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Comfort letter instead of surety – or the enforceability of obligations undertaken in comfort letters

In the event of financing constructions, it may often arise that foreign parent companies do not wish to give a guarantee for the debts of their indebted subsidiaries, but are willing to issue a so-called comfort letter (letter of endorsement, statement of confirmation). However, the legal institution of the comfort letter is not included in the Civil Code, so the question arises whether the obligation contained therein is enforceable at all under the Hungarian law or not.

The content of the comfort letter

As to the content of the comfort letter, it is a unilateral legal statement, in which the parent company of the indebted subsidiary undertakes to do all endeavours to ensure that the subsidiary will be able to fulfil its obligations undertaken vis-à-vis a third party. This obligation is usually based on a credit or loan agreement concluded with a financial institution.

In the comfort letter, the parent company may give specific undertakings, so for example that the debtor will still belong to the group of companies on the due date or no dividend will be paid for a specific term, furthermore that the change of ownership will be agreed upon with the creditor company in advance.

However, many problems arise in connection with the comfort letter, which was also highlighted in numerous judgements of foreign courts. Thus, the court has held in the case of *Kleinswort Benson vs. Malaysia Mining Corporation Berhad* that no legal but only moral obligation arises from a comfort letter. It was stated in the case of *Barbudev v Eurocom Cable Management Bulgaria EOOD and others that since the comfort letter included no specific binding obligation therefore its content was not enforceable*. The decision made in the case of *British Nuclear Group Sellafield Ltd v Kernkraftwerk Brokdorf GmbH & Co [2007] EWHC 2245 (Ch) Walford v Miles [1992] 2 AC 128*) was completely contrary to the aforesaid. In this case the court declared that since the comfort letter regarding its content was in compliance with the agreement between the Parties, therefore, it shall be governed by the rules applicable to agreements.

The Hungarian judicial practice

It was stated in an arbitration case that entitlement to claim a service arises from the unilateral statements only in the cases specified in the rules of law. Comfort letters, however, are not one of the cases specified by these rules of law; therefore, no payment obligation can be established. At the same time, on the basis of the comfort letter, the conditions of compensation arising from tort subsist because there is a causal link between the statement of the parent company and the damage of the creditor bank arising from the non-payment of the credit.

The court highlighted in Case No. EBH2010.2238 that the comfort letter as a legal institution is not recognised by the Hungarian law, **therefore the comfort letter must be judged on the basis of its content**. In the specific case, however, the comfort letter was incapable of being interpreted as guarantee and so it did not constitute vicarious liability for the debts of the company owned indirectly. The court also pointed out that the fact that the parent company will act in accordance with the principles of due care and prudence within legal framework (on the basis of best effort), presents no obligation because it is also generally expected to act as agreed to.

Conclusion

As opposed to the letter of comfort, surety and guarantee are stated as liabilities in the accounts of the parent company for accounting purposes, therefore parent companies prefer their legal statements undertaken on the basis of best effort, set out in the comfort letter, as a guarantee. However, the creditor is unable to handle this situation due to the aforementioned uncertainties, in particular that a poorly drafted comfort letter reduces the probability of the recovery of the provided financing to a great extent.

To sum up, in case of comfort letters applied instead of surety and guarantee, it is recommended that both the creditor company and the obligor act with particular care in drafting the content of the comfort letter.