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## Banking - Austria

### Liability for damages under letter of comfort

Contributed by Binder Grösswang Rechtsanwälte GmbH

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Under Austrian law, the term 'letter of comfort' is a collective description for instruments predominantly issued by parent companies to banks that secure the payment obligations of a third party, usually a subsidiary company, under its financing arrangements with the beneficiary bank. They come in a variety of forms within two 'pure' types:

- the unrestricted comfort letter; and
- the restricted comfort letter.

Unrestricted letters of comfort establish a binding and enforceable obligation of the issuer to vest the obligor with sufficient funds to fulfil its payment obligations with respect to the beneficiary bank, similar to a financial guarantee. In contrast, restricted comfort letters do not establish enforceable payment obligations, but are intended to create some level of assurance that the issuer of the comfort letter will look after the debtor's financial standing or, in the words cited by the Supreme Court, give the beneficiary a "warm feeling". Further, restricted comfort letters typically also contain information undertakings for the benefit of the bank relating to changes in shareholding or changes of control.

The Supreme Court recently ruled on a comfort letter that expressly stated that it "shall not constitute a guarantee" on the part of the issuer and was, accordingly, qualified as a restricted letter of comfort. However, this letter also contained certain undertakings which went well beyond the usual content of a restricted comfort letter (see above), such as an undertaking of the issuer "to promptly inform the beneficiary about any circumstances which may have a material adverse effect on the assets, financial or trading position or prospects of business" of the relevant debtor. Although restricted letters of comfort normally do not contain undertakings of this kind, the Supreme Court stated that the freedom of contract under Austrian law enables the parties to stipulate such clauses in a restricted letter of comfort.

The debtor's business model was already fundamentally flawed at the time when the comfort letter was issued. The issuer, although aware of this fact, informed the beneficiary of "massive problems" only after the beneficiary had extended substantial loans to the debtor, relying, among other things, on the comfort letter. When the debtor went into voluntary liquidation, the beneficiary claimed compensation for a part of its resulting loss from the issuer, arguing that the issuer had failed to comply with its information obligations under the restricted letter of comfort.

Contrary to the court of second instance, the Supreme Court concluded that in the absence of any express carve-out or qualification, the information undertaking at hand was not limited to circumstances occurring after the date on which the letter of comfort was issued, but also covered pre-existing circumstances. This conclusion was particularly based on the definition of 'material adverse change' in a loan agreement concluded between the same parties in relation to the project. According to the Supreme Court, the definition in that case was limited to changes occurring after execution of the loan agreement and the parties to the letter of comfort could therefore have easily used such wording.

Consequently, the issuer had breached its contractual obligations when it failed to inform the beneficiary in a timely manner and was held liable to compensate the beneficiary for its loss incurred as a consequence of this breach of contract - irrespective of the restricted nature of the comfort letter.

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