

The legal status of letters of comfort T Tshepe

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ABSTRACT

Letters of comfort (LOCs) have been in use for many decades, but their legal status remain unclear in South Africa and elsewhere. When a subsidiary needs a loan from a bank but does not have adequate collateral to back up the loan request, the parent company usually steps in to provide surety for its subsidiary, either by issuing a guarantee, surety, or pledge. But in some situations when the parent company does not want to be held accountable for the debts of its subsidiary, it issues a letter of comfort. This letter is issued under the express disclaimer that the holding company does not want to accept the legal liability of its subsidiary but would ensure that its subsidiary repays the loan amount as when it falls due. This creates some uncertainties around the legal capacity and effects of the LOCs in the legal system in South Africa and elsewhere, where these letters are in use.

In South Africa, there is no provision in the statutes to regulate LOCs. The courts treat them on a case-by-case basis, subject to the content inscribed therein as well as the circumstantial evidence leading to their issuance. The seminal case in South Africa in which an LOC was at the centre of a dispute is the *Bernert v ABSA* case. In this case the High Court (HC) ruled in favour of the plaintiff. However, this ruling was abrogated by the Supreme Court of Appeal (SCA). The decision of the SCA was later confirmed by the Constitutional Court (CC). The situation in South Africa is like other Anglo common law jurisdictions, such as the United Kingdom and Canada, with the exception of Australia. In Australia LOCs carry contractual effect, *ab initio*. This became clear in several Australian landmark cases, such as the *Banque Brussels Lambert SA v Australian National Industries* and the *Gate Gourmet Australia (in Liquidation) v Gate Gourmet Holding*. The legal nature of LOCs varies from one country to the other, and are informed by a particular country's legal system, socio-economic landscape and the cultural identity of that jurisdiction. The research has interrogated the legal status and effect of LOCs in the Republic and elsewhere and highlights important lessons and conclusions that could be implemented in future.

DECLARATION OF AUTHENTICITY

I declare that the mini-dissertation titled "The legal status of letters of comfort", is my own work and that all the sources I have used or quoted, have been indicated and acknowledged by means of complete references.

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Go weditwe!

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LIST OF ABBREVIATIONS

ACT	Association of Corporate Treasurers
CC	Constitutional Court
EStAL	European State Aid Law Quarterly
FSR	Financial Service Financial Sector Regulatory Act
HC	High Court
L & Bus Rev Americas	Law and Business Review of the Americas
LOCs	Letters of comfort
MOI	Memorandum of incorporation
PULP	Pretoria University Law Press
Stell LR	Stellenbosch Law Review
SCA	Supreme Court of Appeal
TFLR	Tilburg Foreign Law Review

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Chapter 1: Background to letters of comfort

1.1 Introduction

Letters of comfort (LOCs) have been in use for several decades in the financial sector,^{1,2} dating back to the 19th century following a global expansion of major corporations.³ LOCs became more prevalent in commercial space in the 1960s,⁴ as banks became more competitive around attracting viable businesses.⁵ A letter of comfort (LOC) is regarded and perceived under the financial sector as one of the legal instruments^{6,7} that could be issued by a third party,⁸ or an affiliated company,^{9,10} to facilitate and support a business transaction between its subsidiary and a creditor.^{11,12}

The issuance of an LOC by a holding company is made to assure the creditor that its subsidiary will honour the loan agreement¹³ but, in so doing, the holding company does not wish to provide any security,¹⁴ collateral or tangible guarantee¹⁵ to that loan agreement,¹⁶ in case the loan arrangement falls away in future.^{17,18} This means the letter of comfort, *ab initio*, is not intended to be a legally enforceable undertaking or guarantee by the parent company to the loan arrangement,¹⁹ even though, ironically, the issuer of an LOC encourages parties to conclude a legally

¹ Schonberg 2014 *ESTAL* 151.

² Trichardt 2001 *TFLR* 162.

³ ACT 2013 <https://www.treasurers.org/ACTmedia/loc.pdf> 6.

⁴ Tsu 2007 *L & Bus Rev Americas* 168.

⁵ Faul 1990 *Journal of South African Law* 75.

⁶ Kenton 2020 https://www.investopedia.com/terms/c/comfort_letter.asp.

⁷ Gherghina 2014 *Romanian Public-Private Partnership Law Review* 34.

⁸ *Companies Act* 71 of 2008 defines a "holding company", in relation to its subsidiary, as juristic person that controls that subsidiary. This control grants the holding company to have majority of the voting rights, appoint (See also section 2(2)(a)).

⁹ DiMatteo and Sacasas 1995 *Baylor Law Review* 359.

¹⁰ Franken 1985 *International Financial Law Review* 14.

¹¹ DiMatteo and Sacasas 1995 *Baylor Law Review* 359.

¹² Scott 1994 *Journal of Banking and Finance Law and Practice* 197.

¹³ DiMatteo and Sacasas 1995 *Baylor Law Review* 361.

¹⁴ *Toronto Dominion Bank v Leigh Instruments* 1998 40 BLR 2d 1 para 18.

¹⁵ A guarantee could be seen in this situation as a financial liability that weakens the financial strength of the holding company.

¹⁶ *Toronto Dominion Bank v Leigh Instruments* 1998 40 BLR 2d 1 para 76.

¹⁷ Deane 1992 *Asia Pacific Law Review* 88.

¹⁸ DiMatteo 1997 *Yale Journal of International Law* 117.

¹⁹ Lipton 1999 *Western Australian Law Review* 146.

binding agreement.^{20,21} An LOC is, strictly speaking, subtly different from other letters, such the letter of credit,²² letter of intent,^{23,24} letter of responsibility,²⁵ letter of awareness²⁶ or keep-well agreement,²⁷ but the general aim of these letters is to support a second party to raise capital from a creditor.²⁸ However, some authors consider these type of letters to have the same meaning and utilisation.²⁹ In other words, an LOC could still serve as a letter of intent,^{30,31} responsibility,³² awareness or a business document sent out by a third party (holding company) with the aim of assuring the creditor that its subsidiary will be able to meet its contractual commitments,^{33,34} when they fall due,^{35,36} without tabling any guarantee or security to back up the loan deal.³⁷

²⁰ DiMatteo and Sacasas 1995 *Baylor Law Review* 360.

²¹ DiMatteo *International Business Law* 342.

²² A letter of credit is an instrument which requires a bank or creditor to pay a sum of money to the beneficiary against the presentation of documents stipulated in the letter of credit. The letter of credit is mostly used as a payment instrument for export sales. See DiMatteo *International Business Law* 453, 455.

²³ A letter of intent is a legally non-binding document issued to the selected prospective bidder by the supplier with the intention to continue negotiation with the purpose of concluding a contract. See Sikunyana *Conditional Letters of Intent* 5.

²⁴ Wood 1995 *Journal of International Banking Law* 537-539.

²⁵ The Letter of responsibility is a commitment made by the holding company or related entity to the creditor in which the parent company commits to maintain a sufficient oversight over the subsidiary operations and financial position to ensure that its subsidiary remains a going concern over the period of loan arrangement. See Law insider <https://www.lawinsider.com/dictionary/letter-of-responsibility#:~:text=The%20Letter%20of%20Responsibility%20ismanagement%20and%20other%20relevant%20issues>.

²⁶ The letter of awareness is an acknowledgement letter sent by the parent company to the lender indicating that it remains aware about the business activities of its subsidiary and is aware about the new loan arrangements entered into by its subsidiary with the lender. See <https://www.ventureline.com/accounting-glossary/L/letter-of-awareness-definition/#:~:text=LETTER%20OF%20AWARENESS%20is%20a,weakest%20form%20of%20comfort%20letter>.

²⁷ A keep well agreement is a contract concluded by the holding company with its subsidiary in which the holding parents commit to offer financial support to maintain solvency of its subsidiary for a specific period. See Slawotsky 2021 https://webapp3.law.cuhk.edu.hk/conf/20210625/wp-content/uploads/sites/%34/2021/06/Joel-Slawotsky-Initial-Draft_Comfort-Letters-and-the-Essential-Security-Exception-in-an-Age-of-Instability-Pacta-S.pdf.

²⁸ Forte 1990 *Journal of Maritime Law and Commerce* 106.

²⁹ Thai 2000 *Current Commercial Law* 1; Wittuhn 1990 *McGill Law Journal* 490.

³⁰ Radesich and Trichardt 1988 *De Rebus* 796.

³¹ Wood *Law and Practice of International Finance* 307.

³² Wittuhn 1990 *McGill Law Journal* 490.

³³ Wood 1988 *International Financial Law Review* 21.

³⁴ Stephenson 1998 *International Financial Law Review* 8.

³⁵ Wood 1988 *International Financial Law Review* 21.

³⁶ Stephenson 1988 *International Financial Law Review* 8.

³⁷ Radesich and Trichardt 1988 *De Rebus* 796.

To bring some assurances and commitment by a holding company to the creditor, an independent auditor³⁸ or accounting firm³⁹ might be consulted to sign the letter of comfort, pursuant to carrying out due diligence.⁴⁰ LOCs could also be affixed to copies of a company prospectus to assure that the information contained in it is accurate and any misunderstanding would not materially change the information in the prospectus.⁴¹ Several reasons and advantages⁴² have been provided as to why a third party to a loan agreement, between its subsidiary and the bank,⁴³ would prefer to issue an LOC rather than a guarantee⁴⁴ or a pledge.⁴⁵ Some of the common reasons for the use of LOCs arise when a holding company:⁴⁶

- (a) does not wish to incur legal liability on behalf of its subsidiary⁴⁷ even though it supports the business transaction of its subsidiary with the creditor,⁴⁸
- (b) has some restrictions placed on its memorandum of incorporation (MOI)⁴⁹ to not enter financial contracts to which it is not a direct party,⁵⁰
- (c) does not intend to record contingency liability or commitment⁵¹ in its financial books,^{52,53}
- (d) may wish to avoid tax implications pursuant to such a transaction,^{54,55}
- (e) may wish to provide, in *bona fide*,⁵⁶ "an ambiguous form of security in the hope that 'all will go well' and no question will ever arise as to the actual intentions behind the document",⁵⁷ and
- (f) subsidiaries are not established well enough to grant securities or equivalents.⁵⁸ Scott refers to LOCs of this nature as "poor person's guarantee".⁵⁹

³⁸ Radesich and Trichardt 1994 *South African Mercantile Law Journal* 364.

³⁹ Resnik 1979 *Business Lawyer* 1725.

⁴⁰ Noland and Hardin 2018 *The Journal of Corporate Accounting & Finance* 80.

⁴¹ CFI Team 2020 <https://corporatefinanceinstitute.com/resources/knowledge/other/comfort-letter>.

⁴² Davis and Joyce 2009 *Construction Law Journal* 26.

⁴³ Scott 1994 *Journal of Banking and Finance Law and Practice* 197.

⁴⁴ Radesich and Trichardt 1988 *De Rebus* 796.

⁴⁵ Faul 1990 *Journal of South African Law* 74.

⁴⁶ Thai 2000 *Current Commercial Law* 2.

⁴⁷ Radesich and Trichardt 1988 *De Rebus* 797.

⁴⁸ Thai 2006 *Journal of Banking and Finance Law and Practice* 17.

⁴⁹ Section 45 of *Companies Act* 71 of 2008.

⁵⁰ Forte 1990 *Journal of Maritime Law and Commerce* 100.

⁵¹ Schneider 1978 *International Business Lawyer* 304, 309.

⁵² Deane 1992 *Asia Pacific Law Review* 88.

⁵³ Thai 2006 *Journal of Banking and Finance Law and Practice* 17.

⁵⁴ CFI Team 2020 <https://corporatefinanceinstitute.com/resources/knowledge/other/comfort-letter>.

⁵⁵ ACT 2013 <https://www.treasurers.org/ACTmedia/loc.pdf> 9.

⁵⁶ Lipton 1999 *Western Australian Law Review* 151.

⁵⁷ *Kleinwort Benson Ltd v Malaysia Mining Corporation Berhad* 1989 1 All ER 785.

⁵⁸ ACT 2013 <https://www.treasurers.org/ACTmedia/loc.pdf> 9.

⁵⁹ Scott 1994 *Journal of Banking and Finance Law and Practice* 197.

However, from the lender's perspective,⁶⁰ the reasons for accepting the letter of comfort is to ensure that, even though a formal guarantee has not been offered,⁶¹ a commitment is in place on the part of the borrower that the loan will be paid back.⁶² Failure to back the debt by the subsidiary might tarnish reputational image of both the subsidiary and the holding company as well as damage the long-standing relationship between the holding company and the creditor.⁶³ Notwithstanding the facts above, most of the LOCs carry a disclaimer⁶⁴ to the effect that the holding company is in effect only providing an opinion that should not be construed to mean a fiducial duty, obligation or liability to the recipient on behalf of its subsidiary.⁶⁵

1.2 Research problem

It has been reported in the past how a holding company could "unconscionably abuse"⁶⁶ and manipulate the use of LOCs⁶⁷ with little regard to the independence⁶⁸ and operational needs of its subsidiary.⁶⁹ In most of these situations, the subsidiary company in this parent-subsiary-lender trinity contractual arrangement⁷⁰ has neither power to influence content couched in an LOC,⁷¹ nor control on how the debt secured through the contractual loan arrangements would be utilised.⁷²

⁶⁰ Thai 2000 *Current Commercial Law* 2.

⁶¹ ACT 2013 <https://www.treasurers.org/ACTmedia/loc.pdf> 34.

⁶² Tsu 2007 *L & Bus Rev Americas* 168.

⁶³ Thai 2006 *Journal of Banking and Finance Law and Practice* 17.

⁶⁴ Trichardt Letters of Comfort 63.

⁶⁵ Radesich and Trichardt 1988 *De Rebus* 797.

⁶⁶ Section 20(9) of the *Companies Act* 71 of 2008. Section 20(9) is silent on which conduct constitutes an "unconscionable abuse", thus rendering this term open to the interpretation of the courts. In terms of section 1, read with section 40, of the *Consumer Protection Act* 68 of 2008, "unconscionable conduct" is unethical conduct to a conscience of a reasonable person.

⁶⁷ Mashiri A *Critical Analysis of the Piercing of the Corporate Veil* 45,52; Anderson 2012 *Australian Accounting Review* 132.

⁶⁸ Berle 1928 *Harvard Law Review* 875.

⁶⁹ *Van Zyl NO and Another v Kaye NO and Others* 2014 4 SA 452 (WCC) paras 18 and 33; Pratt 1991 *Connecticut Journal of International Law* 314.

⁷⁰ DiMatteo and Sacasas 1995 *Baylor Law Review* 366.

⁷¹ DiMatteo and Sacasas 1995 *Baylor Law Review* 366.

⁷² Berle 1928 *Harvard Law Review* 882; Matheson 2009 *North Carolina Law Review* 1101, 1103-1104.

The legal nature, status and effect of LOCs remain unclear both in international jurisprudence⁷³ and our domestic law.⁷⁴ Coupled to this, there has been, notably, a general lack of legislation, case law, journal articles and academic books that analyse the legal status of LOCs in South Africa and elsewhere.^{75,76} The promissory nature of LOCs are, in most cases, determined by the courts when contractual disputes, facilitated through the LOCs, arise. According to DiMatteo and Sacasas, the challenge with LOCs seem to reside between the doctrine of inchoate expectations⁷⁷ and legally enforceable reliance.⁷⁸ The reason for this "shadow of judicial non-enforcement",⁷⁹ is that LOCs are carefully and deliberately inscribed in vague juridical⁸⁰ and non-committal terms⁸¹ so as to afford the depositor (of such a letter) an opportunity to escape legal liability should it arise.⁸² The ambiguities of terms used in the LOCs,⁸³ could predispose the recipient to "misrepresent" the actual intended facts of the issuer of an LOC.^{84,85} Previously reported cases,⁸⁶ some which are discussed in this research, necessitated courts to refer to law of contract to arrive at decisions.⁸⁷ This meant the aggrieved party had fewer rights of remedial recourse to claim redress through traditional legal proceedings since LOCs are not recognised as "fully-fledged" types of contractual undertaking.⁸⁸ This remains one

⁷³ Pugh-Thomas 1990 *Journal of International Banking Law* 340, 344.

⁷⁴ Radesich and Trichardt 1988 *De Rebus* 796.

⁷⁵ Lötter *Delictual Liability of a Bank* 12. See also *Holtzhausen v ABSA Bank Ltd* 2008 5 SA 630 (SCA) para 6 and 9.

⁷⁶ Radesich and Trichardt 1988 *De Rebus* 796.

⁷⁷ Nedzel 1997 *Tulane European and Civil Law Forum* 133.

⁷⁸ DiMatteo and Sacasas 1995 *Baylor Law Review* 365.

⁷⁹ Trichardt 2005 *Company Lawyer* 54.

⁸⁰ Schollen 1994 *International Business Law Journal* 793.

⁸¹ Gibbens 1989 *Banking and Finance Law Review* 222; *Kleinwort Benson Ltd v Malaysia Mining Corporation Berhad* 1989 1 All ER 785 at 803.

⁸² McKendrick *Contract Law* 131, 579.

⁸³ Avgitidis *The Liability of the Parent Company* 96.

⁸⁴ Nedzel 1997 *Tulane European & Civil Law Forum* 107.

⁸⁵ Stevens 2013 *Stell LR* 98-102.

⁸⁶ *Holtzhausen v ABSA Bank Ltd* 2008 5 SA 630 (SCA); *Bernert v ABSA Bank Limited* 14302/03 2008 ZAGPHC 337.

⁸⁷ *ABSA Bank Limited v Bernert* 99/09 2010 ZASCA paras 73-76.

⁸⁸ Potgieter, Steynberg and Floyd *Law of Damages* 202, 265, 428.

of the serious drawbacks of LOCs,⁸⁹ especially since these letters are regarded as inequivalent of guarantee, surety or pledge.⁹⁰

The main research problem is: why should a holding company issue a "moral" letter to a creditor in order to influence a business transaction that is binding under law, whilst its conduct should escape legal scrutiny as well as not attach financial liability to the creditor if the transaction goes wrong? What is the value of comfort letters therefore in facilitating business transactions? This is the crux of the matter under this research.

1.3 Motivation

The motivation of this research work is two-fold: firstly, to investigate challenges faced under the South African legal system in determining the legal status, nature, scope, efficacy and validity of the LOCs. Secondly, to identify regulatory gaps in the South African legal framework in order to deal effectively with disputes arising out of LOCs. The research also assesses the congruency or consistency of the South African legal system against the internationally adopted approaches with respect to LOCs, while also taking cognisance of the fact that the jurisprudence of South Africa differs from those of other countries due to its unique material conditions centred on its historic development, socio-economic structure, political landscape and the legal system.

1.4 Research question

The research question is: What is the legal status of letters of comfort? To address this question, the research will interrogate the following key factors, which are intricately linked to LOCs: (a) the legal validity or nature of the LOCs,⁹¹ (b) the extent to which the LOCs could be legally enforceable under domestic law, foreign

⁸⁹ Avgitidis *The Liability of the Parent Company* 96.

⁹⁰ Lipton 1999 *Western Australian Law Review* 139.

⁹¹ *Kleinwort Benson Ltd v Malaysia Mining Corporation Berhad* 1989 1 All ER 785; Fisher 1988 *Journal of International Banking Law* 217.

law or international law;^{92,93} (c) the approaches that courts could adopt in interpreting LOCs;⁹⁴ (d) the implication of the *consensus ad idem* between the parties;⁹⁵ and (e) the notional reliance in LOCs under "gentleman's agreement" between the contracting parties.⁹⁶ In other words, the research is interested in the legal basis upon which LOCs are grounded.

1.5 Research methodology

Qualitative research will be followed in this study. Only secondary sources of data will be analysed, such as Acts of Parliament, textbooks, reported case law, academic articles published in journals, government publications, electronic sources and other scientifically reliable information. The scope of investigation will be limited to laws governing the financial sector in South Africa with respect to LOCs. A limited comparison to other jurisdictions will be carried out, not to transpose developments in other jurisdictions but to evaluate the extent of use of LOCs in the South Africa legal system in relation to developments in other jurisprudences. A quantitative approach to test the validity of the analysed information will be excluded. It is assumed that there are no legal proceedings currently underway to develop, scrap, amend the use, or strengthen any available instrument pertaining to LOCs.

1.6 Framework of the study

The research structure to be followed is summarised in Figure 1-1.

1.7 Relevance of the research unit

⁹² Wittuhn 1990 *McGill Law Journal* 491, 501.

⁹³ DiMatteo 1997 *Yale Journal of International Law* 139.

⁹⁴ *Banque Brussels Lambert SA v Australian National Industries Ltd* 1989 21 NSWLR at 523.

⁹⁵ *consensus ad idem* rests on three elements" (a) the parties had the will to bind themselves. (b) parties had an intention to create, either in writing or orally, a declaration of intent that communicates this willingness to commit. (c) The parties had been conscious of the fact that their minds have met. If these three elements are met, then parties had the will to bind themselves. See also Furmston *Law of Contract* 41; Scott et al *The Law of Commerce in South Africa* 68.

⁹⁶ Bernstein and Zekoll 1998 *American Journal of Comparative Law Supplement* 87.

The study might not contribute to the body of knowledge currently available on the use and application of LOCs but may initiate a legal review on the use of these letters in order to give certainty around their enforceability, especially in situations where contractual breaches and other patrimonial losses had occurred against the aggrieved party in the contractual agreement. This study explores the legal status of letters of comfort in South Africa. The mini dissertation falls under the overall research unit themes: law, justice and sustainability as well as finance, trade and innovation.

1.8 Ethical requirements

Ethics statement: this research does not deal with issues of human behaviour or animals. It does not require ethics clearance.

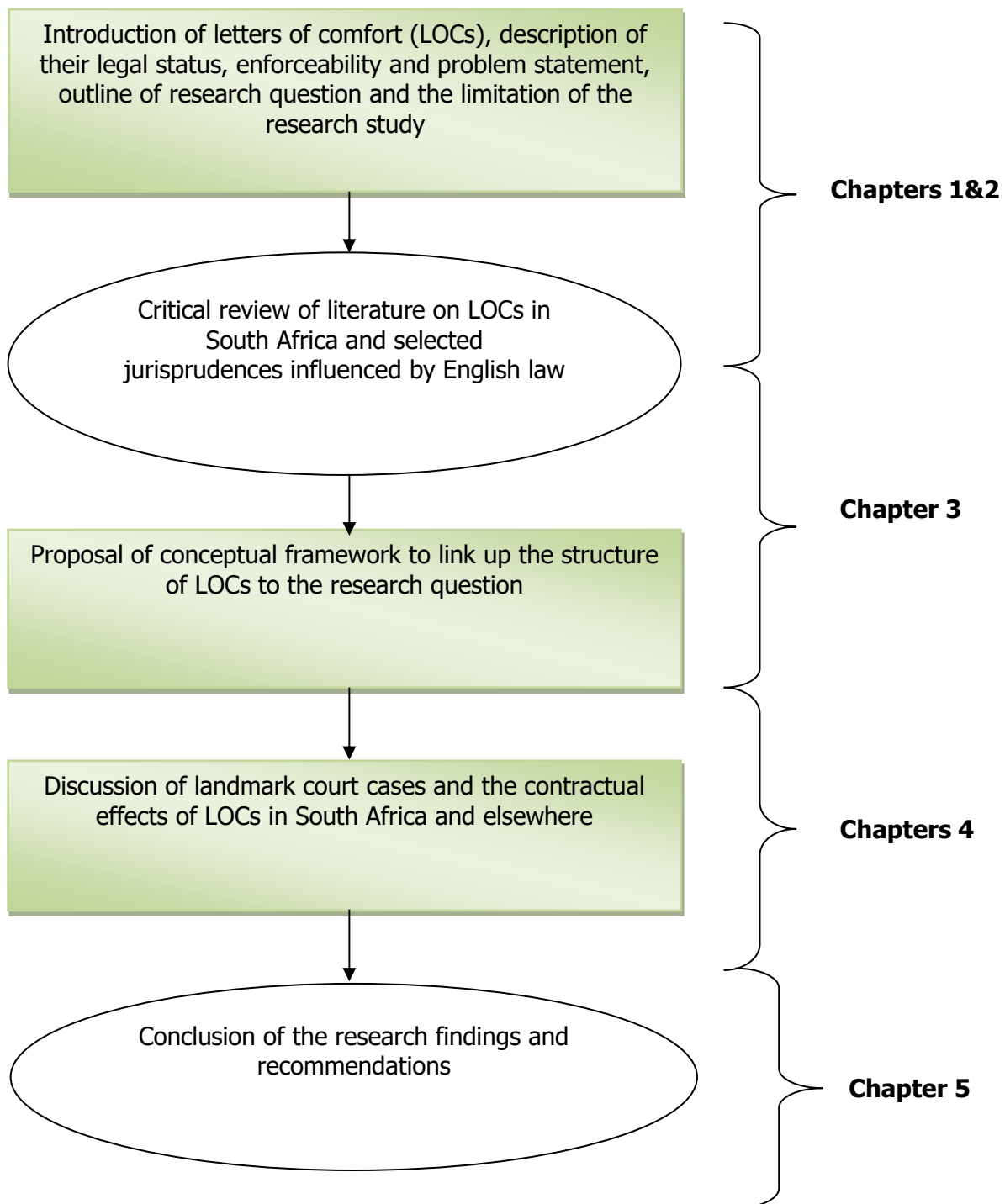


Figure 1-1: Outline of research report and overview of the chapters.

Chapter 2: The legal nature of letters of comfort in context

2.1 Introduction

The legal status of LOCs is one of the contentious⁹⁷ and topical issues in the financial sector.⁹⁸ The main issues centre on the legal status, nature and moral relationship that these letters purport to establish between contractual parties.⁹⁹ The language used, textual interpretation made as well as reasons behind the issuance of LOCs appear to be the most determinant factors in establishing their legal standing.¹⁰⁰ As stated in chapter 1, LOCs do not follow any prescriptive format, structure¹⁰¹, form,¹⁰² pattern,¹⁰³ standard¹⁰⁴ and/or terms.¹⁰⁵ LOCs are written in a non-committal way and carry statements such as: (a) The parent company has noted and fully supports the financial agreement entered into by its subsidiary with the lender,¹⁰⁶ and this transaction will not dilute or decrease the shareholding capacity of the holding company in its subsidiary;^{107,108} (b) It is part of the holding company's business policy to assure that its subsidiary would not default in its obligations during the subsistence of the loan agreement,¹⁰⁹ (c) The parent company will continue to exert its full influence on its subsidiary to ensure that the subsidiary honours its obligation towards the repayment of loan;¹¹⁰ and (d) The parent company has confidence in its subsidiary that it will honour the loan arrangements as and when they become due.¹¹¹

As pointed out in Chapter 1 section 1.2, a holding company can "unconscionable abuse" its subsidiary in a number of ways, such as exercising excessive control over

⁹⁷ Scott 1994 *Journal of Banking and Finance Law and Practice* 197.

⁹⁸ Act 2013 <https://www.treasurers.org/ACTmedia/loc.pdf>.

⁹⁹ McBain 1986 *International Banking Law* 69.

¹⁰⁰ Tsu 2007 *L & Bus Rev Americas* 172.

¹⁰¹ Thai 2006 *Journal of Banking and Finance Law and Practice* 16.

¹⁰² Ehrlicke 1994 *Journal of International Banking Law* 343.

¹⁰³ Radesich and Trichardt 1988 *De Rebus* 796.

¹⁰⁴ Gruzman and Sutherland 2004 *International Financial Law Review* 45.

¹⁰⁵ Reinstein, Bayou and Luecke 2001 *Commercial Lending Review* 62.

¹⁰⁶ McBain 1986 *International Banking Law* 70.

¹⁰⁷ See section 4.7.2; Ellinger 1991 *Singapore Journal of Legal Studies* 3;

¹⁰⁸ Scott 1994 *Journal of Banking and Finance Law and Practice* 199.

¹⁰⁹ McKendrick *Commercial Law* 117-118, 890.

¹¹⁰ Sacasas 1989 *Banking Law Journal* 180.

¹¹¹ *Banque Brussels Lambert SA v Australian National Industries Ltd* 1989 21 NSWLR 502 at 504.

the financial affairs of its subsidiary to the point of determining how loans would be expended to the benefit of the parent company.¹¹² In some cases, a parent company can establish a subsidiary for the sole purpose of committing fraud against the creditors or to conduct some illegitimate acts.¹¹³ The study will not focus on the fraudulent use of LOCs but on LOCs legal status and the content inscribed therein.

The nature and obligations attached to LOCs are critically analysed in various countries that use them in their daily financial transactions. In particular, the analysis will focus on the use of LOCs in South Africa, Australia, the United Kingdom, and Canada. The above countries have been selected since they share similar legal systems to South Africa. A brief description will be provided for those countries outside these Anglo-common law jurisdictions to highlight the commercial use and their legal perceptions on LOCs.

2.2 Letters of comfort in the South African legal system

In South Africa, the *Bills of Exchange Act*¹¹⁴ is one of the instruments that regulates the payment of credit and investment, including bills of exchange, cheques and promissory notes. The *Bills of Exchange Act* has its origin in the English law referred to as the *Bills of Exchange Act 1882*.¹¹⁵ The *Banks Act*¹¹⁶ governs the use of letters of credit, as part of guarantees, but such regulations do not cover LOCs. On the other hand, the objectives of the *Financial Sector Regulation Act (FSR Act)*,¹¹⁷ are to provide a regulatory framework to promote (a) safe and sound financial stability in the markets; (b) protect financial customers; (c) establish efficiency and integral financial system; as well as (d) to prevent and combat financial crimes.¹¹⁸ FSR Act does not make provisions to regulate commercial transactions involving LOCs.

¹¹² Matheson 2009 *North Carolina Law Review* 1103.

¹¹³ Hadden 1992 *University of New South Wales Law Journal* 69.

¹¹⁴ *Bills of Exchange Act* 34 of 1964.

¹¹⁵ *Bills of Exchange Act* 1882.

¹¹⁶ See Regulations 19 of the *Banks Act* 94 of 1990.

¹¹⁷ *Financial Service Act* 9 of 2017 (FSR Act).

¹¹⁸ Section 7 of *FSR Act*.

Due to the absence of a case directly dealing with LOCs in the South African commercial context, the researcher investigated caselaw where parties place reliance on contractual terms that include exemption clauses.

In the case of *Philotex (Pty) Ltd v Snyman*,¹¹⁹ the managing director of Rentmeester Versekeraars Bpk was prepared to issue an LOC to financiers recording certain undertakings of providing information and overseeing management and reinstructing that it is group policy to enable its subsidiary companies to meet their commitments and obligations. The court did not rule on the LOC per se, but on the representations made by directors of the holding company about an insolvent subsidiary. The court ruled that the behaviour of the board of directors amounted to dereliction of fiduciary duty since the board already knew the risky financial standing of the subsidiary of the company, but had failed to inform the other contractual party of the fact, prior to the conclusion of a debt agreement.¹²⁰ According to the *Companies Act*,¹²¹ the directors of a company have a duty of care, skill and diligence for its proper functioning,¹²² especially against reckless or fraudulent trading.¹²³ The roles and functions of a board of directors, whether in executive or non-executive positions, have been outlined and clarified in *inter alia* the case of *Fisheries v Jorgensen*.¹²⁴

In the case of *Bernert v Absa Bank Ltd*,¹²⁵ the High Court ruled in favour of the plaintiff. However, the Supreme Court of Appeal (SCA) set aside this decision, which in effect rendered the contract, which was grounded on a guarantee letter as non-binding. Subsequently, the decision of the SCA was confirmed by the Constitutional Court. However, the court did not directly rule on the nature and legal status of the

¹¹⁹ *Philotex (Pty) Ltd and Others v J R Snyman and Others* 1998 2 SA 138 (SCA) paras 130, 131, 135.

¹²⁰ Stevens 2013 *Stellenbosch Law Review* 95 104-105.

¹²¹ *Companies Act* 71 of 2008, see section 76(3) and section 77(2).

¹²² *Companies Act* 71 of 2008, see section 76 and section 77; Kanamugire and Chimuka 2014 *Mediterranean Journal of Social Sciences* 71.

¹²³ Section 424(1) of the *Companies Act* 61 of 1973. See also section 77(3)(b) and 22(1) of *Companies Act* 71 of 2008.

¹²⁴ *Fisheries Development Corporation of South Africa Ltd v Jorgensen* 1980 4 SA 156 (W) para 156.

¹²⁵ *Bernert v ABSA Bank Limited* (14302/03) 2008 ZAGPHC 337 para 4.

letter of guarantee. The contractual consequences of this seminal court case are discussed in depth in chapter 4 since the case encapsulates the overall perspective of LOCs in South Africa and how the courts might consider them in future. Interestingly, there is usually a clause inscribed in most LOCs which reads as "notwithstanding anything contained herein, this is not to be construed as a legally binding obligation".¹²⁶ Due to dearth of authority on LOCs in South African law, Radesich and Trichardt warn that auditors and lawyers need to render advice about LOCs with hesitation¹²⁷ and to take a cautious approach¹²⁸ when drafting these letters, as they may be interpreted by courts to be binding legal instruments.¹²⁹

2.3 Letters of comfort in the English legal system

Under the United Kingdom Company Law,¹³⁰ the parent company does not inherit liabilities of its subsidiary,¹³¹ unless fraudulent or wrongful trading can be established on the part of the holding company in that commercial transaction.¹³² The English courts largely accept LOCs as non-binding instruments,¹³³ placing emphasis on the textual interpretation contained therein.¹³⁴ This principle has been applied in previous cases such as *Rose & Frank v Crompton*¹³⁵ and *Balfour v Balfour*.¹³⁶ In the *Rose & Frank v Crompton case*, the defendant (Crompton), which was an American company, had a running yearly contract with the English company, Rose and Frank, for the manufacturing of carbonizing tissue paper. However, the defendant was unhappy about the business conducted by the plaintiff in America and summarily withdrew from the arrangements despite an LOC signed by the parties after lengthy negotiations.¹³⁷ The court ruled that, under the British common

¹²⁶ <https://www.treasurers.org/ACTmedia/loc.pdf> 38.

¹²⁷ Neuville 2014 *International Financial Law Review* 36.

¹²⁸ Scott 1994 *Journal of Banking and Finance Law and Practice* 202.

¹²⁹ Radesich and Trichardt 1994 *South African Mercantile Law Journal* 364.

¹³⁰ Lingard 1986 *International Financial Review* 36, 38.

¹³¹ Prentice 1999 *Connecticut Journal of International Law* 324.

¹³² Forte 1990 *Journal of Maritime Law and Commerce* 99.

¹³³ Elland-Goldsmith 1994 *International Business Law Journal* 530.

¹³⁴ *Edwards v Skyways* 1969 1 WLR 349.

¹³⁵ *Rose & Frank Co v JR Crompton & Bros. Ltd.* 17 1923 2 KB 261.

¹³⁶ *Balfour v Balfour* 1919 2 KB 571 (discussed in Forte 1990 *Journal of Maritime Law and Commerce* 104).

¹³⁷ K.P.P. 1925 *The Cambridge Law Journal* 220.

law,¹³⁸ this LOC¹³⁹ that had been signed by all the parties was simply a "contract" binding only in honour, and the loss of honour did not serve as a basis for a contractual liability.¹⁴⁰ In the *Balfour v Balfour* case,¹⁴¹ the husband reached a domestic or social arrangement with the wife in which he undertook to send her £30 per month for allowance and upkeep.¹⁴² The arrangement fell through and the wife decided to sue on the grounds of breach of contractual agreement between the parties.¹⁴³ The court dismissed the claim that it is a common expectation that family members make promises to each other with no intention of creating legally binding relations.¹⁴⁴ However, in the case of separation or divorce proceedings,¹⁴⁵ the court has discretion to enforce those arrangements.¹⁴⁶ It stands to reason that in South Africa family law and arrangements in that sphere are regulated with specific legislation other than the commercial legislation referred to above.

Under the British law, for LOCs to be promissory in nature, the principles of contract need to be met,¹⁴⁷ including existence of consideration to be furnished by the issuer of the LOC, intention of parties to create legal relations, performance and obligations as well as precise use of language to show commitment by both parties. LOCs issued after the loan facilities had come into existence do not form part of the contractual undertaking or replace the earlier legally binding relations.¹⁴⁸

The seminal case in the English courts is the matter involving *Kleinwort Benson Ltd v Malaysia Mining Corporation Berhad*.¹⁴⁹ In this case, the holding company, Malaysia Mining Corporation Berhad (MMC), issued two LOCs to Kleinwort Benson Ltd (KB) to solicit KB to grant credit loan facilities to its subsidiary company,

¹³⁸ Schmidt 2002 *International Business Law Journal* 261.

¹³⁹ K.P.P. 1925 *The Cambridge Law Journal* 220.

¹⁴⁰ DiMatteo *International Business Law* 343.

¹⁴¹ *Balfour v Balfour* 1919 2 KB 571.

¹⁴² Allen 2000 *Anglo-American Law Review* 209.

¹⁴³ Furmston *Law of Contract* 150.

¹⁴⁴ McKendrick *Contract Law* 270-273.

¹⁴⁵ McKendrick *Contract Law* 274.

¹⁴⁶ *Merritt v Merritt* 1970 2 ALL ER 760.

¹⁴⁷ Elland-Goldsmith 1994 *International Business Law Journal* 529.

¹⁴⁸ Elland-Goldsmith 1994 *International Business Law Journal* 530.

¹⁴⁹ *Kleinwort Benson Ltd v Malaysia Mining Corporation Berhad* 1989 1 All ER 785.

Malaysian Mining Corporation Metals Ltd (Metals), to the amount of £10m.¹⁵⁰ However, MMC made it explicitly clear to KB that these LOCs did not constitute a guarantee in any manner or form.¹⁵¹ After a few years of utilising the revolving credit facilities granted by KB, Metals went into liquidation when the metal industry collapsed and was unable to meet its loan obligations.¹⁵² KB approached MMC to pay out the outstanding loan debt accrued under Metals. MMC declined, and the matter was taken to court for adjudication. The High Court ruled in favour of KB on the basis that LOCs issued by MMC were contractual in nature, but the judgement was set aside on appeal. The *Kleinwort Benson Ltd v Malaysia Mining Corporation Berhad* case, because of its importance in respect to LOCs, is discussed in detail in chapter 4.

In summary, it appears that the English law still regards LOCs as a "gentleman agreement"¹⁵³ with no legal status and effect. This, in turn, has resulted with the banks requesting guarantees prior to approval of financial loans, whether such commitment is carried out in LOCs or specified otherwise.¹⁵⁴ However, the situation around LOCs has fallen into a realm of uncertainty in England due to "Brexit" negotiations¹⁵⁵ and the re-arrangement of commercial affairs in the aftermath of Brexit.

2.4 Letters of comfort in the Australian legal system

Four major court cases that refer to LOCs have been handed down in Australia in recent years.^{156,157} The cases involved the following parties: *Commonwealth Bank of Australia v TLI Management Pty Ltd*,¹⁵⁸ *Banque Brussels Lambert SA v Australian*

¹⁵⁰ *Kleinwort Benson Ltd v Malaysia Mining Corporation Berhad* 1989 1 All ER 785.

¹⁵¹ *Kleinwort Benson Ltd v Malaysia Mining Corporation Berhad* 1989 1 All ER 785. See also Shawn 2011 *Mondaq* <https://www.mondaq.com/canada/capital-adequacybasel/158494/how-comforting-is-a-comfort-letter>.

¹⁵² Elland-Goldsmith 1994 *International Business Law Journal* 535.

¹⁵³ Bamford 2016 *Journal of International Banking Law and Regulation* 112.

¹⁵⁴ Deane 1992 *Asia Pacific Law Review* 88-94.

¹⁵⁵ Soltesz 2016 *Competition Law and Policy Debate* 4.

¹⁵⁶ Thai 2000 *Current Commercial Law* 4.

¹⁵⁷ Gruzman and Sutherland 2004 *International Financial Law Review* 45.

¹⁵⁸ *Commonwealth Bank of Australia v TLI Management Pty Ltd* 1990 VR 510.

National Industries,¹⁵⁹ *Australian European Finance Corporation Ltd v Sheahan*¹⁶⁰ and *Gate Gourmet Australia (in Liquidation) v Gate Gourmet Holding*.¹⁶¹ Of these cases, the *Banque Brussels Lambert v Australian National Industries* is regarded to be the most important, since it broadened the scope of LOCs in ruling that these letters were legally enforceable instruments.¹⁶² A brief discussion of these cases is provided.

In *Commonwealth Bank of Australia v TLI Management Pty Ltd*,¹⁶³ the court had to deal with the promissory nature of an LOC. In this case, TLI Management Pty Ltd (TLI) signed an LOC to the Commonwealth Bank of Australia (CBA), in which TLI confirmed to CBA a temporary grant of a loan facility to one company called Hovertravel Australia Pty Ltd (Hovertravel), which TLI had the intention to take over in the near future. An LOC was drafted by CBA on behalf of TLI after Hovertravel wanted to exceed its loan credit facility of \$A125 000 and CBA had refused to extend it. Based on the commitment made by TLI both orally and in writing, CBA made available the loan amount of about \$A250 000 to Hovertravel. An LOC signed by TLI reads as follows:¹⁶⁴

We [TLI] hereby acknowledge that Commonwealth Bank of Australia (CBA) has agreed to make temporary credit facilities totalling \$A2500 000 available to [Hovertravel]...We confirm that the company will complete takeover arrangements (subject to shareholders' approval) of Hovertravel as soon as legally possible. These arrangements include the injection of sufficient capital to repay the temporary facilities as mentioned above ... within 30 days of this date.

TLI only introduced the words "subject to shareholders' approval" in an LOC drafted by CBA. However, pursuant to utilisation of the extended loan facility, Hovertravel encountered further financial difficulties and the planned takeover arrangements fell through. CBA subsequently instituted legal proceedings against TLI to make good the promise. The court had to decide whether an LOC constituted a contractual promise or a guarantee by TLI to repay the debt of Hovertravel to CBA. The court

¹⁵⁹ *Banque Brussels Lambert SA v Australian National Industries* 1989 21 NSWLR 502.

¹⁶⁰ *Australian European Finance Corporation Ltd v Sheahan* 1993 60 SASR 187.

¹⁶¹ *Gate Gourmet Australia (in Liquidation) v Gate Gourmet Holding AG 6-Ors* 2004 1 NSWSC 149.

¹⁶² Thai 2000 *Current Commercial Law* 4.

¹⁶³ *Commonwealth Bank of Australia v TLI Management Pty Ltd* 1990 VR 510.

¹⁶⁴ *Commonwealth Bank of Australia v TLI Management Pty Ltd* 1990 VR 510 para 512.

applied a literal interpretation of this LOC to determine whether it amounted to a promissory undertaking that was legally enforceable.¹⁶⁵ The court had to consider phrases such as "we confirm that the company will" and ruled that this statement was non-promissory in nature and only reflected on the TLI intentions. The court questioned that which constituted a breach in contractual undertaking on the basis of statements such as "takeover arrangements", "as soon as legally possible" and "injecting sufficient capital". The court ruled that an LOC was non-promissory in character and the CBA claim was dismissed.

In the *Gate Gourmet* case,¹⁶⁶ the subsidiary company, Gate Gourmet Australia, instituted legal proceedings against its holding company, Gate Gourmet Holdings (Pty) Limited, to avoid falling foul of prescribed trading provisions of the *Corporation Act*.¹⁶⁷ Gate Gourmet Australia was registered as a trading arm of the Swiss Air Group to run airline catering services under Gate Gourmet Holdings (Pty) Ltd. In December of 2000, Gate Gourmet Australia became technically insolvent prompting auditors of Gate Gourmet Holdings (Pty) Limited to solicit the Swiss parent company to provide an LOC that would assure that Gate Gourmet Australia was not conducting business affairs while insolvent. An LOC was duly issued by the parent company on 16 February 2001. However, a few months thereafter, Gate Gourmet Australia fell into administration and was thereafter finally liquidated. The liquidator instituted court proceedings against Gate Gourmet Holdings (Pty) Ltd to enforce the LOC. The letter of comfort stated that:¹⁶⁸

Gate Gourmet Holdings AG will provide financial support that may be necessary to enable Gate Gourmet Holdings (Pty) Ltd and its controlled entities to meet its financial commitments as and when they fall due.

¹⁶⁵ *Commonwealth Bank of Australia v TLI Management Pty Ltd* 1990 VR 510 para 514; See also Thai 2000 *Current Commercial Law* 4.

¹⁶⁶ *Gate Gourmet Australia (in Liquidation) v Gate Gourmet Holding AG 6-Ors* 2004 1 NSWSC 149.

¹⁶⁷ See section 588FC of *Corporations Act* 2001 (Commonwealth Consolidated Acts). It outlines what constitutes an insolvent transaction under Australian Law. Insolvent trading arises when a parent company becomes aware or suspects, on reasonable grounds, that its subsidiary is conducting business while insolvent at the predicament of creditors.

¹⁶⁸ *Gate Gourmet Australia (in Liquidation) v Gate Gourmet Holding AG 6-Ors* 2004 1 NSWSC 149 para 91.

The main question therefore was this: did the letter of support (or comfort) constitute a "guarantee" in the situation? The court ruled that an LOC was promissory in character.¹⁶⁹ An LOC was in effect a commercial contract.¹⁷⁰ According to the court, the parties had intended to create a legally binding arrangement and the onus of rebuttal lied with the Swiss parent.¹⁷¹ The latter failed to discharge itself from liability. The court decisions were consistent with the earlier findings in *Banque Lambert SA v Australian National Industries* case.¹⁷²

The main issue in *Banque Brussels Lambert* case was whether an LOC amounted to a contractually binding undertaking breached by Australian National Industries Ltd when it did not give the plaintiff the required 90-day notice of sale as well as when it failed to ensure that its subsidiary would meet its financial obligation. This amounts to a major shift when compared to the outcomes of previous cases such as *Sheahan* case¹⁷³ (discussed extensively in Trichardt)¹⁷⁴ on the non-binding nature of LOCs,¹⁷⁵ and the shift was based on a textual approach followed by the courts. These cases took away the "twilight sphere around the commercial morality generated by letters of comfort" in Australia.^{176,177}

It therefore appears that the Australian courts are continually blurring the distinction between LOCs and guarantees.¹⁷⁸ The Australian legal system is steadily moving towards holding corporates accountable on LOCs issued on behalf of their subsidiaries,^{179,180} irrespective of the ambiguities associated with these letters or the non-intended purposes of creating legally non-binding obligations.¹⁸¹ The

¹⁶⁹ ACT 2013 <https://www.treasurers.org/ACTmedia/loc.pdf> 35.

¹⁷⁰ *Edwards v Skyways Limited* 1964 1 WLR 349.

¹⁷¹ *Gate Gourmet Australia (in Liquidation) v Gate Gourmet Holding AG 6-Ors* 2004 1 NSWSC 149 para 4. See also Thai 2006 *Journal of Banking and Finance Law and Practice* 28.

¹⁷² *Banque Brussels Lambert SA v Australian National Industries Ltd* 1989 21 NSWLR 502.

¹⁷³ *Australian European Finance Corporation Ltd v Sheahan* 1993 60 SASR 187.

¹⁷⁴ Trichardt *Letters of comfort* 273-286.

¹⁷⁵ Ehrlicke 1994 *Journal of International Banking* 342.

¹⁷⁶ Bergin 2015 http://www.supremecourt.justice.nsw.gov.au/Documents/Publications/Speeches/2015%20Speeches/Bergin_20150731.pdf 14.

¹⁷⁷ Gruzman and Sutherland *International Financial Law Review* 45.

¹⁷⁸ *Banque Brussels Lambert SA v Australian National Industries Ltd* 1989 21 NSWLR 502 at 523.

¹⁷⁹ Radesich and Trichardt 1994 *South African Mercantile Law Journal* 363.

¹⁸⁰ Gruzman and Sutherland 2004 *International Financial Law Review* 46.

¹⁸¹ *Banque Brussels Lambert SA v Australian National Industries Ltd* 1989 21 NSWLR 502 at 523

contractual effects of the *Banque Lambert SA v Australian National Industries* and other major court cases in Australia are unpacked in chapter 4.

2.5 Letters of comfort in the Canadian legal system

The *Toronto Dominion Bank v Leigh Instruments*¹⁸² case is the main referral when it comes to LOCs in Canada. The main submission here was the failure of the subsidiary to honour loan arrangements obtained through a series of LOCs by the parent company (Plessy Company Ltd), which was also taken over through a hostile bid by GEC Siemens plc.¹⁸³ The court found, after lengthy legal battle, that the LOCs were non-binding and thus not legally enforceable.¹⁸⁴

The appeal against the decision of the court *a quo* was soundly rejected by the Ontario Court of Appeal, including the refusal to grant leave of appeal against its decision to the Supreme Court of Canada.¹⁸⁵ Canadian courts have repeatedly ruled against the binding and contractually enforceable nature of LOCs.¹⁸⁶ Like the English courts, liability could be found on the premise of negligent or fraudulent misrepresentation.^{187,188}

2.6 Brief view of LOCs in other countries

A brief review of other countries not earmarked for this study provides one or two interesting nuances of the analysis made above. The legal nature of LOCs remains uncertain in some countries, including Denmark¹⁸⁹ and Germany¹⁹⁰, while it is promissory in nature and legally binding in others, such as France,^{191,192} and are

¹⁸² *Toronto Dominion Bank v Leigh Instruments* 1998 40 BLR 2d 1.

¹⁸³ Goodman 1999 *Banking and Finance Law Review* 391.

¹⁸⁴ *Toronto Dominion Bank v Leigh Instruments* 1998 40 BLR 2d 1 part V. According to the court, "Letters of comfort are just that, comfort. They are not guarantees or formal security nor are they enforceable as such"; See also Stephenson 1998 *International Financial Law Review* 8.

¹⁸⁵ *Toronto Dominion Bank v Leigh Instruments* 1998 40 BLR 2d 1.

¹⁸⁶ Stephenson 1998 *International Financial Law Review* 7.

¹⁸⁷ Milman 1986 *Company Lawyer* 245-246.

¹⁸⁸ Cook 1999 *Journal of International Banking Law* N26-28.

¹⁸⁹ Wissum 1987 *International Financial Law Review* 23-25.

¹⁹⁰ Franken 1985 *International Financial Law Review* 14-15.

¹⁹¹ Terray 1982 *International Financial Law Review* 36.

¹⁹² Ellinger 1991 *Singapore Journal of Legal Studies* 5.

completely non-binding legal instruments in others, such as Brazil.¹⁹³ Interestingly, the European Union has started to consider the use of LOCs after a majority of commercial institutions refused to accept them in preference of guarantees.¹⁹⁴

2.7 Conclusion of literature review on letters of comfort.

A limited comparative analysis against an international legal framework in disposition of LOCs has been carried out in this chapter. LOCs, because of their convenience in shielding against corporate risk factors,¹⁹⁵ remain one of the preferred and easy-going financial instruments used widely in commercial transactions.¹⁹⁶ Studies and court rulings reveal that the information contained in the LOCs determine their legal status, validity and enforceability.¹⁹⁷ As the cliché goes, "the devil is in the detail". LOCs, subject to the interpretation of the terms used and intentions of the parties, may be construed to form some form of security or guarantee offered by the parent company. It has been found in careful reading of extant literature, as reported in the present chapter, that the vagueness and the ambiguity in which these letters are crafted could be open to misinterpretation which, in the end, might result in liability.¹⁹⁸ It has been established here that the *Bernert v Absa Bank Ltd*¹⁹⁹ case as well the *Kleinwort Benson* case highlight the importance and understanding of LOCs when facilitating commercial contracts. In both these cases, the legal status of these letters had been found to have no effect and thus unenforceable.

In chapter 2, we only considered the use of LOCs and how courts in various jurisdictions had disposed of them, without examining the merits of these letters. Chapter 3 discusses the types, structure and the design of LOCs, as well as the main features of these letters and Chapter 3 delves more deeper into the conceptual design of LOCs, by examining the do's and don'ts that need to be considered by the

¹⁹³ Tsu 2007 *L & Bus Rev Americas* 170.

¹⁹⁴ Buhart and Henry 2020 *World Competition: Law and Economic Review* 305.

¹⁹⁵ Prentice 1999 *Connecticut Journal of International Law* 309.

¹⁹⁶ ACT 2013 <https://www.treasurers.org/ACTmedia/loc.pdf> 6.

¹⁹⁷ DiMatteo 1997 *Yale Journal of International Law* 115.

¹⁹⁸ Scott 1994 *Journal of Banking and Finance Law and Practice* 199.

¹⁹⁹ *Bernert v ABSA Bank Limited* (14302/03) 2008 ZAGPHC 337 para 4.

drafter of the LOCs. Once the structure of the letters of comfort has been unpacked, the contractual effects of these letters will be analysed more closely in Chapter 4.

Chapter 3: Conceptual model in the drafting of letters of comfort

3.1 Introduction

The present chapter focuses on a conceptual model, the legal constructs and designs of LOCs. The nature and content of letters of comfort are discussed in depth at hand of examples, including those that could attach enforceable legal liabilities to the issuer. As it may be recalled from Chapter 1, LOCs are written in the vaguest way possible by the issuers for several reasons, which include (a) to create avenues to escape legal liability if the agreement collapses, (b) to prevent reputational damage to the company, (c) to cast doubt about exact legal interpretations, meaning and effects of the issued LOC, and (d) to assure the creditor that its subsidiary has a strong backing from the holding company underpinning the conclusion of the contractual agreement. There is no specific format or terms that are universally accepted when it comes to the drafting of LOCs.²⁰⁰ However, the method leading up to the issuance of LOCs appears the same. The process followed in issuing them is summarised in Figure 3-1.

²⁰⁰ Gruzman and Sutherland 2004 *International Financial Law Review* 45.

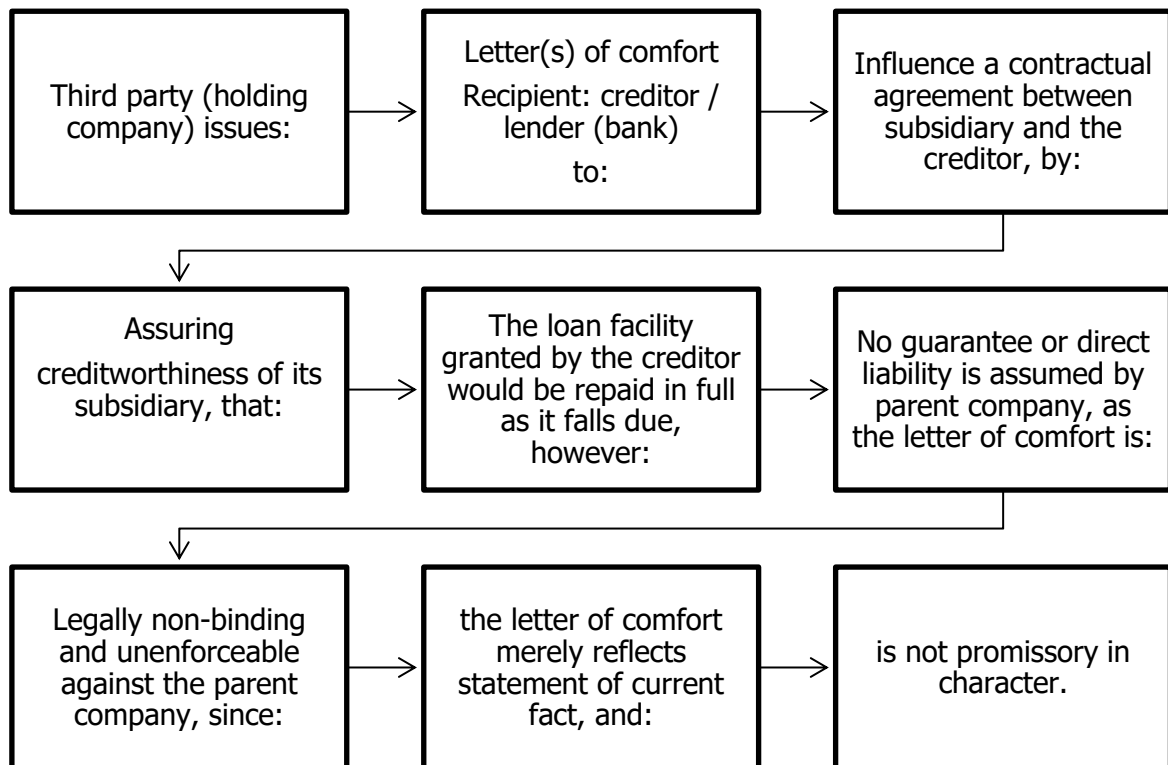


Figure 3-1: Process flow around the issuance of LOCs. Modified from Weststreetmojo.²⁰¹

²⁰¹ Weststreetmojo <https://www.wallstreetmojo.com/letter-of-comfort>.

3.1.1 *Types of LOCs*

There are different types of LOCs in use issued by different stakeholders. The different situations are itemised below.

3.1.1.1 Company's letter of comfort

The present research is mainly focused on the LOCs issued by the holding company. As stated, the holding company may issue an LOC to facilitate a contractual agreement between its subsidiary and the lender (bank), wherein the holding company assures the lender that its subsidiary would meet the loan facility granted by the lender when the obligation became due. Sometimes, the company issues an LOC to assist its subsidiary to raise funds, because its subsidiary is not able to offer security in the form of guarantees to the lender. Guarantees are important to the lender since they get invoked when the subsidiary is to demand payment from the guarantor and the subsidiary company fails to make good on its obligations. The holding company thus prefers to issue an LOC to escape secondary liabilities that could be accrued by its subsidiary, whereas it still wishes its subsidiary to derive benefits from the loan facilities granted by the lender.

3.1.1.2 Bank's letter of comfort

The bank may issue an LOC to a supplier of goods or services to its clients on behalf of its client, whereby it assures the supplier that the client is in a healthy financial position to meet its financial obligations as and when they fall due, and to confirm that the client has access to a short-term financing facility to complete the commercial transaction.²⁰² This letter is simply provided to comfort the supplier that the client was a going concern in the subsequent 12 months in terms of the provisions of the *Companies Act*.²⁰³ However, an LOC does not indicate or offer any affirmation that the client would pay the supplier for goods or services, but only guarantees the stable financial position of its client. Usually, an LOC is accompanied by a signed purchase order or proof of sales agreement. At no point should an LOC

²⁰² Weststreetmojo <https://www.wallstreetmojo.com/letter-of-comfort>.

²⁰³ See section 4 of the *Companies Act* 71 of 2008.

be regarded as substitute for a secondary liability to be assumed by the bank on behalf of its client.

3.1.1.3 Underwriter's letter of comfort

An underwriter could, after carrying out due diligence, issue an LOC to ensure that the information provided in an LOC is accurate, meets the expectations of the parties²⁰⁴ and does not compromise the interest of the recipient.²⁰⁵ The underwriter will ensure that all liabilities that could be incurred, arising out of misstatements or omissions would be avoided.²⁰⁶ In other words, an underwriter must closely assess all the information provided by the third party to establish that that it does not contain material mistakes at the time at which the contractual agreement was concluded.²⁰⁷ This means an LOC issued by the underwriter, on behalf of its client, should carry accurate and relevant information that would assist the courts should any dispute arises during the subsistence of the contractual agreement between the parties. Any false information at the time it is written may give rise to contractual liability on the grounds of deceit or negligent misstatements or misrepresentation.²⁰⁸

3.1.1.4 Accountant's letter of comfort

An accountant may provide an LOC to confirm the financial health, stability and capacity of a client to the lender (bank), in which it assures the lender that the borrower would be able to meet its financial obligations. The accountant may therefore offer updates to the lender on the financial situation of the client if required to do so by law²⁰⁹ or through a standing clause in the LOC.

²⁰⁴ DiMatteo and Sacasas 1995 *Baylor Law Review* 362.

²⁰⁵ Augenbraun 1993 *Business Law Today* 53.

²⁰⁶ Weststreetmojo <https://www.wallstreetmojo.com/letter-of-comfort>.

²⁰⁷ Noland and Hardin 2018 *The Journal of Corporate Accounting & Finance* 81.

²⁰⁸ ACT 2013 <https://www.treasurers.org/ACTmedia/loc.pdf> 14.

²⁰⁹ Reinstein, Bayou and Luecke 2001 *Commercial Lending Review* 63.

3.1.1.5 Governments

A government, through or via its version of National Treasury, could issue an LOC to the lender, usually a public enterprise, that its financial obligations will be duly met in time.

3.2 Conceptual design of letters of comfort

The following information forms the general design basis for LOCs:²¹⁰

3.2.1 Addressee

An address of the particular lender or creditor needs to be specified without adding whom the recipient in the creditor's institution should be. The issuer of an LOC should refrain from reducing it to a personal commitment towards the creditor as this could be considered to be an intention to establish a legal relation with the creditor. In *Paulger v Butland Industries* case,²¹¹ the manager personally assured creditors that his company will meet its financial obligations in due course if it could be given more time to resolve its financial challenges. The court found the manager liable, in his personal capacity, to the company's creditors and was ordered to settle the outstanding debt.

3.2.2 Naming of the subsidiary to use a credit facility

The holding company must clearly specify the name of its subsidiary to whom credit loan facility services will be made available by the creditor. This would limit the liability to the mentioned subsidiary and not extend it to other subsidiaries of the holding company.

3.2.3 Specification of the credit facility services

LOCs must clearly specify the type and form of the loan facility services rendered by the creditor and should be limited to that which the parties had agreed upon.

²¹⁰ ACT 2013 <https://www.treasurers.org/ACTmedia/loc.pdf> 14-16.

²¹¹ *Paulger v Butland Industries Ltd* 1989 3 NZLR 549.

3.2.4 *Statement of awareness*

LOCs must carry a statement of awareness in which the holding company acknowledges the business needs of its subsidiary and states that it would stand by its subsidiary in ensuring that the loan repayments take place as and when they become due.²¹²

3.2.5 *Holding company shareholding capacity in its subsidiary*

The holding company needs to assure the creditor that it would not dilute or abandon its shareholding capacity in its subsidiary during the subsistence of the loan agreement.²¹³ The information should not carry any future commitment or acceptance of the financial liability should the contractual arrangements fall away.

3.2.6 *Insertion of a disclaimer*

The holding company needs to carry a disclaimer in its letter of comfort in which it expressly states that the letter is not intended to create binding legal relations but rather that it is an opinion and a policy of the company that it would ensure that its subsidiary complies with the loan arrangements while in force.

3.2.7 *Information not to be included in the letters of comfort*²¹⁴

The following information needs to be avoided in LOCs:

- (a) A statement of support in which the holding company points out that it is supporting the business venture of its subsidiary.
- (b) Continual assistance of unsecured financial loans to its subsidiary, to keep the subsidiary as a going concern, should not be disclosed to the creditor.
- (c) The holding company should not disclose strategic directives it gives to its subsidiary as this might take away the rights of a subsidiary to operate independently from its holding company. The holding company should not be seen as a "shadow director"²¹⁵ of its subsidiary where responsibilities and internal control measures of the entities are completely blurred.²¹⁶
- (d) The holding company need not disclose other LOCs it had issued to other creditors.

²¹² Deane 1992 *Asia Pacific Law Review* 88-89.

²¹³ Ellinger 1991 *Singapore Journal of Legal Studies* 3.

²¹⁴ ACT 2013 <https://www.treasurers.org/ACTmedia/loc.pdf> 17-20.

²¹⁵ Prentice 1999 *Connecticut Journal of International Law* 326.

²¹⁶ Sacasas and Wiesner 1987 *Banking Law Journal* 335.

3.3 Conclusion

This chapter outlines the design of LOCs and the process involved in the issuance of these letters. The do's and don'ts involved in the preparation of the LOCs have been summarised. The contractual effects, which flow from the do's and don'ts, are discussed in chapter 4.

Chapter 4: Contractual effects of letters of comfort

4.1 Introduction

LOCs seem to have foregrounded the doctrine of trust and *bona fides* (good faith)²¹⁷ around commercial negotiations,²¹⁸ performance and obligation as well as enforcement of contractual arrangements.²¹⁹ LOCs draw their essence, strength and character from the concepts of trust and equitable dealing, which are generally attached to them by contractual parties to the agreement.²²⁰ Courts, in arriving at decisions, accord the relevance and substance of the agreement, as well as on the basis upon which one of parties to the agreement had acted,²²¹ in reliance to the information contained therein,²²² in order to prevent injustice or unjust enrichment.²²³

According to Article 5:102 of the *Principles of European Contract Law*,²²⁴ a contract has to be read with the following understanding: (a) the nature and circumstances in which a contract was finalised (where LOCs could come into play); (b) the parties' conduct pursuant to the conclusion of the agreement; (c) the nature, purpose and object of the agreement; (d) concurrence in the interpretations of clauses; (e) the common meaning attached to interpretation of clauses; (f) procedures; and (g) *bona fide* conducts and equitable dealing. Kam argued that the court is bound to apply the *contra proferentem* rule in reaching its decision when interpreting an LOC.²²⁵ According to the court, the ambiguity around clauses found in LOCs, which were not negotiated prior to conclusion of a contract, should be interpreted against

²¹⁷ Lipton 1999 *Western Australian Law Review* 143.

²¹⁸ Nedzel 1997 *Tulane European & Civil Law Forum* 99.

²¹⁹ Bridge 2005 *New Zealand Business Law Quarterly* 429.

²²⁰ Goode, Kronke and McKendrick *Transnational Commercial Law* 483-484.

²²¹ Perell 2001 *Canadian Business Law Journal* 425-426.

²²² Stevens 2013 *Stell LR* 95, 100.

²²³ DiMatteo and Sacasas 1995 *Baylor Law Review* 403.

²²⁴ SiSu 2007 <https://www.internationalcontracts.net/international-law-documents/Principles-of-European-Contract-Law.pdf>. According to *contra proferentem* rule any ambiguity in written documents is held against the person who drew it up.

²²⁵ Kam 2001 <https://eoasis.rajahtann.com/eOASIS/II/pdf/Letters-Comfort-Morality.pdf>.

the party who inserted them and who seems to rely upon them to escape liability²²⁶. This seems to be the generally accepted position in the Western world which have been strongly influenced by the English legal system.²²⁷

4.2 Letters of comfort in South Africa

The main South African case that involved the use of LOCs is discussed in this section.

4.2.1 *Bernert v ABSA Bank Ltd*²²⁸

4.2.1.1 The facts (at High Court)

The plaintiff, Bernert, was a car mechanic and the sole owner of Rotrax Cars International CC.²²⁹ During about September 1999, the plaintiff entered into a written contractual agreement with a Fawaz group of Dubai, led by Sheikh-Al-Khalifa, to manufacture a specific brand of cars, in South Africa, called El Macho Jeep. The plaintiff approached ABSA bank, through an agent, to facilitate the banking account for this joint venture agreement. Sheikh-Al-Khalifa was to make a deposit of \$6 million as a fixed deposit to the ABSA Bank's credit facility, which would generate some interest for the Sheikh-Al-Khalifa's group.

To give effect to this arrangement, ABSA Bank, through its stakeholder manager, issued a so-called letter "Verbiage of Bank Guarantee"²³⁰ to the Emirates Bank, which was a bank used by Sheikh-Al-Khalifa.²³¹ However, ABSA Bank, upon being made aware of such a transaction, advised the Emirates Bank by letter that the "Verbiage of Bank Guarantee" had been fraudulently issued by one of the ABSA employees without the necessary authority and that, as such, it was irregular and

²²⁶ Thai 2000 *Current Commercial Law* 3; SiSu 2007 <https://www.internationalcontracts.net/international-law-documents/Principles-of-European-Contract-Law.pdf>.

²²⁷ DiMatteo and Sacasas 1994 *Baylor Law Review* 357.

²²⁸ *Bernert v ABSA Bank Limited* (14302/03) [2008] ZAGPHC 337.

²²⁹ *Bernert v ABSA Bank Limited* (14302/03) [2008] ZAGPHC 337 para 11.2.

²³⁰ *Bernert v ABSA Bank Limited* (14302/03) [2008] ZAGPHC 337 para 11.8

²³¹ *Bernert v ABSA Bank Limited* (14302/03) [2008] ZAGPHC 337 para 23.

invalid.²³² When the Sheikh learnt of these developments, he summarily withdrew from the deal. The "Verbiage of Bank Guarantee" letter read as follows:²³³

ABSA wishes to certify that Mr Robert Fanjek, an associate of ROTRAX, will be guaranteed a fixed deposit on an amount of 6 mil USD (six million United States Dollar at our bank. On Receipt of the funds from the Emirates Bank International, the following will be applicable:

1. The \$6 mil USD is a guarantees investment where the guarantee is irrevocable and unconditional.
2. The guarantee is renewable after 12 months.
3. ABSA BANK proposes an interest of libor plus 1% payable to EMIRATES BANK INTERNATIONAL. ABSA guarantees money in US Dollars.
4. ABSA will guarantee the capital and the first quarter's interest and all quarter's thereafter will be paid in advance...
8. Any cheques received from EMIRATES BANK INTERNATIONAL must be a bank guaranteed cheque payable to ABSA BANK. Mr Robert Fanjek is giving the bank certain guarantees on ROTAX on behalf to secure the guarantee to EMIRATES BANK INTERNATIONAL
9. The guarantee (fixed deposit certificate) is legal in terms of international banking practices.

4.2.1.2 Legal questions

The legal questions, at the disposal of the court, were (i) whether or not the written agreement between the plaintiff and the Fawaz Dubai group was valid and lawful and enforceable under the South African law;²³⁴ (ii) whether or not the letter, the "Verbiage of a bank guarantee", that was issued by the ABSA Bank, was fraudulently issued; and (iii) whether or not the defendant could be held delictually liable for the damages that the plaintiff suffered as a result of the defendant's "negligent mis-statement".²³⁵

²³² *Bernert v ABSA Bank Limited* (14302/03) [2008] ZAGPHC 337 paras 49 & 50.

²³³ *Bernert v ABSA Bank Limited* (14302/03) 2008 ZAGPHC 337 para 11.8

²³⁴ *Bernert v ABSA Bank Limited* (14302/03) 2008 ZAGPHC 337 paras 6, 95, 96.

²³⁵ *Bernert v ABSA Bank Limited* (14302/03) 2008 ZAGPHC 337 paras 48, 56, 57.

4.2.1.3 The decision of the High Court

The High Court ruled in favour of the plaintiff that ABSA Bank's letter to the Emirates Bank directly contributed to the plaintiff losing on a potential business dealing.²³⁶ According to the court, the misstatement was clearly unnecessary as no fraud was committed by the plaintiff in his business dealing with the Fawaz group.²³⁷ According to the court, the plaintiff had succeeded in proving the five elements of delict,²³⁸ even though two of these could not be ascertained.²³⁹ The issue of quantum was postponed *sine die*.²⁴⁰ The court did not decide on the appropriateness of the LOC per se, but on the fraud in preparing the document.

4.2.1.4 The decision of SCA²⁴¹

On appeal, the SCA dismissed the respondent's case that two of the five elements of delict could not be established. In particular, the elements of causation and wrongfulness or unlawfulness were not verified.²⁴² The presiding judge remarked that "the document when read as a whole, was an aggregation of nonsense, decorated with financial terminology"²⁴³ and went further to say: "When all the terms are read together, the document is a compendium of gibberish".²⁴⁴ The court ruled that the document "Verbiage of a bank guarantee" was deceiving and misleading to the third party,²⁴⁵ and was fraudulently prepared by someone who had no association with ABSA Bank (referring to Mr Els).²⁴⁶ The SCA dismissed the

²³⁶ *Bernert v ABSA Bank Limited* (14302/03) 2008 ZAGPHC 337 para 60.

²³⁷ *Bernert v ABSA Bank Limited* (14302/03) 2008 ZAGPHC 337 paras 53, 54, 55.

²³⁸ *Bernert v ABSA Bank Limited* (14302/03) 2008 ZAGPHC 337 para 57.

²³⁹ In this case, the plaintiff succeeded in proving the five elements of delict even though two of these could not be ascertained. A delict is the "wrongful act by a person that, in a culpable way, causes harm to another".²³⁹ All five requirements or elements of delict must be present for a liability claim to succeed in a court of law: (i) conduct; (ii) negligence; (iii) wrongfulness or unlawfulness; (iv) legal and factual causation and (v) damages. See Neethling and Potgieter *Law of Delict* 4. The SCA held that not all the five elements of delict were actually proven.

²⁴⁰ *Bernert v ABSA Bank Limited* (14302/03) 2008 ZAGPHC 337 para 60.

²⁴¹ *ABSA Bank Limited v Bernert* (99/09) 2010 ZASCA 36.

²⁴² *ABSA Bank Limited v Bernert* (99/09) 2010 ZASCA 36 para 26.

²⁴³ *ABSA Bank Limited v Bernert* (99/09) 2010 ZASCA 36 para 15.

²⁴⁴ *ABSA Bank Limited v Bernert* (99/09) 2010 ZASCA 36 paras 15, 73; *Bernert v ABSA Bank Limited* CCT 37/10 2010 ZACC 28 para 111.

²⁴⁵ *ABSA Bank Limited v Bernert* (99/09) 2010 ZASCA 36 para 71.

²⁴⁶ *ABSA Bank Limited v Bernert* (99/09) 2010 ZASCA 36 para 34.

case with costs.²⁴⁷ Again, the court did not decide on the use and appropriateness of LOCs in general, but merely held that the document *in casu* was not enforceable.

4.2.1.5 Constitutional Court's decision²⁴⁸

The appellant (Bernert) averred that the SCA was biased against him on a number of grounds, which included the close association of the judges with the respondent (ABSA Bank).²⁴⁹ The delictual damages that had been suffered by the appellant as well as the legal status of document, "Verbiage of a bank guarantee", had been abandoned. The Constitutional Court (CC) after a lengthy deliberation, dismissed the case with costs,²⁵⁰ thereby reaffirming the decision of the SCA.²⁵¹ The ratio of the case accordingly turned on perceived bias of judges and did not deal with LOCs *per se*.

4.2.2 *Summary of letters of comfort in South Africa*

LOCs were previously considered as part of the contract and were interpreted under the law of contract, as demonstrated in several cases.²⁵² The trilogy of cases involving ABSA Bank Limited and Bernert seem to point out that the LOCs are considered on their own merits and the content couched therein. It is not clear at this stage, due to scarcity of case law, whether LOCs receive consistent interpretation by South African courts.²⁵³ However, South African banks still use LOCs in circumstances where the issuer of the letter and the bank has a good relationship, where it would be detrimental to the issuer if such relationships had to break down.

4.3 *Letters of comfort in the United Kingdom*

²⁴⁷ *ABSA Bank Limited v Bernert* (99/09) 2010 ZASCA 36 para 76.

²⁴⁸ *Bernert v ABSA Bank Ltd* (99/09) 2010 ZACC 28.

²⁴⁹ *Bernert v ABSA Bank Ltd* (99/09) 2010 ZACC 28 para 4.

²⁵⁰ *Bernert v ABSA Bank Ltd* (99/09) 2010 ZACC 28 para 120.

²⁵¹ *Bernert v ABSA Bank Ltd* (99/09) 2010 ZACC 28 paras 115, 116.

²⁵² See Section 2.2, *Holtzhausen v ABSA Bank Ltd* 2008 5 SA 630 (SCA).

²⁵³ See *Bernert v ABSA Bank Ltd* (99/09) 2010 ZACC 28.

In this section, the legal efficacy of LOCs in the United Kingdom is unpacked in terms of analysing seminal and "landmark court decision in the world of banking and commerce due to the dearth of court authority on the subject".²⁵⁴

4.3.1 *Kleinwort Benson Ltd v Malaysia Mining Corporation Berhad*²⁵⁵

4.3.1.1 Facts

In 1983, the defendant, Malaysian Mining Corporation (MMC), established a wholly-owned subsidiary company, Malaysian Mining Corporation Metals Ltd. (Metals), to trade exclusively in metal commodities. The plaintiff, Kleinwort Benson Limited (KB), which had long-standing commercial relations with MMC, agreed to extend a loan facility up to £10m to Metals, pursuant to MMC issuing two LOCs to KB in support of this business transaction.²⁵⁶ However, MMC was neither prepared to guarantee or accept liability, whether severally or jointly with Metals, to this loan facility arrangement. Interestingly, the two LOCs issued by MMC carried substantially identical terms. Of particular importance was paragraph 3, which stated that "it is our policy to ensure that the business of MMC Metals Limited (Metals) is at all times in a position to meet its liabilities to you under the above arrangements".²⁵⁷ In 1985 the international tin market industry outlook was depressed, resulting in Metals filing for liquidation and thereby ceasing its operations in the metal industry. At that stage, not all the money owed to KB had been repaid. KB sought payment of the outstanding amount from MMC, which the defendant duly refused to pay. KB subsequently instituted legal proceeding against MMC to recover the outstanding debt from Metals.²⁵⁸

The court *a quo* ruled in favour of KB on the basis that LOCs facilitated a commercial contractual transaction that were legally binding and thus enforceable.²⁵⁹ The court held that MMC had created an impression that it would cover liabilities of Metals if

²⁵⁴ Stephenson 1998 *International Financial Law Review* 8.

²⁵⁵ *Kleinwort Benson Ltd v Malaysia Mining Corporation Berhad* 1989 1 All ER 785.

²⁵⁶ *Kleinwort Benson Ltd v Malaysia Mining Corporation Berhad* 1989 1 All ER 785 at 801.

²⁵⁷ *Kleinwort Benson Ltd v Malaysia Mining Corporation Berhad* 1989 1 All ER 785 at 803.

²⁵⁸ *Kleinwort Benson Ltd v Malaysia Mining Corporation Berhad* 1989 1 All ER 785 at 800.

²⁵⁹ *Kleinwort Benson Ltd v Malaysia Mining Corporation Berhad* 1989 1 All ER 785 at 811.

and/ or when the loan arrangement collapsed and did not rebut such a presumption. As such, the two LOCs issued by MMC formed an integral part of a commercial banking transaction between KB and Metals. The court ruled that KB was therefore entitled to claim damages for breach of contract against MMC for a total amount of just over £12m, which included the interest accrued from outstanding debt. MMC took the ruling of the court of first instance on appeal.

The following paragraphs from the second LOC issued by MMC constitute the grounds for the contractual dispute:²⁶⁰

[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 that 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 agreements. Yours faithfully MALAYSIA MINING CORPORATION BERHAD.

4.3.1.2 The legal issue

The central legal issue was whether the information carried in paragraph 3 of the LOC constituted a contractual undertaking by MMC to make good the default of its subsidiary²⁶¹. A breach of contract by MMC was a central issue in the matter; however, the notion of misrepresentation or a misstatement by MMC in their LOCs did not arise as a legal issue.

4.3.1.3 The decision

No legal dispute arose out of the first two paragraphs. The Court of Appeal ruled that paragraph 3 did not amount to a contractual undertaking. It held that the court *a quo* erred by placing strong reliance on the presumption that the issuance of LOC created a contractual relation between the parties. *In casu*, the terms used in both LOCs issued by MMC did not constitute any form of promise or warranty for the

²⁶⁰ *Kleinwort Benson Ltd v Malaysia Mining Corporation Berhad* 1989 1 All ER 785 at 871 and 872.

²⁶¹ *Kleinwort Benson Ltd v Malaysia Mining Corporation Berhad* 1989 1 All ER 785 at 801; See also Wittuhn 1990 *McGill Law Journal* 494.

future conduct or liability.²⁶² In effect, paragraph 3 simply carried statements of a present fact and not a promise to some future conduct. This means that in the absence of expressive terms of accepting liability, KB could not rely on paragraph 3 to enforce delivery of performance to a loan arrangement with Metals against a third party (MMC). The main terms here were that MMC would not reduce its current financial interest in Metals until the facilities had been repaid²⁶³ or KB has agreed to an amended repayment plan. Such an undertaking could not be regarded as contractual in nature. The appeal of KB to the House of Lords was subsequently refused since there was no prospect of a successful case.

4.3.2 *Re Augustus Barnett and Son Ltd*²⁶⁴

4.3.2.1 The facts

In this case, Augustus Barnett and Sons Ltd ("the company"),²⁶⁵ was a London-based, whole-owned subsidiary of Augustus Barnett Rumasa of Spain ("Rumasa"), which imported wine and sherry from Spain for the UK markets. For several years, the financial fortunes of Augustus were trapped in a downward spiral, thereby forcing the auditors to decline endorsing financial accounts of the company from 1979, 1980 and 1981, unless Rumasa issued an LOC to back up its subsidiary's operation and ensure that it continued to meet its financial obligations.²⁶⁶ Rumasa issued a number of LOCs to auditors in which it assured them that Augustus would continue to meet its financial commitments, including making financial resources available when necessary. By 1981, Rumasa had made about £4m working capital available to Augustus for it to stay afloat.²⁶⁷ Of interest was the last LOC issued by

²⁶² *Kleinwort Benson Ltd v Malaysia Mining Corporation Berhad* 1989 1 All ER 785 at 802; McGee 1998 *Company Lawyer* 133, 134.

²⁶³ *Kleinwort Benson Ltd v Malaysia Mining Corporation Berhad* 1989 1 All ER 785 at 804; Scott 1994 *Journal of Banking and Finance Law and Practice* 199.

²⁶⁴ *Re Augustus Barnett and Son Ltd* 1986 2BCLC 98904.

²⁶⁵ The court referred to *Re Augustus Barnett and Son Ltd* as "the company". However, in case of clarity, the term "Augustus" will be used.

²⁶⁶ *Re Augustus Barnett and Son Ltd* 1986 2BCLC 98904 at 98905; See also Prentice 1987 *Law Quarterly Review* 11.

²⁶⁷ *Re Augustus Barnett and Son Ltd* 1986 2BCLC 98904 at 98905; The Times 1986 *Journal of Business Law* 11.

Rumasa on 01 June 1982, since it was released pursuant to one supplier refusing to ship stock on credit to the company. The contents of the letter read:²⁶⁸

Rumasa ...undertakes to provide such additional working capital as is necessary to enable the [Augustus] 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

However, in 1983, Augustus filed for voluntary liquidation after it had failed to stem its financial misfortunes.²⁶⁹

4.3.2.2 The legal issue

The liquidator subsequently sought relief against Rumasa on the ground that it had full knowledge about the declining financial position of its subsidiary and that Rumasa had deliberately defrauded the creditors or had been complicit in this act as per the then *English Companies Act* of 1948.²⁷⁰

4.3.2.3 The decision

The court held that the LOCs issued by Rumasa were provided in good faith and with an honest intention to assure the creditors about the future commitments of its subsidiary,²⁷¹ which unfortunately became insolvent in the end. The court ruled that the secondary liability of Augustus could not be imputed to the parent company, since there was no reasonable basis averred by creditors that warranted the court to suspect that the parent company or its subsidiary was trading in a fraudulent manner.²⁷² Despite the undertaking by the holding company to take essential steps to ensure that its subsidiary fulfil loan obligations,²⁷³ it did not necessarily entail that

²⁶⁸ *Re Augustus Barnett and Son Ltd* 1986 2BCLC 98904 at 98905.

²⁶⁹ *Re Augustus Barnett and Son Ltd* 1986 2BCLC 98904 at 98907. See also Al-Tawil 2019 *International Journal of Law and Management* 332.

²⁷⁰ Section 332 of the *English Companies Act* of 1948; For the courts to make order under sec. 332, it must first establish that someone had commissioned an act by carrying out a business of the company, with the intention to defraud.

²⁷¹ *Re Augustus Barnett and Son Ltd* 1986 2BCLC 98904 at 98909.

²⁷² Prentice 1987 *Law Quarterly Review* 11.

²⁷³ *Re Augustus Barnett and Son Ltd* 1986 2BCLC 98904 at 98905; Gherghina 2014 *Romanian Public-Private Partnership Law Review* 44.

the holding company was guaranteeing that the creditors would be paid.²⁷⁴ The order to sustain a fraud claim, under section 332 of the *Companies Act* of 1948,²⁷⁵ was summarily dismissed.²⁷⁶

4.3.3 *Re. Atlantic Computers plc (in Administration). National Australia Bank Ltd v Soden & Anor.*²⁷⁷

4.3.3.1 The facts

On the 30 December 1986, the parent company, Atlantic Computers plc ("Atlantic") issued an LOC to National Australia Bank ("NAB") on behalf of its subsidiary, Atlantic Medical Ltd ("AML") to continue receiving credit facilities from NAB. An identical letter of comfort was issued by Atlantic on 31 March 1987 to NAB to further extend hire-purchase facilities to AML, which was leasing medical equipment to nursing homes and other users.²⁷⁸ AML later went into liquidation. Soon after this, Atlantic was placed under administration. NAB commenced legal proceeding against Atlantic to recover their losses, relying solely on LOCs it had received from it. The scheme of administrators duly rejected NAB's claim for a sum of £922 195.72 on the grounds that the LOCs were not enforceable undertakings and had no contractual effect. NAB wanted the administrators' decision to be reversed. The scheme administrators were the respondents in the case.

The LOCs sent out by Atlantic to NAB read as follows:²⁷⁹

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

²⁷⁴ *Re Augustus Barnett and Son Ltd* 1986 2BCLC 98904 at 98909; Scanlan 2003 *Company Lawyer* 241.

²⁷⁵ Section 332 of the *Companies Act* of 1948 deals with responsibility for fraudulent trading of persons concerned. It assigned person liability to anyone who conducts business with the intention of defrauding creditors, "without any limitation, for all or any debts... of the company as the court may direct".

²⁷⁶ *Re Augustus Barnett and Son Ltd* 1986 2BCLC 98904 at 98911.

²⁷⁷ *Re Atlantic Computers Plc (in Administration) National Australia Bank Ltd v Soden & Anor* 1995 BCC 696.

²⁷⁸ *Re Atlantic Computers Plc (in Administration) National Australia Bank Ltd v Soden & Anor* 1995 BCC 696; Lyster 1992 *Journal of International Banking* N228-229.

²⁷⁹ *Re Atlantic Computers Plc (in Administration) National Australia Bank Ltd v Soden & Anor* 1995 BCC 696 at 697.

- (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.

4.3.3.2 The legal issue

The court had to determine the common intention that had to be attributed to the parties in relation to the terms specified in the LOCs, especially paragraph (c), while considering other circumstances. That is, the court had to decide if paragraph (c) on the LOC made Atlantic liable on behalf of its subsidiary by offering to make arrangements for AML's indebtedness in cases where it was unable to meet its financial obligations to NAB, in the present, the future or contingently.

4.3.3.3 The decision

The High Court ruled that paragraph (c), when read in isolation or independently, appeared to have created an enforceable obligation between the parties. However, the final sentence qualified that paragraph (c) was intended to take effect as "an expression of present intention by way of comfort only".²⁸⁰ It simply amounted to a current statement reflecting the intention of Atlantic at the time at which the LOC was issued, that "if in future AML was unable to meet its commitment to NAB",²⁸¹ then the parent would stand behind its subsidiary. For that reason, it did not establish a binding obligation and had to be struck down on the grounds of repugnancy.²⁸² The court dismissed NAB's claim by further reconfirming the decision

²⁸⁰ *Re Atlantic Computers Plc (in Administration) National Australia Bank Ltd v Soden & Anor* 1995 BCC 696 at 698.

²⁸¹ *Re Atlantic Computers Plc (in Administration) National Australia Bank Ltd v Soden & Anor* 1995 BCC 696 at 698.

²⁸² *Re Atlantic Computers Plc (in Administration) National Australia Bank Ltd v Soden & Anor* 1995 BCC 696 at 698.

of the scheme of administrators.²⁸³ Application for leave to appeal was also refused.²⁸⁴

4.3.4 *Associated British Ports v Ferryways NV & MSC Belgium NV*²⁸⁵

4.3.4.1 The facts

A parent company (MSC Belgium NV) issued a "Letter Agreement" on behalf of its subsidiary Ferryways NV, to a British company, Associated British Ports ("ABP"), to back up a series of agreements that Ferryways NV had concluded with ABP. The side letter reads as follows:²⁸⁶

We hereby confirm that Ferryways NV (the "Company") is a member of the same group of companies as MSC Belgium NV.

In consideration of Associated British Ports ("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, the Company (i) has and will at all times 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. We are aware that ABP will rely on this letter in deciding whether to enter into the Agreement with the Company.

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.

However, a number of disputes arose about operational matters between the two companies, which ultimately led to the irretrievable breakdown of relations between them. On about 17 June 2007, Ferryways went into liquidation and was later declared insolvent by the Belgian court in February of 2008. ABP instituted legal proceedings against both Ferryways and the parent company (MSC Belgium NV) to recover its losses on grounds of breach of contract as per the "Letter Agreement".

²⁸³ *Re Atlantic Computers Plc (in Administration) National Australia Bank Ltd v Soden & Anor* 1995 BCC 696 at 699.

²⁸⁴ *Re Atlantic Computers Plc (in Administration) National Australia Bank Ltd v Soden & Anor* 1995 BCC 696 at 700.

²⁸⁵ *Associated British Ports v Ferryways NV, MSC Belgium NV* 2009 EWCA CIV 189.

²⁸⁶ *Associated British Ports v Ferryways NV, MSC Belgium NV* 2009 EWCA CIV 189.

4.3.4.2 Legal issue

The central legal issue was whether the "Letter Agreement" was a guarantee (secondary liability) or an indemnity (primary liability),²⁸⁷ and whether the parent company was liable for the debt of its subsidiary, albeit that variations in the terms and conditions of the principal agreement had been concluded by the parties.²⁸⁸

4.3.4.3 The decision

The court of first instance held that the "Letter Agreement", which was also an LOC, constituted a guarantee, since the holding company's obligations were clearly defined under the principal agreement the parties had. This meant that the parent liability was secondary to the contractual agreement. However, due to the variations of the agreements, the "Letter Agreement" was discharged. APP appealed the High Court decision on grounds that the "Letter Agreement" was an indemnity or alternatively a binding LOC which was not amended at the time at which the new variations in the agreement were formally entered into. The Court of Appeal upheld the decision of the court *a quo* and ruled that the "Letter Agreement" was, in substance, a guarantee and thus fell away due to variations in the terms of the contract, leading to another agreement, known as "time to pay" agreement.

The Court of appeal made the following *obiter dictum*:²⁸⁹

- (a) An LOC does not in itself give rise to a contractual liability since it only creates a moral obligation rather than a legal liability.
- (b) The fact that jurisdiction and choice of law to resolve disputes if or when they arise was a clear indication that the parties wanted to create legal relations, disposition the letter of comfort as a form of a guarantee.
- (c) The label of the document is not determinative in law. The content contained therein is substantive and key. By attaching a label to the document "letter of comfort" will not prevent courts to declare it as a guarantee.

²⁸⁷ *Associated British Ports v Ferryways NV, MSC Belgium NV* 2009 EWCA CIV 189; Schultz 2014 *Auckland University Law Review* 25.

²⁸⁸ *Associated British Ports v Ferryways NV, MSC Belgium NV* 2009 EWCA CIV 189; White 2009 *Journal of International Banking Law and Regulation* N7-10.

²⁸⁹ *Associated British Ports v Ferryways NV, MSC Belgium NV* 2009 EWCA CIV 189; ACT 2013 ACT 2013 <https://www.treasurers.org/ACTmedia/loc.pdf> 31.

4.3.5 Summary: letters of comfort in the United Kingdom

Unless there is fraudulent trading or modicum in the misrepresentation of the facts,²⁹⁰ LOCs under the UK legal regime do not have binding and contractual effects and are therefore legally unenforceable.²⁹¹ The decisions of British courts with respect to LOCs have been largely consistent, as demonstrated in the *Associated British Ports v Ferryways* case, *Kleinwort Benson* case and *Re. Atlantic Computers plc (in Administration)*. *National Australian Bank Ltd v Soden & Anor*.

4.4 Letters of comfort in Canada

4.4.1 *Toronto Dominion Bank v Leigh Instruments*²⁹²

4.4.1.1 The facts

Leigh Instruments ("Leigh") had a long banking relationship with Toronto Dominion ("TD") Bank dating back to 1982. The relationship continued even after Leigh had been taken over by a Canadian company called The Plessey Company Ltd, Canada (The Plessey Canada) in 1988,²⁹³ which was a subsidiary company of The Plessey UK. However, at the time of takeover, Leigh had accrued a debt of \$40.5 million with the TD Bank. The TD Bank requested Plessey Canada to provide it with an LOC rather than a guarantee to the loan facility agreement.²⁹⁴ A total of five LOCs²⁹⁵ were issued by the Plessey UK in which it assured TD Bank that it would not reduce its shareholding in The Plessey Canada without prior notice to the bank.²⁹⁶ However, the concern of TD Bank grew when the loan kept going up supported by LOCs. At that time, the parties became aware of the *Kleinwort Benson* appeal case on LOCs.²⁹⁷ Interestingly, TDB extended a loan facility to Leigh to defend itself against

²⁹⁰ Al-Tawil 2019 *International Journal of Law and Management* 331.

²⁹¹ *Kleinwort Benson Ltd v Malaysia Mining Corporation Berhad* 1989 1 All ER 785.

²⁹² *Toronto Dominion Bank v Leigh Instruments* 1998 40 BLR 2d 1.

²⁹³ *Toronto Dominion Bank v Leigh Instruments* 1998 40 BLR 2d 1 para 9.

²⁹⁴ *Toronto Dominion Bank v Leigh Instruments* 1998 40 BLR 2d 1 para 463; Perell 2001 *Canadian Business Law Journal* 436.

²⁹⁵ *Toronto Dominion Bank v Leigh Instruments* 1998 40 BLR 2d 1 para 281.

²⁹⁶ *Toronto Dominion Bank v Leigh Instruments* 1998 40 BLR 2d 1 para 110. See also Trichardt 2001 *TFLR* 174.

²⁹⁷ *Toronto Dominion Bank v Leigh Instruments* 1998 40 BLR 2d 1 para 359.

a hostile takeover bid by a consortium made up of the General Electric Company and Siemens AG.²⁹⁸ Of further interest is the fifth LOC, which was issued by the General Electric Company after taking over Plessey plc, the UK company, which reads as follows:²⁹⁹

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.

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.

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.

The letter replaces our letter of 31st August 1989, 31st March 1989 and 30th June 1989 and does not constitute a legally binding commitment.

The business undertakings of Leigh continued to plunge until it became insolvent after several months and the bank loan went unpaid. TD Bank tried to recover their losses from Plessey and General Electric. TD Bank brought about 150 causes of action,³⁰⁰ the majority of which were withdrawn before trial, including fraud and misrepresentation.³⁰¹

4.4.1.2 The legal issue

Firstly, the court had to determine whether a series of LOCs submitted by the Plessey and the General Electric company (last letter of comfort) created legally binding contractual obligations,³⁰² particularly when one considers the undertaking that Plessey would ensure that Leigh would be "managed so as to be always in a

²⁹⁸ *Toronto Dominion Bank v Leigh Instruments* 1998 40 BLR 2d 1 para 7; Goodman 1999 *Banking and Finance Law Review* 391.

²⁹⁹ *Toronto Dominion Bank v Leigh Instruments* 1998 40 BLR 2d 1 paras 74 & 417.

³⁰⁰ *Toronto Dominion Bank v Leigh Instruments* 1998 40 BLR 2d 1 para 392.

³⁰¹ *Toronto Dominion Bank v Leigh Instruments* 1998 40 BLR 2d 1 para 404; Perell 2001 *Canadian Business Law Journal* 436.

³⁰² *Toronto Dominion Bank v Leigh Instruments* 1998 40 BLR 2d 1 para 403; See also Cook 1999 *Journal of International Banking Law* N26-28.

position to meet its financial obligations",³⁰³ which would also have included all monies owed to the bank when they fell due. Secondly, the court had to determine whether the policy paragraph (paragraph 3) in each of the LOCs issued by Plessey and later General Electric Company was factually untrue and thus constituted a negligent or fraudulent misrepresentation.³⁰⁴ Thirdly, the court had to ascertain whether the parties (TD Bank, Plessey and GEC) had the same understanding of the statement in the last paragraph, that "the letter ... does not constitute a legally binding commitment".³⁰⁵

4.4.1.3 The decision

The court found paragraph 3 of an LOC to be merely representational³⁰⁶ and not promissory or legally obligatory in nature.^{307,308} This was consistent with the appeal decision in *Kleinwort Benson Ltd v Malaysia Mining Corporation* case.³⁰⁹ The court summarily exonerated Leigh from contractual liability by ruling that none of the LOCs constituted a legally binding agreement between the parties, and thus the agreement was not contractually enforceable.³¹⁰ Of much interest is the fact that the court held the insertion of the words "this letter [...] does not constitute a legally binding commitment"³¹¹ in the final letter of comfort would still not have changed the final decision of the court.³¹² In other words, a disclaimer, even though important, is not a determining factor when LOCs are subjected to literal and contextual interpretation by a court of law.

³⁰³ *Toronto Dominion Bank v Leigh Instruments* 1998 40 BLR 2d 1 para 398.

³⁰⁴ ACT 2013 <https://www.treasurers.org/ACTmedia/loc.pdf> 32.

³⁰⁵ *Toronto Dominion Bank v Leigh Instruments* 1998 40 BLR 2d 1 para 77; Cook 1999 *Journal of International Banking Law* N26.

³⁰⁶ *Toronto Dominion Bank v Leigh Instruments* 1998 40 BLR 2d 1 para 423.

³⁰⁷ *Toronto Dominion Bank v Leigh Instruments* 1998 40 BLR 2d 1 para 555; Stephenson 1998 *International Financial Law Review* 8.

³⁰⁸ Trichardt *Letters of Comfort* 261.

³⁰⁹ *Toronto Dominion Bank v Leigh Instruments* 1998 40 BLR 2d 1 paras 368, 437; *Kleinwort Benson Ltd v Malaysia Mining Corporation Berhad* 1989 1 All ER 785.

³¹⁰ *Toronto Dominion Bank v Leigh Instruments* 1998 40 BLR 2d 1 para 555; Stephenson 1998 *International Financial Law Review* 8.

³¹¹ *Toronto Dominion Bank v Leigh Instruments* 1998 40 BLR 2d 1 para 432.

³¹² Shawn 2011 *Mondaq* <https://www.mondaq.com/canada/capital-adequacybasel/158494/how-comforting-is-a-comfort-letter>.

4.4.2 *Summary on letters of comfort in Canada*

LOCs are non-binding legal instruments in Canada. The landmark case of *Toronto Dominion Bank v Leigh Instruments* serves as precedent setting case in deciding disputes over LOCs. This resonates with the English law as demonstrated in *Kleinwort Benson Ltd v Malaysia Mining Corporation Berhad* case.

4.5 Letters of comfort in Australia

A summary of important decided court cases in Australia is provided in this section.

4.5.1 *Banque Brussels Lambert SA v Australian National Industries*³¹³

4.5.1.1 The facts

Spedley Securities Limited (SS), which was a subsidiary of Spedley Holdings Limited (SH), approached Bank Brussels Lambert SA (BBL), a Belgian bank,³¹⁴ for a loan facility of \$5 million. However, BBL insisted that an assurance must be given beforehand that any drawn-down debt would be settled. A third party, Australian National Industries Limited (ANI), which owned 45% of the share capital in SH, issued a LOC to back up the loan arrangement of SS and BBL. In an LOC of ANI, dated 9 June 1982, it stated that:³¹⁵

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 ...

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.

³¹³ *Banque Brussels Lambert SA v Australian National Industries Ltd* 1989 21 NSWLR 502.

³¹⁴ Perell 2001 *Canadian Business Law Journal* 431.

³¹⁵ *Banque Brussels Lambert SA v Australian National Industries Ltd* 1989 21 NSWLR 502 at 504.

SS utilised the loan facility for a period of over seven years during which SS withdrew funds through a letter of credit in favour of Permanent Trustee Australia Ltd, which was a third party in this case. ANI later disposed its shares without informing BBL, before SS went into liquidation. The idea here was that ANI wanted to preserve its share price before BBL could call on its loan already fully utilised by SS, and this could have jeopardised the business sale transaction that ANI had already concluded with the buyer. ANI did not ensure that the financial commitment made by Spedley for outstanding debt would be met. BBL instituted legal proceedings against ANI to recover its losses.

4.5.1.2 The legal issues

The central legal issues in the case were as follows:

- (a) Did an LOC issued by ANI constitute a legally binding contractual agreement between the parties to the loan agreement?
- (b) Did ANI breach the contractual agreement by not giving the 90 days' notice to BBL prior to disposing its shares in SS?
- (c) Could it be determined whether ANI, by issuing the LOC, had any intention to create a legal obligation to BBL?
- (d) To what extent did terms used in an LOC have to be ascertained as "appropriately promissory in character"³¹⁶ so as to be legally enforceable?

4.5.1.3 The decision

The court ruled that an LOC issued by ANI did not amount to a guarantee or some form of a surety.³¹⁷ The court held that the issuer of an LOC did not inherit a secondary liability (guarantee) for debts of the main contracting party. Subsequently, ANI was found not to be financially liable to the loan arrangement between BBL and SS. However, ANI could not be fully exonerated from damages arising from the contractual breach that occurred by not informing BBL within 90 days before disposing of its shares in SS.³¹⁸ In addition, ANI failed to ensure that the loan agreement between SS and BBL would be paid in full. The fact that an LOC

³¹⁶ *Banque Brussels Lambert SA v Australian National Industries Ltd* 1989 21 NSWLR 502 at 522; Lipton 1999 *University of Western Australia Law Review* 159.

³¹⁷ *Banque Brussels Lambert SA v Australian National Industries Ltd* 1989 21 NSWLR 502 at 521.

³¹⁸ Furmston *Law of Contract* 157.

was used instead of a guarantee did not preclude the intention of the parties to assume legal relations.³¹⁹

The court was highly critical of the moral approach that the UK court had adopted in the *Kleinwort Benson* case on LOCs.³²⁰ The court held that, if statements contained in LOCs are appropriately promissory in nature,³²¹ then the courts should enforce them, especially statements that are "made in the course of business and there is no clear indication that they are not intended to be legally enforceable".³²² To establish the promissory nature of the agreement, the court turned to *Savage & Sons v Blakney*.³²³ In this case, appellant challenged the decision of the court *a quo*, where the issue of collateral warranty was dismissed with other claims adduced by the plaintiff. The court ruled in favour of the appellant to be awarded damages to the extent of collateral warranty which was inscribed in a series of LOCs as well as oral exchanges that the parties had over time.³²⁴ Pursuant to this, the court in the *Banque* case examined the oral exchanges among the contractual parties and noted that BBL strongly rejected an LOC in the following terms: "We [ANI] have given this letter of awareness on the understanding that does not constitute a guarantee".³²⁵ The court ruled that, though an LOC was not a guarantee in any form³²⁶ it was, nonetheless, appropriately promissory in nature³²⁷ and thus enforceable.³²⁸ In effect, the court ruled in the case of *Banque Brussels Lambert SA v Australian National Industry* that the non-contractual part should be enforced.³²⁹

³¹⁹ *Banque Brussels Lambert SA v Australian National Industries Ltd* 1989 21 NSWLR 502 at 522.

³²⁰ Thai 2006 *Journal of Banking and Finance Law and Practice* 26.

³²¹ *Banque Brussels Lambert SA v Australian National Industries Ltd* 1989 21 NSWLR 502 at 521; McKendrick *Contract Law* 386.

³²² *Banque Brussels Lambert SA v Australian National Industries Ltd* 1989 21 NSWLR 502 at 523; Shirbin 1990 *Journal of International Banking Law* N62-63.

³²³ *JJ Savage & Sons v Blakney* 1970 119 CLR 435 para 5.

³²⁴ *JJ Savage & Sons v Blakney* 1970 119 CLR 435 para 9.

³²⁵ *Banque Brussels Lambert SA v Australian National Industries Ltd* 1989 21 NSWLR 502 at 523.

³²⁶ Thai 2006 *Journal of Banking and Finance Law and Practice* 16.

³²⁷ *Banque Brussels Lambert SA v Australian National Industries Ltd* 1989 21 NSWLR 502 at 521; Perell 2001 *Canadian Business Law Journal* 433.

³²⁸ *Banque Brussels Lambert SA v Australian National Industries Ltd* 1989 21 NSWLR 502 at 526.

³²⁹ *Banque Brussels Lambert SA v Australian National Industries Ltd* 1989 21 NSWLR 502 at 529 and 530.

4.5.2 *Australian European Finance Corporation Ltd v Sheahan*³³⁰

4.5.2.1 The facts

Duke Group Ltd ("Duke Group") negotiated with the Australian European Finance Corporation ("AEFC") to grant temporary loan facilities to its wholly-owned subsidiary, Duke Pacific Finance Ltd ("Duke Pacific"). AEFC agreed to make revolving credit loan facility services of \$5 million available to Duke Pacific subject to Duke Group issuing AEFC with a guarantee. However, Duke Group declined to issue a guarantee but instead issued AEFC with a "secure" LOC, which read as follows:³³¹

This company which is 100% owned by The Duke Group Limited will continue to be supported by this company so long as necessary. In the event that any subordinated loans are required to ensure the company's requirements under the necessary legislation or licensing requirements, these will be provided. I confirm that such support as is necessary will be given to this company and its subsidiaries.

While the credit was in subsistence, Duke Group went into liquidation. AEFC commenced legal proceedings against the liquidator, Mr Sheahan, on the grounds of contractual breach.

4.5.2.2 The legal issue

The court had to determine whether the liquidator acted correctly by dishonouring an LOC granted by Duke Group to AEFC, as proof of debt to AEFC. In other words, the court had to decide on whether the Duke Group was liable for contractual breach on behalf of its subsidiary, Duke Pacific.

4.5.2.3 The decision

The court ruled that an LOC issued by the Duke Group did hold elements of promise, especially the first and third sentences, even though these were vaguely crafted. According to the court, words such as "support" can have different meanings along with phrases such as "so long as is necessary". The second sentence, according to the court, were intended to attract even more ambiguity and no evidence could

³³⁰ *Australian European Finance Corporation Ltd v Sheahan* 1993 60 SASR 187.

³³¹ *Australian European Finance Corporation Ltd v Sheahan* 1993 60 SASR 187 paras 205 and 206.

attempt to explain it.³³² Based on constructive analysis, the court confirmed the liquidator's position that the letter was non-binding and that there was no contractual promise in the LOC. The court dismissed the AEFC claim.³³³

4.5.3 *Gate Gourmet Australia (in Liquidation) v Gate Gourmet Holding*³³⁴

4.5.3.1 The facts

Gate Gourmet Australia Pty Ltd (in liquidation) ("GGA") was a whole-owned subsidiary of Gate Gourmet Holding ("GGH") involved in the catering business. GGH was also a whole-owned subsidiary of Gate Gourmet Holding AG ("GGAG"). These companies and others formed part of the Swiss Air Group. Around 1999, GGA acquired the catering rights of Ansett Airlines for a period of eight years. However, GGA was under-capitalised at the time of incorporation into GGH and therefore could not operate profitably due to the terms and conditions meted out in the contract with Ansett Airlines. Auditors demanded an LOC from GGAG for them to sign off the financial accounts of GGA. Two LOCs were duly made available by the Swiss holding group to back up the working capital of GGA. The second letter of comfort read as follows:³³⁵

[1] This is to conform 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.

In order to stay afloat, GGA obtained a major credit loan from Westpac to continue its operations and requested GGAG to issue an LOC that it would honour the loan arrangement with Westpac. GGAG refused to issue such a letter. Soon thereafter, Ansett went into liquidation. GGA, together with other subsidiary companies

³³² *Australian European Finance Corporation Ltd v Sheahan* 1993 60 SASR 187 at 202.

³³³ *Australian European Finance Corporation Ltd v Sheahan* 1993 60 SASR 187 at 206; Trichardt *Letters of comfort* 286.

³³⁴ *Gate Gourmet Australia (in Liquidation) v Gate Gourmet Holding AG 6-Ors* 2004 1 NSWSC 149.

³³⁵ *Gate Gourmet Australia (in Liquidation) v Gate Gourmet Holding AG 6-Ors* 2004 1 NSWSC 149 para 91.

belonging to GGAG, went into liquidation a day after Ansett's demise. In reliance on the second LOC, GGA sought relief against GGAG and GGH.

4.5.3.2 The legal issue

Did the foreign parent, GGAG, have any intention to enter into legal relations with creditors by issuing the second LOC on behalf of its subsidiaries? In other words:

- (a) Did the LOCs issued by GGAG have contractual effect?³³⁶
- (b) Were the LOCs drafted by the third party with the intention to mislead, deceive or likely to mislead the recipient,³³⁷ which will be in contravention of section 52 of the *Corporations Law Trade Practices Act 1974 (Cth)*?³³⁸

4.5.3.3 The decision

The court held amongst other that:

GGAG had an intention to enter into legal relations on behalf of its subsidiaries. The plaintiff's evidence clearly supported the subsistence of the established contract, which had been breached.³³⁹

- (a) The language used in an LOC were promissory in character.³⁴⁰ An LOC expressly indemnified GGA against its financial obligations, as and when they fell due, "up to the point in time when the Australian trading company had sufficient means to meet those commitments without the support of the foreign parent".³⁴¹
- (b) The contract between GGA and its creditors cannot be rendered void for uncertainty or for incompleteness since an alternative to meeting financial liabilities of GGA were expressly made known to the parties in clear terms.

³³⁶ *Gate Gourmet Australia (in Liquidation) v Gate Gourmet Holding AG 6-Ors* 2004 1 NSWSC 149 at paras 1 and 2; Trichardt *Letters of comfort* 317.

³³⁷ *Gate Gourmet Australia (in Liquidation) v Gate Gourmet Holding AG 6-Ors* 2004 1 NSWSC 149 at para 291.

³³⁸ *Gate Gourmet Australia (in Liquidation) v Gate Gourmet Holding AG 6-Ors* 2004 1 NSWSC 149 at para 16.

³³⁹ *Gate Gourmet Australia (in Liquidation) v Gate Gourmet Holding AG 6-Ors* 2004 1 NSWSC 149 at para 208.

³⁴⁰ *Gate Gourmet Australia (in Liquidation) v Gate Gourmet Holding AG 6-Ors* 2004 1 NSWSC 149 at paras 199 and 254.

³⁴¹ *Gate Gourmet Australia (in Liquidation) v Gate Gourmet Holding AG 6-Ors* 2004 1 NSWSC 149 para 191.

4.5.4 *Atco Controls Pty Ltd (in liquidation) v Newtronics Pty Ltd (in liquidation)*

4.5.4.1 The facts

In 1993, Atco Controls Pty Ltd ("Atco") increased its shareholding capacity to 100% in Newtronics Pty Ltd ("Newtronics"). Atco carried on business as a manufacturer of lightning equipment. Newtronics, on the other hand, carried on business as a designer, manufacturer and supplier of electronic components for various electrical applications. Upon acquiring the whole stake of Newtronics, Atco started to advance monies to Newtronics, initially through unsecured loans, later providing loans on a secured basis, in order to ensure that Newtronics remains a going concern. From 1994 to 1999, Pitcher Partners served as auditors for both companies. Atco issued the standard letter of support yearly on behalf of its subsidiary to the auditors:³⁴²

Atco Controls Pty Ltd, being the ultimate holding company of Newtronics Pty Ltd, hereby confirm the following:

1. That the amount owing by Newtronics Pty Ltd to Atco Controls Pty Ltd of \$[amount owed] as at [date of end of relevant financial year] 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.

Since 1994 to 2000, Newtronics has recorded substantive losses on an annual basis.³⁴³ In 2001, Newtronics' statement of accounts were not signed. A substantive loss was also recorded. The Atco-Newtronics circumstance was rather unusual in the sense that the parent company was issuing LOCs to its subsidiary rather than to a third party on the grounds that it had to declare Newtronics as a going concern. For several years, Newtronics had been supplying electronic components to one company, Seely International Pty Ltd ("Seeley"). The components were used in the manufacturing of air-conditioning units by Seeley. However, on several occasions, components supplied by Newtronics led to air-conditioning units catching fire,

³⁴² *Atco Controls Pty Ltd (in liquidation) v Newtronics Pty Ltd (in liquidation)* 2009 VSCA 238 para 5.

³⁴³ *Atco Controls Pty Ltd (in liquidation) v Newtronics Pty Ltd (in liquidation)* 2009 VSCA 238 para 6.

damaging the units, leading up to the reputational damage of Seely products. On 12 February 1998, Seely commenced legal proceedings in claims of money against Newtronics in the Federal Court of Australia, alleging breach of contract, negligence, misleading and deceptive conduct.³⁴⁴

In February 1998, Seeley commenced proceedings in the Federal Court against Newtronics alleging breach of contract, negligence and misleading and deceptive conduct ("the Seeley litigation"). The court found in favour of Seely and duly instructed Newtronics to settle claims to the tune of about \$9 million, with interest fixed at \$5 million by 31 January 2002.³⁴⁵ Simultaneously, Atco demanded from Newtronics to repay all its secured loan amounts granted to it over the years. Around the end of February 2002, a liquidator was appointed to round up the assets of Newtronics and sold to Atco for an amount of just over \$13 million.³⁴⁶ However, Newtronics was rendered financially incapable to settle the claim of Seely. Newtronics sought various reliefs against Atco, mainly for breach of contractual obligation and not calling up the security, which would be detrimental to Newtronics' unsecured creditors.³⁴⁷

4.5.4.2 The legal issue

The central legal issue was whether a holding company could enter contractual undertakings with its subsidiary through LOCs. Newtronics adduced two facts on existence of a contract between itself and Atco: (1) that, by means of the "financial support agreement", Atco had promised not to call upon the secured loan arrangements from Newtronics to the detriment of unsecured creditors. (2) Atco would further ensure, through written submissions to directors of Newtronics, that

³⁴⁴ *Atco Controls Pty Ltd (in liquidation) v Newtronics Pty Ltd (in liquidation)* 2009 VSCA 238 paras 11,12.

³⁴⁵ *Atco Controls Pty Ltd (in liquidation) v Newtronics Pty Ltd (in liquidation)* 2009 VSCA 238 para 13.

³⁴⁶ *Atco Controls Pty Ltd (in liquidation) v Newtronics Pty Ltd (in liquidation)* 2009 VSCA 238 para 17.

³⁴⁷ *Atco Controls Pty Ltd (in liquidation) v Newtronics Pty Ltd (in liquidation)* 2009 VSCA 238 para 23.

Newtronics will adhere to its financial commitments during the period between May 2001 and April 2002.

4.5.4.3 The decision

The court of first instance found that there was a valid standing contract between Newtronics and Atco and found in favour of Newtronics to the claim of money of over \$17.3 million.³⁴⁸ The court made four important remarks in its deliberations to highlight the existence of a contract between these juristic entities:³⁴⁹

- (a) there was actual provision of financial support to Newtronics by Atco, backed up with letters of support. These letters of support carried important terms of an agreement between Atco and Newtronics, which was envisioned to be depended upon.
- (b) the financial statement of accounts of Newtronics were prepared on a going-concern basis, subject to receipt of letter of support by Atco. The letters of support were not merely representational but had contractual effect. The letters of support were important considerations for the contract to permit Newtronics continued trade as a solvent company.
- (c) The board of directors of Newtronics operated the company as a solvent entity, due to financial support Newtronics received from Atco.
- (d) There was lack of intention expressed by Atco, in its dealing with Newtronics, that it would limit its financial support to Newtronics.

However, the rulings of court *a quo* were set aside on appeal on several grounds.³⁵⁰

4.5.5 *Summary on letters of comfort in Australia*

The Australian courts are moving towards regarding LOCs as legally binding instruments. Subsequently, the Australian banks have become reluctant to accept LOCs from third parties in preference of guarantees or other forms of securities. What is important to note here is that LOCs issued by foreign banks or companies may have legal effect in Australia.

³⁴⁸ *Atco Controls Pty Ltd (in liquidation) v Newtronics Pty Ltd (in liquidation)* 2009 VSCA 238 para 23.

³⁴⁹ *Atco Controls Pty Ltd (in liquidation) v Newtronics Pty Ltd (in liquidation)* 2009 VSCA 238 paras 22 and 25.

³⁵⁰ *Atco Controls Pty Ltd (in liquidation) v Newtronics Pty Ltd (in liquidation)* 2009 VSCA 238 paras 69-80.

4.6 Discussion of letters of comfort

The effect of LOCs is often misunderstood or misconstrued by both the lender and the customer.^{351,352} The misunderstanding mainly stems from the fact that some LOCs contain legally binding warranties or representations or even contractual undertakings, while others are crafted in such a manner that a third party (holding company), to the transaction can effectively escape liability. The legal efficacy of these letters is not always appreciated by the issuer or receiver until a legal issue has arisen.³⁵³ Lingard averred that an LOC should carry the following words: "This letter does not give rise to any legal obligations on our part" for it to be considered as non-binding instrument.³⁵⁴ It is submitted by the researcher that this view appears to be somewhat flawed since LOCs are unilaterally issued by one of the parties and the contents of these letters do not form part of the negotiations during the conclusion of financial contracts entered into by the parties. In *Toronto Dominion Bank v Leigh Instruments*³⁵⁵ the respondent, in one of the LOCs it issued, used a phrase stating that this "letter does not constitute a legally binding commitment", but the wording belied the meaning of what the respondent had intended. Important lessons from the *Gate Gourmet Australia Pty Limited* and *Kleinwort Benson Ltd v Malaysia Mining Corp Berhad* need to be taken into account. A little technicality can render an LOC binding and enforceable.³⁵⁶ The main lessons coming from these cases is that the intention to contract (*animus contrahendi*)³⁵⁷ through a LOC must be explicit in language and intention.³⁵⁸

One major challenge of LOCs is that some countries consider them as legally binding instruments while others consider them to have no legal effect to concluding

³⁵¹ Thai 2000 *Current Commercial Law* 1.

³⁵² Lingard 1986 *International Financial Law Review* 36.

³⁵³ Perell 2001 *Canadian Business Law Journal* 443.

³⁵⁴ Lingard 1986 *International Financial Law Review* 37.

³⁵⁵ *Toronto Dominion Bank v Leigh Instruments* 1998 40 BLR 2d 1.

³⁵⁶ Sacasas 1989 *Banking Law Journal* 180.

³⁵⁷ Du Plessis et al *Law of Contract* 4.

³⁵⁸ Perell 2001 *Canadian Business Law Journal* 425.

contracts unless they were used as bases for the strike of agreements.³⁵⁹ The challenge is the promissory nature of LOCs. That which constitutes the promissory nature of these letters has not been made clear in all cases where this term was used. According to Stoljar, there are three factors that one needs to consider to constitute elements of promise.³⁶⁰ The promise: (a) should be a voluntary and a personal act, (b) should happen in future; (c) should embody an act to be wanted by the promisor.³⁶¹ According to Stoljar,³⁶² neither the words in an LOC nor reliance on it would therefore be the main decisive factor in determining its promissory nature. The uncertainty that is embedded in LOCs should be avoided by whenever possible.³⁶³ Words such as "subject to" may be void and uncertain if one party intends to rely upon them to raise a defence.

In South Africa, the situation is still uncertain and unpredictable when it comes to the legal nature of LOCs. Even though there is no legislation that regulates LOCs, the contractual party who suffers damage as a result of a misrepresentation (e.g. the bank) may raise estoppel as a defence for legal redress. The plaintiff, in principle, is allowed to claim the amount of which his or her estate had been diminished with or the monetary sum by which the defendant has been enriched with, "whichever is the lesser".³⁶⁴ The plaintiff must prove the requirements to rely on estoppel.³⁶⁵ The representation contained in an LOC is a matter of fact rather than of law. The claim will be based on fraud (fraudulent misrepresentation) and the party that raises the statement (the holding company in this case) will address the correctness of the statement and authority to represent or bind the holding

³⁵⁹ This is the crux of this research. Misrepresentation, whether introduced on grounds of negligence or intention, can create legal uncertainty on LOCs. See Cook 1999 *Journal of International Banking Law* N27.

³⁶⁰ Stoljar 1998 *The Cambridge Law Journal* 196, 204.

³⁶¹ Trichardt *Letters of Comfort* 303.

³⁶² Stoljar 1998 *The Cambridge Law Journal* 204-206.

³⁶³ Shirbin 1990 *Journal of International Banking Law* N62-63.

³⁶⁴ *Southern Life Association Ltd v Beyleveld* 1989 1 SA 496 (A).

³⁶⁵ The elements of estoppel are: (a) misrepresentation, that is, there was the creation of a belief by the party against whom estoppel is pleaded, (b) fault (intention or negligence), which is not applicable in the case involving LOCs, (c) prejudice suffered by estoppel asserter, (d) causation, that is, the prejudiced person acted on the basis of misrepresentation, and (e) estoppel is permissible by law. See *Electrolux (Pty) Ltd v Khota and Another* 1961 4 SA 244 (W).

company,³⁶⁶ as found in *Monzali v Smith*³⁶⁷ by way of analogy. It is assumed here that the statement is a false representation as per a reasonable-man test.³⁶⁸

Further developments around requirements of estoppel claims³⁶⁹ can be found in the case of *Makate v Vodacom*.³⁷⁰ A delict is considered a wrongful act³⁷¹ by a person with a purpose of inducing the latter into an agreement causing harm to the latter.^{372,373} It is noted here that a parent company could be held delictually liable to the creditor, through its own actions or those of its subsidiary, if it can be proven that it used its subsidiary to commit wrongdoing.³⁷⁴ This amounts to "unconscionable abuse" as highlighted in section 20(9) of the *Companies Act* 71 of 2008.

The test applied in Australian law to determine whether the statement was promissory in nature is different from the approach adopted in the UK courts.³⁷⁵ In *Savage & Sons*,³⁷⁶ it became clear that some additional evidence to support the promissory character of LOCs had to be adduced for the court to arrive at an objective conclusion that the contractual agreement was promissory.³⁷⁷ Under the British law, the courts carry out a narrow punctilious "minute textual analysis" of what is inscribed in the LOCs more closely, which may be an unwelcome danger to South African jurisprudence since the "courts will become irrelevant in their resolution of commercial dispute if [the courts] allow this approach to dominate their consideration of commercial documents".³⁷⁸

³⁶⁶ Nagel et al *Commercial Law* 170.

³⁶⁷ *Monzali v Smith* 1929 AD 382 para 386.

³⁶⁸ *Electrolux (Pty) Ltd v Khota and Another* 1961 4 SA 244 (W) para 246.

³⁶⁹ Nagel et al *Commercial Law* 170.

³⁷⁰ *Makate v Vodacom Pty Ltd* 2016 6 BCLR 709 (CC).

³⁷¹ Potgieter, Steynberg and Floyd *Law of Damages* 39-47.

³⁷² The five elements that constitute delict must be present for a liability claim to succeed in a court of law: (i) conduct; (ii) negligence; (iii) wrongfulness or unlawfulness; (iv) factual and legal causation; and (v) damages. In the absence of an intention to establish legal relations, an LOC does not amount to a legally valid contract or a binding guarantee. See Neethling and Potgieter *Law of Delict* 4.

³⁷³ Ozekhome *Personal Property Law in Nigeria* 29-30.

³⁷⁴ Anderson 2009 *Melbourne University Law Review* 336.

³⁷⁵ Shirbin 1990 *Journal of International Banking Law* N62-63.

³⁷⁶ *JJ Savage & Sons v Blakney* 1970 119 CLR 435 paras 3-5 and 9.

³⁷⁷ *Banque Brussels Lambert SA v Australian National Industries Ltd* 1989 21 NSWLR 502 at 524.

³⁷⁸ *Banque Brussels Lambert SA v Australian National Industries Ltd* 1989 21 NSWLR 502 at 523.

In accordance with the *Kleinwort Case*, and in line with the United Kingdom's Insolvency Act,³⁷⁹ the liability of a parent for its subsidiary entity debts does not stand unless it could be shown to be predicated on fraudulent or wrongful trading acts.³⁸⁰ Creditors of a subsidiary are, therefore, in a somewhat vulnerable position. However, the situation is fundamentally different under the Australian law.³⁸¹

LOCs, if they provide proper effect to a commercial transaction, will be taken as legally binding and enforceable³⁸² in Australia irrespective of statements couched in them.³⁸³ However, according to Deane,³⁸⁴ the purpose of courts, in any contractual disputes, is to give effect to the *consensus ad idem* (meeting of the minds)³⁸⁵ of the parties through closely interrogating the words in their contractual agreements.

4.7 Challenges involving letters of comfort

Several notable challenges on LOCs have emerged from the literature review, case law and electronic sources, that have been analysed. These challenges include:

4.7.1 Classification and categorisation of letters of comfort

There is generally a lack of classification of LOCs as they appear to lie somewhat outside the legal reach. Contract law and/ or common law do not adequately cover LOCs. LOCs have been classified by some authors to range between strong (hard)³⁸⁶ to weak (soft)^{387,388} depending on the wording couched in them.³⁸⁹ The degree of

³⁷⁹ Sections 213 & 214 of the *Insolvency Act* 1986.

³⁸⁰ Forte 1990 *Journal of Maritime Law and Commerce* 99.

³⁸¹ Pugh-Thomas 1990 *Journal of International Banking Law* 342; *Banque Brussels Lambert SA v Australian National Industries Ltd* 1989 21 NSWLR 502.

³⁸² Gruzman and Sutherland 2004 *International Financial Law Review* 45.

³⁸³ Trichardt *Letters of Comfort* 300.

³⁸⁴ Deane 1992 *Asia Pacific Law Review* 92.

³⁸⁵ McLauchlan 2005 *University of Queensland Law Journal* 479.

³⁸⁶ Ellinger 1991 *Singapore Journal of Legal Studies* 3.

³⁸⁷ DiMatteo and Sacasas 1995 *Baylor Law Review* 371, 378.

³⁸⁸ Trichardt 2001 *TFLR* 162.

³⁸⁹ Faul 1990 *Journal of South African Law* 76.

commitment made in the LOCs determines their promissory character³⁹⁰ as well as the extent to which they bind the issuer.³⁹¹

Schneider suggested three categories in relation to the binding nature of LOCs,³⁹² *viz*, (i) strong LOCs which impose strong legal obligations on the issuer³⁹³ because they are comparable to a guarantee; (ii) mild ones which impose some level of obligation on the parent company whereas the latter might not be directly held responsible for the debt of its subsidiary if a contractual agreement fails; and (iii) weak LOCs which do not attach any liability to the parent company at all.

The latter are simply letters of acknowledgement, acts of comity³⁹⁴ or awareness, and carry no legal obligations.³⁹⁵ However, courts are now becoming more reluctant to allow LOCs to "reside in the twilight zone of merely honourable engagements",³⁹⁶ or be merely considered as "matters outside the reach of legal remedies".³⁹⁷ The law in Anglo-common law jurisdictions is moving towards providing legal certainty to transactions involving LOCs.³⁹⁸

4.7.2 *Promissory nature of letters of comfort*

The promissory character of LOCs is determined by two factors: promise and intention.³⁹⁹ First, under the promise, there should be three important requirements: the promise (a) should be a voluntary and a personal act, (b) must be future oriented but not too distant,⁴⁰⁰ and (c) should be an act wanted by the *promisee*.⁴⁰¹

³⁹⁰ Schneider 1978 *International Business Lawyer* 304.

³⁹¹ Schollen 1994 *International Business Law Journal* 795.

³⁹² Schneider 1978 *International Business Lawyer* 304.

³⁹³ Omoaka and Ohajinwa 2019 <https://www.templars-law.com/wp-content/uploads/2019/07/Templars-Thought-Leadership-Just-How-Worthless-is-that-Letter-of-Comfort.pdf> 3.

³⁹⁴ Sacasas and Wiesner 1987 *Banking Law Journal* 315.

³⁹⁵ Faul 1990 *Journal of South African Law* 73.

³⁹⁶ *Banque Brussels Lambert SA v Australian National Industries* 1989 21 NSWLR 502 para 523.

³⁹⁷ Perell 2001 *Canadian Business Law Journal* 434.

³⁹⁸ Perell 2001 *Canadian Business Law Journal* 432; *Banque Brussels Lambert SA v Australian National Industries* 1989 21 NSWLR 502 para 523.

³⁹⁹ Shawn 2011 *Mondaq* <https://www.mondaq.com/canada/capital-adequacybasel/158494/how-comforting-is-a-comfort-letter> Accessed 27 July 2022.

⁴⁰⁰ Stoljar 1998 *The Cambridge Law Journal* 204.

⁴⁰¹ Trichardt *Letters of Comfort* 303.

Second, there must be an intention and understanding of the parties on the contractual agreement reached. Once these elements are met, an LOC can be legally enforced under the concluded contractual agreement. However, LOCs by themselves may not sufficiently amount to contracts or decisions,⁴⁰² but may serve as bases for a promissory estoppel claim⁴⁰³ if the plaintiff can demonstrate that it had relied reasonably on the futuristic promise or assurance made by the defendant to his or her detriment.⁴⁰⁴

Courts will take into account all the circumstances leading to the issuance of LOCs, including written and oral evidence, when they determine their legal efficacy. As demonstrated in a number of cases,⁴⁰⁵ the courts are apparently slowly moving away from applying narrow punctilious "minute textual analysis" of what is inscribed in the LOCs, as this might render the courts irrelevant in mitigating against commercial disputes.⁴⁰⁶ Accordingly, the court held in the *Banque Brussels* case that it would be "inimical to the effective administration of justice in commercial disputes that a court should use a finely tuned linguistic fork"⁴⁰⁷ to settle commercial disputes. The use of LOCs to facilitate an exigent contractual transaction should not be taken lightly in view of their legal ramifications.⁴⁰⁸ The issuer of an LOC needs to beware of the legal traps associated with them.⁴⁰⁹ When dispute arises out of LOCs, the courts would be inclined to entertain all pertinent arguments about the intentions of the parties in contractual agreements as well as the interpretation of the LOCs.⁴¹⁰ In *Chemco Leasing SpA v Rediffusion*,⁴¹¹ the court held that the issuer of an LOC was summarily confirmed to be assuming responsibility for the payment of the affiliate's debts, through an LOC⁴¹² and, as such, had to be subrogated to the

⁴⁰² Furmston *Law of Contract* 424.

⁴⁰³ Hillman *Contract Law* 98.

⁴⁰⁴ DiMatteo *International Business Law* 336.

⁴⁰⁵ *Banque Brussels Lambert SA v Australian National Industries Ltd* (1989) 21 NSWLR 502.

⁴⁰⁶ *Banque Brussels Lambert SA v Australian National Industries Ltd* (1989) 21 NSWLR 502 at 523.

⁴⁰⁷ *Banque Brussels Lambert SA v Australian National Industries Ltd* Supreme Court of NSW (1989) 21 NSWLR 502.

⁴⁰⁸ Schneider 1978 *International Business Lawyer* 304.

⁴⁰⁹ Sacasas 1989 *Banking Law Journal* 174.

⁴¹⁰ Perell 2001 *Canadian Business Law Journal* 425.

⁴¹¹ *Chemco Leasing SpA v Rediffusion PLC* 1983 C 7901.

⁴¹² Brown 1990 *Journal of Business Law* 283.

addressee's rights upon their discharge.⁴¹³ An LOC issued to Chemco stated the following:⁴¹⁴

Dear Sirs, We thank Chemco Leasing S.p.A. ('Chemco') for the confidence which has been expressed in our subsidiary Computer Machinery Corporation Italia S.p.A. ('CMC Italy') of Via F. Ferruccio 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 99.91% by Computer Machinery Corporation France S.A. 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 interest 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.

This is consistent with the court's decision in *Banque Brussels*.⁴¹⁵ Since LOCs are transboundary commercial instruments (for instance, where a holding company could be located in another country while its subsidiary is operating in a different jurisdiction; see *Kleinwort Benson*), the applicable law and the litigation forum could be paramount when it comes to the legal enforceability of the LOC, should one party default in its contractual obligation.

4.7.3 Courts disposition of letters of comfort

It is becoming apparent that, when an LOC is allegedly dishonoured by a defaulting party, it is even more difficult for the courts to arrive at a just outcome.⁴¹⁶ This sentiment is reflected by the inconsistent outcomes between *Kleinwort Benson* and *Banque Brussels* cases, despite the fact that the LOCs in both cases appear

⁴¹³ Ellinger 1991 *Singapore Journal of Legal Studies* 3.

⁴¹⁴ Chemco Leasing SpA v Rediffusion PLC 1983 C 7901; Brown 1990 *Journal of Business Law* 281-282.

⁴¹⁵ *Banque Brussels Lambert SA v Australian National Industries* 1989 21 NSWLR 502.

⁴¹⁶ *Australian European Finance Corporation Ltd v Sheahan* 1993 60 SASR 187 at 206; Perell 2001 *Canadian Business Law Journal* 435.

somewhat similar.⁴¹⁷ The main difference was that, in the case of Banque, the plaintiff (BBL) requested that it be furnished with a strongly worded LOC after it had rejected a draft that expressly stated that an LOC was not a guarantee.⁴¹⁸ This, together with the intention of the parties to create a legal relation, sealed the matter in favour of BBL.⁴¹⁹ In the past, moral obligations of LOCs weighed more than legal consequences. It became a matter for the courts to resolve.⁴²⁰ There is a need by the Anglo-common law jurisdictions to align with the international jurisprudence on the disposition of LOCs.

4.7.4 Prudency in acceptance of letters of comfort

The recipient of an LOC must exercise prudency before accepting it from any holding company. It is important for the recipient to evaluate the degree of importance that the holding company attaches to the economic and financial wellbeing of its subsidiary so as to ascertain that the risk of defaulting by the subsidiary is relatively low. The recipient of an LOC needs to ensure that the holding company has a high standing and reputational track record for trading in that particular business, which might be seriously eroded or severely undermined in the marketplace by other role players if its subsidiary reneges on its obligations. It may be prudent for the recipient to enquire about previous LOCs issued by the holding company and its familiarity with the use of these commercial instruments.

4.7.5 Keep track of the holding company and its subsidiary as their business evolves

The recipient of an LOC (lender) needs to keep track on an on-going basis of commercial developments around the holding company and its subsidiary even when the latter continues to meet its financial obligations. This would alert the lender to early signs of financial deterioration in the holding company and its

⁴¹⁷ Perell 2001 *Canadian Business Law Journal* 433.

⁴¹⁸ Shawn 2011 *Mondaq* <https://www.mondaq.com/canada/capital-adequacybasel/158494/how-comforting-is-a-comfort-letter>.

⁴¹⁹ Shawn 2011 *Mondaq* <https://www.mondaq.com/canada/capital-adequacybasel/158494/how-comforting-is-a-comfort-letter>.

⁴²⁰ Sacasas 1989 *Banking Law Journal* 173.

subsidiary and allow for taking appropriate actions as needed to manage its credit facility with the borrower.

4.7.6 Process awareness

It is critical that designated people selected to prepare and manage LOCs in a company are made aware of the internal control processes that need to be followed prior to the issue of these to the creditor. The content inscribed in them needs to be discussed extensively in terms of a precise interpretation, since it might be difficult to renegotiate the terms once they have been accepted by the creditor. The researcher would caution against negligently issuing a strong and binding LOC or accepting a LOC on the ill-informed premise that it is strong and binding.

4.7.7 Records of letters of comfort in circulation

It would be prudent to keep and maintain all records of all LOCs, including expired ones, in a dedicated company folder. This will ensure that all previously issued LOCs to any credit provider are centrally controlled and managed. There should be a recognised standard guideline used in all LOCs, where possible. They need to be thoroughly reviewed for inaccuracies and it must be ensured that they reflect the correct affairs of the company.

4.7.8 Intentions must be made clear to the creditor

Prior to the issuance of the LOC, the creditor should be made aware about the intention of the parties and the legal efficacy of the LOC. In other words, there should always be a meeting of minds among parties before an LOC is issued to the creditor. This will ensure that the creditor is aware of the contractual effect of an LOC and underline that it is not some form of guarantee granted to the creditor if the arrangements fall away during the subsistence of the contract. The creditor needs to be made aware that a typical LOC is a communication instrument without any legal effect prior to issuing it.

4.7.9 *Specification in letters of comfort*

The issuer of an LOC must limit it to a specific loan arrangement, such as an advance, loan, temporary credit facility or service. Any variation to the terms of the contractual arrangement must invalidate the LOC. As stated, legal counsel needs to peruse closely an LOC prior to its issuance to the creditor so as to ensure that no unintended potential liabilities to the creditor are reflected in the letter. It will also be advisable for the tax advisors to review an LOC to ensure that no unintended tax consequences are created by it. Further information that needs to reflect clearly in an LOC is:

- (a) The name of the entity issuing the LOC;
- (b) The current location from which the issuer is proposing to issue the LOC;
- (c) The recipient (creditor) address;
- (d) The name of the bank which would be providing the credit service including specifying the exact amount an LOC is soliciting;
- (e) The recipient of the credit facilities from the creditor and where the service will be provided;
- (f) Notification by the credit recipient to the issuer of an LOC when the credit facility is no longer in use or when changes are effected in the arrangement of the credit loan facilities;
- (g) Reflecting the benefits it (the LOC) intends to accrue to the issuer to avoid the risk that the latter has acted in *ultra vires* to its company's powers and authority; and
- (h) Ascribing the jurisdiction for resolution of legal disputes and application of law.

4.7.10 *Expiry and termination of letters of comfort*

When the purpose for the issuance of an LOC has been fulfilled for any particular reason such as that it has expired without prospect of renewal, the issuer must notify the creditor about the termination of its effect, and request that the creditor hand it over. A new LOC should be issued for a new service should it be required.⁴²¹

4.8 *Features of the letter of comfort*

The issuer of LOCs needs to be conversant with the following fundamental features attached to LOCs:

⁴²¹ ACT 2013 <https://www.treasurers.org/ACTmedia/loc.pdf> 25-26.

An LOC must not carry unplanned legal formalities that may mean that it will be interpreted as a legally binding and enforceable document. Instead, an LOC is an assurance provided by a third party on behalf of its subsidiary that the subsidiary has the financial ability to meet its financial obligations to the lender. It can be regarded therefore as a moral obligation rather than a legal obligation for the borrower in a contractual arrangement.

It is imperative that no jurisdiction, location of subsidiary and so on are specified in the letter since such specifics could render the LOC legally enforceable as contract.⁴²² Specifics that could render an LOC to be deemed as a personal undertaking⁴²³ need to be avoided.^{424,425} An LOC must specify the use of a credit service to be utilised and clearly indicate that it is issued not as a condition precedent but as a temporary credit facility to be issued by the lender to its subsidiary.

It is not unfathomable that an LOC may carry a statement of awareness to avoid any misstatements:⁴²⁶ i.e. (i) we hereby support the commercial contract that our subsidiary is entering into with you; (ii) it is our policy to ensure that loan arrangements are repaid as and when they become due; (iii) we pledge full cooperation to ensure that the loan agreement between our subsidiary is repaid in full. However, statements such as "we will support the business ventures of our subsidiary" may be enforceable against the issuer of the LOC.⁴²⁷

A disclaimer must also be inserted by the issuer into an LOC to dispel the legal nature that the letter purports to convey.⁴²⁸

An LOC must carefully state the contemporary facts and opinion about the financial, managerial and decision-making independence enjoyed by its subsidiary. This will

⁴²² ACT 2013 <https://www.treasurers.org/ACTmedia/loc.pdf> 14.

⁴²³ Allan 2013 *Otago Law Review* 60.

⁴²⁴ *Paulger v Butland Industries Ltd* [1989] 3 NZLR 549; Pratt 1991 *International Company and Commercial Law Review* 26-29.

⁴²⁵ ACT 2013 <https://www.treasurers.org/ACTmedia/loc.pdf> 14, 16.

⁴²⁶ DiMatteo and Sacasas 1995 *Baylor Law Review* 362; ACT 2013 <https://www.treasurers.org/ACTmedia/loc.pdf> 15.

⁴²⁷ ACT 2013 <https://www.treasurers.org/ACTmedia/loc.pdf> 18.

⁴²⁸ ACT 2013 <https://www.treasurers.org/ACTmedia/loc.pdf> 14.

ensure that there will be no future or promissory undertakings attached to the holding company if the financial misfortune of its subsidiary occurs, unless such a liability is expressively stated. Coupled to this notion, there must be no expiry date on the letter. Some authors prefer setting an expiry date,⁴²⁹ which should in most cases be avoided.⁴³⁰ It is always advisable to use the same letter of comfort if a new temporary credit facility is required by the subsidiary.

The policy of the holding company should be explicitly made clear and must reflect its material condition at the time when an LOC is issued. In this way, the holding company might not be found at fault should its policy change in future.

4.9 Conclusion

The court's decision in the case of *Kleinwort Benson*, in which it was held that LOCs did not create binding obligations,⁴³¹ raised the questions of whether (i) LOCs have commercial value and (ii) whether they should be dispensed with altogether. The nature of LOCs has been too complex to just do away with. Even though the claims advanced in case of *Kleinwort Benson* failed for the respondent, the court found importance and value in the continual use of LOCs. Thus, LOCs still have significant value in commercial transactions.

Another important component of LOCs is that they serve as communication instruments. The issuer, which makes unilateral statements,⁴³² always has a choice to make the meaning of words in an LOC clear or ambiguous. The author of the fifth letter in *Leigh Instruments* made it manifest that an LOC did not constitute a legal undertaking. That provided an escape route for the company since the earlier LOCs did not contain similar language. The other four LOCs presented problems that were even more difficult, namely of interpreting not only their language but also their circumstances. Notwithstanding the detachment of liability to the parent company due to the fifth letter, it is fair to submit that they were also vulnerable to

⁴²⁹ Faul 1990 *Journal of South African Law* 81.

⁴³⁰ ACT 2013 <https://www.treasurers.org/ACTmedia/loc.pdf> 15.

⁴³¹ Cavendish LawCards *Contract Law* 34.

⁴³² Bernstein and Zekoll 1998 *American Journal of Comparative Law Supplement* 99.

defeat.⁴³³ Deane suggests that statements such as "it is our policy (or) practice to ensure that a borrower can repay a loan"⁴³⁴ should not be used unless qualified further with additional submissions by the parent company that it would not go against its policies in relation to repayments of loans by its subsidiary.⁴³⁵ However, care should be taken that such an undertaking can be construed to mean a guarantee as was the situation in the case of *Banque Brussels Lambert SA v Australian National Industries*.⁴³⁶ In this case, the parent company made an undertaking that it will guarantee the loan agreement of its subsidiary until it was fully paid up. The subsidiary went into liquidation and the parent company was held liable for the outstanding loan.

It should be emphasised that a breach of contract and breach in delict are fundamentally different. Breach of contract involves a non-fulfilment or failure to honour an obligation as per contract by a contractual party. The primary remedy is directed at enforcing the fulfilment of performance of the contract. On the other hand, a delict manifests as a result of a violation of a recognised interest or right of another party. Primarily delictual remedies centre around damages and do not occur at non-fulfilment of the contractual obligations.⁴³⁷ It is the combination of statements or undertakings in an LOC that determines its enforceability and the extent to which the holding company can be held legally liable.

In conclusion, LOCs have been proven to have contractual effects in some jurisdictions within the ambit of Anglo-common law. In South Africa, Canada and the United Kingdom, LOCs are, in principle, not binding and legally enforceable. However, in Australia LOCs are considered to be legally binding and are viewed as integral part of the contractual agreement. Chapter 5 accordingly provides integrative conclusions about LOCs.

⁴³³ Perell 2001 *Canadian Business Law Journal* 442.

⁴³⁴ *Kleinwort Benson Ltd v Malaysia Mining Corporation Berhad* 1989 1 All ER 785.

⁴³⁵ Deane 1992 *Asia Pacific Law Review* 93.

⁴³⁶ *Banque Brussels Lambert SA v Australian National Industries* 1989 21 NSWLR 502.

⁴³⁷ Neethling and Potgieter *Law of Delict* 6, 176.

Chapter 5: Conclusion

5.1 Introduction

LOCs are controversial⁴³⁸ as well as complex commercial instruments⁴³⁹ that are often misunderstood in the financial sector.⁴⁴⁰ Unlike a guarantee,⁴⁴¹ an LOC does not, by itself, amount to a contract, while it can nonetheless have a contractual effect.⁴⁴² However, the use and reasonable reliance on LOCs have grown over the years because of the advantages embedded in them,⁴⁴³ despite their legal efficacy.⁴⁴⁴ As stated in chapter 1, LOCs are voluntarily and unilaterally issued by a third party, and do not require any form of response, acceptance or even consideration from the recipient.

The holding company issues LOCs to influence the loan agreement between its subsidiary and the lender without promising anything.⁴⁴⁵ For this reason, LOCs cannot be equated with agreements or contracts. However, in some situations, the lender might require the parent company to issue it with an LOC to facilitate an agreement of loan agreement between the contracting parties.⁴⁴⁶ This phenomenon make it difficult to assess the legal status of an LOC.

5.2 Re-examining the research motivation and research question

The motivation for this research was two-fold:

- (a) Firstly, to investigate the legal status, nature, scope, efficacy and validity of the LOCs in South Africa. As pointed out in Chapter 1, there are several legal problems associated with LOCs, stemming from the fact that LOCs are not legally called for in law for the conclusion of any valid contract. This means, LOCs cannot be classified strictly as part of the agreement or contract. Another problem is that LOCs are couched in such a way that they are to be perceived as statements of financial support but without committing to anything. Therefore, the main objective of this research is to try to evaluate the general

⁴³⁸ Sections 1.1 & 2.1.

⁴³⁹ Sections 1.1 & 2.1.

⁴⁴⁰ Sections 1.2, 2.2 & 4.6.

⁴⁴¹ Sections 1.2 & 4.4.1.

⁴⁴² Sections 1.2 & 4.4.1.

⁴⁴³ Sections 1.1.

⁴⁴⁴ Section 4.3.

⁴⁴⁵ Sections 1.1 & 2.1.

⁴⁴⁶ Sections 1.1.

guidelines in the assessment of letters of support, especially when these can be equated with a legally binding commitment.

- (b) Secondly, to identify and evaluate regulatory gaps in the South African legal framework since there is no legislation that governs and regulate LOCs. The research is also extended to compare how other jurisdictions regulate LOC and what lessons can South Africa learn from those regulations, while taking note of the fact that the jurisprudence of South Africa differs from those of other countries due to its unique material conditions centred on cultural identity, socio-economic structure, political landscape and the legal system.

The research question was: What is the legal status of letters of comfort? To address this question, the research interrogated the following factors, which are linked to LOCs: (a) the legal validity or nature of the LOCs; (b) the extent to which the LOCs could be legally enforceable under various jurisdictions; (c) the approaches of courts in determining the promissory nature of LOCs; (d) the implication of the *consensus ad idem* between the parties; as well as (e) the reliance on a "gentleman's agreement" when dealing with LOCs. In other words, the research was more interested on the legal status of LOCs and the extent to which these letters could have legal capacity to bind parties to the agreement.

5.3 Main research findings

In South Africa, LOCs are treated on a case-by-case basis whereby courts interrogate the content inscribed in them without much reliance to any landmark cases. LOCs are not prominent in South African case law and neither is there much written of LOCs in South African textbooks. The seminal LOC case in South Africa was *Bernert v ABSA*,⁴⁴⁷ which was settled by the Supreme Court of Appeal. Albeit not described as LOC in the aforesaid case, the import and purpose of the bank's letter may be reduced to an LOC. The court abrogated the decision of the court of first instance and ruled that the so-called letter of comfort was non-binding and thus unenforceable. Interestingly, the matter decided by the Constitutional Court, on leave of appeal, did not centre on an LOC but on delict and misrepresentation by ABSA Bank to the aggrieved party (Bernert). Based on review of extant literature, academic articles, case law and electronic sources, the following remarks are

⁴⁴⁷ Sections 2.2 & 4.2.1.

recorded with reference to the research question, as itemised and discussed in each instance below.

In other Anglo-common law jurisdictions, courts' view LOCs differently. In the UK and Canada, LOCs are considered to have no legal effect. However, in Australia, the courts regard LOCs to be promissory in nature, legally binding and enforceable.

5.4 Answering the research question

In responding to the research question, the study probed the following elements:

5.4.1 The legal validity or nature of the letter of comfort

In South Africa, as in other international jurisdictions, it was found that there is no clear legal definition of what constitutes a document to be classified as the letter of comfort. It has been established in this research that the legal validity, nature and efficacy of an LOC resides mainly in its promissory character and the contractual effect it has. The *consensus ad idem* (meeting of minds) between contracting parties plays a significant role in determining the legal validity of an LOC around facilitating contractual agreements. The onus of rebutting the intentions of the parties lies with the issuer of the LOC. The use of LOCs stands in stark contrast to the frequent employment of e.g. suretyships and guarantees in the commercial world in South Africa.

5.4.2 The extent to which letters of comfort is legally enforceable under domestic law, foreign law or international law

It has been established that various Anglo-common law jurisdictions follow different approaches in determining the enforceability of LOCs.⁴⁴⁸ Except for Australia, where courts are likely to enforce contractual agreements which were facilitated through LOCs (see again *Banque Brussels Lambert v Australian National Industry* case and *Gate Gourmet v Gourmet case*),⁴⁴⁹ it would remain up to the discretion of courts to

⁴⁴⁸ Section 4.6.

⁴⁴⁹ Section 4.5.

adjudicate over disputes involving LOCs in other Anglo-common law jurisdictions. In Anglo common law jurisdictions, the legal validity and nature of LOCs are to some extent still uncertain. However, courts are increasingly likely to enforce commercial contracts stemming from LOCs. Other countries, besides Anglo-common law ones, assign far less weight to the textual interpretation of LOCs than they do to contractual obligations and liabilities arising from the breach of contract.⁴⁵⁰ It should be noted that LOCs are autochthonous in nature,⁴⁵¹ as LOCs are largely dependent on the jurisprudence of each jurisdiction.

5.4.3 *The promissory nature of letters of comfort*

It has been shown that the courts have discretion to adopt any literal or constructive approach when it comes to interpreting LOCs. In *Kleinwort Benson*, the court of appeal arrived at a different outcome to the court of first instance in its interpretation of mainly the same facts. In *Banque Brussels*, the court strongly criticised a textual interpretation of LOCs as applied in *Kleinwort Benson*. Most countries accept LOCs to form part of the contractual agreements and thus view them as legally binding and enforceable.⁴⁵²

5.4.4 *The implication of the consensus ad idem between the parties*

In most of the analysed cases, the courts had to interrogate background factors, intention, the understanding of the parties, in respect of the LOCs, and the reasons for the issuance of LOCs. The onus of rebuttal always lied with the party that issued the LOC. More importantly, it was found that the title "letter of comfort" was not considered to be a material factor in deciding a dispute but, instead, that which was specified in the LOC. The *Kleinwort Benson* case showed that, even though the issuer had expressively refused to grant a guarantee, it did not allow the company to escape from contractual liability.

⁴⁵⁰ Section 2.6.

⁴⁵¹ Trichardt *Letters of comfort* 307.

⁴⁵² Sections 2.3, 2.4, 2.5 & 4.6.

5.4.5 The reliance on "gentleman's agreement" when dealing with letters of comfort

The research findings indicate that within the Anglo-common law jurisdictions, the courts have diverse approaches.⁴⁵³ The degree of legal efficacy, as scribed in LOCs, has been a determinant factor for the courts to rule upon them. Most countries within the Anglo-common law jurisdictions, besides Australia, still treat LOCs as gentleman's agreements. Australia, on the other hand, summarily, regards LOCs as commercial instruments that attract legal consequences.

5.5 Recommendations

5.5.1 Enactment of legislation

To bring about legal certainty in the legal space, South Africa should consider enacting specific legislation to regulate the use of LOCs. Failure of which, there are number of statutes that govern the banking regulations in the country which might be considered for amendments to ensure that provisions to manage LOCs are incorporated. The amendments could be made in statutes such as the *Banks Act*,⁴⁵⁴ and *National Consumer Act*⁴⁵⁵ to incorporate provisions that deal with the nature and legal status of LOCs. More importantly, provisions in the above-mentioned Acts must be enacted to protect the rights of the issuer as well as the recipient of LOCs. As the situation currently stands, LOCs could be operating outside legal reach. The research found that it was very cumbersome for the courts to provide literal and contextual interpretation to letters of comfort every time these letters had been dishonoured. As pointed out in this report, LOCs are susceptible to fraudulent use. It is very difficult to establish the nexus between deceitful use of letters of comfort by the third party and misplaced reliance on letters of by creditor.

5.6 Conclusion on the legal status of letters of comfort

⁴⁵³ Section 4.6.

⁴⁵⁴ *Banks Act* 94 of 1990.

⁴⁵⁵ *Consumer Protection Act* 68 of 2008.

At this point, it remains very difficult to establish precisely the legal status of LOCs in South Africa. South Africa does not have specific legislation that governs or regulates LOCs. The disputes arising out of LOCs are resolved through the application of contract law principles. It appears, at this stage, that South Africa legal system could be aligned to the British Common Law in evaluating the legal validity of LOCs. To bring some degree of certainty in the application of LOCs, some authors have proposed that LOCs should be restructured in the form of guarantees. It is argued by the researcher that LOCs should not be conflated with guarantees or be considered as alternatives to guarantees. To try and link up LOCs to guarantees or any form of security will hamper the development of our jurisprudence when it comes to the effectiveness of this legal instrument. To eliminate the uncertainties around LOCs, these letters need to be regulated under law. In that way, LOCs will become "fully-fledged" commercial instruments that have a legally binding and enforceable effect. Concomitantly, this will also guard against unconscionable abuse of subsidiaries by their parent companies. At this stage, subsidiaries have neither influence nor control and generally lack decision-making powers to determine what could be inscribed in the LOCs by their parent companies and what is intended by the parent company may be found wanting when courts are called upon to decide on the interpretation of an LOC. The inverse may also be true: South African commerce succeeded to work without referral to LOCs but should be aware of the risks associated with LOCs when involved in international commerce.

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