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ANALYZING COMFORT LETTERS: THE BRAZILIAN LEGAL PERSPECTIVE

*Fionna Tsu**

COMFORT letters were first designed in the 1960s. Since then, their use has consistently increased to comprise a variety of transactions, from public offering of securities to intellectual property transfers. This paper refers to the most traditional kind of comfort letter: letters issued by a parent company for the benefit of a lending institution in connection with a loan or financing to be granted to a subsidiary of the former.¹ The analysis of this instrument will be developed in the context of international financial transactions subject to or under the laws of Brazil, and according to the current usages of such country.

The wide use of comfort letters in international financial transactions has led to standardization of their contents, which, as will be further detailed, range from a mere statement of fact with respect to the equity interest held in the subsidiary to financial undertakings that resemble guarantees. Depending on how close to a surety they are, comfort letters are classified as either hard or soft letters.² This classification, however, does not lead to a conclusive opinion as to their enforceability. Although the chance of getting hard comfort letters enforced seems greater than soft comfort letters, the binding legal effect of the former still may not be recognized if it is determined that the letter did not create a legal obligation, but rather a moral obligation, as discussed in Part II.

Today it is clear that the main issue involving letters of comfort is the determination of their legal status. In 1989, a striking decision of the English Court of Appeal surprised the international financial markets by ruling that “[under the comfort letter] the defendants would give comfort to the plaintiffs by assuming, not a legal liability to ensure repayment of the liabilities of their subsidiary, but a moral responsibility only.”³ Prior to that decision, comfort letters were commonly taken as guarantees, even when issued in their most informal styles.⁴ Uncertainty has since

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1. MARISTELA BASSO, *CONTRATOS INTERNACIONAIS DO COMÉRCIO* 202 (1st ed. 2002).
2. *Id.* at 204-07.
3. *Kleinwort Benson Ltd. v. Malaysia Mining Corp. Bhd.*, [1989] 1 W.K.L.Y. L. REP. 379, 392 (A.C.) (U.K.).
4. John Evans, *British Court Warn Lenders Not to Rely on Letters of Comfort*, 154 AM. BANKER 7 (1989).

emerged and influenced courts and legal practitioners worldwide. In Brazil, the use of comfort letters in financial transactions is currently limited to specific circumstances where a sufficient guarantee is already in place.⁵

Part I analyzes why comfort letters continue to be used irrespective of the inevitable disputes that arise when a subsidiary defaults on the underlying agreement. The purpose of this section is to compare the main reasons of the parent with those of the lender. This section will argue that uncertainty intersects with both, paradoxically encouraging and discouraging the use of the comfort instrument. Part II briefly describes the rules of interpretation and general doctrinal structure applicable to comfort letters under Brazilian law and discusses the issue of whether they give rise to legal or moral obligations. Part III reviews the most common types of comfort letters and interprets them in view of the description laid out in Part II. Part IV concludes the analysis.

I. REASONS FOR THE USE OF COMFORT LETTERS

Comfort letters are generally issued in lieu of a formal guarantee from the parent company. Although some types of comfort letters may resemble guarantees, both instruments are far from perfect substitutes, as will be described in Part II(C). This tradeoff will therefore depend on the bargaining power of the parties, the financial condition of the borrower, the credibility of the parent, and the wish of the lender to take out the loan and to initiate, or continue, business with any of the parties.

The first reason for granting a comfort letter is the mere unwillingness of the parent to formally guarantee third parties against the risk of insolvency of its affiliate. The parent may not want the guarantee to appear in its financial statements in order to avoid the risk of limiting its own ability to borrow money or triggering negative tax consequences. The parent may, in general, want to keep the liabilities of the subsidiary separate from those of its own. The unwillingness may also derive from legal and contractual restrictions. Existing contracts may provide for negative covenants, whereby the parent has undertaken not to guarantee indebtedness for borrowed money of its affiliates. Similar restrictions may be present in the organizational documents of the parent.⁶

From the perspective of the lender, the reasons for accepting a comfort letter lie in the unwillingness of the financial institution to grant the loan without a minimum amount of comfort that it will be repaid. Financial institutions in Brazil are prohibited from entering into transactions that do not comply with the principles of sound banking practices, which include the principles of selectivity, guarantee, liquidity, and diversification

5. Telephone Interview with Patricia Sauma Giglio, Banking Law and Regulation Professional (Nov. 2005).

6. See Lang Thai, *Letters of Comfort: A Comparative Evaluation of Australian, United States and English Jurisdictions*, 7 *CURRENT COM. L.* 1 (2000); see also Eduardo Salomão Neto, *As Operações de Crédito Documentário, as Cartas de Crédito e as "Comfort Letters"*, 123 *REVISTA DE DIREITO MERCANTIL* 39 (2000) (Braz.).

of risk.⁷ In light of these principles, when granting a loan, financial institutions will demand guarantees compatible with the creditworthiness of the borrower. For that purpose, some financial institutions keep a list that links guarantees to credit quality, indicating what kind of guarantee (from real estate properties to personal sureties) should be required for each particular transaction.⁸ Although, as will be further argued in this paper, comfort letters should not be considered a formal guarantee; interestingly, they can be found in such lists as the least enforceable forms of guarantee.⁹

Irrespective of such classification, it is clear that uncertainty with respect to the legal status and, consequently, the enforceability of the comfort instrument. Accordingly, comfort letters are currently accepted in Brazil only under limited circumstances.¹⁰ Those circumstances may occur when comfort letters are provided in addition to other guarantees or when the creditworthiness of the borrower and the characteristics of the loan are sufficient to meet the principles of sound banking practices.¹¹ At this point, uncertainty may have discouraged and consequently reduced the use of comfort letters in financial transactions taking place in Brazil. Paradoxically, uncertainty may also be considered one of the main factors that continue to drive the use of comfort letters in the context of Brazilian transactions as they give financial institutions an additional basis to seek recovery of damages in case of default on the underlying credit agreement.

In fact, comfort letters represent a compromise between the creditor and the parent company. Both the creditor and the parent believe that the borrower will comply with its obligations under the agreement, but if an event of default occurs, each of them may still rely on the possibility that a court will rule in their favor. By adopting an intermediate position, that is, by agreeing upon an instrument that is still considered to be a hybrid instrument, they allow the transaction to be consummated. This leaves the opportunity open to a future claim of a guarantee that, at the time of contracting, the issuer would not have agreed upon or, alternatively, to reject a guarantee that the lender would not have waived had the circumstances been different. This view is supported by Justice Hirst in *Kleinwort Benson Ltd. v. Malaysia Mining Corp. Bhd.*:

When two businessmen wish to conclude a bargain but find that on some particular aspect of it they cannot agree, I believe that it is not uncommon for them to adopt language of deliberate equivocation, so that the contract may be signed and their main objective achieved.

7. See CENTRAL BANK OF BRAZIL, RELATÓRIO DE ATIVIDADES 12 (1985), available at www.bcb.gov.br/?DOCHIST1985.

8. Interview with Fabio Yamada, Capital Markets, Banking, and Securitization Professional, in New York (Nov. 2005).

9. Interview with Patricia Sauma Giglio, *supra* note 5.

10. Telephone Interview with Nei Zelmanovits, Partner Machado, Meyer, Sendacz e Opice Advogados (Nov. 2005).

11. *Id.*

No doubt they console themselves with the thought that all will go well, and that the terms in question will never come into operation or encounter scrutiny; but if all does not go well, it will be for the courts or arbitrators to decide what those terms mean. In such a case it is more than somewhat artificial for a judge to go through the process, prescribed by law, of ascertaining the common intention of the parties from the terms of the document and the surrounding circumstances; the common intention was in reality that the terms should mean, [what a judge or arbitrator should decide that they mean] subject always to the views of any higher tribunal.¹²

The drafting of a comfort letter will therefore be driven by the possibility that its legal status could be upheld or rejected by the courts. Accordingly, the creditor will try to cause the parent to provide various representations, warranties, and undertakings with respect to the stability of the financial condition of the subsidiary. The subsidiary will attempt to get the parent to agree upon clear and strong wording that will later indicate the conclusion of a binding and legal obligation. Conversely, the parent will use its negotiating efforts to create an informal letter comprised of statements of facts and express disclaimers of liability that might indicate a mere moral commitment.

II. THE LEGAL STATUS OF COMFORT LETTERS

The legal status of comfort letters is currently the most debated issue. The starting point of this debate is usually whether the comfort letter creates a legal relationship between the parties, or if the letter merely represents a moral obligation that no legal effect can be expected to arise. If it is determined that a legal relationship has been formed, the question becomes what kind of obligation it entails. This section will provide a general view of the legal or moral obligations that a comfort letter may create. As will be argued, the center of any discussion will lie not only on the language, but also on the determination of the actual intent of the parties and the circumstances surrounding the issuance of the comfort letter. The concepts analyzed in this part of the paper will be further detailed when applied to the comfort letter model in Part III.

A. GENERAL CONCEPTS AND RULES OF INTERPRETATION

Under Brazilian law, a private statement of intent destined to bring about effects that are expected by the issuer and recognized by the law is considered a legal transaction (*negócio jurídico*).¹³ Contracts are bilateral or multilateral legal transactions whereby two or more parties intend to be bound by the creation of a legal relationship with the purpose of

12. *Kleinwort Benson Ltd. v. Malaysia Mining Corp. Bhd.*, [1988] 1 W.K.L.Y. L. REP. 799, 806, n.2 (Q.B.D.) (U.K.) (citing *Chemco Leasing S.p.A. v. Rediffusion Plc.*, [1985] (unreported), *aff'd*, [1987] 1 FIN. TIMES L. REP. 201 (A.C.) (U.K.)).

13. 3 CAIO MÁRIO DA SILVA PEREIRA, INSTITUIÇÕES DE DIREITO CIVIL: CONTRATOS (BROCHURA) 66 (11th ed. 2004).

producing certain legal effects.¹⁴ Comfort letters are unilateral legal transactions, conceived by the statement of intent of one single party.¹⁵ The two essential elements of a legal transaction are: (1) the intent to create, modify, or terminate a relationship in a legally binding manner; and (2) the autonomy to establish the rules that will govern such relationship.¹⁶ To interpret these rules, it is therefore first necessary to understand the intent. If the rules are different from the intent, the question turns to what should prevail: the statement of intent or the intent itself?

To answer this question, the Brazilian Civil Code adopts an intermediate standard. Civil Code article 112 provides that in statements of intent, the real intent will be more regarded than the language used to express the intent.¹⁷ The following article establishes that legal transactions must be interpreted in accordance with good faith and the common usages of the place where they were formed.¹⁸ The first article seems to give more weight to the intent, whereas the second article privileges the wording. By requiring that legal transactions are interpreted in light of good faith and local customs, the legislators exhibited concern about what the other party could have understood from the statement of intent or, consistent with the common law concept of reliance, what statement of intent could the party rely on or expect to have been provided. When combined, these two articles thus provide a guidance to interpret comfort letters.¹⁹

The interpretation of a comfort letter under Brazilian law should first consider whether a valid legal transaction exists, and if it does: (1) what was the intent of the parent when providing the comfort letter; (2) assuming good faith on the part of the parent, what could the financial institution expect when receiving the comfort letter; (3) what are the local customs for the instrument in similar financial transactions; and, finally, (4) what could one infer from the wording of the letter.²⁰ When the question turns to determining the existence of a valid legal transaction, it has to be analyzed based on whether the intent and autonomy, its core elements, are present. If, under the circumstances, it is determined that there was no intention to create, modify, or terminate a legal relationship, or there was no individual autonomy to do so, it will be considered that no legal transaction exists, and therefore no legal effects will derive from the relevant instrument.²¹

The existence of a legal transaction will also depend on meeting the legal requirements for its validity. The requisites under Civil Code article 104 are: (1) the legal capacity to enter into the transaction; (2) the existence of a legal, possible, determined (or determinable) object; and (3)

14. *Id.*

15. See Neto, *supra* note 6, at 40.

16. PEREIRA, *supra* note 13, at 7.

17. CÓDIGO CIVIL [C.C.] art. 112 (Braz.).

18. *Id.* at art. 113.

19. FRANCISCO AMARAL, DIREITO CIVIL 404-09 (4th ed. 2002).

20. CÓDIGO CIVIL [C.C.] arts. 112 & 113 (Braz.).

21. *Id.* at art. 112.

the compliance with the relevant legal requirements of form or refrain from using a form prohibited by law.²² Accordingly, the comfort letter will not create legal effects if it constitutes a legal transaction that is null, either for the absence of intent or for the absence of the validity requisites of Civil Code article 104. The absence of intent to create a legal relationship should be mainly analyzed in the light of the concept of moral obligations.

B. MORAL OR LEGAL OBLIGATION?

The civil doctrine teaches that an obligation can be created by virtue of an agreement, an illegal act, a unilateral statement of intent, or any other act or fact capable of imposing a duty to perform, or to refrain from performing, a given action.²³ There are obligations that are not perfect from a legal standpoint, as certain legal effects (i.e., enforceability) are not present. Moral obligations are considered one kind of imperfect obligation, as they do not produce effects within the legal boundaries.

Similar to legal obligations, moral obligations are driven by the general principle that a certain action should or must be taken under a particular circumstance. The moral system, however, does not have one essential element present in any legal system: the power to coerce. Moral obligations are natural obligations that society expects one to fulfill, but society cannot force compliance because moral obligations are not embraced by the legal system. An example of a moral obligation is the obligation to pay off a debt incurred as a result of a game, which is not supported by the Brazilian legal system. Therefore, society lacks the required grounds to force compliance, despite the common sense principle that debts should be repaid. The common view that comfort letters are moral, rather than legal, obligations originates from its denomination.²⁴ Its name suggests that the instrument is intended to comfort the recipient or, in other words, “[to] give moral or emotional strength to” the recipient in a moment of concern.²⁵

It is hard, however, to believe that in the present context of international transactions involving multinational companies and financial institutions the parties would expect this comfort to be sitting in plain good faith and honor and that the safeguards of the relevant legal system would not be sought in case of default of the underlying credit facility. This disbelief is the driving reason for questioning the legal status of comfort letters. This view is expressed by Chief Justice Rogers quoted in

22. *Id.* at art. 104.

23. FRAN MARTINS, *CONTRATOS E OBRIGAÇÕES COMERCIAIS* 11 (5th ed. 1977).

24. *See* Thai, *supra* note 6, at 1.

25. WordNet Search - 2.1, <http://wordnet.princeton.edu/perl/webwn> (last visited Nov.15, 2006) (type ‘Comfort’ into the search box and see the first definition under “Verb”).

Australian European Finance Corp. Ltd v Sheahan:²⁶

There should be no room in the proper flow of commerce for some purgatory where statements made by businessmen, after hard bargaining and made to induce another business person to enter into a business transaction would, without any express statement to that effect, reside in a twilight zone of merely honourable engagement. The whole thrust of the law today is to attempt to give proper effect to commercial transactions. It is for this reason that uncertainty, a concept so much loved by lawyers, has fallen into disfavour as a tool for striking down commercial bargains. If the statements are appropriately promissory in character, courts should enforce them when they are uttered in the course of business and there is no clear indication that they are not intended to be legally enforceable.²⁷

The fact that financial institutions in Brazil would no longer consider comfort letters a decisive factor to grant loans does not imply that they would not expect to extract legal effects from them. Accordingly, parent companies should not expect that a financial institution would accept a meaningless instrument, which entails only a moral obligation in the context of an international financial transaction.

In this context, and in light of the prevailing view that there is a presumption that parties intend to create legal relationships in commercial transactions,²⁸ it is fair to conclude that comfort letters will generally create legal effects and bind the parties in a legal relationship, even when the comfort letter contains only statements of fact. Statements of fact will have the purpose to inform²⁹ the financial institution of facts that it may consider relevant for the granting of a loan.³⁰ The parent will be liable for damages if this information is untrue or incorrect, particularly if the creditor considered this information as a material fact for granting the loan.³¹

In that case, a moral obligation to provide financial resources for the repayment of the loan can result from the letter if the parent expressly

26. *Australian European Fin. Corp. v. Sheahan* (1989) 60 S.A. St. R. 187, 202 (Austl.) (citing *Banque Brussels Lambert S.A. v. Australian Nat'l Indus. Ltd.* (1989) 21 N.S.W.L.R. 502 (Austl.)).

27. *Id.*

28. *Edwards v. Skyways Ltd*, [1964] 1 W.K.L.Y. L. REP. 349, 355 (Q.B.D.) (U.K.).

29. AMARAL, *supra* note 19, at 388 ("Legal transactions may be classified as declarative transactions and performance transactions depending on the intent. Statements of intent may have the purpose to bring about legal effects or to be an act of communication") (translated by author).

30. Statement of facts can be compared to representations set forth in a sale agreement, where they are intended to provide the purchaser a clear understanding of the assets that are being acquired. Any untrue or incorrect representation as to a material condition of the assets would be construed as a defect in the intent of the purchaser to enter into the transaction. In this case, the executed sales agreement does not reflect the agreement the purchaser could have understood from the communication of the seller. Likewise, any misstatement of fact in comfort letters may also be construed as a defect in the intent of the creditor if relevant to the decision concerning the grant of the loan.

31. See BASSO, *supra* note 1, at 207; see also CÓDIGO CIVIL [C.C.] arts. 186 & 927 (Braz.).

informed the third party of its awareness of the loan, in order to have control over the affairs of the subsidiary, and/or to follow the policy of providing management support to its subsidiaries.³² But even though the creditor can expect the parent to provide financial support in case the subsidiary is unable to meet its obligations, the parent cannot be forced to perform such action because only a moral obligation is implied. A legal obligation to provide financial support would only exist if the parent expressly assumes a formal and clear obligation to that extent.³³

C. OVERVIEW OF THE LEGAL RELATIONSHIP

If it is determined that a legal transaction exists from the issuance of the comfort letter, the next step would be to define what kind of legal obligation it entails. This distinction is important to determine that legal effects, other than the ones established by the issuer's statement of intent, will be created as a result of the comfort letter. That is, which effects will arise from the law.

Comfort letters are often first mistaken for a guarantee. The comfort letter, however, was designed to be an alternative to a guarantee.³⁴ It is merely an apparent guarantee, as are negative pledge provisions. The main difference from a formal guarantee is that, even though the parent may agree to comply with certain obligations (i.e., not dispose of its equity interest in the subsidiary), in general it does not undertake to secure the debt of its subsidiary.³⁵ This is a key element that distinguishes comfort letters from the personal surety (*fiança*) defined by the Brazilian Civil Code. Pursuant to Civil Code article 818, "by a contract of *fiança*, a person guarantees to the creditor that the obligation undertaken by the principal debtor will be satisfied notwithstanding the non-fulfillment of the latter."³⁶

Another element that militates against the possibility that a comfort letter will be mistakenly viewed as a *fiança* is the requirement that it does not admit an expansive interpretation. To be considered a *fiança*, the issuer must clearly state that it is granting a personal guarantee in favor of a third party. Comfort letters are usually surrounded by uncertainty, and do not provide such clear language. As a result, comfort letters cannot be sheltered by the specific legal rules and enforcement procedures of a guarantee, and are therefore likely to face the barrier of having a court determine their legal status.

Depending on the wording and the factual context, comfort letters could also be framed as a promise of fact of a third party (*promessa de fato de terceiro*). Pursuant to Civil Code article 439, "the person who has

32. *Kleinwort Benson Ltd.* [1989], 1 W.K.L.Y. L. REP. at 379.

33. *Banque Brussels Lambert S.A.*, 21 N.S.W.L.R. at 515-19.

34. See Kenneth M. Block & Jeffrey B. Steiner, *Comfort Letters: Casual Drafting Can Turn One Into a Guaranty*, 231 N.Y.L.J. (2004), available at <http://www.brownrayman.com/resources/documents/NYLJ-01-21-04.pdf>.

35. See Neto, *supra* note 6, at 39.

36. CÓDIGO CIVIL [C.C.] art. 818 (Braz.) (translated by the author).

promised a fact regarding a third party will be liable for losses and damages, if the latter does not accomplish that fact.”³⁷ No consideration or consent on the part of the promisee is required under Brazilian law to enforce such a promise.³⁸ If it is determined that the parent promised that the subsidiary would fulfill its obligations under the loan agreement, then the parent will be liable for the payment of damages arising out of the non-compliance. But the loose language of comfort letters can be an obstacle to establishing that they are promises.

Comfort letters are more likely to create ordinary obligations to refrain from performing (*obrigação de não fazer*), and obligations to perform (*obrigação de fazer*) a certain action. Obligations to refrain from performing a certain action, in the context of comfort letters, are usually those whereby the parent agrees not to dispose of its equity interest during the term of the loan agreement. Obligations to perform may involve a wider range of undertakings under comfort letters. These obligations may target a result or merely provide means to achieve such a result. This distinction is essential to the analysis of comfort letters.

An obligation of result implies the achievement of a promised result. The undertaking to notify in the case of disposition of the interest in the subsidiary will only be fulfilled upon the delivery of a proper notification. The obligation to provide means to achieve a result does not guarantee the result, but only that efforts will be made in that direction. An undertaking to use efforts to provide access to financial resources would be, for instance, an obligation to provide the means for the loan to be repaid. This obligation would be deemed fulfilled if the parent proves that it sought internal approval for the repayment of the loan, or sought other lenders and investors who could provide the required funds to the subsidiary.

The violation of any of these obligations would entitle the creditor to recover damages. The creditor will however face a hard legal barrier to recover such damages because it must prove: (1) the damages, (2) the failure of the parent to comply with its obligation (which may be burdensome in the case of obligations of means), and finally (3) that the damages, that is, the failure of the subsidiary to repay the loan, resulted from the failure of the parent to comply with its obligations under the comfort letter.³⁹ According to the Brazilian Code of Civil Procedure article 333, the burden of proving these facts will lie on the party who claims the right, which is the creditor.⁴⁰ This is a heavy burden when considering that the rules of discovery are not as comprehensive in Brazil as they are in the United States.

Finally, irrespective of the type of obligation contained in the comfort letter, the grantor will always be held liable for damages caused to the

37. *Id.* at art. 439 (translated by the author).

38. PEREIRA, *supra* note 13, at 65.

39. *See* BASSO, *supra* note 1, at 206.

40. CÓDIGO DE PROCESSO CIVIL [C.P.C.] art. 333 (Braz.).

creditor as a result of any misstatement of fact or fraudulent undertaking. In this case, the burden of the creditor will be the same as the one explained above.

III. INTERPRETING COMFORT LETTERS

Comfort may be provided on a variety of different forms, and a wide range of letters can be deemed to be comfort letters. Nonetheless, the frequent use of comfort letters by international entities has caused the development of standardized language that consistently appear in financial transactions, as the same or similar drafts are used by their affiliates worldwide.

Comfort letters generally invoke four types of statements and undertakings, which basically relate to: (1) the awareness of the credit facility; (2) the ownership held in the subsidiary; (3) the lack of intention to dispose of the equity interest held in the subsidiary without prior notice; and (4) the policy of the parent with respect to the management and financial support of the subsidiary.⁴¹ Although the standardization of clauses and agreements in international practices facilitates the negotiation between parties of different countries, it creates difficulties when trying to convince a particular legal system to fully embrace the comfort letters, as can be inferred from Part II(C). Because comfort letters are not modified to fit into a particular legal system, the effects of such legal instruments may diverge at large and their use in each country may be more or less suitable for the purpose each of the parties is trying to reach.

Although courts worldwide may diverge in view of the requirements existing under the applicable legal system, their opinions with respect to such standard statements inevitably influence the drafting and interpretation in other countries. While many courts of civil and common law countries have had the opportunity to render their opinion on this issue, Brazilian courts have yet to explore the extent of comfort letters. As such, Part III of the paper examines the types of language commonly used in comfort letters through the words of an English court and how they would likely be interpreted under Brazilian law.

In 1989, the English Court of Appeal ruled on an important and highly commented case⁴² where the parent, a public company, issued a comfort letter with a policy statement, because it was not willing to guarantee the indebtedness of its wholly-owned subsidiary. The comfort letter under analysis included the following terms:

We refer to your recent discussion with M.M.C. Metals Ltd. as a result of which you propose granting M.M.C. Metals Ltd.:(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

41. See Neto, *supra* note 6, at 38-39.

42. See *Kleinwort Benson Ltd.* [1989], 1 WKLY. L. REP. at 379.

know and approve of these facilities and are aware of the fact that they have been granted to M.M.C. Metals Ltd. because we control directly or indirectly M.M.C. Metals Ltd.(2) We confirm that we will not reduce our current financial interest in M.M.C. Metals Ltd. until the above facilities have been repaid or until you have confirmed that you are prepared to continue the facilities with new shareholders.(3) It is our policy to ensure that the business of M.M.C. Metals Ltd. is at all times in a position to meet its liabilities to you under the above arrangements. Yours faithfully Malaysia Mining Corporation Berhad.⁴³

The lower court ruled in favor of the plaintiff considering:

[1] that where an agreement related to a commercial transaction there was a presumption in favour of an intention to create legal relations . . . ; [2] that the two comfort letters came into existence as part and parcel of a commercial banking transaction, the paragraph in question being an important feature of those letters and apt to constitute a contractual undertaking; [3] that the plaintiffs clearly acted in reliance on the paragraph and it was of paramount importance to the plaintiffs that the defendants should ensure that M. Ltd. could meet its substituted liabilities under the facility; and [4] that, accordingly, the defendants failed to rebut the presumption.⁴⁴

On that basis, the court found that the defendants signaled their intent to create a legal obligation to maintain the subsidiary in condition to repay the loan. The Court of Appeal subsequently reversed the decision on the grounds that the language indicated a representation as to the present policy of the parent and not an undertaking as to the future, and that both parties knew, after defendant refused to grant a formal guarantee, that the comfort letter was not intended to give effect to any legal liabilities but only to moral obligations.⁴⁵

To interpret comfort letters under Brazilian law, one has to balance the legal effects that the issuer intended to produce with the legal effects that the financial institution could have expected the instrument to produce, based on the good faith of the issuer, the factual circumstances, and the common usage of comfort letters in international financial transactions. There are factual circumstances that can help determine the intent of the parties, mainly whether the purpose of the comfort letter was actually to make the parent liable for the obligations of its subsidiary. For instance, if the parent obtained corporate approval for the issuance of a comfort letter, it is reasonable to assume that it intended that the letter create binding legal effects. On the other hand, the denial of a formal guarantee may be an indication that the parent did not intend to be responsible for the liabilities of its subsidiaries. These facts, however, are mere indications of that intent and have to be analyzed in the context of the other

43. *Id.* at 383.

44. See *Kleinwort Benson Ltd.* [1988], 1 W.K.L.Y. L. REP. at 799.

45. See Anthony Pugh-Thomas, *Letters of Comfort Revisited: Australia and England Diverge*, 5 J. INT'L BANKING L. 340 (1990) (U.K.).

facts available. The facts of the case could show, for example, that the denial of a formal guarantee did not mean the unwillingness to guarantee the indebtedness of the subsidiary, but only that the parent did not want to disclose it on its financial statements. In any event, the obligation to provide financial support to the subsidiary will depend on clear language to that extent as discussed in Part II(B).

The analysis of the subjective intent of the parent alone is not sufficient to determine whether any legal effect will arise from the comfort letter. The second step is to balance the expectations of the bank. Because of the standardization of their content, the understanding that a financial institution may have had with respect to comfort letters cannot be interpreted solely by their wording. Internal memoranda of the legal department, creditworthiness analyses, the existence of formal guarantees, the reputation of the borrower and parent, and their relationship with the financial institution are some of the facts that might contribute to the determination of the view and expectations of the financial institution with respect to the comfort letter. Local usages will also be relevant to determine the fair expectation of the creditor, and to interpret the effects of the comfort letter. In Brazil, the use of comfort letters is declining due to uncertainty as to their enforceability. As such, financial institutions make requests for such instruments under very limited circumstances, when sufficient guarantees are provided in connection with the credit facility.

The final element to the interpretation of a comfort letter is the wording: the expressed statement of intent. Words of contractual force such as we confirm or we undertake might cause the other party to expect that a legal relationship has been formed. But words of uncertainty such as would or might soften such presumption. Sufficiently formal and precise language may also cause one to expect the letter to have a binding contractual effect. In *Kleinwort*, the analysis of the wording was determinant for the final ruling.⁴⁶ The judge considered that the policy statement was a statement of fact, rather than a promise as to future conduct.⁴⁷ The parties would have faced a different outcome if the statement contained the word will. Finally, express disclaimers that the letter does not constitute a legally binding commitment⁴⁸ are also indications of the intent of the parent.

In view of the considerations above, under a Brazilian law perspective, the comfort letters transcribed in this section would hardly be considered strong enough to cause the parent to be liable for the debts of its subsidiary. The statements contained in those instruments amount merely to the information regarding specific facts, and the court's opinion has not indicated that they were incorrect or untrue. Furthermore, the factual evi-

46. See *Kleinwort Benson Ltd.* [1989], 1 W.K.L. REP. at 393-94.

47. *Id.* at 391.

48. See Edwin S. Cook, *Canada: Loan Agreements - Letters of Comfort*, 14 J. INT'L BANKING L. N26 (1999) (U.K.).

dence in *Kleinwort*, could not lead to the conclusion that the parties believed that the comfort letter would constitute an obligation to secure, rather than a mere communication of a material fact.⁴⁹ Lastly, under the expressed terms and factual circumstances, such a belief would not be considered reasonable under the current common practices in Brazil.

IV. CONCLUSION

Comfort letters have been designed to provide comfort to financial institutions when granting loans to subsidiaries of multinational groups. The uncertainty as to their legal status has taken away much of the comfort originally sought. Conversely, uncertainty has given an incentive for the use of comfort letters, as both parties will rely on the possibility that a court might interpret the instrument in their favor.

In Brazil, that incentive has proven to be insufficient to increase the use of comfort letters. Although the use of comfort letters is still dictated by international practices, Brazilian financial institutions are less confident about the possibility of recovering damages on the grounds of comfort letters. This lack of confidence results not only from the doubt of whether a comfort letter constitutes a moral or a legal obligation, but also because once it is clear that comfort letters constitute a legal obligation, financial institutions still have to face the heavy burden of proving that the damages were caused by the failure of the parent to fulfill its obligation.

As a result, in order to avoid any uncertainty as to the legal status, and to facilitate the creation of the effects expected to arise from comfort letters, parents and creditors should carefully draft the instrument with sufficiently clear and precise language as to reflect their intent. In any event, the enforceability of the letter, and the recoverability of the sum lent under the loan agreement, will only be certain if the instrument clearly represents an obligation of the parent to guarantee the indebtedness of the borrower.

49. See *Kleinwort Benson Ltd.* [1989], 1 WKLY. L. REP. at 379.

Comments and Casenote

