

Comfort letters Q&A: Brazil

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Country Q&A | Law stated as at 31-Jan-2021 | Brazil

This Q&A provides country-specific commentary on *Practice note, Comfort letters: Cross-border*.

1. Are comfort letters issued under the laws of your jurisdiction? If so, what are they called, and are they always issued by parent companies in respect of subsidiaries?

Yes. They are also called comfort letters in Brazil (*carta de conforto*).

Most comfort letters are issued by parent companies in respect of their subsidiaries, but they can also be issued in other circumstances. For example, a subsidiary company with more financial resources and greater structure may issue a comfort letter in respect of another subsidiary of the same group.

2. Can comfort letters be issued in binding form as well as in non-binding form under the laws of your jurisdiction? If so, how common are binding comfort letters?

Although comfort letters are not often issued in Brazil, some transactions may include them. Two types of comfort letters are used in Brazil:

- "Hard" comfort letters, which impose a defined payment obligation on the issuer, such as a covenant by a parent that it will ensure that its affiliate companies are at all times in a position to meet their financial commitments.
- "Soft" comfort letters, which do not contain specific payment obligations, but only the intention of the company to maintain ownership of the affiliate entity participating in a specific transaction and/or to supply it with funds sufficient to remain solvent.

As a rule, both hard and soft comfort letters are binding on the issuer. In relation to soft comfort letters, if the intention to maintain ownership or solvency of the affiliate is proven to be incorrect at the time the letter was issued,

a breach of obligation leading to damages arises. However, comfort letters that expressly provide that they are non-binding or that they do not create legal rights will not impose legal obligations on the issuer.

3. Are there any particular requirements for comfort letters (whether binding or non-binding) under the laws of your jurisdiction?

Under Brazilian law, a comfort letter should be executed in the jurisdiction chosen to govern it.

Consideration must normally be given to the issuer of the letter if the following apply:

- The letter imposes a binding obligation on the issuer.
- The issuer of the letter has minority shareholders who will not benefit directly from it. This rule is intended to avoid oppression of the minority, who would not benefit from the support given to a parent or sister entity.

However, consideration may not be required for groups of corporations formally governed by a “group convention”, which is similar to the constitutional documents of a company but applicable to more than one entity. Group conventions may create or allow non-arm’s length transactions between the group companies and even obligations that can jeopardise the interests of a specific company, provided that the transaction or obligations benefit the group as a whole. If a group convention allows it, a comfort letter can be issued by a company within a group for the benefit of another company of the same group, without the receipt of consideration.

Standard document, Comfort letter (binding): Cross-border and *Standard document, Comfort letter (non-binding): Cross-border* are valid and enforceable in Brazil.

4. Does a binding comfort letter differ from a primary or secondary liability guarantee under the laws of your jurisdiction, and if so how does it differ?

Binding comfort letters are different from primary and secondary liability guarantees under Brazilian law, as confirmed by Brazilian case law (for example, *Interlocutory Appeal No 1.214.367-4, of the Court of Justice of São Paulo, decided on December 10, 2003*).

Under a personal guarantee, the guarantor undertakes to satisfy certain obligations of the debtor in the case of default. By contrast, in a typical comfort letter, the issuer undertakes to provide funds for its affiliate or related company, or to maintain a certain standard of behaviour in relation to the affiliate or related company (for instance, to keep a majority shareholding), but does not incur direct liability for repayment of the debt. The obligation imposed on the issuer of the letter in relation to the lender (the letter recipient) ceases when the issuer complies with the terms

of the letter (for example, by providing funds for the affiliate or related company). This occurs regardless of whether the affiliate or related company has paid its debts or not (except if otherwise provided for in the comfort letter).

In addition, guarantees are accessory obligations, and so they expire when the principal obligation is extinguished. As a result, if a loan is extinguished, the guarantee connected to it also ceases to exist.

Comfort letters, however, are not accessory obligations and do not expire when the credit relationship between the affiliate company or related party and the lender is extinguished. The potential consequences of this are that:

- A guarantee is rendered ineffective when the main debt is for some reason deprived of effect for formal reasons (for instance, lack of authority of the signing parties), but this would not affect a comfort letter.
- A guarantee loses effect if the debt is repaid and may lose effect if the debt is subject to novation, unless otherwise provided for in the guarantee agreement. A comfort letter, on the other hand, is not normally affected by such events.

5. What are the differences between primary and secondary liability guarantees in your jurisdiction?

Where there is a secondary liability guarantee, the guarantor cannot be subject to debt enforcement until demand for payment and enforcement of security has been tried against the original debtor.

Where there is a primary liability guarantee, the creditor can enforce against the guarantor's assets before or at the same time as enforcing against the debtor.

As comfort letters are not guarantees, the difference between primary and secondary liability guarantees does not affect the rights given under comfort letters.

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