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# Kleinwort Benson Limited v. Malaysian Mining Corporation Berhad — A Comparative Note on Comfort Letters

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In *Kleinwort Benson Ltd v. Malaysian Mining Corp. Bhd*, the English Court of Queen's Bench held that a comfort letter created a binding legal obligation. This case is of particular interest because the Court refused to classify the comfort letter as a guarantee. The author analyzes the reasoning in *Kleinwort*, and provides a comparative analysis of comfort letters at common law, with comfort letters in French and German law.

Dans l'affaire *Kleinwort Benson Ltd v. Malaysian Mining Corp. Bhd*, la Cour du banc de la reine décida qu'une « comfort letter » était source d'obligation contraignante. Cet arrêt est particulièrement intéressant car la Cour refuse de classer la « comfort letter » au chapitre des garanties. L'auteur analyse le *ratio* de *Kleinwort*, et présente une analyse comparative des « comfort letters » en droit français, allemand et en common law.

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## Introduction

Comfort letters, which are also referred to as letters of comfort, letters of intent or letters of responsibility, are used frequently in commercial and corporate legal practice. Such a letter is usually written by a parent company<sup>1</sup> to the creditor<sup>2</sup> of a subsidiary or group company,<sup>3</sup> and makes certain statements about a loan made, or to be made, to the group company. These letters vary considerably in their wording, and as a consequence, in their legal effect.

The comfort letter is a phenomenon that can be observed in domestic as well as international trade. It is frequently used if the parties want to avoid spelling out clear liability, as would be the case, for example, if a guarantee were given. There are various motivations for issuing a comfort letter instead of a guarantee. It would be erroneous to assume that every issuer of a comfort letter is a potential rogue. One of the main reasons why the issuer wishes to avoid a guarantee is that a guarantee must be reflected in the issuer's account. It is arguable whether such an obligation exists for comfort letters.<sup>4</sup> Thus, the comfort let-

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Revue de droit de McGill

<sup>1</sup>Hereinafter referred to as "issuer".

<sup>2</sup>Hereinafter referred to as "receiver".

<sup>3</sup>Hereinafter referred to as "group company".

<sup>4</sup>Obermüller, "Die Patronatserklaerung" (1975) 4 ZGR 2ff.; Stoakes, "I have here a piece of paper signed by ..." [1986] Euromoney 181.

ter does not "taint" the books of the issuer or impair its ability to borrow. From the point of view of the receiver, the comfort letter poses a higher risk than a guarantee as it does not give water-proof security. On the other hand, the choice will frequently be to make a deal with the "perhaps-not-binding" assurance of a good client who has a good name to lose. In such a situation, the receiver would be inclined to accept the comfort letter instead of a formal guarantee, especially if there is a long and well-established business relationship between the issuer and the receiver.

Until recently, one could have said that these letters were treated differently in Germany and France, on the one hand, and in Canada, England and the United States on the other. Whereas French and German courts were more likely to give effect to these letters,<sup>5</sup> the common law jurisdictions did not attribute any legally binding effect to them.<sup>6</sup> This approach may change drastically with the decision in *Kleinwort Benson Ltd v. Malaysian Mining Corp. Bhd*<sup>7</sup>. This decision, of the Queen's Bench Division (Commercial Court), which is currently under appeal, suggests a new approach to comfort letters. Before turning to the *Kleinwort* decision,<sup>8</sup> however, it is useful to give a short overview of the different kinds of comfort letters that are used in commercial practice.<sup>9</sup> The analysis of the *Kleinwort* decision will be followed by a comparative analysis of French and German law,<sup>10</sup> and a critical appraisal of each country's approach.<sup>11</sup>

## I. Existing Types of Comfort Letters

Comfort letters can be drafted in a vast number of ways. Usually, one distinguishes between weak and strong comfort letters, depending on the expected

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<sup>5</sup>See, *infra*, sub. IV.

<sup>6</sup>Cf. *Canadian Encyclopedic Digest (Ontario)*, vol. 14, title 69, s. 6 [hereinafter C.E.D.]: "A guarantee differs from a letter of comfort in that a guarantee is intended to be a legally binding obligation, whereas a letter of comfort is intended to be no more than a statement of intention, and as such will not usually be binding." But, see, K.P. McGuinness, *The Law of Guarantee* (Carswell: Toronto, 1986), s. 12.11 at 363, who concludes that the comfort letter constitutes only a moral obligation and falls short of constituting an assumption of liability by the issuer. See, also, A.T. Miller, "Memorandum on Letters of Responsibility" (1978) 6 *Int. Bus. Lawyer* 328. This article is one of the very few from North America which deals with this subject, and it leaves no doubt that only very strong comfort letters have the potential to be legally binding — but as guarantees. Moreover, LEXIS ignores the word "comfort letter", and *Kleinwort Benson*, *infra*, note 7, is the first case published in England that deals with such letters.

<sup>7</sup>[1988] 1 All E.R. 714 (Q.B.) [hereinafter referred to as *Kleinwort*]. The parties are hereinafter referred to as "KB" (Kleinwort Benson Limited) and "MMC" (Malaysian Mining Corporation Berhad).

<sup>8</sup>*Infra*, s. III.

<sup>9</sup>*Infra*, s. II.

<sup>10</sup>*Infra*, s. IV.

<sup>11</sup>*Infra*, s. V.

degree of enforceability.<sup>12</sup> There is no doubt that one can establish a meticulous system for distinguishing between a dozen or more different types of comfort letters. For practical purposes, however, it is sufficient to mention the following basic types.<sup>13</sup>

### 1. *Declaration of Knowledge*

Infrequently, one encounters comfort letters where the issuer merely informs the receiver about its participation in the group company. This information is sometimes accompanied by a statement to the effect that the issuer has complete confidence in the entrepreneurial abilities of the management of the group company.

A comfort letter with this wording gives the creditor no protection at all in any jurisdiction. Such letters may comfort the addressee in that they suggest that the parent company has a name to lose, but nothing indicates a legally binding effect.

### 2. *Declaration of Intent to Participate*

It is relatively common to combine the acknowledgement of participation with a statement that the issuer does not intend to change his participation in the group company substantially. It may be added that if the issuer decides to sell the group company, it agrees to enter into negotiations until a solution satisfactory to both parties is found.

Such a comfort letter provides slightly more security, but in no way indicates a commitment to pay for the debts of the group company. So far, no court decisions giving effect to this type of comfort letter have been reported.

### 3. *Statement of Policy*

The statement of knowledge about the group company is accompanied, frequently, by a statement of policy. The issuer of the comfort letter may, for example, say that it has been its policy hitherto to regard the group company's obligations as its own; or that it would be contrary to the general policy of the group to let a group company fall into bankruptcy; or that it is the policy of the issuer to make sure that the group company is always in a position to meet its financial obligations.<sup>14</sup>

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<sup>12</sup>Stoakes, *supra*, note 4 at 181; Rümker, "Probleme der Patronatserklärung in der Kreditsicherungspraxis" [1974] WM 990; Obermüller, *supra*, note 4 at 1; see *MünchKerB* *Vertragshandbuch*, Band III, Handels— und Wirtschaftsrecht at 194.

<sup>13</sup>The following classification is based on the empirical research by Obermüller, *supra*, note 4, and Rümker, *supra*, note 12, as well as on the personal experience of the author.

<sup>14</sup>These statements approximate the wording in *Kleinwort*.

Obviously such a comfort letter provides more security than a declaration of intent to participate, although its wording falls short of a guarantee. In any event, the effect of this type of comfort letter is arguable.

#### 4. *Comfort Letters that Come Close to a Guarantee*

Finally, there are comfort letters that indicate a very strong degree of commitment by stating that the issuer will ensure that the group company fulfils its obligations, or will provide the group company with the financial means necessary to satisfy the receiver. Letters to this effect come, as will be seen,<sup>15</sup> very close to a guarantee under common law.

## II. *The Kleinwort Decision*

### 1. *Facts*

The factual background of *Kleinwort* is as follows. In 1983, MMC formed a wholly-owned subsidiary, MMC Metals Limited (M),<sup>16</sup> to operate in the London market. MMC provided the paid up capital of M, totalling £1.5 million. Since M needed substantial additional funding MMC approached KB. KB was, in principle, prepared to open a credit line, but proposed that MMC guarantee such credit.<sup>17</sup> MMC's representatives stated that it was not the policy of the firm to guarantee the debts of subsidiaries, but that they were prepared to issue a comfort letter. KB agreed to this, but on condition that a higher interest rate be paid. In accordance with KB's request, MMC produced a comfort letter for a first credit of £5.0 million. The letter read as follows:

We refer to your recent discussion with MMC Metals Limited as a result of which you propose granting MMC Metals Limited: a) banking facilities of up to £5 million; and b) spot and forward foreign exchange facilities with a limitation that total delivery in cash will not on any one day exceed £5 million.

[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<sup>18</sup>

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<sup>15</sup>See, *infra*, sub. III(3)(a).

<sup>16</sup>Hereinafter referred to as "M".

<sup>17</sup>*Kleinwort*, *supra*, note 7 at 717.

<sup>18</sup>*Ibid.* at 717-18.

Subsequently the facility was increased to a maximum of £10 million.<sup>19</sup> The full £10 million facility had been drawn when MMC Metals Limited became insolvent in 1985. KB demanded payment from MMC. MMC did not consider itself under any obligation and refused to pay. KB sued MMC for payment of the full amount of £10 million.

## 2. Legal Reasoning

The departure point of the decision is the question of whether the comfort letter was intended to create legal relations. This is a crucial point because “[a]n agreement, even though it is supported by consideration, is not binding as a contract if it was made without any intention of creating legal relations”.<sup>20</sup> According to the Court, this intention is generally assumed. Reference is made to *Rose & Frank Co. v. J.R. Crompton & Bros Ltd*,<sup>21</sup> where the Court held that:

To create a contract there must be a common intention of the parties to enter into legal obligations, mutually communicated expressly or impliedly. Such an intention ordinarily will be inferred when parties enter into an agreement which in other respects conforms to the rules of law as to the formation of contracts.<sup>22</sup>

If the parties intend to enter into an agreement without being legally bound, they have to express themselves precisely, such that outsiders may have no difficulty in understanding what they mean.<sup>23</sup>

Therefore, there is a presumption in business matters in favour of a contractual obligation.<sup>24</sup> In light of this, the Court considered the following points to be of particular importance:

(a) the language was formal and appropriate to legal obligations; (b) the letters of comfort were matters of importance to KB, and something on which they plainly relied in granting the facilities, in the first instance for up to £5m, and subsequently up to no less than £10m, to a company with a fully paid up capital of only £1.5m. It was also treated by MMC as important and as of significance, as shown by the board's resolution; (c) the extra 1/8% commission reflected the contrast between a contractual term, giving rise in case of breach to no more than a claim in damages, and a full blooded guarantee, which gave rise to a monetary claim which was much more easily quantifiable and enforceable; (d) if it was intended not to be legally binding, MMC could and should have said so, in which case KB could have considered their position.<sup>25</sup>

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<sup>19</sup>*Ibid.* at 718.

<sup>20</sup>*Chitty on Contracts*, 25th ed. (London: Sweet & Maxwell, 1983), para. 123 at 70, cited in *Kleinwort*, *supra*, note 7 at 718. See, also, *Edwards v. Skyways Ltd*, [1964] 1 All E.R. 494 (Q.B.).

<sup>21</sup>[1923] 2 K.B. 261 (C.A.), *rev'd* [1925] A.C. 445 (H.L.) [cited hereinafter to C.A.].

<sup>22</sup>*Ibid.* at 293 (*per* Atkin L.J.).

<sup>23</sup>*Ibid.* at 288 (*per* Scrutton L.J.).

<sup>24</sup>*Kleinwort*, *supra*, note 7 at 724.

<sup>25</sup>*Ibid.* at 721.

The leading argument, which is clearly spelled out under (b), and underlies argument (d), is the fact that KB relied upon the comfort letter and that MMC was well aware of this.<sup>26</sup> The Court recognized this reliance and delivered a judgment for KB. However, the court refused to classify the letter as a guarantee because it was not as precise and stringent as a guarantee.<sup>27</sup>

In finding in favour of KB, the Court faces the difficulty of how to evaluate the claim. This leads to the following question: what remedies are available to the receiver? A guarantee usually contains straightforward provisions to facilitate prompt enforcement in case of default. The situation is different with a comfort letter. As the Court points out,

the claim will not be for a liquidated sum, but for damages, whose precise quantification may be controversial, and which is always subject to the plaintiffs' duties to mitigate. Having regard to all these considerations, it is not in the least surprising that MMC, while rejecting a formal guarantee, were prepared to accept a paragraph like the present one.<sup>28</sup>

In dealing with comfort letters one has to bear these possible difficulties in mind. If, however, as in *Kleinwort*, the comfort letter is linked to a specific loan, it is obvious that the damages equal the amount which remains unpaid. Thus, the judgment for KB was in the sum of "£10,004,499.25 principal with interest on that sum ... making a grand total of £12,262,323.89."<sup>29</sup>

### 3. *The Decision in the Context of Previous Canadian and American Common Law*

It is not the intention of this paper to criticize the *Kleinwort* decision or to question its compatibility with former caselaw. Some aspects of the judgment, especially the Court's emphasis on the interests of KB, even though both parties were aware of the risks, will certainly draw criticism. In the context of a comparative study, however, it is sufficient to show that the common law, as compared with the law in Germany and France, has moved in a new direction.

It goes without saying that a single English decision, which is not binding as precedent on either Canadian or American courts, does not change the landscape of the law of guarantees and related instruments. However, Canadian courts have followed English precedents on a regular basis in the past, and American courts have already delivered judgments indicating that the treatment of comfort letters will change in the United States as well. It has already been stated that the common law of Canada and the United States has not hitherto

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<sup>26</sup>*Ibid.* at 723-24.

<sup>27</sup>*Ibid.* at 723.

<sup>28</sup>*Ibid.*

<sup>29</sup>*Ibid.* at 724.

attributed a legally binding effect to comfort letters.<sup>30</sup> However, a number of courts have dealt with letters that come very close, or are identical to, the strongest forms of comfort letters. The courts have usually approached these comfort letters as guarantees.

(a) The Notion of "Guarantee"

In this context, it is useful to state the definition of a guarantee *in abstracto* before turning to the caselaw. In *Campbell v. McIsaac*,<sup>31</sup> a guarantee was defined as a contractual obligation undertaken by one person (the guarantor) in which he promises that a second person (the principal) shall perform a contract or fulfil some other obligation, and that if the principal does not, the guarantor will perform the contract for the principal. McGuinness defines a guarantee as a contract to indemnify the creditor upon the occurrence of a contingency, namely the default of the principal.<sup>32</sup> According to a leading English textbook, the guarantee can be reduced to the following formula: "Deal with X, and if he does not meet his obligation, I will be answerable."<sup>33</sup> American definitions are very close to the ones just reported. The *Corpus Juris Secundum* defines the guarantee as a collateral undertaking by one person to answer for the payment of a debt, or the performance of some contract or duty, in the case of the default of another person, who is liable for such payment or performance in the first place.<sup>34</sup>

As with all contracts at common law, a guarantee requires consideration to be legally binding. This requirement is met when the creditor is induced to transfer funds to the principal.<sup>35</sup>

These definitions show that the common law guarantee is a rather flexible instrument. The obligation of the guarantor is not closely attached to the obligation of the principal.<sup>36</sup> The guarantor is *answerable*, and will *indemnify* the creditor. His obligation is not the same as the obligation of the principal.

The case of the guarantee arises when the principal debtor defaults upon the performance of his obligation. This is very similar to the situation of a comfort letter. The receiver cannot ask for damages unless the group company is in a situation where it can no longer meet its obligations.

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<sup>30</sup>See, *supra*, note 6 and accompanying text.

<sup>31</sup>(1873) 9 N.S.R. 287 (C.A.).

<sup>32</sup>*The Law of Guarantee, supra*, note 6, s. 3.7 at 25 *et seq.*

<sup>33</sup>*Anson's Law of Contracts*, by A.G. Guest, 26th ed. (Oxford: Clarendon Press, 1984) at 67.

<sup>34</sup>Vol. 38, "Guaranty", 1 at 1129.

<sup>35</sup>C.E.D., vol. 2, title 14, 584 at 331, with further references.

<sup>36</sup>See, *infra*, s. IV, for a discussion of German and French law. Both are much less flexible in this regard.

The guarantor is usually discharged if a material alteration of the contract takes place.<sup>37</sup> The Court in *Kleinwort* had no reason to decide whether this principle also applies to comfort letters. The question is, therefore, open to speculation. In view of the fact that comfort letters aim at damages, it seems more sensible to ask, in every case, whether such alteration has an impact on the damages sustained by the receiver, and if so, to what extent. In appropriate cases, the claim of the receiver should then be reduced accordingly.

(b) Case Law

In *Hernando Bank v. Bryant Electric Company, Inc.*,<sup>38</sup> the Court dealt with a situation where the defendant had partially taken over a company that was highly indebted to the plaintiff bank. The defendant gave notice of the new ownership and added, with respect to the outstanding loans, that it would "do everything possible to see that this is settled as per agreement."

This is, in effect, a comfort letter, in that it states a certain participation in the company, and declares an intention to proceed in a certain way concerning the debts of the group company. The Court stated that it is of primary importance to determine whether the language chosen by the parties indicates an intention to answer for the principal debt or for the obligation of the group company.

According to the Court, the phrase used by the defendant was not sufficient evidence of such an intention. There can be no doubt that the wording of the letter in this case was much weaker than the wording in *Kleinwort*. It is, of course, difficult to say whether the Court in *Kleinwort* would have decided the case differently. This, however, seems unlikely, in that the letter showed no commitment to a certain result, for example, to repayment, but only a vague commitment to enter into negotiations.

In *Exchange National Bank of Spokane v. Pantages*,<sup>39</sup> the wording of the letter in question was much stronger. The defendant in this case was a shareholder of a company which had asked the plaintiff for an extended loan. The defendant sent a telegram, in the following words, to an officer of the debtor company:

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<sup>37</sup>*The Law of Guarantee, supra*, note 6, s. 10.9 at 247 *et seq.*; "Memorandum on Letters of Responsibility", *supra*, note 6 at 330 *et seq.*

<sup>38</sup>357 F.Supp. 575 (D.C. Miss. 1973).

<sup>39</sup>133 P. 1025 (S.C. Wash. 1913).

Tell bank I request them to renew the note. Security just as good now as when loan was first made and they are collecting interest on their money. I will arrange things satisfactory to them upon my return....<sup>40</sup>

This message was communicated to the bank. The Court concluded that the message was intended to guarantee the loan, mainly because the bank relied on the assurance in renewing the loan, instead of proceeding on the debt. The defendant was aware of the expectation of the bank.

Thus, a letter which under modern notions would qualify as a very strong comfort letter, was treated as a guarantee. The letter in this case was, if at all, only a little bit stronger than the letter in the *Kleinwort* decision. As has been shown, however, the Court in *Kleinwort* rejected the classification of guarantee on formal grounds.

A more recent example is *Nimrod Marketing (Overseas) Ltd and T. Anderson-Slight v. Texas Energy Investment Corp.*<sup>41</sup> The situation in this case differed from that in a standard comfort letter case in that the defendants were participating in a joint venture, rather than being the owners of a group company. They induced the plaintiffs with a comfort letter to invest in this venture.<sup>42</sup> The Court found the defendants liable for "breach of contract", without stating whether it considered the letter to be a guarantee or a contract *sui generis*.

### (c) Conclusion

In conclusion, it can be said that even before *Kleinwort*, common law jurisdictions treated very strong comfort letters as legally binding. These letters were, however, labeled not as comfort letters, but as guarantees. The flexibility of the guarantee did not allow for weaker comfort letters, such as the one issued by MMC, to be treated as legally binding. Thus, the reasoning in *Kleinwort* is definitely a new development in the common law. It remains to be seen whether *Kleinwort* will become good law and whether it will be followed in Canada and the United States. It seems, however, that the foundations have been laid for the adoption of this decision.

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<sup>40</sup>*Ibid.* at 1026. Under the laws of most U.S. states, there are no requirements as to the form of guarantees: *Corpus Juris Secundum, supra*, note 34, 18 at 1155-57. Under Canadian law, the *Statute of Frauds* is applicable. For Ontario, see, R.S.O. 1980, c. 481, s. 4.

<sup>41</sup>769 F.2d 1076 (5th Cir. 1985).

<sup>42</sup>Although the wording of the comfort letter is not reported in this decision, it becomes obvious that it was close to a guarantee.

### III. Comparative Aspects

#### I. Germany

Comfort letters have been used frequently in Germany for several decades. Legal scholars and practitioners have analyzed and categorized comfort letters to an extreme degree. However, they are not regulated in the German civil code, the *Bürgerliches Gesetzbuch*,<sup>43</sup> and it was, therefore, necessary to find a way to fit comfort letters into the general system of the BGB.<sup>44</sup>

##### (a) Comfort Letters Stating a Certain Participation and/or the Intention to Uphold Such Participation

The “weak” comfort letters, which supply only information,<sup>45</sup> have very restricted effects under German law. The crucial question is the same as in common law, namely, whether the issuer had the intention of making a binding promise, or whether he should have reasonably foreseen that his declaration would be interpreted by the receiver as such a promise.<sup>46</sup> In the situation of a parent company corresponding with a financial institution about a loan to a group company, it is generally held that the issuer had this intention, or could reasonably have foreseen such an understanding on the part of the buyer.<sup>47</sup> Merchants who negotiate over considerable amounts of money are expected to know that their declarations have legal consequences.<sup>48</sup>

As a result, comfort letters are considered to be a valid offer by the issuer to enter into a contract *sui generis* to provide certain information about both the issuer and the group company. The implied acceptance of this offer can be seen in the transfer of funds to the group company. If, however, the information was correct at the time it was provided, no further liability can flow from such a letter. Nothing in it indicates or can be interpreted as indicating that the issuer assumes the obligation of the group company. Nothing prevents the issuer from

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<sup>43</sup>Hereinafter referred to as “BGB”.

<sup>44</sup>As noted in sub.(c), *infra*, it is not possible to subsume comfort letters under the provisions that govern guarantees.

<sup>45</sup>See, *supra*, s. II.1.

<sup>46</sup>Obermüller, *supra*, note 4 at 15; Schraepfer, “Die Patronatserklärung als Kreditsicherheit”, [1975] ZKW 215.

<sup>47</sup>Schraepfer, *supra*, note 46 at 216; Palandt, *Kommentar zum BGB*, 48. Auflage, München 1988, 676 Anmerkung 2 (Thomas).

<sup>48</sup>Obermüller, *supra*, note 4 at 6; Palandt, *supra*, note 47 at 676 Anmerkung 3 (Thomas); Möser, “Patronatserklärung und Kreditsicherheit”, [1979] DB 1469.

letting the group company fall into bankruptcy even if the creditor has been promised that a certain level of participation will be maintained.<sup>49</sup>

(b) Comfort Letters Stating a Policy

There is considerable dispute as to how these comfort letters should be treated. Most of them, as they are used in Germany, differ from the comfort letter issued by MMC in that they state that it is the *present* policy of the issuer to provide the group company with the necessary financial means. The majority of scholars stress this component, and argue that there is a binding contract to provide information about the issuer's policy. This does not, however, prevent the issuer from changing this policy.<sup>50</sup> Some scholars, on the other hand, argue that the general good faith clause of 242 BGB requires that even a letter stating only a *present* policy, contains an implied warranty to the effect that such policy will not be changed during the term of the credit.<sup>51</sup>

The majority opinion is convincing in light of the reluctance of German courts to grant motions or hold in favour of a party on the basis of good faith and confidence in commercial law.<sup>52</sup> In the case of the comfort letter issued by MMC, however, there can be no doubt that a legally binding obligation would be assumed under German law. The question of intention to be legally bound, in letters stating the amount of participation, also arises in letters stating a policy.<sup>53</sup> The issuer cannot pretend that he wanted to describe only a present policy, one that he might change any day without consequence. The legal consequence would be that the issuer is liable for the debt secured by the comfort letter — the same result reached by the Court in *Kleinwort*.

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<sup>49</sup>Rehbinder, *Konzernausserrecht und allgemeines Privatrecht*, 1969, at 332; Rümker, *supra*, note 12, at 994.

<sup>50</sup>Rümker, *supra*, note 12 at 994; Rehbinder, *supra*, note 49 at 332; Schraepfer, *supra*, note 46 at 217.

<sup>51</sup>Erman, "Zur Frage der Haftung der Hintermänner überschuldeter Gesellschaften" [1959] KTS 129 at 132; see Gerth, *Atypische Kreditsicherheiten*, Köln 1980 at 40ff.

<sup>52</sup>In BGHZ 45, 204, for example, the court had to decide a case where the wealthy Dean of a College had founded a limited partnership with a poor worker as the sole general partner. Though he was only registered as a limited partner, the Dean ran the business and conveyed to the creditors the impression that he would financially uphold the business in a crisis. (Under German law, a limited partner does not lose his limited liability merely by acting as a manager. See, Karsten Schmidt, *Gesellschaftsrecht*, Köln etc. 1986, at 1154 ff.) The Dean did not, however, issue a comfort letter. The partnership went into bankruptcy and the creditors sued the Dean. The Court ruled that the mere confidence could not generate any liability without the support of a legally binding declaration.

<sup>53</sup>*Ibid.*, sub.(a).

(c) Comfort Letters that Come Close To a Guarantee

In view of the treatment of strong comfort letters in common law jurisdictions, one may ask whether comfort letters can be classified as guarantees under German law.

The guarantee (*Bürgschaft*) is a special contract regulated by 765ff. BGB. Section 765 BGB reads as follows:

- (1) By a contract of guarantee, the guarantor binds himself to the creditor of a third party to be responsible for the fulfilment of the obligation of the third party.
- (2) A guarantee may also be assumed for a future or conditional obligation.

It is undisputed that from the wording of 765 (1) BGB, even the strongest comfort letter cannot be classified as a guarantee. Under 765 (1) BGB, the guarantor assumes the same obligation as the original debtor, the third party. This means that the creditor can demand that the guarantor meet the debt if the third party is in default.<sup>54</sup> The issuer of a comfort letter, on the other hand, is at most obliged to help the group company (the third-party debtor) fulfil the contract. From an economic perspective, there may be no difference between these obligations. A flawless legal analysis, however, commands that the comfort letter be regarded as a contract *sui generis* which bears certain characteristics of a guarantee.<sup>55</sup>

The legal consequences of such a contract are obvious in light of the fact that even weaker comfort letters are considered to be legally binding. The issuer is obliged to provide the group company with sufficient funds during the term of the loan.<sup>56</sup> The issuer is, however, not freed of its obligation merely by providing the money, unless the loan is actually repaid. This means that the issuer has to make further contributions if the money is seized by other creditors or spent by the group company for other purposes.<sup>57</sup> The Oberlandesgericht<sup>58</sup> Stuttgart recently held that this obligation becomes an obligation to pay damages if the group company falls into bankruptcy. These damages cover the loan as well as any expenses (interest, etc.).<sup>59</sup>

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<sup>54</sup>See, Palandt-Thomas, *supra*, note 48 at 765 Anmerkung 1.

<sup>55</sup>Rümker, *supra*, note 12 at 991; Obermüller, *supra*, note 4 at 25; Staudinger-Nipperdey, *Kommentar zum Bürgerlichen Gesetzbuch*, 741-822, 12. Auflage, Berlin 1982, 765 Rdn. 40.

<sup>56</sup>Rümker, *supra*, note 12 at 992; Schraepfer, *supra*, note 46 at 216.

<sup>57</sup>Obermüller, *supra*, note 4 at 26ff.; Rümker, *supra*, note 12 at 991.

<sup>58</sup>Court of Appeal, hereinafter OLG

<sup>59</sup>OLG Stuttgart [1985] WM at 455; see Obermüller, *supra*, note 4 at 28 ff.; Rümker, *supra*, note 12 at 991.

## 2. *France*

French doctrine has not analyzed comfort letters as meticulously as German doctrine. However, the rules that govern comfort letters are very similar. As early as 1973, the president of the Association professionnelle des banques declared that:

[il] atteste et certifie que, dans les usages bancaires français, la lettre, par laquelle une société de renom indiscuté sur le plan tant de la morale commerciale que de l'assise financière, parraine une société qu'elle contrôle pour l'obtention ou le maintien d'un crédit, constitue un engagement moral d'assurer la bonne fin du crédit et est considérée comme présentant en pratique une sécurité comparable à celle d'un engagement de caution.<sup>60</sup>

Nonetheless, this binding effect (of the same type as a "caution"<sup>61</sup>) is not attributed to all comfort letters, as an analysis of the reported decisions shows.

### (a) Court Decisions

In a relatively recent decision, the Cour d'appel de Paris<sup>62</sup> held that comfort letters which merely provide information have no binding effect. The letter in question was somewhat different from a standard comfort letter, in that the defendant bank vouched for the credit-worthiness of a client in the following terms:

Nous avons l'honneur d'introduire auprès de vous et de recommander à votre meilleur accueil M.L., de la société D., bon client de notre établissement. Nous vous serions reconnaissant de bien vouloir mettre à la disposition de M.L. et de lui fournir, dans la mesure du possible, les renseignements qu'il pourrait être amené à vous demander afin de faciliter sa mission.<sup>63</sup>

This letter induced the receiver to open credit lines to the said company which subsequently went bankrupt. The Court held that this letter was far too vague to generate legal obligations.<sup>64</sup> This holding has been approved by several learned writers.<sup>65</sup>

In 1979, the Cour d'appel de Paris dealt with a comfort letter in which the defendant made the following promise:

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<sup>60</sup>Cited in *Juris-Classeur Civil Art. 2011-2020*, Fasc. 1, no. 39.

<sup>61</sup>The equivalent of a guarantee, as shown, *infra*, notes 65 and 66, and accompanying text.

<sup>62</sup>See J. Mestre, "Obligations et contrats spéciaux", [1985] R.T.D.C. 726 at 730.

<sup>63</sup>*Ibid.*

<sup>64</sup>*Ibid.*

<sup>65</sup>Vasseur, "Observation", D.S. 1985, I.R. 340; Mestre, *supra*, note 62 at 731; *Supra*, note 60 at no. 40.

faire tout le nécessaire pour que sa filiale dispose d'une trésorerie suffisante lui permettant de faire face aux obligations par elle contractées envers la banque.<sup>66</sup>

In relation to the legal effects of this clause, the Court held:

En conséquence de la lettre d'intention, par laquelle une société s'engage envers une banque, pour une durée d'une année prorogée d'une seconde année, faute de dénonciation dans le délai prévu, à faire tout le nécessaire pour que telle autre société, sa filiale, dispose d'une trésorerie suffisante, lui permettant de faire face aux obligations par elle contractées envers la banque en compte courant, au titre d'opérations d'escompte et d'autres opérations de mobilisations de créances, du chef d'engagements de toute nature et de ce fait, de tout crédit consenti qu'elle qu'en soit la forme, la société-mère assume une obligation contractuelle aux termes de laquelle elle garantit le solde créditeur du compte de sa filiale dans les livres de la banque.<sup>67</sup>

Thus, the Court confirmed the legally binding character of a comfort letter that was very similar to the one issued by MMC in the *Kleinwort* case.

In 1985, the Cour d'appel de Montpellier reached the same result. The comfort letter in this case was even closer to that in *Kleinwort*, since it contained a statement as to the company's policy:

En qualité d'actionnaire majoritaire ..., nous affirmons notre intention de suivre et soutenir notre filiale dans ses besoins financiers et, dans le cas où cela deviendrait nécessaire, de nous substituer à elle pour faire face à tous les engagements qu'elle pourrait prendre à votre égard, notre souci étant de veiller de façon durable à sa totale solvabilité. Nous confirmons notre intention, en cas de nécessité, d'effectuer immédiatement les démarches nécessaires auprès de nos autorités pour obtenir l'autorisation de transfert des fonds.<sup>68</sup>

As in Germany, the idea of classifying the comfort letter as a guarantee — a "cautionnement" — is rejected. The "cautionnement" is regulated by art. 2011 *et seq.* of the *Code Civil Français*.<sup>69</sup> Article 2011 reads as follows: "Celui qui se rend caution d'une obligation se soumet envers le créancier à satisfaire cette obligation, si le débiteur ni satisfait pas lui-même."

The Cour d'appel de Montpellier held that a "cautionnement" under art. 2011 C.C.F. requires that the guarantor be obliged to satisfy the claim of the creditor as if he were the debtor. A mere obligation to fund the debtor is not sufficient.

French scholars have argued that it would be possible to classify such comfort letters as a "cautionnement", but those scholars do not advance the argu-

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<sup>66</sup>Vasseur, D.S. 1980, I.R. 55.

<sup>67</sup>*Ibid.*

<sup>68</sup>D.S. 1985, I.R. 341.

<sup>69</sup>Hereinafter C.C.F.

ment very forcefully.<sup>70</sup> In any event, the result, namely liability on the part of the issuer, is undisputed.

### Conclusion

A comparison of the laws of Canada, the United States, France and Germany, shows that comfort letters are beginning to receive similar treatment in each jurisdiction.

Concerning those comfort letters that spell out a clear obligation, it can be said that all jurisdictions reached the same result even before *Kleinwort* was decided, albeit for different reasons. The common law jurisdictions did not have to make use of the concept of comfort letters. The notion of guarantee was sufficiently flexible to cover comfort letters even if the wording of such letters did not meet the strictest requirements.

The civil law jurisdictions, Germany and France, were precluded from proceeding in this way. They had to develop the notion of a comfort letter because even the strongest of these letters would not qualify as a guarantee, under the rigid requirements of the BGB and the C.C.F., respectively. France and Germany, however, went one step further, by giving legal effect to comfort letters that could not possibly be subsumed under the notion of guarantee at common law.

The gap between the jurisdictions was quite significant even if German scholars and courts were hesitant about introducing equitable principles into commercial law. Further, it is not particularly difficult to imagine the problems of jurisdiction and private international law that could result from differences in treatment of an instrument that is frequently used in international trade.

It seems that this gap has been closed by the decision in *Kleinwort*. This result is perfectly in tune with the growing willingness of common law courts to apply equitable principles in commercial law, especially in the law of contracts. It is, perhaps, arguable whether this tendency is just or meets the justifiable expectations of the parties involved. From an economic perspective, however, such a change in the legal framework does not make an important difference. Both issuers and receivers will simply reassess their policies concerning comfort letters. Issuers who want to remain in the shady area where liability is doubtful will draft much weaker letters than before. Banks and other receivers who were prepared to take such risks before *Kleinwort* will continue to accept such letters.

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<sup>70</sup>Vasseur, *supra*, note 65 at 342; *Supra*, note 60 at Addendum 1985, no. 40; Mestre, *supra*, note 62 at 730ff.