



Letters of Comfort

Client Breakfast Seminar

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Comfort



“If you look for truth, you may find comfort in the end; if you look for comfort you will not get either comfort or truth only soft soap and wishful thinking to being, and in the end, despair”: **C.S. Lewis**

What are they?



- **Letters of comfort, or letters of support are a letter given by a holding company in circumstances where the addressee party needs written evidence of the ongoing parent company's financial support in order to persuade the addressee that a subsidiary will be going concern.**
- **The letters come in a wide variety of forms and may be, for example, addressed to:**
 - a local bank used by the subsidiary;
 - the local subsidiary's auditors;
 - the subsidiary company, or
 - to directors of the subsidiary board

Letter of Comfort - 1



Parent to Bank:

*"... It is our **policy** to ensure that the business of [] Ltd is at all times in a position to meet its liabilities to you under the above arrangements."*

(Kleinwort Benson – 1988 UK Court of Appeal case)

Letter of Comfort - 1



Parent to Bank:

*"... It is our **policy** to ensure that the business of [] Ltd is at all times in a position to meet its liabilities to you under the above arrangements."*

Result:

- **Not binding**
- Parent had expressly refused guarantee and so subsidiary paid higher interest.
- No promise of policy continuing

Letter of Comfort - 2



Parent to Bank:

*"... We take this opportunity to confirm that it is our **practice** to ensure that our affiliate [], will at all times be in a position to meet its financial obligations as they fall due. These financial obligations include repayment of all loans made by your Bank under the agreements mentioned in this letter."*

(Banque Brussels– 1990 NSW Supreme Court)

Letter of Comfort - 2



Parent to Bank:

"... We take this opportunity to confirm that it is our practice to ensure that our affiliate [], will at all times be in a position to meet its financial obligations as they fall due. These financial obligations include repayment of all loans made by your Bank under the agreements mentioned in this letter."

Result:

- **Binding**
- Clear intention to be bound in the commercial setting
- Estoppel – but not analysed

Letter of Comfort - 3



Parent to Bank:

"This company... will continue to be supported... so long as necessary. In the event that any substantial loans are required to ensure the company's requirement under the necessary legislation or licensing requirements, these will be provided."

(Australian European Finance case – 1993 SA Sup Ct)

Letter of Comfort - 3



Parent to Bank:

"This company... will continue to be supported... so long as necessary. In the event that any substantial loans are required to ensure the company's requirement under the necessary legislation or licensing requirements, these will be provided."

Result:

- **Not binding**
- Woolly wording
- Statement of Intention

Parent/subsidiary – scenario



- **Accruing parent loan**
- **No formal loan agreement**
- **Unsecured loan**
- **Current liability in subsidiary accounts**
- **Haphazard or no repayments**
- **Subsidiary is failing/debt is too high**
- **Auditor requires “comfort” letter**
- **Parent signs a letter to the board which the auditor drafted**

Parent perspective



- **Aim is to limit the contractual liability of the parent for its subsidiary's liabilities**
- **May have to give comfort to the local directors, so they will serve whilst solvency in doubt**
- **May have to ensure the subsidiary accounts will be signed off by directors/auditor**
- **Desire to stay within its existing loan covenants prohibiting the giving of guarantees**
- **Desire to avoid a balance sheet contingency for a formal guarantee**
- **To obtain finance for subsidiary without parent liability**
- **Note:** Parent insolvency trading risk via Corporations Act: 588V

The auditor



- **Requests the letter during an audit for a financially weak subsidiary which will not be a going concern without ongoing parent support**
- **May first trigger the issue of solvency**
- **May author the letter of comfort**
- **For example: Gate Gourmet**

The subsidiary directors

- **Can't sign the accounts as a going concern if they suspect insolvency**
- **The auditor's concern may trigger the directors' concerns**
- **Duty to act in the subsidiary's interests**
- **Duty not to trade whilst insolvent – 588G**
- **May resign without comfort letter**
- **For an insolvent trading defence if the subsidiary fails**

Enforcing the letter?



- **Is the letter legally binding as a contract?**
- **If not, can the letter be the subject of:**
 - Equitable Estoppel
 - Misleading conduct claim (section 52 TPA)

Is the letter a binding contract?



- **Identify the parties**
- **Was the letter intended to be legally binding? (Gate Gourmet case)**
- **What is the consideration? (Atco Controls case)**
- **What does the letter say – what support is promised?**

Gate Gourmet 2004 Sup Ct Letter of Comfort



Feb 2001

Swiss Parent to Australian Parent directors:

"Letter of support

This is to confirm that the parent entity, Gate Gourmet International AG, will provide the financial support that may be necessary to enable Gate Gourmet (Holdings) Pty Ltd and its controlled entities to meet its financial commitments as and when they fall due. This letter of support will not be withdrawn before Gate Gourmet (Holdings) Pty Ltd and its controlled entities have sufficient means to meet their obligations without support of the parent entity."

[Signed by the Executive Vice President of the Parent Company]

Gate Gourmet – Key facts



- **May 2000 – letter of support for auditors from parent**
- **June 2000 – local director signs Dec 99 directors declaration noting support**
- **Finance manual given by parent to local directors about parent cash funding**
- **Dec 2000 – Swiss parent guarantees Westpac loans to subsidiaries**
- **Feb 2001 – PwC seeks second letter of support**

Gate Gourmet – Key facts

- **Company secretary of subsidiary asks parent for letter to be addressed to directors not auditors**
- **Parent queries why in email**
- **Secretary replies that directors need it for local statute purposes of carrying on business**
- **Feb 2001 – parent agrees and sends letter**
- **April 2001 – accounts and declaration signed – notes support**
- **Sept 2001 – Ansett collapses – triggers collapse of Gate Gourmet**

Gate Gourmet - Judgment



- **Held - letter binding as a contract**
- *“Whether conduct of parties viewed in the light of surrounding circumstances, ... shows an agreement having come into existence.”*
- **Objectively, did the parties intend to enter into legal relations?**
- **Look at text itself for assistance**
- *“Strong and plain terms of the letter... promissory.”*
- **Matrix of facts - directors request for letter, letter underpinning the accounts and declarations and directors allowing trade on**
- **Consideration issue not argued**

Gate Gourmet - Misleading conduct



- **Letter a representation as to a future matter i.e. ongoing support**
- **Is it misleading and deceptive conduct? s52 TPA – yes if parent no intention to honour it**
- **Maker must prove reasonable basis for future matter representation – s51A TPA**
- **Reliance by directors of subsidiary**
- **Subsidiary suffers loss or damage by the conduct – s87**

Atco Controls - Victorian Court of Appeal October 2009



Newtronics Pty Ltd – Letter of Support

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

- 1. That the amount owing by Newtronics to Atco Controls of \$[amount owed] as at [date of end of relevant financial year] shall not be called upon within the current period to the detriment of all other unsecured creditors.*
- 2. That if necessary, funds or additional bank security will be provided to Newtronics or its debt financier to ensure that it can meet its current trading obligations that have, or will be incurred."*

Atco Controls – Key facts

(Awaits High Court leave application)



- **Aug 1994 – auditors tell parent to secure its loans**
- **Nov 1994 – first letter of comfort to auditor**
- **April 1995 – charge secures parent loans**
- **Letters addressed to auditor and signed by common director of parent/subsidiary**
- **Letters only provided in years when auditor requested them (1994, 1997, 1999, 2000, 2001)**
- **Newtronics' accounts sporadically mention the support (1997, 2000, 2001 (draft))**

Atco Controls – Key facts

- **1998 – Seeley sues Newtronics**
- **21 Dec 2001 – Seeley judgment \$15m**
- **21 Dec 2001 – Atco demands debt from Newtronics (\$15m)**
- **8 Jan 2002 – Atco appoints receiver under charge**
- **26 Feb 2002 – Atco wound up**
- **Liquidator causes Atco to sue**

Atco Controls – Judgment (Joint Court of Appeal)



- **Appeal from lower court finding of binding contract**
- **Held - no intention to enter into binding agreement as:**
 - Auditor driven
 - Inconsistent with the charge regulating the subsidiary affairs
 - Atco would be in default of its finance agreement with ANZ
 - Directors could have signed accounts based on a non-binding undertaking
 - Period of support uncertain

Atco Controls – Judgment



- **Held - no valuable consideration, reliance on a promise \neq consideration**
- **Must show Atco requested Newtronics to trade on in return for the support and Newtronics acted on it**
- **Here Atco ran Newtronics – no such request**
- **Estoppel not a pleaded issue**

Equitable Estoppel

(Not considered fully in above cases)



- **A complex equitable remedy**
- **Well established in Australia via High Court cases**
- **Boundaries not fully known however**
- **A way around the “no contract” problem**
- **Almost elevates a non-contractual promise to a binding promise – mentioned in Atco**

Equitable Estoppel Cases



- *Waltons Stores (Interstate) Ltd v Maher* (1988) 164 CLR 387
- *Commonwealth v Verwayen* (1990) 170 CLR 394

Estoppel?

Walton Stores case



- No contract existed in Waltons Stores as no exchange
- Mahers thought exchange would occur as a matter of course
- Waltons held the signed Deed and watched the building works progress
- Unconscionable for Waltons to do nothing, as it induced Maher to act on the false assumption that an exchange would occur
- Maher relied on this to their detriment
- Court said Waltons liable as if a contract existed, to avoid the detriment suffered by Maher
- Waltons: “*estopped.. from retreating from its implied promise to complete the contract.*”

Estoppel principles

- The plaintiff **assumes** that a particular legal relationship then existed between the plaintiff and the defendant, or **expected** that a particular legal relationship would exist between them and, in the latter case, that the defendant would not be free to withdraw from the expected legal relationship
- The defendant has **induced** the plaintiff to adopt that assumption or expectation
- The plaintiff acts or abstains from acting **in reliance on** the assumption or expectation and the defendant knew or intended for him to do so

Estoppel principles (cont)

- The plaintiff's action or inaction will occasion detriment if the assumption or expectation is not fulfilled
- Equity seeks to avoid the detriment suffered
- The defendant has failed to act to avoid that detriment, whether via fulfilling the assumption or expectation or otherwise: Brennan J. in *Walton Stores case*

Atco - defence to insolvent trading?



- *“...prove that at the time when the debt was incurred, the person had reasonable grounds to expect, and did expect, that the company was solvent at that time and would remain solvent even if it incurred that debt and any other debts...”: 588H(2)*
- **Directors may have believed that the undertaking would be honoured, though they may have also believed it was not legally binding.**
- **Non-binding assurances may be taken account of by directors, so long as directors in fact expected that it would be honoured and that was a reasonable expectation in the circumstances**

Conservative alternatives?



- **Parent to subsidiary subordinated loan agreement**
- **Subscription Agreement from parent to subsidiary**
- **Formal guarantee/charge to bank by parent**



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