

DOES A LETTER OF COMFORT HAVE ANY BINDING LEGAL EFFECT? - (Simon Bathusi, Associate)

Letters of Comfort (“LoC”) are instruments usually issued by parent companies to creditors of their subsidiaries, instead of guarantees.

This is usually because parties may not want to create any legal obligations but mere moral commitments between two parties which do not appear on the financial statements specifically the balance sheet of a company, as it involves no actual money.

A LoC may contain different forms of commitment ranging from undertakings not to reduce shareholding in the subsidiary during the currency of the loan, to the assurance that the subsidiary will be properly managed so as to ensure repayment of any loan. The parent company may be concerned about its general credit standing and credit rating and consider it to be below its standard to issue a guarantee for its subsidiaries. The parent company may itself be subject to clauses in existing loan agreements preventing it from providing security in the form of guarantees at a later date.

The undertakings which are usually made in LoC’s may create legal obligations or moral commitments between the parties. Our Court of Appeal in the case of **Fashion Enterprises (PTY) Ltd V Image (Botswana) (Pty) Ltd 1994 BLR 288 (CA)** when dealing with the enforcement of a LoC held that:

“For a comfort letter to give rise to a contractual obligation, it must have been written with the intention of creating a legally binding obligation and accepted by the other party as such. The intention must be determined in the first instance from the language used in the particular letter, which must be interpreted as a whole.”

The Court further held that in considering a LoC, one must have regard to the facts of the matter before it and especially to the wording of the document it is called upon to construe.

The position of the law in Botswana is therefore that, if the intention of the issuer of a LoC as determined by the language used and the document as a whole was to create a legally binding obligation and accepted by the other party as such, then such an issuer may be sued for performance of the undertakings made by the issuer.

It is important to highlight that moral commitments made in a LoC on the other hand are unenforceable. However, a creditor wishing to rely on a moral commitment made in a LoC may in our view still have a claim based on delict, provided the general requirements of delict are present. The claim could be established if it is proved that the issuer negligently made a misrepresentation or misstatement in the LoC, which caused the creditor to incur losses. This issue is however still being determined by our Courts.

It is therefore important that when presented with a LoC, one must consider if rights and obligations arise from the LoC.