

## **COMFORT LETTERS AS A FORM OF SECURITY**

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### **Abstract in original language**

Patronátní prohlášení jsou běžně používána při obchodních operacích a jsou často poskytovány mateřskou společností financující instituci (věřiteli) v souvislosti s úvěrem touto finanční institucí poskytnutým dceřiné společnosti. Patronátní prohlášení jako způsob zajištění jsou používány v situacích, kdy vystavující osoba nechce poskytnout ručení, ale přeji si poskytnout dceřiné společnosti určitou podporu věřiteli tím, že specifikuje spojitost mezi mateřskou a dceřinou společností. Podle okolností patronátní prohlášení může představovat právně vynutitelný závazek, na druhou stranu nemusí mít žádný právní význam.

### **Key words in original language**

Patronátní prohlášení; banka; dlužník; zajištění; náhrada škody; ručení.

### **Abstract**

Comfort Letters are commonly used in business and they are often given by a parent company to a lender in connection with the facility granted by the financing institution (the lender) to the parent's subsidiary. As a security, they are usually used in situations where the issuer is unwilling to give a guarantee, but wishes to give some comfort to the lender specifying certain legal consequences that derive from the parent's holding in the subsidiary. The Comfort Letter under certain circumstances may be binding, at the other extreme, it may have no legal effect at all.

### **Key words**

Comfort Letters. Bank. Borrower. Security. Damages. Guarantee.

## **I. INTRODUCTION**

Comfort letters do not represent a legal institute which would be familiar to the Czech law. Nowadays, in international business transactions the Comfort letters are commonly used. Comfort letters are known under a number of different names, including letters of awareness, letters of support, letters of responsibility and letters of patronage.<sup>1</sup> Comfort letters are rather a curious species of document, a compromise between a full guarantee and

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<sup>1</sup> In Czech there is no exact translation available. Comfort letters in Czech could be translated as „patronátní prohlášení“ or „doporučující dopis“.

making no commitments at all.<sup>2</sup> In this article a comparative method is being used.

Therefore, also Czech companies being a party to such transactions are often requested to provide them. In this article I would like to explain the essential mechanics and nature of such documents. It is useful to note that the impacts of the Comfort letters could be different, from those establishing a liability for damages to those which are not binding at all.

## II.

Comfort letters are often given by a parent company to a lender in relation to a loan facility being granted by the lender to the parent's subsidiary. Comfort letters are often used in situations when the issuer, e.g. the parent company is unwilling from different reasons to provide a guarantee to its subsidiary. A comfort letter is usually a letter written by a parent company in a transaction where one party is providing finance to a subsidiary of the parent. The comfort letters are commonly used in situation when the issuer is unwilling to provide the guarantee. A company may not be able to provide the guarantee in situations when such provision is forbidden in its constitutional documents, or it may be restriction on the ground of the financing documents or the shareholders might be simply against it.<sup>3</sup>

Also, commercial grounds might be a reason why not to provide a guarantee, for example the cost reasons, policy consideration or the parent company does not wish to show the contingent liability in its balance sheet.

It is necessary to add that the Comfort letters could be granted by any company and the parent – subsidiary relationship is not needed. Under Comfort letters usually the parent company wishes to provide to the subsidiary certain comfort by specifying certain legal or moral consequences.<sup>4</sup> In the Comfort letter, the parent company grants the approval to a subsidiary company's attempt for financing. The Parent company gives reassurance to the lending institution that the parent company is aware of the financing and approves it.

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<sup>2</sup> Scott, David L., *Comfort Letters*, Houghton Mifflin: Wall Street Words, 1998. 160 pages. ISBN 0395437474.

<sup>3</sup> Collective of authors, American Institute of Certified Public Accountants, Washington: American Institute of Certified Public Accountants, D.C.1455 Pennsylvania Ave., NWWashington, DC 20004-1081. 2010. Cited from: <http://www.aicpa.org/InterestAreas/PrivateCompaniesPracticeSection/Resources/CPAComfortLettersToLenders/Pages/default.aspx>. on 10 April 2010. Page 155.

<sup>4</sup> Collective of authors, American Institute of Certified Public Accountants, Washington: American Institute of Certified Public Accountants, D.C.1455 Pennsylvania Ave., NWWashington, DC 20004-1081. 2010. Cited from: <http://www.aicpa.org/InterestAreas/PrivateCompaniesPracticeSection/Resources/CPAComfortLettersToLenders/Pages/default.aspx>. on 10 April 2010.

The wording of Comfort letters is crucial. Although comfort letters tend to follow standard forms of wording, there are a number of variations which can affect the interpretation considerably. The obligations included in a comfort letter may be similar to those contained in the guarantee and such comfort letter may establish the liability to compensate the damages to the other party. At the other extreme, the comfort letter may have no legal effect at all.<sup>5</sup>

In some countries greater emphasis is laid on the circumstances and intentions than in others which look primarily at the actual terms and content of the letter. Certain jurisdictions impose an obligation to act in good faith, which will apply even where the letter is non binding.

Position of the Comfort Letter under Czech law is a little unclear. In most of the case the wording of the Comfort Letter would be decisive. In case the parent company obliges itself to a certain conduct, it is a question whether such behavior could be enforced from the subsidiary and whether a subsidiary could claim a compensation for damages. Therefore, the language and the extent of obligations the parent company is binding itself shall be the most important in Czech jurisdiction. In my personal view, I would use language using words “would” and the expressions such “we would make our best possible efforts” in situations where my intention by the drafting the Comfort Letter to have it completely non-binding. To sum-up, it is important to be careful with the words and obligations you bound yourself, or the company you are representing. The name of the document is not conclusive and usually the court will examine the Comfort Letter in question whether or not it establishes an obligation to a certain conduct and such could be enforced.

### **III. CONCLUSION**

Letters of Comfort are commonly used in commercial transactions. Can a party be held liable under a letter of comfort? The answer will generally be no if the letter is truly a letter of comfort. This answer would apply also under Czech law. It is important to note that yes Comfort Letters could be used under Czech law, however it is necessary to be careful with the wording and be aware of any and all obligations you or your company obliges yourself. The name of the document is not conclusive and usually the court will examine the Comfort Letter in question to see whether, in fact, the Comfort Letter constitutes an agreement under which a liability may arise.

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<sup>5</sup> Scott, David L., *Comfort Letters*, Houghton Mifflin: Wall Street Words, 1998. 160 pages. ISBN 0395437474. Page 44.

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