TEMPLARS

JUST HOW WORTHLESS IS THAT **LETTER OF COMFORT?**

An appraisal of recent judicial attitude to enforcing Letters of Comfort

INTRODUCTION

There is a general reluctance for parties to accept or deal on the back of Letters of Comfort. This reluctance is fueled by the presumption that, unlike an indemnity or guaranty, Letters of Comfort are usually regarded as nothing more than a "… *mere gentleman's agreement*' which is unenforceable in law.

Often times, holders of Letters of Comfort who have "*gotten their fingers burnt*" by contracting on the back of such letters, usually resign their fate on the belief that they have no recourse in law against the issuing party. But is this really the case?

This article examines the credibility of this conventional notion and more importantly considers the growing judicial attitude of the courts to enforcing Letters of Comfort.

LETTERS OF COMFORT

Letters of Comfort are instruments issued by third parties (e.g., banks, auditors, holding companies, etc.) in favour of one of the parties to a contract, acknowledging either a debt or obligation of such party under the contract, and confirming/attesting to the capability and capacity of the party to perform its obligations under the contract.

As the name suggests, Letters of Comfort are usually intended and generally understood as merely providing "*some comfort*" to its holder in contracting with its beneficiary. In other words, Letters of Comfort carry with them a presumption that they are worth nothing other than some sort of assurance, morale-booster or simply put; "mere expression of support"; so that the issuer is often able to avoid liability in the event of a default by a beneficiary of the Letter of Comfort.

However, it is not in all cases that a Letter of Comfort will afford the issuer the convenience of evading liability in the event of a default. In recent times, the courts have demonstrated a keenness to enforce a Letter of Comfort depending primarily on its content and in some instances, on the surrounding circumstances that necessitated the issuance of the Letter of Comfort.

Accordingly, from recent trends, the courts appear to have acknowledged that a lot of factors could be responsible for the parties' decision to adopt the use of a Letter of Comfort. These factors include avoidance of the tax implication of a Contract of Guaranty on the issuer, avoidance of duty to disclose imminent indebtedness of the issuer on its balance sheet, prior contractual restrictions etc. Thus, where a court is satisfied that some other factor (other than an intention not to be legally bound) exists which prompted the issuance of the Letter of Comfort, the court will most likely be more willing to consider enforcing the terms of the Letter of Comfort against the issuer.

For this reason, it is absolutely incorrect to conclude that once a commercial instrument is captioned "Letter of Comfort", it is not binding on the issuer to the agreement. The undergirding questions which usually engage the mind of the court in determining whether a Letter of Comfort is ultimately enforceable or not are "Did the parties intend the instrument to create binding legal obligation? And, "is there any valid consideration flowing from the recipient of the promise in exchange for the Letter of Comfort?

As simple as these questions may appear, lawyers are usually deadlocked in deciphering the real intention of the parties in adopting the Letter of Comfort. A good understanding of the factors the courts would readily consider in deciding whether or not a Letter of Comfort conveys an intention to create a legal obligation is pertinent to this discourse.

A. INTENTION TO CREATE LEGAL RELATIONS:

As earlier stated, the mere fact that an instrument is titled "Letter of Comfort" is a pointer to the fact that such instrument was not intended to be legally enforceable. However, a few factors could readily negate this presumption in the mind of the court:

i. *Absence of an express Disclaimer*

The courts are now more reluctant to make this presumption where there is no Disclaimer on the face of the Letter of Comfort. In other words, in the absence of a valid Disclaimer on the face of the instrument renouncing any legal liability accruing from any actions ensuing from reliance on the instrument by its holder, the court may opt to proceed on the

safe assumption that the Letter of Comfort, like every other commercial instrument, is legally binding.

In the English case of **Edwards v Skyways**[1], the court held:

> ***"…a promise made for consideration in a commercial transaction will be taken to have been intended to have contractual effect in law unless the contrary is clearly shown"***

Thus, if the issuer intends from the get-go that the Letter of Comfort should not be legally binding, it is perhaps more prudent to include a Disclaimer rather than to proceed on the traditional assumption that by its mere title the instrument is not legally binding.[2]

ii. *The Actual language of the Letter of Comfort*

In the absence of a disclaimer, the courts would then turn to the wording of the Letter of Comfort in determining if the issuer intended to be legally bound.

A Letter of Comfort intended to be a mere expression of interest should not contain firm promises of self- imposed obligations on the issuer. A typical non-binding Letter of Comfort should contain a principal clause that merely acknowledges the issuer's awareness of the intended transaction between the parties. In some instances, the Letter of Comfort could vouch for the financial capacity and entrepreneurial/managerial prowess of the intended beneficiary. Where the beneficiary is a subsidiary of the issuer, such Letter of Comfort could state the issuer's stake in the borrowing entity and also issue some sort of guarantee in maintaining the stake until the debt is fully repaid or the obligation fully performed. The Letter of Comfort could further disclose the issuer's policy of managerial oversight in ensuring that the beneficiary is capable of performing its obligations under the intended transaction without making any express promises entailing personal liability on the part of the issuer[3]. In such instances, the Letter of Comfort is not legally binding. Some jurists classify a letter of this nature as a "*Weak/ Soft Letter of Comfort*[4]".

Once a Letter of Comfort exceeds the limits discussed above, it is most likely to be interpreted as a "*Strong Letter of Comfort*" intended to create legally enforceable obligation against the issuer. In loan transactions for instance, a strong Letter of Comfort could categorically contain self-imposed obligations by way of promises to be financially liable to repay the principal sum and the accruing interest thereto in the event that the beneficiary defaults in repaying the debt. Such promises are usually absolute and made with every intention to secure the loan from the lender in favour of the borrower. This category of a Letter of Comfort is usually employed where the issuer, although willing to guarantee the repayment of the loan but probably intends to avoid some legal obligations that come with a contract of guaranty, e.g. tax implications. The issuer could also opt for this category of a Letter of

[1] Edwards V Skyways (1964) 1 All E.R 494

[2] The above position is supported by the decision of the Nigerian Court of Appeal in ***Nwachukwu v. Boji-Boji Microfinance Bank Nigeria Limited***where the court had cause to consider the Significance of a heading of a document or a letter head of a document, vis a vis its content. In a well-reasoned judgement (which followed other case law precedents on the point), the court concluded that "*a title [to a] letter... does not necessarily control the contents of the document.*" *See also:* Rose and Frank Co. V Crompton Bros Ltd (1925) AC 445

[3] JH Milner V Percy Bilton (1966) 1 WLR 1582

[4] Wittohn G.A.; Kleinthworth Benson Ltd V Malaysian Mining Corporation Berhad- A Comprehensive Note on Letter of Comfort Letters.

Comfort due to an inherent term in a previous contract between the issuer and some other party, which forbids it from issuing guarantees in the currency of the prior contract. Once any of the above or similar circumstances exists, necessitating the acceptance of a Letter of Comfort instead of an express guaranty, the courts will usually interpret the instrument as intended to create Legal obligation.

iii. *Other determinants of the intention of the parties in adopting a Letter of Comfort include:*

a. **The bargaining capacity of the parties vis-à-vis their understanding of the legal implications of Letters of Comfort** in commercial transactions could also weigh heavily in the mind of the court in considering whether a Letter of Comfort is enforceable. A case in point would be the typical loan transaction between a bank and its individual customers where the latter is usually not sufficiently learned in the legal implications of the acceptance of a Letter of Comfort. In such cases, the courts are willing to employ the *Contra Proferentem* rule of construction, which stipulates that in construing the terms of any instrument, the courts will usually construe any ambiguous terms against the party who drafted the document, in this case the issuer[6]. It then follows that where the parties are of unequal bargaining power as at the time of negotiations, the court, adopting this principle of equity is likely to impute the terms of the Letter of Comfort against the issuer.

b. **Evidence of oral representations of the parties and the surrounding facts leading up to the issuance/acceptance of Letters of Comfort.** The court would readily rely on any oral commitments proven to have been made by both parties during the negotiations, which tend to prove that the issuer intended to be personally liable for the obligations covered by the Letter of Comfort, in the event of a default by the beneficiary. Thus where, for instance, the issuer gave strong assurances of willingness and ability to repay the loan in event of a default by the borrower, the court held such Letter of Comfort as binding on the parties.[5]

c. **Evidence of prior similar contracts between the parties or the prevalent practices in the particular profession** could go a long way in rebutting the presumption that the Letter of Comfort was not intended to be binding on the issuer. Thus, where there is evidence that tends to prove that Letters of Comfort are usually intended to convey legally binding obligations in that particular line of trade, the courts will readily infer an intention to be legally bound.

A case in point which best illustrates this point would be the decision of the Abia State High Court in ***Intercontinental Bank Plc ("the Bank") v. Hilman & Bros Water Engineering Services Nig. Ltd***.[6]("Hilman") which was affirmed by the Court of Appeal. In that case, Hilman had approached the court seeking to enforce a Letter of Comfort issued by the bank in favour of one of its customers- Bau – Consult & Producing Nig. Ltd ("Bau"). The Letter of Comfort was issued by the bank in compliance with one of the requirements under construction sub-

[5] Banque Brussels Lambert SA V Australian National Industries (ANI) Ltd (1990) 21 NSWLR 502.
[6] 2013 LPELR – 20670 (CA)

contract between Hilman and Bau. In the letter, the Bank confirmed that its customer Bau was financially capable to pay Hilman for the construction works and further proceeded to state that in line with the requirements of the parties' sub-contract, Hilman would be paid upon completion of the construction works. Hilman completed the construction works and was duly issued a certificate to this effect, however, Bau failed to pay Hilman. Consequently, Hilman called on the Bank to perform the promises under the Letter of Comfort but the Bank declined, hence the suit.

At the proceedings, there was undisputed evidence that the Bank was fully aware of the critical nature of the Letter of Comfort as a pre-requisite to the parties consummating the sub-contract. There was also evidence that putting in place a Letter of Comfort from a commercial bank was a recognized industry practice of which the bank was fully aware of.

Although the Bank argued on the facts that the Letter of Comfort was subsequently returned as rejected by Hilman, there was no evidence of this fact. However, of relevance in the decision is the fact that the Court of Appeal upheld the decision that the nature of the promises in the Letter of Comfort was such that the Bank could not be allowed to renege. Consequently, the court found that there was a valid contractual obligation on the Bank to pay Hilman once there was proof of completion of works under the sub-contract. Accordingly, the court enforced the Letter of Comfort.

From the foregoing, it is safe to conclude that once an intention to enter into binding legal relations has been established between the issuer and holder of the Letter of Comfort, the courts will usually uphold the promises contained in the letter.

B. Consideration:

A popular defense offered by most issuers of a Letter of Comfort is that the promises contained in the document are non-binding because they lack consideration from the holders. Consequently, the burden is always on the holder to establish that some sort of benefit accrues to the issuer. Like in every other contract, the absence of a valid consideration renders the Letter of Comfort unenforceable against the issuer.

However, in some instances the courts appear to move away from the usual strict adherence to the policy of unenforceability of contracts due to the absence of consideration. The courts, more than ever before, are willing to take another look at the whole scenario especially where a grave and untold injustice would be meted to the holder if the rule is strictly adhered to. In other words, where a party relying on such strong promises contained in a letter of comfort, apparently calculated to induce the party into the agreement, has acted to his great detriment. The courts will most likely restrain the issuer of the Letter of Comfort from reneging on his promise.

Although this position has not been universally adopted, some jurisdictions have shown willingness to enforce Strong" Letters of Comfort. For instance, the courts in Scotland and United States of America have readily implored this measure by relying on the equitable doctrine of "**Unconscionability**" and "**Unjust Enrichment**". The implication of these principles (in relation to this discourse) is that the courts will be weary of dismissing any action for recovery of debt because of the

absence of consideration especially where the issuer, to the detriment of the holder, stands to enjoy, directly or indirectly, some benefit or gain from the transaction for which the Letter of Comfort was issued.

Although these doctrines of equity have not received a lot of approval in some common law countries and the United Kingdom in particular, Nigerian courts have shown a willingness to lean towards the precedents in the United States of America when the justice of a matter so demands. The Nigerian Court of Appeal[7] has held thus:

> ***"I think the principle of unjust enrichment which unfortunately is not well developed in English law as both in the U.S and Scotland should, of necessity be nurtured to growth in a new and complex Society like ours where people can easily at the whiff of breath resort to law to ward off debt or other enrichments they have had at the expense of the other. This is a specie of constructive trust which is an instrument which the court of equity may employ to prevent undue enrichment. I believe that when a person is holding tight that which is subject of equity he should not be allowed to hold it firmly. Therefore where a party unjustly enriches himself at the expense of the Plaintiff he must be made to disgorge it. Our legal system should at this instance lean more to U.S. law on principle than to England where the principle is yet to assume a wider dimension. Thus Lord Porter in*** *Reading V A.G. (1951) A.C 507-513-4* ***said "My Lords, the exact status of the law of Unjust Enrichment is not yet assured. It holds a predominant place in the law of Scotland and I think in the United States". The premise behind the doctrine of restituting an unjust enrichment is that justice be done. That being the case, it seems to me that we ought to lean overly to the U.S legal practice to effectuate justice. Therefore, in consonance with the principles enshrined in the restitution a remedy shall be available whenever the defendant is unjustly enriched at the expense of the Plaintiff. In this case the defendants must be made to vomit what they have taken (unjustly)".***

Presently, the state of the jurisprudence in United States of America holds unfavorably against defense of absence of consideration where there is a probability of occasioning grave injustice while sticking with the regular common law requirement of Consideration.[8]The courts in the United States will readily enforce such strong promises contained in a Letter of Comfort.

Much is yet to be seen in this aspect in common law countries like the United Kingdom. However, the Australian Supreme Court in held:

> ***"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 … reside in a***

[7] *Per* Pats-Acholonu J.C.A (as he then was) in Eboni Finance and Securities Ltd V Wole-Ojo Technical Services & 2 Ors. (1996) 7 nwlr (Pt. 461) 464 at 477-478. See also Nwankwo V Nzeribe (2004) 13 NWLR (Pt.890) 422 at 434-435.

[8] The United States Legal System has taken this a step further by enacting legislations which prohibits a *Promisor* from reneging on a promise where he is fully aware that a *Promisee* intends to and infact did rely on his representations in has put himself (the *promisee*) at great detriment. The American Restatement (Second) of Contracts (RSC) 1979; S.90 stipulates: *"A promise which the promisor should reasonably expect to induce action or forbearance on the part of the promisee or a third person and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the* ***promise. The remedy granted*** *for breach may be limited as justice requires"*. Moreso in the American jurisprudence, once detrimental reliance on a promise has been proven; there is no need to establish consideration.

> ***twilight zone of merely honourable engagement. The whole thrust of the law today is to attempt to give proper effect to commercial transactions … 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."***[9]

In support of the position taken by the Australian Supreme Court above, Prof. Alan Tyree, a notable jurist of considerable specialty on commercial instruments opined thus:

> ***"…It is absurd to think that teams of lawyers and business people spend time and money drafting documents that express only moral obligations. It is even more absurd to suppose that they then act on these documents by entering into transactions worth millions of dollars."***[10]

Mark Sneddon, also a prominent professor of commercial law, has argued that enforceability of a Letter of Comfort breeds uncertainty. In his words:

> ***"Plainly, it is desirable from the viewpoint of certainty that courts should follow one presumption about the enforceability of letters of comfort; either that they are legally enforceable or that they are binding in honour only … It is suggested that a presumption against legal enforceability will best promote certainty. That is the traditional view and therefore will more readily permeate the consciousness of the business world. It will warn lenders who want a personal obligation that they should hold out for a guarantee or risk getting no binding commitment. The opposite presumption will tend to create more uncertainty because, even if the letter of comfort is held to be legally enforceable, the nature of the obligation undertaken will vary from case to case and the questions of whether the obligation was breached, whether the breach caused the loss alleged and the appropriate quantum of damages will be disputed in each case. The result will be more uncertainty and more litigation than would occur if the presumption was against legal enforceability and lenders were forced towards a choice between guarantees and non-binding obligations"***[12]

It is pertinent to point out that the support for enforceability of Letters of Comfort especially when unenforceability would most likely occasion a miscarriage of justice is gradually gaining grounds in the courts of most jurisdictions. The Nigerian Court of Appeal decision in the ***Hilman case,*** is a case in point and a commendable one at that.

That said, it is important to bear in mind that there are no straightly cut-out rules to be applied by the court in determining if a Letter of Comfort or similar instruments are enforceable, As such, each case must be dealt with within the sphere of its peculiar facts as no legal precedent can adequately constitute a binding authority to any court. All that a court can do is to follow the guidelines in any given case and as such should readily be willing to divert where such guideline would occasion a miscarriage of justice.

There are other possible remedies that can be available to the recipient of a Letter of Comfort against the issuer in the event of a default in keeping with the promises contained in the Letter of Comfort. In circumstances where the facts represented by the issuer in the Letter of Comfort turns out to be false, the recipient of such a letter,

[9] Rogers CJ in Banque Brussels Lambert SA V Australian National Industries (ANI) Ltd (*supra*)
[10] Prof Alan Tyree; reported in "Comfort Letters – A Fresh Look?" by Lang Thai.

who having relied on such representations has acted to his detriment, can actually sue on grounds of negligent misrepresentation of facts by the issuer.[13] However this is not entirely within the spectrum of this discourse

CONCLUSION

Since the English Court of Appeal decision in **Kleintwort Benson Ltd V Malaysian Mining Corp Berhad**[11], in which the English superior court upturned the lower court decision enforcing a Letter of Comfort, the argument "FOR" and "AGAINST" enforcement of a Letter of Comfort has been on the increase. The uncertainty generated by many ensuing decisions of various courts in different jurisdictions has further compounded the prospect of assuming a strict and certain position of the law. This article however, recommends the adoption of a more flexible than rigid approach to the interpretation of such commercial instruments as Letters of Comfort, Letters of Intent, Letters of Support etc., in line with the growing disposition of the Scottish and American courts, a position which the Nigerian court of appeal on its own has advocated.

In conclusion, the notable words of Prof. Lang Thai an Australian jurist and a famous International Business Lawyer succinctly captures the authors overall thoughts on the subject:

> **"Comfort letters have been around since 1960's and will continue to be a part of the business culture worldwide and in Australia. Therefore, the issue of enforceability will continue to be the subject of an ongoing debate. One compromise may be to presume that the letter is enforceable if it is expressed with clarity and with sincere interest to honour the obligation, whether that obligation is moral or legal. The burden should be placed on the issuer to disprove the presumption. If the letter is held to be enforceable, the issues of breach and of damages can be contested in the ordinary way under contract law"**[12].

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[11] *Hedley Byrne v Heller* Hedley Byrne & Co Ltd v Heller & Partners Ltd (1964) AC 465

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