

### **Letter of Comfort: Enforceable Guarantee or Moral Obligation?**

Letters of Comfort (“**LoC**”) continue to hold a mystifying position in the financing spectrum. While some interpret it as an enforceable obligation on the issuer, some merely see it as an unenforceable representation of a fact. In common parlance, LoC is a letter issued by a parent company or other related party/affiliate which has a controlling stake or power (“**Issuer**”) over another entity (usually a borrower) (“**Obligor**”) to the lenders of the Obligor. LOCs are intended to provide some form of “comfort” to the lenders in relation to the obligations and performance of the Obligor. The level of “comfort” will be integrally linked to the nature of statements made by the issuer in the LoC. These statements generally relate to assurance of financial soundness of the Obligor to repay its debt and perform its obligations and also at times provide comfort as regards the Issuer itself.

#### **Is it a guarantee?**

The difference between LoC and guarantee lies in the terms of their enforceability. While guarantees create an independent financial obligation on the Issuer / guarantor in case of any default by the Obligor, this need not necessarily be the case with an LoC. The provisions of Contract Act 1872 or Companies Act 2013 define and regulate guarantees. LoCs are a derivative of commercial transactional parlance and do not have a strict legal backing, other than that of specific performance under Contract Act 1872. The applicability of contract law also depends significantly on the nature of LoC and therefore the language of the LoC becomes critical to determine the enforceability.

#### **Binding nature – Judicial pronouncements**

- (i) English Courts: Enforceability of LoC depends upon the facts, intention of the parties and the language used therein. In *Kleinwort Benson Ltd. vs Malaysia Mining Corp Bhd [(1989) 5 BCC 337 (CA)]*, subsidiary of the defendant procured £5m credit line from the plaintiff bank. The bank made credit line available, but extracted a LoC from the defendant which stated “*It is our policy to ensure that the business of the subsidiary is at all times in a position to meet its liabilities to you under the above arrangements.*” The subsidiary defaulted and the bank claimed against the defendant under the LoC. The matter went before the court where it was held that the LoC was merely a statement of present fact regarding the parent’s intentions and was not a contractual promise as to parent’s future conduct.

Hence in the United Kingdom, enforceability of LoC is attributed to facts, intention of parties and the language used therein.

- (ii) Malaysia: The Malaysian Court, in *OSK Trustees Berhad v Kerajaan Malaysia [Civil Appeal No. W-01-7-01/2012]*, had an occasion to decide upon enforceability obligations under a LoC which stated that “... *the Government ensures that MITP is (in) a position to meet (and do meet on a full and timely basis) their liabilities in respect of all amounts borrowed for so long as the amount in respect of the borrowings remain outstanding.*” Upon default, the government denied to acknowledge the LoC as a guarantee. Therefore, an action against the

government was filed on the ground that the government had breached its undertaking, representation and assurance in the LoC. However, the court held that *“the words used in the letter of comfort did not contain words which convey the idea that the Government would be undertaking a contractual obligation.”*

- (iii) Singapore: The Singapore High Court had the first occasion to decide upon enforceability of LoC (or letter of awareness, in this case) in *The Hongkong and Shanghai Banking Corporation Limited v Jurong Engineering Limited* [(2000) 2 SLR 54]. The Hon’ble court held that the court must look beyond the terms and at the intentions of the parties in each case as the LoC as a term has no precise meaning under the laws of Singapore. Upon due consideration, it was observed that it is not necessary to examine every single word or term used, but instead only its general tone. In this case, it was found that the comfort letter had been drafted “in the language of deliberate equivocation in keeping with a ‘gentleman’s agreement’ where the issuer confirms that he will abide by his moral obligations”. Therefore, the parties did not intend the letter of awareness to create legal relations.

Hence in Singapore, enforceability of LoC depends upon the text of the LoC along with the surrounding circumstances.

- (iv) China: For enforceability before Chinese courts, LoC must include an assumption of guarantee obligations. In *Foshan Municipal People’s Government vs. Bank of Communications (Hong Kong Branch) Re: Guarantee Dispute* [2005], the government issued a LoC stating that *“If the borrower delays or defaults on its payment of principal and interest due under the facility, we the Guangdong provincial government will be responsible for resolving the default such that the bank does not suffer any economic loss.”* The People’s Republic of China Supreme People’s Court (“**SPC**”) held that the LoC has no guarantee obligations as the government was only responsible only for resolving the problem. This can never be interpreted as taking liability as the guarantee.

This was again reaffirmed by the SPC in *Bank of Communications (Hong Kong Branch) vs. Ganjyun Company Limited, Yunfu Municipal People’s Government and Others Re: Dispute over Loan Guarantee Contract (Appeal)* [2015].

- (v) Australia: The Supreme Court of New South Wales in Australia considered the enforceability of LoC in *Banque Brussels Lambert SA v. Australian National Industries Ltd*. In this matter, Banque Brussels Lambert S.A. (“**BBL**”) provided Spedley Security Ltd. (“**SSL**”) with a line of credit. In negotiating the line of credit, BBL sought a guarantee from the parent company, Australian National Industries Ltd. (“**ANI**”), but ended up with a LoC which stated that the ANI would not reduce its shareholding in Spedley Holding Company before giving 90 days notice to BBL. It also stated about ANI’s practice to ensure that SSL will at all times be in a position to meet its financial obligations as they fall due.

However, ANI reduced its shareholding without giving any notice to BBL and ANI also didn’t make any efforts to ensure that SSL was in a position to meet its financial obligations. Later when SSL defaulted, BBL attempted to recover the loans from ANI by bringing an action for breach of contract.

The court held that a LoC shall not only be interpreted in light of its language, but also in the context of its surrounding circumstances. The course of the negotiations showed that BBL was looking for very strong language in the letter, and went so far as to reject a draft that expressly stated that the letter was not a guarantee. Additionally, ANI was given notice that BBL considered LoC to create binding obligations. Therefore, it is creating binding obligations on ANI.

### **Indian Jurisprudence**

The Delhi High Court considered a question relating to enforceability of LoC in *Lucent Technologies Inc. vs. ICICI Bank Ltd. & Ors. [2009]*. Relying on the principles laid down in various international judgments, the Hon'ble court was of a view that *"the circumstances and documents do not indicate that the parties intended to create any legal relations. The very terms of the letter dated 13<sup>th</sup> September, 2000, the term sheet enclosed therewith and the response of the plaintiff as contained in letters of comfort dated 27<sup>th</sup> September, 2000 and 30<sup>th</sup> November, 2000 are a strong indicator in this regard. Both use phrases and concepts having clear technical legal significance and do not manifest any intent that a final and concluded contract had been entered into. In view of the above discussion, it, therefore, has to be held that the communications placed before this court do not contain the kind of assent required to make for a binding contract."* Therefore, the issuer was not under any financial obligation to pay any amount under the agreement between the borrower and the bank.

The Karnataka High Court also had an occasion to decide on enforceability of LoC in *United Breweries (Holdings) Ltd. vs Karnataka Industrial Investment and Development Corporation Ltd. [AIR 2002 Kar 65]*. In this case, the appellant gave LoC on behalf of one of its associate company stating that *"We hereby confirm that it is our normal practice to see that all our associates companies meet their financial and contractual obligations and this end we will undertake all reasonable steps to ensure that M/s. Dominion Chemical Industries Ltd conducts its operations efficiently to meet its obligations in the usual course of business."*

Upon default, the matter came before the Hon'ble high court where it was held that this was not a guarantee and it was more in the nature of recommendatory letter. If a person has not stood as a guarantor or surety, he cannot be treated as a guarantor or surety without there being a specific undertaking by him that he would discharge the liability of the third person in the case of his default. Lastly, the Hon'ble court also defined LoC as *"A document that indicates one party's intention to try to ensure that another party complies with the terms of a financial transaction without guaranteeing performance in the event of default."*

It may therefore be said that the enforceability of LoC in India depends upon the words used in therein along with the intent of the parties.

## **Implication**

The intention behind issuance of an LoC will determine the nature and extent of its enforceability. “Keep Well Letters”, “Letter of Intent”, “Comfort Undertaking” are some of the terms commonly used for LoCs, depending on the nature of the obligations undertaken by the Issuer (if at all). What one must remember is that LoCs are generally taken as an alternative to Guarantee and could therefore not be enforced as such. Seeking specific performance under LoCs is an option, but it may not necessarily be the case if the parties did not intend it to be so.

There is no “one size fits all” approach to an LoC and therefore each LoC has to necessarily be interpreted on its own standing. The title is not determinative of the substance of the document. A detailed eye to distinguish between contracts and mere statements of fact and / or intent is equally critical.

Changing corporate structures and increased need for financing eventually demand all sorts of “comfort” and therefore LoCs are here to stay. The test of a good lawyer is therefore to reflect the binding / non binding nature in the text of the LoC itself in a manner that it is not an interpretation issue and it gives comfort in the real sense!

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### Contact us:

#### MUMBAI OFFICES

##### Corporate Office

902, Tower 2, Indiabulls Finance Centre,  
S. B. Marg, Elphinstone Road (West),  
**Mumbai** - 400 013, India  
Tel: +91 22 6720 5555 / +91 22 4057 5555  
Fax: +91 22 2421 2547

##### Dispute Resolution Office

802, Raheja Chambers,  
Free Press Journal Marg, Nariman Point,  
**Mumbai** - 400 021, India  
Tel.: +91 22 4920 5555  
Fax: +91 22 2204 3579

#### DELHI OFFICE

H-17, Lower Ground Floor, Kailash Colony,  
**New Delhi** - 110 048, India  
Tel: +91 11 4175 1889  
Fax: +91 11 4108 4175

#### BENGALURU OFFICE

Kheny Chambers, Upper Ground Floor,  
4/2 Cunningham Road,  
**Bengaluru** – 560 052, India  
Tel: +91 80 4669 8200  
Fax: +91 80 2226 6990



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