in France – see JM Philippe, "French and American Approaches to Contract Formation and Enforceability: A Comparative Perspective" (2005) 12 \textit{Tulsa Journal of Comparative and International Law} 357 at 360.
  \item \textsuperscript{11} See E Hieblinger, \textit{Ausgewählte Problemstellungen der weichen und harten Patronatserklärung} (unpublished Master’s dissertation, Paris Lodron Universität, Salzburg, 2002) 46.
  \item \textsuperscript{14} See JGJ Rinkes and GH Samuel, \textit{Contractual and Non-contractual Obligations in English Law} (Ars Aequi Libri, Nijmegen, 1992) 113.
  \item \textsuperscript{15} See JGJ Rinkes and GH Samuel, \textit{Contractual and Non-contractual Obligations in English Law} (Ars Aequi Libri, Nijmegen, 1992) 113.
  \item \textsuperscript{16} It should be noted that consideration is not an element of contract formation in the Continental law jurisdictions, or even hybrid legal systems such as South African or Scotland, and its utility has been doubted by some Anglo-common law jurists – see, in general, H Kötz and A Flessner, \textit{European Contract Law Vol 1: Formation, Validity, and Content of Contracts; Contract and Third Parties} (Clarendon Press, Oxford, 1997) 75; Lord Wright, "Ought the Doctrine of Consideration to be Abolished from the Common law?" (1936) 49 \textit{Harvard Law Review} 1225; AG Chloros, "The Doctrine of Consideration and the Reform of the Law of Contract, A Comparative Analysis" (1968) 17 \textit{International and Comparative Law Quarterly} 137; R Pound, "Promise or Bargain" (1959) 33 \textit{Tulane Law Review} 455.
\end{itemize}
contractual intention or as it is also somewhat awkwardly known, “intention to create legal relations”, and certainty of terms.

In considering the different approaches to determining the contractual effect of letters of comfort, it is necessary to address the difficulties most likely to arise having regard to the underlying principles of contract law. Usually, the element of agreement is present, but difficulties may arise in respect of consideration, certainty and intention to create legal relations, which I now briefly discuss by reference to letters of comfort.

4.2 Consideration

It has been remarked that consideration is the means by which one distinguishes between promises which are enforceable in law and those which are not. The doctrine of consideration, peculiar to the Anglo-common law jurisdictions, is still relatively ill-defined and controversial with no consensus on its true scope or on the expediency of maintaining it in force. There is no precise definition of consideration.

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19 Usually a parent company refuses to provide a formal guarantee to a bank, but offers to provide a letter of comfort. As pointed out by R Sauer and H Marks, “Letters of Comfort” (1986) 18 Commercial Law Association of Australia Bulletin 1 at 2.3, the bank expressly accepts the offer, or impliedly accepts it by ‘acting in the manner contemplated; that is, usually by advancing funds, or by not requiring further security for or any formal guarantees of, the advances to the subsidiary’. The bank gives consideration by providing finance to the subsidiary – although consideration does not have to benefit the parent company (promisor). Sauer and Marks at 2, however, believe that the parent company has an interest in the subsidiary and that such consideration benefits the parent company.
22 The doctrine of consideration does not exist in hybrid legal systems, such as Scottish law, or South African law. See MH Whincup, Contract Law and Practice: The English System, with Scottish, Commonwealth, and Continental Comparisons (Kluwer Law International, Alphen aan den Rijn, 2006) 73.
Although an important element in contract law, consideration is not alone
determinative of whether a promise is legally enforceable.25 Recently, the Court of
Appeal of the Supreme Court of Victoria succinctly commented on the element of
consideration in Atco Controls Pty Ltd (in liquidation) v Newtronics Pty Ltd (receivers
and managers appointed) (in liquidation) as follows:

“Although it is customary to conceive of intention to create legal relations as
a contractual requirement separate and distinct from the need for
consideration, the better view may be that the rules as to consideration
supply the answer as to whether parties intended to enter into a legally
binding bargain. Even so, in some cases consideration and the intention to
create legal relations can be distinct; as where, for example, although
application of the rules as to consideration as such suggest the formation of
legally binding agreement, the parties have otherwise expressly or impliedly
signified that they do not intend their arrangement to be legally binding. In
such cases, the existence of background circumstances, such as that a dealing
is between members of the same family, or between corporations within the
same corporate group, when taken into account in conjunction with the
ordinary rules as to consideration, may yield a different result to the
application of the rules of consideration simpliciter. Thus far, what we have
considered is the background circumstance that the dealings here were
between a holding company and subsidiary and whether that in itself
signified an absence of intention to create legal relations. It remains to
consider the application of the rules of consideration as such.”26

24 See H Beale, A Hartkamp, H Kötz and D Tallon, Cases, Material and Text on Contract Law (Hart
25 MP Ellinghaus, “Consideration Reconsidered Considered” (1975-76) 10 Melbourne University Law
Review 267 at 269.
26 Atco Controls Pty Ltd (in liquidation) v Newtronics Pty Ltd (receivers and managers appointed) (in
liquidation) (2009) 78 ACSR 375 at [60] (hereinafter also referred to as Atco Controls).
Consideration is one area where problems may arise,27 because, due to the informality of their creation, letters of comfort often convey the impression that the consideration is past.28 Unlike a contract of guarantee, which is usually given in consideration of past and future transactions, letters of comfort often contain no more than a statement of awareness that credit or financial facilities have been granted.29 For example, in *Chemco Leasing v Rediffusion Limited* the first letter of comfort was sent about six months after financial arrangements had been made between the parties.30 It was accepted as common ground in the Court of Appeal (but not at first instance) in *Chemco Leasing v Rediffusion Limited*31 that the letter of comfort was not effective to cover any lease or financial arrangement made before the date of the first letter of comfort was provided,32 on the basis that past consideration was no consideration.33 It is therefore important, in order to satisfy the requirement of consideration, that the letter of comfort should refer to the proposed facility and either be issued not later than the date on which the facility is granted or be a condition of the bank’s commitment.34

Consideration may also arise in the context where the parent company issues the letter of comfort not to a bank or other credit provider, but to its subsidiary or the auditor of its subsidiary stating that it will provide financial support to enable the

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29 It should be noted, however, that the duty that the promise performed, or promised to perform, as consideration for the promise may be one that the promise is already contractually bound to a third party to perform – see P Clarke, J Clarke and M Zhou, *Contract Law: Commentaries, Cases and Perspectives* (Oxford University Press, South Melbourne, 2008) 117.
30 (19 July 1985, unreported, Queen’s Bench Division) (hereinafter also referred to as *Chemco Leasing*).
31 See 1 FTIR 201 (hereinafter also referred to as *Chemco Leasing on appeal*).
subsidiary to meet its financial commitments. The question in those circumstances is what consideration does the subsidiary give to the parent company for provision of the letter of comfort? Is the subsidiary’s consideration the promise to continue trading? If the promise to continue trading is the consideration by the subsidiary to the parent company, then it is arguable that the financial failure of the subsidiary and its going into external administration would also constitute a failure of the consideration.

Some commentators are of the view that the inconsistent treatment of letters of comfort in Anglo-common law is because a comfort letter lacks consideration, and have suggested that the American version of the promissory estoppel principle be adopted and that the concept of reliance in contract formation should be emphasised. Apart from the fact that consideration does not usually present a problem in comfort letter disputes, the suggestion would result in a blurring of the borders of contract, estoppel and misrepresentation.

4.3 Certainty

For there to be a valid and enforceable contract, a court must be able to attribute to it a sufficiently precise and clear meaning to identify the scope of the rights and obligations to which the parties had agreed. It is thus not surprising that the lack of certainty or ambiguity is one of the two principal sources of disputes pertaining to the

35 See Gate Gourmet Australia Pty Ltd (in liq) v Gate Gourmet Holding AG [2004] NSWSC 149 (hereinafter referred to as Gate Gourmet) and Newtronic Pty Ltd (Re: and mgstr apptd) (in liq) (ACN 061 493 516) v Atco Controls Pty Ltd (in liq) (ACN 005 182 481) (2008) 69 ACSR 317 (hereinafter referred to as Newtronic) discussed at paragraphs 7.5 and 7.6.
36 See Atco Controls (2009) 78 ACSR 375 at [61].
40 Tomanovic v Argyle HQ Ltd [2010] NSWSC 152 at [62].
construction of contracts. A defence of uncertainty has to be pleaded specifically. Although often interrelated, the element of certainty is separate from that of contractual intention – contractual intention strictly speaking concerns only the effect of an agreement which is first shown to exist. In other words, if parties have reached agreement, the lack of contractual intention will prevent that agreement from having legal effect. Certainty concerns not the effect of an agreement but whether or not there is an agreement at all. In other words, the lack of certainty or vagueness may be a ground for concluding that the parties never reached agreement at all. Moreover, the use of deliberately vague language may negative contractual intention. However, the issues of contractual intention and certainty are related in borderline cases in which the question whether an agreement exists depends on the degree of vagueness or on whether the vagueness can be resolved, for example, by applying the standard of reasonableness; for in such cases the absence of any intention to create legal relations may be a ground for holding that no agreement ever came into existence. The elements of certainty and contractual intention cannot be safely viewed separately.

In the context of comfort letters, there is an overlap between arguments that the agreement is or is not intended to create legal relations and arguments that the

45 In Anaconda Nickel Ltd v Tarmoola Australia Pty Ltd (2000) 22 WAR 101 at 132, Anderson J said that “the principle that Courts should be upholders and not the destroyers of bargains ... is not applicable where the issue to be decided is whether the parties intended to form a concluded bargain. In determining that issue, the Court is not being asked to enforce a contract, but to decide whether or not the parties intended to make one. That enquiry need not be approached with any predisposition in favour of upholding anything. The question is whether there is anything to uphold.”
agreement is or is not sufficiently certain to be enforced.\textsuperscript{49} The requirement of contractual certainty does not appear to have played any significant role in some of the decisions on letters of comfort; for example, \textit{Kleinwort Benson Ltd v Malaysia Mining Corporation Berhad}\textsuperscript{50} and in \textit{Chemco Leasing}.\textsuperscript{51} However, the facts in \textit{Kleinwort Benson and Chemco Leasing} arguably do not manifest any of the traditional problems associated with uncertainty which might involve the court in

\begin{quote}
"reluctant vandalism, and there need be no violation of principle in upholding the contractual undertakings in either case. Thus the language used was not imprecise enough to be 'unintelligible', nor could it be argued that one party deliberately employed ambiguity as a means of preserving freedom of choice, as the comfort letter was drafted as a joint exercise. Similarly no substantial factor was left unresolved by the parties."\textsuperscript{52}
\end{quote}

Sometimes, however, incompleteness and uncertainty will contribute to a court’s finding that the parties to a negotiation did not reach a concluded intention to enter into legal relations, even if the elements of uncertainty or incompleteness would not of themselves vitiate the contract.\textsuperscript{53} This is illustrated, as discussed in paragraph 6.9 and 6.10, by some decisions on letters of comfort, like \textit{Commonwealth Bank of Australia v TLI Management Pty Ltd},\textsuperscript{54} which emphasised the requirement of contractual certainty, while the decision of the Court of Appeal in \textit{Kleinwort Benson Ltd v Malaysia Mining Corporation Berhad}\textsuperscript{55} raises significant issues regarding the relationship of certainty of terms and intention to create legal relations and the continuing role of the presumption of intention in commercial agreements.\textsuperscript{56}

\textsuperscript{50} [1988] 1 WLR 799 (hereinafter also referred to as \textit{Kleinwort Benson at first instance}).
\textsuperscript{51} (19 July 1986, unreported, QBD).
\textsuperscript{53} \textit{Tomanovic v Argyle HQ Ltd} [2010] NSWSC 152 at [63].
\textsuperscript{54} [1990] VR 510 (hereinafter referred to as \textit{TLI Management}).
\textsuperscript{55} [1989] 1 WLR 379 (hereinafter referred to as \textit{Kleinwort Benson on appeal}). See paragraph 6.1.
4.4 Intention to create legal relations or animus contrahendi

A contract must contain an element of agreement supported by consideration. The mere presence, however, of these two elements does not necessarily mean that a legally binding contract has come into existence. The third element necessary for a valid contract - which is distinct from (but related to) the requirement that contracts be sufficiently “certain” - is an intention by the parties to create legal relations, although the necessity for such element has been doubted by some commentators. Although, as Sir William Scott remarked about 200 years ago, “[contracts] must not be the sports of an idle hour, mere matters of pleasantry and badinage, never intended by

57 HK Lucke, “The Intention to Create Legal Relations” (1967-1970) 3 Adelaide Law Review 419; G MacCormack, “Some Problems of Contractual Theory” [1976] The Juridical Review 70 at 79 and 80 points out that the terminology used to refer to this element varies, and the following are used as synonyms: intention to be bound, intention to contract, intention to incur a legal obligation, intention to effect legal relations, and intention to create rights and duties. See G Klass, "Intent to Contract" (2009) 95 Virginia Law Review 1437 for a discussion of the difference between the back-letter contract laws of England and the United States.

58 P Richards, Law of Contract (Pearson Education Ltd, Harlow, 2004) 74. As P Gilker, Pre-contractual Liability in English and French Law (Kluwer Law International, The Hague, 2002) 5 remarks, unless the courts can infer an intention to be bound, the parties are deemed to be acting at their own risk even though the contract is complete.


60 See DW Greig, "Expectations in Contractual Negotiations" (1978-79) 5 Monash University Law Review 165; AG Chloros, "Comparative Aspects of the Intention to Create Legal Relations in Contract" (1959) 33 Tulane Law Review 607; JD McCamus, The Law of Contracts (Irwin Law, Toronto, 2005) 112 remarked that this element is “obviously one of a cluster of doctrines designed to isolate from the universe of promising behaviour, those promises and agreements that are appropriately subject to legal enforcement.” SA Smith, Atiyah’s Introduction to the Law of Contract (Clarendon Press, Oxford, 2005) 98 has observed that it is more realistic to say that no positive intention to create legal relations needs to be shown, and that a deliberate promise seriously made is enforced irrespective of the promisor’s views regarding his legal liability.

the parties to have any serious effect whatever\textsuperscript{62}, it was not until the early 1940's that the requirement of "intention to create legal relations" achieved prominence in Anglo-common law.\textsuperscript{63} Today, it is accepted that in a liberal society intention is necessary: no person may be contractually bound against his will.\textsuperscript{64}

In particular, intention to create legal relations is an essential characteristic of all contracts under Australian law.\textsuperscript{65} In Air Great Lakes Pty Ltd v K S Easter (Holdings) Pty Ltd,\textsuperscript{66} McHugh JA (as he then was) stated that "what ... is clearly the Anglo-Australian law ... [is] that an intention to create a legally enforceable contract is a necessary element in the formation of a contract". Until the decision of the Australian High Court in Ermogenous v Greek Orthodox Community of SA Inc,\textsuperscript{67} it was generally understood that the issue of intention was to be resolved by reference to the double rebuttable presumption\textsuperscript{68} that business deals are,\textsuperscript{69} and that social and domestic arrangements are not, intended to be legally enforceable.\textsuperscript{70} Whilst this appears to remain the

\textsuperscript{62} Dalrymple v Dalrymple (1811) 161 ER 655 at 683.


\textsuperscript{65} See NC Seddon and MP Ellingham, Cheshire and Fifoot's Law of Contract (LexisNexis Butterworths, Chatswood Australia, 2002) 207. H Kötz and A Flessner, European Contract Law Vol 1: Formation, Validity, and Content of Contracts; Contract and Third Parties (Clarendon Press, Oxford, 1997) 71 state that: "A contract must be made with the 'intention of creating legal relations' or 'en vue de produire des effets juridiques'; in Germany it is said that the promisor must have intended 'that his conduct should have legal validity ... and the promise [must have] accepted it on this understanding'. If not, no binding legal obligation arises, even if it is an agreement which all decent people would honour, there being no mistake, deceit or duress."


\textsuperscript{67} J Poole, Textbook on Contract Law (Oxford University Press, Oxford, 2006) 186 points out that the presumption in this context is not used in its technical evidentiary sense, but rather it is used to mean that a reasonable person in this situation would have expected legal consequences to flow from this agreement and, in the absence of some reason of policy against it, the court will enforce that reasonable expectation.

\textsuperscript{68} This is because of the inherent implausibility of a businessman placing himself at the mercy of another – see Home Insurance Co v Administratia Asigurarilor de Stat [1983] 2 Lloyd's Rep 674 at 676.

position in the other Anglo-common law jurisdictions, the use of these presumptions was rejected by the Australian High Court in *Ermogenous*, when Gaudron, McHugh, Hayne and Callinan JJ stated that -

“not only is there obvious difficulty in formulating rules intended to prescribe the kinds of cases in which an intention to create contractual relations should, or should not, be found to exist, it would be wrong to do so. Because the search for the ‘intention to create contractual relations’ requires an objective assessment of the state of affairs between the parties (as distinct from the identification of any uncommunicated subjective reservation or intention that either may harbour) the circumstances which might properly be taken into account in deciding whether there was the relevant intention are so varied as to preclude the formation of any prescriptive rules. Although the word ‘intention’ is used in this context, it is used in the same sense as it is used in other contractual contexts. It describes what it is that would objectively be conveyed by what was said or done, having regard to the circumstances in which those statements and actions happened. It is not a search for the uncommunicated subjective motives or intentions of the parties.

In this context of intention to create legal relations there is frequent reference to ‘presumptions’ ... For our part, we doubt the utility of using the language of presumptions in this context. At best, the use of that language does no more than invite attention to identify the party who bears the onus of proof. In this case, where the issue was joined about the existence of a legally binding contract between the parties, there could be no doubt that it was for the appellant to demonstrate that there was such a contract. Reference to presumptions may serve only to distract attention from that more basic and important proposition.”

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71 (2002) 209 CLR 95 at [25] and [26].
The *Ermogenous* approach recognises that the twofold presumption in respect of intention to create legal relations has a weakness\(^{72}\) – namely, the fact that it solves only obvious cases, but leaves unresolved a large number of atypical cases which do not fit into either category. It is with reference to such cases that Mayo J observed more than half a century ago that: “There can be no definite rule or formula for deducing the purpose or intention entertained, that is to say, whether enforcement of a plan is to depend on trust or legal sanction. The process of elucidation will be empirical.”\(^{73}\) Thus, in Australia the party asserting the existence of a contract, the bank in the context of a letter of comfort, will always bear the burden of proving,\(^{74}\) along with the other elements required, that the parties intended to enter into contractual relations.\(^{75}\) The question whether there is a binding contract depends upon the intention of the parties to be inferred from the language they use and the circumstances in which they use it.\(^{76}\) Regard may be paid to all surrounding circumstances known to the parties as well as the purpose and object of the


\(^{73}\) *Todd v Nicol* [1957] SASR 72 at 79.

\(^{74}\) E McKendrick, *Contract Law* (Oxford University Press, Oxford, 2003) 309 is, however, of the view that in commercial cases the onus of proof is still likely to be on the defendant to show that the parties did not intend to create legal relations, whereas in other contexts the onus is likely to be on the claimant.

\(^{75}\) See also *Pirt Biotechnologies Pty Ltd v Pirtferm Ltd* [2001] WASCA 96 at [21]; *Helmos Enterprises Pty Ltd v Jaylor Pty Ltd* [2005] NSWCA 235 at [45] to [49]; N Courmaridas, “Intention to create legal relations: The end of presumptions?” (2006) *34 Australian Business Law Review* 175 at 180. In *McGellan v Mount King Mining NL* (1998) 144 FLR 288 at 294, Murray J summarised the position as follows: “Because the alleged contract upon which he relies is said to have been achieved in a commercial context, he may rely upon the presumption of fact that, prima facie, promissory statements made in such a context are intended to create legal obligations, but that presumption may be rebutted if the defendant discharges what I conceive to be an evidentiary onus resting upon it to show that the presumption should not be applied in this case. However, it remains overall for the plaintiff to discharge the legal onus of establishing upon the balance of probabilities the intention to create legal relations.”

\(^{76}\) *Pacific Carriers Ltd v BNP Paribas* (2004) 218 CLR 451 at [22]; *Toll (FGCT) Pty Ltd v Alphapharm Pty Ltd* (2004) 219 CLR 165 at [34]. *Parker v Clark* [1960] 1 WLR 286 at 293; *Riches v Hogben* (1986) 1 QdR 315 at 326. However, as Sir Garfield Barwick, delivering his opinion of the Privy Council, in *Damian Development Sdn Bhd v Mathew Lui Chin Teck* (1981) 1 MLJ 56 at 58 noted: “The question of whether parties have entered into contractual relationships with each other essentially depends upon the proper understanding of the expressions they have employed in communicating with each other considered against the background of the circumstances in which they have been negotiating, including in those circumstances the provisions of any applicable law … the question is none as to expressed intention and is not to be answered by the presence or absence of any particular form of words.”
transaction,\textsuperscript{77} including what the parties said or wrote,\textsuperscript{78} their relationship, the nature and terms of the agreement,\textsuperscript{79} and the parties’ post-agreement conduct.\textsuperscript{80} These are assessed objectively\textsuperscript{81} by asking whether a reasonable person,\textsuperscript{82} with knowledge of them, would conclude that both parties intended the agreement to be an enforceable contract.\textsuperscript{83} In ascertaining whether or not the agreement is enforceable the courts use the test of bargain.\textsuperscript{84}

\textsuperscript{77} Toll (FGCT) Pty Ltd v Alphapharm Pty Ltd (2004) 219 CLR 165 at [40].
\textsuperscript{78} Evidence about what the parties said is admissible to assist in determining whether a contract was formed – see Atco Controls Pty Ltd (in liquidation) v Newtronics Pty Ltd (receivers and managers appointed) (in liquidation) (2009) 78 ACSR 375 at [45]; T & T Building Pty Ltd v GMW Group Pty Ltd (2010) QSC 211 at [17].
\textsuperscript{79} See Tomanovic v Argyle HQ Ltd (2010) NSWSC 152 at [56]; Codevita Construction Pty Ltd v State Rail Authority NSW (1982) 149 CLR 337 at 347 to 453; Schenker & Co (Aust) Pty Ltd v Maplas Equipment and Services Pty Ltd (1990) VR 834 at 837; HK Lucke, "The Intention to Create Legal Relations" (1967-1970) 3 Adelaide Law Review 419 at 421 points out that the reason why the strict rules of construction are not applied and extrinsic evidence is not excluded is because strictly speaking the intention to create legal relations is a question of conclusion.
\textsuperscript{80} Abadeen Group Pty Ltd v Bluestone Property Services Pty Ltd (2009) NSWCA 386 at [112]; Brambles Holdings Ltd v Bathurst City Council (2001) 53 NSWLR 153 at [25]; Howard Smith & Co Ltd v Varawa (1970) 5 CLR 68 at 77.
\textsuperscript{83} Maggsbury Pty Ltd v Hafele Australia Pty Ltd (2001) 210 CLR 181 at 188; P Clarke, J Clarke and M Zhou, Contract Law: Commentaries, Cases and Perspectives (Oxford University Press, South Melbourne, 2008) 138. Moreover, because of the emphasis on objective promise rather than subjective agreement (like in Continental law jurisdictions), the notion of contract is interpreted in a particular way by common lawyers in that the courts rarely looks at the actual subjective intention of the contracting parties. The court looks only at their outward actions and construes contractual liability from their objective behaviour – see JGI Rinkes and GH Samuel, Contractual and Non-contractual Obligations in English Law (Ars Aqui Libri, Nijmegen, 1992) 107.
Often, however, the intention to create legal relations depends on a fictional rather than an actual intention,\(^85\) or at least not an intention that is shared or of which the other party is aware.\(^86\) The court imputes to the "intention" of the parties simply what is reasonable on other grounds,\(^87\) having regard to the context out of which the promises in a particular transaction has arisen.\(^88\) In *Chemco Leasing*,\(^89\) Staughton J aptly pointed out that in letters of comfort cases -

"it is more than somewhat artificial for a judge to go through the process, prescribed by law, of ascertaining the common intention of the parties from the terms of the documents and the surrounding circumstances; the common intention was in reality that the terms should mean what the judge or arbitrator should decide that they mean, subject always to the views of any higher tribunal. Those considerations are, it seems to me, particularly likely to apply to a letter of comfort, which is a subsidiary part of the business transaction and one upon which the parties, ex \textit{hypothesi}, are likely to find difficulty in reaching agreement."

Thus, in letters of comfort cases, like in other contract cases, the test ostensibly aimed at discovering the parties' intentions almost invariably leads the courts to impose their view of a fair solution to the dispute, especially since there is no clear indication of

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\(^85\) JG Rinkes and GH Samuel, *Contractual and Non-contractual Obligations in English Law* (Ars Aequi Libri, Nijmegen, 1992) 128 remark that in many transactions the parties do not actually put their minds to the question of whether they are entering into a legal relationship. The question of an intention to create legal relations has, accordingly, to be determined from the context out of which the promise arises.


\(^89\) (19 July 1986, unreported, QBD).
what the parties actually had in mind. In short, the “intention to create legal relations” doctrine gives judges carte blanche to impose or refuse contractual liability in unfamiliar contexts. Indeed, as a “filter of policy” it “enables the courts to cloak policy decisions in the mantle of private contractual autonomy.” In the context of commercial agreements, it is nothing more than “a thinly disguised and largely unnecessary smokescreen for policy choices about the correct scope of the law and legal sanctions.” It tempts courts to favour contractual justice rather than contractual freedom; that is, to introduce their own standard if fairness to decide if parties are bound or not by an agreement. Taking into account the evolution of contract formation, Atiyah has noticed the growing influence of contractual justice in courts: courts used to enforce the will of the parties in an aim to effectively realise their intention, but now courts justify their refusal to enforce promises by stating that the parties did not intend to create legal relations by their promises, which “appears to be merely a legal justification for refusing to enforce a promise which the courts think, for

90 See, in general, S Hedley, “Keeping Contract in Its Place – Balfour v Balfour and the Enforceability of Informal Agreements” (1985) 5 Oxford Journal of Legal Studies 391 at 393 and 394. H Beale, A Hartkamp, H Kötz and D Tallon, Cases, Material and Text on Contract Law (Hart Publishing, Oxford, 2002) 97 point out that: “It is not always easy to determine whether the parties, or the persons claiming to be parties, intended to establish legal relations and, what is more, contractual relations. Borderline situations exist affording the courts a relatively wide discretion. The three trends may be discerned. First, in contrast to the situation prevailing in certain legal systems and at certain times in the past, the courts are somewhat reluctant to engage in artificial enquiries into questions of intention, preferring to stay clear of a subjective approach. Instead, as will be noted, they tend to have recourse to the concept of the balance of interests … finally, this cannot conceal a very distinct propensity toward delivering rulings based on equity.”


95 The interpretation of the intent of the parties can be, doubtless, influenced by the judge’s conceptions on policy, welfare, justice, right and wrong, “such notions often being inarticulate and subconscious” - AL Corbin, “Offer and Acceptance, and Some of the Resulting Legal Relations” (1917) 26 Yale Law Journal 169 at 206.

one reason or another, it is unjust or impolitic to enforce." Indeed, the question could rightly be asked whether intention in the law of contract is elusive or illusory?

It has been said that cases where the parties do not consider the matter of legal enforceability are the rule, not the exception. In most situations the parties will, in fact, have given no thought to the question of legal sanction: contracts are usually concluded with their performance rather than their breach and legal enforcement in mind. Moreover, parties often enter into agreements not expecting to encounter legal difficulties, not thinking about breaches of their arrangement, and if they thought about the matter would often think that it would be too expensive to resolve any legal difficulties that did arise in the courts - that does not, however, follow that they lack the intention to create legal relations. In commercial contexts, it is less likely that agreements would be entered into without an expectation of enforceability, and courts have generally assumed a presence of an intention to create legal relations in commercial settings. Nonetheless there are a variety of commercial situations in which parties may wish to have an understanding that does not "engage the full majesty of legal enforceability."

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99 See paragraph 3.2.3 regarding the different views of lawyers and businesspeople on contracts.
104 LA DiMatteo, "The Counterpoise of Contracts: The Reasonable Person Standard and the Subjectivity of Judgment” (1997) 48 South Carolina Law Review 293 at 303 succinctly remarked:“The reasonable person is a creature of contract and is believed by some to possess a natural inclination towards the finding of contractual intent. This presumption of intentionality is grounded in the belief that parties generally do not intend to create meaningless documents or to nonchalantly engage in contractual-type conduct. 'There is a normal assumption that a business transaction is not meaningless and that words have a purpose.'"
In examining the intention element for purposes of this dissertation, it is necessary to consider two different kinds of commercial situations.\(^{106}\)

(a) There are situations where the parties desire to avoid entanglement in a legally enforceable relationship, and they deliberately state so, either by stipulating that their agreement or arrangement is binding in honour only. In other words, the legal order is expressly excluded by the parties – a situation where the focus is on intent not to create legal relations.\(^{107}\) The parties wish to enter into binding arrangements, but waive *ab initio* any recourse to legal remedies.\(^{108}\) This is the so-called “deliberate no-law” situation.\(^{109}\) Two variants can are envisaged. First, the so-called “no-law ever” clause\(^ {110}\) where the parties agree that their “honour only” regime is to be permanent, resulting from, for example, honour or honourable pledge and no agreement clauses, as well as letters of comfort which contain a statement to the effect

\(^{106}\) See B Rudden, “The Gentleman’s Agreement in Legal Theory and in Modern Practice” (1999) 2 *European Review of Private Law* 199. This article has also been published as part of the United Kingdom Comparative Law Series Volume 20 (A collection of general reports delivered at the XVth International Congress of Comparative Law held at Bristol, United Kingdom, July 1998) in J.W Bridge (ed), *Comparative Law Facing the 21st Century* (UKNCCL, Bristol, 2001) 159.


\(^{109}\) B Rudden, “The Gentleman’s Agreement in Legal Theory and in Modern Practice” (1999) 2 *European Review of Private Law* 199 at 200 adopting the phrased coined by J Carbonnier, “L’hypothèse du non-droit” (1963) 8 *Archives de philosophie de droit* 55. As Rudden points out at 206, the express honour only clause “offers a touchstone by which we may distinguish four visions of the proper function of private law: the individualist, based on the autonomy of the will; the communitarian, based on notions of fairness as between the parties; the instrumentalist, based on efficiency and concern with the effect on markets of particular rules of law; and the sceptical (or realist) which doubts all three of the foregoing. Under the first of these perceptions, the law ought to accept its own conclusion. In the second, the law will more readily permit one of the parties to have second thoughts and will respond to a call for aid. In the third, the questions will be what signal will be sent to parties in similar situations by a decision to abstain or to intervene. The fourth, and bleaker, view will point to the very different responses given to very similar situations by different systems, and given to the very same facts by lower and appellate courts of the same jurisdiction.” See also S Sica, “The Gentleman’s Agreements in Legal Theory and in Modern Practice” in International Congress of Comparative Law (15\(^ {\text{th}}\): 1998: University of Bristol), *Italian National Reports to the XVth International Congress of Comparative Law, Bristol 1998* (A Giuffrè, Milan, 1998) 147 at 151.

that the letter does not constitute a legally binding commitment.\(^{111}\) When lawyers contemplate such no law clauses they may be ignorant of the reasons for their – apparently deliberate – adoption by the parties, even though the clause may be perfectly rational.\(^{112}\) As Rudden comments,\(^{113}\) “an ‘honour only’ relationship is usually fortified by more than honour in general, but by the custom and practice of a particular trade. The parties may perceive good reasons, both positive and negative, for staying outside the legal order. The positive reasons stem from the strengths of the non-legal world and may include such factors as: conscience; the presence of other bonds between the parties (racial, religious, linguistic, kinship and the like); the existence of a common culture of trust; concern for reputation; the high probability of non-legal sanctions imposed on an infringer by the business (or other) community; the future adverse consequences for deals between the parties ... in such contexts the parties have no need of law to achieve their aims ... negative reasons for honour-only clauses focus on the perceived weaknesses of the legal order: its ugly language, high costs, unpredictable behaviour, ignorance of the particular trade or market, and general bad reputation. In addition, where the parties contemplate a relationship which will be prolonged in both time and space they may have to cope with several legal systems and with events and issues which are difficult \textit{ab ante} to reduce to legalese.”\(^{114}\) Secondly, the so-called "no-law yet" clause\(^{115}\) where the parties agree now on their intention not to be legally bound until later, resulting from, for example, letters of intent and agreements in principle.


\(^{114}\) In this regard see paragraph 3.2.3 for a discussion of the economic reasons for the use of letters of comfort.

\(^{115}\) See B Rudden, “The Gentleman’s Agreement in Legal Theory and in Modern Practice” (1999) 2 European Review of Private Law 199 at 210 to 212.
(b) There are situations where the parties do not explicitly state any desire to avoid a legally enforceable relationship (and indeed may even assume operation of the legal order), but the wording and context of their agreement or arrangement evidence such desire, or the terms of the document negative contractual intention, or the wording of the instrument is equivocal so that it may be wondered whether there is a contract or not. In other words, the legal order is not expressly excluded, but declines to intervene – for some reason, the law declines to supply the usual legal consequences of the transaction, forcing the parties instead into a relation ruled by honour only. This is the so-called “contextual no-law” situation where one is confronted with the question whether an agreement has crossed the borderline from no-law to law, from simple agreement to contract, as exemplified by gentlemen’s agreements and letters of comfort.

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In considering the two different kinds of commercial situations, it appears that it is more accurate to view them as turning upon the presence of an intention not to create legal relations.\textsuperscript{123}

4.4.1. “Deliberate no-law” – honour or no agreement clauses

Where commercial parties have entered into an arrangement that they explicitly agree should not constitute a legally enforceable agreement, there would appear to be little reason not to give effect to such intention,\textsuperscript{124} and, in fact, the courts recognised clauses in commercial documents which stated clearly that the document was not intended to create legal relations.\textsuperscript{125} Moreover, no particular form of words is required to exclude the intention to create legal relations.\textsuperscript{126} One of the ways in which the parties can exclude the legal effect of their contract is an honour clause;\textsuperscript{127} that is, a statement in a contract that the contract is “binding in honour only”\textsuperscript{128}

The leading deliberate no-law decision\textsuperscript{129} is Rose and Frank Company v JR Crompton and Brothers Ltd where Scrutton LJ observed that:

\textsuperscript{123}See J Unger, “Intent to Create Legal Relations, Mutuality and Consideration” (1956) 19 Modern Law Review 96.
\textsuperscript{126}See HK Lucke, “The Intention to Create Legal Relations” (1967-1970) 3 Adelaide Law Review 419 at 421.
\textsuperscript{127}Article 2.1.2 of the Principles of International Commercial Contracts (PICC) recognises that parties may stipulate “honour clauses” so as to make their agreement a non-binding gentlemen’s agreement – see S Vogenhauer and J Kleineheisterkamp (eds), Commentary on the Unidroit Principles of International Commercial Contracts (PICC) (Oxford University Press, Oxford, 2009) 227.
\textsuperscript{129}Also regarded as the classic discussion of the doctrine of repugnancy or inconsistence – see LA DiMatteo, “The CISG and the Presumption of Enforceability: Unintended Contractual Liability in International Business Dealings” (1997) 22 Yale Journal of International Law 111 at 114.
"Now it is possible for parties to come to an agreement by accepting a proposal with the result that the agreement concluded does not give rise to legal relations. The reason of this is that the parties do not intend their agreement shall give rise to legal relations. This intention may be implied from the subject matter of the agreement but it may also be expressed by the parties ... But I can see no reason why, even in business matters, the parties should not intend to rely on each other’s good faith and honour, and to exclude all idea of settling disputes by any outside intervention, with the accompanying necessity of expressing themselves so precisely that outsiders may have no difficulty in understanding what they mean. If they clearly express such intention, I can see no reason in public policy why effect should not be given to their intention."  

So, there is nothing to prevent commercial parties from adopting non-enforceable arrangements and, in the absence of public policy concerns, the courts will not interfere and strike down honour clauses in agreements. Since the decision in *Ermogenous*, such an honour clause will make it more difficult, if not impossible if properly drafted, for the party asserting that there was a contract to establish the presence of an intention to create contractual relations. Therefore, it can be said that in Australia if a legal instrument has an honour clause, then it does not have contractual effect. Conversely, if a legal instrument does not have an honour clause, nothing prevents the court from giving effect to the parties’ intention to create a contract. The conclusion is that honour clauses should not be enforced unless they are properly drafted and the court is satisfied of the parties’ clear intention to adopt a non-binding arrangement.

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131 JD McCamus, *The Law of Contracts* (Irwin Law, Toronto, 2005) 115 points out that honour clauses ought to be scrutinised in cases where there exists an imbalance in bargaining power between the parties so as to avoid the more powerful party to take advantage of the weaker party.


135 SA Smith, *Atiyah’s Introduction to the Law of Contract* (Clarendon Press, Oxford, 2005) 100 is of the opinion that it is not necessary to invoke the intent to create legal relations requirement to explain why such agreements should not be enforced. The explanation is rather that, although the agreement is a
then it may have contractual effect. Similarly, if the parties clearly state that their agreement is to have no binding legal effect, the courts will give effect to their unambiguous expressed intention.\textsuperscript{136}

In relation to letters of comfort, Wood is of the view that a “commercial agreement is deemed to be legally binding unless otherwise clearly stated ... However, it is open to the parties to state that an agreement is binding in honour only ... If an agreement states that it is not legally binding then a liquidator would be bound to disregard it”.\textsuperscript{137} Commentators have, therefore, suggested that if a parent company and the bank do not intend to create legal relations, then they should include an honour or no-law clause in the letter of comfort stating that the letter is binding in honour only, that it is not intended to create legally binding obligations, or that it has no contractual effect.\textsuperscript{138} Such clause would, however, nullify what little comfort the letter of comfort seeks to provide – indeed, a letter of comfort with an exclusionary clause is, for a legal perspective,\textsuperscript{139} worth only the paper on which it is issued.\textsuperscript{140}

valid contract, one of its terms stipulates that the parties will not seek legal enforcement of the contract’s substantive obligations. Thus, the clause disclaiming legal intent is a kind of exemption of liability clause, which the court is asked to enforce. Like any other contractual clause.

\textsuperscript{136} See, for example, \textit{Rose and Frank Co v J R Crompton and Bros} [1925] AC 445; P Wood, \textit{Law and Practice of International Finance} (Sweet & Maxwell, London, 1980) at 307. However, it should be noted that even if the letter of comfort states that it does not guarantee any obligation it could still lead to enforceability if the statements contained in the letter are untrue. For example, two former directors of the California Federal Bank (“CalFed”), CalFed and its subsidiary California Communities Inc (“CCI”) were required to pay US$20 million and US$5 million respectively in punitive damages in respect of a letter of comfort which read: “It has been and continues to be the policy of [CalFed] to preserve and maintain the high degree of financial integrity of its subsidiaries, and therefore intends to assist [CCI], if necessary, in meeting its financial obligations to your institution in a timely fashion, in a manner permitted by applicable laws to which [CalFed] is subject.” The letter stated that CalFed was not guaranteeing CCI’s obligations. CCI failed to honour its obligations to Weyerhaeuser Mortgage Co, and when the latter inquired why, CCI explained that while on a cost basis it had a positive net worth, it actually had a negative net worth of US$18 million, a fact known to CCI at the time of the provision of the letter of comfort. See Note, “$31.5m Verdict Against Bank Brings No ‘Comfort’” (1995) 8(5) \textit{Commercial Lending Litigation News} (15 July 1995).


\textsuperscript{138} See, for example, I Parsonage, “letters of comfort” [1989] (September) \textit{Australian Corporate Lawyer} 9 at 10; PJ Ho, \textit{Letters of “Dis”comfort: An Examination of the Legal Effect of Letters of Comfort} (unpublished LLB Honours thesis, Monash University, 1994) 16.

\textsuperscript{139} See P Doyle and J Naughton, “Project and Infrastructure Financing” in Mallesons Stephen Jaques, \textit{Australian Finance Law} (Lawbook Co, Sydney, 2008) 76 point out, however, that “the purpose of letters of comfort is to provide a formal, yet non-contractual and, therefore, unenforceable, assurance from a
Although such a clause does not usually appear in a letter of comfort, it has on occasion. In Re Atlantic Computer Plc (in Administration), National Australia Bank Ltd v Soden, two letters from the parent company of a borrower to the bank stated that if the subsidiary could not meet its commitments, the parent would take steps to ensure that its subsidiary's present and future obligations to the bank were met. However, the letters expressly provided that this was an "expression of present intention by way of comfort only". Similarly in Toronto Dominion Bank, the fifth letter of comfort which replaced the previous ones stated that it "does not constitute a legally binding commitment." In both cases the deliberate no-law stipulations were effective to prevent the letters of comfort from having contractual effect. However, as Thain has remarked, "the cynical may suggest that such a plain statement would in many cases unpalatably interfere with the provider of the letter's plan to play a strategically-timed game of "now you see me, now you don't".  

third party to the financier. However, as some letters of comfort have been found to create enforceable obligations to perform particular acts, most are now expressly stated not to be legally binding. Care should be taken in discussing and preparing comfort letters that the giver is not inadvertently liable in respect of a comfort letter on a non-contractual basis, such as misleading or deceptive conduct or promissory estoppel."

141 As discussed in chapter 3, businesspeople do, however, attach value to obligations of honour. It is apparent from the survey discussed in paragraph 3.2.2 that multinational corporations are influence by considerations of company group reputation. See also B Irlenbusch, "Are Non-Binding Contracts Really Not Worth the Paper?" (2006) 27 Managerial and Decision Economics 21.

142 Accordingly, JLR Davis in The Laws of Australia (Thomson Reuters (Professional) Australia Limited, online) at [7.1.260] and JLR Davis and NC Seddon (eds), "Contract" in The Laws of Australia (Lawbook Co, Sydney, 2003) at 31, are wrong to state that a "letter of comfort is a particular species of 'honour clause'."


144 I Thain, "Almost contract: (i) letters of comfort" 2005 (April) New Zealand Law Journal 122 at 124. CM Parr, "Comfort Letters" 1988 (February 24) Law Society's Guardian Gazette 85.8(2) also remarks that a deliberate no-law clause would be psychologically unacceptable to the recipient of a comfort letter: "It is one thing for a negotiator to accept a letter assuring good faith and expressing a policy. It is a wholly different thing for him to accepting a letter assuring good faith, expressing a policy but ending with a cold statement on unenforceability. The negotiator can show the first to his management but he would be ridiculed for showing the second. It is not that management do not know that a comfort letter is unenforceable, it is just that they do not like being told so, because when they have been told, they have no excuse when the whole thing goes sour!"
4.4.2. “Contextual no-law” - gentleman's agreements and letters of comfort

In Edwards v Skyways Ltd, 145 Megaw J relied on Rose and Frank Company v JR Crompton and Brothers Ltd146 and decided, among other things, that in the usual case it may be assumed that parties to a transaction intended it to have contractual effect and that where the transaction is a business or commercial one, the burden of proving that a transaction was not intended to have legal effect lies on the party so alleging and it will be a difficult task to discharge. Importantly, however, Megaw J also said that: “Where the subject matter of the agreement is not domestic or social, but is related to business affairs, the parties may, by using clear words, show that their intention is to make the transaction binding in honour only, and not in law; and courts will give effect to the expressed intention.”147 It appears from what his Lordship has said, that it cannot be assumed simply from the fact that a transaction is commercial in nature that the parties did not intend it to be binding in honour only. One has to examine the wording in order to determine whether or not it is couched in the language of obligation.148 In other words, there are some cases where no legal consequences flow from an element of a contract, because that element in fact discloses no undertaking of a promissory obligation.149

In Fletcher Challenge Energy Ltd v Electricity Corporation of New Zealand,150 the New Zealand Court of Appeal endorsed an entirely neutral approach to determine contractual intention, and in doing so, impliedly rejected the view put forward by

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146 [1925] AC 445. In Australia the English Court of Appeal’s reasoning was approved in Cohen v Cohen (1929) 42 CLR 91. See, in general, RI Milliner, “Comfort Letters – How Much Comfort Are They For Lenders and Auditors?” (unpublished paper, University of Western Australia, Law Summer School, 1990) at [7].
147 [1964] 1 WLR 349 at 354.
148 See ADM Forte, “Letters of Comfort or Letters of Cold Comfort” (1990) 21 Journal of Maritime Law and Commerce 99 at 105. For example in Maccord v Osborne (1876) 1 CPD 568, Bret J held that when a man writes “I promise to pay the above as a debt of honour”, he does not mean to admit that it is a debt which may be enforced against him at law.
Megaw J in Edwards v Skyways Ltd\textsuperscript{151} that the onus of proving in a commercial case that the parties did not intend to create legal relations “is on the party who asserts that no legal effect was intended, and that the onus is a heavy one.”

In Chemco Leasing,\textsuperscript{152} Staughton J alluded to the uncertain nature of the obligations arising in respect of letters of comfort and remarked that although letters of comfort do not fall precisely within the definition of a gentlemen’s agreement,\textsuperscript{153} “in their case, too, one has to look beyond the name and see what exactly is, in law agreed.”\textsuperscript{154} Some comments about the nature of gentlemen’s agreements,\textsuperscript{155} also known as a herenafspraak or rechts vrijblijvende afspraak in Dutch,\textsuperscript{156} or engagement d’honneur in French, and their comparison with letters of comfort are apposite.\textsuperscript{157}

First, although gentleman’s agreements are among the instruments commonly used in commercial practice to indicate that the parties do not intend to enter into legally

\textsuperscript{151} [1964] 1 WLR 349 at 354.


\textsuperscript{153} See, however, Toronto Dominion Bank (1998) 40 BLR (2d) 1 at 156 where Winkler J stated that comfort letters “are gentlemen’s agreements and moral obligations.”

\textsuperscript{154} Chemco Leasing (19 July 1985, unreported, QBD).


\textsuperscript{157} From a phenomenological point of view gentleman’s agreements may be approached from different perspectives – see FW Grosheide, “The Gentleman’s Agreement in Legal Theory and in Modern Practice – The Dutch Civil Law Perspective” in EH Honduis (ed), Netherlands Reports to the Fifteenth International Congress of Comparative Law (Bristol 1998) (Intersentia Rechtswetenschappen, Antwerpen/Groningen, 1998) 91 at 106. In this dissertation, only the legal perspective is considered. German law does not recognise the term “gentlemen’s agreement”, and when it is used it does not necessarily imply that the parties have no intention to be legally bound – see H Beale, A Hartkamp, H Kötz and D Tallon, Cases, Material and Text on Contract Law (Hart Publishing, Oxford, 2002) 99.
enforceable contracts, they are hardly debated in legal doctrine and only seldom figure in case law. Conceptually, a gentlemen’s agreement, unlike a letter of comfort, is generally understood to be an agreement which is not enforceable in law and is binding only as a matter of honour. Letters of comfort do not contain any formula limiting the scope of the commitment in the way one finds them in a gentlemen’s agreement, but rather on the basis of their deliberately vague wording it may be asked whether there is indeed a legal commitment.

In order to be meaningful, the concept of a gentleman’s agreement in business transactions should be limited to long-term continuing commercial relations relative to business-to-business transactions. Doctrinally, van Dunné has suggested that gentleman’s agreements should be divided into four categories, namely gentleman’s agreements (1) of a general nature; (2) relative to negotiations; (3) as substitute


159 S Sica, "The Gentleman’s Agreements in Legal Theory and in Modern Practice" in International Congress of Comparative Law (15th: 1998: University of Bristol), Italian National Reports to the XVth International Congress of Comparative Law, Bristol 1998 (A Giuffrè, Milan, 1998) 147 at 148 describes a gentleman’s agreement as an arrangement established between two or more parties “based on honour, fairness and loyalty.”

160 See B Rudden, “The Gentleman’s Agreement in Legal Theory and in Modern Practice” (1999) 2 European Review of Private Law 199 at 200. E Dirix, “Gentlemen’s Agreements en Andere Afspraken met Onzeker Rechtsgevolgen” [1985-1986] Rechtskundig Weekblad 2119 at 2130 defines a gentleman’s agreement as “een afspraak waarvan de nakoming niet in rechte kan worden afgedwongen en die de partijen in elk ook in geweten bindt (an agreement the performance of which cannot be enforced by law and which binds the parties only in honour and conscience).” Vandewalle J in Norman Hirschhorn v Wesley Severson 319 NW 2d 475 (1982) at 478 defined a gentleman’s agreement as an “unsinged and unenforceable agreement made between parties who expect its performance because of good faith.”


163 See JM van Dunné, Verbintenissenrecht (Kluwer, Deventer, 2004) 55 to 60.

164 These gentleman’s agreements aim at establishing a commercial relation between the parties – see also FW Grosheide, "The Gentleman’s Agreement in Legal Theory and in Modern Practice – The Dutch Civil Law Perspective" in EH Hondius (ed), Netherlands Reports to the Fifteenth International Congress of
for financial guarantees;166 and (4) accompanying or collateral to contracts.167 This classification has an illustrative value as to the aims for which parties try to avoid contractual commitments, but does not assist to practically delineate the concept168 - the illustration of the various categories by reference to a mixture of other concepts which are themselves in need of conceptualisation does not elucidate anything, but rather obscures the fact that in commerce different instruments are used for different purposes.169 Moreover, van Dunné’s classification does not deal with the different consequences of his types of gentleman’s agreements. A letter of comfort could fit into both the third and fourth categories, depending on the category of comfort letter.170 A hard or strong letter of comfort falls into van Dunné’s third category of gentleman’s agreements, while letters of comfort properly so called (soft or weak comfort letters) fall into his fourth category. Medium strength letters of comfort could be, depending on whether they are held to be legally binding, in either the third or fourth category.

165 These are also so-called letters of intent and heads of agreement. They often contain already what will become later the contents of the contract – see also FW Grosheide, The Gentleman’s Agreement in legal Theory and in Modern Practice – The Dutch Civil Law Perspective” in EH Hondius (ed), Netherlands Reports to the Fifteenth International Congress of Comparative Law (Bristol 1998) (Intersentia Rechtswetenschappen, Antwerpen/Groningen, 1998) 91 at 109.
166 These are also referred to as letters of comfort, letters of responsibility or letters of awareness, because they are used as putatively non-obligatory replacements of contracts – see also FW Grosheide, “The Gentleman’s Agreement in legal Theory and in Modern Practice – The Dutch Civil Law Perspective” in EH Hondius (ed), Netherlands Reports to the Fifteenth International Congress of Comparative Law (Bristol 1998) (Intersentia Rechtswetenschappen, Antwerpen/Groningen, 1998) 91 at 109 and 110.
167 These have no significance as such, for example, an agreement with regard to the execution of a contractual obligation to pay a pension to an employee –see also FW Grosheide, “The Gentleman’s Agreement in Legal Theory and in Modern Practice – The Dutch Civil Law Perspective” in EH Hondius (ed), Netherlands Reports to the Fifteenth International Congress of Comparative Law (Bristol 1998) (Intersentia Rechtswetenschappen, Antwerpen/Groningen, 1998) 91 at 110.
168 It reminds one of the expression, ”ignotium per ignotius “ – that is, ”to explain the obscure by means of the more obscure”.
170 See paragraph 2.5 for the three categories of comfort letters.
Secondly, like the phrase "letter of comfort", the term "gentleman’s agreement" does not describe a universally recognised category of agreements. However, for practical purposes, a gentlemen’s agreement can be said to represent a category which is a subset of the genus of agreement. A gentlemen’s agreement, like a letter of comfort properly so called, but unlike strong and medium strength comfort letters, is also clearly distinguishable from a contract, and both are considered to be examples of contextual no-law. While parties to a contract intend to create a legally binding relationship, the intent of signatories to a gentlemen’s agreement is the opposite, because they agree that the relationship between them shall not give rise to any legal obligations and that, in case of default, the only remedy against the defaulting party shall be that of moral or social discredit. From the point of view of a court of law, a gentlemen’s agreement or honourable obligation (noblesse oblige), however important in business, has no validity. Indeed, “honour has a modest place in the law’s empire.”

Thirdly, it has been said that “[m]ost letters of comfort are not, strictly speaking, gentleman’s agreements, because the drafter of the letter, by making a unilateral statement, does not become a party to any agreement and is also, of course, not

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173 See paragraph 2.5.
174 See paragraph 2.5.
175 "Agreement" has a broader meaning than “contract”, and includes both contracts, by which parties intend to create a legally binding relationship, subject to contractual remedies, and binding in honour only agreements, which are characterised by a clear ouster of the jurisdiction of court.
making a promise or obligating herself in any way. However, sometimes a comfort letter leads to the subsequent involvement of the drafting party in the agreement itself, despite that party’s original intent that the letter not create any obligations. Such comfort letters can thus generate enforcement hazards similar to those … [encountered] with other types of gentleman’s agreements.180 This statement is, however, only correct in a general sense and if the distinction between the different strength comfort letters181 is not taken into account and if keep-well agreements182 are considered as comfort letters.

Fourthly, some commentators negatively view letters of comfort as “inconsistent” and “internally repugnant”183 and as such resemble the attitude vis-à-vis gentlemen’s agreements expressed by Sachs J in Goding v Frazer,184 or as Kuijk’s sardonically remarked, it is “een overeenkomst tussen een stel schooiers (an agreement between a couple of vagrants/lazy or worthless persons)”.185 Fifthly, as an example of contextual no-law, cases on letters of comfort should, as a matter of logic, be more readily considered in terms of the rules governing construction of contract, but “the accidents of litigation have been such that most of the judicial discussion of principle in comfort letter cases has been undertaken as if the matter were one relating to intention to create legal relations.186 However, on a strictly doctrinal level, the reasons for holding a letter of comfort enforceable or not are consistent with those pertaining to gentlemen’s agreements.187 The language used in the instrument alone will not

181 See paragraph 2.5.
182 See paragraph 2.1.
184 [1966] 3 All ER 234 at 239. See paragraph 1.1.
187 Indeed, a letter of comfort which does not contain legally binding obligations is similar to a gentleman’s agreement in that the recipient of a letter of comfort also hopes to be able to shame the giver of the letter into fulfilling whatever is said in the letter, but knows that he cannot sue if the other
determine whether it is binding in law or “in honour only”, rather than the manifested intent of the parties and doctrines such as promissory estoppel need to be considered as well.\textsuperscript{188}

4.5 Early encounters with letters of comfort

4.5.1. Chemco Leasing Spa v Rediffusion plc\textsuperscript{189} - preparing the foundations for the intention to create legal relations approach\textsuperscript{190}

The first major English decision dealing with letters of comfort was Stoughton J's unreported decision in Chemco Leasing.\textsuperscript{191} At the time the decision enjoyed little attention and it was only after Hirst J discussed Chemco Leasing in his decision in Kleinwort Benson at first instance\textsuperscript{192} that commentators focused on the Chemco Leasing decision.\textsuperscript{193} The intention to create legal relations approach to the contractual effect of letters of comfort was first adopted in Chemco Leasing.


\textsuperscript{190}It should be noted that there is a distinction between "intent to create legal relations" and "contractual intent". S Hedley, "Keeping Contract in Its Place – Balfour v Balfour and the Enforceability of Informal Agreements" (1985) 5 Oxford Journal of Legal Studies 391 at 399 state the distinction as follows: "When the courts ask whether 'contractual intent' is present in a particular case, they mean 'Does what the parties intended qualify as a contract?' Thus by implication they refer to all the requirements of the law of contract and ask whether the intentions of the parties comply with them. 'Intent to create legal relations', by contrast, is only one such requirement – namely, the suggested requirement that the parties must intend to create not only actual expectations but legal obligations as well. Thus 'intent to create legal relations' is simply one sub-division of 'contractual intent', and to treat the two concepts as interchangeable can only lead to confusion."


\textsuperscript{192}[1988] 1 All ER 714.

4.5.1.1 The facts

Rediffusion plc ("Rediffusion") owned, through a Dutch company CMC Europe, all the shares in Computer Machinery Corporation France SA ("CMC France"), which in turn owned 99.9% of the shares in Computer Machinery Corporation Italia SpA ("CMC Italy"). \(^{194}\) CMC Italy leased computers to Rediffusion’s customers. CMC Italy negotiated with Chemco Leasing SpA ("Chemco") to buy and lease computers to CMC Italy, who would sub-lease the computers to its customers. Chemco refused to continue buying and leasing computers unless Rediffusion provided a letter of comfort to Chemco. On 21 December 1979, Rediffusion provided a letter of comfort to Chemco.

On 21 August 1980, Chemco bought and leased more computers to CMC Italy, and Rediffusion provided a similar letter of comfort to Chemco, stating that –

"We thank Chemco Leasing SpA (‘Chemco’) for the confidence which has been expressed in our subsidiary, Computer Machinery Corporation Italia SpA (‘CMC Italy’) ... in the provision to the same of lease financing facilities, to be used during the forthcoming twelve months, for the purchase of data entry equipment up to a total value of Italian Lire 17 million for lease terms of up to five years.

We confirm to you that the share capital of CMC Italy is owned 99.91% by ...[CMC France] which is in turn owned by the undersigned Rediffusion Limited. Therefore Rediffusion Limited will be in a position to exercise sufficient control over the administration and management of CMC Italy to ensure that its obligations to Chemco are maintained.

We assure you that we are not contemplating the disposal of our interests in CMC Italy and undertake to give Chemco prior notification should we dispose of our interest during the life of the leases. If we dispose of our interest we

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\(^{194}\) Chemco Leasing SpA v Rediffusion Ltd [1987] 1 FTIR 201.
undertake to take over the remaining liabilities to Chemco of CMC Italy should the new shareholder be unacceptable to Chemco.”

In 1981, Rediffusion sold CMC Italy to a certain Mr Raymond Parry (“Parry”). It did not give notice to Chemco about the sale, but CMC Italy sent a copy of a press release about the sale to Chemco. Chemco did not object to the new shareholders. In 1982, CMC Italy was liquidated. Chemco subsequently gave notice to Rediffusion that Parry was unacceptable to Chemco, and requested Rediffusion to pay CMC Italy’s debt. Rediffusion refused to pay CMC Italy’s debt to Chemco, and the latter instituted proceedings against Rediffusion for breach of contract.

4.5.1.2 The issues

Counsel for Rediffusion conceded that the letters of comfort were effective to impose a legal obligation on the company.196 The issues in this case were threefold. First, the Court had to decide whether it was an implied term of the letters of comfort that Chemco had to give notice to Rediffusion if it considered the new shareholder unacceptable, and, if so, within what period this notice should have been given.197 Secondly, the Court had to determine whether Chemco had lost its rights against Rediffusion under the doctrine of election.198 Thirdly, the Court had to determine the precise meaning of the contentious phrase in the last paragraph of the letters of comfort that Rediffusion would “take over the remaining liabilities to Chemco of CMC

197 The Court held that there was an implied term that reasonable notice had to be given, and that a reasonable time was four months – see JS Fisher, “Comfort Letters and their Legal Status” [1988] 5 Journal of International Business Law 215 at 219.
198 In light of the fact that Chemco failed to give notice to Rediffusion that the new shareholder was unacceptable, it was not necessary for the Court to determine the second issue. However, Staughton J stated obiter that there was no issue as to an election by Chemco – see JS Fisher, “Comfort Letters and their Legal Status” [1988] 5 Journal of International Business Law 215 at 219.
Italy should the new shareholders be unacceptable to Chemco”. Only the third issue is relevant for purposes of this dissertation.

4.5.1.3 The decision

Staughton J, sitting in the Commercial Court of the English Queens Bench Division, rejected Rediffusion’s contention that the letters of comfort were so vague as to be incapable of forming part of an enforceable contract along the lines of G Scammell & Nephew Ltd v Ousten. The judge observed that “the common intention [of the parties negotiating a comfort letter] was in reality that the terms should mean what a judge or arbitrator should decide that they mean”, but that he nevertheless had “to carry out the traditional task of ascertaining what common intentions should be ascribed to the parties from the terms of the ... document in question and the surrounding circumstances.” In practice, it means that there is no conclusive test for determining when a letter of comfort is contractual in effect, and that the outcome will depend on the relative importance a judge attaches to either of these two factors.

Staughton J decided that Chemco had not given notice to Rediffusion that Parry was unacceptable to Chemco within a reasonable time. This finding obviated the need for Staughton J to deal with the third issue – that is, the difficult question of the precise meaning of the words “take over the remaining liabilities”. It was argued that the words were susceptible to three possible meanings:

(a) CMC Italy’s liabilities would be transferred to Rediffusion whereupon CMC Italy would be relieved from those liabilities.

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199 [1941] AC 251 at 268: “The object of the Court is to do justice between the parties, and the Court will do its best, if satisfied that there was an ascertainable and determinate intention to contract, to give effect to that intention, looking at substance and not mere form. It will not be deterred by mere difficulties of interpretation. Difficulty is not synonymous with ambiguity so long as any definite meaning can be extracted.” See also JF Fisher, “Comfort Letters and their Legal Status” [1988] 5 Journal of International Business Law 215 at 217.

200 Chemco Leasing (19 July 1985, unreported, Queen’s Bench Division). Subsequently, in Kleinwort Benson at first instance [1988] 1 WLR 799 Hirst J similarly acknowledged that he had to “carry out precisely the same traditional task.”

201 Chemco Leasing on appeal [1987] 1 FTLR 201 at 205.
(b) Rediffusion would become co-principal obligators with CMC Italy.

(c) Rediffusion would become guarantors of CMC Italy's obligations under the lease.

Staughton J rejected the first meaning and found it unnecessary to decide between the other two meanings.\textsuperscript{202} However, it was merely stated that if Chemco had given notice that Parry was unacceptable to Chemco within a reasonable time, then Rediffusion would have been liable for breach of contract.\textsuperscript{203} Staughton J remarked in general, in a passage subsequently cited by Hirst J in \textit{Kleinwort Benson at first instance},\textsuperscript{204} that letters of comfort “are evidently designed as a compromise between, on the one hand, a guarantee by the parent company of the debts of its subsidiary, and, on the other, a placebo which gives no undertaking at all by the parent company. It is therefore not surprising if, in the circumstances, they are redolent of ambiguity, or ‘woolly’ as Mr Wood puts it.”\textsuperscript{205}

Although it was not argued that the letters of comfort were wholly ineffective to impose any legal obligations at all, Staughton J decided that –

"the words 'take over' simply mean to become responsible for ... I would hold that the letters of comfort provided for Rediffusion to become guarantors, since it was manifestly intended that upon payment [from the sale] they should succeed to the rights of Chemco."\textsuperscript{206}

\begin{flushright}
\textsuperscript{202} See JS Fisher, “Comfort Letters and their Legal Status” [1988] 5 \textit{Journal of International Business Law} 215 at 219 who points out that if the second meaning of the words were accepted, then it would have considerable repercussions for the doctrine of election since in this event Chemco would have been required to choose between CMC Italy and Rediffusion.


\textsuperscript{204} [1988] 1 WLR 799.


\textsuperscript{206} Chemco Leasing (19 July 1985, unreported, Queen’s Bench Division).
\end{flushright}
It appears that Staughton J favoured the third possible meaning of the words which would have rendered Rediffusion a guarantor of the liabilities of CMC Italy.\textsuperscript{207} Such a finding is difficult to reconcile with the view of Hirst J in \textit{Kleinwort Benson at first instance} that the rights and liabilities under a letter of comfort are substantially different from the rights and liabilities under a contract of guarantee.\textsuperscript{208} Thus, Hirst J’s analysis in \textit{Kleinwort Benson at first instance} is arguably inconsistent with the third meaning canvassed in \textit{Chemco Leasing}\textsuperscript{209}

In conclusion, the legal enforceability of the letter of comfort was upheld in \textit{Chemco Leasing}, but no liability was imposed because Chemco failed to give notice to Rediffusion within a reasonable time that the new shareholder was unacceptable so as to activate Rediffusion’s obligation to comply with its undertaking set out in the last paragraph of the letters of comfort.\textsuperscript{210} It appears from \textit{Chemco Leasing}\textsuperscript{211} that where the language of a letter of comfort does not in terms negative contractual intention, it is open to the court to hold the parties bound by the document, and that the court will, in particular, be inclined to do so where the parties have acted on the letter of comfort for a long period of time or have expended considerable sums of money in reliance on it.\textsuperscript{212}

\textbf{4.5.1.4 On appeal}

On appeal, the English Court of Appeal (Fox, Parker and Glidewell LJ) affirmed Staughton J’s decision, but without considering issue of letters of comfort further.\textsuperscript{213}

\begin{footnotesize}
\textsuperscript{207} D White, “Letters of Comfort” in J Prebble (ed), \textit{Dimensions in Banking and Foreign Exchange Law} (Butterworths, Wellington, 1992) 3 at 5, is of the view, however, that Staughton J indicated that the reference in the letter of comfort to the undertaking to “take over the remaining liabilities” would have meant that Rediffusion became co-principal obligor with CMC Italy or guarantor of CMC Italy’s obligations under the leases – that is, both the possible second and third meanings.
\textsuperscript{209} (19 July 1985, unreported, Queen’s Bench Division).
\textsuperscript{211} (19 July 1985, unreported, Queen’s Bench Division).
\end{footnotesize}
The Court of Appeal held that the parent company was not liable, because Chemco had failed to give it reasonable notice that the new shareholders were unacceptable to it (and thus an implied condition precedent to the undertaking in the second sentence of the last paragraph of the letter had not been fulfilled). However, it appears that the decision of Staughton J that the parent company was liable as guarantor would have been upheld but for this.\textsuperscript{214}

4.5.2. \textit{Re Augustus Barnett and Son Ltd}\textsuperscript{215}

4.5.2.1 The Facts

In \textit{Re Augustus Barnett}, Rumasa SA (“Rumasa”), a Spanish company, owned an English subsidiary, Augustus Barnett and Son Ltd (“Augustus”), which imported wine and sherry from Spain. Augustus had a “substantial deficiency of current assets”\textsuperscript{216} and its auditors refused to sign its 1979, 1980 and 1981 financial statements unless Rumasa provided them with a letter of comfort. Several such letters were provided over a four year period and the last dated 1 June 1982, read as follows: “Rumasa ... undertakes to provide such additional working capital as is necessary to enable [the company] to trade at its current level of activity for a period of not less than 12 months from this date and also to provide such long term finance [to Augustus] as is necessary”.\textsuperscript{217} Augustus’ suppliers also refused to provide supplies upon credit to it, but a Rumasa administrator told them that Augustus was supported by Rumasa. Despite additional funding, Augustus' fortunes continued to decline.

\textsuperscript{213} Chemco Leasing on appeal [1987] 1 FTLR 201.
\textsuperscript{215} \textit{Re Augustus Barnett} [1986] BCLC 170 (hereinafter referred to as Augustus Barnett). ADM Forte, "Letters of Comfort or Letters of Cold Comfort" (1990) 21 \textit{Journal of Maritime Law and Commerce} 99 at 100; See D Milman, “Letters of comfort and fraudulent trading” (1989) 7 \textit{The Company Lawyer} 245; and see J Horn, \textit{Patronatserklärungen im common law und im deutschen Recht} (Peter Lang, Frankfurt am Main, 1999) 27 to 30 for a German lawyer’s comments on the decision.
\textsuperscript{216} Augustus Barnett [1986] BCLC 170 at 171.
\textsuperscript{217} Augustus Barnett [1986] BCLC 170 at 171.
4.5.2.2 The issue

In 1983, Augustus was voluntarily liquidated. Consequently Augustus' liquidator applied for relief by way of a declaration that Rumasa was guilty of knowingly being a party to the carrying on of the business of a company with intent to defraud creditors under the then section 332 of the English Companies Act 1948.

4.5.2.3 The decision

Hoffman J held that Augustus' pleadings were defective, and that Rumasa was not guilty as alleged. However, his Lordship stated that “these facts, if proved, would be entirely inadequate to sustain an allegation of intention to defraud” because “[t]hey are quite consistent with a genuine and honest intention on the part of Rumasa, at the time of each of the statements relied upon, to support the company until it was able to stand upon its own feet”218 but that the “promise to provide 'such long term finance as is necessary' had become meaningless in the light of the knowledge that the company could not survive.”219 However, the letter of comfort had not become meaningless to Augustus' creditors. Indeed, as Collins remarked that “in these cases which occur in the law reports at least one party has chosen to litigate, which suggests an original intention to make a legally binding contract.”220

Hoffman J rejected the argument that the effect of his decision would be to make letters of comfort legally worthless, or that the “circumstances in which parent companies should be liable for the debts of their subsidiaries is a matter of considerable public importance and debate.”221 Moreover, his Lordship appeared to accept that a comfort letter might give rise to an action for fraud, but held that no such claim could be made in the case before him.222 Nonetheless, as Forte has pointed

\[\text{218 Augustus Barnett [1986] BCLC 170 at 175.}\]
\[\text{219 Augustus Barnett [1986] BCLC 170 at 175.}\]
\[\text{221 Augustus Barnett [1986] BCLC 170 at 173.}\]
\[\text{222 See ADM Forte, "Letters of Comfort or Letters of Cold Comfort" (1990) 21 Journal of Maritime Law and Commerce 99 at 101.}\]
out,\textsuperscript{223} Augustus Barnett clearly indicates that a letter of comfort may be legally actionable: a point which was conceded in Chemco Leasing\textsuperscript{224} and contested in Kleinwort Benson on appeal.\textsuperscript{225}

\subsection*{4.6 Determining the contractual effect of letters of comfort}

It has been remarked that most commentators on letters of comfort are of the view that the contractual effect of letters of comfort depends upon which of two decisions apply. Under Kleinwort Benson on appeal,\textsuperscript{226} letters of comfort do not have contractual effect, while under Banque Brussels Lambert SA v Australian National Industries Ltd\textsuperscript{227} a decision of the Supreme Court of New South Wales, comfort letters do indeed have contractual effect.\textsuperscript{228} It is submitted that this remark is too broad and inaccurate. As discussed in paragraph 6.1.4, Kleinwort Benson on appeal is not authority for the general proposition that comfort letters do not have contractual effect because, although the English Court of Appeal discussed comfort letters in general, the decision related to the letter of comfort before the court and its particular wording. Similarly, as discussed in paragraph 7.3.4, Banque Brussels was not authority for the general proposition that comfort letters had contractual effect.

It is more accurate to say that the contractual effect of letters of comfort depends not upon which decision applies, but upon which approach to the contractual effect of letters of comfort is applicable.\textsuperscript{229} The case law on letters of comfort in Anglo-common

\textsuperscript{224} (unreported, Queen's Bench Division, 19 July 1985).
\textsuperscript{225} [1989] 1 WLR 379.
\textsuperscript{226} [1989] 1 WLR 379.
\textsuperscript{227} (1989) 21 NSWLR 502 (hereinafter referred to as Banque Brussels).
\textsuperscript{229} See also M Elland-Goldsmith, "Comfort letters in English Law and Practice" [1994] International Business Lawyer 527 at 537; P Ho, Letters of "Dis"comfort: An Examination of the Legal Effect of Letters of Comfort (unpublished LLB Honours thesis, Monash University, 1994) 13. A Smith, S Tuxen and L Mann, Guarantees, Indemnities & Letters of Comfort (paper delivered at the Fourth Annual Mallesons Stephen Jaques Finance Law Summer School, Melbourne, 25 and 26 February 1991) at [1.2.4] seem to differ about the different approaches adopted in Kleinwort Benson on appeal and Banque Brussels, but it appears to be rather a matter of semantics: "Although the result in Kleinwort Benson and Banque
law jurisdictions basically supports five approaches to the contractual effect of comfort letters. The differences in the various approaches are based on the issues which form the focus of the court’s inquiry and determination, and the order in which the court deals with the issues, when determining the contractual effect of a comfort letter:

(a) The court can first focus on contract formation, or the existence of a contract, emphasising the element of intention to create legal relations, and in particular whether or not the presumption of intention to create legal relations in commercial dealings is applicable. As discussed in paragraph 4.4.2, regardless of the application of the presumption, when the court determining the comfort letter dispute focuses on the existence of (the letter as) a contract, it essentially resolves the dispute by reference to two different kinds of commercial situations - the “deliberate no law” or “contextual no law” scenarios - both of which necessitate a consideration of the wording of the letter of comfort.

(b) Alternatively the court can first focus on the interpretation\textsuperscript{230} of the instrument (alleged to constitute the contract), or the content thereof.\textsuperscript{231} Comfort letter disputes, or at least those which are litigated, are ultimately resolved by judicial exegesis of the words used by the parties. Such disputes bring into play what Lord Hoffmann has once described, albeit not referring to comfort letters, as the “intolerable wrestle with words and meanings”\textsuperscript{232}

\textsuperscript{230}In this dissertation no distinction is drawn between interpretation and construction – see G McMeeel, “The rise of commercial construction in contract law” [1998] Lloyd’s Maritime and Commercial Law Quarterly 382, but compare EW Patterson, “The Interpretation and Construction of Contracts” (1964) 64 Columbia Law Review 833.

\textsuperscript{231}The interpretation of contracts is always flexible, because the interpretation of any utterances and statements is flexible, and that flexibility increases risk – see P Mäntysaari, The Law of Corporate Finance: General Principles and EU Law (Springer-Verlag, Berlin, 2010) at 76 and 80.

which can prove to be “as obstinate as an allegory on the banks of the Nile”.233 The court can follow either a literal interpretation approach (whether or not the element of certainty is emphasised),234 or a modern purposive approach235 also known as a commercial (or common sense) approach236 to interpretation of the letter of comfort.237 The latter approach is “an eminently practical process”238 and combines elements of the literalist and purposive techniques, together with an insistence on objectivity, context239 and


239 The emphasis is on a contextual, rather than textual, approach which encompasses, as succinctly stated by G McMeel, “The rise of commercial construction in contract law” [1998] Lloyd’s Maritime and Commercial Law Quarterly 382 at 388, “concentric circles working outwards, ever increasing in scope:

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identification of commercial purpose to facilitate commercial activity,240 or what Lord Steyn has described as fulfilling the reasonable expectations of honest men (objectively understood241 and taking into account good faith and fair dealing)242 in accordance with commercial efficacy or common sense.243

The first approach is found in the decision of Hirst J in Kleinwort Benson at first instance.244 The Court’s focus was on the existence of a contract; it first applied the presumption of intention to create legal relations, and then adopted a commercial interpretation approach. Because of its emphasis on the presumption of intention to create legal relations in commercial situations,245 this approach is coined the “presumption of intention to create legal relations approach”. Under this approach, the court applies the said presumption to a comfort letter situation as a presumption of legal enforceability of letters of comfort, and then applies a commercial or common sense approach to the interpretation of the terms of the comfort letter. Consequently,

...
it is likely that a comfort letter would be construed as having contractual effect. Although it has not been followed in exactly the same way as adopted in Kleinwort Benson at first instance, this approach has influenced the approach in Banque Brussels. The presumption of intention to create legal relations approach is discussed in chapter 5.

The second approach is to be found in the decision of the English Court of Appeal in Kleinwort Benson on appeal. The court's focus was on the content of the comfort letter, applying literalist techniques of construction as a result of which there was no need for the Court to address the issue of contract formation, and consequently the application of the presumption of intention to create legal relations. Under this approach, the court construes the letter of comfort literally and in an analytical way, and it has been referred to as the “literal (or analytical or constructionist) approach.” Although it has regard to evidence of surrounding circumstances, the courts apply the ordinary meaning of the words literally, adopting a strict construction of commercial instruments, such as comfort letters. Consequently, it is likely that a comfort letter will be construed as not having contractual effect. The court either does not apply the presumption of intention to create legal relations in commercial situations or there is no need to do so because of the literal interpretation of the terms of the comfort letter as non-promissory. This is the prevailing approach in England and has been followed in Canada, New Zealand and Hong Kong. The literal interpretation approach is discussed in chapter 6.

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250 See chapter 6.
251 See British Associated Ports v Ferryways NV [2009] 1 Lloyd's Rep 595 (hereinafter referred to as Associated British Ports); and paragraph 6.3.
252 See Toronto Dominion Bank (1998) 40 BLR (2d) 1, and paragraph [6.7.
253 See Bank of New Zealand v Ginivan (unreported, Master Towle, High Court of New Zealand, Auckland, 10 July 1990, CP 556/90); and paragraph 6.6. But see the New Zealand Court of Appeal's remarks in Bank of New Zealand v Ginivan [1991] 1 NZLR 178.
254 See Bouygues SA v Shanghai Links Executive Community Ltd [1998] 2 HKLRD 479 (hereinafter referred to as Bouygues), and paragraph 6.8.
The third approach, an off-shoot of the second approach, is to be found in the decision of Tadgell J in Commonwealth Bank of Australia v TLI Management Pty Ltd.\(^{255}\) This approach is similar to the literal interpretation approach of the English Court of Appeal in Kleinwort Benson, but with an emphasis on the lack of certainty in the content of the instrument.\(^{256}\) Consequently, if the construction of a letter of comfort is uncertain, then it is likely that the letter will not have contractual effect. This approach is called the “certainty of terms approach” and has also been followed in Australian European Finance Corporation Ltd v Sheahan.\(^{257}\) The certainty of terms approach is discussed in chapter 6.

The fourth approach is found in the decision of Rogers CJ in Banque Brussels.\(^{258}\) The approach is similar to Hirst J's approach in Kleinwort Benson at first instance, except that the presumption of intention to create legal relations was applied in the usual way, and not as a presumption of legal enforceability of letters of comfort. Under this approach, the court construes the letter of comfort liberally\(^{259}\) and in a commercial or common sense way, employing techniques which encompass objective analysis, a contextual method and the identification of commercial purpose of the comfort letter.

It applies the ordinary meaning of words liberally, and deprecates judgment based on close textual analysis. The court, furthermore, relies on the presumption of intention to create legal relations in commercial situations. Consequently, it is likely that the letter of comfort will be construed as having contractual effect. This approach, discussed in chapter 7, is coined the “commercial (or common sense) interpretation approach relying on the contractual intention presumption”, and has been regarded not only as the leading Australian decision on letters of comfort, but also as the counterpoise of the approach in Kleinwort Benson on appeal.\(^{260}\)

\(^{255}\) [1990] VR 510 (hereinafter referred to as TLI Management).

\(^{256}\) See also GA Penn, AM Shea and A Arora, Banking Law Vol 2 (Sweet and Maxwell, London, 1987) 372.

\(^{257}\) (1993) 60 SASR 187 (hereinafter referred to as Australian European Finance).


\(^{260}\) [1989] 1 WLR 379.
The fifth approach is found in the decision of Einstein J in *Gate Gourmet*.261 This approach is similar to the approach adopted in *Banque Brussels*,262 except that the court did not rely on the contractual intention presumption, but rather determined the existence of the intention to create legal relations objectively.263 Consequently, it is likely that the letter of comfort will be construed as having contractual effect. This approach, discussed in chapter 7, is referred to as the “commercial (or common sense) interpretation approach sans contractual intention presumption”, and is presently the leading authority in Australia on letters of comfort, having been followed in *Newtronics*.264

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5 THE CONTRACTUAL EFFECT OF LETTERS OF COMFORT – THE PRESUMPTION OF INTENTION TO CREATE LEGAL RELATIONS APPROACH

5.1 Introduction

Despite being an essential element of all contracts, intention to create legal relations is largely inconspicuous in the formation of contracts and rarely looms as large as its “more well-known cousins” – offer, acceptance and consideration.¹ This is largely due to the fact that in the majority of cases, the commercial nature of the transaction makes it clear that the parties intended to enter into legal relations.² However, occasionally this element of contract is of crucial significance when the threshold question as to whether or not there is a contract has to be decided, like when letters of comfort first came before the English Courts in Kleinwort Benson Ltd v Malaysia Mining Corporation Berhad.³ It is thus not surprising that most contract law textbooks deal with letters of comfort, albeit briefly, in the section discussing intention to create legal relations.⁴ In this chapter, I discuss the so-called “presumption of intention to create legal relations” approach adopted in Kleinwort Benson at first instance.⁵

5.2 Intention to create legal relations and letters of comfort

In view of the nature of letters of comfort and the apparent easy application of the presumption to create legal relations in commercial matters, the courts have developed an approach to the contractual effect of letters of comfort based upon intention to create legal relations. They apply the presumption of intention to create legal relations in commercial situations to letters of comfort by presuming, in the absence of honour or no agreement clauses, the legal enforceability of the letter of

² NC Seddon and MP Ellinghaus, Cheshire and Fifoot’s Law of Contract (Lexisnexis, Chatswood, 2008) at 207.
³ [1988] 1 WLR 799 (hereinafter also referred to as Kleinwort Benson at first instance).
⁴ See, for example, P Richards, Law of Contract (Pearson Education Ltd, Harlow, 2004) at 78; NC Seddon and MP Ellinghaus, Cheshire and Fifoot’s Law of Contract (Lexisnexis, Chatswood, 2008) at 221;
comfort. The courts therefore construe the letter of comfort as having contractual effect.\(^6\)

Generally, commentators agree that the application of a common starting presumption will promote greater certainty as to the legal effect of letters of comfort.\(^7\) However, despite the fact that letters of comfort are exclusively used in commercial situations, Sneddon is of the view that a presumption against legal enforceability will best promote certainty because that is the traditional view of parent companies and directors.\(^8\) This view is, startling as it may appear, not entirely contrary to the perceptions and, in fact, use of at least some letters of comfort in practice.\(^9\)

However, to presume that letters of comfort are not legally enforceable is wrong.\(^10\) The traditional legal view as discussed in paragraph 4.4 is that, if parties enter into agreements in commercial situations, then they are presumed, in the absence of an honour or no agreement clause, to intend to create legal relations and their agreements are presumed to be legally enforceable. In other words, according to the traditional legal view a letter of comfort, as commercial agreement, is presumed to have legal effect unless the parties make it clear that the letter of comfort either embodies an agreement binding in honour only or has no legally binding effect (that is, a deliberate no-law situation),\(^11\) or it appears from the context of the letter of comfort that it is legally unenforceable (that is, a contextual no-law situation).\(^12\) To presume the unenforceability of letters of comfort will amount to a reversal of the policy


\(^9\) See paragraph 3.3 in respect of letters of comfort and bank practice.


\(^11\) See paragraph 4.4.1.

\(^12\) See paragraph 4.4.2.
considerations applied by the courts in commercial matters and a carving out of an exception to the presumption to create legal relations in commercial situations. Moreover, in Taylor v Johnson is was held that the test for intention to create legal relations is objective. The subjective intention of parent companies, director and the banks is irrelevant. Furthermore, Tyree has pointed out: "It is absurd to think that teams of lawyers and business people spend time and money drafting documents that express only moral obligations. It is even more absurd to suppose that they then act on these documents by entering into transactions worth millions of dollars."

5.3  **Kleinwort Benson Ltd v Malaysia Mining Corporation Berhad at first instance** - the judicial beacon for the contractual intention approach

The contractual intention approach to determine the contractual effect of letters of comfort was first developed by Hirst J in **Kleinwort Benson at first instance**, sitting in the English Queen’s Bench Division.

5.3.1. The facts

The plaintiff, Kleinwort Benson Ltd (“Kleinwort”), was a merchant bank of high reputation and long experience. The defendant, Malaysia Mining Corporation

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13 This appears to be the approach adopted by P Richards, *Law of Contract* (Pearson Education Ltd, Harlow, 2004) at 78 who deals with letters of comfort on the basis that it is an exception to the presumption of an intention to create a legal relationship in commercial agreements.


MMC, was a public limited company incorporated under the laws of Malaysia in which the Republic of Malaysia had at all material times held a controlling interest. MMC incorporated a wholly-owned subsidiary, MMC Metals Ltd ("Metals"), under the laws of England to operate as a ring-dealing member of the London Metal Exchange to buy and sell tin. MMC negotiated with Kleinwort to provide extra funding to Metals to supplement Metals' paid up capital. Initially, Kleinwort offered to provide financial facilities to both MMC and Metals in return for their joint and several liability for the facilities. MMC was not prepared to assume joint and several liability for funding essentially of Metals.

Kleinwort then offered to provide finance to Metals in return for a 3/8 per cent per year commission and a formal guarantee from MMC. MMC refused to guarantee Metals' borrowings. Later again, Kleinwort offered to provide finance to Metals in return for a ½ per cent per year commission (1/8 per cent per year higher than before) and a letter of comfort from MMC. MMC was prepared to give Kleinwort a letter of comfort. Kleinwort drafted the letter of comfort which was, after much to-ing and fro-ing, approved by the MMC Board and duly signed on behalf of MMC.

In 1984, upon being provided with the letter of comfort, Kleinwort made a credit/multi-currency cash loan facility available to Metals. The following year, again upon receipt of a letter of comfort from MMC, Kleinwort increased Metals' financial facility. Metals' financial facility totalled £10 million. The two letters of comfort were in substantially identical terms. Relevantly the negotiated letter of comfort, exhibiting the three classic characteristics identified by Wood, stated that:

20 Kleinform Benson Ltd v Malaysia Mining Corporation Berhad [1989] 1 WLR 379 at 381 (Kleinform Benson on appeal).
“[1] We hereby confirm that we know and approve of these facilities and are aware of the fact that they have been granted ... because we control directly and indirectly MMC Metals Ltd.

[2] We confirm that we will not reduce our current financial interest in MMC Metals Ltd until the above facilities have been repaid or until you have confirmed that you are prepared to continue the facilities with new shareholders.22

[3] It is our policy to ensure that the business of MMC Metals Ltd is at all times in a position to meet its liabilities to you under the above arrangements.”23

In 1985, the international tin market collapsed when the International Tin Council (“ITC”) announced that it was unable to meet its liabilities which ran into hundreds of millions of pounds sterling.24 At this stage Metals owed Kleinwort the entire amount of the facility. Metals was placed into liquidation and was, accordingly, in breach of its contract with Kleinwort. Kleinwort sought payment of the amount owing from MMC. MMC, however, denied liability and refused to pay. MMC alleged that the letter of comfort was not intended by either party to impose any legally binding obligation on it to support Metals, and, in any event, the circumstances had had materially changed since the letter was issued and with them MMC’s policy regarding the support given to

23 Kleinwort Benson at first instance [1988] 1 WLR 799 at 803. The paragraphs of the letter of comfort have been numbered for easy reference.
24 The ITC was the operative arm of the Sixth International Tin Agreement (“ITA 6”). Under the ITA 6 and earlier agreements, 23 sovereign states, including Australia, Belgium, Canada, Malaysia, the United Kingdom and the European Economic Community, had joined together to form a tin cartel, the ITC, to control the supply and market price of tin through artificial devices. The ITC incurred debts in the process to regulate the international tin market, and on 24 October 1985 when it announced that it was unable to meet its debts, the debts amounted to £900 million. A spate of litigation followed in the English courts. In Maclaine Watson & Co v International Tin Council [1989] 3 All ER 523, the House of Lords found that the members under the ITS 6 were not liable on the ITC’s debts. For a discussion of the ITC and the events leading up to the collapse of the ITC, see J H Rayner (Mincing Lane) Ltd v Department of Trade and Industry [1988] 3 WLR 1033; S Chandrasekhar, "Cartel in a Can: The Financial Collapse of the International Tin Council" (1989) 10 Northwestern Journal of International & Business Law 309.
its subsidiary. Kleinwort subsequently brought action against MMC claiming damages in the order of £12 million inclusive of interest; the same amount as would have been claimed had a guarantee been given.

5.3.2. The issue

Consistent with the separate legal entity doctrine it was accepted that, apart from some additional contractual provision, a creditor of a subsidiary, like Kleinwort, could not look to the parent company for repayment of a debt.25 The question for decision was whether the letters of comfort gave rise to any contractual or other legal liability, or recorded moral obligations only. Critically, however, Hirst J divided the question into two parts: The principal question was whether the undertaking in the third paragraph of the letter of comfort was contractual in status, with its proper construction or interpretation being a subsidiary question.26 Thus, the main question for determination by the Court was whether or not the letter of comfort given by MMC to Kleinwort established a legal obligation on MMC. Because the subject matter was commercial, Hirst J characterised the issue in terms of an intention to create legal obligations - did the letter of comfort record an intention of the parties to enter into legal relations in respect of the “promise” given? In other words, was the promise to be binding in law or only in honour?27

5.3.3. The decision

In a judgment which caused “a certain amount of agitation in the City”,28 Hirst J decided that MMC was liable for breach of contract and gave judgment in favour of Kleinwort. There was no magic attached to the words “comfort letter” which automatically precluded any contractual intention.29 Thus, the learned judge stated

that the main question to be decided was whether the crucial third paragraph of the letter of comfort was contractual in status, because if so, the subsidiary question would then be its proper construction. In other words, the principal question was whether the third paragraph of the letter of comfort was contractual in status \textit{vis-à-vis} intention to create legal relations.

Hirst J had little difficulty ruling positively on this principal question: since the subject matter was a commercial rather than a social or domestic transaction, Kleinwort Benson clearly acted in reliance on the letters of comfort in making the loan facility available, and it was of foremost importance to Kleinwort Benson both that MMC covered Metals' liability and that Kleinwort Benson could have recourse to MMC in the event of Metals' default. The comfort letters thus overcame any argument that they were not meant to have legal effect. Hirst J then dealt with MMC’s arguments about the presumption of intention to create legal relations.

The Court held that \textit{Edwards v Skyways Ltd} was binding authority and applied the test set out in that decision. Hirst J found that the two comfort letters had come into

\begin{quote}
\textit{Kleinwort Benson at first instance} [1988] 1 WLR 799 at 801.
\end{quote}

\begin{quote}
\textit{Kleinwort Benson at first instance} [1988] 1 WLR 799 at 804 et seq.
\end{quote}

\begin{quote}
\textit{Kleinwort Benson at first instance} [1988] 1 WLR 799 at 808.
\end{quote}
existence as an integral part of a commercial banking transaction.\(^{38}\) The presumption of intention to create legal relations in commercial transactions was thus, unless rebutted, determinative of the main question as to the contractual status of the letter of comfort. In other words, the subject matter of the agreement informed the court of the parties’ intentions.\(^{39}\) The Court found that MMC had failed to rebut the presumption.

Concerning the legal status of letters of comfort, Hirst J derived assistance from the judgment of Staughton J in Chemco Leasing SpA v Rediffusion plc.\(^{40}\) Whether or not the letter of comfort was “woolly” was held by Hirst J to depend on the construction of the words in the comfort letter “set in their surrounding matrix or circumstances”.\(^{41}\) This was the traditional way of finding the common intention of the parties, but the learned judge made the pertinent observation that in reality the common intention was that the terms should mean what a judge or arbitrator should decide they mean.\(^{42}\)

In essence, MMC had three principal arguments against the legal enforceability of the letter of comfort.\(^{43}\) The first two arguments focused on the wording of the letter of comfort and the last one on the circumstances surrounding, or the pre-history of, the letter of comfort. Hirst J rejected MMC's first argument that the opening words in the third paragraph were ambiguous and should be construed contra proferentem,\(^{44}\) with Kleinwort being effectively the proponent despite some minor amendments by MMC,

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\(^{38}\) Kleinwort Benson at first instance [1988] 1 WLR 799 at 809.


\(^{40}\) (19 July 1985, unreported, QBD) (hereinafter also referred to as Chemco Leasing).

\(^{41}\) Kleinwort Benson at first instance [1988] 1 WLR 799 at 807.

\(^{42}\) Kleinwort Benson at first instance [1988] 1 WLR 799 at 807. C Bright and S Bright, “Beware the Letter of Comfort” (1988) 138 New Law Journal 365 are of the view that the use of comfort letters is well established practice and that part of the surrounding circumstances that needs to be taken into account is the expectation aroused in market practitioners generally by comfort letters: “Addressing this issue may itself help the court to avoid feeling, as is suggested from the judgment, that it has been left to arbitrage in a situation of impasse between parties. It is very unlikely that on a matter as important as a potential guarantee, formal or otherwise, the parties should decide that its terms are what a “judge or arbitrator should decide that they mean”.


\(^{44}\) Words are interpreted against the party responsible for the drafting of a document.
because the letter of comfort was a joint drafting effort and the words were not ambiguous.\textsuperscript{45} MMC conceded that the second paragraph of the letters of comfort had contractual effect, but argued that there was a difference between the strong opening words of the second paragraph ("we confirm") and the omission of such opening words in the third paragraph, alternatively the weaker opening words of that paragraph ("it is our policy").\textsuperscript{46} Hirst J did not accept the second argument, deciding that there was "no magic" in the opening words of the third paragraph of the letters of comfort and that "no greater strength would have been added to paragraph (3) if it had begun 'We confirm that it is our policy'".\textsuperscript{47} The opening words of the third paragraph of the letter of comfort were unequivocal and clear. Moreover, the language of the comfort letter was appropriate to create legal obligations.\textsuperscript{48}

Hirst J also did not accept the third argument that MMC’s refusal to accept either joint and several liability or provide a formal guarantee implied that MMC and Kleinwort had not intended to create a legal relationship.\textsuperscript{49} This part of the decision has been criticised by commentators because they find it surprising that MMC could have had an intention to be legally bound to meet Metals’ liabilities when it specifically refused to give a guarantee in respect of Metals’ liabilities.\textsuperscript{50} However, Hirst J was conscious of MMC’s refusal to provide a guarantee, but stated that there was a “very substantial difference” between a formal guarantee and a letter of comfort.\textsuperscript{51} The difference was two-fold.

\textsuperscript{45} Kleinwort Benson at first instance [1988] 1 WLR 799 at 809.
\textsuperscript{46} Kleinwort Benson at first instance [1988] 1 WLR 799 at 808 and 809.
\textsuperscript{47} Kleinwort Benson at first instance [1988] 1 WLR 799 at 809.
\textsuperscript{49} Kleinwort Benson at first instance [1988] 1 WLR 799 at 809.
\textsuperscript{51} Kleinwort Benson at first instance [1988] 1 WLR 799 at 809.
First, on the one hand a guarantee was “usually drawn in language the meaning of which is not susceptible to much debate”.\textsuperscript{52} On the other hand, a letter of comfort was invariably drawn in vague or imprecise language, provoking a debate as to its construction.\textsuperscript{53} Secondly, under a formal guarantee, a lender could sue for the amount of the debt. In other words, the mechanism of a guarantee’s enforcement is relatively uncomplicated for the bank and yields a certain, quantifiable pay-out. In contrast, under a letter of comfort, a lender could only sue for damages and the quantum of damages would depend upon causation and remoteness\textsuperscript{54} – in short, the breach of the letter of comfort must be referrable to the bank’s loss.\textsuperscript{55} The enforceability of a letter of comfort is dependent upon its terms, the interpretation of which “often provokes a debate as to its construction.”\textsuperscript{56} Since the forum of enforceability of a letter of comfort is a litigated action, the parent company retains the option to challenge the bank’s contractual rights.\textsuperscript{57} Thus, as a form of “security”, letters of comfort are procedurally more cumbersome to enforce than traditional surety agreements.\textsuperscript{58}

Thus, MMC’s refusal to owe Kleinwort a full legal obligation under a formal guarantee did not imply that it refused to owe Kleinwort a lesser legal obligation under a letter of comfort.\textsuperscript{59} In dealing with comfort letters one has to bear these differences in mind,

\textsuperscript{52} Kleinwort Benson at first instance [1988] 1 WLR 799 at 809.
\textsuperscript{53} Kleinwort Benson at first instance [1988] 1 WLR 799 at 809.
\textsuperscript{54} The extent of the damages will not be a problem in circumstances where there is a causal link between the entire measure of the bank’s loss and the breach of the binding and enforceable commitment in the letter of comfort – see, for example, Banque Brussels Lambert SA v Australian National Industries Ltd [1989] 21 NSWLR 502 (hereinafter referred to as Banque Brussels), discussed in paragraph 7.3, where the damages awarded was identical to that attainable under a formal guarantee.
\textsuperscript{55} For example, the parent company may have reduced its shareholding participation in the subsidiary below the minimum level stipulated in the letter of comfort. To claim damages the bank faces a difficult task of proving the subsidiary’s breach of its obligations was caused by the parent company reducing its participation. Another example is where a parent company promises to maintain a subsidiary in a solvent position. Should the subsidiary be in breach the bank may have to wind up the subsidiary so as to establish its insolvency at the time of default on payment.
\textsuperscript{56} Kleinwort Benson at first instance [1988] 1 WLR 799 at 809.
\textsuperscript{58} R Milliner, “Comfort Letters – How Much Comfort Are They For Lenders and Auditors?” (unpublished paper, University of Western Australia, Law Summer School, 1990) at [4.3].
because there is a risk that the damages payable under the letter of comfort and the sum payable under a guarantee could differ. This risk provides a justification for the extra commission which was charged by Kleinwort. However, in a case where the comfort letter is linked to a specific loan, that risk is basically negated because it is obvious that the damages equal the amount which remains unpaid.

It was of great importance to Kleinwort that Metals' debt was secured by MMC because of the substantial liability and the speculative nature and volatility of the tin market. Kleinwort clearly relied upon the letters of comfort, and in particular the third paragraph which was an important feature of the letters of comfort, for assurance that MMC would ensure that Metals could meet its liabilities to Kleinwort. By submitting the letters of comfort to its Board for approval, MMC signalled that it regarded the letters of comfort as important and of great consequence. The involvement of the MMC Board strongly reinforced the presumption that MMC intended to create a legal relationship with Kleinwort when it provided the letters of comfort. Kleinwort's reliance on the letter of comfort and MMC's failure to clearly state that the letter was not legally binding supported judgment in favour of Kleinwort.

It appears that the presumption of intention to create legal relations in commercial situations weighed so heavily with Hirst J that he effectively applied it as a presumption of the enforceability of letters of comfort, deciding that "[a]s to ... [the

112 at 125 observed, however, that: "It must only be in the rarest of case that a person can say 'I refuse to guarantee, but I hereby intend to create an obligation very similar to a guarantee'."

60 GA Wittuhn, "Kleinwort Benson Limited v Malaysian Mining Corporation Berhad – A Comparative Note on Comfort Letters" (1990) 35 McGill Law Journal 490 at 497 is also of the view that a further difference is that a guarantor is usually discharged if a material alteration of the underlying financing contract between the bank and the subsidiary takes place, while in the case of a letter of comfort such change will only have an impact on the damages, if any, suffered by the bank.


63 Kleinwort Benson at first instance [1988] 1 WLR 799 at


letter of comfort’s] interpretation, that seems to me to be crystal clear without embellishment.” Indeed, there is no express reference in Hirst J’s judgment to the overall requirement of contractual certainty. Accordingly, the Court held that the third paragraph of the letters of comfort was “an undertaking that, now and at all times in the future, so long as MMC Metals Ltd are under any liability to the plaintiffs under the facility arrangements, it is and will be the defendant’s policy to ensure that MMC Metals Ltd is in a position to meet those liabilities.” Justice Hirst, in effect, implied a binding obligation into the letter of comfort by interpreting the words “policy to ensure” in the third paragraph of the letter as a “promise to ensure”.  

The letter of comfort formed an important and integral part of a commercial bank transaction; and, as MMC failed to rebut the presumption of intention to create legal relations in commercial situations, the letter of comfort was taken as creating a contract under which MMC was bound to make good any losses suffered by the failure of its subsidiary. Kleinwort was entitled to claim damages for breach of contract against MMC for £10,004,499.25 together with interest of £2,257,824.64. Thus, in the end, the Court enforced the letter of comfort as if it were a guarantee – the letter of comfort was not a guarantee in form but in effect.

5.3.4. Some comments

The judgement of Hirst J received a mixed response from commentators. A number of commentators have criticised Hirst J’s decision, some remarking that, in reality,

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contractual liability was used to penalise morally unacceptable behaviour where no intermediate position existed. Reynolds expressed surprise at the result and pointed out that the statement as to MMC’s policy may well have been correct and did not require to be read as carrying an implied promise not to change that policy. Davenport noted that if MMC’s policy at the date of the letter of comfort had been deliberately misstated, it would have been liable for the tort of deceit, but -

“[B]y divorcing the question of intended legal effect from the words actually used, the Judge deprived himself of the opportunity of viewing the matter as a whole. When so viewed, para 3 of the ‘comfort letter’ can be seen to have some legal effect, but not that substantial effect for which KB contented and which anyone in their position would wish that it had.”

These criticisms are, however, aimed at his interpretation of the facts rather than his approach to the contractual effect of the letters of comfort. As Pascoe remarked, the decision ultimately involved matters of fine judgment - the wording of the third paragraph were susceptible to uncertainty and the facts, particularly the fact that Kleinwort and MMC could not agree on the manner in which MMC would ensure that Metals would fulfil its obligations, could easily support a construction of the letter of comfort that no legal relationship was contemplated by the parties. As discussed in chapter 6.1.1, on appeal both Hirst J’s approach to the construction of the letter of


comfort and his interpretation of the facts were criticised, and his judgment overturned.

The first criticism of some commentators is that Hirst J does not appear to have specifically addressed the overall requirement of contractual certainty.\(^{78}\) The meaning of the third paragraph of the letter of comfort was said not to be quite “crystal clear”,\(^{79}\) because it could mean, in effect, “we promise to keep Metals in funds at all times to meet its liabilities to KB”, or “it is our present intention to keep Metals in funds etc, but we may change our mind if circumstances change”, or several other things.\(^{80}\) The argument was that the third paragraph used the present tense when stating MMC's policy in relation to Metals' liabilities and did not make any representations about MMC's future policy so that it was open to MMC to change its policy if circumstances changed. However, by ignoring the tense in which the third paragraph was stated, Hirst J imported into MMC's letter of comfort a future obligation that MMC would ensure Metals would meet its liabilities.\(^{81}\) That the wording “it is our policy” was susceptible to different meanings depending on whether the literal or the liberal interpretation approach was adopted, was borne out by the decisions in *Kleinwort Benson on appeal*\(^{82}\) and *Banque Brussels*.\(^{83}\) Furthermore, it should be noted that the third paragraph originally read: “It is our policy to ensure that the business of MMC Metals Limited is conducted in such a way that MMC Metals Limited is at all times in a position to meet its liabilities to you under the above arrangements.”\(^{84}\) The italicised words were removed from the settled letter of comfort and at a Board Meeting of MMC the directors formally resolved to authorise Metals to

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\(^{78}\) See I Brown, “The Letter of Comfort: Placebo or Promise?” [1990] *Journal of Business Law* 281 at 285. Hirst J’s approach appears, however, to be similar to that of Staughton J in *Chemco Leasing* (19 July 1986, unreported, QBD) where his lordship did not consider that “the letters were so vague as to be incapable of forming part of an enforceable contract”.


\(^{82}\) [1989] 1 WLR 379.


\(^{84}\) *Kleinwort Benson at first instance* [1988] 1 WLR 799 at 802.
accept the Kleinwort facility and issue the letter as amended by the deletion of the
words emphasised.85

The second criticism was that “no special status peculiarly attaches to the fact that
MMC’s Board minuted its approval to issue a letter of comfort. This minuting is a
typical and formal requirement that lenders have and should be seen as having no
other significance than simply that.”86 This might be true, but the fact that the MMC
Board approved the letter of comfort remained a surrounding circumstance indicating
that MMC heeded to a requirement of Kleinwort that the giving of the comfort letter
was noted at the highest level in MMC.

The third criticism was that it was significant that MMC was reluctant to give a
guarantee, and that Kleinwort appreciated and accepted the fact that “MMC was not
in a position to guarantee the debts of its subsidiary nor did it wish to. [Kleinwort] was
very aware of these facts and it was because of the absence of a guarantee that the
interest rate under the facilities was increased.” It has been further pointed out that
it looked odd that someone who explicitly refused in negotiation to guarantee a debt
should later accept an obligation which in practical effect was nearly the equivalent of
that both in amount and in the circumstances in which it might arise, albeit less clear-
cut and less susceptible to summary judgment.88 This criticism appears, however, to be
unjustified. Although interlinked, the relationship between Kleinwort and Metals, and
the relationship between Kleinwort and MMC should not be confused. It was true that
MMC refused to formally guarantee Metals’ indebtedness to Kleinwort, and that by
accepting the letters of comfort instead of a formal guarantee from MMC, Kleinwort

85 FT Gulson, “Contract – Loan by bank to subsidiary of a company – Letters of Comfort provided by
86 FT Gulson, “Contract – Loan by Bank to Subsidiary of a Company – Letters of Comfort provided by
Journal 40 at 41; J Pascoe, “Kleinwort Benson Ltd v Malaysian Mining Corporation Bhd” (1989) 7
Company and Securities Law Journal 137 at 139.
Journal 346.
required a 1/8 per cent per year higher commission from Metals in respect of the financial facilities extended to it.  

The fact that Kleinwort demanded a higher commission from Metals (not MMC) to offset the higher risk attached to its acceptance of the letters of comfort, rather than a formal guarantee, from MMC, neither evidenced a lack of, nor negated, the contractual effect of the letters of comfort provided by MMC.  

The difference between the nature of the legal obligations resulting from the provision of a formal guarantee as opposed to the provision of a letter of comfort, meant that Metals' debt to Kleinwort was less secure with the provision of the letters of comfort. A less secure debt meant a higher risk.  

So, Metals had to pay a higher commission to Kleinwort because its debt to Kleinwort was less secure. This higher risk and resultant higher commission was part of the relationship between Kleinwort and Metals, but was reflected in the relationship between Kleinwort and MMC in the lesser legal obligation incurred by MMC pursuant to the letters of comfort.  

Furthermore, in most cases, there was no evidence that a lender required a higher return to offset the higher risk of being provided with a letter of comfort rather than a formal guarantee and, in most cases, a “higher risk, higher return” argument is equivocal to intention to create legal relations.  

Indeed, it should be noted that in Kleinwort Benson, “no witness appeared for MMC and the peculiar nature of the tin industry can be distinguished from the less speculative business of … [other] endeavours”.  

Finally, comparing the rates of letters of comfort and

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89 S Chandrasekhar, “Cartel in a Can: The Financial Collapse of the International Tin Council” (1989) 10 Northwestern Journal of International Law and Business 309 at 331 pointed out that the banks and other lenders should not have been surprised that no-one assumed liability for the debts resulting from the tin market collapse, since the Bank of England unofficially warned brokers on the London Metal Exchange that they should not rely on the government members of the ITC to assume its debts, and that lenders were deliberately less critical of the risks of providing financial facilities to the ITC and other corporate vehicles used by the cartel members.


guarantees was neither here nor there, because each pricing decision should depend on the circumstances and nature of the financial facility, and the type of client.

The association of letters of comfort and guarantees potentially introduced a risk for those dealing with letters of comfort, because it encouraged an assumption that an issuer of a comfort letter faced either contractual liability as if it had given a guarantee, or no liability whatsoever, merely serving as a source of comfort or reassurance, but nothing more.\textsuperscript{95} This was a dangerous assumption because contractual liability was only one potential source of liability for the issuer of a comfort letter.\textsuperscript{96} Promissory estoppel, misrepresentation, and a contravention of section 52 of the \textit{Trade Practices Act} 1974 (Cth) could all give rise to liability for the issuer of a comfort letter.\textsuperscript{97}

The fourth criticism was that Hirst J failed to give sufficient weight to the fact that letters of comfort had been widely used for some time and had been commonly understood not to impose legally enforceable obligations.\textsuperscript{98} This criticism was too general and ignored the fact that nothing turned on the appellation “letters of comfort” (especially if one considers the multiplicity of terminology used),\textsuperscript{99} the fact that the wording of the statements contained in letters of comfort differed, and the fact that the court had to construe the letter of comfort in dispute in the context of the dispute.

Finally, Hirst J was also criticised for attaching too much weight to the fact that Kleinwort clearly placed great reliance on the letter of comfort when agreeing to the loan, because a party’s reliance did not necessarily convert a moral obligation into a

\textsuperscript{97} See \textit{Banque Brussels} [1989] 1 NSWLR 502; \textit{Gate Gourmet Australia Pty Ltd (in liquidation) v Gate Gourmet Holding AG} [2004] NSWSC 149 (hereinafter also referred to as \textit{Gate Gourmet}), and chapter 7.
\textsuperscript{99} See paragraph 2.3.
binding contract. However, it did not appear from the judgment in Kleinwort Benson at first instance that Kleinwort's reliance on the letter of comfort was more than a part of the surrounding matrix or circumstances taken into account in the construction of the words in the comfort letter.

As stated in the beginning of paragraph 5.6.4, however, a number of commentators have supported Hirst J’s judgment. Sacasas was not even surprised at the outcome, as “counsel should have seen the writing on the wall” because the commercial literature and case law at the time, although scanty, pointed in the direction of enforcement. The letter of comfort was of such a type and strength as to receive a rating of 3 out of 10 on the “Comfort Index” which he and Wiesner had developed a couple of years before after a review of the literature, the articulated business policy statements by financial institutions, and the reported case law on letters of comfort. Kleinwort Benson's insistence upon the use of "sufficiently active language in the purportedly inert document to activate contractual remedies", caused the letter to have contractual effect and it “got the benefit of an ersatz guarantee and received an interest premium to boot.”

Tettenborn remarked that Hirst J “got it right” and that the judgment in Kleinwort Benson at first instance was

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100 See J Pascoe, "Kleinwort Benson Ltd v Malaysian Mining Corporation Bhd" (1989) 7 Company and Securities Law Journal 137 at 139.
103 On this index, a score of “1.1” is received by payment and performance bond issued by a solvent surety, “1.2” by an absolute guarantee of payment given by a solvent guarantor, and a “9.5” is given to an unenforceable estoppel letter issued ultra vires – see R Sacasas, "The Comfort Letter Trap: Parent Companies Beware" (1989) 106 Banking Law Journal 173 at 182.
105 For example, Chemco Leasing (19 July 1985, unreported, QBD), and Re Augustus Barnett & Son Ltd [1986] BCLC 170.
“clearly in tune with the need for pretty absolute certainty in cases of this sort. True, one has some sympathy for the defendants on having been held liable for several million pounds on the basis of a rather Delphic document, whose wording they doubtless kept deliberately vague in the hope that they would not be; nevertheless, the Kleinwort Benson case has now settled beyond doubt the meaning of what one suspects is a fairly common form of words in letters of comfort. It is now clear that they give rise to liability practically equivalent to a guarantee: if parties wish to alter this, they are now on notice to change their documents to make clear what they are, and are not, undertaking. If they do not, they only have themselves to blame if they find themselves unexpectedly liable for more than they thought. Such a settlement can only be to the long term advantage of bankers and others.”

Although Tettenborn’s general remarks are still apt for Australia in light of the Banque Brussels109 and Gate Gourmet110 decisions, they are clearly inapplicable to the position in the other Anglo-common law jurisdictions in light of the decisions in Kleinwort Benson on appeal,111 Associated British Ports v Ferryways NV,112 Toronto Dominion Bank v Leigh Instruments Ltd (Trustee of),113 Bank of New Zealand v Ginivan,114 Hong Kong and Shanghai Banking Corporation Ltd v Jurong Engineering Ltd115 and Bouygues SA v Shanghai Links Executive Community Ltd.116

Adhar’s criticism of Hirst J’s decision is interesting from a theoretical viewpoint because it is aimed at the requirements for a valid contract rather than specifically the

110 [2004] NSWSC 149.
113 (1998) 40 BLR (2d) 1 (hereinafter referred to as Toronto Dominion Bank).
114 (1990) 5 NZCLC 66,103 (hereinafter referred to as Bank of NZ).
115 [2000] 2 SLR 54 (hereinafter referred to as Jurong Engineering).
116 [1998] 2 HKLRD 479 (hereinafter referred to as Bouygues).
determination of contractual enforceability of comfort letters. He observed that Hirst J’s decision “implicitly reaffirms the orthodox teaching that contractual intention still remains ... a distinct and necessary element in contract formation” and pointed out that: “References to intention do tend to be artificial or fictitious given the usual situation of the parties never having addressed their minds to the matter at all ... A more serious allegation is that the device of contractual intention is unhelpful or at worst, deceitful since it ‘enables courts to cloak policy decisions in the mantle of private contractual autonomy’ ... These criticisms are difficult to refute. It thus might appear puzzling why the law ever introduced this element into contract law in the first place. Surely an agreement supported by consideration is all that is required? The test of bargain surely renders superfluous any further requirement such as intention to create legal relations.”

As discussed in paragraph 4.4, intention to create legal relations was still an element for a valid contract. The issue was, however, the nature, role and application of the presumption that in commercial matters the parties are presumed to have intended the creation of legal relations. Tettenborn was of the view that Hirst J’s finding on intention to create legal relations was admirable.

However, as discussed in paragraph 4.4.2, one cannot assume simply from the fact that a transaction was commercial in nature that the parties did not intend it to be binding in honour only. Edwards v Skyways Ltd was not authority for an inference of intention to be legally bound merely by virtue of the commercial nature of the transaction in question. The issue was whether one was dealing with a contextual no-law situation. Accordingly, where one of the parties to a dispute maintained that, by

120 [1964] 1 WLR 349.
121 See paragraph 4.4.2.
implication or from the context of the document, there was no contractual intention, it followed that the presumption cannot be of assistance in resolving that point – the outcome depends upon whether or not the court, having regard to the evidence before it, could discover what the parties’ intention was. This point was not fully appreciated in Kleinwort Benson at first instance, or in Banque Brussels, but appeared to have been recognised in Kleinwort Benson on appeal. In the latter case, however, the non-application of the presumption of intention to create legal relations was rather premised upon a distinction between the parties’ intention as regards the existence of the agreement as opposed to the content thereof. Properly used, the presumption of intention to create legal relations could play a role in the determination of the contractual effect of a letter of comfort as demonstrated by Jurong Engineering and Gate Gourmet.

5.4 Conclusion

Despite the fact that Hirst J’s decision in Kleinwort Benson was overturned on appeal, a number of principles gleaned from Hirst J’s reasons were not disturbed by the English Court of Appeal. It remained an important decision on comfort letters for a number of reasons, not least because it renewed interest in the potential for comfort letter enforceability.

First, in reversing Hirst J’s decision the English Court of Appeal did not resolve the issue of the legal status of letters of comfort. Whilst denying any contractual effect to the particular letter of comfort at issue, the Court of Appeal did not go so far as to suggest that comfort letters could not be binding. Conversely, Hirst J did not hold that comfort

126 [2000] 2 SLR 54.
127 [2004] NSWSC 149.
letters would always be binding. In fact, Hirst J’s decision did not alter the general nature of letters of comfort, so that the vast majority would therefore remain binding in honour only. Hirst J’s decision recognised that the title “comfort letter” encompassed not only instruments which were letters of comfort properly so called, but also instruments which were so-called “binding comfort letters” as well as instruments the purpose of which are to “steer a course between the Scylla of non-acknowledgment by the parent company on the one hand and the Charybdis of a legal commitment on the other.” The major principle emerging from the decision was that a letter of comfort had to be classified.

Secondly, each letter of comfort was a unique instrument, and its legal effect, if any, should be determined by analysing its language in the context of the surrounding circumstances. This applied to letters of comfort, the normal law of contract formation and contract interpretation, and also the law about representations. Consequently, the decision demonstrated that contractual liability or liability in tort based on a letter of comfort was a real possibility in Anglo-common law jurisdictions. There was also the possibility that a comfort letter could be both a contract and a representation, in which case there is the prospect of concurrent liability.

Thirdly, it established that the appropriate remedy for a bank attempting to recover under an enforceable letter of comfort was in damages and not for money owing.

131 See paragraph 2.5.
133 See chapter 4.
135 That is, for fraudulent, negligent, innocent or, even statutory, misrepresentation and to the remedies of damages or rescission.
the debtor subsidiary was liquid and able to repay its indebtedness to the bank, the bank should sue the subsidiary.

Fourthly, the decision was approved in *Banque Brussels*138 which has become the leading Australian decision on letters of comfort.139

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139 *Banque Brussels* (1989) 21 NSWLR 502 has been followed in the recent decisions in *Gate Gourmet* [2004] NSWSC 149 (hereinafter referred to as *Gate Gourmet*); *Newtronics Pty Ltd (rec and mgrs apptd)(in liq) v ATCO Controls Pty Ltd (in liq)* (ACN 061 493 516) v *ATCO Controls Pty Ltd (in liq)* (ACN 005 182 481) (2008) 69 ACSR 317. It should be noted, however, that *Banque Brussels* was not referred to by the Victorian Court of Appeal in *Atco Controls Pty Ltd (in liq) v Newtronics Pty Ltd (receivers and managers apptd)(in liq)* (2009) 78 ACSR 375, and that *Gate Gourmet* was distinguished on the facts.
A. Introduction

Construction of a contract is “the task of ascertaining the content of the agreement of the parties”,¹ and depends upon the ordinary meaning of the words and the evidence of surrounding circumstances.² Phillips and O’Donovan are of the view that whether or not a letter of comfort is legally binding and promissory depends on its precise wording and the surrounding circumstances.³

The courts also have developed an approach to the contractual effect of letters of comfort based upon their literal construction of letters of comfort. In doing so, the courts apply the ordinary meaning of the words of a letter of comfort literally and apply evidence of the surrounding circumstances, construing the letter of comfort as not having contractual effect.⁴ In this chapter, I discuss the so-called “literal construction” approach first adopted in Kleinwort Benson Ltd v Malaysia Mining Corporation Berhad,⁵ as well as its off-shoot, the so-called “lack of certainty” approach first adopted in Commonwealth Bank of Australia v TLI Management Pty Ltd.⁶

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¹ DE Allan and ME Hiscock, Law of Contract in Australia (CCH, North Ryde, 1987) 256.
² Codelfa Construction Pty Ltd Pty Ltd v State Rail Authority of New South Wales (1982) 149 CLR 337 at 340.
⁵ [1989] 1 WLR 379 (hereinafter referred to as Kleinwort Benson on appeal).
B. Literal construction of letters of comfort

6.1 *Kleinwort Benson Ltd v Malaysia Mining Corporation Berhad* on appeal\(^7\) – the judicial beacon for the literal construction (or constructionist or analytical) approach.

6.1.1. Literal or constructionist approach\(^8\)

The facts of in this decision have already been set out in paragraph 5.3.1 and will not be repeated. The literal construction approach was first developed in respect of letter of comfort in *Kleinwort Benson on appeal*.\(^9\) Ralph Gibson LJ decided that Malaysia Mining Corporation Berhad ("MMC") was not liable to Kleinwort Benson Ltd ("Kleinwort") for breach of contract in respect of the letter of comfort.

The Court of Appeal had little difficulty in reversing the decision of Hirst J. The Court of Appeal took a fundamentally different approach to the determination of the legal enforceability of the relevant comfort letter to that adopted by Hirst J and left none of Hirst J’s conclusions intact.\(^10\) On appeal, Ralph Gibson LJ (Nicholls and Fox LJ concurring) decided that the proper question was not whether the parties had a contractual intent, but rather whether the third paragraph of the letter of comfort was a promise.\(^11\) In other words, the "promissory hurdle"\(^12\) had to be overcome before the

\(^7\) [1989] 1 WLR 379. This decision has been discussed internationally – see, for example, TC Han, "Giving Cold Comfort – A Look at Comfort Letters" (1989) 3 Malayan Law Journal cii; J Horn, *Patronatserklärungen im common law und im deutschen Recht* (Peter Lang, Frankfurt am Main, 1999) 41 to 52; E Dilger, *Patronatserklärungen im englischen Recht* [1989] *Recht der internationalen Wirtschaft* 573; G Wittuhn, "Patronatserklärungen im Anglo-Amerikanischen Rechtskreis" [1990] *Recht der internationalen Wirtschaft* 495.


\(^10\) See RI Milliner, "Comfort Letters – How Much Comfort Are They For Lenders and Auditors?" (unpublished paper, University of Western Australia, Law Summer School, 1990) at [6.1].

\(^11\) *Kleinwort Benson on appeal* [1989] 1 WLR 379 at 388. The court observed that MMC had conceded that the third paragraph of the comfort letter was legally significant as a representation and that had
presumption to create legal relations would apply in the commercial context.\(^\text{13}\) So, the presumption in *Edwards v Skyways Ltd*\(^\text{14}\) had no application to the issues in this case; it was simply a question of interpreting the terms of the letter of comfort.\(^\text{15}\) However, to read this statement in the decision of the English Court of Appeal as casting doubt on the role of the presumption of intention to create legal relations in commercial agreements\(^\text{16}\) would be incorrect.\(^\text{17}\) The statement had to be read in the context of the arguments presented to the Court.\(^\text{18}\) Ralph Gibson LJ held that the principal question,\(^\text{19}\) and not the subsidiary question as held by Hirst J at first instance,\(^\text{20}\) in deciding whether the third paragraph of the letter of comfort gave rise to any contractual or other legal liability, or record moral obligations only, was the proper construction of the letter of comfort.\(^\text{21}\)

On appeal MMC argued that, if the letters of comfort had contractual effect, then the court should not enforce them because there existed “a separate agreement or

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13 See M Elland-Goldsmith, “Comfort letters in English Law and Practice” 1994 *International Business Lawyer* 527 at 536. This emphasis on promise has also impacted on the determination of content, leading to a subtle distinction between “warranty” (a promise) and “representation” (not a promise).

14 See J Poole, *Textbook on Contract Law* (Oxford University Press, Oxford, 2006) 191. A de Moor, “Intention in the Law of Contract: Elusive or Illusory?” (1990) 106 *Law Quarterly Review* 632 at 636 has remarked that by stressing that the presumption did not apply where the question is whether a party did actually enter into a contractual undertaking (that is, intentionally assumed an obligation), the English Court of Appeal in *Kleinwort Benson* confirmed that “intent to create legal relations” (or substantive contractual intention) and formal contractual intention (that is, the intention determined by an objective interpretation of an instrument) are separate requirements.


16 See, however, paragraph 4.4 for the position regarding the presumption of intention to create legal relations in Australia since *Ermogenos v Greek Orthodox Community of SA Inc* (2002) 209 CLR 95.


20 *Kleinwort Benson Ltd v Malaysia Mining Corporation Berhad* [1988] 1 WLR 799 (hereinafter referred to as *Kleinwort Benson at first instance*). See chapter 5.

21 *Kleinwort Benson on appeal* [1989] 1 WLR 379 at 381. P Giller, “Taking comfort in certainty: to enforce or not to enforce the letter of comfort” [2004] *Lloyd’s Maritime and Commercial Law Quarterly* 219 at 221 is of the view that whilst the English Court of Appeal’s distinction may appear to be over-subtle, in practical terms the approach and analysis were realistic in the circumstances of the case.
understanding” between Kleinwort and MMC not to enforce the letters of comfort.\(^{22}\)

In the alternative, MMC argued that the letters of comfort, in particular the third paragraph, did not have contractual effect. In dealing with these arguments of MMC, Ralph Gibson LJ held that –

> “there was no evidence to support the first plea, i.e., that there had been an agreement that the words of the comfort letters should not have legal effect. The parties had referred to a ‘comfort letter’, but it was not proved that the parties had agreed on any specific meaning for that phrase as descriptive of the liabilities to be undertaken by the defendants [MMC]”.\(^{23}\)

and that

> “the presumption described in Edwards v Skyways Ltd had no application to the issues in this case once the plea of a separate agreement or understanding to the effect that the comfort letters should have no legal effect had disappeared from the case for want of evidence to support it.”\(^{24}\)

Ralph Gibson LJ’s statement\(^{25}\) about Edwards v Skyways Ltd\(^{26}\) was limited to “the way in which the question of ‘intention to create legal relations’ was introduced into this case.”\(^{27}\) The English Court of Appeal, moreover, did not rule out the application of the presumption of intention to create legal relations in commercial situations involving letters of comfort. Edwards v Skyways Ltd\(^{28}\) was merely authority for the proposition that a presumption in favour of an intention to create legal relations arose where a promise or a warranty was shown to have been made; whereas the issue in Kleinwort Benson was whether or not the third paragraph in the letter of comfort constituted a

\(^{22}\) Kleinwort Benson on appeal [1989] 1 WLR 379 at 389.


\(^{24}\) Kleinwort Benson on appeal [1989] 1 WLR 379 at 389.

\(^{25}\) See Kleinwort Benson on appeal [1989] 1 WLR 379 at 389 to 390.

\(^{26}\) [1964] 1 WLR 349.

\(^{27}\) Kleinwort Benson on appeal [1989] 1 WLR 379 at 388.

\(^{28}\) [1964] 1 WLR 349.
contractual promise in the first place. In other words, the presumption of an intention to create legal relations in commercial agreements could only arise if the words used were clearly promissory - the presumption could not be applied when deciding the question of the third paragraph’s promissory status. Thus, the Court at first instance had erred in citing Edwards v Skyways Ltd as authority for the conclusion that the letters of comfort were binding - that is, containing a contractual promise.

6.1.2. The ordinary meaning of words

The Court of Appeal stated that the central question was whether the words of the third paragraph of the letter of comfort, considered in their context, were to be treated as a warranty or contractual promise. In other words, the central question was the construction of the third paragraph, applying the test Esso Petroleum Co Ltd v Mardon; namely, that a promise existed provided it appeared on the evidence to have been so intended. In applying this test, his Lordship said:

"The comfort letter was drafted in terms which in paragraph 3 do not express any contractual promise and which are consistent with being no more than a representation of fact. If they are treated as no more than a representation of fact, they are in that meaning consistent with the comfort letter containing

29 See G Radesich and A Trichardt, "Kleinwort Benson Ltd v Malaysia Mining Corporation Bhd [1989] 1 All ER 785 (CA)" [1990] Journal for Contemporary Roman Dutch Law 436. MMC accepted the commercial context of the transaction resulted in a presumption favouring an intention to form contractual relations, because it admitted that the second paragraph was contractually binding.
20 See RB Lake and U Draetta, Letters of Intent and Other Precontractual Documents (Butterworths Legal Publishers, Boston, 1989) 176. Once the question of contractual intention or the intention to create legal relations was resolved, the presumption should play no part in the court’s reasoning as to the contractual effect of the letter of comfort.
21 [1964] 1 WLR 349.
23 Kleinwort Benson on appeal [1989] 1 WLR 379 at 390. The central question was similar to that in Esso Petroleum Co Ltd v Mardon [1976] QB 801, namely, whether the words in context are to be treated as a warranty or contractual promise.
no more than the assumption of moral responsibility by the defendants in respect of the debts of Metals. There is nothing in the evidence to show that, as a matter of commercial probability or common sense, the parties must have intended paragraph 3 to be a contractual promise, which is not expressly stated, rather than a mere representation of fact which is so stated.”

Ralph Gibson LJ stressed the semantic and grammatical meaning of the phrases used in the letter, and held that the third paragraph of the letter of comfort was “in its terms a statement of present fact and not a promise as to future conduct.” This is a very narrow reading of the third paragraph as it ignores the effect of the phrase “at all times” which logically imputes futurity into the commitment to maintain a policy which ensures Metals can pay its liabilities. Ralph Gibson LJ further held that the third paragraph of the letter of comfort was not an implied promise that the policy would continue in the future because it was “impossible to make up for the lack of express promise by implying such a promise.” However, the impossibility referred to by Ralph Gibson LJ was only because “no such implied promise was pleaded.”

The third paragraph was held not to contain an implied promise to give notice of a change of policy. Even if that paragraph was an implied promise to give notice of a change of policy, there was “nothing to show that any failure to give notice of the change in policy caused loss to the plaintiffs.” However, if MMC had given notice of a change of policy, then Kleinwort would have probably cancelled the facility and requested MMC Metals Ltd (“Metals”) to repay it. Kleinwort applied for leave to appeal to the House of Lords on this point but, unfortunately, leave to appeal was refused.

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38 Kleinwort Benson on appeal [1989] 1 WLR 379 at 388.
There is thus a clear distinction between a statement which involves a promise to ensure that a particular state of affairs exists or continues to exist, and a statement of present intention. The former may give rise to a binding contractual obligation\(^{42}\) whereas, provided that the latter is an honest statement of the writer’s intention at the time when it is made, there is nothing legally preventing the giver of the letter of comfort from changing his mind at any time in the future.\(^{43}\)

The Court of Appeal accepted MMC’s argument\(^{44}\) that to give the words the meaning which Hirst J had held them to have, required that no force be given to the words “it is our policy”.\(^{45}\) There was a difference between the opening words of the second and the third paragraphs of the letter of comfort. The issue was not that the words “We confirm” were absent from the third paragraph but rather the contrast between the words of promise, namely “we will not” in the second paragraph, and the words of statement of fact, “it is our policy” in the third paragraph of the letter of comfort.\(^{46}\)

Ralph Gibson LJ held that if the third paragraph had contractual effect, then the first two paragraphs of the letter of comfort (which MMC conceded had contractual effect) were superfluous, because if the third paragraph “was intended to contain a legally binding promise by the defendants to ensure the ability of Metals to pay the sums due under the facility, there was no apparent need or purpose for the plaintiffs, as bankers,

\(^{42}\) In an appropriate case, it may even amount to a guarantee or indemnity – see Associated British Ports v Ferryways NV [2009] 1 Lloyd’s L Rep 595 (hereinafter referred to as Associated British Ports).

\(^{43}\) See also GM Andrews and R Millett, Law of Guarantees (Sweet and Maxwell, London, 2000) 450. See, however, Chelsea Industries Inc v Accuray Leasing Corporation 699 F2d 58 (1983) where the United States Court of Appeals for the First Circuit, dealt with a so-called “policy letter”. The defendant referred to the letter as a comfort letter, and argued that the policy stated in the letter was its policy at the time of the issuing of the letter and that it could change its policy at will. The plaintiff contended to the contrary. Senior Circuit Judge Aldrich, delivering the judgment of the court, held that: “A policy changeable at will would be cold comfort – the comfort would last only until plaintiff sought to avail itself of it. We consider plaintiff’s understanding far too reasonable for defendant, who intended it, to contend otherwise.”

\(^{44}\) Which was based on the comments on Hirst J’s decision at first instance by BJ Davenport, “A very comfortable Comfort Letter” [1988] Lloyd’s Maritime and Commercial Law Quarterly 290.

\(^{45}\) Kleinwort Benson on appeal [1989] 1 WLR 379 at 387.

\(^{46}\) Kleinwort Benson on appeal [1989] 1 WLR 379 at 390.
to waste ink on paragraphs 1 and 2.”47 This statement of his Lordship does not accord with commercial reality.48 The letter of comfort before the court merely incorporated standard elements of letters of comfort as identified by Wood.49 In practice, the weak commitment in the first paragraph is the hallmark of a letter of comfort properly so called and usually is also included as a matter of course in the medium strength and strong letters of comfort.50 The strong commitment in the second paragraph, which had contractual effect although not breached, addressed a different issue than the one covered by the third paragraph. Indeed, as Kelly remarked: “rather than the businessmen ‘wasting ink' they are setting out clear terms of the agreement which may have both commercial and legal relevance (certainly paragraph (2) has). In view of the difficulties in interpreting comfort letters it is undesirable (as Ralph Gibson LJ’s dicta tend to do) to discourage businessmen from setting out fully the terms of their agreement.”51

The decision of Ralph Gibson LJ in Kleinfeld Benson on appeal has been both lauded and criticised. Prentice suggested that the reversal of Hirst J’s judgement at first instance would “probably not come as a great surprise to the banking community”,52 while his Lordship has been praised for applying “convincing logic”53 and it has been stated that his decision “clearly accords with good business sense and is supported by the surrounding circumstances”.54 One commentator has rhetorically asked,55 however, whether such praise was not based on the belief that the decision in

50 See paragraph 2.5.
Kleinwort Benson on appeal merely “gives rise to some relief among those responsible for directing company finances.”

The decision of Ralph Gibson LJ in Kleinwort Benson on appeal has been criticised because –

“the reasoning of Ralph Gibson LJ seems somewhat strained. His Lordship acknowledged that ‘policy’ is acceptable as embodying a legal obligation but demanded that the policy be expressed as a continuing one. It is suggested that the words ‘at all times’ in para (3) are express words promising that the stated policy will be continued indefinitely and no additions or implications are required to alter the strength and clarity of that promise. Ralph Gibson LJ ignores these words in a judgment which stresses the semantic and grammatical meaning of the phrases employed.”

The Court of Appeal’s judgment in Kleinwort Benson has also been criticised as being “out of touch with commercial reality and even common sense”. The latter sentiment is echoed in the criticism that the decision in Kleinwort Benson on appeal “stresses the semantic and grammatical meaning of the phrases” and “has scant regard for the commercial importance of the letter of comfort to the plaintiffs and the fact of reliance carried forward into performance.”

The English Court of Appeal’s rejection of the presumption of intention to create legal relations as the starting point of its inquiry into the contractual effect of the letter of comfort has been criticised on the basis that parties would be at liberty to establish or deny intention without reference to the intention or its rebuttal, and that

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“with the test introduced in Kleinwort, the Court of Appeal puts the cart before the horse. Surely it is the presumption of intention which must be the primary consideration followed by its possible rebuttal by virtue of uncertainty? The presumption both engenders and is predicated upon commercial certainty – a certainty which Kleinwort appears willing to sacrifice in sanctioning the free-for-all to establish intention...

An objective test of liability is designed to redress the balance between two competing and subjective arguments for the liability's imposition and avoidance. It is submitted that Kleinwort weighted the balance too heavily in favour of the defendant and the decision of the Court of Appeal will inevitably lead to an increase in 'defaulter's all scanning their contracts to find some meaningless clause on which to ride free'.”

This criticism is in line with the criticism expressed by Roger CJ in Banque Brussels Lambert SA v Australian National Industries Ltd, but must now, however, be qualified in light of the Australian High Court’s decision in Ermogenous v Greek Orthodox Community of SA Inc as discussed in paragraph 4.4.

The criticism of Ralph Gibson LJ's decision in Kleinwort Benson on appeal must, however, be seen in perspective, because there is nothing in the decision to suggest that a letter of comfort can never create potential rights and liabilities.

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61 (1989) 21 NSWLR 502 (hereinafter also referred to as Banque Brussels).
6.1.2.1 The ordinary meaning of “policy”

Ralph Gibson LJ held that the third paragraph was not an implied promise that MMC’s policy would continue in the future because it was impossible “to make up for the lack of express promise by implying such a promise.”64 However, the ordinary meaning of the word “policy” included “a definite course of action adopted as expedient or from other considerations”65 or a “course or general plan of action (to be) adopted”.66 Thus, the ordinary meaning of the word “policy” had a futuristic element, and implied that the policy, even if only a present policy, would continue in the future.67

Unless a policy continued in the future, the use of the word “policy” would be meaningless – it is hard to believe that a bank would rely on a statement which is only a representation of policy at the time when the facility was granted.68 It was submitted by counsel for Kleinwort that it would be absurd in commercial terms to claim, as the defendant in Kleinwort Benson did, that MMC was free to change its policy after money had been advanced in reliance upon MMC’s policy.69 Moreover, as argued by Kleinwort’s counsel, to treat the words in the third paragraph as no more than a representation of fact was to give no force to the words “at all times”.70 The argument was forcefully supported with the following example:71 If a shop stated that “it is our policy to take back all goods purchased and to refund the price, without questions, upon return of the goods in good condition within 14 days of purchase”,72 then the shop should not refuse to provide a refund because the policy only applied upon the day the goods were purchased and the shop had changed its policy during the 14 day

65 A Delbridge and JRL Bernard (gen eds), The Macquarie Concise Dictionary (The Macquarie Library Pty Ltd, Sydney, 1995).
67 See also Ho, op cit n , at 33.
70 Kleinwort Benson on appeal [1989] 1 WLR 379 at 387.
period. The shop’s policy should continue during the whole 14 day period. Ralph Gibson LJ agreed with this conclusion because “it would be difficult on those facts to find any sensible commercial explanation for the notice other than a contractual promise not to change the policy over the 14 day period. It would not be satisfactory or convincing to regard the notice as no more than the assumption of a moral responsibility by the shop giving such a notice to its customers. In such a case ... it seems to me that the court would probably hold that the statement was shown to have been intended to be a contractual promise.”

Arguably, the same reasoning and logic ought to be applied to the letter of comfort given to Kleinwort Benson. MMC provided the letter of comfort to induce Kleinwort to provide finance to Metals. Kleinwort relied upon the letter of comfort. It is difficult on those facts to find any sensible commercial explanation for the letter of comfort other than a contractual promise not to change the policy. It is unconvincing and unsatisfactory to regard the letter of comfort as no more than the assumption of a moral responsibility by MMC. The policy statement should have been found as intending to be a contractual promise.

However, Hirst J’s statement that the third paragraph of the letter of comfort was an undertaking that then and at all times in the future, so long as Metals were indebted to Kleinwort under the facility arrangements, it was and would be MMC’s policy to ensure that Metals was in a position to meet its indebtedness, arguably goes too far. It is unrealistic to imply from the words “at all times” that MMC could never change its policy. The operative word is “policy”, and even if MMC stated that its policy would

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76 Kleinwort Benson at first instance [1988] 1 WLR 799 at 811.
77 WE Moojen, “De ongemakkelijke comfort letter” [1990] Nederlands Juristenblad 779 at 780 has argued that the third paragraph constitutes a legal obligation, but the obligation was not cast in stone so that the parent company had to maintain the same policy even though it could or might have led to its demise. He regards the Kleinwort Benson case as a textbook example of a situation where MMC could
continue in the future, it was not, having regard to the ordinary definition of the word mentioned above, making a representation of immutable fact. In other words, assuming MMC’s words were used in their ordinary sense, and taking into account that sophisticated commercial parties were expected to be careful when making and reading documents, to say “it is our policy to” merely expressed an intention to do something rather than the undertaking of an obligation. Indeed, the very reason for saying “it is our policy” rather than “we undertake” or “we promise” or “we agree” was to indicate that one reserved the right to change one’s mind or to not follow through on the policy in all circumstances.

Needless to say, MMC’s policy could have changed after the provision of the letter of comfort to Kleinwort, but that would not detract from the fact that its current policy would continue into the future until and if changed. Indeed, as Reynolds remarked, a “more realistic implication might be that the policy would not be changed without notice.” Brown is similarly of the view that following the approach in Chemco Leasing SpA v Rediffusion Ltd, the undertaking in the third paragraph of the comfort letter in Kleinwort Benson could have been subject to an implied term that the defendants might change their policy upon giving reasonable notice to the plaintiffs. Such an implied term would neither conflict with nor detract from the certainty of the obligation but, instead, would implement the intention of the parties in reflecting their contractual undertaking as differentiated from a guarantee. Moreover, this reasoning would answer the argument that the words in the third paragraph amounted to a statement of existing, not continuing, policy. There was no indication that MMC gave notice to Kleinwort of any change in its policy.

reasonably have refused to provide further support, because (due to the worldwide collapse of the tin market) continued support would have amounted to nothing more than pouring money into a bottomless pit.


79 The position is different when the document is addressed to a consumer – see Bowerman v Association of British travel Agents Ltd [1996] 1 QB 256.


82 (19 July 1985, unreported, QB) (hereinafter referred to as Chemco Leasing).


6.1.2.2 The ordinary meaning of “support”, “influence” and “intention”

Although the words “support”, “influence” and “intention” are not used in the letter of comfort considered in *Kleinwort Benson on appeal*, they are commonly used in comfort letters and have to be understood in the context of the literal approach propounded by Ralph Gibson LJ.

The word “support” has been defined as meaning to “give assistance, encouragement, or approval to.” In the context of a literal approach to the interpretation of a letter of comfort, the word implies that a parent company will keep a subsidiary company from failing, or provide or lend financial assistance to the subsidiary. Sauer and Marks are of the view that “while it is true that the term ‘financial resources’ may take different forms the objective is clear.” However, the word also implies that a parent company will provide encouragement to a subsidiary rather than financial assistance.

The word “influence” is defined as “the power or ability to affect someone’s beliefs or actions,” and is more difficult to understand in the context of a literal approach to the interpretation of a letter of comfort. Sauer and Marks opined that “it is clearly promissory in nature but the uncertainty arises as to what ... [a parent company] is promising to do”, and expressed the view that “the obligation undertaken is not a contingent liability of ... [a parent company] for the debt itself but an obligation to exercise its control in such a manner that if proper and prudent management can contribute to the debt being paid such management will occur.”

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86 *Kleinwort Benson on appeal* [1989] 1 WLR 379.
The word “intention” is defined to mean “the action or fact of intending”,\(^{92}\) which has a futuristic element, and implies that the intention, even if only a present intention, will continue in the future.\(^{93}\) Thus, the concepts of “policy” and “intention” are arguably similar. Both concepts are, however, uncertain because “in law a parent company cannot by reason of its shareholding control the position of its subsidiaries in relation to payment of their debts.”\(^{94}\) Instead, “[i]t is the duty of the directors of the subsidiary to act only in the interests of the company of which they are directors. They must not take orders from the shareholders on such matters as whether the subsidiary is to be in a position to pay its debts.”\(^{95}\)

The view has therefore been expressed that the wording in the crucial third paragraph in *Kleinwort Benson* on appeal\(^{96}\) as well as other statements involving the words “support”, “influence” and “intention” are open for attack on the basis of uncertainty.\(^{97}\) The lack of certainty about the meaning of statements used in letters of comfort has led some courts to adopt an approach to the contractual effect of letters of comfort based upon certainty or, more accurately, the lack thereof.\(^{98}\)

### 6.1.3. Surrounding circumstances

The interpretation of legal instruments is subject to two restrictions in English law:\(^{99}\) First, both prior negotiations and declarations of subjective intention prior to the contract are not relevant or admissible.\(^{100}\) Secondly, the parties’ subsequent conduct is
equally not relevant or admissible in carrying out the process of interpretation.\textsuperscript{101} It appears that the exclusionary rule in \textit{Prenn v Simmonds}\textsuperscript{102} has not been applied where the question for the court is the precise legal status of an undertaking in correspondence.\textsuperscript{103} Indeed, as McMeel points out, one of the exceptions to that exclusionary rule is contract formation and letters of comfort.\textsuperscript{104} Thus, a few comments need to be made about the use of evidence of surrounding circumstances\textsuperscript{105} in the construction of letters of comfort.

In \textit{Kleinwort Benson at first instance},\textsuperscript{106} Hirst J examined the entire factual matrix for the purpose of determining the case, including various types of evidence “which are usually stigmatised as ‘unhelpful’ where the question is a pure question of interpretation.”\textsuperscript{107} Hirst J characterised the main question as being whether the undertaking in the third paragraph of the letter of comfort was contractual in status – that is, a question of contractual intention – and that its proper construction was a subsidiary question. Consequently, the presumption of intention to create legal relations was applied which led the court to conclude that the letter of comfort had contractual effect, but Hirst J still considered:\textsuperscript{108} all the background discussions including a meeting in London and Singapore; evidence that MMC expressly refused to accept joint and several liability or a guarantee; the meeting note of the bank regarding the London meeting; a subsequent internal memorandum of the bank; an earlier draft of the letter of comfort in similar but not identical terms; witness evidence from the bank’s key negotiator concerning MMC’s stance in negotiations; a written board resolution of MMC; and also evidence of negotiations concerning the level of

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\textsuperscript{101} \textit{James Miller & Partners v Whitworth Street Estates (Manchester) Ltd} [1970] AC 583. An exception is that subsequent actions are admissible to show whether there was a contract and what the terms of the contract were, either originally or by variation, or as the basis of an estoppel.

\textsuperscript{102} [1971] 1 WLR 1381. See also \textit{Reardon-Smith Line v Yngvar Hansen} [1976] 1 WLR 989 at 995.


\textsuperscript{106} [1988] 1 WLR 799.


\textsuperscript{108} \textit{Kleinwort Benson at first instance} [1988] 1 WLR 799 at 801 to 803.
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the bank’s commission. Hirst J rejected the submissions that the bank knew that MMC would not agree to a guarantee, because that came “perilously close to infringing the principle that the course of negotiations cannot be invoked in order to influence the construction of a written document.” However, Hirst J’s judgment is not entirely consistent on this point, because the issue for his Lordship was a question of the contractual status of the letter of comfort, not one of pure construction - it is, according to McMeel, an example of “cherry-picking” from the background to justify a particular conclusion.

Evidence of surrounding circumstances has also played a role in Ralph Gibson LJ’s consideration of the letter of comfort in *Kleinwort Benson on appeal*. Even though the principal question on appeal was characterised as more akin to one of construction, Ralph Gibson LJ considered that the concession about the admissibility of the whole of the background evidence was correctly made. His Lordship went even further than Hirst J in accepting the argument that MMC’s refusal to provide a formal guarantee implied that the third paragraph of the letter of comfort did not have contractual effect because “evidence of the refusal by the defendants to assume legal responsibility for the liabilities of Metals to the plaintiffs in the normal form of joint and several liability or of guarantee, and the consequent resort by the parties to what they describe as a comfort letter … are … admissible on the question whether … the defendant’s affirmation in paragraph 3 appears on the evidence to have been intended as a warranty or contractual promise.”

There was not, however, evidence that MMC refused to owe a lesser legal duty under a letter of comfort. Arguably, the absence of such evidence ought similarly to be taken

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109 In the event of a guarantee, the bank’s commission would have been 3/8 per cent, but because MMC furnished a letter of comfort the commission was 3/4 per cent.
110 *Kleinwort Benson at first instance* [1988] 1 WLR 799 at 809.
113 *Kleinwort Benson on appeal* [1989] 1 WLR 379 at 391.
into account as part of the surrounding circumstances. In fact, Ralph Gibson LJ appears to have acknowledged this when he remarked that “the mere fact that the defendants had refused to give a formal guarantee did not mean that there was no further scope for the subsequent agreement by them to a term having the meaning and effect which Hirst J gave in paragraph 3.” Moreover, as Bright and Bright have pointed out in commenting on *Kleinwort Benson at first instance*, “the use of comfort letters is well established practice and part of the surrounding circumstances that needed to be taken into account is the expectation aroused in market practitioners generally by comfort letters of this nature.”

Even though the legal status of the “genuine” letter of comfort is unclear, a court “would not, merely because the parties had referred to the document as a comfort letter, refuse to give effect to the meaning of the words used ... [because] ... [t]he concept of a comfort letter was ... not shown to have acquired any peculiar meaning at the time of the negotiations ... with reference to the limits of any legal liability to be assumed under its terms by a parent company.”

The background to the invention, and modern use, of letters of comfort as discussed in paragraph 1.3, has to be taken into account as part of the surrounding circumstances. It has been argued that letters of comfort have by implication legal effect, because, they have been invented and provided by parent companies to banks or other lenders not to avoid the legal effect of a formal guarantee, but the other effects (principally accounting) of providing a formal guarantee. A contrary view has, however, been

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118 G Tierney, “Letters of Comfort – Are they worth the paper they’re written on?” (1988) 102 Australian Banker 161. See also paragraph 2.5.
119 *Kleinwort Benson on appeal* [1989] 1 WLR 379 at 391.
expressed by Kelly\textsuperscript{121} – for him, Ralph Gibson LJ importantly found the role of a comfort letter as a mere moral obligation could be reconciled with the business context of the transaction.

6.1.4. Some comments

Ralph Gibson LJ’s decision in Kleinwort Benson on appeal,\textsuperscript{122} hailed by some as displaying convincing logic,\textsuperscript{123} gave support to the view of letters of comfort as “woolly”\textsuperscript{124} and unenforceable documents, providing cold comfort,\textsuperscript{125} which do not give rise to substantial rights unless express words of promise are used.\textsuperscript{126} Indeed, the decision lent substance to the view, championed by borrowers and their parent companies, that a letter of comfort expressed only a moral obligation unless the terms of the letter were decidedly promissory.\textsuperscript{127} This was the case as the bank took the comfort letter with full knowledge of the potential default by the subsidiary, and the risk therefore fell squarely on the bank,\textsuperscript{128} unless it was consensually shifted to the parent company.\textsuperscript{129}

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\footnotespace\textsuperscript{113} [1989] 1 WLR 379.
\footnotespace\textsuperscript{114} J Pascoe, ”Kleinwort Benson v Malaysia Mining Bhd” (1989) 7 Company and Securities Law Journal 356; J Pascoe, ”Cold Comfort From A Comfort Letter” (1989) 18 Accounting Communiqué 1. ADM Forte, ”Letters of Comfort or Letters of Cold Comfort” (1990) 21 Journal of Maritime Law and Commerce 99 is of the view that although the decision is correct, the reasoning behind it is not free from criticism.
\footnotespace\textsuperscript{116} WE Moojen, ”De ongemakkelijke comfort letter” [1990] Nederlands Juristenblad 779 at 782 has expressed the view that a Dutch court would have reached the same conclusion as Ralph Gibson LJ in Kleinwort Benson on appeal [1989] 1 WLR 379.
\footnotespace\textsuperscript{118} CSS Ooi, ”Recent Developments and Significance, if any, of Comfort letters in Modern Financial Transactions” (1999) 28 INSIF: The Journal of the Malaysian Bar 6 at 10.
\footnotespace\textsuperscript{119} WE Moojen, ”De ongemakkelijke comfort letter” [1990] Nederlands Juristenblad 779 points out that the first two paragraphs of the Kleinwort Benson comfort letter embodies a ”soft” or ”weak” letter of comfort and signifies that the bank had to evaluate the creditworthiness of the subsidiary on its own merits.
\footnotespace\textsuperscript{120} See DH Clark, ”Contracts-interpretation- creation of legally binding relationship – ’cold comfort letter’: Kleinwort Benson Ltd v Malaysia Mining Corp Bhd [1989] 1 All ER 785)” (1990) 69 Canadian Bar Review 753 at 760.
\end{footnotesize}
His Lordship remarked that, “Paragraph 3 is in its terms a statement of present fact and not a promise as to future conduct”,\textsuperscript{130} thereby alluding, on the one hand, to the linguistic feature that promises tend to use the future tense to state what a person will do, and, on the other hand, that generally representations tend to be statements of past and present fact.\textsuperscript{131} Like Hirst J at first instance, Ralph Gibson LJ recognised that the third paragraph of the comfort letter could be read as containing a promise even if words of present fact were used, and that comfort letters could be, as a matter of individual interpretation, contractual. The difference is, however, that Ralph Gibson LJ did not read, having regard to the factual context, the words of present fact in the third paragraph of the comfort letter as containing a promise.\textsuperscript{132} In other words, given the factual background, the words of the third paragraph of the comfort letter could not be given the force of a promise but could be given the force of a matter of honour only.\textsuperscript{133} Clearly, there are counterarguments to Ralph Gibson LJ’s reasoning about the promissory nature of the words and the context as discussed in Banque Brussels\textsuperscript{134} where Rogers CJ was confronted with similar words in a letter of comfort provided in a similar factual context.\textsuperscript{135} Moreover, it is arguable that Ralph Gibson LJ’s findings are based more on the usage and history of comfort letters than on the intent and understanding of the parties, because an alternative interpretation of the language used in the letter is as reasonable as the one chosen by his Lordship.\textsuperscript{136}

At first sight, Ralph Gibson LJ’s decision confirmed that a presumption in favour of an intention to create legal relations would arise, in relation to a letter of comfort, only

\textsuperscript{130} Kleinwort Benson on appeal [1989] 1 WLR 379 at 390.
\textsuperscript{134} 1989] 21 NSWLR 502.
\textsuperscript{135} See chapter 7.
where the wording at issue was in the nature of a contractual promise or warranty.\textsuperscript{137} His Lordship’s reasoning, however, appeared to allow a circumvention of the presumption rather than its rebuttal by first asking whether the parties had evidenced a general intent to create a contract (or, at least, a promissory intent). Since the answer to that question was no, there was no reason to consider the applicability of the general presumption of intention to create legal relations regarding commercial agreements. Moreover, as Brown succinctly pointed out, Ralph Gibson LJ’s judgment raised significant issues regarding the relationship of certainty of terms and intention to create legal relations and the continuing role of the presumption of intention in commercial agreements:\textsuperscript{138}

“\textit{Kleinwort} did not rebut the presumption of intention but, instead, decided that the parties positively intended to create a certain yet unenforceable and purely moral obligation. In allowing the objective and positive intention to create an ineffective letter of comfort the decision both circumvents and undermines the presumption of intention in commercial transactions. \textit{Rose and Frank Co v JR Crompton and Brothers Ltd} makes it clear that the force of the presumption in commercial agreements is such that an intention not to make a binding contract must be expressly indicated. In the absence of an express denial of intention the presumption could be rebutted by uncertainty but it was suggested earlier that this would have been difficult in Kleinwort in view of the robust validation principles of English law. The Court of Appeal in \textit{Kleinwort} creates a substitute for both the rebuttal of the presumption of intention and an express denial of its existence by allowing a positive intention to create an agreement which is binding in honour only. Furthermore, it is difficult to gauge the potency of the presumption of intention after \textit{Kleinwort}. Ralph Gibson LJ distinguishes \textit{Edwards v Skyways}


Thus, Benson although construction restricted because it was almost certain that this threshold was never reached. It would seem that the Court of Appeal only crosses this threshold if, in a commercial transaction, there is a certain contractual promise supported by consideration but this reasoning would restrict the presumption to situations where intention is almost certain to be present. This limitation when coupled with an ability of the parties to positively establish an unenforceable obligation effectively emasculates the presumption.”

If this presumption had not been rendered redundant by Kleinwort Benson on appeal, it would be very difficult to determine in which circumstances it would apply at all, because by saying that a contractual promise has to be present, the presumption was restricted to situations where intention was almost certainly present. Moreover, although it was said to be of no practical significance in the outcome of Kleinwort Benson, Ralph Gibson LJ suggested that in his approach of relying merely on the construction of the words used, the onus of proof lay on the plaintiff, Kleinwort Benson, to show that the comfort letter should be treated as a contractual promise. However, where the promise was clear, in the context of a commercial contract, the onus was on the party seeking to rebut the presumption of intent to show that the contract was unenforceable. The change in the burden of proof could be significant. Thus, as Poole aptly remarked, there was a difficult distinction between: 139

(a) clauses which state that commercial agreements will not be legally enforceable (where the burden of proof is on the party denying legal enforceability to rebut the normal presumption of intention to create legal relations), and

(b) statements in commercial agreements which are non-promissory in nature and so without legal force (where the burden of proof is on the party asserting that the statement is promissory and therefore has legal force because of the operation of the presumption in the commercial context).

It is perhaps for this reason that the decision in *Kleinwort Benson* [on appeal] has been criticised in some quarters, because it makes it all too easy for a firm to avoid legal responsibilities in the commercial context by establishing that statements are non-promissory”.

The result of the Court’s findings was that the bank was unable to recover, not because there was no mutual intention to create legal relations, but because any promissory statement by the parent company fell short of a promise to remedy the defaults of its subsidiary. The absence of express words of warranty or promise does not conclusively exclude a statement from the status of a warranty or promise; evidence of the intention of the parties can be adduced by the party seeking to rely upon that warranty or promise in determining whether wording which does not, or does not clearly, amount to an express warranty or promise, was intended to be so.140 Furthermore, it was apparent that it was possible for a letter of comfort to be contractually binding in part but not in whole,141 because both parties in *Kleinwort Benson* acknowledged that the first two paragraphs of the letter of comfort were contractual in nature.

There might be an element of recognition of commercial necessity in the English Court of Appeal’s decision.142 It has been argued that the English Court of Appeal appears to

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141 See also S Scott, "Comfort Letters – Let the Issuer Beware!" (1994) 5 *Journal of Banking and Finance Law and Practice* 197 at 199.
142 J Lipton, "Good Faith and Letters of Comfort" (1999) 28 *University of Western Australia Law Review* 138 at 152 is also of the view that it is possible to argue that the consideration of the fact that a guarantee was refused and that a higher commission was demanded and paid "constitute relevant moral imperatives underlying the judgment, notwithstanding that the judgment is expressly based on
have acknowledged the bargaining which occurs in the market place,\textsuperscript{143} and that it paid particular attention to the reality of the commercial dealings between parties.\textsuperscript{144} As Lake and Draetta remarked, although the court made it clear that merely styling a document as a comfort letter did not eliminate its possible contractual nature, it noted that “the expectations of people using such documents were that they are obligatory in honour only. The decision may also reflect an appreciation of London’s position as a major international financial centre where parties may expect not to be ‘hometowned.’”\textsuperscript{145}

The English Court of Appeal’s decision in Kleinwort Benson appeared to be inconsistent with the reasoning of the Court of Appeal’s earlier decision in Chemco Leasing SpA v Rediffusion Plc.\textsuperscript{146} Whincup also censoriously remarked that the decision in Kleinwort Benson on appeal “is nothing if not debatable. If moral responsibility was clear, the letters must surely, in the absence of any disclaimer of liability, have imported more than statements of fact. To the extent that MMC’s assurances were evidently intended to have legal consequences and did in fact have them – in that the bank was persuaded to make the loans – the decision seems inconsistent with basic principles of English contract law.\textsuperscript{147} It would appear also to attach too much importance to forms of words, and thereby not only to invalidate letters of comfort but wilfully to

\textsuperscript{143} A Ayres and A Moore, “‘Small Comfort’ Letters – Kleinwort Benson Ltd v Malaysia Mining Corp Bhd” [1989] Lloyd’s Maritime and Commercial Law Quarterly 281 at 284.

\textsuperscript{144} P Giliker, “Taking comfort in certainty: to enforce or not to enforce the letter of comfort” [2004] Lloyd’s Maritime and Commercial Law Quarterly 219 at 222: “The question of contractual enforceability was not dealt with in the abstract in terms of formal rules of law, but by means of recognition of the commercial role of the letter of comfort, and the expectations of the parties.”

\textsuperscript{145} See RB Lake and U Draetta, Letters of Intent and Other Precontractual Documents (Butterworths Legal Publishers, Boston, 1989) 35.


\textsuperscript{147} I Brown, “The Letter of Comfort: Placebo or Promise?” [1990] Journal of Business Law 281 at 288 has remarked that the Ralph Gibson LJ had scant regard for the commercial importance of the letter of comfort to the bank and the fact of reliance carried forward into performance.
encourage commercial immorality.\textsuperscript{148} The decision of Ralph Gibson LJ illustrated the laissez-faire principles of self-reliance and judicial non-interventionism and also cast doubt upon the whole notion that the courts would strive to uphold the parties' bargain where possible.\textsuperscript{149} Unsurprisingly, prominent jurists\textsuperscript{150} still preferred Hirst J's decision at first instance as correct, even after the English Court of Appeal's judgment in \textit{Kleinwort Benson}.\textsuperscript{151}

The Court of Appeal's decision did not, however, resolve the issue of the legal status of letters of comfort.\textsuperscript{152} Whilst denying any contractual effect to the particular letter of comfort at issue, the Court did not go so far as to suggest that comfort letters could never be binding,\textsuperscript{153} careful drafting could still produce a document which created a legally binding obligation on the part of the parent company to recompense the bank.\textsuperscript{154} Indeed, it has been observed by some commentators that \textit{Kleinwort Benson} involved a "weak" comfort letter,\textsuperscript{155} a classification which correspond with the English Court of Appeal's recent categorisation of a "letter of comfort properly so called" in \textit{Associated British Ports}.\textsuperscript{156}

The lesson from \textit{Kleinwort Benson} was, however, clear: English courts, unlike Australian courts which were more inclined to find an enforceable obligation in

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\textsuperscript{149} See \textit{Hillas & Co Ltd v Arcos Ltd} (1932) 147 LT 503.


\textsuperscript{151} [1989] 1 WLR 379.


\textsuperscript{156} [2009] 1 Lloyd's Rep 595; [2009] All ER (D) 198.
commercial agreements,\textsuperscript{157} were not prepared to disregard, easily, the contention that comfort letters did not create a legal obligation on the part of a parent company.\textsuperscript{158} But to put the matter beyond doubt, if a parent company did not want a comfort letter to have contractual effect, it would be good practice to insert wording in letters of comfort to rebut any legal obligation which may arise from the other wording in the letter\textsuperscript{159} - a practice followed in \textit{Re Atlantic Computer Plc (in Administration), National Australia Bank Ltd v Soden}.\textsuperscript{160} This was particularly so as the wording of the letter of comfort, the exchange of information which led up to the provision of it, and also the surrounding circumstances, would be relevant in order to determine whether a legal obligation could be said to arise from the comfort letter.

The English Court of Appeal’s decision in \textit{Kleinwort Benson}\textsuperscript{161} was, and would remain, a landmark decision on letters of comfort.\textsuperscript{162} As Walker observed,\textsuperscript{163} the judgment in Kleinwort Benson on appeal “is as interesting for what it did not decide as for what it decided. In particular, Ralph Gibson LJ acknowledged that a letter which the parties might have referred to at some stage as a letter of comfort might, after negotiation, have emerged containing words of contractual promise and have been legally enforceable notwithstanding the nomenclature used.” Although, in theory, the English Court of Appeal’s decision was limited to the particular circumstances and wording of the comfort letter in \textit{Kleinwort Benson} and was not conclusive of a future case with a differently worded letter of comfort and a different background, in practice it was likely to be decisive, at least in England, in that the wording was typical and the

\textsuperscript{160} [1995] BCC 696 (hereinafter referred to as \textit{Atlantic Computers}).
\textsuperscript{161} [1989] 1 WLR 379.
\textsuperscript{162} In the most recent decision on comfort letters in Australia, Atco Controls Pty Ltd (in liquidation) v Newtronics Pty Ltd ( Receivers and managers Appointed) (2009) 78 ACSR 375 at [54] (hereinafter referred to as Atco Controls), the Court of Appeal in Victoria referred to \textit{Kleinwort Benson on appeal} [1989] 1 WLR 379.
background in most cases was unlikely to present a stronger case for an implied commitment than in *Kleinwort Benson*.164 Indeed, not only has it recently been re-affirmed by the same court in *Associated British Ports v Ferryways NV*,165 it also appears to represent the law on comfort letters in New Zealand,166 Canada,167 Hong Kong,168 while it has found favour in South Australia169 and, at least in one decision of the Supreme Court of Victoria.170

6.2  

Re Atlantic Computers plc (in administration). National Australia Bank Ltd v Soden171 - following the literal construction approach in England

6.2.1.  The facts

On 30 December 1986 and 31 March 1987, Atlantic Computers plc ("Atlantic Computers") provided letters of comfort to the National Australia Bank Ltd ("NAB") in relation to leasing and hire-purchase facilities granted by the NAB to Atlantic Medical Ltd ("AML"), a former subsidiary of Atlantic Computers. The letters of comfort stated that Atlantic Computers was aware of the facilities which NAB had granted to AML and continued:

"In consideration of the bank granting such credit, we undertake that without the prior consent of the bank:

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165  [2009] 1 Lloyd’s Rep 595 (hereinafter also referred to as *Associated British Ports*).
166  Bank of New Zealand v Ginivan (1990) 5 NZLC 66,103 (hereinafter referred to as Bank of NZ). However, see the comments of the New Zealand Court of Appeal in Bank of New Zealand v Ginivan[1991] 1 NZLR 178.
167  Toronto Dominion Bank v Leigh Instruments Ltd (Trustee of) (1998) 40 BLR (2d) 1 (hereinafter referred to as Toronto Dominion Bank).
168  Bouygues SA v Shanghai Links Executive Community Ltd [1998] 2 HKLRD 479 (hereinafter referred to as Bouygues).
169  Australian European Finance Corporation Ltd v Sheahan (1993) 60 SASR 187 (hereinafter referred to as Australian European Finance).
(a) that the beneficial ownership of Atlantic Medical Ltd will be maintained by this company during the currency of the facility now to be made available by the bank;

(b) that the moneys owing by Atlantic Medical Ltd to the parent company will not be repaid in priority to any moneys owing or contingently owing by Atlantic Medical Ltd to the bank;

(c) that if Atlantic Medical Ltd is unable to meet its commitments, the parent company will take steps to make arrangements for Atlantic Medical Ltd’s present, future or contingent obligations to the bank both for capital and interest to be met.

This document is not intended to be a guarantee and, in the case of para (c) above, it is an expression of present intention by way of comfort only.\textsuperscript{172}

AML went into liquidation and was unable to meet its commitments to NAB under the facilities. NAB claimed that Atlantic Computers came under a liability to ensure the obligations of AML were met. When Atlantic Computers went into administration, NAB lodged its claim with the administrators who rejected the claim. NAB applied to the court for an order that the decision be reversed.

\textbf{6.2.2. The issue}

The amount of the claim was undisputed and only the question of liability had to be decided by Chadwick J, sitting in the Chancery Division (Companies Court). NAB’s claim was under paragraph (c) of the letter of comfort. It was said, and this was not disputed, that AML was unable to meet its commitment to NAB under the facilities described in the letter of comfort and accordingly Atlantic Computers had come under a liability to make arrangements for AML’s indebtedness to be met in full.\textsuperscript{173}

\textsuperscript{172} Atlantic Computers [1995] BCC 696 at 697.
\textsuperscript{173} Atlantic Computers [1995] BCC 696 at 697.
6.2.3. The decision

Chadwick J held that the undertaking contained in paragraph (c) of the letters of comfort, if taken alone, would have constituted a sufficiently certain and enforceable obligation upon Atlantic Computers as a surety for its subsidiary, AML.\footnote{Atlantic Computers [1995] BCC 696 at 697.} That is, the letter of comfort was not strictly a guarantee, in that the obligation could be fulfilled without direct payment by Atlantic Computers to NAB, for example, by the parent company putting its subsidiary into funds sufficient to enable AML to meet its commitments.\footnote{Atlantic Computers [1995] BCC 696 at 97.} Atlantic Computers would have been well aware of what it had to do to perform the obligations which it had undertaken.

Even though, as explained by Staughton J in Chemco Leasing Spa v Rediffusion plc\footnote{(19 July 1985, unreported, QBD) (hereinafter also referred to as Chemco Leasing).} in a passage cited by Hirst J in Kleinwort Benson at first instance,\footnote{Kleinwort Benson Ltd v Read [1995] BCCR 799 at 806.} it might be artificial to assume that parties to a letter of comfort had any common intention at all as to the effect of the letter, it was the task of the court to ascertain what common intention should be ascribed to them from the terms of the document read as a whole and the surrounding circumstances.\footnote{Kleinwort Benson Ltd v Read [1995] BCCR 696 at 699.} Following the Court of Appeal’s decision in Kleinwort Benson,\footnote{[1988] 1 WLR 379.} Chadwick J reiterated that the question for the court in each case was whether, as a matter of construction, in light of the admissible evidence of the relevant surrounding circumstances, the parties intended to make a contractual promise for the future or to give only a warranty as to present intention.\footnote{Atlantic Computers [1995] BCC 696 at 698.} Reading the letters of comfort as a whole it was apparent that they could not be said to contain a contractual promise, because the final paragraph\footnote{Chadwick J equated the final paragraph with the honour clause in Rose & Frank Co v JR Crompton and Brothers Ltd [1925] AC 445 at 454 – see paragraph 4.4.1.} in the letters of comfort clearly showed that the undertaking in paragraph (c) was not intended to create legal
relations but to take effect as an expression of present intention only.\textsuperscript{182} The statements of its existing intentions were not to be construed as a promise as to its future conduct.\textsuperscript{183} The final paragraph in the letters of comfort qualified paragraph (c), and destroyed the obligation contained in that paragraph,\textsuperscript{184} regardless of the fact that it came at the end of the letter, rather than at the beginning.\textsuperscript{185}

It was held that the letters of comfort should be treated as no more than a warranty that the parent company intended, at the relevant date (when the letters were issued), to stand behind its subsidiary if in future AML was unable to meet its commitment to NAB.\textsuperscript{186} There could be no claim for breach of warranty as there was no suggestion, and no evidence to suggest, that there was no such present intention at that time.\textsuperscript{187} There could also be no claim for breach of contractual promise as to future conduct, as no such contractual promise was made.\textsuperscript{188} Chadwick J referred to the \textit{Banque Brussels} decision,\textsuperscript{189} but stated that, apart from the fact that the law of England was clear from the Court of Appeal's approach in \textit{Kleinwort Benson},\textsuperscript{190} the test prescribed by the law of Australia to determine whether a statement was promissory or only representational was different from that in England.\textsuperscript{191} NAB's claim was dismissed, and the decision of the administrators confirmed.

\textsuperscript{182} \textit{Atlantic Computers} [1995] BCC 696 at 698. Although his Lordship accepted that the final paragraph and paragraph (c) could be read independently from each other, he rejected the submissions that the phraseology of paragraph (c), when read independently from the final paragraph, was insufficiently certain to give rise to an enforceable obligation.

\textsuperscript{183} In the absence of such a clear statement, the question whether the letter of comfort gave rise to a binding legal obligation may have been more difficult to resolve – see GM Andrews and R Millett, \textit{Law of Guarantees} (Sweet and Maxwell, London, 2000) 450.

\textsuperscript{184} The final paragraph of the letter of comfort qualified paragraph (c), such that it could only take effect as a statement of present intention by way of comfort only, and provided no contractual promise as to the future policy or intentions of Atlantic Computers.

\textsuperscript{185} \textit{Atlantic Computers} [1995] BCC 696 at 698.

\textsuperscript{186} \textit{Atlantic Computers} [1995] BCC 696 at 698.

\textsuperscript{187} \textit{Atlantic Computers} [1995] BCC 696 at 698.

\textsuperscript{188} \textit{Atlantic Computers} [1995] BCC 696 at 698.

\textsuperscript{189} \textit{Banque Brussels} (1989) 21 NSWLR 502.

\textsuperscript{190} [1989] 1 WLR 379.

\textsuperscript{191} See \textit{Banque Brussels} (1989) 21 NSWLR 502 at 524.
Although the decision in *Atlantic Computers*\(^{192}\) was clear, it continued to add substance to the question: just what was the point of creating a legally worthless but “morally binding” document? The answer lay in the business use of letters of comfort as discussed in chapter 3.

6.3  **Associated British Ports v Ferryways NV**\(^ {193}\) – confirming the literal construction approach in England

6.3.1. The facts\(^ {194}\)

Ferryways NV (“Ferryways”) was a Belgian company formed in order to operate a roll-on, roll-off ferry service between Ostend and Ipswich (“the project”). Its share capital was owned as to 40% by the state-owned Belgian investment company Gimvindus (acting through another company); as to 40% by an associated company of MSC Belgium (“MSCB”), which was in turn indirectly controlled by Mediterranean Shipping Company (SA) Geneva Group, the second largest liner container shipping company in the world; and as to 20% by Mast (GB) Limited, a company owned by the businessmen whose idea had given rise to the project.\(^ {195}\)

In furtherance of the project, Ferryways entered into a series of agreements with Associated British Ports (“ABP”). The first agreement was entered into on 5 January 2000, and was replaced by a second agreement on 1 September 2003 (“second agreement”). On the same day as the second agreement, a written agreement, the so-called “Letter Agreement”, was concluded between ABP and MSCB in order to secure the position of ABP by way of recourse against MSCB. This Letter Agreement which gave rise to the appeal, relevantly reads as follows:\(^ {196}\)

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\(^{194}\) A detailed account of the facts is set out in the judgement of Field J at first instance – see *Associated British Ports v Ferryways NV* [2008] EWHC 1265 (Comm) (hereinafter referred to as *Associated British Ports at first instance*).

\(^{195}\) See *Associated British Ports* [2009] 1 Lloyd’s Rep 595 [2].

\(^{196}\) *Associated British Ports* [2009] 1 Lloyd’s Rep 595 at [4]. The letter, drafted by ABP’s General Counsel, concluded with terms as to service of process, and was signed by the Managing Director of MSCB.
“Dear Sirs

We confirm that Ferryways is a member of the same group of companies as [MSCB].

[i] In consideration of ... ABP entering into an agreement relating to the Port of Ipswich of even date with this letter (the Agreement), we assume full responsibility for ensuring (and shall so ensure) that, for seven years from the date of this letter, [Ferryways] (i) has and will at all time have sufficient funds and other resources to fulfil and meet all duties, commitments and liabilities entered into and/or incurred by reason of the Agreement as and when they fall due and (ii) promptly fulfils and meets all such duties, commitments and liabilities.

[ii] We are aware that ABP will rely on this letter in deciding whether to enter into the Agreement with [Ferryways].

[iii] The construction, validity and performance of this letter shall be governed by English law and we submit to the exclusive jurisdiction of the High Court in London in connection with any disputes arising out of this letter.”

From about August 2004, disputes arose between ABP and Ferryways about the construction of the second agreement between them which was to a certain extent resolved by them entering into a so-called “Concession Agreement”. On 17 February 2006, ABP and Ferryways entered into a further agreement, the so-called “Time to Pay Agreement”, which took the form of a supplementary memorandum to the second agreement.197 Further disputes arose between ABP and Ferryways during March and June 2006, and negotiations over a possible new agreement to replace the second agreement broke down irretrievably. Ferryways operated under the second agreement

until 13 June 2007 when it ceased trading, its share capital having been acquired by a competitor, the Cobelfret Group, on 1 June 2007. Ferryways was placed in liquidation on 27 June 2007 and declared insolvent by the Belgian court on 7 February 2008.\textsuperscript{198} ABP commenced proceedings to recover sums due from Ferryways under the second agreement and from MSCB under the Letter Agreement.\textsuperscript{199}

6.3.2. The issues

At first instance, there was no issue as to whether the Letter Agreement was a letter of comfort. Rather, the issue was whether the Letter Agreement was a guarantee (a secondary liability) or an indemnity (a primary liability), and whether MSCB was liable to ABP under the Letter Agreement. Field J held that the obligations provided for in both limbs (i) and (ii) of the Letter Agreement were defined by reference to the duties, commitments and liabilities of Ferryways under the second agreement and would become concrete and of practical significance on such duties, commitments and liabilities accruing and if Ferryways was in default thereof.\textsuperscript{200} The substance of both limbs of the Letter Agreement was therefore an obligation to see that Ferryways performed its obligations under the second agreement and accordingly both were properly to be characterised as giving rise to a secondary liability, rather than a primary liability. So, assuming that the undertaking was an enforceable contractual warranty, the obligation in the Letter Agreement was “a promise to answer for the debt of another within the meaning of section 4 of the Statute of Frauds”\textsuperscript{201} – that is, a guarantee.\textsuperscript{202} Field J held that the Concession Agreement did not discharge MSCB under the Letter Agreement, but that the Time to Pay Agreement did discharge the liability of MSCB under the Letter Agreement - a guarantee (a secondary obligation) and not an indemnity (a primary obligation)\textsuperscript{203} – and accordingly judgment was given

\textsuperscript{198} Associated British Ports [2009] 1 Lloyd’s Rep 595 at [7].
\textsuperscript{199} Associated British Ports [2009] 1 Lloyd’s Rep 595 at [7].
\textsuperscript{200} Associated British Ports at first instance [2008] EWHC 1265 (Comm) at [60].
\textsuperscript{201} Associated British Ports at first instance [2008] EWHC 1265 (Comm) at [60].
\textsuperscript{202} See the discussion about guarantees and indemnities at paragraph 2.7.
\textsuperscript{203} Associated British Ports [2009] 1 Lloyd’s Rep 595 at [6].
for ABP against Ferryways for damages to be assessed, but ABP’s claim against MSCB was dismissed.  

On appeal, the principal argument was that the Letter Agreement was a contractual undertaking in the nature of an indemnity, and in the alternative that it was “in the nature of a binding and enforceable comfort letter, imposing primary liability on MSCB (at least by the words following (i) in the second paragraph) and not in the nature of a guarantee”.  

6.3.3. The decision

Lord Justice Maurice Kay (Sir Anthony Clarke MR and Jacob LJ agreeing) remarked that:

“In one sense it is surprising, verging on surreal, for a promisee in the position of ABP – the would-be comfortee – to assert that a document is a letter of comfort. More usually, such a contention would be expected to come from a promisor – or would-be comforter. However, surprise recedes a little when it is submitted that the document is not just a letter of comfort but is a legally binding letter of comfort. If that is what it is, then as with an indemnity, any liability would not be discharged by the Time to Pay Agreement.”

In considering whether the Letter Agreement was a guarantee or an indemnity, or whether it imposed a secondary or a primary liability, Kay LJ followed Moschi v Lep Air

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204 Associated British Ports [2009] 1 Lloyd’s Rep 595 at [7].
206 Associated British Ports [2009] 1 Lloyd’s Rep 595 at [16]. The “archaeology” of the submission, as pointed out by Maurice Kay LJ at [17], on behalf of ABP is interesting. ABP did not plead in its statement of claim that the Letter Agreement was a letter of comfort, but MSCB pleaded in its defence that it was a non-binding comfort letter. In its reply, ABP then pleaded that the Letter Agreement was not “a mere comfort letter” but was legally binding.
207 They are two distinct undertakings, generally speaking, in that a guarantee is a collateral undertaking (collateral promise to answer for the debt of another), and presumes some contract or transaction to which it is collateral, while an indemnity is essentially an original contract.
in stating that it will always depend upon the “true construction of the actual words in which the promise is expressed.” Moreover, the Letter Agreement created and was intended to create legal rights and obligations, and was not merely a letter of comfort giving rise simply to moral obligations. The comfort letter was construed as a guarantee, and not an indemnity. The Court of Appeal held that the wording of limb [i] was a “see to it” obligation; that is, MSCP would see to it that Ferryways performed its own obligations. If Ferryways could not meet its liabilities, then the secondary liability of MSCP would accrue by way of guarantee. The Letter Agreement did not contain a common provision found in guarantees whereby a subsequent variation or Time to Pay Agreement between the creditor and debtor was expressed not to discharge the guarantor. This meant that the guarantee was discharged when Ferryways and ABP varied their contract and concluded their subsequent Time to Pay Agreement.

As to whether the Letter Agreement was a binding letter of comfort, the Court of Appeal observed that a document expressed to be a comfort letter would usually not give rise to legal obligations (except perhaps as a warranty of present intention), but sometimes a primary continuing legal obligation could arise as a matter of construction notwithstanding the misleading appellation of a letter of comfort. In this case, the Letter Agreement was not a letter of comfort, or a so-called “binding letter of

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211 See *Gate Gourmet Australia Pty Ltd (in liquidation) v Gate Gourmet Holding AG* [2004] NSWSC 149 (hereinafter referred to as *Gate Gourmet*) where the letter of comfort was held to be a contract of indemnity.


213 See also *Barnicoat v Knight* [2004] 2 BCLC 464 and *Nearfield Ltd v Lincoln Nominees Ltd* [2007] 1 All ER (Comm) 441 at [37] where the courts also described an obligation to “procure” something as one to “see to it”.

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comfort”; it was a guarantee. Importantly, Kay LJ rejected the argument that the Letter Agreement was a “binding and enforceable comfort letter, imposing primary liability on MSCB” (“of the sort considered ... in Banque Brussels ... and found to be binding”), because it did not impose a primary liability on MSCB, but a secondary liability or “see to it” obligation. The Letter Agreement did not imposed a primary liability on MSCB, regardless of whether it was a “binding letter of comfort” or any other contract (not being a guarantee).

Lord Justice Kay also addressed the notion of a “binding letter of comfort” and dealt with Rogers CJ decision in Banque Brussels. To the extent that the reasoning in Banque Brussels was accepted, having regard to the wording of the instrument before the court, the possibility of a primary contractual liability to the creditor of another arising from the insistence of the creditor on such a contract, it was uncontroversial. The confusion arising from the decision in Banque Brussels stemmed from the fact that such a contractual liability is contained within a document described as a “letter of comfort”, because the English Court of Appeal regarded a letter of comfort, properly so called, as one that did not give rise to contractual liability. The label used by the parties was not necessarily determinative of the

214 See the discussion in paragraph 9.2 of the concept of “binding letter of comfort” used in the Principles of European Law on Personal Security.
218 E White, “Agreement did not create primary obligations” (2009) 24 Journal of International Banking Law and Regulation N7 at NB.
220 (1989) 21 NSWLR 502 at 522: “First, there are ... considerations ... in relation to letters of comfort generally, which explain why, consistently with intending to make a legally binding commitment, a company may wish it not to have the character of a guarantee. Secondly, the letter makes clear that the defendant is not assuming secondary liability for the debts of the principal debtor ... The statements made in the letter are more remote from the liability of [the associated company] to repay the facility ... Nonetheless, the promises, had they been fulfilled, were calculated to put the plaintiff in a position to receive payment from [the associated company]. It is these features which both distinguish the letter from a guarantee but make the defendant’s argument based on that undoubted fact an irrelevance.”
223 Associated British Ports [2009] 1 Lloyd’s Rep 595 at [24]. This view of comfort letters is similar to that of PR Wood, “The uncomfortable comfort letter” [1988] International Financial Law Review 21 who points out that the whole point of letters of comfort issued in lieu of a guarantee is that both the parent
nature or enforceability of the document, because whether the document gave rise to contractual liability was a matter of construction of the document as a whole.\(^{224}\) In Kay LJ’s view, Rogers CJ in Banque Brussels\(^{225}\) did not encourage the notion of a “binding letter of comfort”, but it was “more of a case of acknowledging that contractual obligations may arise from a document when properly construed, even though, misleadingly, the label 'letter of comfort' has been applied to it.”\(^{226}\)

Kay LJ furthermore rejected Rogers CJ’s criticism in Banque Brussels\(^ {227}\) of the English Court of Appeal decision in Kleinwort Benson\(^ {228}\) and stated that, apart from the fact that the document before the court in Kleinwort Benson was “a letter of comfort properly so called”.\(^ {229}\)

“That criticism does not resonate in this court, any more than it did at first instance in Re Atlantic Computers plc (in administration)\(^ {230}\) ... Here the position remains that a document expressed to be a letter of comfort will usually not give rise to legal obligations (except, perhaps, as a warranty of present intention) but sometimes a primary continuing legal obligation may arise as a matter of construction, notwithstanding the rubric of a letter of comfort. As always, ‘the court’s task is to ascertain what common intentions should be ascribed to the parties from the terms of the documents and the surrounding circumstances' (Kleinwort Benson ...).”\(^ {231}\)

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\(^{224}\) Associated British Ports [2009] 1 Lloyd’s Rep 595 at [24].


\(^{226}\) Associated British Ports [2009] 1 Lloyd’s Rep 595 at [26].

\(^{227}\) (1989) 21 NSWLR 509 at 523

\(^{228}\) [1989] 1 WLR 189.

\(^{229}\) Associated British Ports [2009] 1 Lloyd’s Rep 595 at [25].


\(^{231}\) Associated British Ports [2009] 1 Lloyd’s Rep 595 at [27].
6.3.4. Some comments

In Associated British Ports, the English Court of Appeal confirmed its earlier approach to letters of comfort in Kleinwort Benson. The English courts’ approach to letters of comfort was clear, but not necessarily commercially sensible: generally speaking, a party would not be held liable under a letter of comfort. However, the name of the instrument was not conclusive and the Court would construe the wording of the letter to see whether, in fact, it constituted an agreement giving rise to liability. In light of this decision, banks and lenders should consider taking another look at any letter of comfort held. Whilst, in the majority of cases, a letter of comfort was likely to be just that, if there was scope to argue that it contains binding obligations or was, in fact, a guarantee, this might be a useful bargaining tool in any negotiations surrounding default or potential default situations. Associated British Ports was also a timely reminder that banks should seek advice on letters of comfort in connection with any amendments, waivers or variations of existing documentation or contracts to ensure that, if there was any chance that such letter actually amounted to a guarantee, this guarantee was not prejudiced by the waiver or amendment. The message from the decision was also that a promise by a company to “ensure” or “procure’ that a third party satisfies a specified liability could amount to a guarantee of the liability.233

233 Those words should be contrasted with the word “understanding” which was held to indicate a gentlemen’s agreement only – see JH Milner & Son v Percy Bilton Ltd [1966] 1 WLR 1582.
6.4  *Bank of New Zealand v Ginivan*\(^{234}\) - the literal construction approach in the New Zealand High Court

6.4.1. The facts

This was the first case in which letters of comfort were mentioned judicially in New Zealand,\(^{235}\) and involved a summary judgment application decided by Master Towle on 6 November 1989; that is, before the judgment of Rogers CJ in *Banque Brussels*.\(^{236}\) It is therefore not surprising that the approach of the English Court of Appeal in *Kleinwort Benson* was followed.

Ginivan was a shareholder and governing director of Unidare Engineering Ltd, which was owned as to one-third by Unidare Ireland plc, an Irish public company. The Bank of New Zealand agreed to provide financial accommodation to Unidare Engineering on the basis that it receive a personal guarantee from Ginivan and a guarantee from the Irish company. Unidare Ireland refused to give a guarantee, apparently because it did not wish such liability to appear on its balance sheet,\(^{237}\) but gave the bank a letter of comfort, which was accepted. The letter of comfort contained an acknowledgment and approval of the proposed banking facilities and ended with the statement that Unidare Ireland’s

“policy is that this Company [Unidare Engineering] will conduct its affairs in a responsible manner, maintain a sound financial condition and meet its


\(^{235}\) Although it was not a comfort letter case, *Glendermid Leathers Limited v Pittsburgh National Seldon & Co Limited* (unreported decision, High Court of New Zealand, Dunedin Registry, Williamson J, 23 October 1986) involved a telex sent to Glendermid Leathers Limited (“Glendermid”) which contained declarations of commitment by Pittsburgh National Seldon & Co Limited (“PNSC”) to John Bull Footwear Limited (“John Bull”), and statements of support under the existing line of credit as well as a confirmation of PNSC’s intent to work with Glendermid in insuring the long-term viability of John Bull. PNSC was held to be liable for a breach of duty of care along the lines of *Hedley Byrne & Co Ltd v Heller & Partners Ltd* [1964] AC 465. See also Paulger v Butland Industries Ltd [1989] 3 NZLR 549.


\(^{237}\) See *Bank of New Zealand v Ginivan* [1991] 1 NZLR 178 at 179 (hereinafter referred to as Bank of NZ on appeal).
obligations promptly and will use our 'best endeavours' to see that the Company continues to do so.”

Unidare Engineering got into financial difficulty. The bank demanded payment from both Ginivan and the company. Receivers were appointed in respect of Unidare Engineering, and the bank sought summary judgment against Ginivan, as guarantor, for the balance still owing to it after certain recoveries had been made.

6.4.2. The issues

The bank succeeded on the question of liability against Ginivan, but the question of quantum was referred to trial. Ginivan maintained that the bank knew about the modest financial means of Ginivan, and that the bank represented that it would first seek recourse from Unidare Ireland pursuant to its collateral contract, the letter of comfort. The bank denied Ginivan’s contentions and stated that it had hoped to recover a further sum from Unidare Ireland, but that any recovery appeared unlikely.

6.4.3. The decision

Master Towle held, on the basis of the English Court of Appeal’s decision in Kleinwort Benson, that the letter of comfort was not intended to create a legal relationship, and had no contractual effect. According to the Master, Unidare Ireland’s letter of comfort went no further than the comfort letter in Kleinwort Benson.

6.5 Bank of New Zealand v Ginivan – on appeal

Both the bank and Ginivan appealed against the judgment of Master Towle. Both the appeal and the cross-appeal were dismissed by the New Zealand Court of Appeal

242 See Annexure 1.
on 21 September 1990. Since the New Zealand Court of Appeal upheld the Master’s decision on the question of the guarantee given by Ginivan to the bank, it was not necessary for the Court to determine the question of the legal nature of the letter of comfort.

Casey J (Somers and Hardie Boys JJ concurring) commented, however, on the letter of comfort itself in a way which threw into doubt the reliability of Master Towle’s subsequent decision in Genos Developments Ltd v Cornish Jenner & Christie Ltd. The New Zealand Court of Appeal commented that the letter of comfort had contractual effect because “the wording of the present letter goes further than the mere declaration of existing policy which led the Court [in Kleinwort Benson on appeal] to conclude that Kleinwort Benson Ltd was not bound by its letter of comfort. Here the words “and will use our ‘best endeavours’ to see that the company continues to do so” in the extract quoted above, suggested an obligation of a legally binding nature, although its extent and the consequences of any failure must depend on relationships between the two companies at the relevant time. Such an obligation is clearly not the same as a guarantee”. Casey J appeared to suggest that despite the reference to the future in the last sentence of the comfort letter, (that is, “will use”), the existence of a best endeavours clause indicated a legally binding obligation. So, although the New Zealand Court of Appeal considered the decision of the English Court of Appeal in Kleinwort Benson, it rejected the argument to apply it to the mixed wording of the comfort letter before it, and clearly evidenced the potentially limited nature of Ralph Gibson LJ’s reversal of Hirst J’s decision in Kleinwort Benson at first instance.

245 (unreported, Master Towle, High Court of New Zealand, Auckland, 10 July 1990, CP 556/90) (Genos Developments)
247 See M Furmston, T Norisada and J Poole, Contract Formation and Letters of Intent (John Wiley & Sons, Chichester, 1998) 177.
Casey J remarked that the words “and will use our ‘best endeavours’ to see that the company continues to do so” in the letter of comfort before him suggested “an obligation of a legally binding nature, although its extent and the consequences of any failure must depend on relationships between the two companies at the relevant time. Such an obligation is clearly not the same as a guarantee.”\footnote{251} In effect, the New Zealand Court of Appeal’s interpreted the phrase “best endeavours” to mean a future promise of a binding nature.\footnote{252} It is clear that in determining whether a letter of comfort had contractual effect, the court would have regard to both the specific undertaking given and the context in which the undertaking was made and broken.\footnote{253} Although there was no reference to the judgment of Roger CJ in \textit{Banque Brussels}, the \textit{obiter dicta} of Casey J indicated that the New Zealand Court of Appeal might well prefer the liberal approach to the construction of letters of comfort,\footnote{254} rather than the literal construction approach of the English Court of Appeal in \textit{Kleinwort Benson}.\footnote{255}

\section*{6.6 Genos Development Ltd v Cornish Jenner and Christie Ltd\footnote{256} – intention to create legal relations approach preferred in New Zealand}

This was the second New Zealand case on letters of comfort,\footnote{257} and was also a summary judgment application before Master Towle, decided at about the same time as the appeal in \textit{Bank of New Zealand v Ginivan} was argued in July 1990.\footnote{258}
6.6.1. The facts

Cornish Jenner and Christie Ltd ("Cornish Jenner"), a wholly-owned subsidiary of Holdcorp Group Ltd ("Holdcorp"), was looking to lease premises in the Onehunga Mall. The landlord, Genos Developments Ltd ("Genos"), requested a guarantee from Holdcorp, which refused to provide one but instead provided a letter in relation to Cornish Jenner on the day after the hearing of *Kleinwort Benson* on appeal,\(^{259}\) which included the following statement:\(^{260}\)

"[Holdcorp's] policy is to ensure that its subsidiaries meet their financial obligations and to this end you can be assured that while [Cornish Jenner] is a subsidiary of [Holdcorp] we will ensure that it meets its obligations under the above lease."

In reliance on that letter of comfort, and just a week or so after the Ralph Gibson LJ's decision in *Kleinwort Benson on appeal*,\(^ {261}\) Genos granted a lease to Cornish Jenner.\(^ {262}\) The rent and other outgoings under the lease fell into arrears, and Cornish Jenner went into liquidation. The landlord sought to recover the arrears from Holdcorp, which denied liability. Genos determined the lease and sought summary judgment for the amount of the arrears on the basis of the letter of comfort which, it claimed, was a binding letter of guarantee.

6.6.2. The issue

Master Towle had to decide whether the quoted statement in the letter given by Holdcorp to Genos had any contractual effect.

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\(^{259}\) [1989] 1 WLR 379.


\(^{261}\) [1989] 1 WLR 379.

6.6.3. The decision

Master Towle clearly associated himself with Ralph Gibson LJ’s decision in *Kleinwort Benson on appeal*, as he did in *Bank of NZ*,263 and stated that: “The real test as identified in that case is whether or not the parties intended to create any legal obligations from the letter and in that instance the Court of Appeal came to the view that that particular letter could not be construed as a guarantee so as to make the parent company liable.”265 The Master then telescopically restated the test in the matter before him as follows: “The real test is did the parties by the writing and acceptance of that letter intend to create a legal obligation upon the Second Defendant [Holdcorp] to become the guarantor of the obligations of CJC [Cornish Jenner] to the landlord under the lease.”266 It did not appear that the Court considered the general contractual effect of the letter – that is, whether it constitutes a contract. Rather it merely focused narrowly on whether the letter constituted a guarantee.267

The Court could find no real dissimilarity between the form and content of the *Kleinwort Benson* letter of comfort268 and the letter which had been given by Holdcorp. Master Towle held that on the evidence before the Court, although part of it was “somewhat vague”,269 that the parties had never intended to create a legal relationship whereby Holdcorp was to become a guarantor of Cornish Jenner’s obligations under the lease. Stating that Holdcorp Group Ltd’s (“HGL”) “policy is to ensure that its subsidiaries meet their financial obligations and to this end you can be assured that while Cornish Jenner and Christie is a subsidiary ... [HGL] will ensure that

264 (1990) 5 NZLC 96,351.
265 (unreported, Master Towle, High Court of New Zealand, Auckland, 10 July 1990, CP 556/90) at page 7.
266 (unreported, Master Towle, High Court of New Zealand, Auckland, 10 July 1990, CP 556/90) at page 9.
267 Although a letter of comfort would not constitute a guarantee unless it was a contract, it could be a contract without necessarily being a guarantee.
268 See Annexure 1.
269 (unreported, Master Towle, High Court of New Zealand, Auckland, 10 July 1990, CP 556/90) at page 10.
it meets its obligations under the above lease", Master Towle decided that the letter of comfort, was nothing more than a statement of present policy and was not intended to be a binding promise as to the future conduct of its subsidiary company. As Thain has remarked, Master Towle’s analysis was somewhat curious, because he seemed to have focused on just the words “ensure” and “at all times” despite remarking that the wording in the letter before him “went somewhat further than that in either the Kleinwort case or the Ginivan case.”. In doing so, the Master said that those words had not persuaded the English Court of Appeal to give the comfort letter in Kleinwort Benson legal force, and accordingly the relevant paragraph in Holdcorp’s letter of comfort was no more than what had been given to Kleinwort Benson; merely a statement of then present policy, not intended to be a binding promise of future conduct.

Master Towle’s conclusion on the actual wording of the Holdcorp letter of comfort appears to be clearly wrong and, in fact, at odds with some of the reasoning in Kleinwort Benson on appeal. The wording of the comfort letter in Kleinwort Benson differed from that of the Holdcorp letter of comfort. The comfort letter in Kleinwort Benson simply stated that “it is our policy to ensure”, while the Holdcorp letter of comfort read that “you can be assured that while Cornish Jenner & Christie Ltd is a subsidiary of Holdcorp Group Ltd we will ensure”. Without doubt what Holdcorp stated in the letter of comfort fell into the category of a promise as to future conduct, similar to the second paragraph in Kleinwort Benson. Thain has pointed out, however, that Master Towle’s decision in Holdcorp’s favour could be explained

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270 (unreported, Master Towle, High Court of New Zealand, Auckland, 10 July 1990, CP 556/90) at page 4.
271 (unreported, Master Towle, High Court of New Zealand, Auckland, 10 July 1990, CP 556/90) at page 9.
272 (unreported, Master Towle, High Court of New Zealand, Auckland, 10 July 1990, CP 556/90) at page 9.
275 Own emphasis added.
276 See Annexure 1.
“if he had relied on extrinsic evidence of a common intention that Holdcorp’s letter was not to be legally binding regardless of its wording. Indeed there was some evidence before the Court that both parties knew and agreed that Holdcorp would not give a guarantee. However, although the Master saw that evidence as confirmatory, he did not rely on it, preferring to decide simply that the wording of the relevant paragraph in the comfort letter was on its face evidence of a lack of intention to create a binding promise as to Holdcorp’s future conduct.”277

As in Bank of NZ at first instance,278 there was no reference in Master Towle’s judgement to the decision in Banque Brussels.279 Moreover, Genos Developments was decided before the New Zealand Court of Appeal handed down its decision in Bank of New Zealand v Ginivan.280 While the evidence in Genos Developments may not have been sufficient to have persuaded the Master to determine the matter on the summary judgment application, it appeared that he was adopting the approach of Hirst J in Kleinwort Benson at first instance, even though the result seemed to be similar to that in Kleinwort Benson on appeal. White has opined that the judgment in Banque Brussels281 and the obiter dicta of Casey J in Bank of NZ on appeal282 on appeal might have caused the Master to pause before following Kleinwort Benson without careful consideration.283

278 (1990) 5 NZCLC 96.351.
6.7 *Toronto Dominion Bank v Leigh Instruments*\(^{284}\) - the constructionist approach in Canada

There were four reported decisions in the courtroom saga of Leigh Instruments Ltd ("Leigh") before and after the 18 month trial started in January 1997 which ended 8 years of litigation.\(^{285}\) The decisions dealing with the pleadings,\(^{286}\) the discovery,\(^{287}\) the calling of adverse witnesses at trial\(^{288}\) and the doctrine of issue estoppel\(^{289}\) are not relevant for purposes of this dissertation.

The statement of claim advanced more than 150 alleged causes of action.\(^{290}\) The focus of the discussion of the case in this chapter will be on the contractual effect of comfort letters aspect of Winkler J’s judgment, and not the other aspects of the judgment which runs to 178 pages in the law reports.\(^{291}\)

### 6.7.1. The facts

Leigh was a high-tech company on the leading edge of the Canadian defence industry. Toronto Dominion Bank ("TD Bank"), one of Canada’s five main chartered banks with operations worldwide, had been Leigh’s bankers since 1982.\(^{292}\) The relationship continued until April 1988 when Leigh was taken over by The Plessey Company Pty Ltd ("Plessey"), a large United Kingdom based company, through its subsidiary, Plessey

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\(^{284}\) (1998) 40 BLR (2d) 1 (hereinafter also referred to as Toronto Dominion Bank). For a discussion of comfort letters prior to this decision, see G David, "Butterworths Forum on Comfort Letters: Canada" (1986) 1 Butterworths Journal of International Banking and Financial Law 3.

\(^{285}\) *Toronto Dominion Bank* (1998) 40 BLR (2d) 1 at 22. The trial transcript ran to more than 15,000 pages and thousands of pages of exhibits. The parties’ written submissions consisted of more than 1,200 pages.


\(^{288}\) *Toronto Dominion Bank v Leigh Instruments Ltd (Trustee of)* 35 OR (3d) 369.

\(^{289}\) *Toronto Dominion Bank v Leigh Instruments Ltd (Trustee of)* 35 OR (3d) 273.

\(^{290}\) *Toronto Dominion Bank* (1998) 40 BLR (2d) 1 at 22.

\(^{291}\) *Toronto Dominion Bank* (1998) 40 BLR (2d) 1.

\(^{292}\) *Toronto Dominion Bank* (1998) 40 BLR (2d) 1 at 6.

252
Canada (1988) Inc (“Plessey Canada”). At the time of the takeover, Leigh was not indebted to TD Bank, but the latter extended a C$10 million loan facility to Plessey Canada to partially assist with financing the takeover.\textsuperscript{293}

The loan was based on the creditworthiness of Plessey and, due to a mistaken belief that Plessey did not provide guarantees for loans to its subsidiaries, TD Bank proposed that Plessey provide it with a letter of comfort.\textsuperscript{294} TD Bank’s willingness to accept a letter of comfort was apparently further motivated by its desire to retain the Leigh business in Canada and to develop a business relationship with Plessey in Canada and elsewhere.\textsuperscript{295}

In April 1988, Plessey provided TD Bank with the first of a series of five letters of comfort. In the letter of comfort Plessey confirmed that it was aware of the credit facility and undertook not to reduce its 100% indirect shareholding in Plessey Canada without prior notice to TD Bank.\textsuperscript{296} The letter of comfort also contained a policy paragraph which stated that it was Plessey’s policy to manage its wholly-owned subsidiaries “in such a way as to be always in a position to meet their financial obligations, including repayment of all amounts owing under the above facility.”\textsuperscript{297} Although the first letter of comfort was neither a formal security nor a formal guarantee, Plessey included it in its guarantee register for convenience.\textsuperscript{298}

A few months later, Plessey Canada was amalgamated with Leigh and the new entity was known as Leigh. The Plessey Canada loan was rolled over and Plessey acknowledged that the first letter of comfort applied to what was then a loan to Leigh. That became the second letter of comfort.\textsuperscript{299} For reasons presently irrelevant, Leigh required more credit from TD Bank. A third letter of comfort was issued by Plessey in

\begin{itemize}
  \item \textit{Toronto Dominion Bank} (1998) 40 BLR (2d) 1 at 6.
  \item \textit{Toronto Dominion Bank} (1998) 40 BLR (2d) 1 at 7.
  \item \textit{Toronto Dominion Bank} (1998) 40 BLR (2d) 1 at 7.
  \item See \textit{Toronto Dominion Bank} (1998) 40 BLR (2d) 1 at 24 to 37
  \item \textit{Toronto Dominion Bank} (1998) 40 BLR (2d) 1 at 8.
  \item \textit{Toronto Dominion Bank} (1998) 40 BLR (2d) 1 at 8.
  \item See \textit{Toronto Dominion Bank} (1998) 40 BLR (2d) 1 at 8 and 37 to 39.
\end{itemize}
terms similar to the first letter of comfort. 300 What had begun as a short-term bridge loan of C$10 million to assist Plessey with the Leigh acquisition, had been transformed into an operating line of C$17 million to Leigh in little more than seven months. 301

During this period there was tension between TD Bank’s Corporate Banking Division which was responsible for direct customer contact and monitoring accounts, and its Credit Division which was charged with reviewing credit risks to the bank. The Corporate Banking Division was still trying to foster and further its business relationship with Plessey while the Credit Division was concerned about the outstanding loan and the unhealthy financial status of Leigh. 302 The Credit Division “flew storm warnings throughout the bank saying that the facility should be regularised, and the bank should avoid being dragged along”, 303 but despite being aware that a letter of comfort was not a formal guarantee, the Corporate Banking Division was, confident that “Plessey will support Leigh as required”. 304 This occurred, as Winkler J noted, 305 at a time when the English Court of Appeal’s decision in Kleinwort Benson 306 was released. The parties knew about the decision, 307 and the “timing of the decision as it pertained to the case at bar was striking especially in light of the bank’s decision some six weeks later in March 1989 to rest its exposure with Leigh solely on the comfort letter from Plessey.” 308

In the northern summer of 1989, TD Bank extended further credit to Leigh to defend itself against a hostile takeover bid by GEC Siemens plc, a joint venture consisting of GEC 309 and Siemens AG. Although not requested, Plessey provided TD Bank with a further letter of comfort in similar terms to the third letter of comfort but covering the

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300 See Toronto Dominion Bank (1998) 40 BLR (2d) 1 at 9 and 39 to 55.
301 Toronto Dominion Bank (1998) 40 BLR (2d) 1 at 9.
302 Toronto Dominion Bank (1998) 40 BLR (2d) 1 at 9.
303 Toronto Dominion Bank (1998) 40 BLR (2d) 1 at 9 and 10.
304 Toronto Dominion Bank (1998) 40 BLR (2d) 1 at 10.
305 Toronto Dominion Bank (1998) 40 BLR (2d) 1 at 11.
307 Toronto Dominion Bank (1998) 40 BLR (2d) 1 at 50 and 52.
308 Toronto Dominion Bank (1998) 40 BLR (2d) 1 at 12.
309 Being GEC Siemens Pty Ltd, General Electric Company Pty Ltd and Siemens AG.
full amount of Leigh's outstanding loans.\textsuperscript{310} Notwithstanding Leigh's opposition, the hostile takeover was successful.

Despite Leigh sinking further into debt, TD Bank approved an increase in Leigh's facility to C$45 million on condition that Plessey provided it with a fifth letter of comfort in the same form and substance as the previous one. Unfortunately, the condition was not communicated by the bank to Leigh, Plessey or GEC Siemens plc. The fifth letter of comfort provided in its entirety:

"[1] This is to confirm that The Plessey plc has full knowledge of the facility of C$45,000,000 (Forty five million Canadian Dollars) which has been granted by the Toronto-Dominion Bank to Leigh.

[2] Leigh is currently a wholly owned subsidiary of 160956 Canada Inc which is a wholly owned subsidiary of Plessey Overseas Limited which in turn is a wholly owned subsidiary of The Plessey Company plc. We undertake not to reduce our shareholding in Leigh or its holding company without prior notification to yourselves.

[3] It is Plessey’s policy that Leigh be managed in such a way as to be always in a position to meet its financial obligations including repayments of all amounts owed under the above facility to yourselves on their due dates.

[4] The letter replaces our letters of 31\textsuperscript{st} August 1989, 31\textsuperscript{st} March 1989 and 30\textsuperscript{th} June 1989 and does not constitute a legally binding commitment."\textsuperscript{311}

TD Bank's London office received and filed the fifth letter of comfort without commenting on the added phrase in the last sentence of the fifth letter of comfort – “does not constitute a legally binding commitment.” Although no one at TD Bank acknowledged having read the fifth letter of comfort until much later, the Court found

\textsuperscript{310} Toronto Dominion Bank (1998) 40 BLR (2d) 1 at 12 and 60.
\textsuperscript{311} Toronto Dominion Bank (1998) 40 BLR (2d) 1 at 74. I have inserted the numbering of the paragraphs for easy reference in the discussion of the letter of comfort.
that the bank's General Manager, Corporate Banking Division received, read and accepted the letter on the bank's behalf when it was provided in January 1990.312

In April 1990, Leigh's financial statements reflected huge losses but the bank was still not prodded into action. It was only after the Executive Director of Siemens plc inquired from TD Bank whether it knew what was happening at Leigh and indicated that GEC Siemens plc might not commit to the Plessey letters of comfort that the TD Bank froze Leigh’s credit line. The following day the bank called up the loan and shortly thereafter Leigh filed for bankruptcy. Shock and dismay followed and in an internal memorandum of TD Bank it was stated:

“Need to give GEC/Siemens lessons on doing business in Canada ... moreover, they are reneging on a commitment to a major Canadian bank, with public sympathy clearing [sic] falling on the side of TD rather than 2 European multinationals.”313

6.7.2. The issues

In its statement of claim TD Bank alleged numerous causes of action against the trustee of Leigh, Plessey, GEC Siemens plc and GEC, but in argument many of the claims were abandoned. The remaining claims were claims in contract, claims in tort and claims based on conduct outside the letters of comfort. Only the claim in contract will now be reviewed. The second paragraph of the letter, which was not in issue, is clearly an undertaking. The question was, however, what was the legal effect of the statement of corporate policy contained in the third paragraph?

TD Bank claimed a breach of contract as against Plessey on the basis that “the comfort letters properly construed in their factual matrix, constituted contractual promises by Plessey to cause Leigh to be managed so as to be always in a position to meet its financial obligations, including all amounts owed to the bank pursuant to the bank’s

312 Toronto Dominion Bank (1998) 40 BLR (2d) 1 at 78.
313 Toronto Dominion Bank (1998) 40 BLR (2d) 1 at 92.
loans to Leigh.”

In effect, TD Bank asserted that the letters of comfort, and in particular the third or policy paragraph, included a contractual commitment by Plessey to directly and indirectly pay it the amount owed by Leigh. To overcome the problem of the added phrase in the fifth letter of comfort, TD Bank sought an order that the fifth letter of comfort be rectified to conform to the alleged agreement between the parties, namely the deletion of, or alternatively the setting aside of, the added phrase.

Plessey denied the claims in contract and essentially made three submissions. The first submission was that, the operative document was the fifth letter of comfort which did not create any legally binding obligation upon Plessey to directly or indirectly make good the indebtedness of Leigh to TD Bank, regardless of the concluding words. Secondly, it was submitted that the concluding words in the fifth letter of comfort accurately recorded the understanding between Plessey and TD Bank and that they merely reinforced the plain meaning of the letter of comfort, ie that it did not create a binding legal obligation to pay Leigh’s debt to the bank. The third submission was that TD Bank’s reliance on the third paragraph of the letters of comfort would require the Court to read into the paragraph words which were not there, and which would, if added, convert a statement of policy or representation into a promise amounting to a guarantee.

6.7.3. The decision

Winkler J first restated the Canadian law pertaining to contract interpretation, before applying it to the circumstances of the case. He held that, subject to the claim for rectification or setting aside of the fifth and last letter of comfort, that such letter of comfort was the document to be construed by the Court in the context of the

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314 Toronto Dominion Bank (1998) 40 BLR (2d) 1 at 104.
315 Toronto Dominion Bank (1998) 40 BLR (2d) 1 at 105.
316 Toronto Dominion Bank (1998) 40 BLR (2d) 1 at 124.
317 Toronto Dominion Bank (1998) 40 BLR (2d) 1 at 139.
318 Toronto Dominion Bank (1998) 40 BLR (2d) 1 at 105 to 111.
319 Toronto Dominion Bank (1998) 40 BLR (2d) 1 at 105 to 112.
claim in contract. Winkler J held that the words “does not constitute a legally binding commitment” in the final sentence of the fifth letter of comfort, which was received, read and accepted by a senior bank officer on behalf of the TD Bank, were a complete defence to the claim alleging breach of contract:

“...The last line of the letter is, in my view, dispositive of the plaintiff’s contract argument. Having regard to the principle that contracting parties are presumed to intend what they say, the fifth comfort letter states on its face that it replaces all prior comfort letters, and must therefore be taken to be a reliable record of the parties’ latest agreement. Moreover, the letter states that it does not constitute a legally binding agreement and must be taken as conclusive of Plessey's intention that it not be so bound. This is a full and complete answer to the plaintiff’s claim in contract.”

In interpreting the letter of comfort as a whole, Winkler J further held that the final paragraph of the comfort letter made it clear that the third or policy paragraph did not constitute a legally binding commitment by Plessey to pay the TD Bank the amount owed by Leigh.

However, the learned judge still considered the legal effect of the statement of corporate policy contained in the third paragraph of the letter of comfort, without taking into account the final paragraph. In this regard, Winkler J had to decide which one of the two conflicting decisions in *Kleinwort Benson on appeal* or *Banque Brussels*, he was going to follow in determining the legal effect of the words “it is Plessey’s policy that Leigh be managed in such a way as to be always in a position to meet its financial obligations.” Since the Australian law differed from that of England as to whether a statement was promissory or merely representational, Winkler J

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320 Toronto Dominion Bank (1998) 40 BLR (2d) 1 at 112.
321 Toronto Dominion Bank (1998) 40 BLR (2d) 1 at 112.
322 Toronto Dominion Bank (1998) 40 BLR (2d) 1 at 116.
adopted the reasoning of Chadwick J in *Atlantic Computers*, stating that *Banque Brussels* “can have no application to the facts before me.”

Winkler J repeated the mantra that, save for cases of patent or latent ambiguity, extrinsic evidence of the parties' intentions was not admissible but evidence of the factual matrix or surrounding circumstances was admissible as an aid to finding an interpretation that did not change the written terms of the contract. His Honour stated:

“Where an agreement is clear and unambiguous on its face, the parol evidence rule operates to prohibit admission of evidence to alter or vary the written terms of the contract. However, the court may admit evidence of the surrounding circumstances, including evidence of the commercial purpose of the contract, the genesis of the transaction, the background, the context and the market in which the parties were operating. In this regard, evidence to be admitted must be objective in the sense of what reasonable persons in the position of the parties have had in mind, rather than subjective evidence of the parties' actual intentions.”

“Accordingly, where there is some doubt as to the meaning of language used in the contract, or the court has difficulty in applying it to the facts, the court should, in light of the factual matrix, search for an interpretation which would appear to advance the true intent of the parties. The more reasonable construction of the words, which produces a fair result consistent with the commercial atmosphere, is the interpretation which the court should adopt.”

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325 *Re Atlantic Computers (in administration); National Australia Bank Ltd v Soden* [1995] BCC 696 at 699.
327 *Toronto Dominion Bank* (1998) 40 BLR (2d) 1 at 113.
329 *Toronto Dominion Bank* (1998) 40 BLR (2d) 1 at 111.
“The court may have regard to extrinsic evidence in order to resolve the ambiguity, and no harm will come from its admission, however extrinsic evidence of facts leading up to the making of at the agreement, circumstances existing at the time of the agreement and subsequent conduct of the parties may only be considered once an ambiguity has been found. Extrinsic evidence demonstrating the intention of the parties is only admissible, however, once an ambiguity has been found, and in my view, should be objective, rather than subjective evidence of the parties’ intentions.”

It appears, however, that Winkler J, like the courts in *Kleinwort Benson* and *Banque Brussels*, adopted a generous attitude about admitting evidence of surrounding circumstances, and a significant volume of this evidence was about the subjective views or understandings of the parties about the nature of comfort letters. Winkler J’s interpretation was clearly influenced by this evidence of the letters of comfort, as the matters extrinsic to the language of the comfort letters were tellingly against TD Bank as Perrell succinctly summarised:

“For example, its credit procedures manual described comfort letters as 'documentation' rather than 'security'. The bank was aware that a guarantee was not available, and its evaluation of the credit risk of the loan to Leigh was found by Winkler J to be inconsistent with the letter being a legal instrument as opposed to a matter of honour. The bank had advice from its internal legal department about the vagaries of comfort letters as effective security instruments. The bank’s decisions to make and to continue to make loans

330 *Toronto Dominion Bank* (1998) 40 BLR (2d) 1 at 111.
333 See *Toronto Dominion Bank* (1998) 40 BLR (2d) 1 at 116 to 122 where the evidence about the circumstances leading up to the first comfort letter and the subsequent letters as well as the parties’ subsequent conduct is dealt with.
334 See *Toronto Dominion Bank* (1998) 40 BLR (2d) 1 at 92 to 102.
were found by Winkler J to have been driven by a desire to foster a relationship with the commercially renowned parent enterprises. As for Plessey’s and general Electric’s perspective, Winkler J accepted the evidence of their witnesses that comfort letters did not ground legally enforceable obligations to pay but were ‘gentlemen’s agreements’ and matters of reputation in the business community.”

Winkler J also found that, as a matter of interpretation, the third paragraph was not promissory or legally obligatory, but merely a representation - a conclusion not only fatal to TD Bank’s contractual claims, but also to its claims in tort. His Honour’s conclusion in respect of the effect of the third paragraph of the letter of comfort was reinforced by the following considerations. First, there was a clear distinction between the second and the third paragraphs of the letter of comfort. The second paragraph, which was not in issue in the case, stated that “[w]e undertake not to reduce our shareholding in Leigh” and constituted an undertaking with legal effect. By contrast, the third paragraph of the comfort letter stated that “[i]t is Plessey’s policy”.

Secondly, it would be necessary to add or imply words like “It is Plessey’s policy to cause Leigh to be managed in such a way” or “Plessey undertakes to ensure that Leigh be managed” to arrive at the construction of the third paragraph of the letter of comfort contended for by the TD Bank, because the word “policy” usually only connoted a guideline or principle, and did not constitute a promise to do anything. It was not legally permissible as a matter of interpreting the letters of comfort to add or

337 Toronto Dominion Bank (1998) 40 BLR (2d) 1 at 114.
338 (1998) 40 BLR (2d) 1 at 134 and 135. It was found that the third paragraph was not a misrepresentation of a current or continuing fact. Winkler J also rejected TD Bank’s arguments that for the third paragraph to be true, Plessey itself had to have a policy of managing the affairs of Leigh so that it was in a position to pay its obligations, as opposed to having a policy that Leigh manage its own affairs so that it was in a position to pay its obligations, which Winkler J found as a fact was the policy in place at all relevant times. See, in general, PM Perrell, “Lessons About Comfort Letters” (2001) 34 Canadian Business Law Journal 421 at 440.
339 Toronto Dominion Bank (1998) 40 BLR (2d) 1 at 114.
340 Toronto Dominion Bank (1998) 40 BLR (2d) 1 at 114.
341 Toronto Dominion Bank (1998) 40 BLR (2d) 1 at 114.
imply words so as to make them promissory.\textsuperscript{342} In any event, making the letters of comfort promissory or effective as creating legal obligations were, in Winkler J's view, inconsistent with the factual circumstances.\textsuperscript{343} So, to go beyond the wording of the comfort letters, whether or not there was a substantive debate about its literal or latent meaning, would not have helped TD Bank.\textsuperscript{344}

Thirdly, the words, “it is Plessey’s policy", at most, were a representation of present policy and not a contractual undertaking by Plessey to retain the policy in the future.\textsuperscript{345} Although the word “always” in the third paragraph of the comfort letter had the effect of making the representation as to Plessey’s policy a continuing representation, albeit subject to change, it did not transform the policy statement into a contractual promise to retain the policy in the future.\textsuperscript{346}

Fourthly, as was held in Kleinwort Benson on appeal,\textsuperscript{347} Winkler J held that the TD Bank’s construction of the third paragraph of the letter of comfort would also emasculate the effect of the first two paragraphs of the comfort letter.\textsuperscript{348} If the third paragraph of the comfort letter was to be read as “a contractual obligation that Plessey will continue to have the policy while the facility is outstanding, and that it will cause Leigh to be managed so that it can meet its obligations under the facility”, the first (that Plessey had full knowledge of the facility extended by the bank) and the second (Plessey’s undertaking not to reduce its shareholding in Leigh or its holding company) would become otiose.\textsuperscript{349} Conversely, leaving the third paragraph as a matter of honour gave weight to the first two paragraphs, while providing whatever commercial value a legally unenforceable statement of policy might have\textsuperscript{350} - because

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\textsuperscript{342} Toronto Dominion Bank (1998) 40 BLR (2d) 1 at 115.
\textsuperscript{343} Toronto Dominion Bank (1998) 40 BLR (2d) 1 at 116.
\textsuperscript{345} Toronto Dominion Bank (1998) 40 BLR (2d) 1 at 115.
\textsuperscript{346} Toronto Dominion Bank (1998) 40 BLR (2d) 1 at 115.
\textsuperscript{347} [1989] 1 WLR 379.
\textsuperscript{348} Toronto Dominion Bank (1998) 40 BLR (2d) 1 at 116.
\textsuperscript{349} Toronto Dominion Bank (1998) 40 BLR (2d) 1 at 116.

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as Winkler J observed, a “comfort letter containing a representation as to policy must, in my view, have more commercial value than a letter which did not contain such a statement.”

Finally, a consideration of the letter of comfort in its factual matrix did not alter Winkler J’s conclusion that the letter of comfort was not only clear and unambiguous, but also that the third paragraph was merely a representation, albeit a continuing one. The difference between the express promissory language of the second paragraph and the wording of the third paragraph of the comfort letter was significant.

6.7.4. On appeal

On appeal TD Bank did not challenge Winkler J’s analysis of the contractual claim, but only argued that it was wrong to use the same analysis to interpret the third paragraph of the letter of comfort for purposes of the negligent misrepresentation claim, and accordingly to find that TD Bank had failed to establish negligent misrepresentation by Plessey pursuant to any of the five letters of comfort or by GEC in respect of the fifth letter of comfort. Doherty, Austin and Sharpe JJA rejected the argument of TD Bank and stated:

“No doubt there are important differences between the two claims; however, the task of determining the meaning to be given to the words in paragraph 3 was common to both. Before considering the legal effect of those words, the trial judge had to determine what they meant. The same words in the same document cannot have one meaning in the context of a contract claim and a

351 Toronto Dominion Bank (1998) 40 BLR (2d) 1 at 119.
352 Winkler J made hard findings of fact against the TD Bank’s witnesses; for example, he found that a senior bank officer received, read and accepted the no-law clause inserted in the fifth letter of comfort, and that the fifth letter did not go unnoticed for months after it was received – see PM Perrell, “Lessons About Comfort Letters” (2001) 34 Canadian Business Law Journal 421 at 437.
353 Toronto Dominion Bank (1998) 40 BLR (2d) 1 at 116
354 Toronto Dominion Bank v Leigh Instruments Ltd (Trustee of) 178 DLR (4th) 634 at [7] (hereinafter also referred to as Toronto Dominion Bank on appeal).
355 Toronto Dominion Bank on appeal 178 DLR (4th) 634 at [4].
different meaning in the context of a tort claim. Once the meaning of the words is fixed, the legal effect of those words must be considered. It is at this stage of the interpretative process that distinctions between contract and tort claims can become important.

The process of determining the meaning to be given to words in a document is governed by the same principles regardless of whether the process is engaged in the context of a contract or a tort claim ... Essentially, the process is captured in the following question: Bearing in mind the relevant background, the purpose of the document, and considering the entirety of the document, what would the parties to the document reasonably have understood the contested words to mean?356

The appeal against Winkler J’s decision was unanimously dismissed by the Ontario Court of Appeal,357 and the application for leave to appeal to the Supreme Court of Canada was refused.358

6.7.5. Some comments359

At first blush, it may seem that the finding that TD Bank accepted the terms of the fifth letter of comfort with its wording that the letter “does not constitute a legally binding commitment”, diminishes the value of any general pointers about letters of comfort to be gleaned from Toronto Dominion Bank.360 However, in deciding that the third or policy paragraph of the letter of comfort, even if considered apart from the deliberate

356 Toronto Dominion Bank on appeal 178 DLR (4th) 634 at [8] and [9].
357 Toronto Dominion Bank on appeal 178 DLR (4th) 634. See also RE Elliott and JM Robinson, "'Comfort' letters may provide cold comfort" 1999 (November 19) The Lawyers Weekly 12.
358 Toronto Dominion Bank v The Plessey Company (Ont) [2000] 1 SCR xxi.
360 (1999) 40 BLR (2d) 1.
no-law language added to the fifth comfort letter, did not amount to a promise, and on his analysis of the specific language of the letters of comfort Winkler J had regard to how comfort letters are viewed in the business world.  

His Honour was clearly influenced by the English Court of Appeal’s decision in Kleinwort Benson because that decision was significant for two reasons. First, Winkler J viewed it as a “landmark decision in the world of banking and commerce due to the dearth of court authority on the subject”, and secondly, because the parties had been aware of the decision when the bank chose to proceed with the credit solely on the basis of the comfort letters. As one commentator remarked, TD Bank knew full well that comfort letters were unenforceable as binding legal obligations, and were prepared to accept them as a gentlemen’s agreement, and when the party reneged on that agreement, the Bank attempted, unsuccessfully, to convert a ‘sow’s ear into a silk purse’.  

The decision in Toronto Dominion Bank suggests that while letters of comfort differ in their terms and must be analysed individually, in general they do not constitute enforceable agreements. Instead, they represent a kind of “gentlemen’s agreement” imposing only moral or commercial obligations, not enforceable in law.  

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361 Toronto Dominion Bank (1998) 40 BLR (2d) 1.  
363 Toronto Dominion Bank (1998) 40 BLR (2d) 1.  
364 It appears from the decision on discovery in the proceeding that TD Bank had a general file on comfort letters in its legal department. None of the documents on comfort letters concerned any specific transaction involving the bank. The documents included newspaper articles and a “Banking Law Update” of Mallesons Stephen Jaques, and related to the Kleinwort Benson case. The bank’s claim of privilege was rejected. See Toronto Dominion Bank v Leigh Instruments Ltd (Trustee of) 32 OR (3d) 575 at 579 to 581.  
365 J Goodman, “No Comfort by Letter of Comfort: Toronto Dominion Bank v Leigh” (1999) 14 Banking and Finance Law Review 389 at 390. All of the letters of comfort except the first were signed after the English Court of Appeal’s decision in Kleinwort Benson [1989] 1 WLR 379, a decision which was widely discussed in the banking world.  
367 Toronto Dominion Bank (1998) 40 BLR (2d) 1 at 156.  
368 See paragraph 4.4.2.  
regard, Winkler J went further than Ralph Gibson LJ in *Kleinwort Benson* on appeal when he stated: "Letters of comfort are just that, comfort. They are not guarantees or formal security nor are they enforceable as such ... this is common knowledge in the business community."

The lesson to be learned is furthermore that banks or lenders should review their loan documentation and letters of comfort to ensure that they correspond with the bank’s expectations, in particular where there has been a change in the circumstances since the letters had been issued, for example, where the parent company or issuer of the letters has been the subject of a subsequent takeover.

The decision in *Toronto Dominion Bank* accepts that letters of comfort may be the source of legally enforceable liabilities if they contain negligent or fraudulent misrepresentations, holding that a representation contained in such a letter could constitute a continuing representation rather than being strictly limited to the time at which the letter was issued. Winkler J’s judgment and the subsequent affirming judgment of the Ontario Court of Appeal in *Toronto Dominion Bank* not only confirm the interpretative approach to letters of comfort of the English Court of Appeal in *Kleinwort Benson* but extended it to the negligent misrepresentation claim, which was not developed in the latter case.

Importantly, it is clear from the Ontario Court of Appeal’s judgment that, if there are claims both in contract as well as in tort, by reason of the common element of having interpret the letter of comfort, it is unlikely to end up with different outcomes. Perrell is of the view that this seems to follow because “if the comfort letter is interpreted as

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370 *Toronto Dominion Bank* (1998) 40 BLR (2d) 1 at 156.
373 *Toronto Dominion Bank* (1998) 40 BLR (2d) 1.
being a matter of honour only, then that interpretation comprehensively precludes any finding of liability in contract or in tort. Conversely, if the letter is interpreted as being contractual and breached, then it is unlikely that a court would find that the promise was also not as actionable false representation. The other elements of the tort would seem to be in place.\textsuperscript{376} It is, however, apparent from \textit{Banque Brussels}\textsuperscript{377} and \textit{Gate Gourmet}\textsuperscript{378} that, at least in New South Wales, a finding of contractual unenforceability will not necessarily preclude a finding of liability in tort.

6.8 \textit{Bouygues SA v Shanghai Links Executive Community Ltd}\textsuperscript{379} - the literal construction approach in Hong Kong

6.8.1. The facts

Shanghai Pudong New Area Links Executive Community Ltd (“SPNA”) was an enterprise established under the law of the People’s Republic of China. Its only asset was its interest in a certain development of housing in the Pudong area of Shanghai. SPNA was a subsidiary of the defendant, Shanghai Links Executive Community Ltd (“SLEC”). The plaintiffs, Bouygues SA and Pomerleau, were companies incorporated in France and Canada respectively. Bouygues SA and Pomerleau entered into a construction contract with SPNA to the value of US$33.25 million.

The solicitors of SPNA sent a letter to Bouygues SA and Pomerleau which stated that funds from SLEC’s investors would be deposited in a segregated account and payment of the contract price under the construction contract would be made from that account.\textsuperscript{380} Thereafter the investors also sent a letter to Bouygues and Pomerleau confirming that payment of the contract price would be made from such account and


\textsuperscript{378} [2004] NSWSC 149.


\textsuperscript{380} Bouygues [1998] 2 HKLRD 479 at 486.
that US$33.25 million was placed in the account.\textsuperscript{381} The parties subsequently fell out and the construction contract was terminated. The parties agreed to resolve their differences by arbitration.

Bouygues and Pomerleau applied to the Hong Kong Supreme Court for a declaration that the money in the segregated account be used to pay them any amount due as determined by the arbitrator. They also argued that, since the money in the segregated account would be used only for the payment of amounts due under the construction contract, they were entitled to the money on the grounds of breach of contract.

SLEC denied that the money was being held in trust for Bouygues and Pomerleau and argued that the letters, which were proved to them regarding the payment terms, were only letters of comfort, which contained no express promise of future conduct; that is, the letters merely informed Bouygues and Pomerleau that money had been set aside which could be used for making payments of the contract price.

\textbf{6.8.2. The issue}

One of the issues which the court had to decide was whether or not the following passages from the SPNA solicitor’s letter and the SLEC investors’ letters respectively rendered the letters “mere comfort letters” without any binding effect:

(a) “We advise that under an agreement entered into by the [defendant/SLEC], all of the funds required to pay the US$33,250,000.00 contract price will be deposit[ed] in a US$4 account of the [defendant/SLEC] at Standard Chartered Bank in Hong Kong. Payment of the contract price under the construction contract will be held in a

\textsuperscript{381} Bouyges [1998] 2 HKLRD 479 at 487.
trust account and funds can be paid out of this account by the signature of Barry Hansen and one other director of the [defendant/SLEC].”  

(b) “The undersigned is the representative of one of several investors which have agreed to make an investment in the [defendant/SLEC]. We confirm that in accordance with the terms of such investment, the [defendant/SLEC] is required to place the US$33,250,000.00 contract price in a segregated US dollar account of the [defendant/SLEC] for payment of the contract price. We agree that payment of the contract price will be made to you according to the terms and conditions of the construction contract signed between the contractor and the developer from the [defendant’s/SLEC’s] account by signature of Barry Hansen and a director appointed by one of the investors as described above.”

6.8.3. The decision

Keith J referred to both Kleinwort Benson on appeal and Banque Brussels and pointed out that, although the outcome of each case was different, the approach of the English Court of Appeal and the New South Wales Supreme Court was the same. In essence, the determination of the legal effect of the comfort letters depended on whether they contained simply statements of fact regarding the parent company’s current policy or whether they amounted to contractual promises as to the parent company’s future conduct.

The absence of express words of promise does not by itself prevent a statement from being treated as a contractual promise. It merely means that it is necessary to consider carefully the context in which the comfort letters were written. However, if it is clear from the language of the relevant letters that they contain express promises of

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382 [1998] 2 HKLRD 479 at 486.
383 [1998] 2 HKLRD 479 at 488.
384 [1998] 2 HKLRD 479 at 491.
385 See also Toppan Printing Company v Chinese United Press Limited (unreported decision, High Court, Hong Kong Special Administrative Region, Court of First Instance, HCA 2898/2002, 13 May 2005) at [43].
future conduct, it will not be necessary for the court to consider the context in which the letters were written.\textsuperscript{386} Keith J pointed out, however, that the solicitor's letter and the investors' letters had to be read together because –

(a) they were all printed on the letterhead of the law firm Stikeman, Elliot and addressed to Bouygues and Pomerleau;

(b) the investors' letters all had the number “2” at the top (indicating that they were page 2 of the instrument);

(c) the terms defined in the solicitor's letter were used in the investors' letters;

(d) all the letters dealt with the same subject matter, namely the deposit of funds provided by SPNA and by SLEC investors in a segregated US$ account, and the method by which the contract price under the construction contract was to be paid.\textsuperscript{387}

Keith J had no hesitation in finding that the words used in the quoted paragraphs of the letters were susceptible to only one sensible construction; that is, they amounted to a promise of future conduct by SLEC and its investors. The learned judge pointed out that the solicitor's letter read “under [the] agreement ... funds ... will be deposited”, not “under [the] agreement ... funds ... are required to be deposited”, and further the letter stated “[P]ayment will be made from this account”, not “[P]ayment ... is required to be made from this account.”\textsuperscript{388} Moreover, the SLEC investors' letters confirm the promissory nature of the terms of the letters, even that of the solicitor's letter. Although the first two sentences of the investors' letters were informative only, the third sentence was clearly promissory. Keith J stated that the third sentence could only be construed as a promise of future conduct, namely that the “contract price” would be paid to Bouygues and Pomerleau from the segregated account, and that the

\textsuperscript{386} [1998] 2 HKLRD 479 at 491.
\textsuperscript{387} [1998] 2 HKLRD 479 at 491.
\textsuperscript{388} [1998] 2 HKLRD 479 at 492.
signatures of Mr Hansen and a director of SLEC appointed by one of the investors would be required before such sums could be paid out of the segregated account.\textsuperscript{389}

Thus, Keith J held “without much difficulty that Mr Ng’s [the solicitor of SPNA] letter contained promises of future conduct on the part of his clients, one of whom was the defendant [SLEC], and that the investors’ letters contained promises of future conduct on the part of the investors. Accordingly, these letters were not merely letters of comfort: they were intended to have, and had in fact, contractual effect.”\textsuperscript{390} In other words, the court found that sums up to a total of US$33.25 million were secured by the comfort letters to Bouygues and Pomerleau so long as there was a liability on SPNA to pay “the contract price” to them. Unfortunately for Bouygues and Pomerleau that finding did not entail success for them, because the question remained as to what payment was secured by the comfort letters. In this regard, Keith J found that the phrase “the contract price” was a term of art, used in the construction contract to denote the “price for all works inclusive of separately priced items and exclusive of excluded items.”\textsuperscript{391} Thus, the phrase in the comfort letters referred to the totality of the sums payable to Bouygues and Pomerleau for performance of their obligations under the contract, not to the amount of secured payment if the construction contract was terminated. Therefore, Bouygues and Pomerleau were unsuccessful with their application.\textsuperscript{392}

C. Certainty in letters of comfort

Wood is of the view that even if a letter of comfort is legally binding, “commonly its terms are so ‘woolly’ and the circumstances of such limited effect that the letter does not give rise to substantial rights.”\textsuperscript{393} Others share this view, and point out that letters of comfort which provide “support if the subsidiary cannot meet its obligations,

\textsuperscript{389} [1998] 2 HKLRD 479 at 493.
\textsuperscript{390} [1998] 2 HKLRD 479 at 493.
\textsuperscript{391} [1998] 2 HKLRD479 at 496.
\textsuperscript{392} [1998] 2 HKLRD 479 at 497.
without saying what 'cannot meet its obligations' means” and “if ... [a parent company] ceases to own an interest in ... [a subsidiary company], he will give a guarantee to the lender” are examples of comfort letters which are too vague and may be nothing more than an agreement to agree.394 In the context of letters of comfort where a party deliberately expresses itself in vague terms, the question is what the law should do about it? Generally stated, two solutions present themselves:

(a) interpret what it said expansively, as a warning to others that careless words can cost money, or

(b) cut down its obligation to a minimum, and tell the other party that if it wanted a more extensive guarantee it should have stipulated for it precisely.395

Despite the differences in approach as mentioned in chapters 5 and 7, Hirst J in Kleinwort Benson at first instance and Rogers CJ in Banque Brussels seem to have clearly adopted the first solution, while Ralph Gibson LJ in Kleinwort Benson on appeal was attracted to the second solution as mentioned in chapter 6. There can be an overlap between arguments that an agreement is or is not intended to create legal relations and arguments that an agreement is or is not sufficiently certain to be enforced.396 In a commercial context, failing an express intention to the contrary, it is highly unlikely that a court will refuse a contract simply on the basis of lack of intention to create legal relations.397 It is far more likely that the agreement will not be enforced on the basis that it lacks certainty or is ambiguous.398

397 This not only because of the presumption of intention to create legal relations in commercial agreements, but as Einstein J pointed out in Gate Gourmet [2004] NSWSC 149, even if the facts are considered objectively the same result as the presumption is likely.
It is therefore not surprising that some courts have refined the second solution, developing an approach to the contractual effect of comfort letters based upon certainty or, more correctly, the lack thereof, because even if a letter of comfort is found to create legal relations, its terms will only be enforceable if they are sufficiently certain to permit legal enforcement. Acc. to this approach, which is based on the conservative approach in *Kleinwort Benson on appeal* and adopted in *TLI Management* and *Australian European Finance*, if the construction of a letter of comfort is uncertain, then it does not have contractual effect.

### 6.9 Commonwealth Bank of Australia v TLI Management Pty Ltd – the literal construction approach in Australia

After the English Court of Appeal’s decision in *Kleinwort Benson*, the focus in Anglo-common law shifted from England to Australia. The first Australian decision on letters of comfort is *TLI Management Pty Ltd*.

#### 6.9.1. The facts

Hovertravel Australia Pty Ltd (“Hovertravel Australia”), a subsidiary of Hovertravel Ltd (“Hovertravel”), was building a hovercraft passenger service in Port Phillip Bay. In February 1987, TLI Management Pty Ltd (“TLI”), a company managed by a certain Mr Thompson, began takeover arrangements for Hovertravel. In March 1987, before the takeover arrangements were finalised, Hovertravel Australia negotiated with its bank, the Commonwealth Bank of Australia (“CBA”), to provide financial facilities to it.

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404 See J Horn, *Patronatserklärungen im common law und im deutschen Recht* (Peter Lang, Frankfurt am Main, 1999) 58 to 61 for a German lawyer’s comments on the decision.
406 [1990] VR 510. This decision was, however, reported subsequent to *Banque Brussels* (1989) 21 NSWLR 502.
407 *TLI Management Pty Ltd* [1990] VR 510 at 510 to 511.
CBA extended facilities to Hovertravel Australia under a temporary overdraft facility of $125,000.00. However, Hovertravel Australia drew cheques totalling $229,205.00, well in excess of its overdraft facility and requested CBA to honour the cheques. CBA refused to honour the cheques drawn by Hovertravel in excess of its overdraft facility unless it was provided with security. Hovertravel Australia asked CBA to contact Mr Thompson in this regard.

The evidence as to how the letter of comfort came to be prepared and sent was by no means clear, but generally it appears to be as follows. A bank official telephoned Mr Thompson and asked him whether or not he intended to take over Hovertravel, and whether or not he knew about the temporary overdraft facility extended to Hovertravel Australia. Mr Thompson, a director of TLI, informed the loans officer of CBA during the telephone conversation that TLI was taking over Hovertravel, would be injecting funds of $750,000.00 into Hovertravel, and stated that as a result TLI would ensure that the debt owed by Hovertravel Australia to CBA would be paid in full. The bank official asked Mr Thompson to confirm his acknowledgment in writing and dictated a letter of comfort to Mr Thompson to sign and fax to CBA. Mr Thompson penned down the letter of comfort as dictated, including the heading “Draft Letter of Comfort”, but added the words “subject to shareholders’ approval” in the second paragraph of the letter which read as follows:

”[1] We hereby acknowledge that the Commonwealth Bank of Australia has agreed to make temporary credit facilities totalling two hundred and fifty thousand Australian dollars $A250,000 available to Hovertravel Australia Pty Ltd which represents payments for ongoing operating costs and salaries.

[2] We confirm that the company will complete takeover arrangements (subject to shareholders’ approval) of Hovertravel Ltd as soon as legally

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410 TLI Management Pty Ltd [1990] VR 510 at 512 to 514.
411 Mr Thompson signed the letter which was on Thompson Land Group letterhead paper.
possible. These arrangements include the injection of sufficient capital to repay the temporary facility as mentioned above to takeover date or within 30 days of this date.”

In May 1987, TLI took over Hovertravel. On 1 June 1987, Hovertravel’s shares were suspended from trading, and TLI could not refinance Hovertravel Australia. CBA instituted proceedings against TLI claiming damages for breach of contract.

6.9.2. The issues

Tadgell J had to deal with the question whether the letter of comfort in the terms set out in paragraph 6.9.1 given to CBA embodied contractual promises to complete the takeover of Hovertravel and inject sufficient capital into that company, or itself repay Hovertravel Australia’s debt to CBA.

6.9.3. The decision

Tadgell J held that, having regard to the context and to all the surrounding circumstances, the “so-called letter of comfort” did not contain contractual undertakings, but only statements of the intentions of TLI. His Honour’s reasons for this conclusion were as follows.

First, his Honour applied Ralph Gibson LJ’s literal approach in Kleinwort Benson on appeal to construe the letter of comfort, deciding that: “There was no plea of a want of consideration that the defendant [TLI] did not intend its acknowledgment and confirmation to have legal effect. The presumption in Edwards v Skyways Ltd [1964] 1 WLR 349 – that a promise given in a commercial context is presumed to be intended to have legal effect unless the contrary is shown – has no application ... The question is

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412 TLI Management Pty Ltd [1990] VR 510 at 512. I have added the paragraph numbers for easy reference.
413 TLI Management Pty Ltd [1990] VR 510 at 514.
whether the legal effect of the transaction was promissory." The onus lay upon the plaintiff, CBA, to show that the defendant had undertaken contractual obligations.

Secondly, the draft letter of comfort which CBA gave to Mr Thompson was not calculated to indicate to TLI that any undertaking was being sought from TLI in consideration of, or as a condition of CBA making facilities available to Hovertravel Australia. The first sentence of the second paragraph of the letter of comfort contained the proviso - the only change made to the draft provided by CBA - that the arrangements were "subject to shareholders' approval". In light of the fact that TLI had not begun takeover arrangements for Hovertravel and, under the prevailing corporations legislation, could not take over Hovertravel unless the shareholders approved, Mr Thompson inserted the words "subject to shareholders' approval" in the first sentence of the second paragraph. Tadgell J pointed out that it was therefore "highly unlikely in the circumstances that the defendant [TLI] should have agreed to make itself responsible for payment of the plaintiff's [CBA] customer's overdraft facility whether or not it [the defendant] effected a takeover or outlaid money by way of 'injection' into the company, not having otherwise made itself liable to complete the takeover". Indeed, it is questionable whether TLI, as a prospective maker of an offer of takeover, would have been likely to bind itself to CBA to take over a public company under pain of a liability for damages if it did not do so.

Thirdly, there were no words in the draft provided by CBA, and which with the insertion of the proviso became the letter of comfort, conveying to TLI the idea that TLI would be undertaking a contractual obligation. The letter of comfort was a confirmation in writing that Mr Thompson intended to take over Hovertravel, not a

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promise to act upon such an intention. The Honour decided that the contract between CBA and Hovertravel had been made before TLI provided the letter of comfort to CBA, and that TLI had had no part in it, because the letter of comfort stated that CBA has "agreed". The letter of comfort only "invited the defendant [TLI] to acknowledge the fact, which it did. The draft was not calculated to indicate to the defendant that any undertaking was being sought from the defendant in consideration of, or as a condition of, the plaintiff's [CBA] making the facilities available, or agreeing to do so." What was stated in the second paragraph of the letter of comfort was in essence a reiteration of no more than was already known or believed by CBA to be TLI's intention.

Fourthly, while the words "we confirm" in the first sentence of the second paragraph of the letter of comfort might be said to be not inconsistent with a contractual undertaking, a court must nevertheless have regard to the whole of the circumstances in which such words were said or written. The letter of comfort was not a promise to act upon the intention expressed in the second paragraph because the opening words of the second sentence – "we confirm that we will" – were not "words of promise". Tadgell J stated that "it would have been very simple, if that had been intended, to have used words of promise, such as 'we agree', 'we undertake', or even 'we promise'," and that "the words 'we confirm that we will' were, in the circumstances, at least ambiguous". The learned judge did not accept the argument that the opening words of the second paragraph were similar to the opening words of the third paragraph in Kleinwort Benson on appeal because "there is ... a real and material distinction between the force of 'we confirm that we will not [do that which is within

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our power to do or refrain from doing in order to preserve the status quo’ and ‘we confirm that we will [do a particular thing if we become entitled to it].’

Fifthly, the second paragraph of the letter of comfort was “otherwise ambiguous on several grounds. The first sentence of the second paragraph of the letter of comfort is perfectly capable of being construed simply as a non-promissory statement of intention ... To construe as a promissory undertaking by the defendant [TLI], which if not performed would render the defendant liable for damages, is much more difficult. The difficulty is accentuated by the relative vagueness of many of the words – for example, ‘complete’, ‘takeover arrangements’ and ‘as soon as legally possible’. What would constitute a breach of such an undertaking? ... If the ‘arrangements’ include ‘the injection of sufficient capital’ etc, what are the other arrangements?’ Indeed, it was not easy to say what would constitute a breach of the undertaking, if it were contractual.

It was open to CBA to have secured a definite contractual undertaking on the part of TLI, whereas something less than definite had emerged in the draft letter of comfort which CBA requested TLI to sign. In fact, the draft letter of comfort "was not calculated to indicate to the defendant [Hovertravel] that any undertaking was being sought from the defendant in consideration of, or as a condition of, the plaintiff’s [CBA] making the facilities available, or agreeing to do so.” In the circumstances, the burden of proof

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428 TLI Management Pty Ltd [1990] VR 510 at 516. L Thai, “Comfort Letters – A Fresh Look?” (2006) 17 Journal of Banking and Finance Law and Practice 15 at 27 observed, however, view that the difference between Kleinwort Benson and TLI Management is that, “in the former, the court focused on the element of intention to create legal relations and found that the intention did not exist, whereas in the latter case, the court went one step further and specifically said that the expression ‘we confirm’ in the comfort letter was merely a non-promissory statement of intention. By contrast, the court in Kleinwort Benson made no reference to the expression ‘we confirm’. This suggests that Tadgell J in TLI Management was prepared to consider promissory estoppels if more assertive words of promise were used in the comfort letter.” If the reference is to Kleinwort Benson at first instance the observation is accurate but not if the reference is to the English Court of Appeal’s decision which did not focus on the issue of intention to create legal relations.


lay on CBA, and it had failed to discharge the onus.\textsuperscript{431} The letter of comfort was merely a genuine expression of intention – the letter of comfort did not, and was not intended to, contain any contractual undertaking.\textsuperscript{432}

6.9.4. Some comments

It is clear that Tadgell J, like Ralph Gibson LJ in \textit{Kleinwort Benson on appeal},\textsuperscript{433} emphasised the semantic and grammatical meaning of the phrases used in the letter of comfort. His Honour focussed primarily on a construction of the actual terms of the letter of comfort in issue.\textsuperscript{434} The question of intention to create legal relations as such was peripheral.\textsuperscript{435} The events and circumstances surrounding the generation of the letter of comfort were relevant only to the extent that they assisted in a proper construction of the words of the letter.\textsuperscript{436} Tadgell J’s analysis was very similar to the analysis of Ralph Gibson LJ in \textit{Kleinwort Benson on appeal}\textsuperscript{437} where it was also held that the fact that the letter of comfort involved a serious acknowledgment by the provider of the commercial position between the parties and the recipient relied on this letter in the provision of finance was not enough to create a promissory undertaking. A letter of comfort would be contractual only if, after careful construction and scrutiny of its terms a court can find clear, express words of promise.\textsuperscript{438} However, Tadgell J went farther than the literal approach propounded in \textit{Kleinwort Benson on appeal}\textsuperscript{439} and adopted an approach to the contractual effect of letters of comfort based on certainty, or more specifically, the lack thereof – that is, where the letter of

\textsuperscript{432} See G Nash, “Letter of Comfort Revisited” [1990] October \textit{Australian Accountant} 87 at 89.
\textsuperscript{433} \textit{JLR Davis in The Laws of Australia} (Thomson Reuters (Professional) Australia Limited, on-line) at [7.1.260].
\textsuperscript{438} \textit{JLR Davis in The Laws of Australia} (Thomson Reuters (Professional) Australia Limited, on-line) at [7.1.260].
\textsuperscript{439} [1989] 1 WLR 379.
comfort was full of inherent ambiguities or uncertainties, it did not embody any contractual promise.\textsuperscript{440}

Tadgell J's decision is interesting in that, although it adopted the literal approach to the construction of letters of comfort and emphasised the lack of certainty, his Honour relied heavily on the surrounding circumstances and factors external to the letter of comfort, especially the fact that CBA provided a draft to TLI, to support his construction of the letter of comfort, and the fact that the comfortor was a company which only intended to take over the borrower company subject to a number of contingencies, but was not otherwise associated with it.\textsuperscript{441} Importantly, his Honour rejected the evidence of the CBA officer in respect of critical aspects of the case; for example, the allegation that Mr Thompson orally stated on behalf to Hovertravel that it would repay or "clear" the debt of Hovertravel Australia to CBA. Tadgell J criticised the absence of any evidence at all from the CBA officers suggesting how the draft letter of comfort had been sent to Mr Thompson.\textsuperscript{442}

Subsequently, in \textit{Toyota Motor Corporation Australia Ltd and Toyota Finance Australia v Ken Morgan Motors Pty Ltd},\textsuperscript{443} a case which did not involve a letter of comfort, Tadgell J revisited the argument that the inquiry as to the existence of a contract should start with the presumption set out in \textit{Edwards v Skyways},\textsuperscript{444} and that the party claiming that there was no contract had a heavy onus of disapproving an intention to contract. In dealing with the issue, his Honour referred to both his decision in \textit{TLI Management} \textsuperscript{445} and Rogers CJ in \textit{Banque Brussels},\textsuperscript{446} and stated the position succinctly as follows:

"I should not doubt that if, as in that case [Edwards v Skyways], there was conduct (including the use of words) appropriately to be classified as involving a promise, the appellants [in the case before him] could not be heard to say that they did not intend their promise to have legal effect. In my opinion, however, there can be no presumption of an intention to make a promise. No intention to make a promise can be imputed to a person whose words and conduct, objectively considered, do not lead to the inference that he intended to make one. Negotiations, no matter how heavily commercial in character, are no substitute for such an intention. I remain of the view I expressed in Commonwealth Bank of Australia v TLI Management Pty Ltd ... that, when the question is whether the legal effect of a transaction is promissory there is no presumption that it is ... I note the animadversions of Rogers CJ Comm D in the Banque Brussels Case, at pp 523-5, upon the decision of the Court of Appeal in Kleinwort Benson Ltd v Malaysia Mining Corporation Berhad ... I do not derive from what his Honour said anything that absolves a party who alleges an agreement from proving it. Indeed his Honour decided the Banque Brussels Case, as I understand it, by determining that the relevant parts of the letter of comfort in question were expressed in language of promise or undertaking or obligation and were contractual. He seems to have regarded the language of the letter of comfort in question in the Kleinwort Benson Case also as promissory."

The decision in TLI Management has not been discussed widely. This may be because, although the reasoning in the decision was arguably unsound, it is submitted that the result was correct. Tadgell J's decision in TLI Management was examined by the United Stated District Court of New York, in Mutual Export Corp v Westpac Banking

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Corporation. After discussing Tadgell J’s decision in relation to “words of promise”, Knapp J held that a letter of comfort stating that “the Bank hereby undertakes to issue the credit” had contractual effect because the “defendant’s use of the word ‘undertakes’ … while not thus mystically transforming it into a contract, nevertheless reinforces our concluding that a contract was intended.”

Although the decision can be criticised for introducing the lack of certainty approach to the construction of letters of comfort, the emphasis on the consideration of the surrounding circumstances cannot be faulted and that led to a correct result. Moreover, the view that there is a clear distinction between the intention to create a contractual or legal relationship and the question whether a party did actually enter into a contractual undertaking, as well as the application and rebuttal of the presumption of an intention to assume legal obligations in commercial relations, which Tadgell J adopted in TLI Management, as had the English Court of Appeal in Kleinwort Benson, is not without support. The wording of the letter of comfort needs to be ex facie promissory before the presumption arises, and, if applicable, the onus to rebut the presumption cannot arise where the words and conduct of the parties, objectively considered, do not lead to an inference of a promise. In essence, when the question is whether the legal effect of a transaction is promissory, there is no presumption that it is.

Finally, Lipton is of the view that Tadgell J’s use of the “balance or reasonableness’ to conclude that the bank should not have the benefit of forcing the defendant to make good its losses in respect of a loan to another company in circumstances where it

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456 See A de Moor, “Intention in the Law of Contract: Elusive or Illusory?” (1990) Law Quarterly Review 632 at 636. However, as DW Greig and JLR Davis, The Law of Contract Fourth Cumulative Supplement (Law Book Company, Sydney, 1992) 55 have remarked, the question is whether that is a helpful distinction.
457 See also Toyota Motor Corps Australia Ltd v Ken Morgan Motors Pty Ltd [1994] 2 VR 106 at 150 and 177.
would not be fair to do so, is indicative that the underlying explanation of his judgment is based on notions of good faith and moral imperatives.\(^{458}\)

6.10 **Australian European Finance Corporation Ltd v Sheahan**\(^{459}\) - the literal construction approach in Australia

6.10.1. The facts

Duke Pacific Finance Ltd ("Duke Pacific") was a subsidiary of Duke Group Ltd ("Duke Group"). Duke Group negotiated with Australian European Finance Corporation ("AEFC") to provide financial facilities to Duke Pacific. AEFC offered to provide the requested financial facilities to Duke Pacific, but in return asked for a formal guarantee by Duke Group. The latter refused to grant a formal guarantee but provided a letter of comfort to AEFC which relevantly stated that:

[1] Duke Pacific, wholly owned by Duke Group, would "continue to be supported" by Duke Group "so long as is necessary";

[2] in the event that any subordinate loans were required to ensure Duke Pacific's "requirements under the necessary legislation or licensing requirements", those would be provided;

[3] such support "as is necessary" would be given to Duke Pacific "and its subsidiaries".\(^{460}\)

AEFC provided a $5 million revolving term loan facility to Duke Pacific which was in part "secured" by the letter of comfort of Duke Group. The circumstances surrounding the case indicated a lack of hard bargaining similar to that in *Banque Brussels*.\(^{461}\)

\(^{458}\) J Lipton, "Good Faith and Letters of Comfort" (1999) 28 *University of Western Australia Law Review* 138 at 155 and 156.


Duke Group was liquidated, and AEFC commenced proceedings for breach of contract against Mr Sheahan, the liquidator of Duke Group.

6.10.2. The issues

The issue was whether the liquidator of Duke Group was correct in disallowing a proof of debt by AEFC based on the letter of comfort.

6.10.3. The decision

The decision by the liquidator of Duke Group to disallow AEFC’s proof of debt based on the letter of comfort was affirmed. Matheson J held that Duke Group was not liable for breach of contract. 462

Faced with a choice of at least two possible approaches, the South Australian Supreme Court chose to follow that of the English Court of Appeal in Kleinwort Benson, and, in doing so, held that the letter of comfort was not relied upon by AEFC and contained no inference on the part of Duke Group that it would make good any losses sustained by AEFC at the hands of Duke Pacific. Moreover, the court held that the letter of comfort was clearly intended by Duke Group to be ambiguous and it neither contained a statement of awareness nor approval of the subject loan facility. Accordingly, Matheson J found that the letter of comfort did not contain any contractual promise.

His Honour decided that the letter of comfort was a statement of fact about Duke Group’s intention in relation to Duke Pacific, not a promise to act upon such an intention. The learned judge stated that “the letter does not contain any statement of awareness of the loan facility or that The Duke Group Limited approves of it. It does not say that it will maintain its 100 percent ownership of Duke Pacific” 463 and that “I

am not persuaded that the vague words of the first and third sentences contain contractual promises. Support can mean many different things, and I do not know what support ‘so long as is necessary’ or ‘as is necessary’ means ... The second sentence is even more ambiguous, and the evidence contained no attempt to explain it. I construe it as mere padding, as is the addition of the words ‘and its subsidiaries’ at the end of the third sentence.”\textsuperscript{464}

It appears that Matheson J also adopted an approach to the contractual effect of letters of comfort based upon certainty or the lack thereof. His Honour held that the letter of comfort was not a promise to act upon any intention because of “an almost cavalier attitude by the plaintiff [AEFC] to the receipt of the letter and to the date of its receipt”,\textsuperscript{465} and because “there is no evidence to indicate that its wording was actually discussed, or that any person on behalf of The Duke Group Limited encouraged any expectation on the part of the plaintiff [AEFC] that The Duke Group Limited would make good any losses that might occur”.\textsuperscript{466}

Matheson J also briefly discussed the issue of intention to create legal relations. His Honour held that, because the letter of comfort was not a promise to act upon such an intention, he was not “persuaded that the parties intended that the letter would amount to a legally enforceable security.”\textsuperscript{467} Moreover, the presumption of an intention to assume legal obligations in commercial relations was inappropriate because of the dearth of evidence that the lender had relied on the letter of comfort in making a loan available.

\textbf{6.10.4. Some comments}

It was an easy decision to reach on the facts and, although his Honour quoted extensively from various relevant authorities and academic writings, he saw no need to

\textsuperscript{464}Australian European Finance (1993) 60 SASR 187 at 206.
\textsuperscript{465}Australian European Finance (1993) 60 SASR 187 at 206.
\textsuperscript{466}Australian European Finance (1993) 60 SASR 187 at 206.
\textsuperscript{467}Australian European Finance (1993) 60 SASR 187 at 206.
attempt an analysis of the law.\textsuperscript{468} Matheson J’s decision is disappointing. Although his Honour cited the conflicting decisions of \textit{Kleinwort Benson on appeal},\textsuperscript{469} \textit{Banque Brussels}\textsuperscript{470} and \textit{TLI Management},\textsuperscript{471} he did not discuss them or state a preference for one decision over the others.

\subsection*{6.11 Conclusion}

The lack of certainty approach has not found favour with other courts. In \textit{Chemco Leasing}, Staughton J remarked that “when two businessmen wish to conclude a bargain but find that on some particular aspect of it they cannot agree ... it is not uncommon for them to adopt language of deliberate equivocation, so that the contract may be signed and their main objective achieved. No doubt they console themselves with the thought that all will go well, and that the terms in question will never come into operation or encounter scrutiny; but if all does not go well, it will be for the courts or arbitrators to decide what those terms mean.”\textsuperscript{472} Moreover, in \textit{Banque Brussels}, Rogers CJ stated that “the whole thrust of the law today is to attempt to give proper effect to commercial transactions. It is for this reason that uncertainty, a concept so much loved by lawyers, has fallen into disfavour as a tool for striking down commercial bargains.”\textsuperscript{473}

\begin{thebibliography}{99}
\item [1989] 1 WLR 379.
\item [1989] 21 NSWLR 502.
\item [1990] VR 510.
\item (19 July 1985, unreported, QBD).
\item (1989) 21 NSWLR 502 at 523.
\end{thebibliography}
7 THE CONTRACTUAL EFFECT OF LETTERS OF COMFORT - THE COMMERCIAL (OR COMMON SENSE) INTERPRETATION APPROACH

7.1 Introduction

The “intention to create legal relations” approach\(^1\) and the “literal construction” approach\(^2\) - as well as the latter’s off-spring, the “lack of certainty” approach\(^3\) - have generally been criticised. First, Ralph Gibson LJ’s reasons\(^4\) for denying contractual effect to the letter of comfort, and those of Hirst J\(^5\) for coming to the opposite conclusion are debatable in the sense that they are very much exercises of persuasion.\(^6\) Secondly, it has been argued that the contractual intention and literal construction approaches to the construction of letters of comfort ignore traditional contract law.\(^7\) Under traditional contract law, intention to create legal relations is “an essential characteristic of all contracts”,\(^8\) and the construction of a contract is “one of the most important functions of the court in relation to contracts”.\(^9\) The contractual intention approach, however, almost ignores the construction of letters of comfort, reducing it to a “subsidiary question”,\(^10\) whilst the literal construction approach ignores intention to create legal relations as “having no application”.\(^11\) Brown opines that Ralph Gibson LJ in *Kleinwort Benson on appeal*\(^12\) was “unduly restrictive in [his] interpretation of the wording of paragraph (3)\(^13\) and that, if the court had chosen to

\(^{1}\) See chapter 5.
\(^{2}\) See chapter 6.
\(^{3}\) See chapter 6.
\(^{4}\) Kleinwort Benson Ltd v Malaysia Mining Corporation Berhad [1989] 1 WLR 379 (hereinafter referred to as *Kleinwort Benson on appeal*).
\(^{5}\) Kleinwort Benson Ltd v Malaysia Mining Corporation Berhad [1988] 1 WLR 799 (hereinafter referred to as *Kleinwort Benson at first instance*).
\(^{10}\) Kleinwort Benson at first instance [1988] 1 WLR 799 at 801.
\(^{11}\) Kleinwort Benson on appeal [1989] 1 WLR 379 at 392.
\(^{12}\) [1989] 1 WLR 379.
\(^{13}\) See Annexure 1 for the wording of the comfort letter.

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apply the presumption of intention, the wording of that paragraph would not be sufficiently uncertain to displace the presumption.”

Thirdly, it has been argued that the intention to create legal relations, constructionist and lack of certainty approaches ignore the relationship between intention to create legal relations and construction of contracts, because when a “court construes a contract it does so in order to give effect to the intention of the parties”. Moreover, in G Scammell and Nephew Ltd v Ouston, Lord Wright remarked that “the object of the court is to do justice between the parties, and the court will do its best, if satisfied that there was an ascertainable and determinate intention to contract, to give effect to that intention, looking at substance and not mere form. It will not be deterred by mere difficulties of interpretation. Difficulty is not synonymous with ambiguity.”

Finally, the intention to create legal relations, constructionist and lack of certainty approaches are said to ignore the important role of policy, because “in the interests of political and economic safety or policies, or in the interest of social justice and the prevention of oppression, the law may provide rules which bind the parties.”

In the light of the shortcomings of the intention to create legal relations, constructionist and lack of certainty approaches, the New South Wales Supreme Court in Australia have developed an approach to the contractual effect of letters of comfort based upon both the intention to create legal relations and construction as well as policy. Under this approach, the courts apply the presumption of intention to create legal relations in commercial situations to the letter of comfort, and then, applying policy reasons to establish the legal enforceability of comfort letters, they construe the

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16 JW Carter and DJ Harland, Contract Law in Australia (Butterworths, Sydney, 1991) 203.
17 [1941] AC 251 at 268.
meaning of the words of the letter of comfort liberally with the result that the letter would have contractual effect. In this chapter, I discuss the so-called “commercial (common sense) interpretation” approach first adopted in Banque Brussels Lambert SA v Australian National Industries Ltd.  

7.2 Policy reasons for the legal enforceability of letters of comfort

In paragraph 5.2, reference was made to Sneddon’s view on the presumption of intention to create legal relations in the context of letters of comfort. Sneddon further observed that “even if the letter of comfort is held to be legally enforceable, the nature of the obligation undertaken will vary from case to case and the questions of whether the obligation was breached, whether the breach caused the loss and the appropriate quantum of damages will be disputed in each case.” At first sight, Sneddon’s observation is a truism. If the observation is, however, intended to somehow detract from the legal effect of a letter of comfort, it is submitted that there is little, if any, merit in this observation - determining factual issues, deciding questions of breach, causation and quantum of damages are what courts do; whether in the context of contract law, tort or under a statutory regime, and there is no reason why courts could not deal with, or should be deterred by, such questions when dealing with letters of comfort.

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7.3  **Banque Brussels Lambert SA v Australian National Industries Ltd**\(^{23}\) - the judicial beacon for the commercial interpretation approach

This was the second Australian case\(^{24}\) on letters of comfort and has become the leading Australian decision on the approach to the construction of comfort letters and their contractual effect.

7.3.1.  The facts\(^{25}\)

The basic facts of the Banque Brussels case were very similar to the facts of the Kleinwort Benson case.\(^{26}\) Spedley Securities Ltd ("SS"), a wholly owned subsidiary of Spedley Holdings Ltd ("SH"), wished to obtain a loan facility of US$5 million from the plaintiff, Banque Brussels Lambert SA ("BBL"). BBL wanted reassurance that any drawn down loan would be repaid. As a means of backing the loan, the defendant, Australian National Industries Ltd ("ANI"), which held 45% of the share capital in SH, issued a letter of comfort to BBL.

In the negotiated letter of comfort, ANI confirmed that it was aware of the loan in question and acknowledged that the arrangement had its approval. ANI stated further that

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\(^{23}\) (1989) 21 NSWLR 502 (hereinafter referred to as Banque Brussels). See J Horn, Patronatserklärungen im common law und im deutschen Recht (Peter Lang, Frankfurt am Main, 1999) 61 to 74 for a German lawyer’s comments on the decision.

\(^{24}\) The first Australian case on letters of comfort, although published after Banque Brussels, is Commonwealth Bank of Australia v TLI Management Pty Ltd [1990] VR 510 (hereinafter referred to as TLI Management).

\(^{25}\) Banque Brussels (1989) 21 NSWLR 502 at 504 et seq. It should be noted that the name of the plaintiff is actually "Banque Bruxelles Lambert" but in the law report the hybrid spelling "Banque Brussels Lambert" has been used, and the latter spelling is retained in this dissertation.

\(^{26}\) See paragraph 5.3.1. See, however, S Vogenhauer and J Kleinheisterkamp (eds), Commentary on the Unidroit Principles of International Commercial Contracts (PICC) (Oxford University Press, Oxford, 2009) 232 who remark that the vigorous criticism by Rogers CJ in Banque Brussels of the English Court of Appeal’s decision in Kleinwort Benson was "without reason because of the different facts".
“[1] it would not be our intention to reduce our shareholding in Spedley Holdings Limited from the current level of 45% during the currency of this facility.

[2] We would, however, provide your Bank with ninety (90) days notice of any subsequent decisions taken by us to dispose of this shareholding ...

[3] We take this opportunity to confirm that it is our practice to ensure that our affiliate, Spedley Securities Limited, will at all times be in a position to meet its financial obligations as they fall due. These financial obligations include repayment of all loans made by your bank under the arrangement mentioned in this letter.”

After the facility had been fully drawn down, ANL proceeded to sell its shares in SH without giving any notice to Banque Brussels, and it did not ensure that SS was in a position to meet its financial obligations to the bank. This was done deliberately because ANI feared that, if BBL was notified of the sale, it would call up the loan and that could have the effect of reducing the value of the shares and of precluding the sale at the favourable price obtained by ANI. SS subsequently went into liquidation. BBL brought an action to recover its loss from ANI.

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7.3.2. The issues

The principal issue\textsuperscript{29} in the case was whether the letter of comfort constituted legally binding undertakings which ANI had broken by not giving BBL the required notice of sale and by not ensuring that SS remained able to meet its liabilities. Rogers CJ stated that two questions arose in dealing with the letter of comfort, namely –

(a) whether there was an intention to create legal obligations; and

(b) whether the terms of the letter of comfort were of a sufficiently promissory nature to be held to be contractual,\textsuperscript{30}

and that, although these questions were independent, they were inter-related in that it was from the terms of the letter seen against the backdrop of surrounding circumstances that the parties’ intentions in both respects fell to be determined.\textsuperscript{31} In other words, there was an interrelation between contract intention and contract interpretation.

7.3.3. The decision

From the language used, Rogers CJ concluded that the letter of comfort was clearly not a guarantee,\textsuperscript{32} and consequently ANI was not liable in debt upon SS's default.\textsuperscript{33} ANI was not, however, necessarily exonerated from any liability. If it was proven that the

\textsuperscript{29} Banque Brussels also institute the proceeding on the alternative grounds of contravention of section 52 of the Trade Practices Act 1974 (Cth), promissory estoppel, and unjust enrichment, but the discussion in this dissertation is focused on the contractual effect of letters of comfort.


\textsuperscript{31} Banque Brussels (1989) 21 NSWLR 502 at 521.

\textsuperscript{32} In Banque Brussels (1989) 21 NSWLR 502 at 522 it was held that "the letter makes clear that the defendant is not assuming secondary liability for the debts of the principal debtor. It is not suggested that the letter makes the defendant liable for the debt of Spedley conditioned merely on non-payment by Spedley. The statements made in the letter are more remote from the liability of Spedley to repay the facility. By reason of this, a failure to adhere to the statements made will, at best, give rise merely to a claim for damages and throw up considerable questions of causation." J O'Donovan, "Grouped Therapies for Grouped Insolvencies" in M Gillooly (ed), The Law Relating to Corporate Groups (Federation Press, Sydney, 1993) 46 has suggested that, with only a slight variation in wording, as a general proposition, letters of comfort such as the one in Banque Brussels, set out in paragraph 7.3.1, could fall within the definition of a guarantee.

\textsuperscript{33} Banque Brussels (1989) 21 NSWLR 502 at 521.
letter of comfort constituted a legally binding undertaking, ANI could still be liable in damages for breach of contract.\(^{34}\)

In considering whether, in the case before him, the parties had entered into a binding contract, Rogers CH stated that there was a “prima facie presumption that in commercial transactions there is an intention to create legal relations, and the onus of proving the absence of such intention rests with the party 'who asserts that no legal effect is intended, and the onus is a heavy one'”.\(^{35}\) Indeed, it appeared that, unless there was an express statement negating an intention that the letter of comfort should have legal effect, it was unlikely that the provider of the comfort letter would be able to rebut the presumption that it was so intended.\(^{36}\) The presumption was not rebutted by the fact that the letter described itself as a 'letter of comfort' or by the fact that letters of comfort were often deliberately used with the intention of avoiding the legal liability of a guarantor. The fact that the parties had chosen a letter of comfort instead of a guarantee did not indicate that they did not intend to assume legal relations\(^{37}\) – the letter of comfort could be attributed to the commercial benefits that the issuer would enjoy, such as the exemption of liability on their accounts.\(^{38}\) His Honour proceeded to state that the overriding test was that of the intention of the parties, as deduced form the document as a whole seen against the background of the practices of the particular trade or industry,\(^{39}\) and the surrounding circumstances.\(^{40}\) His Honour

\(^{34}\) *Banque Brussels* (1989) 21 NSWLR 502 at 522. In *Banque Brussels Lambert SA v Australian National Industries Ltd* (unreported, Supreme Court of New South Wales, 5 October 1990) the court awarded damages equal to the amount as if a guarantee was given. See GD Cooper, Representations of ‘Comfort Enforceable Against the Maker’ [1990] *Journal of Banking and Finance Law and Practice* 287.


\(^{40}\) In *Codelfa Construction Pty Ltd v State Rail Authority New South Wales* (19820 149 CLR 337 at 352, it was held that if the words of a contract are ambiguous or susceptible to more than one meaning, or even uncertain, the court can look at evidence of the circumstances surrounding the making of the contract to construe the contract.
concluded that Banque Brussels intended to extract a “strong” letter of comfort from ANI, and that there was an intention to create legal relations.\footnote{Banque Brussels (1989) 21 NSWLR 502 at 521.}

Referring to the judgment of Hirst J in \textit{Kleinwort Benson at first instance}\footnote{[1988] 1 WLR 349.} and Staughton J in \textit{Chemco Leasing SpA v Rediffusion Ltd},\footnote{(19 July 1985, unreported, QBD) (hereinafter referred to as \textit{Chemco Leasing}).} Rogers CJ held that these decisions “reflect the bias of experienced commercial judges to pay higher regard to the fact that the comfort letters in issue before them came into existence as part and parcel of a commercial banking transaction and that the promises were an important feature of the letters.”\footnote{Banque Brussels (1989) 21 NSWLR 502 at 523.} As such, his Honour was highly critical of the “moral” versus “legal” approach adopted by the English Court of Appeal in \textit{Kleinwort Benson}\footnote{[1989] 1 WLR 379.} towards commercial transactions finalised after extensive negotiations between both parties.\footnote{See also J Shirbin, “Securities –Comfort Letters – Whether Binding” (1990) 5 \textit{Journal of International Banking Law} N62.} In other words, commercial courts were sceptical of the legitimacy and place of moral obligations in commercial relations, and in Australian there was a trend in the courts to bring commercial morality into alignment with the law.\footnote{J Kelly, \textit{Comfort Letters in Australian Banking Practice – A Moral Obligation or Contract?} (unpublished thesis, Macquarie University, Sydney, 1990) 26 and 32.} Rogers CJ clearly favoured a more commercial approach and expressed himself forcefully about the appropriateness of relying on a letter of comfort:

“There should be no room in the proper flow of commerce for some purgatory where statements made by businessmen, after hard bargaining and made to induce another business person to enter into a business transaction would, without any express statement to that effect, reside in the twilight zone of merely honourable engagement. The whole thrust of the law today is to attempt to give proper effect to commercial transactions. It is for this reason that uncertainty, a concept so much loved by lawyers, has fallen into disfavour as a tool for striking down commercial bargains. If the
statements are appropriately promissory in character, courts should enforce them when they are uttered in the course of the business and there is no clear indication that they are not intended to be legally enforceable.48

To his Honour, the area of letters of comfort was clearly not an Alsatia49 where the law did not run.50

Turning to the question of the promissory nature of the statements in the letter of comfort, Rogers CJ considered JJ Savage & Sons v Blakney51 and Ross v Allis Chalmers Australia Pty Ltd,52 and consistent with McPherson J’s dicta in Nemeth v Bayswater Road Pty Ltd53 concluded that the test in Australian law to determine whether a statement was promissory or only representational was different from the test applied in England. The test in Australia was stricter, because it was insufficient for Banque Brussels to prove it would not have entered into the contract with SS without the inducement of the letter of comfort. Reliance was not enough – some additional evidence of the surrounding circumstances and the statement’s nature had to be adduced to enable an objective conclusion to be drawn that it was promissory.54 Rogers CJ therefore took a broader approach in finding that statements were

48 Banque Brussels (1989) 21 NSWLR 502 at 523. This proposition was adopted in Gate Gourmet Australia Pty Ltd (in liquidation) v Gate Gourmet Holding AG [2004] NSWSC 149 [hereinafter also referred to as Gate Gourmet.
49 Alsatia was the name given to an area lying north of the River Thames covered by the Whitefriars monastery, to the south of the west end of Fleet Street and adjacent to the Temple. Between the 15th and 17th centuries, it was a place where thieves, debtors and perpetrators of every grade of crime and debauchery were able to have sanctuary from the law. In other words, an area where the normal processes of law did not apply. In the present context, the reference is pertinent to the enquiry whether there are legal consequences flowing from the letter of comfort.
53 [1988] 2 Qd R 406 at 416. In this case, it was held that the fact that a statement was made for the purpose of inducing one party to act upon it, and that the statement actually did induce him to act upon it by entering into the contract, is insufficient to make the statement promissory. Other matters, including the surrounding circumstances, must be taken into account.
promissory in character.\textsuperscript{55} There were also no specific factors that had to be taken into account, but it appeared that a factor which weighed strongly in favour of Banque Brussels was its refusal to accept a draft letter of comfort which read: “We [ANI] have given this letter of awareness on the understanding ... that it does not constitute a guarantee.” Banque Brussels rejected this draft contending that it regarded the letter of comfort as a binding obligation.\textsuperscript{56} Moreover, his Honour also paid particular attention to an oral statement made by a director of ANI that “it is our corporate policy to support our subsidiaries”.\textsuperscript{57}

Rogers CJ recognised that the “actual words used are a very important indactor” of the promissory nature of a statement,\textsuperscript{58} but was unimpressed by the English Court of Appeal’s decision in \textit{Kleinwort Benson},\textsuperscript{59} because in his Honour’s view, the approach adopted by Ralph Gibson LJ in \textit{Kleinwort Benson on appeal} which subjected the letter of comfort to “minute textual analysis”\textsuperscript{60} carried with it the danger that “courts will become irrelevant in their resolution of commercial disputes if they allow this approach to dominate their consideration of commercial documents.”\textsuperscript{61} It would be “inimical to the effective administration of justice in commercial disputes that a court should use a finely tuned linguistic fork.”\textsuperscript{62} Guided by his abhorrence of a nebulous penumbra of moral obligation in commercial transactions, his Honour invoked the business circumstances of the transaction as a virtual presumption that the letter of comfort would have a promissory effect.\textsuperscript{63} Central to Rogers’ CJ’s decision was a fear that a narrow reading of express wording of the letter of comfort, similar to that of the English Court of Appeal in \textit{Kleinwort Benson on appeal},\textsuperscript{64} would render it a “scrap of

\textsuperscript{56} Banque Brussels (1989) 21 NSWLR 502 at 522.
\textsuperscript{57} Banque Brussels (1989) 21 NSWLR 502 at 508.
\textsuperscript{58} Banque Brussels (1989) 21 NSWLR 502 at 524.
\textsuperscript{59} [1989] 1 WLR 379.
\textsuperscript{60} Banque Brussels (1989) 21 NSWLR 502 at 523.
\textsuperscript{61} Banque Brussels (1989) 21 NSWLR 502 at 523.
\textsuperscript{64} [1989] 1 WLR 379.
paper”65 – a conclusion not readily reconcilable with the complex and time-consuming process of negotiation which produced the comfort letter.66

Rogers CJ had regard to the legal developments a propos of comfort letters in England, Germany and France,67 and in view of his Honour’s apparent opinion on the place of moral obligations in the commercial world, it was not surprising that he concluded that the letter of comfort before him was indeed couched in sufficiently promissory language and enforceable.68 His Honour noted that paragraph [1] of the letter of comfort before him approximated the second paragraph of the letter in Kleinwort Benson,69 which was contractual in nature.70 Paragraph [2] of the comfort letter in Banque Brussels was similarly contractual because it “intended to confer a clear benefit”71 on Banque Brussels. The clear aim of the second paragraph was to devise “a carefully crafted trigger to allow for recovery”.72 More contentious or difficult was paragraph [3] of the letter of comfort which, like the third paragraph of the Kleinwort Benson comfort letter, was within the intermediary range of support usually found in medium strength letters of comfort.73 Rogers CJ dealt with the problem of interpreting the paragraph as a promissory statement by just rewording it – ANI’s commitment that “it is our practice to ensure … Spedley … will at all times be in a position to meet its financial obligations” was read as “it is our practice to [or we promise to] ensure that Spedley is at all times in a position to repay all loans made to it by your bank”.74 This

66 J Kelly, Comfort Letters in Australian Banking Practice – A Moral Obligation or Contract? (unpublished thesis, Macquarie University, Sydney, 1990) 33 has remarked that “in this respect he, for all practical purposes, has taken the path the Court of Appeal had said was not open to Hirst J. That is, the presumption which is strictly only relevant to the intention issue is applied in deciding a letter’s promissory effect.” See also M Howard, “Interpreting Comfort Letters and Construing Statements” (1990) 18 Australian Business Law Review 188 at 192.
73 See paragraph 2.5.
approach was significantly different from the English Court of Appeal’s punctilious formalistic examination of the wording of the letter of comfort in *Kleinwort Benson*.75

7.3.4. Some comments

Some academic commentators76 have welcomed the departure from the English treatment of letters of comfort as set out in *Kleinwort Benson on appeal*,77 even though the extent of the difference in the treatment of letters of comfort in Australia and England has been questioned by Giles J in *Esanda Finance Corp Ltd v Wordplex Information Systems*.78

Rogers CJ was clearly correct in concluding that the author of the letter did not expressly assume a secondary liability for the debts of the principal. However, as O’Donovan and Phillips remarked,

“it is at least arguable that the second sentence of the relevant part of the letter, which makes specific reference to the fact that ‘[t]hese financial obligations include the repayment of all loans’, is an implied promise to pay the loans if the subsidiary does not and thus falls within the definition of a guarantee. Certainly somewhat different wording with, for example, some reference to default by the borrower might well result in a letter of comfort being held to be a guarantee. Even on the analysis of Rogers CJ it is also arguable that a letter of comfort imposes a liability which is at least somewhat analogous to that imposed on a guarantor. One consequence is that the beneficiary of the letter should be under similar obligations to those imposed upon a creditor who has the benefit of a contract of guarantee, for example, in respect of the duty of the creditor to preserve securities for the

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78 (1990) 19 NSWLR 146 at 157 (hereinafter referred to as *Esanda Finance*).
enforcement of the principal contract. But there is no indication in the cases that the courts view letters of comfort in this light.”79

The Banque Brussels decision affirms the view held by other courts that no particular legal meaning can be attached to the nomenclature of “letter of comfort.”80 A court will have to construe the letter of comfort in issue. The approach adopted by a court in construing the letter of comfort is therefore of critical importance. Rogers CJ’s criticism of the English Court of Appeal’s approach to the interpretation of comfort letters in Kleinwort Benson81 where the letter was subjected to what his honour called a “minute textual analysis”82 is somewhat inconsistent with his own detailed analysis of the text of the letter of comfort before him in order to refute the arguments put forward by the defendants.83 Even if a “minute” textual analysis is undesirable, a fairly close analysis continues to be unavoidable. The difference in approach by Ralph Gibson LJ in Kleinwort Benson on appeal and Rogers CJ in Banque Brussels towards the contractual effect of letters of comfort is, however, more fundamental. On the one hand, Ralph Gibson LJ looked first to the exact words used to determine if they were promissory in nature or merely a statement of policy. Only if they were promissory would the question of intention to create legal relations become relevant.84 On the other hand, Rogers CJ felt that such an approach would render courts irrelevant in the solution of commercial disputes. If, on a review of the circumstances of each matter, the statement made was of a commercial nature and promissory in character and was relied upon as such to induce the deal, the court would, notwithstanding any uncertainty in the actual words used, give effect to the true intention of the parties as

83 S Deane, “Letters of Comfort” (1997) 1 Asia Pacific Law Review 88 at 92 suggests, however, that what really underlies Rogers CJ’s reason was his remark that “it is the remedies which the law in Australia permits when confronted with this type of conduct that represent the advance of law which this country has achieved over concepts that inform the decision of the English Court of Appeal in Kleinwort Benson.”
revealed by these circumstances. Thus, in construing the letter of comfort, the stated emphasis in Banque Brussels was upon giving “proper effect to commercial transactions” rather than the form of the statements in the letter of comfort. This approach is commendable, because as Simpson observed, “difficulties in interpretation ... seem to be difficulties about words [but] are really difficulties about the applicability of rules to facts” and corresponds with the Australian High Court’s subsequent statement in Royal Botanic Gardens and Domain Trust v South Sydney City Council that “it is appropriate to have regard to more than internal linguistic considerations and to consider the circumstances with reference to which the words in question were used and, from those circumstances, to discern the objective which the parties had in view. In particular, an appreciation of the commercial purpose of a contract: ... presupposes knowledge of the genesis of the transaction, the background, the context, the market in which the parties are operating.”

Rogers CJ’s analysis of the contractual question clearly showed a preference for the approach of Hirst J in Kleinwort Benson at first instance. However, unlike Hirst J, his Honour did not rely primarily on the Edwards v Skyways presumption to find that the letter of comfort in issue had contractual effect. The approach adopted was rather the following: If a letter of comfort contained a statement that would in the whole context be reasonably understood as promissory, the courts would not infer that the issuer of the comfort letter (a parent company) intended a commitment which was binding in honour only. Instead, the obvious commercial setting and the subject matter of a letter of comfort would generate the Edwards v Skyways presumption, not lightly displaced, that any genuine promise in the letter envisaged a legal obligation to a recipient (bank)

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89 (2002) 186 ALR 289 at [10].
91 [1964] 1 WLR 349.
supplying consideration. The presumption was not rebutted by the fact that the instrument was described as a “letter of comfort” or by the fact that letters of this sort were often deliberately used with the intention of avoiding the legal liability of a guarantor. A clear statement of intent to exclude legal relations was needed to displace the presumption.

While accepting the need to construe the terms of the letter of comfort as promissory, in effect Rogers CJ applied the Edwards v Skyways presumption.\(^\text{92}\) Rogers CJ’s unwillingness to allow commercial instruments or statements to assume the status of “honourable purgatory” that is, neither binding nor not entirely non binding, has clearly been influenced by this presumption that everything said by one businessperson to another must have been seriously intended to be promissory.\(^\text{93}\) However, by reasoning that parties entering into an agreement within a commercial context intend to form contractual relations, his Honour arguably assumed that moral obligations were without value in commercial relations. As discussed in paragraph 3.3, such assumption was not necessarily consistent with banks’ expectations about letters of comfort and their role. Moreover, as mentioned in paragraph 3.2, analysis of comfort letter transactions disclosed cogent commercial motives for its use by the parties as a non-enforceable commitment. The criticism was therefore that “contractual enforceability of comfort letters is being legitimated via a fiction that the parties intend to be bound. In reality the commercial players can, and frequently do, resort to comfort letters on sound commercial grounds without evincing any such intention.”\(^\text{94}\) Thus, by adopting an interventionist role and a pragmatic approach, the

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\(^{94}\) J Kelly, Comfort Letters in Australian Banking Practice – A Moral Obligation or Contract? (unpublished thesis, Macquarie University, Sydney, 1990). S Deane, “Letters of Comfort” (1997) 1 Asia Pacific Law Review 88 at 92 emphasises that the purpose of the courts in contractual disputes is to give effect to the parties’ intentions, and in doing so, courts have to analyse the wording in documents to find out what 301
court determined that a contract existed based on what the judge thought was reasonable rather than on the actual intention of the parties or commercial practice.\textsuperscript{95} This criticism did not, however, mean that legal enforceability of letters of comfort was undesirable. Rather, instead of trying to justify the enforceability of a letter of comfort by grappling with the parties’ supposed intention and try to clothe the decision as giving effect to a commercial transaction, there ought to be an explicit recognition of a powerful policy argument, namely the desire for certainty in a unique banking transaction.\textsuperscript{96} Moreover, commercial people should be warned that this might be the sign of a growing trend by courts to interpret what business norms should be rather than taking into account usual market practice.\textsuperscript{97} Accordingly, in comfort letter litigation parties would forensically be well-advised to lead evidence of business norms and usual market practice to minimise the risk of policy decisions being made which are divorced from commercial practice.

The main issue left unresolved by the decision in \textit{Banque Brussels} was what precisely constituted an “appropriately promissory” statement.\textsuperscript{98} Three observations would


\textsuperscript{97} E Simes, “Recent Cases: Their practical Significance – Kleinwort Benson Limited v Malaysia Mining Corp Berhad” [1988] AMPLA Yearbook 207 at 215.

suffice. First, one should ask oneself what was it to make a promise? Stoljar provided some pointers: “To promise is for a person to announce certain acts he will do for another. Promises thus begin with a statement of intention, yet a statement concomitantly designed to arouse and key into another’s expectations – to open the eyes of expectations, as a Shakespeare play [Timon of Athens, V, 1, 25-26] puts it.” Roughly three requirements have to be satisfied –

(a) the promise should only concern personal acts, namely, acts to be done by the promisor, acts broadly within his capacity, not acts beyond his means;\(^{100}\)

(b) the promise should have to do with future acts.\(^{101}\) In other words, one cannot promise what one is already doing, or what one has already done. Present or past acts cannot form the basis of the promise. A promise may appear to state present facts, but is still future, because the promissory future need not be distant; it only needs to come after the announcement of what is intended to be done.\(^{102}\) A promise states intentions for the future, the fulfilment of which is up to the promisor.\(^{103}\)

(c) the promised act should be wanted by the promisee.\(^{104}\) A promise is not merely a communication of an intended act, because only if the act is wanted, can it give rise to the kind of expectations a promissory intention is meant to create.\(^{105}\) To say that a promisee wants a promise, or its performance, means that he presumes, or can presume, that that promise is sincere.\(^{106}\)

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Thus, a promise is a verbal performativa, in the context or circumstances in which the statement has been made, aimed at causing a particular response or expectation on the part of the promisee.\textsuperscript{107} This expectation of the promisee (or his passive reliance), the “expectations of honest men” in the context of the commercial or common sense interpretation approach,\textsuperscript{108} becomes his reliance when he acts in response to the statement of the promisor (that is, he acts in reliance on the promise), usually to his detriment.\textsuperscript{109} Stoljar’s pointers not only clarify what constitutes an appropriately or sufficiently promissory statement, but support Rogers CJ’s finding that the letter of comfort before him was couched in promissory language, and put the role which reliance played in perspective.

The second observation is that this inevitably leads one back to what Roger CJ said should be avoided, namely that uncertainty should not be used as a way to strike down commercial bargains.\textsuperscript{110} It is clear that neither the words used in the comfort letter in issue nor reliance alone would be decisive in determining whether or not a statement was promissory. The court would look at other factors or circumstances to assist it in determining the promissory nature of a statement, and those factors or circumstances would depend on the court’s view of the strength of the evidence in each particular case.\textsuperscript{111} Like the literal construction and lack of certainty approaches, the context and circumstances in which the letter of comfort was provided would be relevant as would be the phraseology used in the comfort letter in applying the liberal construction approach used in \textit{Banque Brussels}.
\textsuperscript{112} The main differences between the \textit{Banque Brussels} approach to the construction of letters of comfort and the other

\begin{thebibliography}{99}
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\item \textsuperscript{107} S Stoljar, “Promise, Expectation and Agreement” (1988) 47 \textit{Cambridge Law Journal} 193 at 207.
\item \textsuperscript{108} See paragraph 4.6.
\item \textsuperscript{109} S Stoljar, “Promise, Expectation and Agreement” (1988) 47 \textit{Cambridge Law Journal} 193 at 207.
\item \textsuperscript{110} As D White, “Letters of Comfort” in J Prebble (ed), \textit{Dimensions in Banking and Foreign Exchange Law} (Butterworths, Wellington, 1992) 3 at 19 remarks: “But if the evidence establishes that the lending bank and the parent company have agreed that the parent company need not provide a guarantee, is not the possible imposition of liability on the parent company, through the provision of a letter of comfort, going to create uncertainty?”
\item \textsuperscript{112} \textit{Banque Brussels} (1989) 21 NSWLR 502.
\end{thebibliography}
approaches are the relative importance attached to these two factors, and the fact that the words used in the comfort letter should be construed liberally in light of the commercial use of such letters. It appears that Australian courts will be inclined to treat a statement of intent or commitment made as an integral part of a commercial bargain as indicating an intention to enter legal relations unless that intention is expressly negated. Moreover, where a statement has promissory effect it will not easily be found to be void for uncertainty.

The third observation is that the characterisation of a statement as promissory is not merely a linguistic determination, and the form in which the statement is expressed does not alone determine its legal effect. The promissory dimension of a statement can be inferred from the parties' conduct and the context in which the statement was made, as well as the linguistic manner in which it was expressed - if the proper inference is that the statement was intended and accepted as a promise, it does not matter that the language used to express it was not promissory. However, the linguistic form of the statement does have a bearing on whether it should be regarded as promissory, because the less precise the statement, the less likely it is to be regarded as promissory.

*Banque Brussels* is a significant decision. It effectively formulated the approach which Australian courts have followed since. The decision is indicative of the fact that Australian courts may more readily give contractual effect to a letter of comfort than appears to be the case in England after *Kleinwort Benson on appeal*, despite any lack

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118 See Gates v City Mutual Life Assurance Society Ltd (1986) 160 CLR 1 at 63; Rawson v Hobbs (1961) CLR 466 at 490.
120 [1989] 1 WLR 379.
of certainty or imprecision in the terms of the letter. It appears that in light of Banque Brussels,\textsuperscript{121} and the cases following it, Australian courts have difficulty, in the absence of clear language stating an intention to be non-binding, in accepting that a non-binding letter would be either sent or accepted as part of a commercial relationship.\textsuperscript{122} Banque Brussels\textsuperscript{123} also illustrates a growing willingness of Australian courts to adopt and expand equitable principles of unconscionability and estoppel as alternative bases for regulating corporate behaviour.\textsuperscript{124} Indeed, the Banque Brussels approach to comfort letters is an example that commercial transactions have not been immune to the wave of morality passing through the law.\textsuperscript{125}

The main criticism against the liberal construction approach followed in Banque Brussels,\textsuperscript{126} given the emphasis on commercial intent, is really a concern that the continued usefulness of letters of comfort from a borrower’s point of view has been compromised, especially since an express disclaimer of contractual intent is unlikely to be acceptable to a lender.\textsuperscript{127} Alam bin SM Hussain has remarked that:

“This leads to the disturbing fact that commercial players will be less willing to risk the uncertainty that attends to comfort letters. One party may strongly insist on a guarantee and will not settle for a comfort letter in lieu thereof while the other party will be most reluctant to give a comfort letter which it intends to be in lieu of a guarantee only to find out later that it is as good as a guarantee. Faced with this predicament commercial dealings involving comfort letters may tend to be less popular thus inhibiting the growth of

\textsuperscript{121} Banque Brussels (1989) 21 NSWLR 502.
\textsuperscript{123} Banque Brussels (1989) 21 NSWLR 502.
\textsuperscript{126} Banque Brussels (1989) 21 NSWLR 502.
autochthonous instruments which help to facilitate commercial interactions.”

The continued frequent use of letters of comfort in Australia since the *Banque Brussels* decision suggests, however, that the criticism or concern is unfounded. Moreover, a proper classification of letters of comfort, and the application of the familiar rules of contract in the construction of letters of comfort clearly show that there is a role for letters of comfort properly so called, as well as binding comfort letters, in the commercial world.

The decision in *Banque Brussels* does not lay down a general principle that letters of comfort will necessarily create legal obligations. Indeed, it would be commercially unrealistic, as well as contrary to principle, to adopt any rule which assumed that letters of comfort were generally effective in creating a liability on their issuer. Nevertheless, it does point to an inclination on the part of the Australian courts at least that they are more likely than not to find an enforceable obligation in instruments provided in a commercial context. It appears that Australian courts are far more concerned with standards of conduct than with the application of fixed rules. This inclination is not only evident in an earlier Australian decision, but also in a number

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129 See paragraph 2.5.
132 J Burrows, J Finn and S Todd, *Law of Contract in New Zealand* (LexisNexis, Wellington, 2002) 160 is of the view that: “In most cases, the choice between a letter of comfort and a contract of guarantee is matter of negotiation and election between the parties. To assume that the issue of a letter of comfort creates a binding obligation to recompense a financier for any losses incurred in the transaction is to create a contract of guarantee which the parties have refused to make for themselves.”
134 See *Capita Financial Group Ltd v Rothwells Ltd* (CommD, NSWSC, 13 October 1989) where Giles J concluded that the letters of comfort in that case were intended to create legal relations, and referred to *York Air Conditioning and Refrigeration (A/sia) Pty Ltd v The Commonwealth* [1949] 80 CLR 11 at 26 where it was stated that if the court “comes to the conclusion that the parties intended to make a contract, it will, if possible, give effect to their intention no matter what difficulties of construction
of subsequent Australian decisions.\textsuperscript{135} There is, however, a risk involved, because as Seddon has pointed out, "in developing the law to reflect these standards of conduct, the courts may sometimes overreach themselves."\textsuperscript{136} But then, there is always a risk in a “Denningesque” approach to providing effective solutions for commercial people.

The decision and the approach in \textit{Banque Brussels}\textsuperscript{137} are to be contrasted with the earlier Supreme Court of Victoria decision in \textit{TLI Management},\textsuperscript{138} and were criticised in \textit{Australian European Finance Corporation Limited v Sheahan} where Matheson J remarked that "Rogers CJ after criticising the Court of Appeal [in \textit{Kleinwort Benson}] for subjecting the letters ‘to minute textual analysis’, seems ... to have undertaken just that".\textsuperscript{139} No doubt, the question of whether a statement in a letter of comfort is promissory, continues to depend upon an examination of the words used in the particular document in the light of the whole context in which they were used. Although a “minute” textual analysis is undesirable, a fairly close analysis continues to be unavoidable when considering the contractual effect of a letter of comfort. Despite the criticism levelled at Rogers CJ’s decision, it seems that, on balance, the approach reflected in \textit{Banque Brussels}\textsuperscript{140} is still the one preferred by the Australian courts.

\footnotesize

\begin{itemize}
\item \textsuperscript{135} See also J Horn, \textit{Patronatserklärungen im common law und im deutschen Recht} (Peter Lang, Frankfurt am Main, 1999) 82 to 87 for a German lawyer’s comments on the decision.
\item \textsuperscript{136} N Seddon, “Australian Contract Law: Maelstrom or Measured Mutation?” (1994) 7 \textit{Journal of Contract Law} 93 at 100.
\item \textsuperscript{137} \textit{Banque Brussels} (1989) 21 NSWLR 502.
\item \textsuperscript{138} [1990] VR 510. See paragraph 6.9.
\item \textsuperscript{139} (1993) 60 SASR 187 at 204 (hereinafter referred to as \textit{Australian European Finance}). See also R Clark, \textit{Contract Law in Ireland} (Thomson Round Hall, Dublin, 2004) 94 and paragraph 6.10.
\item \textsuperscript{140} \textit{Banque Brussels} (1989) 21 NSWLR 502.
\end{itemize}
7.4 *Hong Kong and Shanghai Banking Corporation Ltd v Jurong Engineering Ltd*¹⁴¹ - letters of comfort in Singapore

7.4.1. The facts

The first defendant, Jurong Engineering Limited (“Jurong”), was a blue-chip government linked public company incorporated in Singapore and engaged in the business of mixed construction activities. Huge Corporation Pte Ltd (“Huge”) was a related company of Jurong. In June 1992, the Hong Kong and Shanghai Banking Corporation (“HSBC”) offered credit facilities to Jurong. At the time, however, Jurong had ample funds and it was agreed that HKSBC would provide credit facilities to Huge instead. Jurong refused to grant a corporate guarantee to secure Huge’s credit facilities with HSBC, but issued a letter of awareness or comfort letter to HSBC as part of the facility agreement.¹⁴²

Over the following years, HSBC renewed and increased Huge’s credit facilities, and Jurong granted fresh letters of comfort in support of these facilities. The last such letter of comfort was dated 19 September 1994. This letter of comfort contained, amongst other things, the following clauses:¹⁴³

(a) First, Jurong would continue to maintain its 51% ownership of Huge and it undertook to advise HSBC forthwith of any decision to dispose of any part of its shareholding in Huge;

(b) Secondly, Jurong would cause Huge to be operated and maintained in such a way as to be in a financial position to meet all its obligations to

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¹⁴² In the judgment, no distinction is drawn between the terms “letters of awareness” and “letters of comfort”, both of which are used interchangeably in reference to a generic group of instruments the effect of which generally falls short of guarantees – see *Jurong Engineering* [2000] 2 SLR 54 at 70. See, however, paragraph 2.5 for a discussion of the difference between the terms.

¹⁴³ See *Jurong Engineering* [2000] 2 SLR 54 at 60 to 61. The full text of the letter is set out in Annexure 1.
HSBC, and furthermore that Jurong would endeavour to make funds available to Huge, sufficient to meet its obligations;

(c) Thirdly, Jurong would not take any action which would result in Huge being unable to carry out its business or otherwise being unable to meet all its obligations to HKSBC, and also that Jurong undertook to advise HSBC forthwith of any circumstances which might affect the continuing operation of Huge.

Huge began to experience serious financial difficulties in 1995. HSBC discovered this in about August 1996 from newspaper reports, and it reduced the credit facilities from S$16 million to S$11 million. In November 1996, Jurong disposed of 15% of its shareholding in Huge, thereby going against the ownership covenant in the letter of comfort. When HSBC learned of the disposal in December 1996 from newspaper reports, it further reduced Huge’s credit facilities to S$8.25 million. The reduced credit facilities continued to be supported by the letter of comfort dated 19 September 1994.

In 1997, a meeting was held between HSBC and Jurong in an effort to reach an agreement as to how Huge’s debt to HSBC would be repaid. Despite the meeting, no solution was found. HSBC served a notice of demand on Huge asking for full repayment of all the outstanding sums due under the credit facilities. The legal officer of Jurong put to HSBC’s representatives a proposal for repayment of the sums owed by Huge to HSBC. The letter which contained the repayment proposal stated that the proposal was being made “as a gesture of goodwill and for continued business relations”.144 It was on Jurong’s letterhead and duly signed. HSBC replied by stating that it awaited repayment of Huge’s debts in accordance with the repayment schedule. However, no payments were made under the repayment schedule.

As the debts owed by Huge to HSBC remained outstanding, the latter sent a second letter of demand to Huge for repayment of the sum of S$8,207,809.57. Huge was

144 Jurong Engineering [2000] 2 SLR 54 at 61.
subsequently liquidated. HSBC then sought payment of the amount owing from Jurong.

7.4.2. The issue

The main issue for determination by the court was whether the final letter of comfort dated 19 September 1994 created legally and enforceable obligations between HSBC and Jurong.

7.4.3. The decision

Tay Yong Kwang JC dismissed HSBC’s claim, holding that the letters were not intended to be legally enforceable – not least because there were virtually no negotiations with respect to the wording as well as the content of the letters.\textsuperscript{145} The learned judge reiterated the presumption annunciated in Edwards v Skyways Limited.\textsuperscript{146} However, his Honour pointed out that, like the Court of Appeal in Kleinwort Benson,\textsuperscript{147} the operation of the presumption (that having been created in a commercial setting the letter would generally be intended to create binding obligations) did not detract the court from its fundamental task, which was to ascertain what common intention should be ascribed to the parties from the specific text of the letter of comfort and the surrounding circumstances.\textsuperscript{148}

His Honour found that the circumstances surrounding and leading up to the issuing of the letter of comfort showed clearly that HSBC and Jurong had understood that the letter would only create moral obligations. It was HSBC who first approached Jurong, eager to establish business relations. Jurong had ample funds and was in a very strong bargaining position. Jurong made it very clear from the outset that it would not grant

\textsuperscript{145} The Court distinguished Banque Brussels (1989) 21 NSWLR 502 on the basis that, unlike that case, there was no heavy negotiation of the letter of comfort between HSBC and Jurong. See also A Phang, Cheshire and Fifoot and Furmston’s Law of Contract – Second Singapore and Malaysian Edition (Butterworths Asia, Singapore, 1998) 230 and 231.

\textsuperscript{146} [1964] 1 WLR 349.

\textsuperscript{147} [1989] 1 WLR 379.

\textsuperscript{148} Jurong Engineering [2000] 2 SLR 54 at 71.
any corporate guarantee to secure Huge’s credit facilities, and HSBC was told to assess for itself the risk of extending banking facilities to Huge on either a “clean basis” or on the basis of a comfort letter. The fact that there were virtually no negotiations as to the wording and content of the letters of comfort also indicated that these letters were not intended to be legally binding.

Moreover, HSBC was responsible for the drafting of the letters of comfort. It could easily have included an express term stating that the letters of comfort were to have binding legal effect, but failed to do so. This, combined with Jurong’s stated refusal to issue a corporate guarantee, resulted in sufficient ambiguity to apply the contra proferentem rule of interpretation against HSBC; that is, if HSBC required a legal promise from Jurong’s, it should have drafted the letter of comfort in such terms. In construing the text of the letter of comfort the court did not need to examine every single word or term, but instead looked at its general tone. Tay Yong Kwang JC emphasised, in the words of Straughton J in Chemco Leasing, that the letter of comfort of 19 September 1994 was drafted “in language of deliberate equivocation, in keeping with a ‘gentlemen’s agreement’ where the issuer conforms that he will abide by his moral obligations.” His honour was not convinced that experienced and prudent bankers “would or should rely wholeheartedly on such a document as security.”

The first and third clauses of the letter of comfort merely contained vague moral undertakings. The first clause did not prohibit Jurong from disposing of its shareholding in Huge. This clause only provided that Jurong had to maintain its 51%

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149 This is reminiscent of the approach of the Court of Appeal in Kleinwort Benson [1989] 1 WLR 379 where the Malaysia Mining also refused to prove a guarantee, and it was held to be indicative of the lack of legal enforceability of the letter of comfort.
151 Jurong Engineering [2000] 2 SLR 54 at 73.
152 (19 July 1985, unreported, QBD).
153 Jurong Engineering [2000] 2 SLR 54 at 76.
154 Jurong Engineering [2000] 2 SLR 54 at 76.
155 Jurong Engineering [2000] 2 SLR 54 at 76.
shareholding in Huge and to advise HSBC of its decision to sell its shareholding, not necessarily prior to its disposal of the shares. This clause was different from the shareholding maintenance statement in the letter of comfort in Banque Brussel,\(^{156}\) where the obligation was to give prior notification of the shareholding disposal. Moreover, Jurong only sold 1\% of its shares in Huge, not its shareholding. The third clause was also held to be a vague undertaking by Jurong that it would not take any action resulting in Huge’s inability to meet its obligations to HSBC. The court held that this did not, however, mean that Jurong itself had to be legally obliged to promptly inform HSBC of every commercial decision regarding Huge which it might be considering in the privacy of its boardroom.\(^{157}\)

Although the second clause of the letter of comfort was somewhat more specific than the other two clauses, it was qualified by the words, “will endeavour”, which were indicative of the fact that Jurong would only try to carry out what was stated in that clause; that is, Jurong would try to ensure that Huge was in a position to meet its obligations. In view of the general tenor of the comfort letter and in light of the surrounding circumstances, it was held that the second clause of the letter of comfort was no more than an acknowledgment by Jurong of its moral obligation to do its best to support its subsidiary, Huge, if the latter ran into financial trouble.\(^{158}\)

### 7.4.4. Some comments\(^{159}\)

Some commentators have expressed the view that *Jurong Engineering*\(^ {160}\) seems very questionable in light of its facts.\(^ {161}\) However, the case confirms that letters of comfort have not yet acquired a precise meaning in law describing the liability to be assumed

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\(^{157}\) *Jurong Engineering* [2000] 2 SLR 54 at 76.

\(^{158}\) *Jurong Engineering* [2000] 2 SLR 54 at 76 and 77.


\(^{160}\) [2000] 2 SLR 54.

by the issuer. Indeed, as Phang\textsuperscript{162} points out, this case illustrates “what must surely be standard procedure in situations of this nature: a meticulous examination of the specific text of the Letter(s) concerned as well as the surrounding circumstances in order to ascertain the true intention of the parties (see at 71); indeed, the learned judicial commissioner opined thus (ibid): ‘Since the effect to be attributed to each Letter of Awareness is essentially a matter of construction, each case turns on its own facts. Past cases concerning Letters of Awareness are not precedents in the strict sense of the word and only provide useful guidelines for the court.’”

The reasoning and the result in \textit{Jurong Engineering} reiterate the vital role played by the concept of contractual intent in the protection of parties’ expectations and has provided an opportunity to consider how such intent is to be ascertained.\textsuperscript{163} In applying the presumption in \textit{Edwards v Skyways}\textsuperscript{164} notwithstanding the finding that the terms of the letter of comfort were not “in the form of an express contractual promise”,\textsuperscript{165} Tay Yong Kwang JC has departed from Ralph Gibson LJ’s approach in \textit{Kleinwort Benson} on appeal.\textsuperscript{166} As Lee\textsuperscript{167} points out, however, the learned judge has not referred to \textit{Kleinwort Benson} on appeal in his judgment and it is therefore possible that he may not have considered the distinction drawn by Ralph Gibson LJ as regards the applicability of the \textit{Edwards v Skyways} presumption. But the effect of the judgment in \textit{Jurong Engineering} is nonetheless that the presumption applies to place a burden on the defendant to rebut the presumption of contractual intent and that it is the totality of the evidence before the court which must be considered in determining whether the burden has been discharged.\textsuperscript{168} The language used by the parties is only one of the factors, albeit an important one, indicating the parties’ intention.

\textsuperscript{164} [1964] 1 WLR 349.
\textsuperscript{165} \textit{Jurong Engineering} [2000] 2 SLR 54 at 74.
\textsuperscript{166} [1989] 1 WLR 379.
7.5 Gate Gourmet Australia Pty Ltd (in liquidation) v Gate Gourmet Holding AG - applying the common sense approach without relying on the presumption to create legal relations

7.5.1. The facts

Gate Gourmet Australia Pty Ltd (in liquidation) (GGA) was part of the Gate Gourmet Group (Group), the world’s second largest catering company in 1999. At all material times, GGA, the Australian trading company of the Group, was a wholly-owned subsidiary of a non-trading Australian holding company, Gate Gourmet (Holdings) Pty Ltd (GGH), which was, in turn, a wholly-owned subsidiary of Gate Gourmet Holding AG (GGAG), the holding company of the Group and itself part of the Swiss Air Group. There were other companies in the Group, but they are not relevant for this discussion.

GGA was not only undercapitalized, but the sole basis upon which it was permitted to operate was wholly dependent upon borrowings organized within the Group on the strength of the balance sheet of its Swiss parent company (GGAG), including external borrowings, always underpinned by arrangements made higher up in the Group. In late 1999, GGA won the tender to acquire the catering arm of Ansett Airlines, which included a contract to supply in-flight catering services to Ansett for a period of eight years. The terms of the contract with Ansett made it very difficult for GGA to operate profitably, at least in the first few years. In light of the late commencement of GGA’s operations it had been in operation for only a few weeks, there was no requirement for it to lodge financial statements for the year ended 31 December 1999. During the

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571 Following its incorporation, GGA was not capitalised by any injection of equity or subscription of shares, the amount of the share subscription being purely nominal – see Gate Gourmet [2004] NSWSC 149 at [4].
preparation of GGA’s financial statement for the following year, however, its auditors indicated that they required a letter of comfort be provided to the Group in Australia by GGAG confirming ongoing financial support in order to sign off on the accounts. A letter of this type had already been provided by GGAG the previous year to various other subsidiaries within the Group and it was proposed that the same text be used once more.

GGA’s borrowings were supported by two comfort letters. The second comfort letter formed the basis of the proceedings.172 The second comfort letter was addressed to GGH, provided by GGAG, and read as follows:

“[1] This is to confirm that the parent entity, Gate Gourmet Holding AG, will provide the financial support that may be necessary to enable Gate Gourmet Holdings Pty Limited and its controlled entities to meet its financial commitments as and when they fall due. [2] This Letter of Support will not be withdrawn before Gate Gourmet Holdings Pty Limited and its controlled entities have sufficient means to meet their obligations without the support of the parent entity.”173

GGA, incorporated to acquire the Ansett catering contract, provided catering services to Ansett, and when the latter’s pending demise became apparent, and under pressure from Westpac which had granted a major banking facility, GGA sought confirmation from GGAG that the comfort letters would be honoured. GGAG failed to provide the confirmation, and GGA (and the other Australian Group companies) went into liquidation on the day after Ansett had gone into liquidation. In light of the second

172 The first comfort letter was similar to the second comfort letter, except that (1) it was addressed “To whom it may concern”, (2) it was provided by Gate Gourmet International AG (another subsidiary of GGAG), and (3) the word “guarantee” was used instead of the words “Letter of Support” in the second sentence. The Court dealt with the relevance of the first comfort letter, the fact that it was not specifically addressed to the plaintiff, and with the change in the wording of the two letters. However, for purposes of this discussion it is not relevant to deal with the first comfort letter. Accordingly, reference will only be made to the second comfort letter. See Gate Gourmet [2004] NSWSC 149 at [47].
173 Gate Gourmet [2004] NSWSC 149 at [91].
comfort letter, GGA prosecuted a number of claims against GGAG, GGH and the individuals who signed the comfort letter.\textsuperscript{174}

7.5.2. \textbf{The issues}

In essence, the following three claims were made:

(a) Upon a proper construction, the second comfort letter amounted to an offer by GGAG to GGA, alternatively an offer to GGH as agent for its controlled entities, which was accepted by GGA and accordingly had contractual effect.

(b) The second comfort letter constituted a contract between GGAG and GGH, the promises contained therein were held on trust by GGH for the benefit of GGA.

(c) The second comfort letter was misleading or deceptive or likely to mislead or deceive in contravention of section 52 of the \textit{Trade Practices Act 1974} (Cth).

The principal issue was, however, whether or not any legally binding obligations arose in the circumstances in which GGA, the Australian subsidiary, was provided with a letter of comfort by its Swiss parent company, GGAG.

7.5.3. \textbf{The decision}

Einstein J, sitting in the New South Wales Supreme Court, held that the letter of comfort was legally enforceable. In respect of the first claim, his Honour stated that, with reference to the \textit{Banque Brussels} decision, the test of whether a particular comfort letter imposed legal obligations on the parties ultimately turned on its

\textsuperscript{174} The claim against the individuals under section 75B of the \textit{Trade Practices Act 1974} (Cth) for aiding and abetting the contravention of section 52 of the said Act by GGAG was dismissed for want of evidence.
terms.\textsuperscript{175} Thus, the “central and centrally significant considerations” in determining the issues of contractual intent and construction of a comfort letter were –

(a) the commercial purpose of the comfort letter discerned from the circumstances in which the words to be found in the letter were used, in particular, drawn from the admissible evidence as to the mutually known matrix of facts in which the letter came to be written; and

(b) the words used in the comfort letter.\textsuperscript{176}

Einstein J conveniently recapitulated the Australian law regarding contract formation, contractual construction, and the use of extrinsic evidence and evidence of surrounding circumstances.\textsuperscript{177} In determining the crucial question of whether the letter of comfort had been intended to create a binding legal agreement, Einstein J considered Megaw J’s view from Edwards v Skyways Ltd,\textsuperscript{178} that intention to be bound was to be presumed in commercial cases. His Honour noted that Megaw J’s view had been followed in Banque Brussels\textsuperscript{179} but stated that the issue was not properly to be regarded as one of a presumption. Although his Honour did not refer to Ermogenous v Greek Orthodox Community of SA Inc.,\textsuperscript{180} Einstein J went on to say that: “Applying the objective approach the high probability is that a commercial communication will generally be seen to have been intended to be regarded as a relatively formal matter both by the sender as well as by the recipient.”\textsuperscript{181} Moreover, although not as a matter of presumption, it can be expected that similar circumstances, including similarities in the relationship of the parties, may lead to similar results.\textsuperscript{182} However, as Murray J (lpp and Owen JJ agreeing) stated in Pirt Biotechnologies Pty Ltd v Pirtferm Ltd,\textsuperscript{183} the “onus

\textsuperscript{175} His Honour also referred to the other Australian decisions on letters of comfort see Gate Gourmet [2004] NSWSC 149 at [ ].

\textsuperscript{176} Gate Gourmet [2004] NSWSC 149 at [199].

\textsuperscript{177} Gate Gourmet [2004] NSWSC 149 at [170] to [184].

\textsuperscript{178} [1964] 1 WLR 349 at 354.

\textsuperscript{179} (1989) 21 NSWLR 502.

\textsuperscript{180} (2002) 209 CLR 95.

\textsuperscript{181} Gate Gourmet [2004] NSWSC 149 at [213].

\textsuperscript{182} See Dowdell v Knispel Fruit Juices Pty Ltd (trading as Nippys) [2003] FCA 851 at [127].

\textsuperscript{183} [2001] WASCA 96 at [21].
may be readily discharged in the case of commercial negotiations where agreement on important matters might readily persuade the court that a contract was made.”  

Moreover, the Court upheld this claim taking into consideration the following matters:

Viewing the evidence objectively, the words of the comfort letter showed an intention on the part of GGAG to enter into legal relations. The second comfort letter used strong operative words - “its controlled entities” and “to meet its financial commitments as and when they fell due” - which have very clear technical legal significance under the Corporations Law (now Corporations Act 2001 (Cth)). Moreover, the second sentence of the second comfort letter clearly evidenced that GGAG would support GGA until the latter was in a position to trade and meet its financial obligations without GGAG’s support, which was indicative of “a promissory intent to be bound in terms of legal relations.”

This was also evident from the circumstances in which the comfort letter had been provided. It had been provided in the course of business and it was mutually known and understood in the Group that GGA could only trade and meet its financial obligations with Group support. The existence of the second comfort letter was crucial to GGA’s ability to be able pay its debts as and when they fell due. So, the commercial purpose of the comfort letter was to enable (a) GGA to operate and meet its financial obligations, and (b) the directors of GGA to be able to discharge their responsibilities and (if it was unable to pay its debts) to allow GGA to continue trading in order to avoid the contravention by GGA’s directors of the insolvent trading provisions of s 588G (1)-(3) of the Corporations Law (now the Corporations Act 2001

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84 See also Makieig v Batterham [2009] NSWSC 344 at [149].
85 Gate Gourmet [2004] NSWSC 149 at [208].
86 Pursuant to section 50AA of the Corporations Law (now the Corporations Act 2001 (Cth)) “any entity controls a second entity if the first entity has the capacity to determine the outcome of decisions about the second entity’s financial and operational policies.” See JB Cilliers, Liability of a Holding Company for the Debts of Its Insolvent Subsidiary (unpublished PhD dissertation, University of Western Australia, 2002) 25 to 57 for a discussion about “control” and the regulation of corporate groups.
87 Gate Gourmet [2004] NSWSC 149 at [208].
(Cth)) and the severe sanctions for such contravention.\textsuperscript{189} Moreover, GGA’s directors relied on the comfort letter in making their declaration of GGA’s ability to pay its debts as and when they fell due under s 295 of the \textit{Corporations Law} (now the \textit{Corporations Act 2001} (Cth)).

The offer made by GGAG in the comfort letter, and accepted by GGA as a result of its continued trading in financially precarious conditions, was “to supply financial support in consideration for what was, in effect, to be the incurring of the continued risks of trading.”\textsuperscript{190} It did not matter that the letter of comfort had not specified how the financial support had to be provided.\textsuperscript{191} Accordingly, there was a contract between GGAG and GGA and as a result of its breach, the latter suffered loss and damage. Although the letter of comfort was addressed to the holding company, the trading company could enforce it because the letter itself clearly showed an intention that the subsidiaries were to benefit from the terms.

In light of the Court’s finding that there was a contract between GGAG and GGA, it was not necessary to deal with the second claim. However, Einstein J applied \textit{Trident General Insurance Co v McNiece Bros Pty Ltd}\textsuperscript{192} (which established a specific exception, relating to insurance, to the privity rule) to find that, even if GGH (and not GGA) were the promisee of the promises in the comfort letter, the facts and circumstances indicated that GGH obtained the benefit of such promises with the intention that they should subsist for the actual benefit of GGA and the other Australian Group companies which were to incur the anticipated financial commitments.\textsuperscript{193} So, the promises in the second comfort letter were held on trust for the benefit of GGA.

As regards the third claim, his Honour briefly recapitulated the general propositions regarding the statutory misleading or deceptive conduct provisions of the \textit{Trade


\textsuperscript{190} \textit{Gate Gourmet} [2004] NSWSC 149 at [222].

\textsuperscript{191} \textit{Gate Gourmet} [2004] NSWSC 149 at [215].

\textsuperscript{192} (1988) 165 CLR 107.

\textsuperscript{193} \textit{Gate Gourmet} [2004] NSWSC 149 at [262].
Practices Act 1974 (Cth). Einstein J was satisfied that the terms of the second comfort letter were clear and unequivocal, and essentially contained two representations with respect to future matters, namely that –

- GGAG would provide the financial support that may be necessary to enable GGH and its controlled entities (including GGA) to meet their financial commitments as and when they fell due; and
- The second comfort letter would not be withdrawn before GGH and its controlling entities (including GGA) had sufficient means to meet their financial obligations without the support of GGAG.

Pursuant to s 51A of the Trade Practices Act 1974 (Cth) and in the absence of evidence by GGAG as to the matters relied upon by it in making the representations, GGAG was deemed not to have had reasonable grounds for making the representations.

Accordingly the representations were taken to be misleading under s 52 of the Trade Practices Act 1974 (Cth), which provides that a corporation “shall not, in trade or commerce, engage in conduct that is misleading or deceptive or is likely to mislead or deceive.” In view of the facts and circumstances of the matter set out above, Einstein J found that the representations were a real inducement to GGA continuing to trade and that, as a result thereof, GGA suffered loss and damage.

7.5.4. Some comments

Gate Gourmet confirm that the correct approach in determining whether a comfort letter is legally binding is to give proper effect to commercial transactions, having

595 Gate Gourmet [2004] NSWSC 149at [294].
596 Section 51A of the Trade Practices Act 1974 (Cth) provides, amongst other things, that “(1) ... where a corporation makes a representation with respect to any future matter (including the doing of, or refusing to do, any act) and the corporation does not have reasonable grounds for making the representation, the representation shall be taken to be misleading. (2) For purposes of the application of subsection (1) in relation to a proceeding concerning a representation made by a corporation with respect to any future matter, the corporation shall, unless it adduces evidence to the contrary, be deemed not to have had reasonable grounds for making the representation.”
597 Gate Gourmet [2004] NSWSC 149 at [300], [307] and [313].

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regard to the purpose of, and the words used in, the comfort letter and viewed against the matrix of facts at the time when the comfort letter is drafted and provided. Since Banque Brussels,\(^{198}\) the passage of 15 years has not eroded the significance of giving legal effect to commercial transactions, including comfort instruments and specifically letters of comfort.\(^{199}\) Indeed, Gate Gourmet, which considered Banque Brussels as a “leading authority in Australia”,\(^{200}\) has actually helped to strengthen the concept of letters of comfort as enforceable instruments in law.\(^{201}\)

However, although the courts will have regard to the background factual matrix, that background will in itself not be determinative, because ultimately the question is whether what has been stated forms a contract.\(^{202}\) So, the actual wording of a letter of comfort itself has to be examined. Indeed, in finding that the words of the letter of comfort were clearly promissory, Einstein J quoted from Santow JA in Optus Vision Pty Ltd v Australian Rugby Football Pty Ltd:\(^{203}\) “But resort to extrinsic evidence ... must not detract from the axiomatic proposition that the starting point when considering a point of interpretation must be the text itself.” This clearly demonstrates that finding that a letter of comfort generates contractual liability is not the usual case.\(^{204}\)

Interestingly, the letter of comfort in Gate Gourmet was held not only to have constituted a contract, but particularly a contract of indemnity.\(^{205}\) In this regard it is worth noting that in Associated British Ports v Ferryways NV,\(^{206}\) the English Court of Appeal held the letter of comfort to be a contract of guarantee and not an

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199 Gate Gourmet [2004] NSWSC 149 at [212].
200 Gate Gourmet [2004] NSWSC 149 at [187]. Einstein J also referred at [191] to [197] to TLI Management [1990] VR 510 and Australian European Finance (1993) 60 SASR 187, but was of the opinion that the authorities needed to be considered in view of their particular facts and that the question of whether a letter of comfort gave rise to legal obligations ultimately turned on its terms.
The decision shows that a comfort letter can lead not only to contractual liability, but also to liability based on promissory estoppel, or misleading or deceptive conduct. Accordingly, “Gate Gourmet echoes the importance of determining enforceability of comfort letters in the light of promissory estoppel, reliance, intention and s 52.”

Gate Gourmet is novel in that the dispute was about the enforceability of a comfort letter in the context of the relationship between the subsidiary and the parent company. The decision illustrates that a liquidator can also enforce a letter of comfort, and sets the tone that any creditor or stake-holder who has some form of nexus with a letter of comfort, whether directly or indirectly, may be able to enforce a comfort letter on the same principles.

Gate Gourmet shows how effectively a court can employ traditional notions of contract to ensure that statements in a letter of comfort are contractual in nature. The decision serves as a reminder that the use of comfort letters should be approached with caution. Moreover, Gate Gourmet has also opened the door for prosecution of companies and directors failing to honour a letter of comfort for breach of the Trade Practices Act 1974 (Cth).

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207 See paragraph 6.3.
211 C Shultz, "Letters of Comfort: Gate Gourmet – Feast or Famine" 2004 AMPLA Yearbook 546 at 560.
7.6 **Newtronics Pty Ltd (reps and mgers appt) (in liq) v Atco Controls Pty Ltd (in liq)**\(^{212}\) – following *Gate Gourmet*

### 7.6.1. The facts

Atco Controls Pty Ltd (“Atco”) provided substantial loans to its subsidiary, Newtronics Pty Ltd (“Newtronics”), over the course of several years, which enabled Newtronics to continue trading.\(^ {213}\) The loans were secured by a mortgage debenture.\(^ {214}\) During the period between 1994 and 2001,\(^ {215}\) Atco issued a series of letters of support,\(^ {216}\) or comfort letters, to Newtronics’ auditors in which it offered to support Newtronics:

(a) to enable Newtronics to prepare its accounts on a going concern basis;

(b) to enable Newtronics’ directors to declare that the accounts gave a true and fair view of the financial position of the company, and that there were reasonable grounds to believe that the company would be able to pay its debts as and when they fell due; and

(c) to enable Newtronics’ auditors to form a view on whether Newtronics’ financial statements could be prepared on a going concern basis, and express an audit opinion that Newtronics’ financial statements were in accordance with the *Corporations Act 2001* (Cth).

\(^{212}\) (2008) 69 ACSR 317.

\(^{213}\) Newtronics (2008) 69 ACSR 317 at [5].

\(^{214}\) Newtronics (2008) 69 ACSR 317 at [1].

\(^{215}\) Letters of support were not written in all of the accounting periods between 1994 and 2000, but those which were given were in materially the same terms - see Newtronics (2008) 69 ACSR 317 at [2] and [14].

\(^{216}\) The letter of support stated that: “Atco Controls Pty Ltd, being the holding company of Newtronics Pty Ltd, hereby confirms the following: 1. That the amount owing by Newtronics Pty Ltd to Atco Controls Pty Ltd of $414,622,183 as at 30 April 2001 shall not be called upon within the current period to the detriment of all other unsecured creditors. 2. That if necessary, funds or additional bank security will be provided to Newtronics Pty Ltd or its debt financier to ensure that it can meet its current trading obligations that have, or will be incurred.” See Newtronics (2008) 69 ACSR 317 at [12], and Atco Controls (2009) 78 ACSR 375 at [5].
Thus, the case did not involve a comfort letter in the so-called "original classic context of a letter of comfort",217 where a parent company provided a letter of comfort to a bank in respect of the debts of its subsidiary, but rather in the context of a subsidiary claiming the existence of a contract between itself and its parent company.218

On 12 February 1998, an unrelated company, Seeley International Pty Ltd ("Seeley") commenced proceedings against Newtronics in the Federal Court of Australia.219 The court found in favour of Seeley and ordered Newtronics to pay an amount of $8,901,708.20 to Seeley.220 At about the same time Atco decided to enforce its security. Atco demanded repayment by Newtronics of all money owing to Atco.221

In January 2002, Atco appointed receivers and managers over all of the assets of Newtronics.222 Later in January 2002, the Federal Court of Australia awarded Seeley interest on the judgment amount of $5 million, and ordered Newtronics to pay Seeley's taxed costs.223 On 26 February 2002, a liquidator was appointed to Newtronics,224 and in April 2002, the receivers sold the business and assets of Newtronics to Atco realising $13,161,064.00.225 Satisfaction of the purchase price was made by way of a reduction of the debt owed by Newtronics to Atco.226

As a result of Atco enforcing its security, Newtronics was, among other things, not in a position to pay the amounts owing to Seeley from the Federal Court proceeding. Newtronics, in liquidation, commenced proceedings in the Supreme Court of Victoria seeking various relief,227 in particular, damages from Atco for the latter's breach of a

217 See paragraph 1.5.
221 Newtronics (2008) 69 ACSR 317 at [17] and [19].
223 Newtronics (2008) 69 ACSR 317 at [16].
227 There was also a claim in tort for conversion – see Newtronics (2008) 69 ACSR 317 at [18].

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contractual obligation to provide financial support and not to call upon secured debts to the detriment of unsecured creditors.

7.6.2. The issues

Newtronics did not base its claim on the letters of comfort alone, but also argued that a contract existed between itself and Atco, the terms of which were found in the letters. Newtronics pleaded the existence of two alternative agreements, the terms of which were “partly to be inferred and partly to be implied”.\(^\text{228}\)

First, it relied on the so-called “financial support agreement”, which in essence, provided that in consideration for Newtronics’ continuance of normal business activity after 1 May 2001, Atco:

(a) would not call upon, collect or exercise any rights against Newtronics before 30 April 2002 in respect of the amounts owing from Newtronics to Atco, to the detriment of unsecured creditors;

(b) would provide funds to Newtronics to ensure Newtronics could meet its trading obligations incurred during the period 1 May 2001 to 30 April 2002; and

(c) would provide written confirmation of (a) and (b) to Newtronics, its directors and auditors in connection with an audit:

(i) to enable Newtronics’ financial statements to be prepared on a “going concern basis”;

(ii) to enable Newtronics’ directors to declare that the accounts for the 2001 financial year gave a true and fair view in accordance with the accounting policies described in the financial statements and that in the opinion of the directors there were reasonable grounds to believe that

\(^{228}\) *Newtronics* (2008) 69 ACSR 317 at [3].

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the company would be able to pay its debts as and when they became due and payable; and

(ii) to enable Newtronics’ auditors to form an opinion as to whether Newtronics’ financial statements for the 2001 financial year could be prepared on a going concern basis and so express an audit opinion that the 2001 financial statements were in accordance with the provisions of the Corporations Act 2001 (Cth).229

Secondly, in the alternative, Newtronics pleaded a so-called “continuing support agreement”,230 which was in substantially similar terms as the financial support agreement, but without being limited to 30 April 2002 or to the provision of funds for trading obligations incurred in the 2002 financial year. Basically, it was alleged that the terms of the continuing support agreement were that Atco had agreed, without any limit as to time, that it:

(a) would not call upon, collect or exercise any rights against Newtronics in respect of amounts owing to Atco to the detriment of unsecured creditors;

(b) would provide funds to Newtronics to enable it to meet its trading obligations; and

(c) would provide written confirmation of (a) and (b) to Newtronics, its directors and auditors in connection with an audit in the manner as contemplated by the financial support agreement.

7.6.3. The decision

Pagone J, sitting in the Supreme Court of Victoria, found that a contract existed the relevant terms of which were contained in the letters of comfort given by Atco to Newtronics (2008) 69 ACSR 317 at [4].

Newtronics’ auditors, and gave judgment in favour of Newtronics against Atco in the sum of $17,361,031.69.

His Honour, referring to *Ermogenous v Greek Orthodox Community of SA Inc.*, reiterated the elements necessary to establish a contract, and pointed out the difficulty for a party, like Newtronics, seeking to rely wholly upon inference and implication for the existence of a contract to prove it. Turning to the letters of comfort, Pagone J referred to the decided cases concerning letters of comfort in the “original classic context”, and applied them to his consideration of the enforceability of the letters of support before him. Interestingly, his Honour stated that:

(a) the issue of enforceability of letters of comfort turned on whether the words used in them were “promissory and not merely representational” as held by Tadgell J in *TLI Management*;

(b) the critical question was whether the provider of a letter of comfort assumed a legal responsibility, or merely a moral responsibility, towards the beneficiary as stated in *Kleinwort Benson on appeal*;

(c) the facts before him were broadly similar to those in *Gate Gourmet* where it had been held that the terms of the letters of comfort clearly indicated a promissory intent to be bound in terms of legal relations, particularly having regard to the implications for directors of the parent

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232 Newtronics (2008) 69 ACSR 317 at [33].
233 (2002) 209 CLR 95 at [24].
236 Newtronics (2008) 69 ACSR 317 at [6].
238 [1990] VR 510 at 516.
240 [2004] NSWSC 149 at [208].
company in case of a contravention of the insolvent trading provisions of the Corporations Act 2001 (Cth).241

Pagone J held that the circumstances in which the letters of comfort were created, and the legal and commercial consequences that their provision secured for both Atco and Newtronics, were persuasive in establishing the existence of an enforceable agreement.242 Furthermore, it was held that the letters were not the sole basis of the contract between Atco and Newtronics, but rather “an integral part of the circumstances from which the contract may be seen and in which its terms are reflected.”243 His Honour held that the circumstances establishing the existence of an enforceable agreement were fourfold:244

(a) The actual provision of financial support by the parent company, Atco.

The actual provision of financial support by Atco to Newtronics was one of the circumstances that the court considered persuasive in establishing the existence of an enforceable agreement, especially since Newtronics’ ability to continue trading without being insolvent depended upon the support.245 His Honour pointed out that it was not “simply a case of Atco indicating that it would not enforce its entitlements under the mortgage”, but rather a case where Newtronics “could not have continued to trade without a significantly escalating increase in the amount of money lent by Atco to Newtronics over several years.”246

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241 See, sections 588G (director’s duty to prevent insolvent trading), 588M (civil penalty provision to compensate the company), 588V (liability of holding company for insolvent trading by subsidiary), and 563C (debt subordination) of the Corporations Act 2001 (Cth).
242 Newtronics (2008) 69 ACSR 317 at [9]. See also GEC Marconi Systems Pty Ltd v BHP Information Technology Pty Ltd (2003) 128 FCR 1 at 63 and 64.
245 Newtronics (2008) 69 ACSR 317 at [9].
246 Newtronics (2008) 69 ACSR 317 at [9].
(b) The accounts of the subsidiary, Newtronics, being prepared on a going concern basis. Newtronics’ accounts were prepared on a going concern basis at least until the year ended 30 April 2000. His Honour pointed out that “[f]undamental to the preparation of the accounts on that basis was the fact of continued support by Atco during the financial periods in which the support was given, and the commitment to do so which was represented to the auditors and to the directors of Newtronics, and which was relied upon by Newtronics’ directors and Newtronics.” Importantly, the notes to the 1997 accounts expressly stated that the going concern assumption was “dependent upon the continued support” of Atco in conjunction with the company continuing to retain adequate sources of finance. Moreover, in the 2000 accounts, the notes regarding the going concern basis of the financial reporting contained a sentence that Newtronics’ parent company had “provided an undertaking to assist the company to meet its debts as and when they [fell] due”.

(c) The solvency declarations of Newtronics’ directors. Pagone J held that it was of little significance that the letters of support had been sent to Newtronics’ auditors and not its directors. What was important was the fact that Newtronics’ directors could only have made declarations that the accounts gave a true and fair view of the financial position of Newtronics for the relevant reporting periods, and that there were reasonable grounds to believe that Newtronics would be able to pay its debts as and when they fell due and payable in reliance upon Atco’s

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249 Newtronics (2008) 69 ACSR 317 at [10].
250 Newtronics (2008) 69 ACSR 317 at [10].
252 See sections 298 to 300 (directors’ report), and 295(4) (directors’ declaration) of the Corporations Act 2001 (Cth). See also the relevant accounting standards – AASB 1001: Accounting Policies (dealing with the going concern assumption), AASB 1002: Events Occurring After Reporting Date, and AASB 1040: Statement of financial Position.
promise of continued support in the terms reflected in the letters of support.\textsuperscript{253} If that had not been the case, Newtronics could not have continued to trade.\textsuperscript{254} Furthermore, each letter of support from Atco to Newtronics’ auditors was signed by an Atco director who was also a Newtronics director authorising the latter’s accounts.\textsuperscript{255}

\textbf{(d) The absence of an express intention by Atco to limit its support.} The facts and circumstances in the case did not disclose an intention on Atco’s part to limit its promises, apart from limiting them to the financial period in which the letters of support and the actual support were given.\textsuperscript{256} The letters were not expressed to operate narrowly for the purpose of enabling the directors only to finalise the accounts or to enable the auditors to report without qualification.\textsuperscript{257}

His Honour held that the consideration for the contract between Atco and Newtronics was that Newtronics continued to trade.\textsuperscript{258} Accordingly, Pagone J concluded that:

“Letters of support may be inherently problematic in steering a narrow path between promise and representation but these letters, in the context in which these were given, went beyond representation and in my view were on their facts intended to do so. These letters on their face confirmed an agreement between parent and subsidiary which was well known to both and intended to be relied upon; the letters were not mere representations for limited purposes with a clear intention to that effect. It is no doubt possible, and at times commercially desirable, for letters of support, or letters of comfort, not to have promissory effect, as the cases make clear. Letters of support which do not have promissory effect can be useful in business for a

\textsuperscript{256} Newtronics (2008) 69 ACSR 317 at [12].
\textsuperscript{257} Newtronics (2008) 69 ACSR 317 at [12].
\textsuperscript{258} Newtronics (2008) 69 ACSR 317 at [13].
variety of reasons even though they may have no legal effect. These letters, however, did more than merely provide non binding comfort to Newtronics's auditors or, even, to Newtronics' directors: they contained the essential terms of an agreement between Atco and Newtronics which was known to both, which was intended to be relied upon and which was relied upon.”

7.6.4. Some comments

The decision in Newtronics, even though it was overturned on appeal, provides valuable guidance on when the terms of a letter of comfort will be legally enforceable. It illustrates the continued willingness of Australian courts to find terms contained in letters of comfort legally binding. Pagone J's decision is also a useful guide on the circumstances in which a court would find that the provider of a letter of comfort intended to be bound by the terms of the letter, and would be bound by them. Furthermore, Newtronics evidences the willingness of courts to consider that letters of comfort may not of themselves constitute the entirety of a contract between parent and subsidiary companies, but that such letters may provide the indicia of the terms of a contract for financial support. Finally, Newtronics clearly foreshadows a difficulty - where the promissory nature of an express statement is sought to be inferred or implied it may be difficult to distinguish the process from the process of implying terms generally.

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259 Newtronics (2008) 69 ACSR 317 at [12].
264 The tests governing the implication of terms do not, however, apply to the inference that an express statement is promissory.
7.7 Atco Controls Pty Ltd (in liq) v Newtronics Pty Ltd (recs and mgs appt) (in liq)\textsuperscript{265} – distinguishing Gate Gourmet and focusing on consideration

7.7.1. The decision

Atco appealed against Pagone J’s decision in Newtronics. The Victorian Court of Appeal (Warren CJ, Nettle and Mandie JJA) unanimously upheld the appeal and found that the letters of support given by Atco to Newtronics’ auditors were not binding, and in reaching this decision, the Court distinguished Gate Gourmet\textsuperscript{266} on its facts.

The Court rejected Pagone J’s finding that there was an agreement by inference between Atco and Newtronics.\textsuperscript{267} Although it was correct that a contract could be inferred from the circumstances surrounding the dealings of parties,\textsuperscript{268} a contract could only be inferred from what was manifest by the parties’ communications and other conduct. The Court drew a distinction between the admissibility of evidence for purposes of determining the question of contract formation and the question of contract interpretation, and stated that where –

“the question is one of inferring the existence of an agreement from conduct, as opposed to construing a written agreement, it is permissible, indeed it may be essential, to have regard to the parties’ conduct not only in order to determine whether at some point they may have reached a binding legal agreement but also to determine whether by later conduct they should be taken to have varied that earlier agreement.”\textsuperscript{269}

The significance of the conduct displayed by and in the letters of comfort was to be assessed objectively in light of the circumstances known to both parties at the times at

\begin{itemize}
\item \textsuperscript{265} 2009) 78 ACSR 375.
\item \textsuperscript{266} [2004] NSWSC 149.
\item \textsuperscript{267} Atco Controls (2009) 78 ACSR 375 at [25].
\item \textsuperscript{268} In Atco Controls (2009) 78 ACSR 375 at [25] the Court of Appeal listed the 10 circumstances (basically the four mentioned in paragraph 7.6.3) relied upon by Pagone J in support of his finding that the provision of the letters of comfort formed ‘an integral part’ of an enforceable agreement.
\item \textsuperscript{269} Atco Controls (2009) 78 ACSR 375 at [45].
\end{itemize}

333
which the letters were provided. The Court held that the letters, although known to the common directors of Atco and Newtronics, were provided and relied upon as non-binding assurances. The directors could have made the declarations without believing that the undertaking in the letters of support was legally binding, and referring to Kleinwort Benson on appeal, the Court stated that: “Commercial practice is such that companies and other organisations can, and frequently do, rely upon non-binding letters of comfort and other such assurances as a basis to conclude that debts will be repaid. That accords with the law”.

The Court referred to Dunn v Shapowlof and stated that where the question in such circumstances was whether directors had a reasonable or probable ground of expectation that a company would be able to pay a debt then, depending upon the circumstances of the case, they might take into account non-binding assurances. Approaching the matter as one of commercial reality, in light of the legal significance of non-binding undertakings and assurances, and bearing in mind that the support arrangement had been put in place sometime before (in 1997), it did not seem to the Court at all unlikely that the directors of Newtronics would have been prepared to accept and rely upon a non-binding undertaking by Atco to provide Newtronics with support.

According to the Court, even if it was important to Atco that Newtronics continued to operate, and for it to provide support, the Newtronics’ directors, “assuming that ... [they] were endowed with at least a rudimentary level of commercial common sense, and so understood that holding companies tend to conduct operations through limited liability subsidiaries in order to avoid liability in the event of the subsidiary’s failure”.

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270 Atco Controls (2009) 78 ACSR 375 at [49].
271 Atco Controls (2009) 78 ACSR 375 at [53].
273 Atco Controls (2009) 78 ACSR 375 at [53].
274 [1978] 2 NSWLR 235 at 244.
275 Atco Controls (2009) 78 ACSR 375 at [54].
276 Atco Controls (2009) 78 ACSR 375 at [55].
277 Atco Controls (2009) 78 ACSR 375 at [57].
would have understood and accepted that Atco’s undertakings to provide support were intended not to be legally binding. The Court pointed out, however, that:

“So to say is not to suggest that Atco’s undertakings to provide support were not seriously given or received. Other things being equal, the directors of Newtronics were entitled to assume that the undertakings, albeit not legally binding, would be honoured, and so to declare that there were reasonable grounds to conclude that Newtronics would be able to pay its debts when due and payable. It is conceivable that the actions of Newtronics’ directors in reliance on Atco’s undertakings could, in some circumstances, have founded an estoppel precluding Atco from resiling from the undertaking or at least resiling without first giving reasonable notice. But for present purposes it is unnecessary to consider that possibility. Newtronics never pleaded nor sought to argue estoppel”.

In considering the requirements for an enforceable contract, the court held that the requirements of intention to create legal relations and consideration could be viewed in conjunction. Indeed, the Court held that “[a]lthough it is customary to conceive of intention to create legal relations as a contractual requirement separate and distinct from the need for consideration, the better view may be that the rules as to consideration supply the answer as to whether parties intended to enter into a legally binding bargain.” The Court was, however, mindful of the possibility of the so-called “deliberate no-law” and “contextual no-law” situations, where the contractual elements of consideration and intention to create legal relations required distinct treatment and application.

278 Atco Controls (2009) 78 ACSR 375 at [58].
279 Atco Controls (2009) 78 ACSR 375 at [60].
280 Atco Controls (2009) 78 ACSR 375 at [60].
281 See paragraphs 4.4.1 and 4.4.2.
282 Atco Controls (2009) 78 ACSR 375 at [60].
Newtronics’ continued trading did not constitute valuable consideration for the undertaking by Atco.283 The Court found that there was nothing stated in the letters of support which recorded that the undertakings of Atco had been offered on condition that Newtronics continued to trade,284 that there was no evidence of such request,285 and even if some sort of request to continue to trade could be implied, such implication would be devoid of contractual certainty.286 Moreover, the finding at first instance that the Newtronics’ directors “must have been acting in reliance upon Atco promising continuing support in the terms reflected in the letters” was rejected.287 The court also held that the fact that Newtronics had granted a charge to Atco to secure money owed to the latter, was inconsistent with a binding agreement to provide financial support.

7.7.2. Some comments

The decisions in Atco Controls and Gate Gourmet,288 which on their face appear to be at odds with each other, were distinguished on their facts.289 The basic principles of contract formation were applied in each case, but different results were produced because of the different circumstances. In Gate Gourmet,290 the letter of support was said to be the contract as opposed to confirmation of the essential terms of an agreement already in existence.291 In that case there was evidence of specific requests for support and insistence upon its provisions, and there was no indication that it had been argued that action in reliance upon a letter of support could not of itself have amounted to good consideration. The Court emphasised that: “But in the end, it seems to us that gate Gourmet turned on the particular facts of that case and the issues which were agitated in it. We do not perceive it to contain any

283 Atco Controls (2009) 78 ACSR 375 at [61].
284 Atco Controls (2009) 78 ACSR 375 at [63]. In fact, the Court pointed out at [45] that the letters of support were only provided when the auditors asked for them.
285 Atco Controls (2009) 78 ACSR 375 at [64].
286 Atco Controls (2009) 78 ACSR 375 at [66].
287 Atco Controls (2009) 78 ACSR 375 at [75].
288 [2004] NSWSC 149.
289 Atco Controls (2009) 78 ACSR 375 at [79].
290 [2004] NSWSC 149.
291 Atco Controls (2009) 78 ACSR 375 at [79]
statement of principle which is necessarily inconsistent with the view which we take of this case."\textsuperscript{292}

Atco Controls confirmed that the central question when dealing with a letter of comfort was whether it was clear from the language used, and the surrounding circumstances, that there was an objective intention\textsuperscript{293} to create legal relations, and if so, whether the key elements of that commercial relationship were agreed and recorded, as well as consideration.

Atco Controls propounded no specific or new approach to the construction of letters of comfort. The Court of Appeal arrived at a different conclusion to that of Pagone J by interpreting and applying the facts differently. In light of the facts which were before the court, it is submitted that the Court of Appeal’s decision was correct.

The Court’s comments about the possibility of liability based on estoppel reiterate, however, the findings in Banque Brussels\textsuperscript{294} and Gate Gourmet\textsuperscript{295} that comfort letter liability could be based on estoppel. Indeed, reliance based liability\textsuperscript{296} could be the answer to the popular fallacy of contractual thinking, to the effect that the failure to find a legally enforceable contract between the parties left them without rights of recourse against each other,\textsuperscript{297} particularly in respect of letters of comfort.

Interestingly, the Court did not refer to Ermogenous,\textsuperscript{298} but stated that they did not "overlook that there is a presumption with commercial arrangements that parties intend to create legal relations and thus to make a contract, and that courts will strive to give legal effect to such arrangements"\textsuperscript{299} – however, there could not be a binding

\textsuperscript{292} Atco Controls (2009) 78 ACSR 375 at [79].
\textsuperscript{293} Atco Controls (2009) 78 ACSR 375 at [37], referring to Bell Group Ltd (in liq) v Westpac Banking Corporation (2008) 70 ACSR 1 at [2657].
\textsuperscript{294} (1989) 21 NSWLR 502.
\textsuperscript{295} [2004] NSWSC 149.
\textsuperscript{296} See paragraph 10.5.
\textsuperscript{298} (2002) 209 CLR 95.
\textsuperscript{299} Atco Controls (2009) 78 ACSR 375 at [68].
and enforceable obligation unless the terms of the bargain, or at least its essential and critical terms, have been agreed upon. Thus, according to Atco Controls, Ermogenous did not change the application in Australia of the double rebuttable presumption that business deals are, and that social and domestic arrangements are not, intended to be legally enforceable.\footnote{300}

The Court’s comments about commercial practice and its reference to \textit{Kleinwort Benson on appeal}\footnote{301} in support thereof, are curious.\footnote{302} It does not appear from the reported decision that there was any evidence of commercial practice before the Court. The Courts reference to banking practice in the City of London in the 1980s in the context of a letter of comfort provided by a parent company to a bank in respect of credit facilities extended to its subsidiary, appears to be unjustified and unsupported in the context of the letters of support in Atco Controls.

Newtronics’ application for leave to appeal to the High Court of Australia against the decision of the Victorian Court of Appeal was refused on 23 April 2010.\footnote{303} This was done on the basis that there were insufficient prospects of success in displacing the conclusion in Atco Controls\footnote{304} on the issue of the meaning of the phrase “current trading obligations”\footnote{305}.

\footnotesize
\begin{itemize}
\itemdera\textsuperscript{300} See the discussion in paragraph 4.4.
\itemdera\textsuperscript{301} [1989] 1 WLR 379.
\itemdera\textsuperscript{302} [2009] 78 ACSR 375 at [54] and [57].
\itemdera\textsuperscript{303} \textit{Newtronics Pty Ltd (recs and mgrs apptd) v Atco Controls Pty Ltd (in liq)} [201] HCA Trans 109.
\itemdera\textsuperscript{304} [2009] 78 ACSR 375 at [80] to [87] dealt with the meaning of the phrase “current trading obligations”.\end{itemize}
8 ELEMENTS OF FRENCH CONTRACT LAW

8.1 Introduction

When one is engaged in comparative legal research about a concept or instrument internationally encountered, it is almost inevitable that one has to consider its treatment in French law, a Romanistic legal system. It is also to French law that Common Law lawyers mainly turn when looking beyond the confines of their own legal system. The eminence of the French Code Civil or Civil Code, arguably the best example of the Continental law systems, is widely recognised. Similarly, French legal doctrine developed by jurists such as Pothier and Domat has had a significant influence in various countries, even in England, the cradle of the Common Law.

In this chapter, I briefly discuss the elements of the French law of contract from the viewpoint of someone familiar with a Common Law system, and in particular with Anglo-Australian law. A comparative study of this kind has two aims: to provide the

1 In particular, since the structure of letters of comfort found in practice in Anglo-common law jurisdictions, greatly resembles that used in France and in the other Continental law jurisdictions - see M Elland-Goldsmith, "Comfort letters in English Law and Practice" [1994] International Business Lawyer 527.
2 FH Lawson, The Comparison: Selected Essays, Volume II (North-Holland Publishing Company, Amsterdam, 1977) 283 has remarked that "French law is one of the most important that the world has known."
3 See paragraph 1.4.
5 In this dissertation, I use the translation of the French Civil Code available from Legifrance.
7 See, for example, J Domat, The Civil Law in Its Natural Order Vol 1 translated by W Strahan (Charles C Little and James Brown, Boston, 1850).
essential keys to the understanding of the French law on letters of comfort (as opposed to a full-scale exposition), and to promote a better and more critical appreciation of the characteristics of the Anglo-common law systems' approach to letters of comfort.

8.2 The concept of contract and patrimony

Common Law and Civil Law contracts have been traditionally seen as distinctive and fairly diverse. Tallon remarked that the “French law of contract is at the same time similar and different from English or American law. What is important is that often the similarities are misleading – as faux amis – and the differences more apparent than real. And this is true from the start, with the very definition of contract.” In other words, as Beale, Hartkamp, Kötz and Tallon have stated: “A contract under common law is not exactly the same as under the German or French legal systems.” Giliker and de Moor also observed that the homogeneity of terms and general definitions in French and Anglo-common law must not mislead the Common Law lawyer into minimising the difference in practical results, especially when dealing with the issue of contract formation.

The differences in approach between the Anglo-common law and French law to the binding nature of contractual obligations, which are particularly apposite when considering the contractual effect of letters of comfort, have been succinctly stated as follows:

“French law gives greater weight to evaluating the behaviour of the parties, whereas English law [and so too Australian law], being more utilitarian than Kant, is primarily interested in the exchange of economic value achieved by contract. However, this contrast needs to be qualified and explained in more detail. Beginning with Domat and Pothier, French academic writing abandoned the concept of contract as an economic exchange in favour of the concept of contract as an exchange of consents; this took place at the expense of seeking equality in the value of the exchange of undertakings ...

... In England, however, it was commercial practice which influenced contract law. Although French contract law has a general and abstract character and applies to any kind of agreement, English contract law is modelled on commercial transactions, which are treated by the judges as the paradigm of contract. For various reasons, English courts have not regularly handled non-commercial transactions, where an ethical view of contract would be more relevant to the litigation. Since commercial litigation has predominated in England, the ethical view has a less important role ...

The contrast between the two approaches can be put in two statements: *pacta sunt servanda* for French law, which accordingly insists on exact performance of a contractual undertaking; and for the common law, Holmes’ celebrated statement, which, although contemporary writers may treat it as exaggerated, none the less reflects a general attitude of mind. According to Holmes, in Anglo-American law the contractual promisor has a choice between performing his promise and paying damages: in a way, it is a kind of alternative obligation. It follows that French law resorts to issues of morality, such as fraud, serious fault, or good faith, more readily than does English law. Even the English principles of Equity are based more on normal standards of commercial probity than on abstract moral values ... French contract law is
both more ‘moral’ and more dogmatic; English contract law is both more
‘economic’ and more pragmatic.”15

French contract law16 falls within the wider purview of obligations.17 It is codified in
Book III, Title III of the Civil Code.18 Article 1101 of the French Civil Code19 defines a
contract as an agreement (convention)20 by which one or more persons obligate
themselves toward one or more other persons to give (transfer), to do or not to do
something.21 Thus, a contract is the agreement of two or more parties directed
towards the creation, modification or extinction of certain legal consequences, or
towards the transfer of them.22 Importantly, pursuant to article 1135 of the French
Civil Code an agreement is not only binding as to what is therein expressed, but also as
to all the consequences which equity, usage or statute give to the obligation according
to its nature. Moreover, an agreement must be performed in good faith.23 Anglo-
common law has a more analytical concept of two separate promises linked by
consideration, whereas French law tends to consider the contract as the joint product

385 and 386. See also H Beale, A Hartkamp, H Kötz and D Tallon, Cases, Material and Text on Contract
16 The general theory of contract is essentially contained in the French Civil Code, as elucidated and
complemented by case law, to which should be added the rules on consumer contracts contained in the
French Consumer Code, law No 95-96 of 1 February 1995 – see H Beale, A Hartkamp, H Kötz and D
contract law is similar, and the articles in the French and Belgian Civil Codes correspond; accordingly,
reference is sometime also made to Belgian commentaries.
17 See JM Philippe, “French and American Approaches to Contract Formation and Enforceability: A
Comparative Perspective” (2005) 12 Tulsa Journal of Comparative and International Law 357 at 361.
18 The general rules for contract cover the following subjects: contract formation, performance of
contracts, remedies for breach of contract and termination of contracts.
306.
20 According to G Cornu, Vocabulaire Juridique Henri Capitant (PUF, Paris, 2000) a convention is any
agreement intended to produce legal effects.
21 Article 1142 of the French Civil Code provides that any obligation to do or not to do resolves itself into
damages, in case of non-performance on the part of the debtor.
22 See paragraph 8.4. Belgian law: J Herbots, Contract Law in Belgium (Kluwer Law and Taxation
23 See article 1143 of the French Civil Code. This is also the position proposed for the Principles of
European Contract Law – see O Lando and H Beale (eds), Principles of European Contract Law Parts I and
of an exchange of consents.\textsuperscript{24} Thus, generally speaking, whilst Anglo-common law regards a contract as an objective bargain, French law emphasises the personal relationship between the parties.\textsuperscript{25} In French law a contract is a juridical act\textsuperscript{26} – that is, it is an expression of will, the intention and normal effect of which is to produce a lawful change in the legal position of its author.\textsuperscript{27} Typically, a contract is a result of at least two juridical acts, namely the offer and the acceptance.\textsuperscript{28} This does not mean, however, that unilateral juridical acts, for example, guarantees, are not recognised in French law.\textsuperscript{29}

The law of contract is part of the law of obligations.\textsuperscript{30} Obligations are one of the component elements of a patrimony.\textsuperscript{31} Patrimoine or patrimony\textsuperscript{32} is the totality of an individual’s economic assets and liabilities; that is, those rights and duties which are capable of valuation in money terms.\textsuperscript{33} A contract, being a juridical act, changes a


\textsuperscript{26} A juridical act, or acte juridique is a voluntary act which is intended to produce (and produce) legal effects, and can be either unilateral or bilateral. An acte juridique bilateral is a convention (an agreement with legal effects) and most conventions are contracts – see B Nicholas, \textit{The French Law of Contract} (Clarendon Press, Oxford, 2002) 37.


\textsuperscript{28} W De Bondt, “Contracts” in H Bocken and W De Bondt (eds), \textit{Introduction to Belgian Law} (Bruylant, Brussels, 2001) 222 at 227, and J Herbots, \textit{Contract Law in Belgium} (Kluwer Law and Taxation Publishers, Deventer, 1995) 91 to 94 for a discussion of offer and acceptance as part of the formation of the contract.


\textsuperscript{32} The nearest analogy in Anglo-Australian law is the rather imprecise notion of the “estate” of a deceased person. See C Dadomo and S Farran, \textit{French Substantive law: Key Elements} (Sweet & Maxwell, London, 1997) 12.

\textsuperscript{33} B Nicholas, \textit{The French Law of Contract} (Clarendon Press, Oxford, 2002) 29. A patrimony implies a person, whose patrimony it is, and conversely, a person implies a patrimony, the conception being
person's patrimony – his or her patrimony is either diminished if he or she has to pay money or incur an obligation, or enhanced if he or she is to be paid money or is the obligee.34

8.3 Types of contract

Contracts are classified into different types,35 although, regardless of their denomination, contracts are subject to the general rules of Book III, title III of the French Civil Code.36 For purposes of this dissertation, the classification of the following contracts is important: synallagmatic (or bilateral)37 and unilateral contracts,38 commutative and aleatory contracts.39 A synallagmatic contract is a contract which creates reciprocal obligations, each party having both rights and duties, while a unilateral contract creates only rights in one party and only duties in the other.40 In a sufficiently abstract to include the case where, at a given moment, the balance of assets and liabilities is nil or negative. A person can, in principle, only possess one patrimony - see J Herbots, Contract Law in Belgium (Kluwer Law and Taxation Publishers, Deventer, 1995) 41; T Klimas, Comparative Contract Law: A Trans-systemic Approach with an Emphasis on the Continental Law (Carolina Academic Press, Durham, 2006) 6.


36 See article 1107 of the French Civil Code.


commutative contract one knows from the outset which mutually equivalent performances are due by the parties,\textsuperscript{41} while a contract is aleatory when the extent of one party’s performance depends on some future uncertain event and the other party’s performance does not vary correspondingly.\textsuperscript{42}

8.4 Validity of contracts

Article 1108 of the French Civil Code\textsuperscript{43} enumerates the four requirements for a valid contract,\textsuperscript{44} namely, the consent (consentement or toestemming)\textsuperscript{45} of the party binding itself,\textsuperscript{46} its capacity (capacité or bekwaamheid),\textsuperscript{47} a legal cause\textsuperscript{48} and a definite object (cause et objet or oorzaak en voorwerp).\textsuperscript{49}

bilateral and unilateral contracts are used in Anglo-Australian law, but although there are similarities between the French and Anglo-Australian approaches to such contracts, there are important differences – see JGJ Rinkes and GH Samuel, Contractual and Non-contractual Obligations in English Law (Ars Aqui Libri, Nijmegen, 1992) 105; GH Treitel, Remedies for Breach of Contract: A Comparative Account (Oxford University Press, Oxford, 1988) at [189] to [193].


\textsuperscript{43} Article 1108-1 of the French Civil Code deals with contracts where writing is a requirement.


\textsuperscript{45} Articles 1109 to 1122 of the French Civil Code deal with the requirement of consent, and specifically with the validity of consent, and matters which affect consent, like error, duress, and deception. In French law, it is customary to distinguish two elements here: that there be a meeting of the minds of the parties – an accord de volontés – whose aim is the creation or modification of contractual obligations and, secondly, that each party’s consent be free from defect – see C Dadomo and S Farran, French Substantive law: Key Elements (Sweet & Maxwell, London, 1997) 33 to 35; J Bell, S Boyron and S Whittaker, Principles of French Law (Oxford University Press, Oxford, 1998) 310; D Tallon, “Contract Law” in GA Berman and E Picard (eds), Introduction to French Law (Kluwer Law International, Alphen aan de Rijn, 2008) 211 to 215.

Although not stipulated in article 1108 of the French Civil Code as a requirement for a valid contract, intention to create legal consequences or relations appears to be indirectly and to an extent an element in the French concept of contract distinguishable from the requirement of legal cause. In other words, in order to have a contract it is necessary that the parties agree with the intention to bind themselves


legally, or as usually expressed, *animo contrahendae obligationis*. In ordinary commercial transactions it is not usually necessary to prove that the parties in fact intended to create legal relations, rather the party who asserts that there is no such intention has the burden of proving that no legal effect was intended.

Consideration is not a requirement of the French law of contract. The essence of a contract in French law is its consensualistic approach - the meeting of minds or an agreement - not the notion of a bargain, or consideration or a promise given in return for good consideration. Where the essence of a contract is absent, French courts turn to the law of torts (*droit de la responsabilité* or *aansprakelijkheidsrecht*) - the basic principles of which are to be found in articles 1382 to 1386 of the French Civil Law.

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52 J Herbots, *Contract Law in Belgium* (Kluwer Law and Taxation Publishers, Deventer, 1995) 38 and 95. This does not mean that gentlemen’s agreements are not valid – see E Dirix, “Gentlemen’s agreements en andere afspraken met onzekere rechtsgevolgen” 1985-1986 *Rechtskundig Weekblad* 2120 and paragraph 8.7.

53 J Herbots, *Contract Law in Belgium* (Kluwer Law and Taxation Publishers, Deventer, 1995) 95. Importantly, in Belgian law there is no presumption in favour of an intention to create legal relations.


Code\textsuperscript{59} - to solve the issues.\textsuperscript{60} This is because the fundamental principle and general rule of liability of tort law in France is that any act (intentional, negligent or imprudent)\textsuperscript{61} by which a person causes damage to another makes the person through whose fault the damage occurred liable to compensate the other for such damage.\textsuperscript{62}

8.5 Construction and style of contracts

In Anglo-common law the terms of a contract are usually classified as being either conditions or warranties – a condition being a term which is essential to the contract, while a warranty is a term which is subsidiary or collateral. French law neither distinguishes between conditions\textsuperscript{63} and warranties, nor does it make a technical distinction between terms and representations, nor does it have the concept of collateral contract, in the sense of an assurance given in the course of negotiations and giving rise to a contractual obligation.\textsuperscript{64} Contracts are usually comprised of a number of terms consisting of words which invariably do not express what is intended by the parties. Thus, when disputes arise as to the meaning of contracts, courts are trying to decide the rights and obligations of parties who have expressed themselves unclearly or incompletely by construing the terms in contracts by giving meaning to the words used.

The French Civil Code contains a number of rules,\textsuperscript{65} set out in articles 1156 to 1164, intended to guide courts when construing contracts.\textsuperscript{66} The fundamental rule


\textsuperscript{61}Article 1383 of the French Civil Code.


\textsuperscript{63}There are, however, different kinds of conditions, namely casual or contingent, mixed and potestative conditions – see J Herbots, Contract Law in Belgium (Kluwer Law and Taxation Publishers, Deventer, 1995) 155.

\textsuperscript{64}J Herbots, Contract Law in Belgium (Kluwer Law and Taxation Publishers, Deventer, 1995) 147.

concerning construction of contracts is set out in article 1156 of the French Civil Code which provides that the real intention of parties has to be found rather than keeping to the literal meaning of the words used by the parties.\textsuperscript{67} As in France, contract law focuses on the relationships of the parties,\textsuperscript{68} the French judge has to discover the real will of the parties,\textsuperscript{69} the spirit of their relationship that is not necessarily revealed by the words used in the document.\textsuperscript{70} The French starting point in determining the effect of a contract is to look into what was the common (subjective) intention of the parties and in this respect no distinction is drawn between what they expressly or impliedly

\textsuperscript{64} See B Nicholas, The French Law of Contract (Clarendon Press, Oxford, 2002) 47; J Bell, S Boyron and S Whittaker, Principles of French Law (Oxford University Press, Oxford, 1998) 332; J Herbots, Contract Law in Belgium (Kluwer Law and Taxation Publishers, Deventer, 1995) 151 and 152. These rules concern the interpretation of clauses in contracts which are ambiguous, incomplete or unclear, and have no application if the meaning of the contract is clear.


\textsuperscript{68} C Pierrot, A Comparative Legal Study of Preliminary Agreements under French and American Law (unpublished LLM thesis, Institute of Comparative Law, McGill University, Montreal, 2000) 52. The Dutch law is instructive in this regard. The determination of the legal effect of a letter of comfort in Dutch law is regarded as involving the interpretation of agreements. The starting point of interpretation is to establish the intention of the parties to the agreement pursuant to the so-called wilsleer or doctrine of intention. The wilsleer is, however, tempered by the vertrouwensbeginsel (the meaning which a party reasonably attaches to an agreement, or a statement in an agreement, in light of the circumstances and the conduct of the other party), or principle of trust pursuant to which the parties’ respective expectations or reliance on the statements in the agreement are taken into account in determining the legal effect of the agreement. Thus, interpretation necessitates consideration of three matters: the text of the agreement, the surrounding circumstances, and the expectations and reliance of the parties. In so far as letters of comfort are concerned, the intention of the parties to a letter of comfort basically has to be established in context, and taking into account what the parties had in mind and expected in negotiating and using the letter of comfort. The interpretation of a letter of comfort therefore involves more than a mere linguistic construction of the text of the letter. See JV Boonacker and ED Drok, De mogelijke rechtsgevolgen van de letter van comfort volgens Nederlands, Engels, Duits en Frans Recht in NIBE-Bankjuridische reeks (NIBE, Amsterdam, 1992) 12; RIVF Bertrams and FGB Graaf, “Letters of Comfort en rechtspraak” (1990) 68 De Naamloze Venootschap 75 at 82.

\textsuperscript{69} See J Schmidt, “Letters of Intent” 2002 International Business Law Journal 257 at 265. This is similar to the German search for the wirkliche Wille or true will of the parties – see the discussion by P Moskwa, “Interpretation of Commercial Contracts in the Future European Civil Code - Objective or Subjective Method?” 2004(1) European Law Students’ Association Selected Papers on European Law 51 at 53.

\textsuperscript{70} C Pierrot, A Comparative Legal Study of Preliminary Agreements under French and American Law (unpublished LLM thesis, Institute of Comparative Law, McGill University, Montreal, 2000) 52.
agreed.71 The interpretation of a contract, which in French law entails questions of fact,72 is much less strictly bound by the letter of the contract than is the case under Anglo-common law.73 In determining the real intention of the parties, one has to examine first their expressed intention in the contract (which is usually in writing),74 but the court may also take into consideration extrinsic elements such as the circumstances surrounding the making of the contract, the conduct of the parties while performing the contract, or during the preliminary negotiations, the conduct of the parties while performing previous contracts, the practices which the parties have established between themselves, and the nature and purpose of the contract.75 The writings or other external manifestations of intention are important, but secondary.76 Moreover, if the real intention cannot be ascertained, a term of a contract must be interpreted contrary to the interests of the party which benefits from it (the creditor or obligee) and in favour of the party bound by the term (the debtor or obligor).77

74 The evidential force of a written instrument (fois due à l’acte or bewijskracht van de akte) has to be taken into account pursuant to articles 1319, 1320, 1322 and 1341 of the French Civil Code. See J Herbots, Contract Law in Belgium (Kluwer Law and Taxation Publishers, Deventer, 1995) 103 to 112 for a discussion of the articles in the Belgian Civil Code.
75 W De Bondt, "Contracts" in H Bocken and W De Bondt (eds), Introduction to Belgian Law (Bruylant, Brussels, 2001) 222 at 231. Article 5.102 of the Principles of European Contract Law provides for similar factors to be taken into account: the circumstances in which the contract was concluded (including preliminary negotiations), the conduct of the parties (even subsequent to the conclusion of the contract), the nature and purpose of the contract, the interpretation which has already been given to similar clauses by the parties and the practices they have established between themselves, the meaning commonly given to terms and expressions in the branch of activity concerned and the interpretation similar clauses may already have received, usages, and good faith and fair dealing - see T Klimas, Comparative Contract Law: A Trans-systemic Approach with an Emphasis on the Continental Law (Carolina Academic Press, Durham, 2006) 526.
77 Article 1162 of the French Civil Code.
Interpretative rules and style of drafting are linked in a circular relationship.\textsuperscript{78} Generally speaking, French contracts are shorter and simpler than their Anglo-common law counterparts, because the draftsman works within the framework provided by the French Civil Code which contains both general rules and particular rules appropriate to specific contracts.\textsuperscript{79} French contracts therefore do not have to deal with the main incidents of the contract, but focus only on the points which are of particular concern to the parties.\textsuperscript{80}

The formation of contracts is an area in particular where French law applies a more subjective approach than Anglo-common law:

"rather than look for what might appear to third party observers to be the indicia of a contractual relationship it hunts for evidence of a real agreement between the parties. There are of course several requirements\textsuperscript{81} to be fulfilled before a transaction will be recognised as a valid contract in French law, but the concepts embraced by those requirements are not reified to the same fictitious degree as they are in English law."\textsuperscript{82}

The effect of this relationship between the subjective approach to interpretation and the requirements for a contract stipulated in article 1108 of the French Civil Code, is that “French law, in contradistinction to English law, cannot separate the issue of formation of a contract from that of genuine agreement as to its content.”\textsuperscript{83}

\textsuperscript{78} See also J Herbots, \textit{Contract Law in Belgium} (Kluwer Law and Taxation Publishers, Deventer, 1995) 74.
\textsuperscript{79} See also J Herbots, \textit{Contract Law in Belgium} (Kluwer Law and Taxation Publishers, Deventer, 1995) 74.
\textsuperscript{80} In this regard, J Herbots, \textit{Contract Law in Belgium} (Kluwer Law and Taxation Publishers, Deventer, 1995) 74 remarks that; "For Civil lawyers law is in principle a complete and intellectually coherent system which, explicitly or implicitly, embodies the rules necessary for life in society. The Common law, on the other hand, is seen as never compete, but always in the process of becoming, and the draftsman’s function therefore necessarily involves an element of prediction or anticipation. The wise draftsman reduces this element to a minimum."
law approaches the efficacy of business instruments in a direct, common sense way - would two sophisticated entities intend to create a meaningless, unenforceable instrument? The French have developed a presumption that the question should be answered negatively. To them, “the creation [in the commercial world] of a meaningless instrument ... is unthinkable.” Business instruments are more likely to be considered obligations de faire (obligations to perform) that commit the writer to some level of performance. As discussed in chapter 9, this subjective common sense approach is more likely to result in a letter of comfort being considered an obligation de faire, and having contractual effect in French law.

8.6 Breach of contract

In order to establish breach of contract, one has to prove that the obligor has failed to perform his contractual obligation, bearing in mind that a contract in French law involves a party giving, doing or not doing something or obligations de faire (obligations to perform). In other words, in determining whether the creditor of an obligation has a remedy, one must compare what has been promised with what the

than the subjective meeting of the minds is required and that the court, in particular, will look to the certainty of the objet of the agreement in determining whether a valid contract has been formed.”


88 French law recognises natural obligations – see paragraph 8.7. A natural obligation is a moral obligation to which legal consequences are attached. In all the heterogeneous types of natural obligations, there is always a common element, the existence of a conscience duty on the part of the person obligated toward the person to whom he is obligated. The question whether or not there is a natural obligation only arises after there has been a voluntary performance or a voluntary recognition by the person obligated. The transformation of a natural obligation into a civil obligation depends solely on the intention of the obligor – see J Herbots, Contract Law in Belgium (Kluwer Law and Taxation Publishers, Deventer, 1995) 97.

debtor has done or has omitted to do.\textsuperscript{90} Unlike in the Anglo-common law jurisdictions where the emphasis is on the notion of promise as the focal point of liability, the focus in French law is on the notion of agreement - in other words, the English contractor is liable in damages at common law for breach of promise, while the French contractor is liable because of non-performance of an agreement.\textsuperscript{91}

Contractual liability in French law, unlike in Anglo-common law,\textsuperscript{92} is founded on a \textit{faute contractuelle}\textsuperscript{93} or contractual fault,\textsuperscript{94} which means basically a breach of duty, the duty in question being the obligation imposed by the contract itself.\textsuperscript{95} Such an understanding of fault raises the question to what standard of care French law holds parties to a contract in relation to performance of what they have agreed: what is the exact content of the obligation?\textsuperscript{96} To put it differently, is the obligation absolute, strict or based on negligence? As Bell, Boyron and Whittaker point out, the general

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\textsuperscript{91} See JGJ Rinkes and GH Samuel, \textit{Contractual and Non-contractual Obligations in English Law} (Ars Aqui Libri, Nijmegen, 1992) 104.


\textsuperscript{93} B Nicholas, \textit{The French Law of Contract} (Clarendon Press, Oxford, 2002) 31 and 32. As Nicholas points out at 50, "French law (following Roman law) traditionally bases contractual liability, as it also bases delictual liability, on fault, whereas the Common law has traditionally thought of contractual obligations as in principle absolute and therefore ostensibly finds no place for fault in contractual liability. In practical consequence the difference in this respect between the two systems is largely illusory in that what French law expresses in terms of a rule is embodied by English law in an implied term, but whereas the English approach is fragmentary and turns ostensibly on the interpretation of the individual contract. French law applies a broad rule and proceeds, once again, by categorising the agreement in question."


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provisions of the French Civil Code are not clear on this point.\textsuperscript{97} Article 1137 of the French Civil Code\textsuperscript{98} require that a person entrusted with the preservation of a thing must take all the care of a \textit{bon père de famille} (a good father of family),\textsuperscript{99} the French equivalent\textsuperscript{100} of the Anglo-common law reasonable man.\textsuperscript{101} However, article 1147 of the French Civil Code\textsuperscript{102} provides that where a person has failed to perform an obligation, he is liable in damages subject only to the defence of \textit{force majeure}.\textsuperscript{103} In other words, article 1137 of the French Civil Code makes liability dependent on proof of fault, whereas article 1147 makes exemption from liability dependent on proof of a \textit{cause étrangère} or a cause beyond the debtor’s control.\textsuperscript{104}

In this regard, the distinctions between an \textit{obligation de résultat} or \textit{obligation déterminée} (\textit{resultaatsverbintenis} and anglicized as an obligation to produce or achieve a particular result),\textsuperscript{105} an \textit{obligation de moyens} or \textit{obligation de diligence} (\textit{middelenverbintenis} or \textit{inspanningsverbintenis} and anglicized as an obligation of

\textsuperscript{98} The article provides: “An obligation to watch over the preservation of a thing, whether the agreement has as its object the profit of one party, or it has as its object their common profit, compels the one who is responsible to give it all the care of a prudent administrator.”
\textsuperscript{101} Even though one usually refers to the reasonable “man”, some argue that women are also reasonable, and urge courts to recognise a reasonable woman standard - see, for example, SL Bass, “The ‘Reasonable Woman’ Standard: The Ninth Circuit Decrees Sexes perceive Differently” (1992) 43 \textit{Labor Law Journal} 449; HA Simon, “Ellison v Brady: A ‘Reasonable Woman’ Standard for Sexual Harassment” (1991) 17 \textit{Employee Relations Law Journal} 71. RKL Collins, "Language, History and the Legal process: A Profile of the "Reasonable Man"" (1976-77) 8 \textit{Rutgers-Camden Law Journal} 311 has suggested that the standard should be gender-free in order to avoid any gender bias.
\textsuperscript{102} The article provides: “A debtor shall be ordered to pay damages, if there is occasion, either by reason of the non-performance of the obligation, or by reason of delay in performing, whenever he does not prove that the non-performance comes from an external cause which may not be ascribed to him, although there is no bad faith on his part.” See H Beale, A Hartkamp, H Kötz and D Tallon, \textit{Cases, Material and Text on Contract Law} (Hart Publishing, Oxford, 2002) 663.
\textsuperscript{105} Sometimes also referred to as a “duty of result” or “obligation to obtain result” – DC van hoof, D Verbruggen and CH Stoll, \textit{Elsevier’s Legal Dictionary} (Elsevier, Amsterdam, 2001) 375.

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means or obligation to use best efforts or endeavours, or obligation to take reasonable care), an obligation de garantie (anglicized as a guarantee obligation) are essential. The distinction between an obligation de résultat and an obligation de moyens as a criterion of allocation of contractual liability, proposed by Demoge in his Traité des Obligations V, has been adopted from French law, not only in Belgium but also in The Netherlands, Luxembourg, Italy, Romania, Poland, Lebanon, Latin America and Quebec, and has also been incorporated into the Unidroit Principles of International Commercial Contracts 2004. Under the Unidroit Principles, however, all liability (subject only to force majeure) is no-fault liability, and the distinction between obligations de moyens and obligations de résultat has lost its juridical significance.

As discussed in paragraph 8.6.1, an obligation de moyens is an obligation of means which suggests the use of reasonable effort or care. However, commentators in the

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106 Sometimes also referred to as "obligation to do irrespective of results" - DC van hoof, D Verbruggen and CH Stoll, Elsevier’s Legal Dictionary (Elsevier, Amsterdam, 2001) 675.
108 See D Alessi, "The Distinction between Obligations de Résultat and Obligations de Moyens and the Enforceability of Promises" (2005) 2 European Review of Private Law 657 for a detailed critical discussion of the distinction, describing it at 659 as "logically based upon a questionable method of abstraction, resting on the work of the inductive reasoning."
112 C Pierrot, A Comparative Legal Study of Preliminary Agreements under French and American Law (unpublished LLM thesis, Institute of Comparative Law, McGill University, Montreal, 2000) 41 to 43 is of the opinion that French concept of appropriate means can be considered as the counterpart of the American concept of best efforts.
Anglo-common law jurisdictions\textsuperscript{113} often misleadingly anglicised the obligation as one of best efforts.\textsuperscript{114} This misleading Anglicisation is perpetuated and entrenched in the \textit{Unidroit Principles Principles of International Commercial Contracts} \textit{2004} where the English titles for article 5.1.4, which sets forth two types of obligations in line with the French distinction between an \textit{obligation de résultat} and an \textit{obligation de moyen}, are translated as “duty to achieve a certain result” and “duty of best efforts”.\textsuperscript{115} For purposes of this dissertation, the confusion about the appropriate English terminology for a peculiar French juridical abstraction which is based upon inductive generalisations,\textsuperscript{116} may compromise a proper consideration of the French law on letters of comfort. Accordingly, it is necessary to scrutinise the Anglo-common law concepts of reasonable and best efforts or endeavours to clarify the standards applicable when obligations of result and means are encountered.

The expressions “reasonable efforts” and “best efforts” are common in American law,\textsuperscript{117} and are synonymous with the expressions “reasonable endeavours” and “best endeavours” in Anglo-Australian law.\textsuperscript{118} In light of the scope of this dissertation,\textsuperscript{119} the discussion focuses on the concepts of best endeavours and reasonable endeavours. It is generally considered that “best endeavours” imports a significantly higher standard


\textsuperscript{115} See also C Chappuis, “Provisions for best efforts, reasonable care, due diligence and standard practice in international contracts” \textit{[2002 International Business Law Journal} 281 at 285.

\textsuperscript{116} D Alessi, “The Distinction between \textit{Obligations de Résultat} and \textit{Obligations de Moyens} and the Enforceability of Promises” \textit{[2005 2 European Review of Private Law} 657 at 691.

\textsuperscript{117} See, for example, A Miller, “Best Efforts?: Differing Judicial Interpretations of a Familiar Term” \textit{(2006 48 Arizona Law Review} 615; A Tettenborn, “What It’s Worth To Do Your Best” \textit{(2008 Pace Law Review} 297.

\textsuperscript{118} C Chappuis, “Provisions for best efforts, reasonable care, due diligence and standard practice in international contracts” \textit{[2002 International Business Law Journal} 281.

\textsuperscript{119} See paragraph 1.4.
of obligation than "reasonable endeavours". In one of the earliest English decisions dealing with the meaning of "best endeavours", *Sheffield District Railway v Great Central Railway*, the Court held that the words mean what they say; they do not mean second best endeavours, but that no stone should be left unturned. However, it has subsequently been held that an obligation to use best endeavours only imposes a duty to do what can reasonably be done in the circumstances. In practice, as Cotton observed, that meant that a company which had given a best endeavours undertaking must:

(a) "Take action which, having regard to costs and degree of difficulty, is commercially practicable. The company would not be required to take action that could lead to its financial ruin, or that would undermine its commercial standing or goodwill."

(b) "Incur expenditure that is reasonable in taking the action."

(c) "Act in the interests of the company."

In Australia, courts have read down the phrase “best endeavours” even more than in England so that it may not be much more burdensome than “reasonable endeavours”. In *SVI Systems Pty Ltd v Best and Less Pty Ltd*, the Court held, referring to *Hospital Products Ltd v United States Surgical Corp* and *Transfield Pty Ltd v Arlo International Ltd*, that the term “‘best endeavours’ implies an obligation to do

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121 (1911) 27 TLR 451.
123 *Terrell v Mabie Todd & Coy Ltd* (1952) 69 RPC 234. See also *B Davis Ltd v Tooth & Co Ltd* [1937] 4 All ER 118.
124 S Cotton, "Structure of commercial contracts" 1999 (September) PLC Contract Series 21 at 25.
126 (2001) 187 ALR 302 at [101].
127 (1984) 156 CLR 41 at 64.
all one reasonably can in the circumstances to achieve the contractual object but no more ... and to do all that could reasonably be expected of [the promisor] having regard to the circumstances of its business operation.” Importantly, whether a party used his “best endeavours” to achieve a stated intention or purpose, “must be determined objectively in light of what in fact is required to be done, in the circumstances as they exist, to achieve the stated objective. In such a case ... he is required to do all that he reasonably can in the circumstances to achieve the contracted objective but no more.”129 In other words, in Australia the phrase “best endeavours” has been interpreted as implying an obligation to do all one reasonably can in the particular circumstances surrounding the contract.130 In practice, it basically means that if a person has an obligation to use his best endeavours, he has to act reasonably, honestly and not hinder or prevent the fulfilment of the contractual purpose.131

In England, the Court of Appeal132 has held “reasonable endeavours” to be “appreciably less than best endeavours” - basically it means an honest try, which involves taking into account the prevailing circumstances - a determination of whether the party liable has at least considered using certain efforts and then honestly balancing those efforts against his own commercial considerations. In Australian Securities Commission v Gallagher,133 the test in Australia for “reasonable endeavours” was stated to be whether a person used “a fair, proper and due degree of care and ability as might be expected from an ordinary prudent person with the same knowledge and experience as the defendant, engaging in the defendant’s particular conduct or omission and under the particular circumstances.”

129 Paltara Pty Ltd v Dempster [1991] 6 WAR 85 at 89. See also Hawkins v Pender Bros Pty Ltd [1990] 1 Qd R 135 at 155; Parland Pty Ltd v Mariposa [1995] 5 Tas R 12 at [28].
It appears that the English courts continue to maintain a distinction between the phrases "best endeavours" and "reasonable endeavours" (albeit faintly),\textsuperscript{134} while the Australian courts tend to regard the distinction between the two terms as even less significant.\textsuperscript{135} In fact, one commentator has remarked that "it would appear that essentially the definition of the phrase 'best endeavours' means what many had thought 'reasonable endeavours' meant."\textsuperscript{136} Although it is a matter of degree, the distinction between "best endeavours" and "reasonable endeavours" does, however, remain in Australian law. In light of the content of the obligation referred to as a reasonable endeavours obligation in Anglo-Australian law, and the test to determine whether such obligation had been performed, it is more appropriate to refer to an \textit{obligation de moyens} as an obligation of reasonable endeavours. However, in order to avoid any potential confusion as a result of the different status the phrases have in Anglo-common law, I refer to an \textit{obligation de moyens} or \textit{middelenverbintenis} as an obligation of means, which is a neutral term but which still gives effect to the fact that the distinction in French law is by reference to the purpose of the obligation.\textsuperscript{137} The phrase "obligation of result" is used for an \textit{obligation de résultat} or \textit{resultaatsverbintenis}.

\textsuperscript{134} J Emerson, "Simply the Best? Discovering the real meaning of 'best endeavours'" (2001) 17 \textit{Building and Construction Law} 223 at 226.
\textsuperscript{135} S Doyle and K Mulgrew, "What Do 'Best Endeavours', 'Reasonable Endeavours' and 'All Reasonable Endeavours' Mean?" [2002] \textit{Australian Corporate Lawyer} 11 at 13.
\textsuperscript{136} Q Lowcay, "'Best endeavours' and 'Reasonable endeavours'" 1999 (June) \textit{New Zealand Law Journal} 214.
\textsuperscript{137} T Klimas, \textit{Comparative Contract Law: A Trans-systemic Approach with an Emphasis on the Continental Law} (Carolina Academic Press, Durham, 2006) 190 refer to an \textit{obligation de moyens} as an obligation of diligence which would be equally appropriate. J Gordley, "Impossibility and Changed and Unforeseen Circumstances" (2004) 52 \textit{American Journal of Comparative Law} 513 at 519 refers to \textit{obligations de moyens} as "obligations to use proper means", and E Zamir, "Toward a General Concept of Conformity in the Performance of Contracts" (1991) 52 \textit{Louisiana Law Review} 1 at 42 as "obligations to adopt appropriate means for achieving the purpose".
8.6.1. Distinction between an obligation of result (obligation de résultat or resultaatsverbintenis) and an obligation of means (obligation de moyens or middelenverbintenis)

French law essentially distinguishes between two types of contractual obligations, or more accurately, two types of obligations in contracts. First, there are contracts which bind the debtor to no more than the exercise of reasonable care or diligence to achieve the purpose of the contract. The debtor’s obligation is to take the measures which a reasonable man would take to achieve the purpose of the contract, and this obligation Demoge has therefore called an obligation of means (obligation de moyens). Even where a contract purportedly binds the party to expend maximum effort, the law imposes a duty of reasonable effort or diligence. The debtor is not held to a precise result but only commits himself to diligently pursue the desired result. In other words, viewed in the context of breach of contract an obligation of means (obligation de moyens) is breached if the obligor has not used due diligence or best efforts to perform his obligation under the contract. Accordingly, one can say that the first type of contractual obligation is an obligation of means

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138 D Alessi, “The Distinction between Obligations de Résultat and Obligations de Moyens and the Enforceability of Promises” (2005) 2 European Review of Private Law 657 at 660 points out that the distinction is one of obligations, not of contracts.
140 “Diligence” in French as in English, appears to imply no more than “efforts”, the fact of trying to do something – see M Fontaine, “’Best Efforts’, ‘Reasonable Care’, ‘Due Diligence’ and Industry Standards in International Agreements” (1988) 8 International Business Law Journal 983 at 1015. The word “diligence” in this context does not have the technical meaning it has in the field of corporate law – see C Chappuis, “Provisions for best efforts, reasonable care, due diligence and standard practice in international contracts” 2002 International Business Law Journal 281 at 282.
144 T Klimas, Comparative Contract Law: A Trans-systemic Approach with an Emphasis on the Continental Law (Carolina Academic Press, Durham, 2006) 190 points out that “best efforts” should be read as “reasonable efforts.”
(obligation de moyens) to achieve a promised result.\textsuperscript{145} If the debtor or obligor has used reasonable care the fact that some result the parties hoped for has not come about does not mean that the debtor has failed to perform.\textsuperscript{146} The debtor’s responsibility in the case of an obligation of means (obligation de moyens) is based on fault (faute). The responsibility is subjective, because the employment of standards of care represents the content of obligations of means (obligations de moyens).\textsuperscript{147}

The French concept of an obligation of means (obligation de moyens) is similar to the “duty of best efforts obligation” described in article 5.1.4(1) of the Unidroit Principles of International Commercial Contracts 2004,\textsuperscript{148} namely: “To the extent that an obligation of a party involves a duty of best efforts in the performance of an activity, that party is bound to make such efforts as would be made by a reasonable person of the same kind in the same circumstances.”\textsuperscript{149} The bon père de famille has traditionally been described as “a careful and diligent man, an average man who is aware of his responsibilities. He is responsible for slight or light fault but not the slightest or lightest fault; that is to say, he is responsible for culpa levis in abstracto.”\textsuperscript{150} Pierrot has pointed out, however, that although the test as to what is enough diligence or effort in the context of an obligation of means has traditionally been abstract using the reasonable man (le bon père de famille) as the touchstone,\textsuperscript{151} the test has changed in that the

\textsuperscript{145} D Alessi, “The Distinction between Obligations de Résultat and Obligations de Moyens and the Enforceability of Promises” (2005) 2 European Review of Private Law 657 at 660.


\textsuperscript{147} D Alessi, “The Distinction between Obligations de Résultat and Obligations de Moyens and the Enforceability of Promises” (2005) 2 European Review of Private Law 657 at 665.


\textsuperscript{149} See D Alessi, “The Distinction between Obligations de Résultat and Obligations de Moyens and the Enforceability of Promises” (2005) 2 European Review of Private Law 657 at 689 for a discussion of the difference in the structures of French contract law and contract law according to the Unidroit Principles of International Commercial Contracts 2004 in so far as the use of the distinction between obligations of means and result is concerned. It is not necessary to deal with that issue in this dissertation.


\textsuperscript{151} See F Ferrari, “Comparative Remarks on liability for One’s own Acts” (1993) 15 Loyola Los Angeles International & Comparative Law Journal 813 at 826 and 827 who refers to the standard of “reasonable man” as “independent of the idiosyncrasies of the particular person whose conduct is in question.’ This ‘excellent but odious character’ is not, however, a man who is ‘constantly preoccupied with the idea
reasonable man is now defined as a shrewd and circumspect person of the same profession.\(^{152}\)

Secondly, there are contracts which bind the debtor not only to show due diligence or to take the measures which a reasonable man would take, but to actually achieve the result which he has promised.\(^{153}\) The debtor’s obligation is to achieve a particular result, and this obligation Demogué has therefore called an obligation of result (\textit{obligation de résultat}).\(^{154}\) In other words, viewed in the context of breach of contract an obligation of result (\textit{obligation de résultat}) is breached whenever the obligor has not produced the promised result. Accordingly, one can say that the second type of contractual obligation is an obligation of result (\textit{obligation de résultat}); that is, to achieve a promised result.\(^{155}\) The debtor’s responsibility in the case of an obligation of result (\textit{obligation de résultat}) is not based on fault (\textit{faute}) or dependent upon the application of standards of care. The responsibility is strict and objective, because “the result represents the exact contractual performance whose objective character renders superfluous any consideration of the debtor’s conduct.”\(^{156}\)

The French concept of an obligation of result (\textit{obligation de résultat}) is similar to the "duty to achieve a specific result obligation described in article 5.1.4(2) of the Unidroit Principles of International Commercial Contracts 2004, namely: “To the extent that an obligation of a party involves a duty to achieve a specific result, that party is bound to


\(^{154}\) See M Fontaine, "Content and Performance" (1992) 40 \textit{American Journal of Comparative Law} 645 at 648.

\(^{155}\) D Alessi, "The Distinction between Obligations de Résultat and Obligations de Moyens and the Enforceability of Promises" (2005) 2 \textit{European Review of Private Law} 657 at 660.

\(^{156}\) D Alessi, "The Distinction between Obligations de Résultat and Obligations de Moyens and the Enforceability of Promises" (2005) 2 \textit{European Review of Private Law} 657 at 665.
achieve that result.” The obligation of result (obligation de résultat) is the most common type of obligation under commercial contracts.157

It is apparent that the distinction between obligations of means (obligations de moyens) and obligations of result (obligations de résultat) accentuates the fact that a contractual obligation can lead to either subjective or objective liability,158 and can be assumed with different degrees of intensity159 – sometimes the obliged party promises to achieve a specific result (the promised result being the purpose of the contract), while on other occasions the party merely promises to exert his reasonable efforts to perform the obligation, with no firm undertaking as to the achievement of any specific result.160

The obligation of result (obligation de résultat) in a contract is not, however, absolute. An obligor can escape liability by proving that his failure to achieve or produce the result promised is due to a cause beyond his control, or a so-called cause étrangère or outside cause.161 Thus, the only defence against or excuse for a breach of an obligation of result (obligation de résultat) is impossibility to perform the obligation.162 The burden of proving impossibility or the existence of the exculpating circumstances is on the obligor. The scope of impossibility is far narrower than that of frustration in Anglo-

common law. There has to be an event which makes it absolutely impossible to

158 See D Alessi, ”The Distinction between Obligations de Résultat and Obligations de Moyens and the Enforceability of Promises” (2005) 2 European Review of Private Law 657 at 665.
162 T Klimas, Comparative Contract Law: A Trans-systemic Approach with an Emphasis on the Continental Law (Carolina Academic Press, Durham, 2006) 190 points out that impossibility would also be a defence relieving a person of his best efforts obligation as he merely must use ordinary care – having proved that he did use ordinary care he will not be held liable for non-performance, because in effect he has performed, since his obligation was simply to be diligent.
perform the obligation,\footnote{163} such as an act of God (\emph{force majeure} or \emph{overmacht}) and fortuitous events (\emph{toeval} or \emph{cas fortuity}).\footnote{164} The obligor has to prove that the impediment to the performance of his obligation under the contract was beyond his control and that he could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the contract.\footnote{165} Moreover, the exculpating circumstances would have had to occur prior to the breach of contract and notice of default.\footnote{166}

The essential difference between the two types of obligations lies in the burden of proof.\footnote{167} The distinction has important legal consequences. In respect of both types of contracts or obligations the burden of proving that the debtor or obligor has not performed his obligation rests, as is common, with the creditor or obligee.\footnote{168} When dealing with an obligation of means (\emph{obligation de moyens}) the failure to take care or use best efforts is an essential element in the non-performance of the obligation, and the burden of proof of fault rests with the creditor or obligee.\footnote{169} Thus, the creditor must prove fault in the sense of “lack of care” in order to establish contractual liability where the obligation in question is classified as an obligation of means (\emph{obligation de moyens}).\footnote{170} In other words, if there is only an obligation of means (\emph{obligation de moyens})

\begin{footnotesize}
\addcontentsline{toc}{section}{Notes}

\footnotetext{163}{The impossibility could also, for example, be as a result of exchange control or sanctions legislation which prohibits the transfer of money from a particular country or to a particular country. J Bell, S Boyron and S Whittaker, \textit{Principles of French Law} (Oxford University Press, Oxford, 1998) 342. As to the criteria to determine whether a person could have prevented the supervening event, Bell, Boyron and Whittaker state at 342, by reference to Malaurie and Aynès, that “it is clear that the law is not absolute, it does not require the debtor to be superhuman. Tarzan, Asterix, Tintin, Superman, Rambo or the Count of Monte Cristo; on the other hand, it does not have to accept that he be subhuman, devoid of any sense of effort.”}

\footnotetext{164}{Articles 1147 and 1148 of the Belgian Civil Code refer to acts of God and fortuitous events as circumstances in which the non-performing party cannot be held contractually liable – for example, natural disasters, death, strikes, and war.}

\footnotetext{165}{W De Bondt, “Contracts” in H Bocken and W De Bondt (eds), \textit{Introduction to Belgian Law} (Bruylant, Brussels, 2001) 222 at 236.}


\footnotetext{169}{J Herbots, \textit{Contract Law in Belgium} (Kluwer Law and Taxation Publishers, Deventer, 1995) 114.}


\end{footnotesize}
moyens), dissatisfaction as to the performance received puts the burden on the aggrieved party to prove that the obliged party did not act with the required diligence (en bon père de famille). However, when dealing with an obligation of result (obligation de résultat), the creditor or obligee only has to prove that the promised result had not been achieved, and it is then for the debtor or obligor to prove an outside cause. Thus, the creditor does not have to prove fault. To put it differently, if there is an obligation of result (obligation de résultat), failure to obtain that result presumes fault and constitutes a breach of contract, leaving the defaulting party with the burden of trying to establish an exculpatory cause, such as force majeure. This does not mean, however, that fault in a party who fails to perform an obligation of result (obligation de résultat) is irrelevant because fault comes into the definition of force majeure, which is the primary excuse for the non-performance of an obligation of result (obligation de résultat). It is apparent that the type of obligation assumed by a party to a contract does not only determine the intensity of the efforts required in performing or satisfying his obligation under the contract, but also the situation of the aggrieved party in case performance is not satisfactory.

The distinction between an obligation of means (obligation de moyens) and an obligation of result (obligation de résultat) is not precise, and there is no clear test

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176 In other words, fault does not play a part as such, but rather by way of the defence of cause étrangère – see B Nicholas, "Rules and Terms – Civil Law and Common Law" (1974) 48 Tulane Law Review 946 at 953.
178 See M Fontaine, "Content and Performance" (1992) 40 American Journal of Comparative Law 645 at 649; L du Jardin, Un confort sous-estimé dans la contractualisation des groupes de sociétés: la lettre de patronage (Bruylant, Brussels, 2002) at [58].
which a court should apply ex post facto to determine the intensity of the obligation. The intention of the parties is the decisive factor to distinguish between the two types of obligations. Often the nature of the obligation can be determined from the wording of the contract that enunciates it. If not, the basic test usually applied is that of the aleatory character of the undertaking of the debtor or obligor – if the promised performance can in the ordinary course of events be expected to be achieved, one is dealing with an obligation of result (obligation de résultat). The test is imprecise and in applying it, the court often will have interpreted the contract, especially since it is possible that a party to a contract may be bound to perform both kinds of obligations. The obscurity of the distinction between obligations of means (obligations de moyens) and obligations of result (obligations de résultat) is emphasised by the fact that additional criteria are needed to determine and clarify the distinction. Accordingly, the courts generally determine the likely intention of the parties through an analysis of the particular obligation, using the sort of criteria that have been formulated in article 5.1.5 of the Unidroit Principles of International Commercial Contracts 2004 which states that: “In determining the extent to which an obligation of a party involves a duty of best efforts in the performance of an activity or a duty to achieve a specific result, regard shall be had, among other factors, to –

(a) the way in which the obligation is expressed in the contract;
(b) the contractual price and other terms of the contract;
(c) the degree of risk normally involved in achieving the expected result;


(d) the ability of the other party to influence the performance of the obligation.”

However, Bell, Boyron and Whittaker are of the view that, although various suggestions have been made as to the criteria which French courts use to make the classification between an obligation of result (obligation de résultat) and an obligation of means (obligation de moyens), none is entirely convincing, and the courts appear to be swayed rather by considerations of policy.\textsuperscript{186} Although it is difficult to find a satisfactory criterion, because obligations impose a highly variable degree of duty on the debtor, the distinction between an obligation of means (obligation de moyens) and an obligation of result (obligation de résultat) is still a useful guideline for the courts and widely used as such since it compels the judge to define with some precision what has been promised.\textsuperscript{187} It supplies classification criteria for obligations according to their purpose.\textsuperscript{188} The distinction also provides not only an efficient means for determining and allocating responsibility for breach of contract, but it is “an excellent working tool which, by creating a criterion for the allocation of the burden of proof in civil liability, helps the activity of the courts to easily determine the conditions for the triggering of responsibility.”\textsuperscript{189} It is, therefore, not surprising that this distinction between an obligation of means (obligation de moyens) and an obligation of result (obligation de résultat), which pertains to obligations, is the cornerstone of responsibility for breach of contract in French law,\textsuperscript{190} and has been the hallmark of French law,\textsuperscript{191} and also

\textsuperscript{188} C Chappuis, “Provisions for best efforts, reasonable care, due diligence and standard practice in international contracts” 2002 International Business Law Journal 281 at 284; L du Jardin, Un confort sous-estimé dans la contractualisation des groupes de sociétés: la lettre de patronage (Bruylant, Brussels, 2002) at [60].
\textsuperscript{189} D Alessi, “The Distinction between Obligations de Résultat and Obligations de Moyens and the Enforceability of Promises” (2005) 2 European Review of Private Law 657 at 662. The distinction between obligations of means (obligations de moyens) and obligations of result (obligations de résultat) is a reference model which corresponds to two common types of contractual obligations.
\textsuperscript{190} D Alessi, “The Distinction between Obligations de Résultat and Obligations de Moyens and the Enforceability of Promises” (2005) 2 European Review of Private Law 657 at 666.
Belgian law, on comfort letters.\textsuperscript{192} Moreover, the distinction deals with single obligations, and it is possible that a contract can combine obligations of both types.\textsuperscript{193} As the case law in France shows, whether a particular letter of comfort obliges the parent company to achieve a result (an obligation of obligation) rather than employ means (an obligation of means) often involves difficult questions of interpretation. In practice, however, obligations of result (\textit{obligations de résultat}) are the more common type in contracts.\textsuperscript{194}

Fontaine further points out that, in practice, obligations of means (\textit{obligations de moyens}) and obligations of result (\textit{obligations de résultat}) between them do not cover the field, because some obligations can be stricter than obligations to achieve a specific result.\textsuperscript{195} These obligations are so-called \textit{obligations de garantie} or \textit{absolute obligations} (warranty obligations)\textsuperscript{196} pursuant to which the debtor or obligor is strictly liable, regardless of fault or the existence of an outside cause\textsuperscript{197} – impossibility is not an excuse for non-performance or defective performance or non-payment, because the obligor has assumed the risk of impossibility.\textsuperscript{198}

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\textsuperscript{193} M Fontaine, “Content and Performance” (1992) 40 American Journal of Comparative Law 645 at 650.

\textsuperscript{194} E Zamir, “Toward a General Concept of Conformity in the Performance of Contracts” (1991) 52 Louisiana Law Review 1 at 42.


\textsuperscript{196} E Zamir, “Toward a General Concept of Conformity in the Performance of Contracts” (1991) 52 Louisiana Law Review 1 at 44.

\textsuperscript{197} H Beale, A Hartkamp, H Kötz and D Tallon, Cases, Material and Text on Contract Law (Hart Publishing, Oxford, 2002) 668; T Klimas, \textit{Comparative Contract Law: A Trans-systemic Approach with an Emphasis on the Continental Law} (Carolina Academic Press, Durham, 2006) 191 remarks that there is one exception to this rule, namely the party who is burdened with a warranty obligation will not be held liable if he can prove that the non-performance was due to the fault of the creditor.

Although there has been an attempt to introduce the distinction into American law, in the Anglo-common law jurisdictions, and some Continental jurisdictions like Germany, there is no parallel to the obligation of result (obligation de résultat), and no distinction is made between obligations of means (obligations de moyens) and obligations of result (obligations de résultat). While the distinction between obligations of means (obligations de moyens) and obligations of result (obligations de résultat) has been adopted in the Unidroit Principles of International Commercial Contracts 2004, a normative instrument of great relevance, it is significant that the Principles of European Contract Law has not adopted the distinction. It appears to have been considered that it was not possible to lay down useful general rules on which obligation would apply under what circumstances.

8.6.2. Remedies

Strictly speaking, French law does not refer to remedies for breach of contract like Anglo-common law. Rather, it concerns itself with the effects of contracts or of obligations. In French law the effect of a contract, which is part of the law of obligations, is to create or modify or extinguish an obligation, while the consequence of an obligation is that it is either performed (voluntarily or under legal compulsion) or

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199 See EA Farnsworth, "On Trying to keep One’s Promises: the Duty of Best Efforts in Contract law" (1980) 46 University of Pittsburgh Law Review 1 at 4. Interestingly, C Chappuis, "Provisions for best efforts, reasonable care, due diligence and standard practice in international contracts" 2002 International Business Law Journal 281 at 284 observes that: "It is exciting to see that the best efforts provisions, without any doubt from an American origin, have a particular resonance in systems which, based on the French legal system, regard a summa divisio between the obligation of moyens and that of résultat."


that a substitute for performance is provided by way of damages.\textsuperscript{204} The difference between the approach in French law and Anglo-common law, in theory, is essentially that, in the former, the creditor’s primary recourse is in principle to have the contract performed, while in the latter the primary remedy is damages.\textsuperscript{205} In practice, however, like in Anglo-common law, the usual remedies for breach of contract are specific performance (exécution en nature or uitvoering in natura)\textsuperscript{206} and damages (dommages et intérêts or schadevergoeding).\textsuperscript{207} Where obligations of result (obligations de résultat) are concerned, the nonconformity between the result promised or agreed, and that achieved constitutes not only the breach but is also indicative of the remedy; that is, performing the obligation, or making payment of the sum, promised or agreed as the case may be. Where the obligation can be met by adopting appropriate means for achieving the result (obligation of means), the difference between the hoped-for result and that actually attained is not, however, indicative of the remedy, because the measure of damages in such cases is the difference between the actual result and that which would probably have followed in the absence of fault.\textsuperscript{208} Consequently, compensation in damages may be more difficult to obtain when a letter of comfort contains an obligation of means (obligation de moyens).

\textsuperscript{204} Article 1142 of the French Civil Code provides that any obligation to do or not to do resolves itself into damages, in case of non-performance on the part of the debtor.
\textsuperscript{208} See E Zamir, "Toward a General Concept of Conformity in the Performance of Contracts" (1991) 52 \textit{Louisiana Law Review} 1 at 43.
8.7 Gentlemen’s agreements

Although contracts are agreements under French law, not all agreements are contracts, but only those which create or modify a person’s obligations.209 It is for this reason that purely social agreements are excluded from the definition of contracts.210

The status of gentlemen’s agreements is uncertain in French law.211 Although the courts have accepted that agreements which are expressed to be binding in honour only (or non-binding agreements (accords décontractualisés))212 will not be treated as contracts when made between members of a family or between friends, in other circumstances they nevertheless enforce them, regarding them as an illegitimate attempt to escape the legal consequences of agreements which have been made,213 and using a variety of approaches to justify ignoring honour clauses.214 Accordingly, it has been remarked that the French approach to gentlemen’s agreements is that “the compulsory force [of an agreement] does not originate in the parties’ will, but is a consequence that law relates to the accomplished agreement”, because the “legislator and ‘the judge cannot admit the systematic failure of the statutes and case law’.215 Thus, French law gives contractual effect to any agreement drafted in clear and precise terms which shows the promisor’s intention to be bound, and he cannot escape his

210 See paragraph 4.4 for the discussion in respect of the position in Anglo-common law.
211 See paragraph 4.4.2 for a discussion of the position in Anglo-common law.
214 R Youngs, English, French & German Comparative Law (Routledge-Cavendish, London, 2007) 527. L Vandomme, “Negotiating international contracts” (2003) 5 International Business Law Journal 487 at 496 has observed that: “It is also generally admitted by the French Courts that undertakings binding in honour only have the same value as an ordinary contract and that therefore any exclusion of jurisdiction is void. This results from the position of the French Courts which refuse that it may be possible to escape any form of jurisdiction, whether administrative or arbitral. It appears that under French law, unlike English law, it is difficult to fully understand the scope of contractually moral undertakings or ‘obligations which are not binding.’”
obligations by stating that the promise is binding in honour only.216 Philippe217 is, however, of a contrary view:

“In France, according to the classic doctrine, the ‘honor-only’ deal cannot produce legal effects. Ripert218 wrote that these deals concern only the duty of conscience which the judge cannot enforce so long as he has any soul. In the past, these ‘honor-only’ agreements seemed to be confined to family or friendly relations. However, nowadays, a lot of ‘honor-only’ agreements exist especially in commerce, corporate, and international relations. Thus, there are some situations in which, without binding themselves legally, the parties still intend to bind themselves, and each party expects that the other will carry out the obligation to which they have consented.”

8.8 Early encounters with letters of comfort

The decision of the Tribunal de Commerce Paris (5e Chambre) or Commercial Court of Paris219 in Trade Development Bank France v Cheminées Richard le Drob on 27 October 1981,220 is one of the first French cases dealing with letters of comfort.221 The facts of

218 The reference is to G Ripert, La Regle Morale Dans les Obligations Civiles (4th edition, 1949) 144.
219 In commercial matters, the so-called Commercial Court or Tribunal de Commerce is the court of first instance, and the judges sitting in this court are only merchants, that is, businessmen and there is no professional judge. The consequence is a balance between a business point of view and purely legal considerations, with a tendency of the appellate judges to consider very carefully the business-like approach to problems by the non-professional judges, especially as to the extent of damages to be allocated which is not a legal problem, but more one of fact. The French Supreme Court or Cour de Cassation “has little influence in the matter of violation of a commitment and, ascertaining the amount of damages insofar as the Court of Appeal has given reasons, escapes appreciation by the Supreme Court” – see L Proscour, “Letters of Responsibility: France” (1978) 6 International Business Lawyer 302.
the case were intricate, but may be summarised as follows: A company experienced financial difficulties. In order to overcome its financial woes, the subsidiary caused its parent company to increase its shareholding in it to 67%. The parent company granted a guarantee to Trade Development Bank France (“TDBF”) to secure credit facilities in an amount of FF5 million, and it issued a letter of comfort in favour of TDBF to increase the facilities to FF9 million. The letter of comfort contained statements to the effect that –

(a) the parent company undertook to take all necessary steps to ensure that its subsidiary would be in a position to fulfil all its obligations towards TDBF; and

(b) the parent company undertook to give notice to TDBF of its intention to dispose of its shareholding in its subsidiary.

The Commercial Court of Paris had to decide whether the letter of comfort contained legally binding obligations. The court found that the first undertaking clearly meant that the parent company would provide its subsidiary with the means to comply with its obligations immediately when the subsidiary failed to do so. However, in light of the strong and clear wording of the first undertaking in the letter of comfort and the circumstances in which the comfort letter had been given to TDBF, namely the increase of the credit facilities in the amount of FF4 million, the court held that that undertaking in the letter of comfort constituted an obligation of result (obligation de rechtspraak) (1990) 68 De Naamloze Vennootschap 75 at 78; M de Vita, “La jurisprudence en matière de lettres d’intention: Etude analytique” 1987 (2e sem) Gazette du Palais 667.

221 There is also a decision of the same court dated 25 April 1979, which involved a similar comfort letter, but the decision deals mainly with procedural issues and not the legal effect of the letter of comfort. See RIVF Bertrams and FGB Graaf, “Letters of Comfort en rechtspraak” (1990) 68 De Naamloze Vennootschap 75 at 78.

222 The statement read as follows: toutes les dispositions nécessaires pour que la société [A] soit en mesure de tenir ses engagements à votre égard comme prévu (translated as: all steps necessary to ensure that company [A] is able to keep fulfil its obligations towards you as anticipated).

223 In light of the court’s finding in respect of the first undertaking, the legal effect of second undertaking did not feature in the judgment.

224 The parent company had known of the financial problems of its subsidiary before sending the letter and had benefited from the input of fresh capital.

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résultat) and not an obligation of means (obligation de moyens). Accordingly, the parent company was obliged to capitalise its subsidiary so as to enable the subsidiary to satisfy its indebtedness to TDBF. The amount “covered” or guaranteed by the letter of comfort was the difference between the total sum of the facilities extended to the subsidiary (FF9 million) and the sum secured by the guarantee (FF5 million). Since the parent company had failed to do so, it was ordered to pay damages to TDBF. The court further held that although the letter of comfort containing an obligation of result (obligation de résultat) required authorisation by the board of directors of the parent company pursuant to article 98 of the Law of 24 July 1966 on commercial companies, such authorisation could be implied from earlier board resolutions.

Trade Development Bank France v Cheminées Richard le Droc is an important decision because it distinguishes between four categories of letters of comfort: letters of awareness which are purely informative and entail moral obligations, letters containing obligations of means (obligations de moyens), letters containing obligations of result (obligations de résultat), and letters which are in effect guarantees. The decision established the framework within which the French courts have subsequently dealt with letters of comfort.

In was only in 1987, however, that the legal status of letters of comfort was first recognised by the commercial chamber of the French Cour de Cassation or French

226 The amount of damages awarded was, however, less than FF1 million. The court did not give any reasons why it awarded damages for an amount less than the amount of the facilities “covered” or guaranteed by the letter of comfort.
228 In SARL Worwag v SA Chaffoteaux et Maury, SA Chaffoteaux et Maury v SA Dragages Agglomérés Columbero 31 May 1989, 1989 Dalloz Somm 327, the court did not enforce a comfort letter in view of the absence of board authorisation. See also RIVF Bertrams and FGB Graaf, “Letters of Comfort en rechtspraak” (1990) 68 De Naamloze Vennootschap 75 at 78.
230 Subsequently there have been a number of other noteworthy decisions of the Commercial Court of Paris; for example, Société Générale de Fonderie v SA Champex [1989] Recueil Dalloz Sirey (Jurisprudence) 436; JV Boonacker and ED Drok, De Mogelijke Rechtsgevolgen van de Letter of Comfort 374.
Supreme Court in Viuda de José Tolra v Société de développement regional du Languedoc-Roussillon.\textsuperscript{231} The French Supreme Court responded positively, finding that, despite its unilateral character, a comfort letter could give rise to contractual obligations\textsuperscript{232} even if it did not amount to a formal guarantee of payment or cautionnement.\textsuperscript{233} Advocate-General Montannier suggested that moral responsibility would be insufficient to support the obligations often contained in letters of comfort and the banks would run the risk of exploitation by parties wishing to ensure credit facilities at no cost to themselves.\textsuperscript{234} As tools equivalent to cautionnement or guarantees, he argued that they should be regulated by the law.\textsuperscript{235} The regulation of letters of comfort in French law is discussed, in the next chapter.

\textsuperscript{231} Cour de Cassation (chamber commerciale), 21 December 1987, 1988 Banque 361, or 1988 II Juris-classeur périodique. La semaine juridique number 21113, note by Advocate-General M Montannier – rejecting the appeal from Montpellier, 10 January 1985. See paragraph 9.4.1 for a discussion. This was an appeal from the court in Montpellier dated 10 January 1985, 1985 Dalloz IR 340. See, in general, RIVF Bertrams and FGB Graaf, “Letters of Comfort en rechtspraak” (1990) 68 De Naamlouze Vennootschap 75 at 79 and 80.

\textsuperscript{232} See paragraph 2.6.1.

\textsuperscript{233} On the facts of the case, the letter of comfort in question was found to be indistinguishable from a guarantee. Article 2011 of the French Civil Code provides that whoever guarantees an obligation accepts that he will meet this obligation if it is not met by the debtor.


\textsuperscript{235} Advocate-General Montannier rhetorically asked: \textit{ne vaut-il mieux dans ces conditions le prendre en compte pour le canaliser?} (translated as “would it be better in these conditions to take into account the channel [this route]?”)
9 CONTRACTUAL EFFECT OF LETTERS OF COMFORT IN FRENCH LAW

9.1 Introduction

French legal doctrine and jurisprudence on letters of comfort have been extensive and unique, and have been followed beyond the borders of France in countries like Belgium,1 The Netherlands2 and Ivory Coast.3 In England, Staughton J referred to French Law on comfort letters in Chemco Leasing Spa v Rediffusion Ltd,4 and in Australia Rogers J remarked in Banque Brussels that “the French approach to letters of comfort is refreshingly honest and sensible.”5 Recently, France also became the first jurisdiction to legislate on letters of comfort. In this chapter, I analyse the contractual effect of letters of comfort in French law.

9.2 Letters of comfort and legislation

Ordonnance6 346 of 23 March 2006 significantly changed French security interests laws “with a view to providing players in the business sector with modern and efficient

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1 See for example, the decisions of the Rechtbank van Koophandel Brussels (Commercial Court) in NMKN v Glenoit Mills Inc [1987] Tijdschrift voor Belgisch handelsrecht 64.
2 For example, in Banque Internationale Pour L’Afrique Occidentale Togo SA v BV Compagnie Commerciale Hollando Africaine (unreported decision, roll num H87.0544, 14 December 1988), in the Amsterdam District Court the law of Togo was applicable to a letter of comfort, but the court concluded that the civil law of Togo was identical to that of France, and then said that there was “weinig van geen verschil van deze [letters d’apaisement] naar Frans of naar Nederlands rechts worden beoordeeld, omdat in beide rechtssystemen in de literatuur ten aanzien van dit vraagstuk aansluiting wordt gezocht bij de internationale literatuur en de Angel-Saksische jurisprudentie op dit terrain (translated: there is little or no difference whether the letters of comfort are considered according to French or Dutch law, because in respect of the question the literature in both legal systems follows the international literature and the Anglo-Saxon jurisprudence in this area).” A Gerbranda, “Netherlands Antilles” in WE Moojen and M Ph van Sint Truiden (eds), Bank Security and Other Credit Enhancement Methods (Kluwer Law International, The Hague, 1995) 291 at 308 points out that the judgments and doctrine on comfort letters in The Netherlands are equally applicable under Netherlands Antilles law.
4 (19 July 1985, unreported, QBD) (hereinafter referred to as Chemco Leasing).
6 An Ordonnance or Ordinance is a mode of delegated legislation exercised by the Executive but subject to parliamentary ratification.
collateral instruments.”

As a result of the reform, all security interests laws are now found in the Fourth Book of the French Civil Code which is divided into two titles. The first title deals with personal security interests (sûretés personnelles), while the second title deals with collateral security interests (sûretés réelles).

Apart from redefining the traditional security interests, new security interests were also introduced into the French Civil Code, namely the garantie autonome or independent guarantee and the lettre d’intention or letter of comfort.

The letter of comfort was introduced into the French Civil Code by way of articles 2287-1 and 2322. Until then letters of comfort had been treated as instruments which had their genesis in commercial practice, and which had been developed informally by legal doctrine and jurisprudence in France. The Ordonnance of 23 March 2006 was a consequence of the Law of 26 July 2005, a law to instil confidence and modernisation in the French economy, which specifically dealt with the reform of the law of personal


8 See J Herbet and C Sabbah, "Will secured lending in France benefit from recent overhaul of Civil Code provisions relating to security interests?" [2006] International Business Law Journal 853. The reform was based on the recommendations of the Grimaldi Commission and was aimed at creating an up to date, coherent and attractive set of rules which are not only theoretically sound but would facilitate efficient security interests to support economic development.


10 See J Herbet and C Sabbah, "Will secured lending in France benefit from recent overhaul of Civil Code provisions relating to security interests?" [2006] International Business Law Journal 853 at 854. Article 2321 of the Civil Code defines the independent guarantee as "the undertaking pursuant to which a guarantor undertakes to pay a certain amount of money in consideration of a third party’s obligation, upon immediate demand or according to agreed upon terms." The difference between an independent guarantee and a guarantee lies in the fact that the guarantor may not assert any claims in connection with the original obligation arising out of the debtor-creditor relationship.

11 As C Pomart, "La lettre d’intention après l’ordonnance du 23 mars 2006 relative aux sûretés" (2008) 63 Petites affiches 19 has observed, in regard to letters of comfort, it is about "donner une base légale à la lettre d’intention par laquelle un tiers exprime au créancier son intention de soutenir le débiteur dans l’exécution de son obligation" (translated: giving a legal basis to the letter of comfort by which a third party expresses his intention to a creditor, supporting the debtor in executing his obligation).

and real securities, and which was in particular concerned with providing a legal basis for the letter of comfort by which a third party expressed its intention to a creditor to support a debtor in performing its obligations. The aim of the reform was to dispel any uncertainties in relation to the legal nature of the comfort letter. The result of the reform, however, was that despite some clarification there were still some uncertainties surrounding the letter of comfort in French law.

Article 2322 of the French Civil Code refers to the letter of comfort as a "letter of intent", and defines it as l’engagement de faire ou de ne pas faire ayant pour object le soutien apporté à un débiteur dans l’exécution de son obligation envers son créancier (translated: an undertaking to do or not to do which purpose is the support provided to a debtor in the performance of his obligation in respect of his creditor). This is a curious definition and requires comment. First, the terminology used, letter of intent instead of letter of comfort, is confusing as mentioned in paragraph 2.3. Secondly, the definition appears to be the culmination of legal evolution, and confirms the definition of letter of comfort used in the 1987 decision of the French Supreme Court in Viuda de José Tolra v Société de développement regional du Languedoc-Roussillon.

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15 J Herbet and C Sabbah, “Will secured lending in France benefit from recent overhaul of Civil Code provisions relating to security interests?” [2006] International Business Law Journal 853 at 854 point out that although innovative, legally delimitation of the letter of comfort in the Code Civile raises the issue as to what qualification should be given to letters that do not exactly satisfy the defined requirements. Moreover, since the letter of comfort has traditionally been treated as a purely contractual product which the parties may adapt to their needs, the legislator was conscious of the fact that setting stringent legal boundaries for letters of comfort would limit their practical utility.
16 I have used the English translation of the French Civil Code available on the website of Legifrance.
19 (1989) Recueil Dalloz Sirey (Jurisprudence) 112, conclusion by M Montanier and annotated by JP Brill. See paragraph 9.3.1 for a discussion of this decision.
without clarifying its legal nature.\textsuperscript{20} Thirdly, article 2322 of the French Civil Code expresses a definition of the letter of comfort which is usually referred to in French legal doctrine as the so-called “letter of intent strictly speaking”.\textsuperscript{21} In other words, article 2322 of the French Civil Code encapsulates the definition of so-called binding letters of comfort; that is, it deals with medium strength letters of comfort which contain obligations of means (\textit{obligations de moyens}) or obligations of result (\textit{obligations de résultat}), as well as strong or hard letters of comfort which are in effect \textit{garanties à première demande} (first instance guarantees) rather than with weak or soft letters of comfort giving rise only to moral obligations.\textsuperscript{22} Article 2322 of the French Civil Code does not, however, deal with the distinction between obligations of means (\textit{obligations de moyens}) and obligations of result (\textit{obligations de résultat}).\textsuperscript{23} Fourthly, although the jurisprudential origin of the definition is understandable, its unitary nature is puzzling. The definition uses the singular, referring to “a letter of intent”, while it is clear from both French legal doctrine and jurisprudence that, until the adoption of the statutory definition, letters of comfort were referred to in the plural.\textsuperscript{24} In so far as the definition purports to convey that there is something such as \textit{the} letter of comfort, it is arguably wrong and evidences a misunderstanding of letters of comfort because the content and legal enforceability of letters of comfort vary according to their drafting,\textsuperscript{25} and the type of obligations, which can vary in intensity.

\textsuperscript{20} L. Aynès, “Présentation générale de la réforme du droit des sûretés” 2006 Recueil Dalloz Sirey de doctrine, de jurisprudence et de legislation 1289 at 1290.
\textsuperscript{22} D Houtcieff, “Les sûretés personnelles” 2006 (May) Juris-classeur périodique. La semaine juridique (supplement) 7 at 10.
\textsuperscript{23} See D Houtcieff, “Les sûretés personnelles” 2006 (May) Juris-classeur périodique. La semaine juridique (supplement) 7 at 10.
\textsuperscript{24} See paragraph 9.3.
\textsuperscript{25} See paragraph 2.5. C Pomart, “La lettre d’intention après l’ordonnance du 23 mars 2006 relative aux sûretés” (2008) 63 Petites affiches 19 at 20 pointed out that the draft article 2322 definition differed from the enacted definition in that it referred to the variability of terms found in letters of comfort, which read to the effect that “the letter of intent is an undertaking to do or not do, signed by a third party, on variable terms, and having as its objective the support given to a debtor in the performance of his obligation to a creditor.”
depending upon whether they are obligations of means (obligations de moyens) or obligations of result (obligations de résultat).26

The French letter of intent or comfort letter is now classified as a personal security as stated in article 2287-1 of the French Civil Code: Les sûretés personnelles régies par le présent titre sont le cautionnement, la garantie automome et la lettre d’intention (translated: Personal securities regulated by this title are suretyship, independed guarantee and letter of intent (letter of comfort)).27 It is now in the same chapter of the French Civil Code as securities like suretyship. Classified as a security, the letter of comfort in French law seems to have moved further away from obligations of means, moving closer to obligations of result, or even suretyship (contrat de garantie) without actually being a suretyship.28 According to Adelle, the French codification of the letter of comfort is “[S]ufficiently general not to reduce the parties’ flexibility in characterising instruments which are broadly used in international transactions, the codification formally recognises these instruments as enforceable collaterals in France.”29 It is clear, however, that letters of comfort are defined by reference to the variable terms of the commitment of the issuer so that the legal doctrine30 and case

26 See paragraph 8.6.1.
27 In Luxembourg, where there is no equivalent provision in its legislation but the law is similar to that in France, a letter of comfort does not, according to C Zeyen and K Manhaeve, “Luxembourg” in WE Moojen and M Ph van Sint Truiden (eds), Bank Security and Other Credit Enhancement Methods (Kluwer Law International, The Hague, 1995) 255 at 271, constitute a personal security right, “since it does not give the creditor a second debtor. It only creates a duty to perform (‘obligation de faire’) some specific act(s). If the signatory fails to perform the latter, ordinary principles of liability apply ... The letter of comfort, can in certain cases amount to a true suretyship. Two conditions must be met: first, there should be an undertaking to pay the subsidiary’s debt, and second, there may be no personal contribution to the said debt (this means that the parent company will be able to call upon its subsidiary to obtain reimbursement). In such case the rules relating to suretyship will apply.”
law on letters of comfort predating the legislation distinguishing between an obligation of result (obligation de résultat) and an obligation of means (obligation de moyens) are still relevant. In other words, the intensity or scope of the obligation contained in a particular litigated letter of comfort will still have to be determined by the court.

The French legislation on personal security interests which has provided letters of comfort with a statutory basis, is reminiscent of the Principles of European Law on Personal Security or the so-called “PEL Pers Sec”. In both the PEL Pers Sec and the French Civil Code a letter of comfort, other than a letter of awareness, is regarded as a form of personal security, albeit atypical. However, there two important differences between the comfort letter regimes of the PEL Pers Sec and the French Civil Code. First, pursuant to article 2:101(2) of the PEL Pers Sec, a binding comfort letter is only


31 It should be noted that in French law the term obligation may bear two significances: it may describe the totality of the relationship between two parties, the duty-bearer (known as the débiteur, whether or not the obligation concerns a sum of money) and the right-holder (known as créancier, equally generally). However, obligation may also bear the significance which is most common to the English word obligation: that is, to describe the duty itself, la dette, the correlative of which is the creditor’s personal right, the droit de créance. See S Whittaker, “Performance of Another’s Obligation: French and English Law Contrasted” (2000) Oxford University Comparative Law Forum 7.


33 The principles were prepared by the Study Group on a European Civil Code and the Research Group on EC Private Law (Acquis Group), and the Draft Common Frame of Reference (DCFR) was published as Principles, Definitions and Model Rules of European Private Law (Sellier European Law Publishers, Munich, 2009), edited by C von Bar, E Clive, H Schulte-Nölke, H Beale, J Herre, J Huef, M Storme, S Swann, P Varul, A Veneziano and F Zoll. See also U Drobnig (ed), Principles of European Law: Personal Security (Oxford University Press, Oxford, 2007) at 3 to 12. The English text is the authentic text, but there are also French, Danish, German, Italian, Spanish and Dutch texts available.

34 U Drobnig (ed), Principles of European Law: Personal Security (Oxford University Press, Oxford, 2007) at 124 and 128 points out, however, that most binding letters of comfort used in commercial transactions differ from the usual forms of personal security in that the comfortor undertakes to make payment to its subsidiary in order to enable it to perform its obligations to the comfortee. Practice converts any breach of this promise, especially in the subsidiary’s insolvency, to a claim for damages by the comfortee against the comfortor.
presumed to be a dependent personal security.\textsuperscript{35} Secondly, in accordance with the Principles of European Contract Law,\textsuperscript{36} PEL Pers Sec does not refer to the distinction between obligations of means (\textit{obligations de moyens}) and obligations of result (\textit{obligations de résultat}).

The PEL Pers Sec distinguishes between two types of contractual personal security\textsuperscript{37} – dependent personal security, which includes “binding comfort letters”,\textsuperscript{38} and independent personal security.\textsuperscript{39} The terms “dependent” and “independent” personal security are not derived from any national legal system, but have been coined to express the salient features of the two central institutions covered by the PEL Pers Sec.\textsuperscript{40} Article 1:101(a) of the PEL Pers Sec defines a dependent personal security

\textsuperscript{35} U Drobnig (ed), \textit{Principles of European Law: Personal Security} (Oxford University Press, Oxford, 2007) at 196. The presumption of the classification of a binding letter of comfort can be rebutted. The presumption is based upon the typical interests pursued by a comfortor in issuing a binding letter of comfort in a commercial transaction: on the one hand, if the promise to the comfortee to support the subsidiary financially is not met, the breach of that promise is sanctioned by an obligation to compensate the comfortee for its damages. On the other hand, the comfortor will not be willing to be liable for those obligations of the subsidiary which are subject to objections or defences. A Carraśo, “The DCFR – Guarantee and Personal Security” (2008) 4 \textit{European Review of Contract Law} 389 at 391 and 392 remarks, however, that the presumption is “certainly bizarre and original, because the equation of the binding comfort letter to the classical surety ship rests unsupported on the common experience in the different European Law systems. Probably, further, this presumption is also contrafactual, because parties to a letter of comfort who are intended to be bound (by a strong comfort letter) normally agree that the most binding commitment the issuer will bear is to make the necessary advances to the debtor for such debtor be able to comply with the underlying duty when needed.”

\textsuperscript{36} See paragraph 8.6.1.


\textsuperscript{38} See article 1:102(1)(a) of the PEL Pers Sec. Binding comfort letters are referred to as \textit{les lettres de confort obligatoires} in the French text, \textit{bindende hensigterklæringer} in the Danish text, \textit{bindende patronaatsverklaringen} in the Dutch text, \textit{bindender Patronatserklärungen} in the German text, \textit{le lettere di patronage vincolanti} in the Italian text, and \textit{las cartas de patrocinio que contienen} in the Spanish text. See paragraph 2.3 for the variety in terminology used for comfort letters in legal texts.


(suretyship guarantee)\(^{41}\) as “a contractual obligation by a security provider to make payment or to render another performance or to pay damages to the creditor that is assumed in order to secure a present or future obligation of the debtor owed to the creditor and that depends upon the validity, terms and extent of the latter obligation.”\(^{42}\) Thus, the security under article 1:101(a) of the PEL Pers Sec may take three forms: the payment of money, the rendering of another performance, or the payment of damages.\(^{43}\) The PEL Pers Sec does not refer to the concepts of obligations of means and obligations of result as used in French law, but in the context of letters of comfort the effect of the security obligation under the PEL Pers Sec is similar to that under article 2322 of the French Civil Code. Both article 101:1(a) of the PEL Pers Sec and article 2322 of the French Civil Code make it clear that a “binding comfort letter” or comfort letter “strictly speaking” as a personal security is a contractual obligation of the security provider or comfortor to make payment or render another performance to the creditor or comfortee. A preliminary general issue under both article 1:101(a) of the PEL Pers Sec and article 2322 of the French Civil Code is whether letters of comfort are binding. This issue is outside the rules of the PEL Pers Sec and must be solved according to the general rules of interpretation laid down in Chapter 5 of the PECL.\(^{44}\)

\(^{41}\) The dependent personal security (suretyship guarantee) is referred to as contrats de cautionnement (sûretés personnelles accessoires) in the French text, kautions (afhængige personlige sikkerheder) in the Danish text, borgtochten (afhankelijke persoonlijke zekerheid) in the Dutch text, Bürgschaften (abhängige persönliche Sicherheiten) in the German text, fideiussioni (garanzie personali dipendenti) in the Italian text, and las fianzas (garantias personales dependientes) in the Spanish text.

\(^{42}\) Article 101:1(b) of the PEL Pers Sec defines an independent personal security (indemnity/independent guarantee) as “a contractual obligation assumed for the purposes of security by a security provider to make payment or to render another performance or to pay damages to the creditor that is expressly or impliedly agreed not to depend upon the validity, terms or extent of another person’s obligation owed to the creditor.”


\(^{44}\) U Drobnig (ed), Principles of European Law: Personal Security (Oxford University Press, Oxford, 2007) at 124. Chapter 5 contains the rules of interpretation which is similar to the French guidelines in articles 1156 to 1164 of the French Civil Code. For example, a contract is to be interpreted according to the common intention of the parties even if this differs from the literal meaning of the words (article 5:101(1)); if it is established that one party intended the contract to have a particular meaning, and at the time of the conclusion of the contract the other party could not have been unaware of the first party’s intention, the contract is to be interpreted in the way intended by the first party (article 5:101(2)); if an intention cannot be established according to either articles 5:101(1) or (2), then the contract is to be interpreted according to the meaning that reasonable persons of the same kind as the parties would give to it in the same circumstances (article 5:101(3)); in interpreting a contract regard
The position is similar in French law where the courts will still have to construe a letter of comfort which is litigated having regard to articles 1156 to 1164 of the French Civil Code as discussed in paragraph 8.5. In other words, the PEL Pers Sec provisions, like the French Civil Code provisions on letters of comfort, only apply after it has been determined that a letter of comfort is binding or has legal effect.45

9.3 Letters of comfort and selected case law

French courts have considered the legal effect of letters of comfort on numerous occasions.46 It is not possible, however, in the context of and within the limits of this dissertation to discuss all the French decisions on comfort letters.47 Accordingly, I will only discuss a selection of the decisions48 of the French Supreme Court (Cour de Cassation (Chambre Commerciale), in order to give an overview of the approach of the French courts to letters of comfort. Compared to Anglo-common law decisions, analysing French decisions is more limited, because –

“it can be said that the laconic decisions, the anonymous authorship of decisions without dissents, and the authoritarian tone, confines [French] judges to the language of assertion and logical inevitability that prevents

must be had to, among other things, the circumstances in which it was concluded (including preliminary negotiations), the conduct of the parties (even subsequent conduct), the nature and purpose of the contract, good faith and fair dealing (article 5:102); the contra proferentem rule is applicable (article 5:103); and the contract must be interpreted as a whole (article 5:105).


48 See, for example, the other decisions: Locafrance v Holding Enterprises, a decision of the Cour de Cassation (Chambre Commerciale) of 15 October 1996 in [1997] Recueil Dalloz (Jurisprudence) 330 with the note by S Piedelièvre.

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them from developing a full reasoning which could be educational and thus better understood and accepted.\textsuperscript{49}

Although several questions arise about the evaluation of the facts, the legal consequences flowing from the facts, and the legal reasoning behind the findings, I have not, for the sake of brevity due to word length consideration and by reason of the purpose of the discussion as set out in paragraph 8.1, descended into a detailed critical analysis of the decisions.

9.3.1.  \textit{Viuda de José Tolra v Société de développement regional du Languedoc-Roussillon} - decision of the \textit{Cour de Cassation (Chambre Commerciale)} dated 21 December 1987\textsuperscript{50}

9.3.1.1 The facts

Textiles du Vallespir ("TV"), a subsidiary of the Spanish company, Viuda de José Tolra ("Tolra"), obtained three loans from Société de développement régionale du Languedoc-Roussillon ("Solder") for purposes of constructing a factory in 1973. In addition to security given to secure the first loan, Tolra provided Solder with a letter of comfort dated 29 May 1974 in which Tolra affirmed its intention to “support its subsidiary in its financial needs and, in the event that it should be necessary, to substitute itself to meet all the commitments that it would make vis-à-vis Solder”, expressing at the same time its willingness to watch in a permanent fashion over its total solvency and confirming its “intention, in the case of necessity, to take immediately the necessary steps with the Spanish authorities, in order to obtain permission for the transfer of funds”.\textsuperscript{51} The letter of comfort was not only mentioned in a notarial deed executed in


respect of the third loan, but it also envisaged the second loan. Corporate reorganisation proceedings were commenced in respect of TV, and TV was subsequently placed into liquidation. Solder instituted action against Tolra for payment of the second and third loans plus interest based in the letter of comfort. Solder was successful with its claim at first instance, and Tolra's subsequent appeal was unsuccessful.

9.3.1.2 The issue

Tolra argued that the court below erred in finding that the letter of comfort contained result obligations, because the unilateral letter of comfort could not create a civil obligation.\textsuperscript{52} In light of the fact that Tolra unilaterally expressed its intent without the formation of a contract due to the lack of agreement between the parties, Tolra could not incur any civil obligation towards Solder. Tolra further argued that the obligation in the letter of comfort whereby it would substitute itself for TV in order to meet TV's obligations to Solder constituted a contract of suretyship which had to be express and had to have a determined or determinable object.\textsuperscript{53} The letter of comfort contained an obligation to reach a result different from that of a suretyship.

9.3.1.3 The decision

This was the first occasion in which the French Supreme Court had to deal with a letter of comfort and its effects.\textsuperscript{54} The French Supreme Court dismissed the argument about

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\textsuperscript{51} The letter of comfort provided: “As the majority shareholder of TV, we confirm our intention to follow and support our subsidiary in its financial needs and, should it be necessary, to substitute ourselves for it in regard to all commitments which it might enter into with yourselves, our concern being to ensure that it remains totally solvent. We confirm our intention, in the event of need, of immediately taking the necessary steps with our authorities in order to obtain authorisation to transfer the funds.” See H Beale, A Hartkamp, H Kötz and D Tallon (eds), \textit{Cases, Materials and Texts on Contract Law} (Hart Publishing, Oxford, 2002) 106.

\textsuperscript{52} See SA Riesenfeld and WJ Pakter, \textit{Comparative Law Casebook} (Transnational Publishers, Ardsley NY, 2001) 410.


\textsuperscript{54} See the opinion of Attorney-General M Montainer (1988) \textit{62 Jurisclasseur périodique Jurisprudence} 2113.
the unilateral character of the letter of comfort.\textsuperscript{55} It held that the letter of comfort might, according to the terms in which it was couched, and where it had been accepted by the addressee, Solder, and regard being had to the common intention of the parties, impose a contractual liability on the part of Tolra (the issuer of the letter of comfort) to act or not to act (\textit{obligation de faire}), which might be an obligation of means (\textit{obligation de moyens}) but might go as far as to impose an obligation of result (\textit{obligation de résultat}), even if it did not constitute a contract of suretyship (\textit{contrat de garantie}).\textsuperscript{56} In other words, in the circumstances where Solder accepted the letter of comfort in order to extend facilities to TV, there was an offer by reason of the letter of comfort, and an acceptance of the offer by Solder, resulting in an agreement between Tolra and Solder.\textsuperscript{57} The letter of comfort contained an obligation of result (\textit{obligation de résultat}) on the part of Tolra which was different from an obligation under a suretyship (\textit{obligation de garantie}).\textsuperscript{58} The court emphasised that it was the task of the court to qualify the letter of comfort and categorise the obligations contained therein without being tied to the designation which the parties had given to it.\textsuperscript{59}

Tolra’s argument about the letter of comfort being a contract of suretyship (\textit{contrat de garantie}) without a determinate or determinable object was also dismissed. It was held that although a suretyship could not be inferred but had to be in express terms,\textsuperscript{60} it was possible for a party, who by means of an unequivocal and informed declaration of intent declared that he would undertake to meet the obligation of the debtor if the latter failed to do so itself, to set itself up as guarantor of the obligation of the

\textsuperscript{58} See paragraph 8.6.1.
\textsuperscript{60} SA Riesenfeld and WJ Pakter, \textit{Comparative Law Casebook} (Transnational Publishers, Ardsley NY, 2001) 411.
debtor. In the present matter Tolra unequivocally obligated itself to perform TV’s obligation to Solder itself – that is, to pay TV’s indebtedness to Solder – and in light of TV’s default, Tolra had to pay to Solder any balance remaining due on the stipulated loans.

The French Supreme Court held, however, that even if the letter of comfort contained an obligation on the part of Tolra to pay Solder the outstanding amount of TV’s indebtedness, the obligation would be void because the obligation did not conform to Spanish company law. The court below erred in applying French law on the basis that it was “seized with a litigation based on acts and facts having taken place in France and to which French law applies”; because Tolra was a Spanish company and the powers of its managers had to be determined according to its national law, Spanish law. The judgment of the court below was set aside, but the matter was remanded to the Lyons Court of Appeal to deal with the matter in accordance with Spanish law.

The judgment of the French Supreme Court, based on carefully drafted reasoning, touched upon most of the questions arising in connection with comfort letters and the different forms they take. The court distinguished between obligations of means (obligations de moyens) and obligations of result (obligations de résultat). In case of the former, the parent company would only have an obligation to provide the means

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64 See SA Riesenfeld and WJ Pakter, Comparative Law Casebook (Transnational Publishers, Ardsley NY, 2001) 411.
65 Article 3 of the French Civil Code provides that the status and capacity of French nationals are governed by French law even if they reside abroad. Article 3 of the Law of 24 July 1966 on commercial companies subjected the capacity of foreign corporations and their offices to the law of the location of their headquarters.
to its subsidiary to satisfy its obligations, while in case of the latter, the parent company would have a genuine obligation to secure a result, namely to take the place of the defaulting debtor subsidiary, which would constitute a guarantee. 68 As discussed in paragraph 8.6.1, this classification, which was fundamental to French law, determined not only the nature of the obligation undertaken, but also established when it would be breached. 69 Under French law, an obligation of result (obligations de résultat), being tantamount to a guarantee, required board authorisation pursuant to article 98 of the Law of 24 July 1966 on commercial companies. 70

In the final analysis, however, it is clear that the determination of the nature of the obligation in a letter of comfort is all a question of interpretation which depends on the form of words used, and which is all the more difficult to resolve since frequently the parties are careful not to be too specific 71 in regard to the commitments which they are undertaking. 72

69 See also P Giliker, “Taking comfort in certainty: to enforce or not to enforce the letter of comfort” 2004 Lloyd’s Maritime and Commercial Law Quarterly 219 at 225.
71 In fact, the ambiguity in the wording of letters of comfort is often intentional, as Staughton J has observed in Chemco Leasing Spa v Rediffusion Plc (19 July 1986, unreported, QBD).
9.3.2. Compagnie générale de banque Citibank v SA Le Crédit d’équipement des petites et moyennes entreprises (CEPME) et autres – decision of the Cour de Cassation (Chambre Commerciale) dated 23 October 1990

9.3.2.1 The facts

Compagnie générale de banque Citibank (“Citibank”), in cooperation with Société Crédit d’équipement des petites et moyennes entreprises (“CEPME”), extended a privileged line of credit (credit de mobilisation de creance) to Société Cooperative d’entreprise générale du midi (“CEGM”). In order to obtain a renewal of the line of credit, Société de pavage et des asphalts de Paris (“SPAPA”) addressed a letter of comfort dated 1 April 1981 to the creditors of CEGM stating that SPAPA would do everything necessary to enable CEGM to dispose of funds sufficient to meet its obligations. CEGM failed to make repayments and Citibank and CEPME demanded the payments from SPAPA.

The Paris Court of Appeal (Cour d’Appel) dismissed Citibank’s appeal on the basis that although the letter of comfort was signed by the general director of SPAPA, Mr Gee, it was not authorised by the board of directors (the so-called administrative council) of SPAPA.

9.3.2.2 The issue

Citibank appealed to the French Supreme Court on the ground that the letter of comfort merely imposed on SPAPA an obligation to bring about a result and that such an obligation of result (obligation de résultat) did not constitute an agreement of guarantee within the meaning of article 98 of the Law of 24 July 1966 on commercial


74 See SA Riesenfeld and WJ Pakter, Comparative Law Casebook (Transnational Publishers, Ardsley NY, 2001) 408.

companies which required a guarantee to be authorised by the board of a guarantor company. Citibank argued further that article 98 of the Law of 24 July 1966 on commercial companies had to be interpreted restrictively and applied only to guarantees which entailed an obligation by the obligor to substitute itself as debtor in favour of a third party and constituted a necessary diminution of the assets or patrimony of the obligor. Citibank submitted that the letter of comfort signed by Mr Gee on behalf of SPAPA constituted neither a diminution of the assets or patrimony of SPAPA, nor did SPAPA substitute itself as debtor for CEGM. Thus, it was argued, the letter of comfort was not a guarantee for purposes of article 98 of the Law of 24 July 1966 on commercial companies which required board approval.

9.3.2.3 The decision

The court dismissed Citibank’s appeal and held that the letter of comfort imposed an obligation of result (obligation de résultat) on SPAPA in a manner which rendered SPAPA liable for the consequences of the default of CEGM. Accordingly, the letter of comfort constituted a guarantee for purposes of article 98 of the Law of 24 July 1966 on commercial companies which required board approval.76 Since the letter of comfort was not authorised by the board of SPAPA, it could not be enforced against the latter.77

76 The Cour de Cassation was bound by the finding of the Paris Court of Appeal that the result obligation constituted a guarantee – see SA Riesenfeld and WJ Pakter, Comparative Law Casebook (Transnational Publishers, Ardsley NY, 2001) 408.
9.3.3. **Compagnie générale de travaux et d'installations électriques v Banque atlantique de Côte-d'Ivoire - decision of the Cour de Cassation (Chambre Commerciale) dated 19 March 1991**

9.3.3.1 **The facts**

On 8 September 1982, Société compagnie générale de travaux et d'installations électriques ("GTIE") provided a letter of comfort to Banque atlantique de Côte-d'Ivoire ("BACI") which extended credit facilities to GTIE’s wholly-owned subsidiary, Société L'Ivoirienne électrique ("LIE"). The letter of comfort provided to BACI stated that, among other things, GTIE would watch “very closely that the financial policy defined in a common agreement be observed and, especially, that the obligations of LIE vis-à-vis your enterprise be performed” and that GTIE would give BACI prior written notice of its intention to divest itself of its shares in LIE. On 28 November 1985, GTIE effectively divested itself of its shareholding in LIE by transferring the shareholding to another company in payment of the balance of a debt of LIE. LIE went into liquidation.

BACI instituted proceedings against GTIE based on the letter of comfort claiming that GTIE had to ensure that LIE, its former subsidiary, performed its obligations to BACI by repaying the credit facilities extended to LIE. BACI was successful at first instance and GTIE’s appeal to the Versailles Court of Appeal was also dismissed.

9.3.3.2 **The issue**

On appeal GTIE asserted that it had intervened several times to support LIE; for example, GTIE as surety paid a debt of FF 209,011,980 on behalf of LIE, and it paid out a running account of LIE so that the account showed a positive balance of FF 1,700,000

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78 (1991) IV No 110 Bulletin officiel des arrêt de la Cour de cassation 77.
in favour of LIE resulting from a loan by GTIE to LIE. GTIE submitted that it had used its best efforts to comply with its obligations under the letter of comfort provided to BACI.\textsuperscript{82}

9.3.3.3 The decision

The French Supreme Court held that an obligation of means (\textit{obligation de moyens}) imposed on the obligor a duty of providing means reasonably within its power - that is, the focus in determining whether or not GTIE had satisfied its obligation under the letter of comfort should not merely be on the needs of LIE, but the examination ought to be whether GTIE possessed the means to go beyond the interventions GTIE made for the benefit of LIE. In the present case, the court found that by looking at the interventions GTIE made on behalf of LIE, it was apparent that, having regard to GTIE’s financial position, it was not possible for GTIE to do more for LIE than what it had done.

The court was, however, critical of GTIE’s “brutal dis-involvement” from LIE without giving BACI any prior notice.\textsuperscript{83} The court found GTIE’s disinvestment of its shares in LIE to be a manifestation of GTIE’s desire to limit its obligations and to minimise as far as possible the consequences of the management of LIE for which GTIE was responsible as a sole and later dominant shareholder, especially at a time when LIE was experiencing financial difficulties. In the circumstances, GTIE’s intentional breach of its obligation under the letter of comfort by failing to give BACI prior written notice of the change in the shareholding of LIE, thereby preventing BACI from taking the measures it might have deemed appropriate in view of the changes circumstances, was clear proof that GTIE was conscious of the fact that it had not fully satisfied its obligation of means (\textit{obligation de moyens}) to BACI by employing all means reasonably within its power. Accordingly, contractual fault (\textit{faute contratuelle}) was established and GTIE could not

\textsuperscript{82} SA Riesenfeld and WJ Pakter, \textit{Comparative Law Casebook} (Transnational Publishers, Ardsley NY, 2001) 405.

rely on the defence that it was not able to do more for the benefit of BACI. GTIE’s appeal was dismissed.84

9.3.4. **SNE Sitraco v Société Curtainwalls Unlimited Inc – decision of the Cour de Cassation (Chambre Commerciale) dated 16 July 1993**85

9.3.4.1 The facts

Société Sitraco-Curtainwalls (“Sitraco”) was a subsidiary of Société SNE Sitraco (“SNES”). Curtainwalls Unlimited Inc (“Curtainwalls”), an American corporation, extended credit facilities to Sitraco. SNES participated in the negotiation of the facilities to its subsidiary and, on 28 August 1982, gave a letter of comfort to Curtainwalls which provided that, among other things –

(a) Sitraco “has and will have our total support in its engagements which it undertakes vis-à-vis you, according to the terms of the agreement mentioned below”;

(b) Upon demand of supplementary services by Cutainwalls, “we confirm to you hereby the authorisation of [Sitraco] to obligate itself to incur this supplementary expenditure.”86

Sitraco defaulted and Curtainwalls instituted proceedings claiming that SNES was obliged to perform Sitraco’s obligations pursuant to the letter of comfort. Curtainwalls’ claim was upheld by the Versailles Court of Appeal and SNES was ordered to pay to Curtainwalls the total amount of Sitraco’s indebtedness.

9.3.4.2 The issue

SNES asserted on appeal that although in the letter of comfort it gave Sitraco its “support in all the obligations into which it entered”, SNES had never declared that it substituted itself for Sitraco to meet the financial obligations to Curtainwalls, or that it would satisfy Sitraco’s obligation if the latter defaulted. SNES further contended that the Versailles Court of Appeal erred in deducing an undertaking of SNES from the fact that the letter of comfort contained an “allusion” to the financial conditions of the agreement between Curtainwalls and Sitraco, and from the fact that SNES participated in the negotiations between Sitraco and Curtainwalls. Apparently there was no question whether the letter of comfort was properly authorised by the board of SNES as required by article 98 of the Law of 24 July 1966 on commercial companies.

9.3.4.3 The decision

The French Supreme Court dismissed SNES’ appeal. The court held that the wording of the letter of comfort read in the context of the circumstances, where the director of finances of SNES participated directly in the negotiations between Curtainwalls and Sitraco, clearly indicated that SNES undertook an obligation of means (obligation de moyens) in respect of Sitraco’s obligations to Curtainwalls. In other words, SNES obligated itself to comply to all reasonable means for the purposes that the obligations incurred by its subsidiary, Sitraco, vis-à-vis Curtainwalls were satisfied. On the evidence, SNES failed to use reasonable efforts to enable Sitraco to meet its indebtedness to Curtainwalls. Accordingly, SNES had to pay the total amount of Sitraco’s indebtedness to Curtainwalls.

90 SA Riesenfeld and WJ Pakter, Comparative Law Casebook (Transnational Publishers, Ardsley NY, 2001) 395
9.3.5. Sony Music Entertainment France v France Télécom – decision of the Cour de Cassation (Chambre Commerciale) dated 26 January 1999

9.3.5.1 The facts

Mediadealers, a subsidiary of Sony Music Entertainment France (“Sony”), owed a debt to France Télécom (“Télécom”) in the amount of FF2,407,699.93. Sony provided Télécom with a comfort letter in terms of which Sony undertook to:

(a) make all necessary arrangements for the proper performance of Mediadealers’ obligations;

(b) guarantee that Sony would organise itself so that Mediadealers would fulfil its obligations.92

Mediadealers became insolvent and Télécom called on Sony to comply with the terms and conditions of the letter of comfort.93

9.3.5.2 The issue

In the French Supreme Court, Sony argued that a letter of comfort was a guarantee under article 98 of the Law of 24 July 1966 on commercial companies. Article 98 provided that guarantees and securities (cautions, avals et garanties) given by a company must be authorised in advance by the board of directors otherwise they were unenforceable against the parent company, even if the parent company's intention was to guarantee the obligations of its subsidiary, whether or not wholly owned. As

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the letter of comfort had not been authorised by Sony's board of directors, it was not enforceable against Sony.94

9.3.5.3 The decision

The French Supreme Court stated that the nature and strength of the obligations contained in a letter of comfort would depend mainly on the wording of the letter. In its analysis, the French Supreme Court followed the generally adopted analysis of French academics as to the contents of contractual obligations and distinguished between letters of comfort that entailed –

(a) only a moral commitment by the parent company to pay the debt of its subsidiary. These commitments did not require prior authorisation of the board of directors of the parent company, Sony, but was devoid of any legal consequences.

(b) an obligation to use all reasonable means (obligation de moyens)95 to enable the subsidiary to pay its debts, without guaranteeing the payment. This obligation was not a guarantee according to the meaning of article 98 of the Law of 24 July 1966 and a prior decision of the board of directors of the parent company was not necessary in order for it to be effective. In order for the parent company, Sony, to be liable for the debt of its subsidiary, Medialeaders, the creditor, Télécom, had to show that there had been a default under the letter of comfort in that the parent company failed to use all reasonable endeavours to place the subsidiary into a position to meet its debt vis-à-vis the creditor. This kind of obligation could be more burdensome than a guarantee since it was not limited in amount and could result in all un-

94 The board of a company can only give its authorisation before the guarantee is granted, for a limited amount and for a limited period of time (one year maximum) – see the Decree of 24 March 1967 on commercial companies.

met liabilities being transferred to the parent company, the issuer of the letter of comfort.

(c) an obligation to pay the debt of the subsidiary (obligation de résultat)\(^\text{96}\), which had to be submitted to the board of directors of the parent company for prior approval. As soon as non-performance of the obligations in the letter of comfort had been proven, the parent company would be liable unless it proved that the breach was due to extraneous circumstances (cause étrangère).\(^\text{97}\) An obligation de résultat was tantamount to a guarantee and it had to be approved in the same way as a guarantee by the board of directors of the parent company, Sony, prior to its grant, otherwise it would not be binding on the parent company issuer of the letter of comfort.

Thus, the French Supreme Court recognised and applied the division by legal doctrine of obligations in French contract law into three types as mentioned in paragraph 8.6.1, namely; (1) obligations of means (obligations de moyens or obligation de diligence) which required a person to take reasonable care to achieve the result envisaged by the contract or agreement; (2) obligations of result (obligations de résultat or obligations determine) which required a person to achieve a particular result, though it allowed the excuse for non-performance of force majeure; and (3) obligations of guarantee (obligations de garantie) which required a person to achieve a particular result come what may, so that the person was liable for any failure even in the case of force majeure.\(^\text{98}\) If a comfort letter contained both an obligation of means (obligation de moyens) and an obligation of result (obligation de résultat), the issuer of the comfort letter would have an obligation de faire (obligation to perform); that is, the undertaking of the parent company, the issuer of the letter of comfort, extended to

\(^{96}\) See the discussion of obligation de résultat in paragraph 8.6.1; L du Jardin, “Lettre de patronage – Patronaatsverklaring” 2000 Tijdschrift voor Belgisch Handelsrecht 315 at 318 to 320.

\(^{97}\) See paragraph 8.6.1.

both the maintenance by its subsidiary of a sufficient level of cash and to do what was necessary to ensure that the subsidiary would have the necessary funds at its disposal to pay outstanding debts.

The French Supreme Court, in dismissing the appeal,\(^9^9\) held that article 98 of the Law of 24 July 1966 did not apply so that it was not necessary for the board of directors of Sony to approve the provision of the letter of comfort to Télécom.\(^1^0^0\) The court further held that Sony had to perform the obligations arising from the letter of comfort. The obligation in the letter of comfort was not that Sony pay instead of Medialeaders, but that Sony had to use all reasonable means (\textit{obligation de moyens}) to fulfil the obligations contained in the letter of comfort - that is, to place Medialeaders in a position to comply with its obligations to pay its debt to Télécom. The Court held that Sony did not perform its \textit{obligation de faire} (obligation to perform), because contrary to its obligation of means (\textit{obligation de moyens}) it failed to put Medialeaders in a position to satisfy its debts toward Télécom.

With this decision, the French Supreme Court categorised an obligation to make all necessary arrangements for the proper performance of the debtor’s obligations as an obligation of means (\textit{obligation de moyens}), and not as an obligation of result (\textit{obligation de résultat}).\(^1^0^1\) In the context of the letter of comfort, the critical factor in distinguishing between an \textit{obligation de moyens} and an \textit{obligation de résultat} was the absence of any indication that the parent company had intended to substitute itself for its subsidiary, and act as a guarantor. This decision meant that parent companies, in the context of French law, had at their disposal a discreet and flexible legal instrument to guarantee the obligations of their subsidiaries which did not entail payment of the


\(^1^0^0\) See L du Jardin, “Lettre de patronage – Patronaatsverklaring” 2000 \textit{Tijdschrift voor Belgisch Handelsrecht} 315 at 325.

\(^1^0^1\) J Buhart, “Letters of Comfort” 1999 (July/August) \textit{European Counsel} 74.
subsidiaries debts as such and did not require prior authorisation of its board of directors. However, the ruling appeared to be clearly contrary to the actual words used, and distorted the traditional distinction between the different forms of obligation in French law. The uncertainty caused by the Sony Music case meant that parties using a comfort letter could no longer rely on familiar forms of wording to produce a particular result. The French Supreme Court followed its Sony Music approach in Le Crédit d’équipement des CEPME v Chauffour investissement on 18 April 2000.

9.3.6.  **Sofiber v Banque Populaire de Bretagne** - decision of the Cour de Cassation  
*(Chambre Commerciale)* dated 26 February 2002

9.3.6.1  The facts

The Banque Populaire de Bretagne ("BPB") granted various types of financing to a corporation, Loiseau Mécanique ("Loiseau"). Loiseau was a subsidiary of Sofiber, subsequently known as Exel Industries. In order to ensure the maintenance of Loiseau's working capital and overdraft facilities with BPB, Sofiber provided BPB with a letter of comfort valid until 30 September 1993. In the letter of comfort Sofiber

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102 See paragraph 9.4 for some of the alternative ways to comply with an obligation to use all reasonable means.
103 J Buhart, "Letters of Comfort’ 1999 (July/August) European Counsel 74.
undertook to “do everything necessary” to ensure that Loiseau had “sufficient working capital to meet its commitments”.

On 23 September 1993, a week before the expiry of the letter of comfort, BPB notified Loiseau that it was no longer prepared to continue the credit facilities which had been granted for an indefinite term, and that its commercial discounting and other receivables facilities would expire in 30 days’ time and all other facilities within 60 days’ time. BPB also informed Sofiber of the termination of Loiseau’s financial facilities and Sofiber’s undertaking in the letter of comfort on the same day. Loiseau went into receivership and BPB sought payment from Sofiber in respect of an amount of FF1.3 million owed by Loiseau to BPB.

9.3.6.2 The issue

BPB was successful with its claim against Sofiber. The Court of Appeal Lyons (Cour d’Appel de Lyons) dismissed Sofiber’s appeal and Sofiber was ordered to pay the amount of FF1.3 million to BPB. Sofiber petitioned to the French Supreme Court, alleging that the court below –

(a) incorrectly held that Sofiber’s undertaking to do everything necessary to ensure that Loiseau had sufficient working capital to meet its commitments constituted an obligation de résultat – an obligation to pay the debts of Loiseau - because it was at most an obligation de moyens – an obligation to use all reasonable means to enable Loiseau to pay its debts;

(b) erred in its interpretation of the letter of comfort because it deduced the obligation de résultat from the fact that the board of directors of Sofiber authorised the letter of comfort pursuant to article 98 of the Law of 24 July 1966 on commercial companies as if it was a guarantee in respect of the commitments of Loiseau;

(c) erred in holding that the notice by BPB terminated the financial facilities it had granted to Loiseau as from the date of the notice, and submitted that the
facilities terminated only after 30 and 60 days respectively, being on dates after the expiry of the letter of comfort and at a time when Sofiber was no longer liable under the letter of comfort.

9.3.6.3 The decision

The French Supreme Court dismissed the appeal, and held that the Lyons Court of Appeal neither erred in its interpretation of the letter of comfort, nor in holding that the undertaking in the letter of comfort constituted an obligation to achieve a result, namely to pay the debts Loiseau owed to BPB. The Court focussed on the actual wording of the letter of comfort and found that, while not a guarantee, it envisaged a result, and to construe it otherwise would violate article 1134 of the French Civil Code, which provided that: “Agreements legally formed have the character of law for those who have made them.”

The French Supreme Court further held that although the financial facilities were not terminated on the date of the notice to Loiseau, BPB did give notice of the termination of the facilities as a result of which Loiseau became obliged to repay its debt to BPB (the debt “crystalised”), and BPB called on the letter of comfort, before the expiry of the letter of comfort. Since Loiseau’s debt to BPB existed before the expiry of the letter of comfort, BPB could rely on Sofiber’s undertaking. Accordingly, Sofiber had to pay to BPB the amount of FF1.3 million or to fund Loiseau sufficiently so that the latter could pay its debt to BPB.

Compared to its position in Sony Music Entertainment France v France Télécom,\(^\text{108}\) the French Supreme Court made a volte face in Sofiber v Banque Populaire de Bretagne.\(^\text{109}\) It classified an obligation to “do everything necessary” to ensure that the subsidiary’s indebtedness was satisfied, which was very similar to the obligation in Sony Music Entertainment France v France Télécom, as an obligation of result (obligation de résultat), and not as an obligation of means (obligation de moyens). As Giliker

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\(^{108}\) See paragraph 9.3.5.

\(^{109}\) See paragraph 9.3.6.
observed, by reverting to its previous position, the French Supreme Court resurrected “the debate as to the distinction between the different types of letters of comfort and their relationship with guarantees. It is even more unfortunate that the court gave no guidance as to the future application of the regulations governing guarantees to this area of law.”

9.3.7. Lordex v La Rhénane – decision of the Cour de Cassation (Chambre Commerciale) dated 9 July 2002

9.3.7.1 The facts

On 30 June 1983, Lordex, the Regional Development Corporation of Lorraine, granted a loan secured by a mortgage to a company Bove SMS (“SMS”). SMS obtained the mortgage release against the issuance of a letter of comfort by SMS’s parent company, la Rhénane, in which it confirmed that:

“dans le cadre de la restructuration de notre filiale, [SMS] ... nous vous confirmons, étant donné les liens qui nous unissent à cette société, que nous veillerons, à compter de ce jour, au bon déroulement de cette operation et que nous ferons, envers vous, le nécessaire pour la mener à bonne fin (for the purpose of restructuring our subsidiary [SMS] ... and having consideration of our links with that company, from now on we shall pay attention to the closing of the operation and we shall take the necessary steps in order to bring the operation to a successful conclusion).”

In 1996, winding up proceedings were initiated against SMS. Lordex requested the parent company for the payment of the money which SMS owed it. La Rhénane refused, claiming that it was not obliged to pay any amount to Lordex since the comfort letter did not contain a guarantee in respect of the indebtedness of SMS.

Consequently, Lordex instituted proceedings against la Rhénane, the parent company, seeking enforcement of the letter of comfort on the basis of articles 1134\textsuperscript{112} and 2011\textsuperscript{113} of the French Civil Code, under which a letter of comfort should be considered as creating a guarantee of the debtor towards the creditor. In other words, Lordex claimed that under the comfort letter the parent company guaranteed its subsidiary’s debt.

9.3.7.2 The issue

The issue for determination was whether the letter of comfort pursuant to which la Rhénane stated that it would take all necessary steps and use its best efforts created a guarantee, or commitment to perform the obligation of its subsidiary, towards Lordex.

9.3.7.3 The decision

Lordex’s claim against la Rhénane was partially upheld by the French Supreme Court based on article 1134 of the Civil Code.\textsuperscript{114} The Court decided that the provisions of the letter of comfort could be validly interpreted and applied, and that, although it was not a guarantee, the letter obliged the parent company to achieve the successful conclusion of its subsidiary’s business. Having regard to the release of the mortgage, La Rhénane agreed to achieve that outcome by creating an obligation of result (\textit{obligation de résultat}) through the letter of comfort, and as a consequence it was obliged to repay the loan to Lordex.

The French Supreme Court not only adopted its approach in \textit{Sofiber v Banque Populaire de Bretagne}, but provided further clarification in respect to the interpretation of the various obligations under a letter of comfort:

\[\text{\textsuperscript{112} This article provides that: "Agreements lawfully entered into take the place of the law for those who have made them. They may be revoked only by mutual consent, or for causes authorised by law. They must be performed in good faith."}
\[\text{\textsuperscript{113} Article 2011 is now article 2288 of the French Civil Code and provides that: "A person who makes himself surety for an obligation binds himself towards the creditor to perform that obligation, if the debtor does not perform it himself."}
\[\text{\textsuperscript{114} The French Supreme Court based its decision on article 1134, but not article 2011, of the Civil Code.}
(a) If a parent company, or comfortor, specifies in the letter of comfort that it agrees to pay the bank, or comfortee, on behalf of its subsidiary, or debtor, the letter qualifies as a guarantee.

(b) If a parent company agrees to “take all necessary steps” or “use its best efforts” in order to complete an operation successfully or to perform its subsidiary’s obligations, the letter contains an obligation of result (obligation de résultat) and requires it to achieve the successful completion of the subsidiary’s conclusion or to perform the subsidiary’s obligations. Since the letter of comfort requires performance by the parent company of the obligations of its subsidiary, and not merely a facilitation of performance by the subsidiary of its own obligations, such a letter has almost equivalent weight to a guarantee of the subsidiary.

(c) If a parent company agrees only to adopt certain behaviour or to use reasonable means in respect of its subsidiary’s obligations - such as to survey or control the management of the subsidiary - it does not agree to perform the obligations of its subsidiary, but it merely supports the facilitation of the performance of such obligations by the subsidiary. Thus, the letter of comfort contains an obligation of means (an obligation de moyens).

In Lordex v La Rhénane, the French Supreme Court did not deal with the issue of board authorisation in respect of securities pursuant to article 98 of the Law of 24 July 1966 on commercial companies (currently article L 225-35 of the Commercial Code) which featured in its Sony Music decision. The implication of the decision in Lordex v La Rhénane is that the letter of comfort has lost part of the flexibility for which it was created in commercial practice, but has gained in certainty from a legal perspective.
9.3.8.  Askea v Société Générale - decision of the Cour de Cassation (Chambre Commerciale) dated 19 April 2005

9.3.8.1  The facts

Askea provided a letter of comfort to Société Générale in respect of the indebtedness of its subsidiary, Verboom, to Société Générale. The letter of comfort provided that Askea undertook to "do what was necessary (faire le nécessaire)" so that Verboom could "fulfil its undertaking (remplisse ses engagements)" and to "make sufficient funds available (dispose d’une trésorerie suffisante)" to Verboom to do so. Verboom was put into judicial receivership (mise en redressement judiciaire), and it became the subject of a restructuring. Société Générale was successful with its damages claim against Askea, because Askea failed to "do what was necessary" for Verboom to fulfil its obligations towards Société Générale.

9.3.8.2  The issue

Askea appeal against the decision of the Paris Court of Appeal dated 19 November 2002, arguing that "le créancier d’une obligation de moyen doit démontrer la faute de son débiteur (the creditor of an obligation of means must demonstrate the debtor’s fault)". In other words, Askea argued that the obligation in its letter of comfort was, like the obligation of Sony in Sony Music Entertainment France v France Télécom and unlike Sofiber’s obligation in Sofiber v Banque Populaire de Bretagne, an obligation of means (obligation de moyens) and not an obligation of result (obligation de résultat).

9.3.8.3  The decision

The French Supreme Court rejected Askea’s appeal. It held that Askea’s obligation to "do what was necessary" was an obligation of result (obligation de résultat) and that

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116 See paragraph 8.6.1.
117 See paragraph 9.3.5.
118 See paragraph 9.3.6.
Askea was bound to ensure that Verboom pay its indebtedness to Société Générale.\textsuperscript{119} Askea would have discharged its obligation if it had taken all necessary steps to ensure that Verboom did not become insolvent. Accordingly, it was not necessary for Société Générale to prove that Askea was at fault.\textsuperscript{120} The Court recognised that, in effect, by providing a letter of comfort to a bank a parent company obtained credit through its influence over its subsidiary. Askea had leverage over Verboom, and could have prevented it from going into receivership. Since Askea did not prove that it was impossible for it to assist Verboom to pay its indebtedness to Société Générale, Askea was liable to compensate Société Générale for the detriment it had suffered because of Verboom’s default. In respect of this obligation of result (\textit{obligation de résultat}), Askea was the debtor and Société Générale the creditor.

In \textit{Askea v Société Générale}, the French Supreme Court followed its 2002 decision in \textit{Sofiber v Banque Populaire de Bretagne}, and finally put the ghost of \textit{Sofiber v Banque Populaire de Bretagne} to bed: an undertaking to do what was necessary for a subsidiary to fulfil its obligations to a bank was an obligation of result (\textit{obligation de résultat}).

\textbf{9.3.9. \textit{Nief Plastic v Crédit Lyonnais} - decision of the Cour de Cassation (Chambre Commerciale) dated 19 January 2010}\textsuperscript{121}

\textbf{9.3.9.1 The facts}

Crédit Lyonnais granted a loan to a company, Sainte-Savine, and required its parent company, Nief Plastic, to sign one of the bank’s standard letters of comfort in respect of the loan. In the letter of comfort Nief Plastic committed itself to take the necessary steps so that its subsidiary would have sufficient liquidity to repay the loan to Crédit Lyonnais.

\textsuperscript{119} The Court stated that: “La société qui s’oblige à faire le nécessaire pour que sa filial respecte ses engagements envers un tiers contracte à l’égard de celui-ci une obligation de faire qui s’analyse en une obligation de résultat (translated: the company which is bound to do what is necessary in order that its subsidiary honours its undertaking towards a third party, has in regard to that party an obligation to do, which converts into an obligation of result).”

\textsuperscript{120} See paragraph 8.6.1.

\textsuperscript{121} (unreported decision, Appeal no 09-14438, dated 19 January 2010).
Lyonnais. After the parent company had realised that the letter of comfort contained an obligation of result (obligation de résultat) so that it was committed to ensure that its subsidiary has sufficient cash flow to meet its loan repayment obligations (that is, basically to perform the subsidiary’s obligations), it immediately forwarded another letter of comfort to the bank stating that its commitment was confined to an obligation of means (obligation de moyens); that is, an undertaking that it would facilitate the performance of its subsidiary’s repayment obligations to the bank. After it had received this revised letter, Crédit Lyonnais released the loan funds to Sainte-Savine. When the subsidiary defaulted with its loan repayment, Crédit Lyonnais called upon Nief Plastic to make the loan repayment pursuant to the original letter of comfort signed by the latter.

9.3.9.2 The issue

Nief Plastic refused to make any payment under the original letter of comfort and maintained that, since Crédit Lyonnais only released the loan funds to Sainte-Savine after receipt of the revised letter of comfort which contained only contained an obligation of means, Credit Lyonnais tacitly agreed to limit Nief Plastic’s commitment to such an obligation.

9.3.9.3 The decision

The French Supreme Court found in favour of Crédit Lyonnais, because Nief Plastic had failed to prove that the bank consented to its standard letter of comfort being replaced by the revised comfort letter which Nief Plastic sent, or that the obligation of result in the original comfort letter was transformed into an obligation of means as a result of the revised letter. The release of the funds after receipt of the revised letter of comfort did not imply an acceptance of its terms. Based on article 1134 of the French Civil Code, Nief Plastic was bound to perform its obligation of result under the original comfort letter in good faith. Nief Plastic’s undertaking under the original comfort letter was an obligation of result (obligation de résultat) and that obligation was not transformed into an obligation of means (obligation de moyens) by Nief Plastic
sending the revised letter of comfort. An undertaking “to take the necessary steps” or “to do what is necessary” was an obligation of result, and the parent company had to compensate the bank for the prejudice suffered by it because of the breach by the parent company of its obligation of result. The compensation payable to the bank was assessed in an amount equal to the capital sum of the loan plus interest and the amount stipulated in the penalty clause of the loan agreement. In essence the letter of comfort had the same effect as a guarantee but for the subrogation mechanism.122

9.4 Comments on French law on letters of comfort

Proscour’s123 comment that a letter of comfort will be “considered as a commitment to perform (“obligation de faire”) because in the commercial world the creation of a meaningless instrument or document is unthinkable ... some performance is provided in order to help a creditor insure his rights. Refusal of such performance opens a case for damages; this is the legal rule of violation of an ‘obligation de faire’”,124 succinctly encapsulates the approach to comfort letters in French legal doctrine. It also appears from the French case law that the courts are attuned to the complex nature and peculiar role that letters of comfort play in business transactions and corporate finance. A French court will invariably enquire whether a letter of comfort given by the parent company caused the bank or financier to have an inaccurate or false view of the creditworthiness of the subsidiary, recipient of the credit facilities.125 The result is that there is always a chance that even “weak” letters of comfort could be enforced by French courts.126

122 In the case of a straight guarantee, the guarantor who has paid the creditor of a subsidiary has, by law, an automatic claim against the subsidiary. Should the parent company pay the creditor directly, pursuant to a letter of comfort, the issuer of the letter will not benefit from automatic subrogation. The courts tend, however, to grant this subrogation and to recognise it as automatic if the payor establishes an interest to its payment obligation.


124 See paragraph 8.6.2.


Three issues loom large in French courts’ determination of comfort letter cases. First is the classification of the obligations in the letter of comfort; that is, whether the undertaking in the letter of comfort is an obligation of result (obligation de résultat) or an obligation of means (obligation de moyens).127 The nature of the obligation is usually determined by French courts’ reference to the circumstances in which the letter of comfort is given, the wording of the letter of comfort, and to what extent the letter of comfort differs from a guarantee since the provision of a guarantee under French law may not be subject to conditions.128 Secondly, if the letter of comfort contains an obligation of result (obligation de résultat), it is regarded as a so-called “letter of comfort-result”.129 The relationship between such a letter of comfort and a guarantee is important, because the obligation contained in the letter of comfort will be enforceable only if the parent company’s board of directors authorise the letter of comfort since corporate guarantees require specific board resolutions. Thirdly, pursuant to the 2006 enactment of the definition of a letter of comfort in article 2322 of the French Civil Code,130 and the statutory basis of the letter of comfort as a personal security pursuant to article 2287-1 of the French Civil Code, the court has to deal with letters of comfort within a legislative framework.

The courts’ development of French law on comfort letters, having regard to these three issues, can be divided into three distinct periods: The first period from 1979 to 1998, is the so-called “une obligation de résultat (an obligation of result)” period,131 which commenced when a letter of comfort first came before a French court, and includes the French Supreme Court decisions in Viuda de José Tolra v Société de

130 See paragraph 9.2.
131 See C Bernat, L’exploitation commercial des navires et les groupes de contrats, Ou Le principe de l’effet relative dans les contrats commerciaux internationaux (Éditions ANRT, 2005) at [98-1].
développement regional du Languedoc-Roussillon,132 Compagnie générale de banque Citibank v SA Le Crédit d’équipement des petites et moyennes entreprises (CEPME) et autres,133 Compagnie générale de travaux et d’installations électriques v Banque atlantique de Côte-d’Ivoire,134 and SNE Sitraco v Société Curtainwalls Unlimited Inc,135 and ended with the French Supreme Court’s decision in Sony Music Entertainment France v France Télécom.136 The latter decision introduced the second period, the so-called “une obligation de moyens (an obligation of means)” period137 which lasted from 1999 and includes the 2000 decision in Le Crédit d’équipement des CEPME v Chaufour investissement.138 The third period, the so-called “le retour à l’obligation de résultat (return to the obligation of result)” period,139 commenced with the French Supreme Court’s decision in Sofiber v Banque Populaire de Bretagne on 26 February 2002,140 and includes its subsequent decisions in Lordex v La Rhénane,141 Askea v Société Générale, and the recent decision in Nief Plastic v Crédit Lyonnais.142

In its 1987 decision in Viuda de José Tolra v Société de développement regional du Languedoc-Roussillon,143 the French Supreme Court recognised that the undertakings in letters of comfort usually did not stipulate for the direct payment of money by the comfortor to the comfortee, but they rather involved the performance of some obligation, an obligation to perform (obligation de faire). Accordingly, the French

132 Cour de Cassation (chambre commerciale), 21 December 1987, 1988 Banque 361.
133 Cour de Cassation (chambre commerciale), 23 October 1990 IV No 256 Bulletin officiel des arrest de la Cour de Cassation 179.
137 See C Bernat, L’exploitation commercial des navires et les groupes de contrats, Ou Le principe de l’effet relative dans les contrats commerciaux internationaux (Éditions ANRT, 2005) at [98-2].
139 See C Bernat, L’exploitation commercial des navires et les groupes de contrats, Ou Le principe de l’effet relative dans les contrats commerciaux internationaux (Éditions ANRT, 2005) at [98-3].
142 (unreported decision, 19 January 2010, Appeal No 09-14438).
143 See paragraph 9.3.1.
Supreme Court made it clear that the legal effect of a letter of comfort was contingent upon the nature of the undertakings contained in the letter, which depended on the form of the words used. Thus, by classifying the undertakings contained in the comfort letter, the legal effect of the letter corresponded to the types of contractual obligations recognised in French law. The result was that there were three categories of letters of comfort, namely the letter of comfort as a moral obligation,144 the letter of comfort as a guarantee (that is, containing an obligation de garantie), and the letter of comfort as an obligation to perform, either in the sense of being an obligation to use reasonable means to achieve a result (obligation de moyens) or an obligation to achieve a specific result (obligation de résultat). The latter two categories of letters of comfort were important. In practice, French courts have found it problematic to distinguish between letters of comfort imposing an obligation de résultat and guarantees.145

In Viuda de José Tolra v Société de développement regional du Languedoc-Roussillon, the French Supreme Court acknowledged that certain letters of comfort may constitute a form of true guarantee, that is, an undertaking by the parent company to perform – usually to pay – in the place of its subsidiary.146 In that case, the operative language of the letter of comfort included a statement to the following effect: the parent company confirmed its intention to support its subsidiary in its financial needs, and, if it became necessary, to substitute itself for the subsidiary in order that the subsidiary may fulfil all its obligations to the financier.147 In its decision, the French Supreme Court emphasised the conscious and unequivocal manifestation by the

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144 This category entails no contractual liability, but attracts moral responsibility, unregulated by the courts. As P Giliker, “Taking comfort in certainty: to enforce or not to enforce the letter of comfort” [2004] Lloyd’s Maritime and Commercial Law Quarterly 219 at 224 points out, however, delictual or tortuous responsibility under article 1382 of the French Civil Code is a possibility if misconduct causing loss can be shown. This provision is wider than the Anglo-common law of misrepresentation and provides the French courts with a broad basis on which to impose standards of commercial morality where the parties are acting in bad faith.
147 See paragraph 9.2.
parent company of its intention to guarantee the obligations of its subsidiary.\textsuperscript{148} However, to categorise a letter of comfort as a guarantee, the text of the letter of comfort had to be unambiguous and the creditor must have had accepted the undertaking by the parent company.\textsuperscript{149}

The French Supreme Court further approved the characterisation of the letter of comfort in the French legal doctrine as an undertaking by the parent company to perform the acts specified in the letter under examination.\textsuperscript{150} It accepted that this obligation to perform (\textit{obligation de faire}) could itself be analysed either as an obligation to achieve a specific result (an obligation of result or \textit{obligation de résultat}), or as an obligation to exercise reasonable efforts to accomplish a result (an obligation of means or \textit{obligation de moyens}). Importantly, the French Supreme Court stated that a comfort letter \textit{may} “constituer à la charge de celui qui l’a souscrite un engagement contractuel de faire ou de ne pas faire pouvant aller jusqu’à l’obligation d’assurer un résultat (translated; constitute an obligation to the party who has signed a contractual undertaking to do or not to do and which could be determined as an obligation to ensure a result)”.\textsuperscript{151}

Initially, the use of the word “\textit{may}” did not create any uncertainty in the way the French courts dealt with letters of comfort containing obligations to perform (\textit{obligations de faire}), and more specifically obligations of result (\textit{obligations de résultat}). Letters of comfort falling into this category included\textsuperscript{152} an undertaking by the parent company to do all that was necessary so that its subsidiary respected its undertaking to honour an order, a letter in which the parent company confirmed that


it would take all steps necessary so that its subsidiary could respect its obligation, and a letter in which the parent company undertook that its subsidiary would have funds available sufficient to meet its obligations.\textsuperscript{153} The consequence of such an obligation of result (\textit{obligation de résultat}) in a letter of comfort was that the parent company was required to take either preventative action with respect to its subsidiary before the subsidiary’s default, or remedial action after the subsidiary’s default.\textsuperscript{154} In most cases, this consisted of putting the subsidiary in funds to meet its obligations, even where there may be no explicit promise to advance funds, since as a practical matter, the making available of funds could be the only way to achieve the promised result.\textsuperscript{155} A failure to achieve the promised result was evidenced by the subsidiary’s default, and it would lead to liability in damages resulting from the failure; that is, the comfortee had to be compensated for all the loss and damages suffered by it, even though the damages could exceed the sum of the subsidiary’s indebtedness.\textsuperscript{156} This was so because, for example, an undertaking by a parent company to financially support its subsidiary consisted of an undetermined obligation.\textsuperscript{157} In other words, a letter of comfort which contains an undertaking to provide the debtor with sufficient funds to meet its financial obligations is very often more burdensome than a guarantee since it is not limited in amount and could result in all unmet liabilities being transferred to the issuer of the letter.\textsuperscript{158}


\textsuperscript{156} IE Davidson, J Wohl and D Daniel, “Comfort Letters Under French, English and American Law” (1992) 3 Journal of Banking and Finance Law and Practice 3 at 7 have pointed out that this does not mean that the parent company is precluded from raising defences or counter-claims, such as the potential liability of the comfortee for negligence extension of credit to the subsidiary.


Letters of comfort falling into the category of letters containing obligations of means (obligations de moyens) included comfort letters in which the parent company promised to use all its efforts so that its subsidiary had sufficient funds to meet its obligations, or in which it was stated that the parent company would monitor its subsidiary's conduct so that it performed its obligations to the bank. The distinction between the an obligation of means (obligation de moyens) and an obligation of result (obligation de résultat) had been drawn by looking at whether or not the wording evinced an undertaking by the parent company to substitute itself for its subsidiary - if not, the obligation was one of means, and the court only had to examine the level of support or funding provided by the parent company to its subsidiary, and if it was sufficient, then the parent company would have fulfilled its undertaking regardless of whether the subsidiary met its obligations to the bank. The parent company was not, however, expected to expose itself to insolvency in order to prevent the default by its subsidiary so that it could fulfil an obligation of means (obligation de moyens).

It was apparent that the wording of the letter of comfort was important, because as Giliker succinctly put it: "The stronger the wording (an agreement to 'promise' or 'guarantee' performance), the more likely the court will classify the obligation de faire as one de résultat. Lesser wording ('do whatever possible') is likely to be viewed as an obligation de moyens." Furthermore, it appeared that if the undertaking in the letter of comfort involved to give of something or to refrain from doing something, then it

559 Compagnie générale de travaux et d’installations électriques v Banque atlantique de Côte-d’Ivoire (1991) IV No 110 Bulletin officiel des arret de la Cour de cassation 77. See paragraph 9.3.3.
562 P Giliker, "Taking comfort in certainty: to enforce or not to enforce the letter of comfort" [2004] Lloyd’s Maritime and Commercial Law Quarterly 219 at 225. For example, a statement in a letter of comfort that, a parent company will do "everything necessary to ensure that its subsidiary has sufficient funds to fulfil its obligations" amounts to an obligation de résultat. In contrast, a promise by a parent company to "watch over the subsidiary to see that it has sufficient funds to meet its debts", impose only an obligation de moyens.
would usually be classified as an *obligation de résultat*. However, apart from the wording of a letter of comfort, another important indicator used in the classification of an obligation as either one of means or result, was the relationship between the comfortor and the third party. For example, if a parent company exercised absolute control over its subsidiary, then an undertaking in a letter of comfort given by the parent company to the bank to the effect that it would support its subsidiary to meet its obligations to the bank would be more readily construed as containing an obligation of result, because the payment of the debt to the bank effectively depended on the conduct of the parent company.

The French courts' consistent classification of letters of comfort by reference to whether or not they contained obligations of means (*obligations de moyens*) or obligations of result (*obligations de résultat*) was disturbed by the aberrant decision of the French Supreme Court in *Sony Music Entertainment France v France Télécom* in 1999. Contrary to the preceding case law, the French Supreme Court held that an undertaking by a parent company to "do what is required" for its subsidiary to honour its obligations, was an obligation of means (*obligation de moyens*). As discussed in paragraphs 9.3.6 to 9.3.9, in *Sofiber v Banque Populaire de Bretagne*, *Lordex v La Rhénane*, *Askea v Société Générale*, and *Nief Plastic v Crédit Lyonnais*, the French Supreme Court has since restored consistency in the classification of letters of comfort, and made it clear that an undertaking by a parent company to "do what is necessary" for its subsidiary to comply with its obligations, was an obligation of result (*obligation

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166 See paragraph 9.3.5.

167 *Sony Music Entertainment France v France Télécom* was followed in a few other cases before the French Supreme Court's decision in *Sofiber v Banque Populaire de Bretagne* – see P Giliker, "Taking comfort in certainty: to enforce or not to enforce the letter of comfort" [2004] *Lloyd's Maritime and Commercial Law Quarterly* 219 at 227.
However, the differing positions in *Sony Music Entertainment France v France Télécom* and *Le Crédit d’équipement des CEPEM v Chauffour investissement* on the one hand, and *Sofiber v Banque Populaire de Bretagne, Lordex v La Rhénane, Askea v Société Générale*, and *Nief Plastic v Crédit Lyonnais* on the other, should not be seen as a struggle with the concept of the letter of comfort by the French courts. The French Supreme Court was not inconsistent in respect to the contractual effect of the letters of comfort, because in those cases they were held to be binding; rather, the difference was in the approach to the nature, scope and intensity of the obligations contained in the letters due to the corporate law requirements of board authorisation.

The deviation in *Sony Music Entertainment France v France Télécom* was linked with the second issue which featured in almost all the French cases on letters of comfort, namely the need for corporate authorisation. Previously, article 98 of the Law of 24 July 1966, the basic French company law, stipulated that guarantees delivered by French public limited companies (*sociéties anonyme*) were not valid unless approved by the board of directors of the company. In the context of letters of comfort, this provision caused concern because it raised the question whether or not the comfort letter under examination was subject to the procedural requirements of article 98 of the Law of 24 July 1966. More often than not, the letter of comfort was not approved by the board of directors because it was not regarded by the parent company as constituting a guarantee.

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\(^{170}\) See P Giliker, “Taking comfort in certainty: to enforce or not to enforce the letter of comfort” [2004] *Lloyd’s Maritime and Commercial Law Quarterly* 219 at 228: “As noted by Professor Aynès, in making its decision, the Cour de Cassation succeeded in rendering the obligation de résultat indistinguishable from a guarantee. In addition, whilst attempting to simplify the question of enforceability, the Sony Music decision singularly failed to resolve the ongoing debate concerning the nature of comfort letters and their relationship with the regulation of guarantees.”

\(^{171}\) See paragraph 9.3.5. See also P Giliker, “Taking comfort in certainty: to enforce or not to enforce the letter of comfort” [2004] *Lloyd’s Maritime and Commercial Law Quarterly* 219 at 227.

Initially, the French courts treated letters of comfort containing obligations to perform (obligations de faire), regardless of whether they were classified as containing an obligation of means (obligation de moyens) or an obligation of result (obligation de résultat) as falling outside the ambit of article 98 of the Law of 24 July 1966, but that changed with the French Supreme Court’s decision in Compagnie générale de banque Citibank v SA Le Crédit d’équipement des petites et moyennes entreprises (CEPME) et autres. The French Supreme Court held that, while the letter of comfort did not constitute a formal guarantee since it did not expressly obligate the parent company to substitute itself for the defaulting subsidiary, the undertaking of the parent company was such that, if it could not avoid the insolvency of its subsidiary, it would be obligated to pay in its stead. In other words, the parent company’s obligation of result (obligation de résultat) could involve payment in the place of its subsidiary, and as such fell within the scope of article 98 of the Law of 24 July 1966. In light of this decision, it has been difficult for a third party to accept a letter of comfort which contained an obligation of result (obligation de résultat) without verifying whether the article 98 procedure had been followed. Thus, in order to overcome the potential obstacle created by French company law by way of article 98 of the Law of 24 July 1966 in the classification, and subsequent enforcement, of an undertaking in a letter of comfort as an obligation of result (obligation de résultat), the consistent classification of obligations was compromised in Sony Music Entertainment France v France Télécom - by classifying the undertaking of Sony to “do what is required” for Medialleaders to honour its obligations to France Télécom, the letter of comfort was not invalid, France Télécom could enforce it, and Sony had to pay damages to France Télécom, a result which appeared just in the circumstances.

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174 (1990) IV No 256 Bulletin officiel des arrest de la Cour de cassation 179. See paragraph 9.3.2.
175 See paragraph 9.3.2.
Since 2003, article L225-35 of the French Commercial Code\textsuperscript{177} has provided that undertakings, avals and guarantees given by companies other than banks or other financial institutions had to be authorised by the board of directors. Thus, the fate of letters of comfort containing an obligation of result (\textit{obligation de résultat}) was similar to that under article 98 of the Law of 24 July 1966.\textsuperscript{178} The position has changed, however, with the entering into force on 25 March 2006 of \textit{Ordonnance} 346 of 23 March 2006.\textsuperscript{179} By not referring to the distinction between obligations of means (\textit{obligations de moyens}) and obligations of result (\textit{obligations de résultat}), the definition of a letter of comfort in article 2322 of the French Civil Code\textsuperscript{180} has made any letter of comfort issued after 25 March 2006, which was a personal security pursuant to article 2287-1 of the French Civil Code,\textsuperscript{181} susceptible to authorisation under article L225-35 of the French Commercial Code.\textsuperscript{182} So, to avoid the possibility of a letter of comfort, whether or not it contained an obligation of means (\textit{obligation de moyens}) or an obligation of result (\textit{obligation de résultat}), being unenforceable for a lack of board authorisation, it would be prudent for a comfortee to insist that the board of the comfortor authorised the letter of comfort.\textsuperscript{183}

Some commentators have expressed concern about the effect of \textit{Ordonnance} 346 of 23 March 2006 on the continued use of letters of comfort in France.\textsuperscript{184} First, the hallmark of letters of comfort has been the fact that they are flexible and informal instruments which usually contain a broad spectrum of undertakings and are not burdened by the formalities that accompany the traditional securities. \textit{Ordonnance} 346 of 23 March 2006 can potentially result in the “l’étranglement de la catégorie des

\textsuperscript{177} See also article L225-68 of the French Commercial Code which deals with public companies with a supervisory board.


\textsuperscript{179} See paragraph 9.2.

\textsuperscript{180} See paragraph 9.2.

\textsuperscript{181} See paragraph 9.2.

\textsuperscript{182} See M Cozian, A Viandier and F Deboissy, \textit{Droit des sociéties} (Litec, Paris, 2009) 160.

\textsuperscript{183} See D Houtcief, “Les sûretés personnelles” 2006 (May) \textit{Juris-classeur périodique. La semaine juridique (supplement)} 7 at 10.

lettres d’intention (translated: the strangling of the category of letters of comfort),

because since 25 March 2006 the letter of comfort is a personal security, not only recognised in the French Civil Code but also subject to the company board authorisation requirements of the French Commercial Code. Secondly, the definition of the letter of comfort in article 2322 of the French Civil Code excludes two of the three types of letters of comfort recognised in Viuda de José Tolra v Société de développement regional du Languedoc-Roussillon. In other words, the only instrument that can be said to be a letter of comfort is the letter of comfort as an obligation to perform. The concerns are only partly justified. The fact that two of the types of letters of comfort recognised in Viuda de José Tolra v Société de développement regional du Languedoc-Roussillon (the letter of comfort as a moral obligation and the letter of comfort as a guarantee) fall outside the scope of the statutory regime, is of no consequence, because they will continued to be used either without any appellation or they will be called by different names; for example, letters of awareness or moral undertakings in respect of the first type, and letters of support or guarantee for the second type. The third type of letter of comfort identified in Viuda de José Tolra v Société de développement regional du Languedoc-Roussillon (the letter of comfort as an obligation to perform) remains unaffected by the statutory reform, and within that category a broad spectrum of undertakings is still possible, whether they be obligations of means (obligations de moyens) or obligations of result (obligations de résultat). The flexibility of letters of comfort has, however, been compromised by the statutory reform in the sense that a letter of comfort (that is, one falling within the scope of article 2322 of the French Civil Code), as a type of personal security, is since the coming into force of Ordonnance 346 of 23 March 2006 subject to the company board authorisation requirements in articles L225-35 and L225-68 of the

186 See paragraph 9.3.1.
French Commercial Code, regardless of whether it contains an obligation of means (obligation de moyens) or an obligation of result (obligation de résultat).

A further and related consequence is the fact that such a letter of comfort will have to be noted in the balance sheet of the parent company. Article L232-1 of the French Commercial Code\(^\text{189}\) requires the board of the company to annex to the balance sheet a list of the sureties and guarantees given by the company.\(^\text{190}\) Thus, in practice, the impact of Compagnie générale de banque Citibank v SA Le Crédit d’équipement des petites et moyennes entreprises (CEPME) et autres,\(^\text{191}\) which has been exacerbated by the coming into force of Ordonnance 346 of 23 March 2006, is important: It will effectively undermine a decision by the court to render a letter of comfort, falling within the scope of article 2322 of the French Civil Code, contractually enforceable, because letters of comfort are, by their very nature, an informal means of reassurance, given in preference to the formalities of a guarantee.\(^\text{192}\) There is therefore a real possibility that they will fail to satisfy the strict requirements necessary to render a guarantee enforceable. Secondly, the stronger the wording of the letter of comfort, the less likely that the bank will be able to enforce it, unless it is fortunate enough to find that the issuer has undertaken the formalities necessary for the issue of a guarantee under article L225-35 of the French Commercial Code.\(^\text{193}\) Thus, in the context of the contractual effect of letters of comfort, the commendable French approach to contract law, may, in certain circumstances, be subverted by the technical requirements of French corporate law.\(^\text{194}\) In practice, as appears from the recent

\(^{189}\) Previously article 340 of the law of 24 July 1966.


\(^{191}\) (1990) IV No 256 Bulletin officiel des arrêt de la Cour de cassation 179. See paragraph 9.3.2.

\(^{192}\) P Giliker, "Taking comfort in certainty: to enforce or not to enforce the letter of comfort" [2004] Lloyd’s Maritime and Commercial Law Quarterly 219 at 226.

\(^{193}\) See also P Giliker, "Taking comfort in certainty: to enforce or not to enforce the letter of comfort" [2004] Lloyd’s Maritime and Commercial Law Quarterly 219 at 226.

\(^{194}\) See also the comments by P Giliker, "Taking comfort in certainty: to enforce or not to enforce the letter of comfort" [2004] Lloyd’s Maritime and Commercial Law Quarterly 219 at 230, made before the coming into force of Ordonnance 346 of 23 March 2006: "Yet, it may be suggested, that the real problem in French law lies not in its technical requirements, but in the failure of the courts to address the true nature of the letter of comfort. By ignoring the role of the business community in the growth
decision in *Nief Plastic v Crédit Lyonnais*, the French approach to the contractual effect of letters of comfort is still effectively employed.\textsuperscript{195}

There are similarities between the French legal system’s approach to letters of comfort and the approach in the Anglo-common law jurisdictions. In both the French legal system and the Anglo-common law systems, the question of enforceability of letters of comfort is a matter of common law as determined by the courts, albeit in France within the framework of the statutory regime introduced by *Ordonnance* 346 of 23 March 2006.\textsuperscript{196} Moreover, the same test is applied by the courts: did the parties intend that their agreement would be contractually binding and so enforceable?\textsuperscript{197} In considering the enforceability of letters of comfort, French and Anglo-common law courts adopt a similar approach: examine the wording used in the instrument to ascertain whether the parties intended to create more than a moral obligation.\textsuperscript{198} A finding by French courts that a letter of comfort contains moral obligations is the exception, rather than the rule, because they are prepared to go further and grant contractual status to comfort letters.\textsuperscript{199} This propensity was established firmly in *Viuda de José Tolra v Société de développement regional du Languedoc-Roussillon*,\textsuperscript{200} the first French Supreme Court decision on letters of comfort.

The dissimilarities between the French legal system’s approach to letters of comfort and the approach in the Anglo-common law jurisdictions are, however, significant. When thinking about the concept of a letter of comfort as an instrument to assure a

\textsuperscript{195} See paragraph 9.3.9.
\textsuperscript{196} Needless to say, as discussed in chapter 8, the general provisions of the French Civil Code dealing with the law of obligations are applicable to letters of comfort.
\textsuperscript{197} P Giliker, “Taking comfort in certainty: to enforce or not to enforce the letter of comfort” [2004] *Lloyd’s Maritime and Commercial Law Quarterly* 219 at 220.
\textsuperscript{198} P Giliker, “Taking comfort in certainty: to enforce or not to enforce the letter of comfort” [2004] *Lloyd’s Maritime and Commercial Law Quarterly* 219 at 224.
\textsuperscript{199} P Giliker, “Taking comfort in certainty: to enforce or not to enforce the letter of comfort” [2004] *Lloyd’s Maritime and Commercial Law Quarterly* 219 at 224.
\textsuperscript{200} See paragraph 8.8.
potential creditor that a debt will be repaid, the English courts contemplate a “letter of comfort properly so called”, or an instrument containing only moral obligations, not dissimilar to the perception of letters of comfort held by the Association française des banques in the early 1970’s. As discussed in paragraph 1.3, letters of comfort have evolved and such perception is no longer widely held. Moreover, especially since the enactment of Ordonnance 346 of 23 March 2006, the French concept of a letter of comfort is that of a binding comfort letter; that is, a personal security containing legal obligations.

In adopting a subjective approach to contract law, which more readily finds a contract in the presence of an accord de volontés or meeting of the minds, combined with the moral and dogmatic nature of French contract law, the French courts have been led to the inevitable conclusion that letters of comfort should be contractually enforceable. This conclusion is fundamentally different from that reached in English law. The English economic and pragmatic approach to contract law has led it to the inevitable conclusion, as is evident from Kleinwort Benson on appeal and Associated British Ports, that letters of comfort are contractually unenforceable in the absence of a clear intention to the contrary. However, the Australian courts’ conclusion on the enforceability of letters of comfort, evidenced by Banque Brussels and Gate

202 See P Giliker, “Taking comfort in certainty: to enforce or not to enforce the letter of comfort” [2004] Lloyd’s Maritime and Commercial Law Quarterly 219 at 229 at footnote 62, where the author refers to the 1973 statement of the French Bankers’ Association, translated as follows: “In relation to bank practice, the letter, by which a company of indisputable renown in terms of commercial morality as well as financial base supports a company which it controls to enable it to obtain or continue to receive credit, amounts only to a moral obligation to ensure the receipt of credit and is considered in practice to amount to security comparable to that of a guarantee”. This statement highlights the protean nature and paradoxical origin of the comfort letter concept – a moral commitment considered in practice as being tantamount to a security.
203 See paragraph 9.2, and the similar approach adopted in the PEL Pers Sec.
204 See paragraph 8.2.
205 See paragraph 8.2.
207 See paragraph 8.2.
Gourmet Australia Pty Ltd (in liq) v Gate Gourmet Holding AG,\textsuperscript{211} is more aligned with that of the French courts.\textsuperscript{212} The Australian courts’ willingness to entertain the notion of commercial morality in contract law has led to an inclination that letters of comfort are contractually enforceable in the absence of a clear intention to the contrary.

\textsuperscript{211} [2004] NSWSC 149. See paragraph 7.5.
\textsuperscript{212} See, however, Atco Controls Pty Ltd (in liquidation) (ACN 005 182 481) v Newtronics Pty Ltd (receivers and managers appointed) (in liquidation) (ACN 061 493 516) [2009] VSCA 238 at [54]. See paragraph 7.6.
10.1 Autochthonous commercial instruments in search of a doctrinal basis

Over the last few decades, banks throughout the world have found it increasingly difficult to obtain outright guarantees from companies to cover loans to subsidiaries. Consequently, various third party credit support devices or comfort instruments, generally known as letters of comfort, have developed to provide an alternative, which can be seen as a compromise, or sometimes cynically, as the result of jeu du chat et de la souris or een kat-en-muispel. Letters of comfort are instruments, commercial agreements, often used in business transactions as an alternative to guarantees or other forms of surety because of commercial considerations. They are autochthonous commercial instruments facilitating commercial interactions, fulfilling a security function outside the traditional scheme of instruments of personal security. It is an irony, as Bernard remarked, that “despite the mysticism clouding its nature, comfort

8 P Giliker, Pre-Contractual Liability in English and French Law (Kluwer Law International, The Hague, 2002) 54 observes that the use of letters of comfort reflects a common commercial practice developed by which parent companies, unwilling or unable to guarantee the debts of their subsidiaries, send a message of support to financial institutions to encourage the grant of loan facilities to their subsidiaries.

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letters have been put to good commercial use. In spite of this paradox, the fact remains that an LoC [letter of comfort] is a less viable alternative to a guarantee.”

In the past four and a half decades, letters of comfort have forged a niche within banking and finance practice despite being a heterodox form of banking document. They have become to be regarded as one of the “documentary forms of security generally in the world of commerce.” Indeed, a new form of personal security - especially the so-called “binding comfort letter” - with “vele gezichten (many faces)”.

They will continue to be a part of the business culture worldwide and in Australia. Letters of comfort do not, however, have a precise legal meaning or standard wording, are susceptible to different legal nuances, and do not constitute a distinct type of legal instrument - invariably differing in content if not in form - which makes a conclusive analysis difficult, if not impossible. There is no separate body of legal principles peculiar to letters of comfort. So, the legal effect of a letter of comfort depends on the precise wording used, the context in which it has been

12 Standard Trust Company v The Mortgage Insurance Company of Canada; 568707 Ontario Limited v Reemark Group Inc 1992 Ont CJ LEXIS 1220 at 7. The others are the standby letter of credit, the performance guarantee and the surety bond.
13 E Dirix, “Gentlemen’s Agreements en Andere Afspraken met Onzeker Rechtgevolgen” [1985-1986] Rechtskundig Weekblad 2119 at 2144. See paragraph 9.2 for a discussion of comfort letters as one of the forms of personal security in French law. G Walker, “Letter of Cold Comfort” (1989) 5 Banking Law Bulletin 120 is, however, of the view that a letter of comfort is a “non-security”.
18 RI Milliner, “Comfort Letters – How Much Comfort Are They For Lenders and Auditors?” (unpublished paper, University of Western Australia, Law Summer School, 1990) at [2.2].
provided, the approach adopted by the court hearing the comfort letter dispute, as well as the applicable legal system, and not on some preconceived notion of the legal effects of letters of comfort.\textsuperscript{21} Consequently, as Jacobs remarked two decades ago:\textsuperscript{22}

“Letters of comfort have not yet reached that nirvana, blessed to those who like to know where they stand before a judge pronounces, where a transaction is so stereotyped that the use of a particular label or verbal formula is sufficient to raise so strong a \textit{prima facie} presumption in favour of a legal classification that all but the most unusual case is decided without more ado. Letters of comfort are still at the stage where it is necessary not only to examine the wording of each letter but also the factual matrix which formed the background to the arrangement.”

Not much appears to have changed. The outcome of litigation relating to letters of comfort should never be taken for granted.\textsuperscript{23} A letter of comfort is a document of potential legal significance, not merely an ancillary piece of paper in a closing package required merely to facilitate an exigent deal.\textsuperscript{24} In certain circumstances a letter may have the practical effect of a guarantee, and therefore deserves equal attention by companies, directors and lawyers involved in their drafting and negotiation.\textsuperscript{25}

In the past, it was widely thought that letters of comfort had only moral (rather than legal) effect.\textsuperscript{26} In 1980, Wood discussed letters of comfort and disparagingly

\begin{footnotesize}
\begin{enumerate}
\item See R Sacasas, “The Comfort Letter Trap: Parent Companies Beware” (1989) 106 \textit{Banking Law Journal} 173. RE Elliott and JM Robinson, “‘Comfort’ letters may provide cold comfort” 1999 (November 19) \textit{The Lawyers Weekly} 12, in discussing \textit{Toronto Dominion Bank v Leigh instruments} (1998) 40 BLR (2d) 1 (hereinafter referred to as \textit{Toronto Dominion Bank}), also express the view that unless a comfort letter suggests otherwise, it will generally not be a legally enforceable obligation.
\end{enumerate}
\end{footnotesize}
concluded: “In essence, comfort letters are only of use where political assurances are considered better than legal assurances (this must be almost never) or where a shadow of a guarantee is considered better than nothing at all (only just). They are inappropriate for lenders who require a serious legal claim.” Indeed, they were regarded as non-binding instruments of commerce. This initial view of letters of comfort as being unenforceable was probably due to the vagueness and breadth of the first generation of comfort letters which invariably were only letters of awareness. Due to comfort letters initially being vaguely written, they were generally regarded by the business community as unenforceable. However, as letters of comfort continued to grow in use, they became more detailed in content and more guarantee-like in nature. The result is more litigation about the enforceability of letters of comfort and, because of courts undertaking more contractual analysis of such letters, perhaps a new jurisprudence of enforceability. Today, it is generally accepted that it is possible for a letter of comfort to create a legally binding obligation, although this will not always be the case. DiMatteo has aptly observed that, as letters of comfort have become more widely used, “a growing cadre of cases questioning their nonenforceability has developed. A number of cases, mostly foreign, have begun to lay a doctrinal foundation for the assessment of liability against the letter issuer.” If a letter of comfort has contractual effect, it may be a further issue whether it constitutes a contract of guarantee or of indemnity. The association of letters of

28 See, for example, K/S A/S Bani v Korea Shipbuilding & Engineering Corp [1987] 2 Lloyd’s Rep 445 at 455 where it was stated that letters of comfort “can be treated as a source of comfort but no more than that.”
comfort and guarantees must not, however, be overemphasised because it could potentially have a stifling effect on the proper analysis of letters of comfort, as well as the development of comfort letter jurisprudence. As DiMatteo and Sacasas have observed:

“Historically, courts have dealt initially with developments in the law by making use of semantics. This has been the case in the area of comfort instruments. The use of semantic pigeonholing to label comfort instruments as nonguaranty or nonguaranty substitutes is the end of the court's legal analysis. Once labelled as ‘simple or cold comfort' the courts have routinely presumed that these instruments lacked the required intent needed for enforceability. Arguably, however, instead of being the end of the analysis, the labelling of an instrument as a nonguaranty should only be the first step in the judicial reasoning process.”  

Letters of comfort, when used to “fudge” difficulties in negotiations may well rebound if things go wrong. In effect, by not opting for a distinct and recognised type of legal instrument, the parties have chosen to leave it to the courts to determine who the more successful negotiator was. Indeed, in light of the judicial treatment of letters of comfort worldwide, banks and businesspeople can no longer caricature the phenomenon, thinking of such letters as gentlemen’s agreements, and smile drily at Justice Vaisey’s often quoted droll observation that:

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34 See Gate Gourmet Australia Pty Ltd (in liquidation) v Gate Gourmet Holding AG [2004] NSWSC 149 (hereinafter referred to as Gate Gourmet). See paragraph 7.5.
35 LA DiMatteo and R Sacasas, “Credit and Value Comfort Instruments: Crossing the Line from Assurance to Legally Significant Reliance and Towards a Theory of Enforceability” (1995) 47 Baylor Law Review 357 at 378. Hirst J in Kleinwort Benson Ltd v Malaysia Mining Corp Berhad [1988] 1 WLR 799 at 809 and 810 (hereinafter referred to as Kleinwort Benson at first instance) was conscious of this potential problem in analysing comfort letters where he said: "I am quite unable to accept the underlying premise ... namely the suggestion that once a formal guarantee had been rejected ... there was no further scope for the possibility of any contractually binding obligation".

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“A gentleman's agreement is an agreement which is not an agreement, made by two persons neither of whom is a gentleman, whereby each expects the other to be expressly bound without himself being bound at all.”

10.2 Letters of comfort in global legal context

Comparative law, and similarly trans-systemic legal analysis, as a discipline is seen by some as having the practical utility of the proverbial treatise on snakes in Ireland since clients do not need lawyers who know comparative law because courts do not apply it. However, apart from the general utility of comparative law, such a view is

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38 As quoted in Chemco Leasing SpA v Rediffusion plc (19 July 1985, unreported, Queens Bench) (hereinafter referred to as Chemco Leasing). See also Bloom v Kinder [1958] TR 91.

39 There are no snakes in Ireland. Pious legend credits St Patrick with banishing snakes from Ireland.


41 See B Markesinis, “The Destructive and Constructive Role of the Comparative Lawyer” (1993) 57 Rabels Zeitschrift für ausländisches und internationales Privatrecht 438 at 447 to 448: “He who is interested in other people’s law must have a gregarious and extrovert disposition and yet he must also be prepared to see his interest condemn him to an unusual kind of loneliness. For the comparatist becomes more lonely as he realises that he has to learn more than he can ever possibly understand. This leads to an intense, omnivorous erudition; but it also comes with a sense of desperation as he realises early on in his career what Socrates proclaimed towards the end of his: the more one reads the less one really knows. Yet the quest for understanding others as much as learning about them, must and will continue in our shrinking world. And often, by accident rather than by design, it leads to some unique insights into the law and its rules, as well as understanding the commonness of human suffering and the universality of the basic notions of justice which one’s nationalistic schooling has done so much to blur. The comparatist must, however, also have courage – courage that goes beyond that which is needed to fight the loneliness of true scholarship. His is a courage different in kind and not just in intensity. It is the courage to tolerate accusations of disloyalty levied against him by his fellow countrymen as his criticisms of their law strike closer to the bone; and it is the courage to ignore the criticisms of his foreign colleagues who may treat him – often but not always rightly – as a superficial outside observer of their systems. But a comparatist must persevere and remain true to his vocation as an international and not national lawyer. For all the true comparatists that I have ever met seem to me to be de facto if not de iure citizens of many countries, lovers of many cultures, unbound by the exigencies of modern nationalism, perhaps even nostalgic for the days of a ius commune.

The comparatist must withstand the attacks on his work – worse still the neglect of his work – by recalling how Lord Devlin once described ‘[t]he law [as] the gatekeeper of the status quo’. And the learned judge continued: ‘There is always a host of new ideas galloping around the outskirts of a society’s thought. All of them seek admission but each must first win its spurs: the law as first resists, but will submit to a conqueror and become his servant.’ This is the challenge that confronts the comparative methodology I am advocating, and that will be its destiny if it is properly pursued. But at the end of the day, the determination to persevere will come not from belief in the intellectual value of the comparatist’s work, but from his conviction of the intrinsic value of his aims: to increase
a delusion in respect of letters of comfort. It also fails to recognise the effect of the internationalisation of contract law,42 aptly illustrated by DiMatteo with reference to Albert Einstein’s theories of relativity:

"The time-space continuum can be manipulated through the process of speed to bend time and thus travel through it. A theory of relativity can be ventured for the international law of contracts as well. The speed of the process of the internationalisation of contract law can result in the bending or shifting of the enforceability-nonenforceability continuum as it pertains to business persons’ use of informal business letter, instruments, and correspondences. The relative likelihood of unexpected contractual liability (L) is a function of the informality (i) of a business relationship or correspondence and the universalisation or internationalisation (ii) of principles of contractual liability. The (i) functions will be squared to illustrate that the speed of internationalisation is positively related to unexpected contractual liability. In short, an informal correspondence previously considered to be nonbinding in nature may be transformed into an unexpected liability through an international recognition of enforceability at odds with a given national legal system’s holding of nonenforceability."43

In the preceding chapters, I have provided a comparative law and trans-systemic analysis of letters of comfort in some Common Law and Civil Law jurisdictions with specific reference to case law. The foreign decisions each contributes to the identification and better understanding of the legal pitfalls associated with the use of letters of comfort in international banking and finance. What is apparent is that letters

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of comfort in almost identical terms can be interpreted in uncomfortably different ways not only in the Anglo-common law jurisdictions but also in the Continental law jurisdictions.44

In theory, when dealing with comfort letters, a distinction is invariably made between a liability enforceable in law and a moral obligation.45 In practice, however, the critical question is whether the wording of what is alleged to be a letter of comfort is tight enough to avoid corporate liability.46 All turns on the interpretation to be given to the intention of the author of the letter of comfort.47 Thus, each case must be decided on its own facts and, in the Anglo-common law jurisdictions, will turn essentially on questions of intent, construction and interpretation. The formal legal doctrines which are usually turned to in the context of letters of comfort are uncertainty and intention to create legal relations.48 Although "intention" to create a legal obligation figures in essentially all formulae of contractual obligations, whether it be in Anglo-common law or Continental law jurisdictions, a close look at the decisions shows that the courts

44 See, however, S Vogenhauer and J Kleinheisterkamp (eds), Commentary on the Unidroit Principles of International Commercial Contracts (PICC) (Oxford University Press, Oxford, 2009) 232 who boldly state that "the seeming divergences in national case law can in most cases be explained by the uniqueness of the specific circumstances rather than by a general tendency to treat letters of comfort as binding or not."
45 See P Spector, "Comfort letters – How to get support from your customer’s parent company" (1995) 16 Credit Control 6.
48 See paragraphs 4.3 and 4.4.
impute to the “intention” of the parties simply what is reasonable on other grounds.\(^{49}\) In the rather rare cases where the parties explicitly state that their agreement is to have no legal effect\(^{50}\) their intention really does play a crucial role, but generally they give no thought to whether their agreement is to have legal consequences or not, and when the court refers to the “intention” of the parties, this is mostly a fiction.\(^{51}\) There are techniques\(^{52}\) to achieve a desired result and there is of course scope for the merits of each party’s position or for issues of conscionability\(^{53}\) to be (at least tacitly) influential in the result.

In the Anglo-common law jurisdictions, regardless of the approach adopted, a letter of comfort can only be enforceable in contract\(^{54}\) if two threshold requirements are satisfied; namely, (1) where the person providing the letter of comfort and the recipient of it intend that the letter affect their legal relations (that is, there must be an intention to enter into legal relations) ("intention requirement"), and (2) where the relevant statements in the letter are promissory in nature\(^{55}\) (and not mere representations or statements of moral obligation) ("promise requirement").\(^{56}\) These requirements are distinct because intention to create legal relations poses a problem of conclusion of contract (or contract formation), and relates to the existence of the


\(^{50}\) See paragraphs 4.4.1 and 4.4.2 for a discussion of “deliberate no-law” and “contextual no-law”.


\(^{54}\) MJ Bernard, "The Seven Commandments for Letters of Comfort" 2003 (March/April) *Banking Today* 6 at 7 goes further and states that if those two requirements are satisfied, the letter of comfort “will be tantamount to a guarantee.”

\(^{55}\) Not all statements are made by parties in the course of coming to an agreement give rise to, describe or qualify a contractual obligation, because the law distinguishes between (a) promissory statements, variously called undertakings, warranties, conditions, promissory conditions, terms or covenants; (b) contingent conditions, and (c) non-promissory statements or representations which form no part of the parties’ contract.

contract as opposed to the determination of the terms of a contract concluded, or the content thereof. They are, however, interrelated since in both instances the terms and backdrop of circumstances must be considered when construing the parties’ intention. Thus, a case about the contractual effect of a letter of comfort stands at the interface of the doctrines of contract formation, intention to create legal relations, and the technique of construction. It is apparent from chapters 5 to 7 that the approach a court adopts to, and the order of, dealing with the two issues, as well as the court’s willingness or reluctance to apply “commercial morality”, plays a significant role in, if not having a determinative effect on, the ultimate decision on the contractual effect of a letter of comfort. Past cases concerning letters of comfort are not, however, precedents in the strict sense of the word, but only provide useful guidelines, and evidence the development of outlines of a jurisprudence of enforceability.

For most commentators, the English Court of Appeal's decision in Kleinwort Benson Ltd v Malaysia Mining Corporation Berhad and Banque Brussels remain the judicial beacons in the Common Law regarding letters of comfort. The constructionist approach adopted in Kleinwort Benson on appeal, which was recently again endorsed by the English Court of Appeal in Associated British Ports, and followed in Toronto

62 See Hong Kong and Shanghai Banking Corporation Ltd v Jurong Engineering Ltd [2000] 2 SLR 54 at 71 (hereinafter referred to as Jurong Engineering).
64 [1989] 1 WLR 379 (hereinafter referred to as Kleinwort Benson on appeal)
67 [1989] 1 WLR 379. See also paragraph 6.1.
Dominion Bank v Leigh Instruments Ltd (Trustee of)\textsuperscript{69} Genos Developments Ltd v Cornish Jenner and Christie Ltd,\textsuperscript{70} Bank of New Zealand v Ginivan,\textsuperscript{71} and Bouygues SA v Shanghai Links Executive Community Ltd\textsuperscript{72} is rather restrictive and is the conventional way of determining the contractual effect of letters of comfort,\textsuperscript{73} and has been criticised.\textsuperscript{74} The lack of certainty approach followed in Commonwealth Bank of Australia v TLI Management Pty Ltd\textsuperscript{75} and Australian European Finance Corporation Ltd v Sheahan\textsuperscript{76} are closely related to the constructionist approach, are equally restrictive in determining the legal effect of letters of comfort, and have not been adopted in the recent Australian cases on comfort letters. By adopting a functional approach in Banque Brussels,\textsuperscript{77} Rogers CJ aligned himself with Hirst J robust approach in Kleinwort Benson at first instance,\textsuperscript{78} and was far more sympathetic to the enforceability of letters of comfort,\textsuperscript{79} and his preparedness to purposefully give effect to business practice has been lavishly praised.\textsuperscript{80} In light of the Australian High Court’s decision in Ermogenous v Greek Orthodox Community of SA Inc\textsuperscript{81} on the presumption of intention to create legal relations, Banque Brussels\textsuperscript{82} has become dated. However, like the Banque Brussels decision,\textsuperscript{83} the approach in Gate Gourmet,\textsuperscript{84} followed in Newtronics Pty Ltd (reces and mgrs apptd)(in liq) (ACN 061 493 516) v ATCO Controls Pty Ltd (in liq) (ACN 005 182

\textsuperscript{69}(1998) 40 BLR (2d) 1.
\textsuperscript{70}(unreported, Master Towle, High Court of New Zealand, Auckland, 10 July 1990, CP 556/90) (hereinafter referred to as Genos Developments).
\textsuperscript{71}(1990) 5 NZCLC 66,103 (hereinafter referred to as Bank of NZ). See, however, the obiter remarks by the New Zealand Court of Appeal in Bank of New Zealand v Ginivan [1991] 1 NZLR 178.
\textsuperscript{72}[1998] 2 HKLRD 479 (hereinafter referred to as Bouygues).
\textsuperscript{74} See paragraph 6.1.4.
\textsuperscript{75}[1990] VR 510 (hereinafter referred to as TLI Management).
\textsuperscript{76}(1993) 60 SASR 187 (hereinafter referred to as Australian European Finance).
\textsuperscript{77}Banque Brussels (1989) 21 NSWLR 502.
\textsuperscript{81}(2002) 209 CLR 95 (hereinafter referred to as Ermogenous). See also paragraph 4.4.
\textsuperscript{82}Banque Brussels (1989) 21 NSWLR 502.
\textsuperscript{83}Banque Brussels (1989) 21 NSWLR 502.
\textsuperscript{84}Gate Gourmet [2004] NSWSC 149.
481), also reflects a flexible approach supportive of the contractual effect of letters of comfort, but without reliance on the presumption of intention to create legal relations. Gate Gourmet86 and Banque Brussels have become the judicial beacons in Australia.

The different approaches adopted played a crucial role in the final outcome of Kleinwort Benson on appeal, Banque Brussels and Gate Gourmet and the other cases following them, and gives an indication of what litigants can expect in those jurisdictions. So, although each case will be decided on its merits, with no presumption for or against enforceability, the approach of a particular court is an indication of the policy in that jurisdiction.87 Ultimately, any conclusion as to which is the more appropriate approach must be dependent upon the perceptions of the parties' expectations and a country's economic and industrial public policies.88 Interpreting letters of comfort purposefully, rather than formalistically, against the matrix of circumstances is preferable. Courts must, especially when dealing with commercial transactions, ensure that their decisions are in synchrony with commercial reality.89

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85 (2008) 69 ACSR 317 (hereinafter referred to as Newtronics). But see, however, the decision of the Supreme Court of Victoria, Court of Appeal, in Atco Controls Pty Ltd (in liq) v Newtronics Pty Ltd (receivers and managers appointed) (in liq) (2009) 78 ACSR 375 (hereinafter referred to as Atco Controls).
86 Gate Gourmet [2004] NSWSC 149.
88 See GE Berendt et al, Contract Law and Practice (Anderson Publishing Co, Cincinnati, 1998) 617: "business runs on contractual relationships. Employment, supply, construction, finance, research and development, distribution, sales and purchase – all of the fundamental commercial relationships required to fuel the economy are governed by contracts. Consequently, the enforceability of contractual relationships, and more precisely the legal liabilities imposed for failing to honour contractual obligations, can be seen as a direct reflection of a country's economic and industrial public policies. If contract law reflects (at least in part) a society's choices regarding economic policy, then one strong policy behind requiring parties to 'honor their promises' (particularly in a commercial setting) will be the need for predictability of enforcement of those obligations. Only when commercial parties can rely on each other's promises (because they are legally enforceable), can they develop the commercial relationships required to sustain a modern, industrial and commercial economy."
89 That is, what would reasonable business people in the position of the parties have taken the agreement or clause in the agreement to mean – see Schenker & Co (Aust) Pty Ltd v Maplas Equipment and Services Pty Ltd [1990] VR 834 at 837 (McGarvie J, with whom Kaye and Ormiston JJ agreed): "A contract is to be construed in the light of the surrounding circumstances existing and known to the parties when the contract was made ... This includes the genesis of the transaction, the objective
What is clear is that one cannot afford to be blasé or to adopt a general policy of assuming that letters of comfort are non-binding. The divergent ways in which courts have dealt with letters of comfort and the resultant decisions preclude such an approach.

Numerically it appears that the English Court of Appeal’s decision in *Kleinwort Benson*, ostensibly inconsistent with the Court of Appeal’s decision in *Chemco Leasing* but recently confirmed by that court in *Associated British Ports*, has been followed in more Anglo-common law jurisdictions – in Canada in *Toronto Dominion Bank,* in New Zealand in *Bank of NZ* and *Genos Developments,* and in Hong Kong in *Bouygues.* However, it is apparent that Master Towle’s decisions in *Bank of NZ* and *Genos Developments* are based on an incorrect application of Ralph Gibson LJ’s decision in *Kleinwort Benson on appeal,* a failure to give proper effect to the wording of the letters of comfort in question, and are contrary to the *obiter* remarks of the New Zealand Court of Appeal in *Bank of New Zealand v Ginivan.* In Australia, *Kleinwort*

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90 [1987] FTLR 201, discussed in paragraph 4.5.1.4. See I Brown, “The Letter of Comfort: Placebo or promise?” [1990] Journal of Business Law 281 at 284. EP Ellinger, “Reflections on Letters of Comfort” [1991] Singapore Journal of Legal Studies 1 at 10 remarks, however, that “Chemco – just as the Court of Appeal’s decision in *Kleinwort Benson* – shows that their Lordships would uphold the liability of the issuer of a letter of comfort, provided his intention to be bound was clearly discernible from the document. The letter of comfort issued in *Chemco* was, of course, perfectly clear as regards this point. The Court of Appeal indicated that it was, however, unwilling to take the matter further and imply a contractual undertaking into a document that did not do so expressly.”


94 See paragraph 6.6.


97 [1991] 1 NZLR 178. See paragraph 6.5. In *Paulger v Butland Industries Ltd* [1989] 3 NZLR 549, the New Zealand Court of Appeal held a managing director (Mr Paulger) liable in contract on a letter which he circulated, written on the company’s letterhead and when it was experiencing financial difficulties, asking for the ‘tolerance’ of all creditors whilst a certain deal concerning the acquisition of a part of the company’s business by another entity was being finalised. He also advised that the company, Dingwall and Paulger Ltd, would “make good all outstanding matters within 90 days” and that he “personally guarantees that all due payments will be made” (at 551). When the company was subsequently placed in receivership and the claims of creditors remained unsatisfied, one of the creditors successfully instituted proceedings against Mr Paulger on the basis that the letter constituted a personal guarantee.
Benson on appeal\textsuperscript{98} has also found favour in Victoria and South Australia in TLI Management Pty Ltd\textsuperscript{99} and Australian European Finance\textsuperscript{100} respectively. However, the decision in Banque Brussels\textsuperscript{101} was favoured in Singapore in Jurong Engineering\textsuperscript{102} and in the New South Wales Supreme Court decision in Gate Gourmet\textsuperscript{103} which was in turn followed in Victoria in Newtronics.\textsuperscript{104} So, the numerical weight of the cases following the respective leading Anglo-common law decisions on letters of comfort is irrelevant in the consideration of the contractual effect of letters of comfort. Indeed, it is also wrong to approach the question of the contractual effect of letters of comfort from the point of view that it is not the usual case that a letter of comfort generates contractual liability and that the more usual view is that a letter of comfort does not lead to contractual liability.\textsuperscript{105} Rather, it is more correct to approach the issue of the contractual effect of letters of comfort in light of the classification of letters of comfort\textsuperscript{106} and the different approaches followed in Kleinwort Benson, both at first instance\textsuperscript{107} and on appeal,\textsuperscript{108} Banque Brussels,\textsuperscript{109} Gate Gourmet\textsuperscript{110} and the decisions following them. It is then apparent that, depending on the wording, letters of comfort properly so called or letters of awareness\textsuperscript{111} do not lead to contractual liability, and that letters of responsibility would,\textsuperscript{112} regardless of the approach adopted. The uncertainty about the contractual effect of letters of comfort pertains to the category

\textsuperscript{98} [1989] 1 WLR 379.
\textsuperscript{100} [1993] SASR 187. See paragraph 6.10.
\textsuperscript{101} Banque Brussels (1989) 21 NSWLR 502. See paragraph 7.3.
\textsuperscript{102} [2000] 2 SLR 54. See paragraph 7.4.
\textsuperscript{103} [2004] NSWSC 149. See paragraph 7.5.
\textsuperscript{104} (2008) 69 ACSR 317. See paragraph 7.6. This decision was overturned on appeal, but without commenting on whether the English Court of Appeal’s approach in Kleinwort Benson is to be preferred to the Banque Brussels or Gate Gourmet approaches.
\textsuperscript{106} See paragraph 2.5.
\textsuperscript{107} See chapter 5.
\textsuperscript{108} See chapter 6.
\textsuperscript{109} See paragraph 7.3.
\textsuperscript{110} See paragraph 7.5.
\textsuperscript{111} See paragraph 2.2.
\textsuperscript{112} See paragraph 2.5.
of medium strength comfort letters, where the schism between England and Australia is evidenced by the analytical approach of the English Court of Appeal in Kleinwort Benson and the functional approach in Banque Brussels and Gate Gourmet which is generally more likely to result in a letter of comfort generating contractual, or contractual-like, liability in Australia than in England. Moreover, despite the differences in the conclusions and approach to the contractual effect of letters of comfort in Australia (Banque Brussels and Gate Gourmet in favour of enforceability of comfort letters; TLI Management and Australian European Finance against enforceability), there are similar lines of reasoning in the first three cases – the New South Wales and Victorian courts did not dismiss the claims lightly and assessed the enforceability issue against the test of promissory estoppel to a varying degree. The conclusion in TLI Management is different from that in Banque Brussels and Gate Gourmet in that Tadgell J was prepared to consider promissory estoppel favourably only if more assertive words of promise had been used in the letter of comfort. The main difference between TLI Management and the other two New South Wales cases is that the Victorian Supreme Court did not consider the phrase “we confirm” in the letter to be strong enough to constitute enforceability. In any event, in light of the decisions in Gate Gourmet and Newtronics, as well as most of the Australian commentaries, it seems as though the favoured approach in Australia,

113 See paragraph 2.5.
115 Gate Gourmet [2004] NSWSC 149.
118 See L Thai, “Comfort Letters – A Fresh Look?” (2006) 17 Journal of Banking and Finance Law and Practice 15 at 28. The similarities in Banque Brussels and Gate Gourmet are: (1) both were prepared to consider the promissory estoppels principle enunciated in Walton Stores, and both applied that principle to allow letters of comfort to be enforced; (2) both were prepared to consider the intention of the parties before and during the preparation of the letters of comfort, and held that there were sufficient circumstantial evidence to suggest that the parties intended the letters to have some legal force; and (3) both considered that the statutory misleading or deceptive conduct provision in section 52 of the Trade Practices Act 1974 (Cth) could be used in the context of a representation made in comfort letters. In neither it was, however, necessary to apply the section because the letters had contractual effect. Thai at 29 questions, however, the basis upon which the Banque Brussels and Gate Gourmet courts relied upon promissory estoppel as stated in Walton Stores in order to resolve the legal effect of the letters of comfort, an issue that is not dealt with in this dissertation.
despite it not being referred to by the Victorian Court of Appeal in Atco Controls,\textsuperscript{120} is still that of Banque Brussels.\textsuperscript{121}

Although the outcomes for the banks in Kleinwort Benson on appeal\textsuperscript{122} and Banque Brussels\textsuperscript{123} are opposite, and the approaches to the contractual effect of comfort letters adopted in the two decisions differ, it is possible to reconcile the judgments to a certain extent and to glean important pointers about letters of comfort in the process.\textsuperscript{124} These pointers also assist to put the progeny of Kleinwort Benson on appeal and Banque Brussels into perspective, and to develop a pattern of consistency in the treatment of letters of comfort.

The judgments in Kleinwort Benson (both at first instance and on appeal) and Banque Brussels apply the established principles of contract and tort law, and recognise that the problem with letters of comfort is that they have to be classified,\textsuperscript{125} with some categories of comfort letters being matters of honour outside the reach of legal remedies.\textsuperscript{126} Classification of letters of comfort according to their legal enforceability as letters of comfort properly so called, medium strength and strong comfort letters,\textsuperscript{127} is not only in accordance with the their development in contemporary use,\textsuperscript{128} but also facilitates a sensible and rational determination of the contractual effect of letters of comfort in general, and of a letter of comfort in a particular case.

\textsuperscript{120} (2009) 78 ACSR 375.
\textsuperscript{122} [1989] 1 WLR 379.
\textsuperscript{123} Banque Brussels (1989) 21 NSWLR 502.
\textsuperscript{124} RIVF Bertrams and FGB Graaf, “Letters of comfort: de Kleinwort Benson-zaak in hoger beroep” 1989(16) Bank-en effectenrecht 181 at 182 are of the view, however, that in Kleinwort Benson the court had to deal with a weak or soft letter of comfort.
\textsuperscript{125} See paragraph 2.5.
\textsuperscript{127} See paragraph 2.5.
\textsuperscript{128} See paragraph 1.3.
It appears from the case law on letters of comfort that the standard procedure, as with other documents, for courts confronted with them is: a meticulous examination of the specific text of the letter of comfort as well as the surrounding circumstances - having regard to the sophistication of the parties and their subsequent conduct - in order to ascertain the true intention of the parties, and if it is determined that a legally binding obligation has arisen, what the nature of that obligation is. This is necessary because a letter of comfort is the product of the negotiation that precedes its creation, and is invariably less specific and frequently more vague when compared to traditional legal commitments. So, apart from the language of the letter of comfort itself, the circumstances surrounding the creation of any particular letter of comfort and the background practices of the particular trade or industry in question are significant factors in determining the classification of the letters and are critical to the outcome in each case. In other words, factors external to the comfort

129 Codelfa Construction Pty Ltd v State Rail Authority of New South Wales (1982) 149 CLR 337.
130 See B Rudden, “The Gentleman’s Agreement in Legal Theory and in Modern Practice” (1999) 2 European Review of Private Law 199 at 217. See also M Vedenkannas, Tukkirje vakuutena (Nuomalainen Lakimiesyhdistys, Helsinki, 2007) 408 who, writing in the context of Finnish law, comments that the emphasis “will be placed on the wording of the letter in light of the surrounding circumstances.”
135 Generally speaking, the surrounding circumstances can be categorised as: “circumstances relating to the behaviours of the issuer and the receiver of the letter; circumstances relating to the credit agreement; and circumstances relating to the concern relationship” see M Vedenkannas, Tukkirje vakuutena (Nuomalainen Lakimiesyhdistys, Helsinki, 2007) 408.
136 For example, the sophistication of the parties and whether they sought legal advice as to the meaning and legal significance of the letter of comfort, the fact that the letter was part of the contractual relationship between lender and borrower and not merely tangential to it, the reasons for the use of the letter as well as the role played in the parties agreement.
137 Stauthon J stated in Chemco Leasing (19 July 1985, unreported, QBD) that evidence of the trade practice may be adduced in construing provisions in a comfort letter, and intimated that courts are not sufficiently aware of commercial practice relating to letters of comfort. See also C Bright and S Bright, “Beware the Letter of Comfort” (1988) 138 New Law Journal 365 who are of the view that the use of comfort letters is well established practice and that part of the surrounding circumstances that needs to be taken into account is the expectation aroused in market practitioners generally by comfort letters.
letter itself either expressly or impliedly have influenced the court's reasoning.139 Moreover, the external factors, which appear to relate to or are linked to and inform issues of commercial morality or good faith140 in a commercial context,141 emphasise the dynamic character of contractual relationships, so that the binding effect of a letter of comfort can be described as a dynamic process - this effect can cease if the surrounding circumstances change fundamentally.142

Hirst J in Kleinwort Benson at first instance, Ralph Gibson LJ in Kleinwort Benson on appeal and Rogers CJ in Banque Brussels all seem to have adopted a rather generous attitude about admitting evidence of surrounding circumstances.143 Ralph Gibson LJ in Kleinwort Benson on appeal emphasised the circumstance that the parent company had flatly refused to join in a direct contract or to provide a guarantee, and a higher rate of interest had to be paid on the loan.144 Hirst J in Kleinwort Benson at first instance and Rogers CJ in Banque Brussels, however, did not regard the refusal to provide a guarantee as precluding other types of promises – in Kleinwort Benson other parts of the letter of comfort were contractual and in Banque Brussels there was

139 See J Lipton, "Good Faith and Letters of Comfort" (1999) 28 University of Western Australia Law Review 138 at 140.
141 As J Lipton, "Good Faith and Letters of Comfort" (1999) 28 University of Western Australia Law Review 138 at 143 pointed out: "What the relevant parties had in mind when negotiating and drafting their agreement will be of paramount importance in ascertaining the moral imperatives underlying the transaction, in indeed any can be ascertained in various commercial contexts. Equally, the way the parties proceed in performing and/or enforcing the obligations bargained for may give some idea of the types of relationship they believed existed between them. In the context of letters of comfort, the initial negotiations and drafting process will be of most interest in ascertaining both the legal and moral objectives intended to underlie the transaction in question. This is because the main question in litigation concerning the interpretation of a letter of comfort is often whether there was an intention to create legal relations between the parties or merely an intention for one party to give some vague, moral assurance to the other without undertaking a clear legal liability for repayment of another's debt. The answer to this question will depend on the exact wording of the letter ultimately given. However, much emphasis in the case law has also rested on the stages of drafting and negotiation and extrinsic elements concerning the parties' relationship with each other."
142 See M Vedenkannas, Tukikirje vakuutena (Nuomalainen Lakimiesyhdistys, Helsinki, 2007) 408.
evidence that during the negotiations the bank had stated that it regarded a letter of comfort as legally binding. In both matters, there were indications of commercial importance and hard bargaining about the subject matter of the crucial paragraphs in the respective comfort letters. But, although such evidence provided support for arguments that promises or legally significant representations were intended, it fell short of being conclusive because the language of the comfort letters permitted debate about the purpose of the effort.\textsuperscript{145} The role of other matters, which include the surrounding circumstances, was, however, more important in Australia than in the other Anglo-common law jurisdictions in determining whether a statement is promissory, not least because of the order in which the court deals with the intention and promise requirements. It appeared from both \textit{Banque Brussels} and \textit{TLI Management Pty Ltd} that other matters, including the surrounding circumstances, should be taken into account in such determination - which differed from the position in England as set out in \textit{Kleinwort Benson on appeal} – and supported a greater emphasis upon the circumstances in which the letter of comfort was provided, rather than using a “finely tuned linguistic fork” to determine the parties’ intent.\textsuperscript{146} The Australian approach, compared to the somewhat artificial traditional approach, was also more in tune with what the expectations were of a commercial court, as poignantly observed by Staughton J in \textit{Chemco Leasing}.\textsuperscript{147}

“When two businessmen wish to conclude a bargain but find that on some particular aspect of it they cannot agree, I believe that it is not uncommon for them to adopt language of deliberate equivocation, so that the contract may be signed and their main objective achieved. No doubt they console themselves with the thought that all will go well, and that the terms in question will never come into operation or encounter scrutiny; but if all does not go well, it will be for the courts or arbitrators to decide what those terms

\textsuperscript{147} (19 July 1985, unreported, QBD).
mean. In such a case it is more than somewhat artificial for a judge to go through the process, prescribed by law, of ascertaining the common intention of the parties from the terms of the document and the surrounding circumstances; the common intention was in reality that the terms should mean what a judge or arbitrator should decide that they mean, subject always to the views of any higher tribunal. Those considerations are, as it seems to me, particularly likely to apply to a letter of comfort, which is a subsidiary part of the business transaction and one on which the parties, ex hypothesi, are likely to find difficulty in reaching agreement. Nevertheless, I must carry out the traditional task of ascertaining what common intentions should be ascribed to the parties from the terms of the ... documents in question and the surrounding circumstances."

All the judgments in both Kleinwort Benson and Banque Brussels noted that the nomenclature of the instrument was not determinative of its legal effect, but that the consequences of a letter of comfort depended upon the particular circumstances and the precise wording of the letter in question. This had two major consequences. First, the use of semantic pigeonholing to label comfort letters as non-guaranty or non-guaranty substitutes would not be the end of the court’s legal analysis of comfort letters. Rather, it would only be the first step in the judicial reasoning process as Hirst J recognised in Kleinwort Benson at first instance. Secondly, courts would entertain intricate and elaborate arguments about both contractual intention and contractual interpretation. More importantly, however, was the order in which the

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148 However, in Lasalle Bank National Association v Citicorp Real Estate Inc 2003 US Dist Lexis 15069 at 26 it was stated that “the fact that these were sophisticated commercial entities also weighs against Citicorp. As a sophisticated commercial entity, Citicorp should have realized that the phrase ‘comfort letter’ indicated that Marriott did not intend to be bound and, more significantly, that courts as a general rule would not hold them to this promise.” See also Toronto Dominion Bank (1998) 40 BLR (2d) 1 at 156 where Winkler J has stated that: “Letters of comfort are just that, comfort. They are not guarantees or formal security nor are they enforceable as such. They are gentlemen’s agreements and moral obligations.”


150 [1988] 1 WLR 799 at 809 to 810.
courts determined whether the two threshold requirements had been met, and whether there was a distinction between the intention to create a contractual relationship and the question whether a party did actually enter into a contractual undertaking. As discussed in paragraph 6.1.1, in *Kleinwort Benson on appeal*, Ralph Gibson LJ addressed the promise requirement first, and held that the application of the presumption in *Edwards v Skyways* was restricted to those occasions where the language of a term of the letter of comfort disclosed a promissory obligation. His Lordships’ judgment shows much in common with the approach of critics of the intention to create legal relations doctrine, who point to the notion of bargain as the key to the seriousness of promises. Accordingly, in *Kleinwort Benson on appeal*, the presumption did not apply, because the statement in the third paragraph of the comfort letter before the court (that it was the parent company’s policy to ensure that its subsidiary was at all times in the position to meet its liabilities) disclosed no such promissory obligation but was a mere representation of fact which was correct at the time when it was made. As Lee has observed, the “central idea of this approach rests on the distinct dichotomy between the parties’ intention as regards the existence of the agreement as opposed to the content thereof.” Arguably, the question as to the existence of a contract preceded the question as to the content of the contract if found to exist. In other words, as Greig and Davis have pointed out, it is

152 [1964] 1 WLR 349. See paragraph 4.4.2.
154 S Wheeler and J Shaw, *Contract Law* (Clarendon Press, Oxford, 1996) 164 are of the view that, in the light of *Kleinwort Benson on appeal*, it would be better to regard comfort letter cases not as cases of a rebutted presumption of a fictitious intention to create legal relations in commercial agreements but as cases where an apparent bargain is carries outside the law’s reach by the clear intention of the parties. The extent to which the parties should be permitted to do this could then be judged in the light of the principles of autonomy, equality of bargaining power, and the protection of detrimental reliance in the case of an executed agreement.
156 It is perhaps more accurate to refer to “contract” rather than “agreement”.
questionable whether it was helpful to draw a distinction, as did Ralph Gibson in *Kleinwort Benson on appeal* and Tadgell J in *TLI Management*, between the intention to create a contractual (legal) relationship and the question whether a party did actually enter into a contractual undertaking.\(^{159}\)

This approach of Ralph Gibson LJ to deal with the promise requirement first has two important consequences. First, it renders the presumption (and indeed the first requirement) of little utility, if not otiose. In *Kleinwort Benson on appeal*, Ralph Gibson LJ elevated *contractual interpretation* as the key issue to determine, while the emphasis was on *contractual intention* in both *Kleinwort Benson at first instance*, *Banque Brussels* and in *Gate Gourmet*. By addressing the promise requirement first, the English Court of Appeal in *Kleinwort Benson* put the cart before the horse. If the presumption in favour of intention to create legal relations is available in commercial dealings, it seems logical that it is that presumption which must be the primary consideration followed by its possible rebuttal by virtue of uncertainty.\(^{160}\) Indeed, “[T]he presumption both engenders and is predicated upon commercial certainty – a certainty which Kleinwort appears willing to sacrifice in sanctioning the free-for-all to establish intention.”\(^{161}\) In so far as contractual intention is concerned, the decision in *Kleinwort Benson on appeal* shows that intention, while essential, is a subordinate requirement to *commitment* – and, intention may be inferred from commitment, but commitment cannot be inferred from intention.\(^{162}\) Secondly, although Ralph Gibson LJ refers to the surrounding circumstances or factors external to the comfort letter, the implications or effect of the associated good faith or commercial morality in commercial relationships are either ignored or emasculated by his approach of dealing

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\(^{159}\) There is, however, support for the view that there is such distinction – see A de Moor, “Intention in the Law of Contract: Elusive or Illusory?” (1990) 106 Law Quarterly Review 632 at 636.


\(^{162}\) E Jacobs, “Little Comfort from Letters of Comfort” (1989) 7 *International Banking Law* 190 at 191. Interestingly, MK Omalu, “Precontractual Agreements in the Energy and Natural Resources Industries – Legal Implications and Basis for Liability (Civil Law, Common Law and Islamic Law)” [2000] *Journal of Business Law* 303 at 313 remarks that under Islamic law the significant element is the intention of the parties, and that the presence of an intention to assume legal liability would render a letter of comfort binding, because such an intention would be regarded as a promise.
with the promise requirement before dealing with the intention requirement. The
minute textual analysis of the letter of comfort resulting in the finding that the
promise requirement was not satisfied basically precludes the giving effect to the legal
and moral objectives intended to underlie the transaction in question because that
relates to the intention requirement.

Because the premises for the conclusions depend on the interpretation of disputed
facts, the conclusions about the interpretation of the text of the comfort letters are
frequently controversial and subject to criticism.\textsuperscript{163} It is thus not surprising that the
different approaches adopted in \textit{Kleinwort Benson on appeal} and in \textit{Banque Brussels} to
determine whether the relevant statements in the letters of comfort are promissory,
are important to the contractual effect of the letters. Rogers CJ in \textit{Banque Brussels}
refers to Ralph Gibson LJ’s decision in \textit{Kleinwort Benson} where the approach taken was
to subject the letter of comfort to “minute textual analysis” and comments that
“Courts will become irrelevant in the resolution of commercial disputes if they allow
this approach to dominate their consideration of commercial documents”.\textsuperscript{164}
Moreover, Rogers CJ observes that “it is inimical to the effective administration of
justice in commercial disputes that a court should use a finely tuned linguistic fork”.\textsuperscript{165}
Accordingly, the emphasis in \textit{Kleinwort Benson on appeal} upon the express words of
the letter of comfort renders “the document a scrap of paper” and “if the Lord Justice
is correct, the writer [of the letter of comfort] has not expressed itself on anything

\textsuperscript{164} \textit{Banque Brussels} (1989) 1 NSWLR 502 at 523. S Deanne, “Letters of Comfort” (1992) 1 \textit{Asia Pacific Law
Review} 88 at 92 is of the view that this reasoning of Rogers CJ is flawed: ‘The purpose of the courts in
contractual disputes is to give effect to the parties’ intentions. Commercial contracts are of necessity
complicated documents. Their purpose is to illustrate in writing sometimes very complex arrangements
between businessmen. In these circumstances, the court’s job must be to analyse these contracts
‘minutely’ to find out what the parties had agreed. To do otherwise makes a nonsense of the parties’
intentions and is most certainly not what should be expected of a commercial court in a sophisticated
society. If this is the approach that Australian courts are to take in the construction of commercial
contracts, then it would seem to be more likely that they would become (to use Rogers CJ’s words)
‘irrelevant in the resolution of commercial disputes if they allow this approach to dominate their
construction of commercial documents.’

\textsuperscript{165} \textit{Banque Brussels} (1989) 1 NSWLR 502 at 524.
relevant as a matter of honour".\textsuperscript{166} This may have been because the writer would then be treated as having only made a representation of present intention which, having no reference to future conduct, imposes no obligation, honourable of otherwise, upon the writer.\textsuperscript{167} The overriding importance for Rogers CJ in \textit{Banque Brussels} is clearly the giving of “proper effect to commercial transactions” - rather than the form of the statements in the letter of comfort which prevailed in \textit{Kleinwort Benson on appeal}\textsuperscript{168} - notwithstanding any uncertainties in the matters agreed or the failure of the parties to address certain issues.\textsuperscript{169} It appears that Australian courts will not permit letters of comfort, commonly drafted in terms which are ambiguous or equivocal, to be used as a placebo (to use Staughton J’s term in \textit{Chemco Leasing})\textsuperscript{170} - that is, to avoid any legal obligation whilst appearing to the recipient to provide some commitment.\textsuperscript{171} If a letter of comfort has no contractual effect, a non-contractual promise may still be enforced in equity by means of promissory estoppel\textsuperscript{172} even where many or important terms have not been agreed, provided that this failure to agree is not the result of a deliberate decision not to agree.\textsuperscript{173}

\textsuperscript{166} \textit{Banque Brussels} (1989) 1 NSWLR 502 at 523.
\textsuperscript{168} See also W Faul, "Letters of Comfort" [1990] \textit{Journal of South African Law} 73 at 84.
\textsuperscript{169} See GD Cooper and JG Fox, "Commercial Morality - Enforceability of Letters of Comfort" (1990) [ ] \textit{Journal of Banking and Finance Law and Practice} 66 at 70 and 71.
\textsuperscript{170} (19 July 1985, unreported, QBD).
\textsuperscript{171} GD Cooper and JG Fox, "Commercial Morality - Enforceability of Letters of Comfort" (1990) [ ] \textit{Journal of Banking and Finance Law and Practice} 66 at 71. In \textit{Capita Financial Group Ltd v Rothwells Ltd} (unreported decision, Supreme Court of New South Wales, 13 October 1990) 52, decided shortly before \textit{Banque Brussels} (1989) 21 NSWLR 502, Giles J stated that: “The letters of undertaking clearly recorded commercial arrangements. Anticipating my conclusion as to intention to create legal relations, they were in my view intended to record legally binding arrangements, but even if the arrangements were to be binding in commercial honour only one would hesitate to attribute to the parties such inattention to a most important element in their relationship that they should be held to have failed to express any meaning or intention. I do not think that the letters of undertaking are vitiated by uncertainty.” See also RI Milliner, “Comfort Letters – How Much Comfort Are They For Lenders and Auditors?” (unpublished paper, University of Western Australia, Law Summer School, 1990) at [9.9]; F Macindoe, “Australia – Comfort Letters: Contribution” (1994) 9 \textit{Journal of International Banking Law} N96.
\textsuperscript{172} See paragraph 1.5. In \textit{Banque Brussels} (1989) 1 NSWLR 502 at 529 it was held that, in the event the letter of comfort was not a contract, Banque Brussels was entitled to relief on the basis of the doctrine of promissory estoppel as stated in \textit{Walton Stores (Interstate) Limited v Maher} (1988) 164 CLR 387.
\textsuperscript{173} See \textit{Banque Brussels} (1989) 1 NSWLR 502 at 529 and 530; \textit{Austotel Pty Ltd v Franklins Selfserve Pty Ltd} [ ]. See also L Thai, "Comfort Letters – A Fresh Look?" (2006) 17 \textit{Journal of Banking and Finance Law and Practice} 15 at 32.
The respective criticism and praise are justified, because courts will become irrelevant to resolution of commercial disputes if their decisions do not accord with business needs. To explain the difference between the approaches of the English Court of Appeal (in *Kleinwort Benson* and *Associated British Ports*) and the commercial courts (in *Kleinwort Benson at first instance*, Chemco Leasing, Banque Brussels, Gate Gourmet and Newtronics) by reference only to the competing “form” and “substance” interpretation processes, or the “moral” versus “legal” approach adopted in *Kleinwort Benson on appeal* towards commercial transactions, is to ignore a more fundamental point of divergence – the approaches taken to determine whether the relevant statements were promissory. On the one hand, the English Court of Appeal, like the Victorian Court of Appeal, is emphatic that a letter of comfort binding in honour only is consistent with its business nature; that is, the enforceability of letters of comfort is viewed against the backdrop of businessmen regarding moral commitments coupled with non-legal sanctions as of sufficient value to induce them to enter into commercial agreements. In other words, there is a

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178 (19 July 1985, unreported, QBD).
180 Gate Gourmet [2004] NSWSC 149.
186 (2009) 78 ACSR 375 at [54].
188 J Pascoe, “Kleinwort Benson v Malaysia Mining Bhd” (1989) 7 *Company and Securities Law Journal* 356 at 357 has commented that: “In experienced commercial and banking circles the parties know very well the difference between a legally enforceable agreement and an unsecured moral obligation. When the former cannot be achieved the latter solution may well be adopted.”
recognition that non-legally enforceable commitments may be of sufficient value to businessmen to legitimise the use of letters of comfort which are not intended to be contractually binding.\textsuperscript{189} However, as Brown\textsuperscript{190} remarked, Ralph Gibson LJ in \textit{Kleinwort Benson on appeal}\textsuperscript{191} was unduly restrictive in his interpretation of the wording of the third paragraph of the letter of comfort before him, and if he chose to apply the presumption of intention the wording of that paragraph would not be sufficiently uncertain as to displace the presumption. The basic jurisprudential premise behind the English Court of Appeal’s approach in \textit{Kleinwort Benson},\textsuperscript{192} and twenty years later in \textit{Associated British Ports},\textsuperscript{193} is that both decisions evince an extreme positivism, emphasising in no uncertain terms that legal rules are separate and distinct from moral considerations.\textsuperscript{194} Moreover, the English Court of Appeal adopts a traditional literal interpretation or analytical approach\textsuperscript{195} to letters of comfort,\textsuperscript{196} and categorises letters of comfort as only moral obligations or obligations in honour except where the terms of the letter are clearly promissory.\textsuperscript{197} In so doing, it has been argued, the English Court of Appeal in \textit{Kleinwort Benson} appears to have been willing to sacrifice commercial certainty ‘in sanctioning the free-for-all to establish intention’,\textsuperscript{198} and encouraging commercial immorality.\textsuperscript{199} However, supporters of the English courts’ approach to letters of comfort point out that, in respect of any other approach, “there is a distinct

\textsuperscript{191} [1989] 1 WLR 379.
\textsuperscript{192} [1989] 1 WLR 379.
\textsuperscript{193} [2009] 1 Lloyd’s Rep 595.
\textsuperscript{195} The focus is primarily on the linguistic interpretation of written promises – see JG Rinkes and GH Samuel, \textit{Contractual and Non-contractual Obligations in English Law} (Arsequi Libri, Nijmegen, 1992) 108.
danger of ignoring social factors outside the legal framework which render such instruments a useful commercial tool.\textsuperscript{200}

On the other hand, in using a commercial functional analysis the commercial courts, as in \textit{Banque Brussels},\textsuperscript{201} are equally insistent that a non-enforceable letter of comfort is irreconcilable with business practice; that is, either the enforceability of letters of comfort is viewed against the backdrop of businessmen placing little reliance on moral obligations when making commercial decisions,\textsuperscript{202} or there is a blurring of the difference between legal rules, on the one hand, and moral and commercial considerations, on the other. Consequently, some commentators have warned that the assumption is that the only justifiable role of letters of comfort in business is as an enforceable instrument.\textsuperscript{203} Indeed, as Howard has observed, the reference by Rogers CJ in \textit{Banque Brussels}\textsuperscript{204} to the undesirability of creating an “honourable purgatory” for business statements\textsuperscript{205} may lead one to conclude that there exists, even at “a judicial subconscious level, a presumption that something said by one businessperson to another after hard bargaining will be promissory. It might well be that this presumption owes much to its better exposed relation in the field of intention to create legal relations.”\textsuperscript{206} It is perhaps more appropriate to view Rogers CJ’s “honourable purgatory” observation really as a concern with unfair, unreasonable or

\textsuperscript{200} See P Giliker, “Taking comfort in certainty: to enforce or not to enforce the letter of comfort” 2004 Lloyd’s Maritime and Commercial Law Quarterly 219 at 230.
\textsuperscript{201} \textit{Banque Brussels} (1989) 21 NSWLR 502.
\textsuperscript{204} \textit{Banque Brussels} (1989) 21 NSWLR 502 at 523.
\textsuperscript{205} As N Courmadias, “Intention to create legal relations: The end of presumptions?” (2006) 34 \textit{Australian Business Law Review} 175 at 184 remarks, there is no reason why the High Court’s rejection of presumptions in \textit{Ermogenous} (2002) 209 CLR 95, even with its implication on the burden of proof, should result in “some purgatory where statements made by businessmen, after hard bargaining and made to induce another business person to enter into a business transaction would, without any express statement to that effect, reside in a twilight zone of merely honourable engagement” \textit{(Banque Brussels} (1989) 1 NSWLR 502 at 523. See also \textit{Gate Gourmet} (2004) NSWSC 149 at [212] and [213].
immoral conduct – with good faith – when considering commercial, unsecured lending transactions such as involving bare guarantees, negative pledges and letters of comfort. In other words, the result of the commercial interpretation approach is the fact that transactions involving comfort letters is an example within the sphere of commercial law of arrangements where some measure of fairness and good faith or “commercial morality” - basically equity - is generally involved. Commercial morality cannot be said to be a question for the parties, and not the courts. Australian courts do not appear to confine themselves solely to pragmatic commercial considerations, like the English courts. It should, however, be noted that some commentators cannot see any justification for Rogers CJ's sympathy and regard it as clearly misplaced:

207 That is, not secured by one of the traditional securities such as a guarantee or indemnity.
209 As LA DiMatteo, “The Norms of Contract: The Fairness Inquiry and ‘The Law of Satisfaction’ – A Nonunified Theory” (1995) 24 Hofstra Law Review 349 at 430, correctly remarks: “A number of courts have looked outside the language of the comfort instrument to determine if contractual intent and liability may be implied. I submit that this is in essence a fairness inquiry. Given the ‘totality of the circumstances’ and of the nature of the relationship, it is inherently unfair to allow a party to avoid liability for issuing a letter that was reasonably relied upon by another to its detriment.” S Vogenhauer and R Kleinheisterkamp (eds), Commentary on the Unidroit Principles of International Commercial Contracts (PICC) (Oxford University Press, Oxford, 2009) 232 observe that under the PICC the approach to the contractual effect of comfort letters would be to apply the reasonable reliance test expressed in article 1.8: “Where it is reasonably clear in the light of all circumstances that the risk of default was assumed by the ‘comforting’ party, that party is precluded from invoking its lack of intention to be bound if the creditor relied on it to its detriment. It follows, however, from the logic of Art 1.8 that this solution can only constitute an exception to the rule that the party acting to its potential detriment is responsible for managing its risk either by insisting on a proper guarantee or by raising its interests for a loan requested by the subsidiary in the case of difficulties (principle of caveat creditor).”
213 See, for example, the comments of Kirby J in Pan Foods Company Importers & Distributors Pty Ltd v Australia and New Zealand Banking Group Ltd (2000) 170 ALR 579 at [24]; “Business is entitled to look to the law to keep people to their commercial promises. In a world of global finances and transborder capital markets, those jurisdictions flourish which do so.”
"If after hard bargaining, the agreement was purgatory, to give effect to the bargain, the court must send the parties to the purgatory. The fact is that far from impeding the flow of commerce, this class of in-between statements facilitates transactions which would otherwise have aborted. The party who extends credit against a letter of comfort is not a little old lady, he (often an ‘it’) does so with his eyes open and charges a higher rate of interest to compensate for the higher risk. It is often he who insists on omitting any statement on the presence or absence of contractual intention. When he has bargained for purgatory, it is most unfair to send him to heaven when he loses his gamble."215

In light of Banque Brussels and Gate Gourmet, it appears that a letter of comfort will no longer be dismissed for uncertainty of terms216 as in TLI Management in Australia.217 Courts in Australia,218 at least at first instance, are now more likely to acknowledge and enforce deliberate uncertainty which is tactically employed in business negotiations.219 In this regard, Banque Brussels and Gate Gourmet appear to

215 BM Ho, Hong Kong Contract Law (Butterworths, Hong Kong, 1994) 73. See, however, J Lipton, "Good Faith and Letters of Comfort" (1999) 28 University of Western Australia Law Review 138 at 159. Who is of the view that although Rogers CJ’s reference to the “honourable purgatory” may be interpreted as contradicting previous case law (Kleinwort Benson on appeal and TLI Management) by saying that commercial parties should not be able to avoid enforcement of agreed terms by drafting them in a vague and uncertain way, it is in reality not so.
217 See McGellin v Mount King Mining NL (1998) 144 FLR 288 at [14], and Sir Robin Cooke’s remark in The Queensland Electricity Generating Board v New Hope Collieries Pty Ltd [1989] 1 Lloyd’s Rep 205 at 210: "Arguments invoking alleged uncertainty, or alleged inadequacy in the machinery available to the courts for making contractual rights effective, exert minimal attraction.”
218 This attitude is also evident from the observations of Hirst J in Kleinwort Benson at first instance [1988] 1 WLR 799 at [ ], that a lack of precision is left to the courts to resolve by business people, “so that the contract can be signed and their main objective achieved” which was referred to in Semco Salvage & Marine Pty Ltd v Lancer Navigation Co Ltd [1996] 1 Lloyd’s Rep 449.
219 See K Young, "Letters of Comfort" (1998) 26 Australian Business Law Review 309 at 310. The Dutch academic, HCF Schoordijk, "Letter of Comfort" (1989) 45-46 Nederlands Juristenblad 1676 to 1678, has advocated that letters of comfort, despite of or maybe because of their language of deliberate equivocation, ought to be judged by the real and main objectives of the parties, not by their intentional misleading vagueness, which often obscures that a real contract has been entered into. However, Schoordijk has been criticised by a number of Dutch practitioners – see RE de Rooy, "Letter of Comfort: Nogmaals de Kleinwort Benson-zaak" [1990] Nederlands Juristenblad 784, J Spier, "Schoordijk vs Court of Appeal" [1990] Nederlands Juristenblad 785, PIM Akkermans, "Letters of Comfort: een kwestie van
be consistent with the reasoning of Hirst J *Kleinwort Benson at first instance* (where the overall requirement of contractual certainty was not expressly referred to), and of the English Court of Appeal in *Chemco Leasing* (where it was held that, although not necessarily easy, it was possible to determine the common intention of the parties) that the law strives to uphold intention in the face of uncertainty so that, without violation of essential principle, the dealings of business persons may as far as possible be treated as effective. The decision in *Banque Brussels* serves as a useful precedent in favour of maintaining stability in commercial transactions.

The decision in *Kleinwort Benson on appeal* no longer has much impact in Australia insofar as letters of comfort are concerned - there is a divergence of approach to comfort letters in Australia and England. The Australian stance, evidencing a diminution of English influence, is aptly encapsulated by Buckley’s comment that: “It is the right of British jurists to give absolute primacy to technical legal rules. However, such an approach is at odds with the resurgence of equitable principles recognised in a string of recent decisions in the High Court of Australia and will ill serve the orderly development of Australian commerce.” So, it appears that in dealing with a letter of


221 [1987] FTLR 201.


227 P Clarke, J Clarke and M Zhou, *Contract Law: Commentaries, Cases and Perspectives* (Oxford University Press, South Melbourne, 2008) 16 remark that: "What is at stake is not, of course, the development of a law of contract branded with specifically Australian virtues and loaded with local colour, or isolated from outside influence, but simply one that cleaves to our own social condition." See also MP Ellingham, “An Australian Contract Law” (1989) 2 *Journal of Contract Law* 13.

comfort, the court's decision can turn on not only the methods and standards of interpretation which prevail in the relevant jurisdiction, but also on the court's essentially subjective view of what the terms in the letter of comfort means, the moral behaviour of the parties in question,229 the adoption of standards of good faith230 and fair dealing231 in connection with commercial relationships,232 and to some extent placing a greater importance on the purpose of comfort letters to induce reliance.233 This approach by the Australian courts, which is different from the English courts' approach,234 in some ways evidences “the trend of ‘commercial morality' which is

estoppel in Australia has to some extend transcended contract in that the existence of a contract is no longer necessary for contract like obligations to arise.

230 See J Lipton, "Good Faith and Letters of Comfort" (1999) 28 University of Western Australia Law Review 138 at 139.
233 RE Elliott and JM Robinson, "'Comfort' letters may provide cold comfort” 1999 (November 19) The Lawyers Weekly 12. This is also apparent from Hirst J’s decision in Kleinwort Benson [1988] 1 All ER 714 because the court emphasised the fact that the bank acted in reliance on the stated policy of the parent company - that is, that the parent company was at all times in a position to meet its liabilities under the facility arrangements - which was of paramount importance to the bank. See also S Gold, "Comforting Story” (1988) 138 New Law Journal 54. Some commentators are of the view that there ought to be a widened conception of contract founded on reliance – see B Fauvarque-Cosson and D Mazeaud (eds), European Contract Law (Sellier European Law Publishers, Paris, 2008) 4; L Thai, “Letters of comfort: A Comparative Evaluation of Australian, United States and English Jurisdictions” (2000) 7 Current Commercial Law 1; L Thai, “Comfort Letters - A Fresh Look?” (2006) 17 Journal of Banking and Finance Law and Practice 15.
234 See P Giliker, "Taking comfort in certainty: to enforce or not to enforce the letter of comfort” [2004] Lloyd’s Maritime and Commercial Law Quarterly 219 at 231: "English law has traditionally maintained a strictly commercial view of contract law in the business context, and attempted to adopt a system close to commercial practice. Certainty is required, with the minimum of interference by the courts. More interventionist concepts such as good faith have therefore been treated with suspicion, or confined to limited ad hoc situations: the courts preferring pragmatic examples to broad principle ... In accepting a limited role in commercial contracting, the courts acknowledge explicitly (or more usually implicitly) that the parties' interests are best protected by certainty rather than court-based regulation. Such a view – which has been described as static market-individualism – remains contentious”.

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percolating through the judicial decision making process\textsuperscript{235} – indeed, it recognises that contract law is part of the law of obligations, imports into that part of the law a moral dimension,\textsuperscript{236} and accepts that in translating a business deal into contractual concepts, the matter should not only be viewed from a litigator’s perspective, but also that of a deal lawyer.\textsuperscript{237} In other words, instead of merely using the paradigm favoured by the analytic skills of litigators - seeking a certain legal result by working backwards from the law to a static set of facts – there is a recognition that deal lawyers start from the business deal, the terms of which are the deal lawyer’s facts, and then proceed to translate the business deal into contractual concepts, recognising that a contractual concept has both a legal aspect and a business purpose.\textsuperscript{238} This approach evidences that in Australia the whole thrust of the law is to attempt to give proper effect to commercial transactions,\textsuperscript{239} be astute to uphold commercial bargains,\textsuperscript{240} and recognise that parties in commercial dealings often construct and rely upon informal devices to signal commitment,\textsuperscript{241} such as comfort letters. The tendency in Australian courts is not

\textsuperscript{235} GD Cooper, “Representations of ‘Comfort’ Enforceable Against the Maker” [1990] Journal of Banking and Finance Law and Practice 287 at 289; J Lennard, “Enforcing moral obligations in commercial transactions” 1991 (August) Law Society Journal 81. Indeed, the approach is likely to discourage “defaulters all scanning their contracts to find some meaningless clause on which to ride free” – see Denning LJ in Nicolene Ltd v Simmonds [1953] 1 QB 543 at 552.

\textsuperscript{236} See J Lipton, “Good Faith and Letters of Comfort” (1999) 28 University of Western Australia Law Review 138. JGJ Rinkes and GH Samuel, Contractual and Non-contractual Obligations in English Law (Ars Aequi Libri, Nijmegen, 1992) 121 observes that the moral dimension of the law of obligations in Continental law jurisdictions is generally accepted because the basis of contract is pacta sunt servanda (agreements are to be observed).

\textsuperscript{237} See also C Mitchell, “Contracts and Contract Law: Challenging the Distinction between the ‘Real’ and ‘Paper’ Deal” (2009) 29 Oxford Journal of Legal Studies 675 at 694 and 695. A Rossett and DJ Bussel, Contract Law and Its Application (Foundation press, New York, 1999) 64 point out that a lawyer plays many different roles and his perspective as an interpreter will depend on his role: as advisor, as drafter and as advocate.


\textsuperscript{240} See Bellmore Park Pty Ltd v Benson [2007] QCA 102 at [12].

\textsuperscript{241} In Heisler v Anglo-Dal [1954] 2 All ER 770 at 772, the English Court of Appeal observed that one has to bear in mind that commercial men do not look at these things quite from the lawyer’s point of view... [Although a lawyer would consider an instrument to be worthless] a commercial man would regard the guarantee, perhaps furnished in the form of [a] letter, as having some value as underlining, as it were, the promise that had been undertaken.” See also C Mitchell, “Contracts and Contract Law: Challenging the Distinction between the ‘Real’ and ‘Paper’ Deal” (2009) 29 Oxford Journal of Legal Studies 675 at
to permit persons to hide behind the imprecision of a commercial document as a means of escaping liability, or to have a “free ride”. Australian courts have shown reluctance to allow letters of comfort to remain in the twilight zone of morality. The courts have adopted an interpretational approach to commercial instruments which accords with commonsense, and the reasonable expectations of honest businessmen to ascertain whether the statements in the letter of comfort are sufficiently promissory. Consequently, the courts are more inclined to categorise letters of comfort as legal obligations. Unless there is an express statement negating an intention that the letter of comfort has legal effect, it is unlikely that the provider of the letter would be able to rebut the presumption that it was so intended - this is especially so if the letter has been provided by a parent company after hard bargaining and made to induce the bank to provide credit facilities to its subsidiary. In the broader context of contract law, the Australian courts’ approach to letters of comfort, being instruments at the frontier of contractual obligation where contractual certainty is at its weakest, may be evidence of “the easing of the strict bargain principle of

246 See Cohen & Co v Ockerby & Co Ltd (1917) 24 CLR 288 at 300, where Isaacs J said that “the expressions, and particularly any elliptical expressions, in a mercantile contract are to be read in no narrow spirit of construction, but as the Court would suppose two honest business men would understand the words they have actually used with reference to their subject matter and the surrounding circumstances”, and Upper Hunter County District v Australian Chilling & Freezing Co Ltd (1968) 118 CLR 429 at 437, where Barwick CJ observed that in the search for intention, “no narrow or pedantic approach is warranted, particularly in the case of commercial arrangements.”
247 The opposite is true in respect of English law where a position of non-enforceability in the absence of a clear intention to the contrary has been adopted – see also P Gilliker, “Taking comfort in certainty: to enforce or not to enforce the letter of comfort” [2004] Lloyd’s Maritime and Commercial Law Quarterly 219.
contract law and the corresponding growth of equitable principles in the realm of contract law. The Victorian Court of Appeal's decision in *Atco Controls* is, however, a reminder that Australian law, like the other Anglo-common law jurisdictions, has not reached the stage where the requirements for contract formation are revisited.

When a letter of comfort is allegedly dishonoured and litigated, it is far from easy for a court to find a just result. For example in *Kleinwort Benson*, on the one hand Kleinwort Benson lost money because of its own failure to express adequately any legal consequences of the letter of comfort it accepted, while Malaysia Mining sullied its reputation, which is no trivial matter in the commercial world, and perhaps justice was done. On the other hand, if Kleinwort Benson were to be believed and the comfort letter was an instrument with contractual effect, then as the person suffering loss and damage as a result of the alleged breach of the letter of comfort, the bank was not comforted by only the tarnished reputation of Malaysia Mining without compensation for the commercial misdeed, and perhaps justice was not done.

However, as Perrell has remarked,

“there may be little reason to be sympathetic for the loser in a particular case – it could either have refused to enter into a transaction or it could have made the language of the comfort letter state more clearly whether the agreement was a matter of legal consequences or a matter of honour only. In such circumstances a court might conclude that, to make an overall bargain, the parties had taken a calculated risk about the classification of the letter, and thus comfort letters are aptly named because they provide no more than

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251 (2009) 78 ACSR 375.
a feeling of confidence and a diminished anxiety for taking on the risk of not being paid.”

In *Toronto Dominion Bank* and *Bouygues* the courts referred to both *Kleinwort Benson on appeal* and *Banque Brussels*. In *Toronto Dominion Bank* it was not necessary for Winkler J to comment on Rogers CJ’s reasoning in *Banque Brussels* that comfort letters should not be subjected to minute textual analysis and that the law should attempt to give proper effect to commercial transactions. The relevant letter of comfort in *Toronto Dominion Bank* specifically provided that it did not constitute a legally binding commitment. Winkler J in *Toronto Dominion Bank*, like Chadwick J in *Atlantic Computers plc (in administration); National Australia Bank Ltd v Soden*, pointed out *obiter*, however, that the Australian law differed from English and Canadian law as to whether or not a statement was promissory or merely representational, and stated that the reasoning in *Kleinwort Benson on appeal* was more appropriate in Ontario. By contrast, in *Bouygues*, Keith J commented, like Giles J in *Esanda Finance Corp Ltd v Wordplex Information Systems Ltd*, that the approach of the English Court of Appeal in *Kleinwort Benson* and that of the New South Wales Supreme Court in *Banque Brussels* was the same. Nevertheless, Keith J appeared to have subjected the letter of comfort before him to close scrutiny as was the case with the comfort letter in *Kleinwort Benson on appeal*.

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257 (1998) 40 BLR (2d) 1.
259 (1998) 40 BLR (2d) 1 at 74.
262 *Toronto Dominion Bank* (1998) 40 BLR (2d) 1 at 115.
263 [1998] 2 HKLRD 479 at 491.
267 *Bouygues* [1998] 2 HKLRD 479 at 491 to 492.
Unlike the Ontario and Hong Kong courts, Tay Yong Kwang JC in Jurong Engineering\textsuperscript{268} only referred to Banque Brussels.\textsuperscript{269} The learned judge distinguished Banque Brussels\textsuperscript{270} and the case before him on the facts, but appears to have followed the approach of Roger CJ in Banque Brussels\textsuperscript{271} in holding that (1) evidence of the negotiations as to the wording and content of the relevant letters of comfort could have been indicative of the fact that they were intended to be legally binding,\textsuperscript{272} and (2) it was not necessary to engage in a minute and protracted examination of every single word or term of the comfort letters before him – instead, he looked at the general tone of the comfort letters, and having regard to the surrounding circumstances of the case.\textsuperscript{273}

From a litigation perspective, Winkler J’s decision in Toronto Dominion Bank\textsuperscript{274} is insightful, because it provides an example of the factual detail to which the parties to comfort letter litigation may have to and may be allowed to descend, ranging from the parties’ understanding of comfort letters, their conduct outside the comfort letter, the circumstances leading up to the provision of the comfort letter, and the subsequent conduct of the parties. Toronto Dominion Bank\textsuperscript{275} also provides clear pointers for dealing with negligent and fraudulent misrepresentation claims based on comfort letters, and the assessment of damages in respect of both contractual and tort claims.

In light of the Anglo-common law decisions discussed in this dissertation, the following checklist of factors suggested by DiMatteo and Sacasas to determine whether the two threshold requirements for the enforceability of letters of comfort have been satisfied appears to be accurate and could be useful.\textsuperscript{276}

\textsuperscript{268} [2000] 2 SLR 54.
\textsuperscript{269} Banque Brussels (1989) 21 NSWLR 502.
\textsuperscript{270} Banque Brussels (1989) 21 NSWLR 502.
\textsuperscript{271} Banque Brussels (1989) 21 NSWLR 502.
\textsuperscript{272} Jurong Engineering [2000] 2 SLR 54 at 73.
\textsuperscript{273} Jurong Engineering [2000] 2 SLR 54 at 72 and 73.
\textsuperscript{274} (1998) 40 BLR (2d) 1.
\textsuperscript{275} Toronto Dominion Bank (1998) 40 BLR (2d) 1.
\textsuperscript{276} LA DiMatteo and R Sacasas, "Credit Value Comfort Instruments: Crossing the Line from Assurance to Legally Significant Reliance and Toward a Theory of Enforceability” (1994) 47 Baylor Law Review 357 at 460.
(a) The actual language of the letter of comfort, and in particular the operative language of the letter – that is, whether or not words of promise, or words usually encountered in contracts or guarantees, are use, and whether there is a disclaimer;

(b) The commercial sophistication of the parties and their familiarity with letters of comfort;

(c) Oral representations made before the creation of the letter of comfort;\textsuperscript{277}

(d) Whether there were prior dealings between the issuer and the recipient of the letter of comfort;\textsuperscript{278}

(e) Whether the letter of comfort was customarily viewed as enforceable in the particular trade or profession at issue;\textsuperscript{279}

(f) The parties’ reasons for using the letter of comfort;

(g) The role the letter of comfort played in the agreement;

(h) Guidelines or standards developed by particular groups of comfort letter issuers to categorise letters of comfort;\textsuperscript{280}

(i) Whether there was reliance on the letter of comfort and the degree of reliance established.\textsuperscript{281}

\textsuperscript{277 See also LA DiMatteo, “The CISG and the Presumption of Enforceability: Unintended Contractual Liability in International Business Deals” (1997) 22 Yale Journal of International Law 111 at 127.}
\textsuperscript{278 See also LA DiMatteo, “The CISG and the Presumption of Enforceability: Unintended Contractual Liability in International Business Deals” (1997) 22 Yale Journal of International Law 111 at 127.}
\textsuperscript{279 See also LA DiMatteo, “The CISG and the Presumption of Enforceability: Unintended Contractual Liability in International Business Deals” (1997) 22 Yale Journal of International Law 111 at 127 to 129.}
\textsuperscript{280 LA DiMatteo, “The CISG and the Presumption of Enforceability: Unintended Contractual Liability in International Business Deals” (1997) 22 Yale Journal of International Law 111 at 129 and 130.}
\textsuperscript{281 See also LA DiMatteo, “The CISG and the Presumption of Enforceability: Unintended Contractual Liability in International Business Deals” (1997) 22 Yale Journal of International Law 111 at 129.}
(j) Whether there was detriment on the recipient for such reliance;

(k) The intention of the parties in relation to the letter of comfort; and

(l) The court should construe any ambiguity in the terms in the letter of comfort against the drafter.

Internationally, courts have been more likely to enforce such instruments. Legal hybrids, such as letters of comfort, are more likely to result in contractual liability in Continental law jurisdictions than in the Anglo-common law jurisdictions,282 perhaps with the exception of Australia. Generally, Continental jurists283 are more in favour of the approach in Banque Brussels than the approach in Kleinwort Benson on appeal. The Continental law jurisdictions seem to place less weight on the semantic labelling of instruments when determining the existence of a legally enforceable obligation. As DiMatteo remarked, the

“objective viewfinder of the civil law system is broader in scope than the one found in the common law system. The lack of dependency upon legal literalism, both in the labelling of instruments and in the words of art used within the instruments, allows for greater flexibility in the affixation of contractual liability in the civil law system.”284

French law is a good example,285 of the subjective approach in the Continental law jurisdictions where the issue of contractual intent is addressed in a direct, commonsensical way: A letter of comfort is considered to be a commitment to perform (obligation de faire) because in the commercial world the creation of a meaningless instrument or document is unthinkable.286 Moreover, if the Principles of

283 See, for example, DCC van Everdingen, “Alternativen voor klassike zekerheden” (1991) 3 Dossier 88 at 94.
285 See chapter 9.
European Law: Personal Security are any indication of the attitude and approach of European jurisdictions, then the general attitude and approach to letters of comfort in those jurisdictions are clearly in favour of the enforceability of letters of comfort.287

A presumption of intentionality can be discerned from both the Anglo-common law and Continental law jurisdictions. This presumption plays a key role in the construction of instruments that are often highly negotiated and ambiguously worded. It has been remarked that:

"In the field of comfort instruments the problem is compounded by internal repugnancy. The instrument possesses equally clear language and operative phraseology that support both findings of intentionality and non-intentionality. They often posses disclaimer-type language at the behest of the promisor and language that is contractual in nature in order to appease the promise. It ultimately falls to the subjective determination of the court to decide who was the successful negotiator. In case of doubt, modern jurisprudential leanings regarding enforceability will win the day. The classically inclined jurist will look to the ambiguity of consent and hold that there is no contract. For those who believe it against reason for two reasonably sophisticated parties to pursue negotiations over the wording of a nonlegal instrument, a presumption of intentionality will be an attractive device. The key point of interest is the potential utilisation of the presumption in the face of language not clearly reflective of mutual assent. The presumption of intentionality could simply be a factor to be weighed by a reasonable promise. Under the objective theory of contracts the test is whether a reasonable person in the position of the receiving party would conclude that the sending party had made a commitment. The parameters

used in the construction of this reasonable person are likely to be pivotal to the outcome of the judicial decision-making process.”

Enforceability of a letter of comfort is, in the end, a matter for the courts. Banks will naturally seek to choose courts most favourable to their interpretation of letters of comfort, and in particular the letter of comfort it has received. The question that arises is whether it is sensible to include in a comfort letter a governing law clause and, perhaps also, an exclusive jurisdiction clause. Such clauses are not usual, but have been used. Choice of law and forum provisions could be helpful to ensure the application of the law in the courts with which the bank is comfortable and familiar. The disadvantage is, however, that such provisions are legalistic and work against the idea that the letter of comfort is not intended to give rise to legal relations.

In considering the enforceability of a letter of comfort, courts in both the Anglo-American law and Continental law jurisdictions are conscious of the frequent informality of business dealings and do not regard casual language, the appellation of the letter, and the absence of form itself as evidence of no intention to enter into a contract. Courts in those jurisdictions may look instead at other evidence of intention to create legal relations and to incur legally enforceable obligations. In considering the legally enforceability of a letter of comfort, a court will not only look at the wording of the letter, but will also have regard to the surrounding circumstances, both before and after the issuing of the letter of comfort. Factors that may be taken into account by courts are, for example:

(a) If the letter of comfort was the subject of intense and prolonged negotiation, “heavy drafting” and multiple drafts, it may be an indicator that the letter was

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intended to create binding obligations, because those factors appear to be inimical to the idea that the letter of comfort is supposed to be a unilateral expression of mere goodwill.\textsuperscript{292} It has been suggested that if there are negotiations about the wording of the letter of comfort and multiple drafts, it may be prudent to maintain a cover note on file stipulating that the letter is intended just to be a unilateral expression of goodwill, and not a binding undertaking.\textsuperscript{293} In this regard, it may also be relevant which party was responsible for the drafting of the letter of comfort due to the application of the contra proferentem rule in the construction of documents.\textsuperscript{294}

(b) The courts may look at whether the conduct of the issuer of the letter of comfort has been consistent with an intention of enforceability or unenforceability. In this regard, it is not only relevant what the issuer of the letter of comfort has stated, but its internal documentation regarding the status, classification and treatment of comfort letters may also be relevant.\textsuperscript{295} For example, it may be relevant whether the letter of comfort is treated as a security provided by the issuer either by it being kept with the other securities provided or noted as such in the financial account of the issuer. Moreover, although the issuer “may want to indicate some moral inclination to the bank – that it might at least consider, ex gratia and without any obligation whatsoever, making the bank whole if it suffers a loss at the end of the day”,\textsuperscript{296} it should avoid weakening the unenforceability of a letter of comfort by allowing the bank to form the impression that the issuer will as a matter of course “bail out” subsidiaries in financial distress or settle a subsidiary's

\textsuperscript{295} See Toronto Dominion Bank (1998) 40 BLR (2d) 1.
\textsuperscript{296} The Association of Corporate Treasurers, Letters of Comfort: A Practical Guide (London, April 2007) 12. Needless to say, liability in tort can follow from a statement or representation made in a letter of comfort which is not true or accurate when made.
obligations to selected creditors, including banks, in receipt of letters of comfort.\textsuperscript{297}

(c) The corporations law consequences of the letter of comfort; for example, the contravention of the insolvent trading provisions of the Corporations Act 2001 (Cth).

(d) If the letter of comfort was the subject of company board discussions and resolutions, it may be an indicator of the importance the issuer attaches to the letter which points to the likelihood that the letter contains enforceable undertakings.

(e) Another factor that may be taken into account are the terms of the credit facility covered by the letter of comfort and more particularly whether the higher interest or commissions have been charged by the bank.

In any event, if possible, any inclusion in a letter of comfort of an express disclaimer of any intent to create enforceable obligations or deliberate no-law\textsuperscript{298} clause is advisable, if not necessarily an entirely reliable prophylactic,\textsuperscript{299} as evidenced by the Canadian decisions in Toronto Dominion Bank.\textsuperscript{300}

In light of the decisions in Banque Brussels,\textsuperscript{301} Gate Gourmet\textsuperscript{302} and Newtronics,\textsuperscript{303} it can be said that in Australia a comfort letter will usually give rise to legally enforceable obligations if the parties’ intention is that it is to create legal relations which will be evidenced by:

\textsuperscript{298} See paragraph 4.4.1.
\textsuperscript{300} (1998) 40 BLR (2d) 1.
\textsuperscript{301} (1989) 21 NSWLR 502.
\textsuperscript{302} [2004] NSWSC 19.
\textsuperscript{303} (2008) 69 ACSR 317.
(a) The absence of any disclaimer that it does not create legally binding obligations;

(b) The circumstances or the comfort provider in correspondence indicating that the financier is relying upon its statements and representations;

(c) Any promises as to future facts made by a party with superior knowledge in relation to the repayment of the facility;

(d) The statements in the comfort letter being sufficiently promissory in nature and not merely statements of fact;

(e) The letter containing a provision that the undertakings refer to the current and future policies of the provider of the comfort letter;

(f) The comfort letter containing clear contractual language; and

(g) The factual circumstances surrounding the transaction supporting the importance of the letter of comfort to the addressee. \(^{304}\)

The case law discussed in the chapters 5 to 7 is illuminating and shows that in the Anglo-common law jurisdictions there is a difference in the approach and attitude of the Australian \(^{305}\) courts which (with two notable exceptions) \(^{306}\) seem more inclined to find a contract, and the courts in England, \(^{307}\) which are not so inclined.

From a transystemic perspective, comfort letter disputes highlight the difference in the development of the law of contract on the Continent and in England. In the twelfth and thirteenth centuries the development of the law of contracts on the Continent and


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in England began to diverge as different forces\textsuperscript{308} came into play in moulding the civil and common laws.\textsuperscript{309} The Church, with its large temporal interests and power, and its able lawyers, taught that Christians should keep their promises – \textit{pacta sunt servanda}\textsuperscript{310} or Stair's tongue-twister translation of this canonist maxim "every paccion produceth action",\textsuperscript{311} a concept that found its fullest expression in the French Civil Code.\textsuperscript{312} "After the clergy got out of the law business,\textsuperscript{313} practical men of affairs took over the legal system and created the English common law, that marvel of pragmatic reasoning."\textsuperscript{314}

Owing to the cessation of the influence of the civil and canon law at the end of the thirteenth century, English lawyers were obliged to construct for themselves their own law of contract.\textsuperscript{315} In England the common law of contracts was developed pragmatically and judicially.\textsuperscript{316} The common law of contract is a law of bargains; a promise is not enforced merely because someone has relied upon it.\textsuperscript{317} In Anglo common law, a contracting party knows that breaching a contract can primarily cost it

\textsuperscript{308} On the Continent, revived Roman law based on Justinian's \textit{Corpus Iuris Civilis}, had a much greater impact than in England.


\textsuperscript{311} As quoted by HL MacQueen, "Scots and English Law: The Case of Contract" (2001) 54 \textit{Current Legal Problems} 205 at 212.

\textsuperscript{312} Combined with the notion of binding force: that which has been freely done by the parties must be performed as such and may only be undone or modified by the same parties – see chapter 8.

\textsuperscript{313} In 1179, the third Lateran Council (the 11\textsuperscript{th} Ecumenical Council of the Roman Catholic Church) issued a prohibition. Canon 12, against clerics acting as advocates before secular judges in matters unconnected with church causes.


\textsuperscript{315} See WS Holdsworth, "The Formation and Breach of Contract" (1933) 7 \textit{Tulane Law Review} 165 at 168.

\textsuperscript{316} As A von Mehren, "The French Civil Code and Contract: A Comparative Analysis of Formation and Form" (1955) \textit{Louisiana Law Review} 687 at 701 observed, "the common law of contract was little influenced by the speculation of learned men, relatively remote from the day to day practice of the law as were many of the civilians and canonists who played such a large role in the development of the general principles of the law of contractual obligation in France. The common law of contracts developed concretely and pragmatically, not systematically and speculatively."

damages; under French law, the contract must primarily be performed in kind as
decided when the parties entered into their agreement. Although fairness in business
is upheld, Anglo common law takes no moral view of a contract, being more interested
in the concrete situations created than how they came about.

It is thus not surprising that the courts in the Continental law jurisdictions – France,318
Belgium,319 The Netherlands,320 Portugal,321 and Spain,322 – are also more inclined to

318 See chapter 9.
319 See, for example, the Rechtbank van Koophandel Brussels (Brussels Commercial Court) in NMKN v
Glénolit Mills Inc [1987] Tijdschrift voor Belgisch handelsrecht 64; the Tribunal de première instance of
Verviers (First Instance Court) in SA Artesia v Larbuison 2002/1 Forum Financier 45, with note by L du
Jardin; the Hof van Beroep Gent (Ghent Court of Appeal) in BVBA BDi-construct v KV (unreported
judgment 2006/AR/3100 dated 13 June 2008); KBC Bank NV v BVBA Construct (unreported decision of
the Court of Appeal, Ghent, dated 16 June 2008); Delta Lloyd Bank v SRB 2009/I Droit Bancaire et
Financier 95, 2010/02 Tijdschrift voor Belgisch Handelsrecht 183, 2009/11 Forum Financier 95; SA
Remaer v Trust Capital Partners NV 2008/2 Rechtspraak Antwerpen, Brussels Gent 115. See also the
discussion of the Belgian case law by L du Jardin, “La lettre de patronage: un engagement de qualité”
2010/02 Tijdschrift voor Belgisch Handelsrecht 188; A Verbeke, “De kameleoïden der zekerheidsrechten:
over interpretative of patroonafspraakverklaringen” [1994-1995] Algemeen Juridisch Tijdschrift 512; A
Verbeke and D Blohmaert, “De patronaatsverklaring: Een persoonlijke zekerheid met vele gezichten”
(1994) 31 Ondernemingsrecht 71; B Volders, “Patronaatsverklaringen en toepasselijk recht” 2008/2
Rechtspraak Antwerpen, Brussels Gent 125.
320 See, for example, the decision of the Dutch Hoge Raad (Supreme Court) in Albada Jelgersma [1988]
Ars Aequi 452; the decision of the Rechtbank Zutphen (Regional Court) in Coutts Eddag Display BV v
Coutts Holdings plc 2005 Jurisprudentie Onderneming & Recht 4; the decision of the Dutch Hoge Raad in
Van Dusseldorp v Coutts Holdings Limited 2008 JOR 297; the decision of the Rechtbank Amsterdam in
Deutsche Bank AG v DPW van Stolk Holding BV 2008/53 Jurisprudentie Onderneming & Recht 516, the
decision of the Arrondissementsrechtbank Amsterdam (District Court) in Banque Internationale Pour
L’Afrique Occidentale Togo SA v BV Compagnie Commerciale Hollando Africaine (unreported decision,
roll number H87.0544, 14 December 1988); the decision of the Gerechtshof Amsterdam Appellate Court in
Union Industrielle de Credit SA v Nimox NV (unreported decision, roll number 524/87, 16 May 1991); the
decision of the Rechtbank Utrecht (Regional Court) in Coöperatieve Raiffeiseen-Boerenleenbank BA v
HAK Business Ventures BV (HBV) 2008/89 Journaal insolventie, financiering & zekerheden 113, with a
note by RIVF Bertrams, 2008 Jurisprudentie Onderneming & Recht 1045, with a note by RIVF Bertrams;
the decision of the Rechtbank Rotterdam in Plaid Enterprises Inc v Plaid Beheer BV 2008/10
Jurisprudentie Onderneming & Recht 2484, with a note by RIVF Bertrams; and the decision by JM
Ramhorst, “De support letter en doorbraak van aansprakelijkheid” [2008] Vennootschap & Onderneming
252; the decision of the Rechtbank Zwolle in Reha Vital Gesundheitservice GmbH v WZG Group BV
(unreported decision roll number 142656/HA ZA 08-289); and also RM Avezaat, ‘Support Letters’ (2007)
12 Journaal Insolventie, Financiering & Zekerheden 471; SA Kruisinga and L Leber, “A letter of comfort:
does it offer any comfort?” 2010 (7) Vermogensrechtelijke Analyses 1.
321 See, for example, the decision of the Lisbon Court of Appeal (unreported judgment 9792/2004-8,
dated 17 February 2005) and the decision of the Supreme Court in Porto (unreported judgment,
322 See the decision of the Spanish Supreme Court (Civil Division, 1st Section) in Banco Zaragozana v
Rusticas SA (unreported, 30 June 1995) (“Banco Zaragozana”). There are three main Supreme Court
decisions in Spain on letters of comfort, namely Hotel Plan v Banco del Noroeste (unreported, 16
find a contract, and that appears to be the view of legal doctrine in those Continental law jurisdictions where letters of comfort have not yet been before the courts such as Greece. The courts in the Scandinavian jurisdictions, for example Sweden and Denmark are also inclined to find a letter of comfort to have contractual effect, but in so doing do not categorise the contractual obligations in letters of comfort like the French courts.

December 1985), Banco Zaragozano, and Banco del Commercio v Benjamin S (unreported, 13 February 2007), and Banco Zaragozano all of which are discussed by MD Mullerat, "Comfort Letters" (2006) 17 International Company and Commercial Law Review N18; A Carraso, Guarantees – Letters of Comfort" (2007) 22 Journal of International Banking law and Regulation N 92; E Zamora, "Comfort Letters – Requirements for a letter of Comfort to be Considered as a Personal Guarantee" (2008) 19 International Company and Commercial Law Review N19; AC Perera, "Cartas de patrocinio y garantías independientes en el concurso" (2006) 4 Revista de derecho concursal y paraconcursal 91. The requirements for contractual liability are: (1) there has to be an intention to be bound to give financial support to the subsidiary or to assume positive obligations to co-operate for the subsidiary to satisfy its obligations to the bank; (20 the obligation must be clear, and cannot be based on confusing expressions; (3) person who has signed the comfort letter must be authorised to do so; (4) the wording of the letter is conclusive for the closing of the agreement between the subsidiary and the bank; and (5) the support contained in the letter falls within the scope of the usual parent-subsidiary relationship.

See paragraph 8.5 in respect of the French approach to construction of contracts, and chapter 9 in respect of the French case law on letters of comfort.

See TN Rakintzis, "Comfort letters in Greece" 2008 (October) The European Lawyer 43.

There does not appear to be Norwegian decisions on comfort letters. E Røaæg, "Garantier Eller Fattigmanns Trøst (Universitetsforlaget, Oslo, 1992) 586 and 587 points out that although English decisions are usually held in high regard in Norway and followed to achieve international uniformity, it is not likely that Kleinwort Benson on appeal will be followed in light of the adverse French decisions which render international uniformity unattainable in any event.


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As discussed in chapter 9, a letter of comfort is recognised in the French Civil Code as a personal security, and is defined as an undertaking to do or not to do the purpose of which is to support a debtor in the performance of his obligation in respect of his creditor. The comfort letter regime introduced into the French Civil Code by Ordonnance 346 of 23 March 2006 is reminiscent of the Principles of European Law on Personal Security or PEL Sec, except that PEL Sec does not refer to the distinction between obligations of means (obligations de moyens) and obligations of result (obligations de résultat).

In France the wording of a letter of comfort will decide whether it should be characterised as a mere moral undertaking or as a legally binding agreement. The content of the letter is more important than the surrounding circumstances in determining whether it is binding. The letters of comfort which are legally binding (containing obligations de faire) fall into two categories – those which contain an obligation on the issuer to reach a given result (obligation de résultat) and those which contain an obligation to endeavour to achieve a given result (obligation de moyens). In France, if a letter of comfort contains an obligation of result (obligation de résultat), it should be mentioned as a contingent liability in the annex to the financial statements.

In France, if a letter of comfort is to be regarded only as a gentlemen’s agreement, it is not legally binding and unenforceable before the courts. However, as discussed in paragraph 8.7, the French courts often use a variety of approaches to justify ignoring honour clauses and to endeavour to give contractual effect to agreements. The French decisions, in particular, concentrate mainly upon the issue of whether or not a letter of

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328 See paragraph 9.2.
329 See article 2322 of the French Civil Code.
330 See paragraph 8.6.1 for a discussion of the distinction.
comfort contains a legally enforceable obligation, focussing on the question of the distinction between obligations of means (obligations de moyens) and obligations of result (obligations de résultat). The latter question is more often than not resolved with a finding in favour of an obligation of result (obligation de résultat), which is then linked with the immediate conclusion that the parent company or comfortor is liable to compensate the bank or comfortee for the damages it has suffered. The reason for this may be two-fold: first, it is usually not too difficult to identify an obligation of result from the wording used in a comfort letter, even though it may be more difficult to determine the contents and effect of such obligation. Secondly, the letters of comfort which are the subject of litigation invariably contain both obligations of means and result.

The French courts are far more willing to intervene and to regulate agreements between commercial entities, and thus more readily adopt concepts such as good faith and reasonableness as part of their role in controlling contractual behaviour. As Giliker remarked, “the French courts are prepared to accept a system whereby litigants are ‘educated’ in commercial morality, which would be considered invasive and paternalistic to many English lawyers.” Indeed, the English courts’ approach is diametrically opposed, whilst that of the Australian courts represents a via media.

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337 This is also true of the Swedish courts’ approach to letters of comfort. In the so-called PK Banken case, which ended up in the Swedish Supreme Court (1995 Nytt jurisdikt arkiv 586), the Swedish Court of Civil and Criminal Appeal had to interpret a letter of comfort which was drafted by a British lawyer and contained statements of policy similar to that in Kleinwort Benson. The court stated: “Det kan väl av utredningen sluts att engelsk rätt måhända inte skulle anse löften av den art de båda breven rymmer som binande annat än i utfärdandeögonblicket och kanske kort tid därefter. Men det är svårt att se att en så oförbindlig utfästelse skulle ha någon rimlig kommersiell function att fulla. Och eftersom den inte av annat skäl kan beredas meningsfyllt utrymme i svensk rätt, väljer HovRm att inte ta intryck av vad som sålunda må vara engelsk rättssyn. [It can well be concluded from the investigation that English law should perhaps not consider promises (pledges) of the sort which both the letters contain as binding, other than at the moment of the issuing of the letter, and maybe for a short period after that. But it is difficult to perceive that it is likely that such a discourteous pledge would serve a purpose commercially.
Although the unique French approach to contract law as applied to comfort letters, may, in certain circumstances, be subverted by the technical requirements of French corporate law,\(^{338}\) it appears from the recent decision of the French Supreme Court in *Nief Plastic v Crédit Lyonnais*\(^{339}\) that the concerns about compromising their use in practice are not justified.

There are many French Supreme Court decisions on letters of comfort. However, for Anglo-common law courts the guiding and predictive value of these judgments and the other judgments of the courts in the Continental law jurisdictions, is relative.\(^{340}\) In most cases it appears that the decisions merely involved *ad hoc* judgments with little, if any, attempt to provide clear legal reasoning, or to espouse well-defined criteria or a lucid doctrinal approach to letters of comfort. Perhaps it is because of the pithy manner in which judgments are reported in those jurisdictions, or the inherent nature and variety of letters of comfort. In any event, it also appears that some of the courts readily equate the legal approach to letters of comfort in different jurisdiction with each other, and seek guidance from international legal commentaries and the case law in Anglo-common law jurisdictions.\(^{341}\)

### 10.3 Practical considerations for the use of letters of comfort

The different approaches adopted by the Anglo-common law courts as discussed in chapters 5 to 7, to determine the contractual effect of a letter of comfort, demonstrate the delicacy of the task faced by the draftsman of such a letter.\(^{342}\) For that task to be satisfactorily fulfilled – from the draftsman’s perspective – the letter of

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\(^{338}\) That is, the requirement that a letter of comfort has to be authorised by the board of the company under article L225-35 of the French Commercial Code.

\(^{339}\) (unreported decision, Appeal n 09-14438, dated 19 January 2010).

\(^{340}\) See RIVF Bertrams and FGB Graaf, “Letters of comfort en rechtspraak” (1990) 68/2 De Naamloze Vennootschap 75 at 77.

\(^{341}\) See the decision of the Amsterdam District Court in *Banque Internationale Pour L’Afrique Occidentale Togo SA v BV Compagnie Commerciale Hollando Africaine* (unreported decision, roll num HB7.0544, 14 December 1988).
comfort must avoid contractual liability while at the same time encourage the recipient to derive comfort or assurance from it. The letter of comfort ought not to contain explicit contractual language but instead employ a certain “cultivated ambiguity”. If this equilibrium is achieved, the result is a letter of comfort properly so called.

Needless to say, however, the recipient of the letter of comfort, the bank, would prefer the letter to be drafted so that it is contractually binding, while the provider of the letter of comfort, the parent company, would prefer for it not to be contractually binding. Accordingly, the equilibrium is invariably disturbed by the insertion of various statements, undertakings and declarations insisted upon by either the bank or the parent company in order to improve their respective positions as reflected in the letter of comfort. Consequently, the various statements, undertakings and declarations in a letter of comfort will be of differing significance depending on whether the matter is examined from the bank or the parent company’s perspective, and whether or not the letter of comfort is intended to have legal effect.

The result in practice is that the prototypical letter of comfort “tries to provide a guarantee-type assurance without the resultant guarantee-type liability. The results are legal hybrids that ill serve one and possibly both of the parties”, but allow both of the parties to believe they have not given up any ground. At the same time, the lawyer who drafted the letter of comfort “keeps his fingers crossed and prays that

342 For examples of letters of comfort, see annexure 1, and also JA Nilsson, Ready Drafted Legal and Business Letters (Director Books, Hemel Hempstead, 1993) 38.
344 See H Ominsky, “Counseling the Client on ‘Gentleman’s Agreements’” (1990) 36 The Practical Lawyer 25 at 34.
345 See paragraph 2.5.
there may never be litigation over the meaning of his handiwork."348 Given that the range of possible meaning of a comfort letter can extend from having no legal significance to concurrent liability in tort and contract, the commercial value of the letter may in some cases have to wait the outcome of a trial and the appeals. Perrell has remarked, however, that this observation "does not entail the practical lesson that parties to a comfort letter should be very careful to be clear and precise about where on the range of possible meanings their comfort letter is located. It is a reality of negotiating that sometimes the parties may have to rest with an unclear agreement. Rather, the practical lesson is that the parties to comfort letters should appreciate the acute risks posed to both sides by the acute problems of interpreting these documents."349

A letter of comfort needs to be carefully drafted in order to properly determine whether the parent company is entering into legal commitments to the bank or rather is making non-binding statements of fact relating to itself or to its subsidiary, or is merely acknowledging the existence of certain events or policy.350 The available possibilities in the area of letters of comfort are limited only by the draftsman's creativity. There are, however, a few drafting rules in dealing with comfort letters which are particularly relevant from the bank's perspective:351 First, the drafter must ensure that the letter is not unenforceable for failure to comply with formalities such as consideration, authorisation, proper execution,352 and certainty of terms. Secondly,

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348 AHH, A comfort letter may create a contractual obligation' 1988 (February) Business Law Brief 4.
352 In contrast to guarantees, comfort letters often are signed by relatively junior officers within a company, and rarely are authorised by the company's board of directors. This raises the possibility of an otherwise enforceable comfort letter being attacked as lacking proper corporate authorisation. So, it is important to ensure that a comfort letter, to be enforceable, is properly authorised and executed. It
the covenants or statements of intention in the letter should be capable of being policed or enforced. Thirdly, to the extent possible, the letter should be made to look like a legal document such as a guarantee. The use of operative language, formal and suggestive of legal obligation, such as “guarantee”, “contract” or other words of promise goes a long way towards the instrument being legally enforceable. Although the substance of the document will determine what type of liability, if any, it creates, the form may be indicative of the importance given to the document by the parties and may influence the court’s opinion as to intent. Fourthly, as far as possible the comfort letter should be connected to the underlying loan contract; for example, by the loan contract referring to the comfort letter. Fifthly, the more detailed the instrument, the more likely a court will be to find it indicative of an intent to contract. However, from the parent company’s perspective in order to avoid such perils, letters of comfort would have to be drafted as vaguely and broadly as possible, and preferably state that the letter does not give rise to any legal obligations on the part of the parent company. Thus, there are no per se rules of

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356 E Sedlak, “Comfort Letters: United States” (1986) 1 Butterworths Journal of International Banking and Financial Law 6. In Banque de Paris et de Pays-Bas v Amoco 573 F Supp 1464 (1983) the court noted that a comfort letter may be deemed inseparable from the underlying contract and should be construed in accordance therewith. In Barclays Bank of New York v Goldman 517 F Supp 403 (1981) the court pointed out that the closing condition requiring a comfort letter from the parent company was different from requirement that a third party provide a guarantee of the obligations of the borrower.
358 CSS Ooi, “Recent Developments and Significance, if any, of Comfort letters in Modern Financial Transactions” (1999) 28 INSAF: The Journal of the Malaysian Bar 6 at 8 points out that usually letters of comfort are vague not referring to specific amounts or even a particular designation of accounts, contracts or commitments that are the subject of the assurance.
359 See JR Lingard, “Comfort letters under English law” (1986) 5 International Financial Law Review 36. Bankers usually object to such a statement in a letter of comfort, or seek to qualify the denial of liability
enforceability, but generally, however, the broader and more vaguely drafted the letter, the lower the likelihood of enforceability.\textsuperscript{360}

\section*{10.4 The tension between business needs, the law and judicial application}

It has been said that for lawyers a contract is a mixture of rights, obligations and remedies for breach, but for businesspeople it is “primarily a facilitative device within an economic cycle which turns on such processes as the acquisition of materials, the production of finished goods, marketing and sales, finance and payment.”\textsuperscript{361} Accordingly, businesspeople are said to “believe that they need not insist on the rights associated with the contractual relationship if some other device or method can achieve their goals. They can begin their performance relying on ‘a man's word’ in a brief letter, a handshake, or ‘common honesty and decency’. They keep their promises because they fear business sanctions rather than legal sanctions.”\textsuperscript{362} In other words, businesspeople are prepared to receive documents such as letters of comfort, even if they deny any legal binding effect, because they expect that, regardless of legal force, such document obliges the other person to abide by what he or she has promised. Letters of comfort can be binding ethically or morally, if not legally. Indeed, as Furmston points out, “it seems that businesspeople frequently do not take the legal effect of a document into consideration and are rarely conscious of the legal position when they insert provisions which deny legal effect. This explains why such documents are often so vague and ambiguous in terms of their legal effect.”\textsuperscript{363} Consequently, in commercial litigation, and advising before such litigation and in order to forestall it, lawyers all over the world frequently deal with the consequences at law of the conduct of persons whose formal training in “the legal means of satisfying the creation of a binding contract has been sadly neglected in favour of other activities such as making things, growing things or trading things.”\textsuperscript{364} No matter what liberties business people

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may choose to take with the law of contract, the courts will continue to treat it seriously.\textsuperscript{365}

The paradigm in banking has shifted from banks being in a strong position to enforce letters of comfort to their being at the mercy of large corporations.\textsuperscript{366} The facts in \textit{Toronto Dominion Bank}\textsuperscript{367} and \textit{Jurong Engineering}\textsuperscript{368} clearly indicate that banks are not necessarily in the stronger bargaining position. In both cases, the issuers of the comfort letters were not dependent upon the credit facilities extended by the banks and the banks were keen to establish and maintain business relationships with the issuers of the letters of comfort, albeit indirectly through their subsidiaries. They knew the risks associated with accepting comfort letters for extending credit facilities to the subsidiaries, but consoled themselves with the thought that all would go well and that they would not need to rely on the comfort letters.\textsuperscript{369} The paradigm shift has a further consequence – parent companies of multinational groups invariably resort to the use of standard text comfort letters so that banks have little say in respect of the wording of letters which parent companies provide.\textsuperscript{370}

The shift in the paradigm has important consequences for banks accepting comfort letters. Letters of comfort are instruments used in business transactions because of

\begin{footnotesize}
\begin{enumerate}
\item See M Furmon, "Letters of Intent and Other Preliminary Agreements" (2009) 25 \textit{Journal of Contract Law} 95 at 96.
\item See M Furmon, "Letters of Intent and Other Preliminary Agreements" (2009) 25 \textit{Journal of Contract Law} 95 at 96.
\item See A Trichardt, "Chameleonic Documents in Law – A Comfort Letter Trilogy" 2001 (October) \textit{Butterworths Journal of International Banking and Financial Law} 416 at 419; Wolfs, op cit n [ ], at 5. L Thai, "Comfort Letters – A Fresh Look?" (2006) 17 \textit{Journal of Banking and Finance Law and Practice} 15 at 17 is also of the view that "where market completion is intense and when people are competing for business, there will always be a degree of imbalance of bargaining power and undue influence, even between two very commercially minded people."
\item (1998) 40 BLR (2d) 1.
\item [2000] 2 SLR 54.
\end{enumerate}
\end{footnotesize}
commercial considerations. They are usually “binding” on the issuer because its corporate reputation and its relationship with the bank are at stake; if it fails to honour its “gentlemen’s agreement” and moral and commercial obligations it may become a pariah in both the business world and the financial world of credit providers.\textsuperscript{371} The creditworthiness of the issuer of a letter of comfort in the market place has been the leverage available to banks in enforcing it, notwithstanding the fact that the comfort letter may be unenforceable at law. However, nowadays, like in \textit{Toronto Dominion Bank}\textsuperscript{372} and \textit{Jurong Engineering}\textsuperscript{373} where the issuers were not dependent on the banking industry for its goodwill, the banks had no leverage and the traditional strategy of market pressure could not ensure compliance with the moral and commercial obligations contained in the letter of comfort.\textsuperscript{374} Moreover, banks should be careful not to try to transpose whatever commercial pressure it may be able to exert on the issuer of a comfort letter in the market place to a court of law, because it may face an adverse special costs order as Toronto Dominion Bank learned the hard way. In awarding solicitor and client costs against Toronto Dominion Bank after dismissing its contractual claims based on comfort letters as well as its claims based on fraud and misrepresentation pertaining to the comfort letters, Winkler J stated:

“The bank was a sophisticated commercial lender. It chose to take Plessey’s word rather than insist upon its bond. The subsequent fraud allegations made against named individuals appear to be one further step in the bank’s overall strategy to pressure the defendants to pay on the comfort letters. While the bank may have brought commercial pressure to bear on the defendants in the marketplace, such a strategy is not appropriate in a court of law,

\textsuperscript{372} (1998) 40 BLR (2d) 1.
\textsuperscript{373} [2000] 2 SLR 54.
particularly if allegations of fraud are involved. Such conduct carries with it the risk of an adverse costs award, should the fraud allegations fail.”

Toronto Dominion Bank restated the position that courts would not rewrite bargains, substitute a better bargain than the one the parties made for themselves or enforce moral or commercial obligations and gentlemen’s agreements. This does not, however, mean that courts “condone the actions of a large multinational company with over a billion pounds sterling in cash reserves in walking away from a gentlemen’s business agreement to support its subsidiary.”

10.5 Letters of Comfort – A Vehicle for Revitalising Australian Law of Obligations?

In 1951, Lord Devlin observed that: “The danger in any branch of the law is that it ossifies. If all lawyers were made doctors overnight, they would flock to the dissecting rooms, for I am sure that they would prefer corpses to live patients.” Not much appears to have changed, and this comment remains as true today as ever. It is rarely better illustrated than within the Anglo-common law of contract where the formalities of contract formation, and the paradigm of a contract inherited from classical free-market thinking and solidified toward the end of the nineteenth century, continue to dominate the minds of lawyers despite their mismatch with modern business practices, and some contemporary legal needs. In other words, in the context of business transactions there are situations where the contractual approach to transactions is less appropriate than it may once have been. It has been argued that

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376 (1998) 40 BLR (2d) 1 158.
377 Toronto Dominion Bank (1998) 40 BLR (2d) 1 at 158. It appears that an offer to settle was made for C$15 million in 1996 – see the judgment on appeal at 178 DLR (4th) 643.
these needs could be met more effectively if artificial and outdated barriers between different parts of the common law were broken down, particularly “in situations which should be more readily categorised as giving rise to reliance-based liability rather than contractual-based liability.”

Unless “contractual-based liability” is a reference to Anglo-common law contract as “promise-based liability”, the juxtaposition of reliance-based and contractual-based liability is not correct. In the context of letters of comfort, reliance-based liability could be based on the doctrine of promissory estoppel - either promissory estoppel as developed in Australia or America. There has been a growing realisation of the role played by estoppel in giving legal validity to the parties’ own understanding of their business relationship. However, Anglo-common law remains cautious about the role of reliance in contract formation.

First, let us first briefly consider the doctrine of promissory estoppel in Australia as a method of revitalisation of the Australian law of obligations. There is an infinite variety of facts and circumstances that may give rise to a promissory estoppel. The principles

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386 Strictly speaking, there is no “American contract law”, because contract law is largely state rather than federal law. Nevertheless, it is permissible to make general statements on “American contract law”, as there is a common basis and the differences are usually only on details, and for purposes of the discussion, reference is only made to the Restatement Second of the Law on Contracts (1979). See also the Honourable Mr Justice LJ Priestley, “A Guide to a Comparison of Australian and united States Contract Law” (1989) 12 University of New South Wales Law Journal 4.
which govern promissory estoppel are, however, well developed and require consideration of three primary requirements.  

"First, the words or conduct of the defendant must be clear and unambiguous ... Second, the conduct of the plaintiff in relying to its detriment on those words or that conduct must be reasonable ... Third, the defendant must know or intend that the plaintiff will act or abstain from acting in reliance on those words or that conduct".  

It is apparent that reliance is central to promissory estoppel, even if its role is usually “relegated to that of hovering Polonius-like on the fringes of the action and making only occasional forays into the footnotes of the private law plot”. Having regard to the nature of business transactions, promissory estoppel undoubtedly has a role to play in modern day business dealings in situations where the instruments business people have used are contractually unenforceable, or their relations make it clear that they did not intend or desire a contract to be the legal vehicle to govern the relations. Lawyers and the law have to be flexible in responding to business needs, and look beyond contractual-based liability only. As Lord Neuberger MR observed, "contract looks forward from what the parties agreed. Estoppel, on the other hand, looks back. It involves assessing the parties’ rights and obligations as at the date they fall to be

389 See Legione v Hately (1983) 152 CLR 406; Giumelli v Giumelli (1999) 196 CLR 101. The seminal description of the doctrine of promissory estoppel appears in Walton Stores (Interstate) Ltd v Maher (1988) 164 CLR 387 at 428 where Brennan J set out six criteria that are necessary to establish an equitable estoppel: (1) the plaintiff has assumed that a particular legal relationship then existed between the plaintiff and the defendant or has expected that a particular legal relationship would exist between them and, in the latter case, that the defendant would not be free to withdraw from the expected legal relationship; (2) the defendant has induced the plaintiff to adopt that assumption or expectation; (3) the plaintiff has acted or has abstained from acting in reliance on the assumption or expectation; (4) the defendant knew or intended him to do so; (5) the plaintiff’s action or inaction will occasion detriment if the assumption or expectation is not fulfilled; and (6) the defendant has failed to act to avoid that detriment whether by fulfilling the assumption or expectation or otherwise.

390 See Summer Hill Business Estate Pty Ltd v Equititrust Ltd [2010] NSWSC 776 at [42]. For a useful summary of the law applicable to promissory estoppel, as well as the other forms of estoppel, see Hughes v St Barbara Mines Ltd (No 4) [2010] WASC 160 at [788].


392 See chapter 3.

The wrong complained of in a promissory estoppel claim "is not primarily in depriving the plaintiff of the promised reward but in causing the plaintiff to change position to his detriment." Promissory estoppel was mentioned in Banque Brussels and Gate Gourmet as a possible way to go about resolving comfort letter disputes. In Atco Controls, where Atco Controls Pty Ltd ("Atco Controls"), the ultimate holding company of Newtronics Pty Ltd ("Newtronics"), issued letters of support to its subsidiary's auditor in connection with the preparation of Newtronics's accounts, the Victorian Court of Appeal held that the letters did not have contractual effect, but stated that:

"It is conceivable that the actions of Newtronics's directors in reliance on Atco's undertakings [non-legally binding undertakings in the letters] could, in some circumstances, have found an estoppel precluding Atco from resiling from the undertakings or at least resiling without first giving reasonable notice. But for present purposes it is unnecessary to consider that possibility. Newtronics never pleaded nor sought to argue estoppel and, as Callaway JA observed in Riseda Nominees Pty Ltd v St Vincent's Hospital (Melbourne) Ltd, it is not open to a party: 'to choose for legitimate forensic reasons not to advance a case of conventional estoppels at trial but then to rely upon

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395 WA Seavey, "Reliance Upon Gratuitous Promises or Other Conduct" (1951) 64 Harvard Law Review 913 at 926.
397 [2004] NSWSC 149.
398 L Thai, "Comfort letters – a fresh look?" (2006) 17 Journal of Banking and Financial Law and Practice 15 at 29 criticises the decisions on the basis that: "The key point in the promissory estoppel cases is the fact that there were pre-existing contracts. In Gate Gourmet and Banque Brussels, however, there were no pre-existing contracts, only comfort letters." The criticism is, however, questionable in light of the fact that in Walton Stores (Interstate) Ltd v Maher (1988) 164 CLR 387, the Australian High Court extended the doctrine to relationships outside a pre-existing contract. See also Hughes v St Barbara Mines Ltd (No 4) [2010] WASC 160 at [788].
399 [2009] 78 ACSR 375 at [58].
400 See paragraph 7.6.
401 [1998] 2 VR 70 at 76.
conventional estoppels, or a similar argument based on an overarching doctrine, on appeal."

In each case where promissory estoppel is pleaded, the claim will have to be tested against the aforementioned three requirements. The third requirement of promissory estoppel (knowledge of reasonable reliance) may be an obstacle for the legal enforceability of letters of comfort. In effect, the bank (as recipient of the comfort letter) would have to prove that the parent company (as comfortor) had a reasonable expectation that the words used in the comfort letter and its conduct in issuing the letter would induce some detrimental reliance by the bank. The second requirement may also be problematic for the bank. Reliance by the bank which is unforeseen, unexpected, foolish, or imprudent, would usually indicate that it is not reasonable. In particular, the anticipated reliance would not be reasonable if the bank knew or ought to have known that the parent company’s representation in the comfort letter, which has to be clear and unambiguous to satisfy the first requirement, could not have been intended to bind it unless it formed part of a contract of a traditional security instrument. In appropriate cases, however, the doctrine of promissory estoppel may be applicable, and letters of comfort may prove to be an appropriate vehicle for the revitalisation of the Australian law of obligations.

Secondly, let us briefly turn to the doctrine of promissory estoppel in America as a possible basis to resolve comfort letter disputes. Promissory estoppel in America, differs from the similarly named doctrine in Australia, and has introduced via section


90 of the Restatement (Second) of Contracts (1979)\textsuperscript{405} reliance as a ground for recovery in American contract law. Section 90, on its face, reflects a closer connection with the general law of contract than the doctrine of promissory estoppel in Australia, with its origins in the equitable concept of unconscionable conduct would allow.\textsuperscript{406}

In America, assent\textsuperscript{407} and consideration\textsuperscript{408} are two of the fundamental requirements which have to be satisfied for the formation of a contract.\textsuperscript{409} However, it has been accepted in America that contract is also a relationship, a link between two people: a promisor and a promisee.\textsuperscript{410} In other words, although the concept of bargained-for exchange is no doubt part of contracts, they also have a relational character\textsuperscript{411} which has caused the focus to be shifted to the role of reliance in contract law, and the introduction of section 90 of the Restatement (Second) of Contracts which is worded as follows:

“A promise which the promisor should reasonably expect to induce action or forbearance on the part of the promise or a third person and which does induce such action or forbearance is binding if injustice can be avoided only


\textsuperscript{407} In the form of a complete and definite offer and acceptance conforming to that offer.

\textsuperscript{408} The consideration requirement is dual: apart from the demand that there must be a quid pro quo, the promise or act of each person is to be bargained for by the other in exchange for the latter’s promise or act.


by enforcement of the promise. The remedy granted for breach many be limited as justice requires.”

Promises are thus recognised to be enforceable because of one person’s foreseeable acting or forbearing in reasonable reliance upon another person’s promise – consideration is not required, in fact, no contract needs (yet) to exist between the parties. Accordingly, section 90 of the Restatement (Second) of Contracts has infused reliance-based liability, as an alternative to promise-based liability, into American contract law. A recent empirical study has found, however, that promissory estoppel in the American context (as section 90-liability is often termed) cannot be thought of exclusively as either a reliance based or promise-based theory of recovery:

"Instead, courts have been much more even handed in their approach, usually making sure that a promissory estoppel plaintiff has satisfied both the promise and reliance prongs of the test, although they have been much more hesitant in requiring a showing of injustice before enforcing the promise. The reasons for this, while uncertain, are fascinating: They reveal that, even if the roots of promissory estoppel were once embedded in the older doctrine of equitable estoppel, promissory estoppel has now freed itself from this equitable chrysalis and emerged as a fully independent – and distinct – theory of promissory recovery ... the percentage of claimants who receive full contractual damages is much higher than has previously thought. This reveals that, for better or worse, many judges are conceptualising promissory estoppel actions as fully contractual causes of action. However, because

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promissory estoppel actions are generally easier to prove than traditional breach of contract claims, such a move seems to be creating a new type of ‘super contract’ capable of prevailing more frequently and easily than traditional contracts, extracting from defendants a higher (contractual) amount of recovery and avoiding traditional contract-based defences”.

It is apparent that the two main requirements for section 90-liability are a promise and reasonable reliance.414 Although a promise is essential to establish liability based on promissory estoppel,415 there is a tendency to interpret the promise requirement broadly. Henderson has observed that: “Section 90 promises are more frequently implied from conduct than was previously true, and patterns of conduct which resembles factual representations rather than promises often suffice”.416 Thus, context and circumstances of conduct are important,417 and when reliance is justifiable and serious, the promise requirement of section 90 of the Restatement (second) of Contracts is not difficult to satisfy.418 Indeed, Metzger and Phillips have remarked that: “Instead of asking, is this behaviour a true promise meeting certain contractual tests? Courts might come to inquire 'is this promise or other behaviour, however characterizable in the abstract, such as to promote foreseeable reliance in the context

414 MJ Jimenez, “The Many Faces of Promissory Estoppel: An Empirical Analysis Under the Restatement (Second) of Contracts” (2010) 57 UCLA Law Review 669 at 701 points out, however, that the empirical research shows that the role played by reliance is slightly more significant than the role played by promise.
415 MJ Jimenez, “The Many Faces of Promissory Estoppel: An Empirical Analysis Under the Restatement (Second) of Contracts” (2010) 57 UCLA Law Review 669 at 699. SD Henderson, “Promissory Estoppel and Traditional Contract Doctrine” (1969) 78 Yale Law Journal 343 at 376 has pointed out that in American law a sharp distinction is made between promises and representations – promises are declarations of one’s intention to do or refrain from doing something in the future, whereas representations are statements relating to past or present fact.
where it occurred?" The promisee's reliance on the promise must be reasonable or justified, and of a definite and substantial character.

Letters of comfort and promissory estoppel appeared briefly on the judicial stage in the United States in 2003. In *Lasalle Bank National Association v Citicorp Real Estate Inc.*, decided in the United States District Court for the Southern District of New York, Brock Suite Greenville Inc (Brock) operated a hotel pursuant to a franchise agreement with Marriott International Inc (Marriott). Brock borrowed $6.76 million from LJ Melody & Company (Melody) in exchange for a promissory note and a mortgage on its hotel property. At Melody’s request Marriott issued a comfort letter in which it indicated the procedures it would follow if Brock defaulted on the franchise agreement, in particular that it would notify Melody of any breach.

Melody sold the loan to Citicorp Real Estate (Citicorp) and with it assigned “all rights, title and interest in, to and under the note, the mortgage and certain related loan documents.” Citicorp, in turn, sold the loan under a Pooling and Services Agreement (PSA) to Lasalle Bank National Association (Lasalle). In the PSA, Citicorp made several representations and warranties, namely that “there [was] no material default, breach or even of acceleration existing under the related Mortgage Note.” However, unbeknown to Citicorp, Marriott had already sent a notice of default to Brock’s parent company.

Contrary to its representations in the comfort letter, Marriott did not inform Melody, the initial lender, of the fact that Brock was in default of the loan agreement. Both Melody and Citicorp were subsequently informed. Lasalle sued Citicorp for breach of warranties and representations under the PSA. Citicorp instituted third party

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420 See A Rosenbrand-Kuyken, "Section 90 of the Restatement (Second) of Contracts: Recovery Based on Reliance in American Contract Law" (1992) 1 Tilburg Foreign Law Review 133 at 147.
422 2003 WL 21671812 (SDNY) (hereinafter referred to as *Lasalle Bank*).
423 *Lasalle Bank* 2003 WL 21671812 (SDNY) at 1.
proceedings against Marriott for its failure to notify it of Brock’s default in breach of its obligation in the comfort letter on the bases of promissory estoppel, indemnity and negligence. The Court dismissed both the indemnity and negligence claims.

The court pointed out that in New York, promissory estoppel has three elements, namely “a clear and unambiguous promise; a reasonable and foreseeable reliance by the party to whom the promise is made, and an injury sustained by the party asserting the estoppel by reason of the reliance.” Baer Jr J pointed out that although comfort letters were well-known to business people, there was relatively little American case law on the extent to which courts would give them any legal effect. The essence of a comfort letter was to encourage a lender to enter into a legally binding transaction with a subsidiary while the parent company endeavoured to avoid liability should the subsidiary fail to perform. Although courts generally viewed comfort letters as unenforceable, a court could, depending on the facts, find the comfort letter to be part of an implied contract and could find that the comfort letter provider assumed legal obligations. The enforceability of a comfort letter depended on a number of factors, namely –

- the language of the instrument itself, for example, whether it was detailed and contained strong or operative language such as “guarantee”, “contract” or other words of promise; the overall context in which the comfort letter was written and provided, as well as other external factors, for example, the sophistication of the parties, whether they sought legal advice as to the meaning and legal significance of the instrument, oral representations and previous dealings between the parties, the way in which the instrument was viewed in a particular trade, profession or business, the parties’ reasons for

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426 Lasalle Bank 2003 WL 21671812 (SDNY) at 6. This probably due to the fact that, although American corporations often issue letters of comfort in respect of their foreign subsidiaries, comfort letters are not – according to RM Plehn, “The United States” in WE Moojen and M Ph van Sint Truiden (eds), Bank Security and Other Credit Enhancement Methods (Kluwer Law International, The Hague, 1995) 431 at 449 - common in the United States itself, so that when disputes arise they are determined in foreign jurisdictions.
issuing and accepting a comfort letter, and the role the instrument played in the transaction;

- if the lender reasonably relied on the terms, express or implied, in the comfort letter, then the statements in the comfort letter, even if promissory language had been avoided, may be held enforceable under a theory of promissory estoppel or detrimental reliance despite the parent company having had good reasons for wanting to avoid a formal guarantee. 427

Having regard to these factors, Baer Jr J stated that “[b]ecause of the fact-specific nature of the inquiry ... I will not dismiss Citicorp’s claim at this stage ... I have to permit Citicorp the opportunity to develop sufficient facts that show, among other things, that Citicorp in fact relied on the letter and its reliance was reasonable given the specific transaction and the parties involved, and this [promissory estoppel] claim may proceed.”428

However, subsequently Baer Jr J dismissed Citicorp’s promissory estoppel claim on the basis that, although the comfort letter used “strong” operative words – Marriott “will follow” certain procedures and “will notify Lender” and described this as an “obligation” – the other circumstances pertaining to the comfort letter clearly indicated that Citicorp’s reliance on “this promise was unreasonable.”429 The other circumstances were –

- first, the comfort letter was addressed to Melody and it neither formed part of the documents in the loan packet Melody submitted to Citicorp nor was it included in the PSA materials - so, Marriott’s promise was to Melody and no-one else;

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428 Lasalle Bank 2003 WL 21671812 (SDNY) at 7.
secondly, the purpose of the comfort letter was not clearly spelt out, namely, that it was to serve as a formal certificate of good standing of Brock or an estoppel on the franchise – so, the fact that Citicorp accepted the comfort letter in lieu of a formal certificate was indicative that it appreciated the difference and accepted the risk;

thirdly, as a sophisticated commercial entity, Citicorp should have realized that the phrase “comfort letter” indicated that Marriott did not intend to be bound and, “more significantly, that courts as a general rule would not hold them to this promise.”

So, although the Court intimated that legal liability based on a comfort letter was a real possibility, such liability did not eventuate in light of the evidence ultimately put before the Court.

It is clear that a section 90-like liability could revitalise Australian law of obligations, and in the context of a letter of comfort, provide an attractive alternative basis for enforceability - in particular, since a letter of comfort is often viewed as an expression of some state of affairs designed to be reassuring to the recipient without offering a guarantee or contractually binding promise. For liability to be established, a letter of comfort would not have to contain a statement of a promissory nature (in a contractual sense), as long as there has been reasonable reliance on the letter. Jimenez’s empirical research in the United States has revealed that –

“promissory estoppel has an uncanny ability to disguise itself as ‘contractual’ in some instances and ‘non-contractual’ in other. This means that a judge’s ex ante conceptualisation of this chameleon-like cause of action has a marked effect on the ex post remedies available to the promissory estoppel litigant,

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and on whether such traditional, contract-based defences will apply to preclude the action from going forward.\textsuperscript{433}

American promissory estoppel, the chameleon-like cause of action, may be very appropriate for chameleonic instruments such as letters of comfort. But that is a matter for another day and for someone else.

10.6 Epilogue - The ten commandments of letters of comfort

If one accepts another person's word instead of taking his bond, one does so at one's peril.\textsuperscript{434} Comfort letters should not necessarily be equated with accepting another's word.\textsuperscript{435} They are useful and flexible instruments in business transactions and they have been frequently employed in international commerce for many years. The use of letters of comfort between major corporations and bank covering significant transactions and across jurisdictional boundaries indicates the existence of a commercial “morality” and honour in dealings between business people.\textsuperscript{436} Although the rationale for their continued existence and the nature of their value are not easy questions for lawyers to answer, it is clear that an important component of any answer is the feature that letters of comfort must be classified,\textsuperscript{437} with some classes of comfort letters being matters outside the reach of legal remedies\textsuperscript{438} and other being enforceable in contract or tort, or even under a statutory regime such as the Trade Practices Act 1974 (Cth) in Australia. Importantly, even though the contractual claims


\textsuperscript{434} Toronto Dominion Bank (1998) 40 BLR (2d) 1 at 158.

\textsuperscript{435} See, however, CM Parr, “Comfort Letters” 1988 (February 24) Law Society’s Guardian Gazette 85.8(2) who describes the comfort letter dynamics as follows – “the giver of a comfort letter was saying to the recipient; ‘trust me’. The recipient was replying: ‘I will trust you but, if you are not good for your word, do not expect me to trust you the next time.”


\textsuperscript{437} LGHJ Houwen, AP Schoonbrood-Wessels, JAW Schreurs, Aansprakelijkheid in concerneverhoudingen: een rechtsvergelijkinge studie naar de positie van crediteuren van concernafhankelijke vennootschappen in Duitsland, Frankrijk, Engeland en Nederland (Kluwer, Deventer, 1993) 327. See paragraph [ ].

\textsuperscript{438} As WE Moojen, “De ongemakkelijke comfort letter” [1990] Nederlands juristenblad 779 at 781 points out, non-legal binding comfort letters fulfill an important role in banking practice and should be recognised as such by the courts. Any attempt to convert every comfort letter into a legally binding instrument would not only be contrary to the commercial use of such letters in practice as discussed in chapter 3, but would deprive banks of a flexible instrument to facilitate transactions.
based on the letters of comfort in, for example, *Kleinwort Benson on appeal*, failed, the courts or the parties conceded that parts of the letters of comfort created legally significant promises or representations that could have supported claims by the banks, which points to them having more than mere commercial value.

In view of recent decisions and the change in the financial fortunes of businesses worldwide, legal risk management or “preventative lawyering” is a prudent step for banks and businesspeople who use comfort letters to ensure that they know the nature and effect of the comfort letters they hold. Usually, when a legal dispute about a letter of comfort arises, it is the comfortee who may be exposed to the reality of the financial risk of the transaction covered by the letter of comfort. It is, however, possible to state the “ten commandments”, or common sense rules, for letters of comfort as aids to the comfortee, like a bank, in assessing the acceptability of such letters in order to avoid much heartache and to guide its actions in dealing with comfort letters:

1. **Thou shalt not compromise**: A bank ought not compromise the quality of the underlying deal by the peculiar practice of accepting a letter of comfort in lieu of a guarantee – or, as Bernard has observed, a lender “ought not to dilute credit quality through such uncanny substitution, because the two are fundamentally different documents.” Letters of comfort often do not offer appropriate credit support, like the traditional securities, for banks who seek

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440 (1998) 40 BLR (2d) 1.
441 (2000) 2 SLR 54.
444 See MJ Bernard, “The Seven Commandments for Letters of Comfort” 2003 (March/April) *Banking Today* 6 at 8 has identified the first seven commandments.
swift and cost efficient recourse and debt satisfaction from parent companies in respect of their defaulting subsidiaries. It is the nature of the underlying risk that should drive the lender’s choice between guarantee and letter of comfort – thus, if the size of the financial facility is significant not only in the context of the subsidiary’s capital, assets and liabilities, but also in the context of the parent company or group of companies to which it belongs so that honouring the letter of comfort would jeopardise or compromise financial solvency of the parent company or the group, then it is likely that the parent company will dispute legal liability in respect of the letter of comfort and would rather sacrifice the subsidiary than the group or itself.

2. Thou shalt know its contents inside out: A comfort letter is not a traditional security, like a guarantee or indemnity, under a different nomenclature. No two letters of comfort are alike, and because they differ in their content, banks ought to review the letters of comfort they receive scrupulously to ensure that they meet expectations.446 Letters of comfort need to be carefully and systematically analysed to determine whether a particular letter contains merely moral obligations or legal obligations.447

3. Thou shalt seek professional counsel: Letters of comfort are not as straightforward as they may seem.448 Banks should entrust the task of drafting and vetting letters of comfort to legal counsel – and, in so doing, should brief them adequately about the circumstances surrounding and leading to the acceptance of the letter of comfort to help ensure that the wording of the letter of comfort is not ambiguous or uncertain and to enable

446 RE Elliott and JM Robinson, "'Comfort' letters may provide cold comfort" 1999 (November 19) The Lawyers Weekly 12.
447 See paragraph 2.5.
448 See P Spector, "Comfort letters – How to get support from your customer’s parent company" (1995) 16 Credit Control 6

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them to express clearly the nature and extent of the parent company’s commitment to support in case of default.\textsuperscript{449}

4. \textit{Thou shalt uphold basic prudence}: The nature and quality of the parent company and its relationship with the subsidiary are important factors in minimising the risk of default on the letter of comfort. A letter of comfort should only be accepted from a reputable trading, not holding, (parent) company whose financial strength, background and rating is of the highest order and who stands to lose or at least seriously undermine its (and the group’s) reputation in the marketplace upon reneging on its obligations contained in the letter of comfort so as to affect the parent company and other companies in the group in carrying on their business and obtaining credit facilities in the future.\textsuperscript{450} Moreover, the parent company should have a genuine economic, commercial and beneficial interest in the subsidiary and its financial well-being. That would ensure that the degree of support for the subsidiary is high and the risk of default relatively low.\textsuperscript{451} It may also be prudent to request the parent company to declare the details of all letters of comfort issued by it with a view to ascertain possible hidden liability not disclosed by its financial statements, to enable the bank to evaluate the nature of the commitments in such letters, and to determine the parent company’s familiarity and experience with comfort letters.

5. \textit{Thou shalt rate letters of comfort}: The contents of letters of comfort indicate the degree of comfort or promise that is forthcoming.\textsuperscript{452} In order to understand the risks inherent in dealing with such letters, letters of comfort ought to be classified based on the degree of comfort as evidenced by the nature of the statements and undertakings contained in a particular letter of

\textsuperscript{449} See MJ Bernard, “The Seven Commandments for Letters of Comfort” 2003 (March/April) \textit{Banking Today} 6 at 8.
\textsuperscript{450} See chapter 3.
\textsuperscript{451} See MJ Bernard, “The Seven Commandments for Letters of Comfort” 2003 (March/April) \textit{Banking Today} 6 at 8.
\textsuperscript{452} See paragraph 3.3.
comfort.  Although the classification of letters of comfort would not be determinative of its legal enforceability, it would draw attention to the weakness of a particular comfort letter.

6.  Thou shalt monitor both the parent company and the subsidiary: It is important for a bank to continuously revisit these commandments during the currency of the credit facility, and to monitor on an ongoing basis (a) the financial standing of the parent company which has issued a letter of comfort in support of a subsidiary on an on-going basis so as to ensure that it has the financial resources to support its obligations under the letter of comfort; (b) the business and financial standing of the subsidiary so as to be attuned to strengthening its securities at any early signs of financial deterioration; and (c) any change in the control of the parent company in order to carefully consider what comfort continues to exist because commercial considerations of reputation, adverse publicity and the threat of higher borrowing costs may not motivate a party that is not dependent on lenders in the market.

7.  Thou shalt be wary of traps: Enforcing or relying upon a letter of comfort, even one that contains contractually enforceable obligations, is not straightforward. When seeking to enforce a comfort letter, a bank may become very discomforted, and the phrase "comfort letter" may indeed appear to be an oxymoron. As mentioned in chapter 4, the issue of contract formation, and in particular the requirements of consideration, intention to create legal relations or certainty, is subjected to scrutiny. Also, the subsidiary's default under the credit facility may not necessarily trigger the obligation of the parent company under the letter of comfort. The link between subsidiary default and parent company obligation has to be

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453 See paragraph 2.5.
454 See paragraph 3.2.4.
455 RE Elliott and JM Robinson, "'Comfort' letters may provide cold comfort" 1999 (November 19) The Lawyers Weekly 12. In this regard, see the discussion of Toronto Dominion Bank (1998) BLR (2d) 1.
456 RE Elliott and JM Robinson, "'Comfort' letters may provide cold comfort" 1999 (November 19) The Lawyers Weekly 12.
established. Moreover, since the claim would invariably not be for a liquidated sum, but rather for damages, causation usually looms largely in comfort letter litigation. All these issues are to be reckoned to avoid falling into a comfort letter litigation trap.

8. **Thou shalt be aware of the law in other jurisdictions:** Since letters of comfort are predominantly used in transnational contexts with the bank, the parent company and the subsidiary in at least two different jurisdictions, the applicable law and the forum of litigation could play a significant role in the contractual enforceability of a particular letter. As discussed in this dissertation, generally speaking a letter of comfort is more susceptible to be held to have contractual effect in Continental law jurisdictions, and in Australia, than in the other Anglo-common law jurisdictions.

9. **Thou shalt meticulously note the event and facts leading up to and surrounding the issuing and acceptance of a letter of comfort:** Although the wording of a particular letter of comfort is important in the determination of its contractual effect, it is clear from the case law in both the Anglo-common law jurisdictions, the Continental law jurisdictions and the Oriental law jurisdictions that letters of comfort are construed in the context of the surrounding circumstances, and that evidence about, for example, the negotiations preceding the letter of comfort, company board approval, and the trade practice could play a decisive role in the outcome of comfort letter litigation. Moreover, even if the comfort letter is held not to have contractual effect, non-contractual liability could be possible.\(^{457}\)

10. **Thou shalt not overestimate the effect of commercial or business morality in the absence of legal sanctions:** In chapter 3 the economic explanation for the use of letters of comfort is discussed in conjunction with the relational theory

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\(^{457}\) See paragraph 1.5.
of contract law. Although businesspeople, generally speaking, may conduct themselves according to fairness and by keeping promises without a focus on legal sanctions, one should be mindful of the somewhat cynical observation often made that most persons have principles according to which they conduct themselves, but when it comes to money, they have different principles. Moreover, as Fish has observed: “Morality is something to which the law wishes to be related, but not too closely”.458

As for the comfortor, like a parent company, a prudent thought: a parent company's so-called “commercial amour propre”459 may not be enough to rule out its willingness to enter into a contractually binding obligation under a letter of comfort. Legal liability based on a letter of comfort is a real possibility: it may just be a matter of “releasing the comfort letter trap”.460 Like a boomerang,461 a letter of comfort is potentially a dangerous instrument when it returns to its unsuspecting originator.462

459 See Hirst J in Kleinwort Benson at first instance [1988] 1 WLR 799 at 810. “Amour propre’ means literally “own love, self-love”. But in English it is used mainly to suggest the sort of prickly good opinion of oneself that is easily flattered but also easily offended.
461 A bent or curved piece of hard wood used by Aborigines in Australia, one form of which can be thrown so as to return to the thrower; also used for an act, utterance, plan or scheme that backfires on its originator.
462 A Trichardt, “Comfort letters are like boomerangs ... they tend to come back” (2005) 26 Company Lawyer 54 at 57.
Annexure 1


“We confirm that we have a copy of and approve the terms and conditions of the proposed Loan Agreement with the Borrower intended to be signed today. We confirm that we are the beneficial owners of X per cent of the issued share capital of the Borrower and will maintain this shareholding as long as any sums remain outstanding under the above facility.

It is our policy to ensure that our subsidiaries have adequate and competent management and sufficient financial resources to carry on their businesses efficiently. In particular, we undertake not to take any action which results in the Borrower being unable to carry on its business or otherwise defaulting under the above Loan Agreement.

This letter is to be interpreted according to English Law.”

Comfort letter in Chemco Leasing SpA v Rediffusion Plc (19 July 1986, unreported, QBD) 1; on appeal [1987] 1 FTLR 201

“Dear Sirs

We thank Chemco Leasing SpA (“Chemco”) for the confidence which has been expressed in our subsidiary, Computer Machinery Corporation Italia SpA (“CMC Italy”) of Via F Ferrucio 8 20145 Milano, Italy in the provision to the same of lease financing facilities, to be used during the forthcoming 12 months, for the purchase of data entry equipment up to a total value of Italian Lire 1,700 million for lease terms of up to five years.

We confirm to you that the share capital of CMC Italy is owned 99.915 by Computer Machinery Corporation France SAA which is in turn 100% owned by the undersigned Rediffusion Limited. Therefore Rediffusion Limited will be in a position to exercise sufficient control over the administration and management of CMC Italy to ensure that its obligations to Chemco are maintained.

We assure you that we are not contemplating the disposal of our interests in CMC Italy and undertake to give Chemco prior notification should we dispose of our interest during the life of the leases. If we dispose of our interest we undertake to take over the remaining liabilities to Chemco of CMC Italy should the new shareholders be unacceptable to Chemco.”
Comfort letter in *Kleinwort Benson Ltd v Malaysia Mining Corporation Berhad* [1988] 1 WLR 799

“We refer to your recent discussion with MMC Metals Limited as a result of which you propose granting MMC Metals Limited:

(a) Banking facilities of up to £10,000,000; and

(b) Spot and forward foreign exchange facilities with a limitation that total delivery cash will not on any one day exceed £5,000,000.

[1] We hereby confirm that we know and approve of these facilities and are aware of the fact that they have been granted to MMC Metals Limited because we control directly or indirectly MMC Metals Limited.

[2] We confirm that we will not reduce our current financial interest in MMC Metals Limited until the above facilities have been repaid or until you have confirmed you are prepared to continue the facilities with new shareholders.

[3] It is our policy to ensure that the business of MMC Metals Limited is at all times in a position to meet its liabilities to you under the above arrangements [numbering inserted by the judge]."


“We confirm that we are aware of the Eurocurrency facility of US$ 5 million which your bank has granted to Spedley Securities Limited, which is a wholly-owned subsidiary of Spedley Holdings Limited.

We acknowledge that the terms and conditions of the arrangements have been accepted with our knowledge and consent and state that it would not be our intention to reduce our shareholding in Spedley Holdings Limited from the current level of 45% during the currency of this facility. We would, however, provide your Bank with ninety (90) days notice of any subsequent decisions taken by us to dispose of this shareholding, and furthermore we acknowledge that, should any such notice be served on your Bank, you reserve the right to call for the repayment of all outstanding loans within thirty (30) days.

We take this opportunity to confirm that it is our practice to ensure that our affiliate Spedley Securities Limited, will at all times be in a position to meet its financial obligations as they fall due. These financial obligations include repayment of all loans made by your Bank under the arrangements mentioned in this letter.”
Letter of awareness in *Hongkong and Shanghai Banking Corporation Ltd v Jurong Engineering Ltd* [2000] 2 SLR 54

The first letter of awareness approved by the Jurong Engineering Board (with the deleted words in brackets and the amendments in italics) read as follows:

“We confirm that we are aware that you have offered to grant/continue banking facilities to Huge Corporation Pte Ltd ("the borrower") for $4m and approve the terms and conditions of such banking facilities.

We also confirm that for so long as any amount is outstanding to you under such banking facilities:

1. We will continue to maintain our 50% ownership of the borrower and hereby [undertake] ensure to advise you forthwith in the event of any decision being taken to dispose of the whole or part of our shareholding in the borrower.

2. We will cause the borrower to be operated and maintained in such a way as to be in a financial position to meet all its obligations from time to time to you. If the borrower is unable for any reason to meet its obligations, we will, on demand, immediately either:
   
   a. make funds available to the borrower sufficient to meet its obligations; or
   
   b. have funds made available to the borrower by others in amounts sufficient to enable the borrower to meet its obligations.

3. We will not take any action which will result in the borrower being unable to carry on its business or otherwise being unable to meet all its obligations from time to time to you and hereby [undertake] ensure to advise you forthwith of any circumstances which may affect the continuing operation of the borrower.

4. We will furnish you with our consolidated annual audited financial statements and accounts and will procure that the borrower will furnish you with annual financial statements and accounts together with such additional financial information as may be reasonably required.

This letter is to be interpreted according to Singapore Laws.”

The letter of awareness which was issued after the facilities were increased to SG$26 million and approved by the Jurong Engineering Board was similar:
"We confirm that we are aware that you have offered to grant/continue banking facilities to Huge Corporation Pte Ltd ("the borrower") for SGD26,000,000 as per your Letter of Offer dated 3 August 1994 and approve the terms and conditions of such banking facilities.

We also confirm that for so long as any amount is outstanding to you under such banking facilities:

1. We will continue to maintain our [50%] 51% ownership of the borrower and hereby [undertake] ensure to advise you forthwith in the event of any decision being taken to dispose of the whole or part of our shareholding in the borrower.

2. We will cause the borrower to be operated and maintained in such a way as to be in a financial position to meet all its obligations from time to time to you. If the borrower is unable for any reason to meet its obligations, we [shall] will endeavour to either:

   a. make funds available to the borrower sufficient to meet its obligations;
   
      or
   
   b. have funds made available to the borrower by others in amounts sufficient to enable the borrower to meet its obligations.

3. We will not take any action which will result in the borrower being unable to carry on its business or otherwise being unable to meet all its obligations from time to time to you and hereby [undertake] ensure to advise you forthwith of any circumstances which may affect the continuing operation of the borrower.

4. We will furnish you with our consolidated annual audited financial statements and accounts and will procure that the borrower will furnish you with annual financial statements and accounts together with such additional financial information as may be reasonably required.

This letter is to be interpreted according to Singapore Laws."

**Comfort letter in Bouygues SA v Shanghai Links Executive Community Ltd [1998] 2 HKLRD 479**

The letter written by the solicitor read as follows:

"We advise that under an agreement entered into by the [defendant], all of the funds required to pay the US$33,250,000 contract price will be deposited in a segregated
account of the [defendant] at Standard Chartered Bank in Hong Kong. Payment of the contract price under the contract will be made from this account and funds can be paid out of this account by the signature of Barry Hansen and one other director of the [defendant].”

The letter of the investors read as follows:

“The undersigned is the representative of several investors which has agreed to make an investment in the [defendant]. We confirm that in accordance with the terms of such investment, the [defendant] is required to place the US$33,250,000 contract price in a segregated US dollar account of the [defendant] for payment of the contract price. Payment of the contract price will be made from the [defendant ‘s] account by signature of Barry Hansen and a director appointed by one of the investors as described above.”

**Comfort letter in Re Augustus Barnett & Son Ltd [1986] BCLC 170**

“Rumasa ... undertakes to provide such additional working capital as is necessary to enable [the company] to trade at its current level of activity for a period of not less than 12 months from this date and also to provide such long term finance as is necessary”.
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