return to AMPLA 2004 Table of Contents

Letters of Comfort: Gate Gourmet – Feast or Famine

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SUMMARY

This paper explores the judicial response to what are commonly referred to as "letters of comfort" and examines the circumstances in which they have been found to give rise to legally binding obligations.

In particular, the paper considers the recent decision of Einstein J in the New South Wales Supreme Court: Gate Gourmet Australia Pty Ltd v Gate Gourmet Holding AG, where a letter of comfort provided by the Swiss parent company was held to amount to a contract with, and capable of enforcement by, the Gate Gourmet group's wholly owned Australian subsidiary. In the decision, the court also revealed a preparedness to expand the recognised exception to the privity rule as established by the High Court in Trident v McNiece where it is intended by the parties that the non-party beneficiary obtain the benefit of the letter of comfort and the non-party beneficiary continues to trade solely on the faith of the letter. The applicability of the Trade Practices Act concerning misleading and deceptive conduct is also discussed.

INTRODUCTION

A "letter of comfort" is a form of security provided by a third party intending to give "comfort" on behalf of a borrower to a lender. The terms of a letter of comfort will vary widely, but characteristically they will express an awareness of the debt, an intention by the third party to maintain its interest in the borrower and the "comfort" or support offered. Historically, parties granting such a letter have been confident of their being non-contractual and unenforceable, creating a moral responsibility only,[1] Recent Australian decisions, including *Gate Gourmet,*[2] however, suggest such confidence may be misplaced and that in certain circumstances a letter of comfort may give rise to legally binding obligations.

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1 See for example the definition of "comfort letter", P E Nygh & P Butt (eds), *Butterworths Australian Legal Dictionary*, Butterworths, Sydney 1997.

2 *Gate Gourmet Australia Pty Ltd v Gate Gourmet Holding AG* [2004] NSWSC 149.

Letters of comfort have become attractive to parent companies negotiating to obtain financing for their subsidiaries as an alternative to a guarantee. Apart from obviously wanting to avoid liability for the debts of its subsidiary, a parent company might not want a contingent liability on its balance sheet or the tax or foreign exchange disadvantages possibly attaching to a guarantee. Letters of comfort may also be granted by major shareholders. A letter of comfort undoubtedly represents a compromise on the part of lenders who would prefer the certainty offered by a guarantee but often have unequal bargaining power when dealing with major borrowers.

Unlike a guarantee, a letter of comfort does not amount to an automatic assumption of secondary liability by the parent for the debts of its subsidiary. At most, non-payment by the subsidiary will give rise to a claim for damages for breach of contract against the parent, although frequently, putting aside questions of causation, the measure of damages for breach of the letter of comfort will be equivalent to the amount recoverable pursuant to a guarantee.

The commonly held assumption as to the non-enforceability of comfort letters was endorsed by one of the early judicial decisions on the subject, the leading English case *Kleinwort Benson Ltd v Malaysia Mining Corp Bhd*[3] decided by the Court of Appeal in 1989.

The defendant, Malaysian Mining Corporation Berhad (Malaysian Mining), had furnished the plaintiff, Kleinwort Benson Ltd (Kleinwort) being a merchant bank, with a comfort letter in connection with an acceptance credit/multi-currency cash loan facility made available to Malaysian Mining's wholly owned subsidiary, MMC Metals Ltd (Metals). The letter related the banking facilities and continued as follows:

> "We hereby confirm that we know and approve of these facilities and are aware of the fact that they have been granted to MMC Metals Limited because we control directly or indirectly MMC Metals Limited.
>
> We confirm that we will not reduce our current financial interest in MMC Metals Limited until the above facilities have been repaid or until you have confirmed that you are prepared to continue the facilities with the new shareholders.
>
> It is our policy to ensure that the business of MMC Metals Limited is at all times in a position to meet its liabilities to you under the above arrangements."

Metals ceased trading following the collapse of the tin market and Kleinwort terminated the facility (then totalling £10m), demanding payment of all outstanding bills, loans and other sums payable. Metals went into liquidation shortly after and Kleinwort sought payment from Malaysian Mining pursuant to the letter of comfort. Malaysian Mining denied liability, claiming no assurance had been given that the policy would not be reviewed and no legal obligation to support Metals arose.

[3] [1989] 1 All ER 785.

At first instance,[4] Hirst J held that the second and third paragraphs of the comfort letter had contractual status. Malaysian Mining had not met the burden of displacing the presumption laid down in *Edwards v Skyways Ltd,*[5] namely that in ordinary commercial transactions the creation of legal relations is intended by the parties.

The Court of Appeal considered that the central question was "whether the words of paragraph 3 considered in their context are to be treated as a warranty or contractual promise".[6] The words "It is our policy" were a statement of present fact. To interpret paragraph 3 as a promise as to future conduct necessarily required the addition of the words "and will be". Ralph Gibson LJ with whom Nicholls LJ and Fox LJ agreed, found such an interpretation was consistent with the understanding of both parties that the letter was a document under which Malaysian Mining would give comfort by assuming moral responsibility only. Significantly, the concept of a letter of comfort arose in circumstances of a refusal by Malaysian Mining to assume joint and several liability or give a guarantee, and Kleinwort charged a higher commission as a result. These circumstances also explained why Kleinwort agreed to proceed without any legally enforceable security being provided. If Kleinwort had required a promise as to Malaysian Mining's future policy, Ralph Gibson LJ considered that "it was open to them as experienced bankers to draft paragraph 3 in those terms".[7]

THE LAW RELATING TO LETTERS OF COMFORT: AUSTRALIAN AUTHORITY

The leading Australian authority on letters of comfort, the New South Wales Supreme Court decision of *Banque Brussels Lambert SA v Australian National Industries Ltd*[8] was delivered 12 December 1989 by Rogers CJ. The plaintiff, Banque Brussels Lambert SA (Banque Brussels) a Belgian bank, extended a $5 million loan facility to Spedley Securities Ltd (Spedley Securities) allegedly secured in part by a letter of comfort made available by the defendant Australian National Industrial Ltd (ANI). ANI had a 45% shareholding in Spedley's parent Spedley Holdings Ltd (Spedley Holdings). Following lengthy negotiation and exchange of drafts between the parties, the letter as ultimately settled stated:

> "We confirm that we are aware of the eurocurrency facility of US$5 million which your Bank has granted to Spedley Securities Limited, which is a wholly-owned subsidiary of Spedley Holdings Limited.
>
> We acknowledge that the terms and conditions of the arrangements have been accepted with our knowledge and consent and state that it would not be our intention to reduce our shareholding in Spedley Holdings Limited from

4 *Kleinwort Benson Ltd v Malaysia Mining Corp Bhd* [1988] 1 All ER 714.
5 1964] 1 All ER 494.
6 *Kleinwort Benson Ltd v Malaysia Mining Corp Bhd* [1989] 1 All ER 785 at 794.
7 [1989] 1 All ER 785 at 797.
8 (1989) 21 NSWLR 502.

> the current level of 45% during the currency of this facility. We would, however, provide your Bank with ninety (90) days notice of any subsequent decisions taken by us to dispose of this shareholding, and furthermore we acknowledge that, should any such notice be served on your Bank, you reserve the right to call for the repayment of all outstanding loans within 30 (30) days.
>
> We take this opportunity to confirm that it is our practice to ensure that our affiliate Spedley Securities Limited, 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 arrangements mentioned in this letter."

Banque Brussels had initially sought a guarantee from ANI but this was refused. ANI subsequently sold its shares in Spedley Holdings without giving Banque Brussels the required ninety days notice, denying Banque Brussels the opportunity to call up the loan. As well as claiming breach of contractual promise with respect to paragraph 3 of the letter, Banque Brussels argued that had the notice been given and the loan recalled, ANI as a matter of commercial reality would have been forced to pay Banque Brussels as ANI's shares would have become unsaleable had Spedley Securities' defaulted.

Disapproving of the "minute textual analysis"[9] of the letters of comfort undertaken by the Court of Appeal in *Kleinwort Benson*, Rogers CJ was of the opinion that the Court of Appeal's construction rendered the letter "a scrap of paper".[10] Rogers CJ observed that a court should not "use a finely tuned linguistic fork"[11] and found a schedule prepared by ANI's representatives showing the similarities and differences between the letter in *Kleinwort Benson* and the present case to be singularly unhelpful.

The starting point for Rogers CJ was that statements uttered in the course of business should be enforced by the courts where they are "appropriately promissory in character",[12] no doubt persuaded by his view that

> "[t]here 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, without any express statement to that effect, reside in a twilight zone of merely honourable engagement".[13]

Rogers CJ found the statements contained in paragraphs 2 and 3 were of a promissory nature. The surrounding circumstances also tended toward an intention to create legal relations. The evidence established that both Spedley Securities and ANI were aware the facility was conditional on some commitment from ANI and that any letter of comfort needed to be "strong" to meet Banque Brussels' requirements. ANI's general manager had expressed to Banque Brussels on a

[9] (1989) 21 NSWLR 502 at 523 per Rogers CJ.
[10] (1989) 21 NSWLR 502 at 525.
[11] (1989) 21 NSWLR 502 at 524.
[12] (1989) 21 NSWLR 502 at 523.
[13] (1989) 21 NSWLR 502 at 523.

number of occasions ANI's intention to maintain its shareholding and support its subsidiary. Although Rogers CJ accepted that the letter was not a guarantee, this was consistent with ANI still intending to make a legally binding commitment. ANI's resistance to a guarantee merely showed that ANI did not want the commitment to have the *character* of a guarantee. Rogers CJ concluded that ANI were liable at contract.

If this assessment were incorrect, Rogers CJ also indicated Banque Brussels would succeed on a claim of unconscionable conduct, essentially grounded in ANI's failure to disabuse Banque Brussels of the incorrect perception it knew Banque Brussels must hold held regarding the protection afforded by the letter.

The Supreme Court of Victoria's decision: *Commonwealth Bank of Australia v TLI Management Pty Ltd*[14] was delivered on 29 June 1989, some months prior to the *Banque Brussels* judgment, but does not appear to have been considered by Rogers CJ. In *Commonwealth Bank*, a letter of comfort was provided by the defendant TLI to the plaintiff bank in the context of TLI's proposed takeover of Hovertravel Ltd. The letter was furnished prior to the takeover at the request of the bank as security for a temporary overdraft facility granted to Hovertravel Ltd's wholly-owned subsidiary Hovertravel Australia Pty Ltd. Signed by TLI's director, the letter stated:

> "We hereby acknowledge that the Commonwealth Bank of Australia has agreed to make temporary credit facilities totalling two hundred and fifty thousand Australian dollars $A250,000 available to Hovertravel Australia Pty Ltd which represents payments for ongoing operating costs and salaries.
>
> We confirm that the company will complete takeover arrangements (subject to shareholders' approval) of Hovertravel Ltd as soon as legally possible. These arrangements include the injection of sufficient capital to repay the temporary facility as mentioned above to [sic] takeover date or within 30 days of this dater."

TLI proceeded with its takeover of Hovertravel but Hovertravel's shares were suspended from trading soon after. The extension of financial assistance to Hovertravel Australia did not therefore eventuate.

Tadgell J regarded "[t]he central question for determination [as] whether, by the letter, the defendant undertook a promissory obligation to the plaintiff".[15] Tadgell J accepted that the bank had relied on the protection afforded by the letter in honouring cheques drawn on the account by Hovertravel Australia. However the draft letter supplied by the bank to TLI (in terms substantially the same as those of the final letter) merely invited TLI to acknowledge the fact of the credit facility which the bank "ha[d] agreed" to provide to Hovertravel Australia. The draft letter did not suggest that any undertaking was being sought from TLI as consideration for, or as a condition to, the granting of the facility. It did not for example use words such as "we undertake" or "we promise" which would have indicated the assumption by TLI of a contractual obligation. The words "we confirm that we

[14] [1990] VR 510.
[15] [1990] VR 510 at 514.

will" were ambiguous, the first sentence of the second paragraph merely conveying a non-promissory statement of intention. The inherent vagueness and uncertainty of words including "complete", "takeover arrangements", "as soon as legally possible", "the arrangements" and "injection" supported such a view.

Kleinwort Benson, in which it was held that the words "we confirm" had contractual force, was distinguished by Tadgell J on the basis that a confirmation by Malaysian Mining that it would not do that which was within its power to do was distinct from a confirmation to do a particular thing if TLI became entitled to do it, although the words needed to be examined in light of the whole of the circumstances.

It was also unlikely that TLI, otherwise not bound to take over Hovertravel Ltd, would have intended to bind itself to the bank and thereby assume responsibility for payment of Hovertravel Australia's overdraft facility if the takeover did not proceed. Whilst accepting TLI's letter was calculated to ensure the continued funding of Hovertravel Australia's business, Tadgell J held that it was non-committal and non-promissory.

The next reported decision directly considering letters of comfort, *Australian European Finance Corporation Ltd v Sheahan*[16] was delivered by the South Australian Supreme Court in June 1993. The plaintiff, Australian European Finance Corporation Limited (AEFC) being a merchant bank, made available to Duke Pacific Finance Limited (Duke Pacific) a revolving term loan facility of $5 million. The facility was secured by a guarantee from Duke Pacific's parent, Duke Holdings Limited (Duke Holdings) and letters of comfort from Duke Holding's major shareholders Dalgety Farmers Limited (Dalgetys) and Genoa Resources and Investment Limited (Genoa). Duke Pacific was subsequently sold to Duke Group Limited (Duke Group) in which Duke Holdings had a 44% shareholding. Before extending the loan facility for a second 12-month term, AEFC advised that it would also require a guarantee from Duke Group. Duke Group refused to provide a guarantee but indicated that it would issue a letter of comfort in common with Dalgetys and Genoa. This was accepted by AEFC, the letter of comfort it received from Duke Group being in the following terms:

> "Re Duke Pacific Finance Limited
>
> This company which is 100% owned by The Duke Group Limited will continue to be supported by this company so long as is necessary.
>
> In the event that any subordinated loans are required to ensure the company's requirements under the necessary legislation of licensing requirements, these will be provided.
>
> I confirm that such support as is necessary will be given to this company and its subsidiaries."

Following the compulsory winding up of Duke Pacific and Duke Group, AEFC submitted a Proof of Debt to Duke Group's liquidator, the defendant Sheahan. The Proof of Debt was disallowed on the ground that the letter did not create a

[16] (1993) 60 SASR 187.

liability on the part of Duke Group. AEFC sought an order setting aside the defendant's determination.

Matheson J rejected AEFC's plea that it had permitted the loan facility to continue in reliance upon the letter. No evidence was called by AEFC to support such a contention, Matheson J finding AEFC had demonstrated "an almost cavalier attitude"[17] to the receipt of the letter of comfort from Duke Group. The letter was not received until some months after AEFC had approved the extension of the term of the facility. An internal AEFC memorandum concerning the extension of the facility noted that the financial strength of Duke Pacific was in Dalgety and Genoa whose support was evidenced through the letters of comfort, no mention being made of Duke Group or what security it would provide. AEFC's General Manager also gave evidence that he expected the letters of comfort would merely be "statements of commercial intent … rather than as promises which were capable of being legally enforced".[18] There was no evidence of any discussion or negotiation between the parties as to the letter's wording; no "hard bargaining" as such.

Furthermore, Matheson J concluded it was intended by the wording of the letter that it be ambiguous, the letter containing no statement of awareness or approval of the loan facility or an assurance that Duke Group would maintain its ownership of Duke Pacific. Words such as "support" and "as is necessary" had equivocal meaning. Ultimately, Matheson J was not persuaded either that the words of the letter contained a contractual promise or that the parties intended it would amount to a legally enforceable security.

The *Gate Gourmet* Decision

The first defendant, Gate Gourmet Holding AG (the Swiss parent), was the overseas holding company for the Gate Gourmet group, then the world's second largest airline catering company. The plaintiff, Gate Gourmet Australia Pty Limited (the Australian trading company) was one of a number of Australian entities controlled by the Swiss parent's wholly owned subsidiary Gate Gourmet (Holdings) Pty Ltd (the Australian holding company), the second defendant to the proceedings. The Australian companies provided the vehicle for the Gate Gourmet group's acquisition of a number of Cathay Pacific Catering services group companies and its eventual successful tender for the provision of in-flight catering services to Ansett airlines commencing 15 November 1999. The third and fourth defendants, Mr Engebretsen and Mr Larsen, along with Mr McIntyre were the directors of both the Australian holding company and its subsidiaries, including the Australian trading company.

Pursuant to the Ansett Catering Services Agreement, the Australian trading company conducted the domestic in-flight catering business. Other aspects of the group's operations, such as international in-flight catering services, ownership of land and buildings and non-kitchen staff were the responsibility of other entities

[17] (1993) 60 SASR 187 at 206.
[18] (1993) 60 SASR 187 at 194.

controlled by the Australian holding company. The Australian holding company did not trade at any relevant time.

Shares subscribed by the Swiss parent were purely nominal and with no other capital injection, the Australian trading company depended on a series of borrowing arrangements to fund its operations. The Australian trading company's purchase of Ansett's catering units was financed by bank borrowings which the Swiss parent repaid pursuant to a $35 million subordinated parent company loan agreement with the Australian trading company. The subordinated loan could not be cancelled by the Swiss parent so long as it owned at least 51% of the Australian trading company's shares. As at 11 August 2001, $25 million had been drawn down.

Arrangements were put in place at an early stage to facilitate regular reporting of the Australian trading company's performance to the Swiss parent and its budgetary requirements were closely monitored. It was not disputed that it was a practice of the Swiss parent, borne out in various financial manuals and other documentation, to ensure funding would be made available to its subsidiaries when cash shortages arose.

Around May 2000, the company secretary of the Australian holding company and its subsidiaries, Mr Joseph Goggi, organised for Gate Gourmet International AG (of which the Swiss parent was a wholly owned subsidiary) to provide PriceWaterhouseCoopers, worldwide auditors to the Gate Gourmet group, with a letter of comfort confirming their ongoing financial support, ostensibly to enable PriceWaterhouseCoopers to sign off on the group's accounts. Gate Gourmet International AG was another subsidiary of the Swiss parent. The letter dated 31 May 2000 was addressed "To Whom It May Concern" and signed on behalf of Gate Gourmet International AG by its Chief Executive Officer, Mr Henning Boyson (the fifth defendant to the plaintiff's action) and Chief Financial Officer, Mr Niels Smedegaard. The letter was headed "Letter of Support" and then continued as follows:

> "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 Limited and its controlled entities to meet its financial commitments as and when they fall due.
>
> This guarantee will not be withdrawn before Gate Gourmet (Holdings) Pty Limited and its controlled entities have sufficient means to meet their obligations without the support of the parent entity."

In July 2000 the financial statements for the Australian holding company as a consolidated entity and another of its subsidiaries, Gate Gourmet Services Pty Ltd, were lodged with ASIC for the companies' relevant financial year, being 1 January 1998 to 31 December 1999. Mr McIntyre, as Managing Director and sole Australian director for all the Australian companies, signed the Directors Statements declaring that in his opinion there were reasonable grounds to believe the companies would be able to pay their debts as and when they fell due. In view of the group's net losses, Einstein J accepted Mr McIntyre's evidence that without the letter of 31 May 2000 such statement would have been false. A note to the

consolidated financial statements (incorporating the assets and liabilities of all entities controlled by the Australian holding company) recorded that the financial statements had been prepared on a going concern basis on the assumption the parent entity would continue to provide the necessary financial support. As the Australian trading company had only commenced its operations in November 1999, there was no need for it to lodge a separate financial statement.

In early 2000, loan facilities had also been established with Standard Chartered Bank and Westpac to provide the Australian trading company with working capital. The Standard Chartered Bank facilities were later consolidated with those provided by Westpac. By late 2000 it had become apparent to all concerned that key financial assumptions made during the acquisition did not accord with the business reality. Both the Cathay Pacific and Ansett kitchens were capital starved in terms of infrastructure and management. It was also discovered that some $13 million in costs had not been accounted for in the initial contract with Ansett making it extremely difficult for the Australian trading company to conduct a profitable operation. The Australian trading company's financial forecasts for August 2000 circulated on 14 August anticipated losses of some $8.88 million greater than the $8.405 million loss originally budgeted for. Highly dependent on revenue from Ansett, it did not help that Ansett itself was in financial turmoil.

The Australian trading company's budget for 2001 was presented to the Swiss parent in September 2000 and forecast losses well into 2003. Einstein J found that the Swiss parent could have been in no doubt that to meet its debts as and when they fell due, the Australian trading company would be entirely dependant on its Swiss parent's financial support during 2001. By 1 November 2000, the Australian trading company had drawn down $49 million on the $50 million Westpac facility. Those circumstances made it "more credible"[19] that the Australian trading company's directors would perceive a real need for a legally binding commitment of support from the Swiss parent.

In December 2000, Westpac made available an additional $10 million to the Australian trading company at the request of the SAir Relation (part of the SwissAir group, the ultimate parent). The Swiss parent provided a guarantee to Westpac in respect of the obligations of the Australian holding company and each of its wholly owned subsidiaries.

At PriceWaterhouseCoopers' request, a second letter of comfort ("the Letter") was provided by the Swiss parent in mid February 2001. The sample letter provided by Price Waterhouse and forwarded by Mr Goggi to Mr Nielson, Vice-President of Finance to the Swiss parent, was in identical terms to the letter of support of 31 May 2000. Mr Nielson queried why the letter should be addressed to the directors of the Australian holding company, the Swiss parent wishing to address it to PriceWaterhouseCoopers. Mr Nielson emailed Mr Goggi:

> "Why not PWC? I assume they are the one requesting the Support Letter in order for them to sign off on the Australian trading company financial

[19] [2004] NSWSC 149 at para 75 per Einstein J.

statements as at 31 December 2000. I think this is the normal way to do it. Please get back to me."

Mr Goggi responded (with copy sent to Mr Larsen, a director of the Australian holding company and its subsidiaries):

"NO!!! The guarantee needs to be provided to the Directors of the company so that they can carry on the business within Australian statutory legislation. PWC only require proof (copy) that a 'Letter of Comfort' exists."

Mr Nielsen replied "Fine, I will get the Letter signed".[20]

Einstein J accepted Mr Goggi's evidence that he did not regard the provision of the Letter as being merely a procedural exercise to permit PriceWaterhouseCoopers to sign-off on the accounts, and would have been alarmed at any suggestion the Swiss parent did not consider itself obliged to honour it, as in those circumstances the Australian Trading company would have been trading whilst insolvent.

The Letter dated 16 February 2001, headed "Letter of Support" addressed to the directors of the Australian holding company was ultimately provided to Mr Goggi, who passed a copy on to PriceWaterhouseCoopers. Mr Boyson and Executive Vice President & CFO Lucas Grolimund, were the signatories on behalf of the Swiss parent (Boysen and Grolimund were fifth and sixth defendants to the plaintiff's action). The content of the letter was as follows:

"This is to confirm that the parent entity, Gate Gourmet Holding 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 the support of the parent entity."

Mr Nielson had replaced the word "guarantee" in the second paragraph of the sample letter with "letter of support", although this amendment apparently escaped the notice of Mr Goggi.

Concerns developing as early as February 2001 within the Gate Gourmet group as to Ansett's survival led to Mr McIntyre and Mr Boysen investigating the possibility of selling the Australian trading company or merging its business with Qantas. Ansett's declining share of the domestic market left the Australian trading company struggling to meet its budget and it continued to trade at a loss throughout 2001.

In April 2001, the Australian trading company's statutory accounts for the financial year ending 31 December 2000 and Directors Statement declaring that there were reasonable grounds to believe the company would be able to pay its debts as and when they fell due, were signed by Mr McIntyre with the approval of the other directors. A note to the accounts stated:

"[T]he financial statements have been prepared on a going concern basis on the assumption that the related entities will continue to provide the necessary

[20] [2004] NSWSC 149 at paras 86-88.

> financial support to enable the company to pay its debts as and when they become due and payable, and not to call for repayment of the amounts owing to it until, and then only to the extent to which, sufficient funds are available."[21]

Einstein J accepted that in making the declaration, Mr McIntyre relied on the Letter as a legally enforceable inter-company guarantee that would be honoured by the Swiss parent, and that he would not have signed the Directors Statement without it. In the absence of the Swiss parent's support, Mr McIntyre would have considered that the plaintiff was trading whilst insolvent and recommended that a voluntary administrator be appointed.

In mid-May 2001, Mr Nielsen sent an email querying whether companies within the Australian group having a negative equity in 1999 and 2000 were legally permitted to trade. Mr Goggi responded that business can carry on notwithstanding any thin capitalisation rules, on the basis that a "Letter of Support" was provided by the Swiss parent at the end of each financial year, certifying that the Swiss parent would provide the financial support. In July 2001, Mr McIntyre obtained advice from Baker & McKenzie concerning his own legal obligations as the sole Australian director in the event the Swiss parent discontinued its support of the Australian trading company or did not honour its letter of support. Appointment of an administrator was raised. Mr McIntyre forwarded Baker & McKenzie's advice to Messrs Boysen, Grolimund, Engebretsen and Larsen.

From June 2001 onwards Westpac began expressing its reluctance to extend its lending facilities to the Australian trading company for another term beyond 15 December 2001 in view of its ongoing operating losses unless certain conditions were met, including a capital injection by the SwissAir group to reduce the facility to $35 million. An amended facility was eventually agreed with Westpac, Mr McIntyre certifying the plaintiff's solvency. Einstein J again accepted Mr McIntyre's evidence that he was aware that the Swiss parent had committed a substantial sum to reduce the facility and assumed that the Letter was in place.

On 12 September 2001 Ansett was placed into voluntary administration, the Australian trading company following suit the subsequent day when the Swiss parent failed to confirm that it would honour the Letter. My Boyson informed Mr McIntyre that although the Swiss parent would "pay off Westpac" it did not "have the money for anything else".[22] In September 2001 the Swiss parent remitted $35 million to Westpac in satisfaction of the Australian trading company's debt.

On 15 November the Australian trading company was placed into liquidation, with debts amounting to $97 million. $30 million of the Australian trading company's assets related to companies associated with Ansett. A month later proceedings were issued by the Australian trading company's liquidator to enforce the Letter, claiming that the Letter constituted a contract between the Swiss parent and the Australian trading company. Alternatively, it was pleaded, inter alia, that the promises contained in the letter were held on trust by the Australian holding company for the benefit of the Australian trading company and that the conduct of

[21] [2004] NSWSC 149 at para 101.
[22] Evidence of Mr McIntyre, [2004] NSWSC 149 at para 161.

the Swiss parent, to which Messrs Boysen and Grolimund were parties, amounted to misleading and deceptive conduct in contravention of the *Trade Practices Act*. Proceedings against Messrs Engebretsen and Mr Larsen as third and fourth defendants were settled during the hearing.

Reviewing the decisions of *Banque Brussels, Kleinwort Benson, Commonwealth Bank* and *Sheahan*, it was Einstein J's opinion that the authorities needed to be considered in view of their particular facts and that the question of whether a letter of comfort gave rise to legal obligations ultimately turned on its terms.

Einstein J found that there was an intention by the parties to enter into legal relations. Citing *Film Bars Pty Ltd v Pacific Film Laboratories*[23] and other relevant authorities, Einstein J affirmed that the common intention of the parties was to be examined objectively, based on the standard of the reasonable person. Extrinsic evidence of pre- and post-contractual conduct, mutually known facts, the common commercial objectives and the relationship between the parties was admissible.

The purpose of the Letter was to enable the Australian trading company and its directors to satisfy their statutory obligations. Its terms contained a promise that the Letter would not be withdrawn before the Australian holding company and its controlled entities had sufficient means to meet their obligations without the Swiss parent's support. Phrases such as "confirm" "the financial support that may be necessary" did not appear to present the difficulties for Einstein J that they did for Tadgell J in *Commonwealth Bank*. In Einstein J's view it was a "matter of impression"[24] that the language of the Letter was promissory. Although the promise to provide financial support did not have to be *legally binding* for it to be taken into account by the directors in forming the opinion that there were reasonable grounds to believe that the company would be able to pay its debts as and when they fell due, Einstein J considered that the directors were entitled to anticipate the Swiss parent's compliance with the Letter in permitting the continued trading of the Australian trading company. This was true notwithstanding the existence of banking and other facilities made available.

Einstein J approved the assertion of Rogers CJ in Banque Brussels that "where statements are appropriately promissory in character they should be enforced 'when they are uttered in the course of business and there is no clear indication that they are not intended to be legally enforceable'".[25] Although highly persuasive on the question of intent, the commercial context of the statement was properly viewed as another objective factor to be taken into account in determining intent, rather than creating the presumption advocated by Rogers CJ.

The actual text of the Letter also constituted an integral part of the admissible evidence to be taken into account in determining intention. Phrases in the first paragraph of the letter such as "it's controlled entities", "[ability] to meet its financial commitments as and when they fall due" carried legal connotations. The statement in the second paragraph that the Letter would not be withdrawn before

[23] (1979) 1 BPR 9251.
[24] [2004] NSWSC 149 at para 223.
[25] [2004] NSWSC 149 at para 213 per Einstein J.

the Australian holding company and its controlled entities had sufficient means to meet their obligations without the support of the parent entity similarly evidenced a promissory intent to be legally bound.

Einstein J, rejected the defendants' argument that the letter was too imprecise, stating:

> "In my view, properly construed, the Letter entitled the Australian trading company to be indemnified by the Swiss parent against its financial commitments, as and when they fell due, and to be so indemnified up to the point in time when the Australian trading company had sufficient means to meet those commitments without the support of the Swiss parent."[26]

As the letter of comfort was addressed by the Swiss parent to the directors of the Australian holding company, the defendants contended that even if the Letter constituted a contract, the Australian trading company was not a party.

Einstein J noted that the identity of the "promisees" or "offerees" was not necessarily the same as the "addressee". There was no rationale in limiting the promise to the nominal "addressee" as the Australian holding company did not trade and had no ongoing financial commitments. As the ultimate beneficial owner, it was logical to suppose that the Swiss parent intended all its Australian controlled entities to obtain the benefit of its promise. The circumstances in which the Letter came into existence, particularly the continued trading losses sustained by the Australian trading company, made it abundantly obvious that it was the entity for which financial support was necessary. In fact, the Australian trading company was dependent on the letter for its continued trading. It was not at all certain in February 2001 that in the absence of the Letter, the facilities in place would be adequate for the Australian trading company's requirements. The Australian trading company had plainly accepted the Swiss parent's offer to supply financial support and in consideration undertook trading activities in relation to which its directors would otherwise have been criminally liable. The email communications between Mr Nielson and Mr Goggi in February 2001 made it patently clear that the purpose of the Letter was to enable the directors of the Australian trading company to continue its business and that its support was not to be restricted by addressing the Letter to PriceWaterhouseCoopers.

It was also noted that the directors of the Australian holding company and the Australian trading company were one in the same and shared the same postal address. The addressing of the Letter to the Australian holding company was merely for reasons of convenience. In finding that the Australia trading company was a promisee, his Honour said:

> "The submission that the Australian trading company was not a party to the contract flies in the fact of the obvious commercial intent of the Letter….[w]hat was being accomplished by the production of the Letter was the underpinning for the Australian trading company, in the circumstances which prevailed, *to be permitted to continue to trade at all.*"[27]

[26] [2004] NSWSC 149 at para 218.
[27] [2004] NSWSC 149 at paras 229-233.

If wrong in finding Gate Gourmet Australia was party to the contract, Einstein J was prepared alternatively to expand the exception to the privity rule as established by the High Court in *Trident General Insurance Co Ltd v McNiece Bros Proprietary Ltd.*[28] *Trident* is authority for the "Privity of Contract" rule under which only parties to a contract are entitled to enforce the obligations it contains. *Trident* established an exception to the privity rule in the context of a liability insurance policy where it was the common intention of the insurer and assured that the policy would indemnify those with whom the assured contracts and the contractor can be reasonably expected to order its affairs by reference to the policy. In those circumstances the contractor could sue directly on the policy.[29] According to Einstein J, it was clear that the Swiss parent and the Australian holding company similarly intended the Australian trading company to obtain the benefit of the promises in the Letter and that the Australian trading company continued to trade on the faith of the letter.

Einstein J regarded it irrelevant that one concerned a contract of insurance and the other a contract of indemnity. Even if *Trident* could be distinguished factually, the same considerations in *Trident* would justify "the relatively modest incremental step"[30] of declaring the exception to the privity rule as applicable in this case. Einstein J suggested this in fact to be a clearer case than *Trident* for the application of the exception because here the beneficiaries, namely the Australian holding company's subsidiaries, were in existence and ascertainable at the date of making the contract.

In the further alternative, Einstein J was willing to find that the Australian holding company held the benefit of the promise contained in the Letter "on trust" for the Australian trading company. It was held to be clear from the language of the letter and the surrounding circumstances that the Australian holding company intended that its' controlled trading entities, including the Australian trading company, obtain the benefit of the promise.

His Honour also found that the Letter was misleading or likely to mislead in contravention of s 52 of the *Trade Practices Act*. Einstein J considered it beyond doubt that the Letter contained the express representation that the Swiss parent "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" and that the Letter "will not be withdrawn before Gate Gourmet Holdings Pty Ltd and its controlled entities have sufficient means to meet their obligations without the support of the parent entity". The Letter also contained the implied representations that the Swiss parent believed it had reasonable grounds for making those representations and that at that time intended to honour the Letter's terms.

Whilst accepting the Swiss parent provided the Australian trading company with considerable financial support, Einstein J held that the evidence adduced by

[28] (1988) 165 CLR 107.
[29] (1988) 165 CLR 107 at 123-134 per Mason CJ and Wilson J and 172 per Toohey J.
[30] [2004] NSWSC 149 at para 255 per Einstein J.

the Swiss parent "did not go [the] distance"[31] in establishing that it had reasonable grounds on 16 February 2001 for making the implied representations, and by the deeming provision contained in s 51A(2), the representation was therefore to be taken to be misleading pursuant to s 51A(1).[32]

His Honour found that in the absence of the Letter and the representations it contained the Australian trading company would not have continued trading and that the representations materially contributed to the loss and damage suffered by the Australian trading company. The evidence failed to establish however that Messrs Boysen and Grolimund as signatories to the Letter were party to the Swiss parent's contravention.

A further hearing has been listed commencing 16 August 2004 for the determination of quantum of damages and it is unknown at this stage whether an appeal will be filed in relation to his Honour's judgment.

CONCLUSION

There has perhaps in the past been a wrongly held assumption that a letter of comfort gives rise to a moral responsibility as opposed to legal obligations. The *Gate Gourmet* decision serves as a timely reminder that their use should be approached with caution. Einstein J has opened the door for prosecution of companies and their directors failing to honour a letter of comfort for breach of the *Trade Practice Act*.

As the interpretation of letters of comfort is very factually driven it is difficult to predict with any real conviction how they will be viewed by the courts. It has been suggested that the introduction of a presumption against legal enforceability would reduce uncertainty in this area[33] but this has not been taken up. As matters currently stand, in certain circumstances a letter of comfort may have the practical effect of a guarantee, and therefore deserves equal attention by companies, directors and lawyers involved in their drafting and negotiation.

[31] [2004] NSWSC 149 at para 302 per Einstein J.

[32] Section 51A of the *Trade Practices Act* 1974 (Cth) provides: "(1) For the purposes of [Division 8], where a corporation makes a representation with respect to any future matter (including the doing of, or the refusing to do, any act) and the corporation does not have reasonable grounds for making the representation, the representation shall be taken to be misleading. (2) For the purposes of the application of subsection (1) in relation to a proceeding concerning a representation made by a corporation with respect to any future matter, the corporation shall, unless it adduces evidence to the contrary, be deemed not to have had reasonable grounds for making the representation …"

[33] M Sneddon, "Banking Law & Practice", *Annual Survey of Australian Law 1990* at 99-100, cited by Matheson J, *Australian European Finance Corporation Ltd v Sheahan* (1993) 60 SASR 187 at 204.

return to AMPLA 2004 Table of Contents