CIRCUMVENTING VEIL PIERCING: POSSIBLE DELICTUAL LIABILITY OF A HOLDING COMPANY TO A CREDITOR OF ITS INSOLVENT SUBSIDIARY

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1 Introduction

The decision in *Aron Salomon v A Salomon & Co Ltd*[1] still confirms the most fundamental aspect of company law more than a century after the decision was handed down, namely the principle of limited liability in a company. In terms of this principle the contractual creditors of the company can only look to the company for the payment of the company's debts and not to the shareholders of the company. Liability is therefore on the contractual party of the creditor. This principle has also now been codified in the new Companies Act 71 of 2008.[2] The traditional approach to hold a shareholder liable for the obligations of the company of which he or she is a shareholder is the piercing of the corporate veil doctrine, or to argue that the company is the agent of the shareholder, or that the subsidiary and the holding company were in fact a partnership.[3]

This article will, however, explore the possibility of holding the holding company liable for the losses suffered by a contractual creditor of the subsidiary of the holding company. The article does not intend to investigate whether the holding company is liable for the debt of the subsidiary to the creditor but whether the relevant creditor has an independent delictual action against the holding company for the loss it suffered due to the actions of the holding company. In this regard the article only deals with a delictual action based on pure economic loss which the creditor suffered in the context of a letter of comfort which was issued by the holding company to a creditor of its subsidiary. The article therefore does not deal with the piercing of the corporate veil doctrine. The context of the article is that a creditor lent money to a subsidiary company. The holding company, instead of issuing a guarantee for that debt, issues a letter of comfort to the creditor of its subsidiary. The letter of comfort either states that it is the (current) *policy of the holding company to ensure that its subsidiary meets its obligations* or that it is the (current and future) *policy of the holding company to ensure that its subsidiary meets*

* I would like to thank Prof Max Loubser for his valuable comments

1 [1897] AC 22 (HL)

2 S 19(2) of the Companies Act

3 D Milo "The Liability of the Holding Company for the Debts of its Subsidiary: Is Salomon still Alive and Well?" (1998) 115 *SALJ* 318 323-333

its obligations. The creditor extends further credit to the subsidiary and the subsidiary cannot repay the loan. The creditor looks to the holding company for repayment. The creditor attempts to hold the holding company liable in contract, based upon the letter of comfort, but fails.

Due to the failure of the contractual action, the creditor considers an action based on delict against the holding company. The article will focus on the nature of an action for pure economic loss in South African law and which factors a court will take into consideration to impose liability on this basis. The focus will be on the element of wrongfulness and when there could be a legal duty on a person to not cause pure economic loss to another. Thereafter the article will focus on the legal nature of a letter of comfort. Finally it will be argued that a letter of comfort could under certain circumstances impose a legal duty on a holding company to not cause pure economic loss to a creditor of its subsidiary. The questions of negligence and legal causation will only be looked at in a cursory manner.

2 Possible delictual liability

A creditor would have to prove the elements for delictual liability to succeed with any claim against the holding company.[4] The advantage of this option is that it does not require the piercing of the corporate veil, since the purpose is not to make the holding company liable for the debts of the subsidiary company. Olaerts, with reference to Bartman and Dorresteijn,[5] states in this regard that a delict by the holding company is required for indirect piercing (of the corporate veil) and therefore this does not violate the principle of limited liability. The shareholder is not held liable for the debts of the (subsidiary) company but for its own debts, which are the result of its delict committed against the creditors of the subsidiary company.[6]

Wrongfulness in the context of an action for pure economic loss requires either proof that a subjective right has been infringed or that a legal duty has been broken.[7] It would appear that the problem with proving of wrongfulness in the context of pure economic loss is the question whether there was a legal duty on the wrongdoer *vis-à-vis* the wronged. In *Arthur E Abrahams and Gross v Cohen*[8] the court held:

> "Setting the boundaries of liability *ex delicto* for causing what has come to be styled as pure economic loss not flowing from physical damage has been a major concern of Western Courts in recent times. Fear of introducing what Cardozo J in *Ultramares Corporation v Touche* [(1931) 255 NY 170 179

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4 See MM Loubser, R Midgley, A Mukheibir, L Nessing & D Perumal *The Law of Delict in South Africa* 2 ed (2012) 21 for the requirements for delictual liability, namely wrongfulness, fault, causation, conduct and harm

5 SM Bartman & AFM Dorrestijn *Van het concern* (2006) 231

6 M Olaerts *Vennootschappelijke beleidsbepaling in geval van financiële moeilijkheden; de positie van bestuurders en aandeelhouders* PhD thesis Maastricht (2007) 194 in the original states:

> "Doordat voor indirecte doorbraak een eigen onrechtmatige daad van de moedervennootschap vereist is, wordt met deze rechtsfiguur… strict genonem geen inbreuk gemaakt op het pricipe van de beperkte aansprakelijkheid De aandeelhouder wordt immers niet persoonlijk aansprakelijk gesteld voor de schulden van de vennoorschap maar voor zijn eigen schulden, schulden die resulteren uit een door hem jegens de crediteuren van de dochtervennootschap gepleegde onrechtmatige daad "

7 PQR Boberg *The Law of Delict* (1984) 104

8 1991 2 SA 301 (C)

(74 ALR 1139 1145)] called 'liability in an indeterminate amount for an indeterminate time to an indeterminate class' has deterred Courts from upholding too readily claims for damages for pure economic loss unassociated with physical damage. Thus, the mere fact that the loss which has occurred was reasonably foreseeable by the defendant is not necessarily *per se* sufficient to have given rise to a legal duty to act or to abstain from acting in order to avoid the loss.

As I see the position it comes to this. A defendant may be held liable *ex delicto* for causing pure economic loss. [I]t will have to be established that the possibility of loss of that kind was reasonably foreseeable by him *and that in all the circumstances of the case he was under a legal duty to prevent such loss occurring*. It is not possible or desirable to attempt to define exhaustively the factors which would give rise to such a duty because new situations not previously encountered are bound to arise and societal attitudes are not immutable."[9]

The most difficult point therefore that a plaintiff in a group context has to prove is that the holding company had a legal duty not to cause him loss. The other aspects of delictual liability may not necessarily be much easier though. The focus of this article will, however, be on the issue of whether a legal duty could be imposed on a holding company under specific circumstances to not cause pure economic loss to certain specific creditors of its subsidiaries. Of the most recent South African cases in respect of pure economic loss, the most relevant for purposes of this article are the following: *Telematrix (Pty) Ltd t/a Matrix Vehicle Tracking v Advertising Standards Authority of SA*,[10] *Holtzhausen v ABSA Bank Ltd*[11] ("*Holtzhausen*"), *Fourway Haulage SA (Pty) Ltd v SA National Roads Agency Ltd*[12] ("*Fourway Haulage*") and *Viv's Tippers (Edms) Bpk v Pha Phama Staff Services (Edms) Bpk h/a Pha Phama Security*.[13]

In *Telematrix (Pty) Ltd t/a Matrix Vehicle Tracking v Advertising Standards Authority of SA*[14] the court stated:

"When dealing with the negligent causation of pure economic loss it is well to remember that the act or omission is not *prima facie* wrongful ('unlawful' is the synonym and is less of a euphemism) and that more is needed. Policy considerations must dictate that the plaintiff should be entitled to be recompensed by the defendant for the loss suffered (and not the converse as Goldstone J once implied unless it is a case of *prima facie* wrongfulness, such as where the loss was due to damage caused to the person or property of the plaintiff). In other words, conduct is wrongful if public policy considerations demand that in the circumstances the plaintiff has to be compensated for the loss caused by the negligent act or omission of the defendant. It is then that it can be said that the legal convictions of society regard the conduct as wrongful…"[15]

The court further stated that to determine whether the law should recognise the existence of a legal duty requires a balancing against one another of identifiable norms.[16] Furthermore, the courts are also wary to impose liability for pure economic loss if it would lead to a flood of indeterminate plaintiffs instituting action against the alleged wrongdoer. [17]

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9 1991 2 SA 301 (C) 307G-309F (original emphasis)
10 2006 1 SA 461 (SCA)
11 2008 5 SA 630 (SCA)
12 2009 2 SA 150 (SCA)
13 2010 4 SA 455 (SCA)
14 2006 1 SA 461 (SCA)
15 Para 13
16 Para 16
17 Para 19

In the *Holtzhausen* case H entered into an agreement to sell diamonds to a buyer through an agent of the buyer. He undertook to pay commission to the agent should the transaction be concluded. The agent informed H that the purchase price for the diamonds was paid into his bank account with ABSA and provided H with three telephone numbers to verify the deposit of the purchase price into his bank account. The bank account of H reflected the deposit of the purchase price. H contacted the bank manager of the branch where he held his account to ascertain whether he could proceed with the transaction, namely to deliver the diamonds and pay the commission to the agent. He told the bank manager why he needed the verification. H gave the three telephone numbers, which the agent gave to him, to the bank manager. The bank manager assured him that he could proceed with the transaction and also personally authorised the withdrawal of the commission payable by H to the agent. Fraud was subsequently discovered on the side of the agent and buyer and the bank account of H was debited with the amount paid to the agent. H now sought to recover his losses from ABSA based on the negligent misstatement of the bank manager. The court of first instance gave absolution of the instance. H appealed to the Supreme Court of Appeal. His action was based on a delictual claim for the pure economic loss which he had suffered due to the alleged negligent misstatement by the defendant bank.

The Supreme Court of Appeal referred to *Bayer South Africa (Pty) Ltd v Frost*[18] where the Appellate Division, as it then was, held that it would in principle be possible that a negligent misstatement which induced a person to enter into a contract may give rise to a delictual claim for damages by that person.[19]

The Supreme Court of Appeal also needed to clear up any confusion created by the decision in *Lillicrap, Wassenaar and Partners v Pilkington Brothers (SA) (Pty) Ltd*[20] ("*Lillicrap*") which had been misinterpreted in a number of decisions. According to the Supreme Court of Appeal it was decided in the *Lillicrap* case that no delictual claim would be possible where the negligence which was relied upon consisted of a breach of a contractual term.[21] This did not mean, however, that a person could not choose between two actions, one based on delict and one based on contract, should the facts allow either one of the two.[22] Since the plaintiff in the *Holtzhausen* case was not relying on a breach of a contractual obligation by the defendant bank but on a claim which he had independently of any contract with the bank, the *Lillicrap* decision was not applicable.[23]

On the question of wrongfulness the Supreme Court of Appeal held the following:

> "So far as unlawfulness is concerned, the following findings might be made on the evidence led thus far: That the statement by the bank manager was made in response to a serious request; that the

[18] 1991 4 SA 559 (A)
[19] 632D-F
[20] 1985 1 SA 475 (A)
[21] 633A-B
[22] 633H-J
[23] 634B-C

plaintiff approached the bank manager because of his expertise and knowledge of banking matters; and that the plaintiff's purpose in making the enquiry was, to the knowledge of the bank manager, to ascertain whether he could safely proceed with the transaction. It could be inferred that the bank manager realised that the plaintiff would rely on his answer. On the evidence led thus far, it might further be found that there are no considerations of public policy, fairness or equity to deny the plaintiff a claim; that no question of limitless liability could arise; and that an unfair burden would not be placed on the manager or the bank if liability were to be imposed - inasmuch as the manager could have refused to act on the plaintiff's request and could have protected himself and the bank against the consequences of any negligence on his part by a disclaimer… Of course it goes without saying that at the end of the case, the trial court might come to the conclusion that no legal duty rested upon the bank manager to take reasonable steps to ensure that any representation which he may have made, was correct."[24]

In *Fourway Haulage SA (Pty) Ltd v SA National Roads Agency Ltd*[25] the court stated the following:

"Recognition that we are dealing with a claim for pure economic loss brings in its wake a different approach to the element of wrongfulness. This results from the principles which have been formulated by this court so many times in the recent past that I believe they can by now be regarded as trite. These principles proceed from the premise that negligent conduct which manifests itself in the form of a positive act causing physical damage to the property or person of another is prima facie wrongful. By contrast, negligent causation of pure economic loss is not regarded as prima facie wrongful. Its wrongfulness depends on the existence of a legal duty. The imposition of this legal duty is a matter for judicial determination involving criteria of public or legal policy consistent with constitutional norms. In the result, conduct causing pure economic loss will only be regarded as wrongful and therefore actionable if public or legal policy considerations require that such conduct, if negligent, should attract legal liability for the resulting damages."[26]

The court held that a plaintiff should not only prove that the negligent conduct was wrongful but also that considerations of public policy give rise to a legal duty on a defendant. The court further stated:

"Does this mean we are back to the proposition that, in the field of pure economic loss, liability depends on the idiosyncratic views of the individual judge as to what is reasonable and fair? In the first instance some degree of certainty is established by the identification of categories where liability will be imposed. In *Telematrix* (para 15) one such category was recognised, by way of example, with reference to the liability of collecting banks. Another example is to be found in *Perre v Apand* (paras 28 - 30) where liability for the failure to provide accurate information or advice - ie for negligent misstatements - was recognised as a category of liability for pure economic loss in the context of Australian law… When determining whether the law should recognise the existence of a legal duty in any particular circumstances what is called for is not an intuitive reaction to a collection of arbitrary factors but rather a balancing against one another of identifiable norms. (See also eg *Telematrix* paras 15 - 16.) In a case like the present where the claim for pure economic loss falls outside the ambit of any recognised category of liability, the first step is therefore to identify the considerations of policy that are of relevance… The first policy consideration is the law's concern to avoid the imposition of liability in an indeterminate amount for an indeterminate time to an indeterminate class. (See also eg *Canadian National Railway Co v Norsk Pacific Steamship Co* (1992) 91 DLR (4th) 289 ([1992] 1 SCR 1021) at 359; MM Corbett 'The Role of Policy in the Evolution of our Common Law' 1987 *SALJ* 52 at 59.)

But the absence of indeterminate liability itself will not automatically give rise to the imposition of liability. That much was expressly held in *Trustees, Two Oceans Aquarium Trust* para 20. The reason why this court refused to come to the aid of the plaintiff in that case, despite the absence of indeterminate liability, was that the plaintiff was in a position to avoid the risk of the loss claimed by contractual means (see para 24)."[27]

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[24] 635E-I
[25] 2009 2 SA 150 (SCA)
[26] Para 12
[27] Paras 13, 16-25

In *Viv's Tippers (Edms) Bpk v Pha Phama Staff Services (Edms) Bpk h/a Pha Phama Security*[28] the court confirmed the principles laid down by previous Supreme Court of Appeal decisions in respect of the establishment of a legal duty to answer the question of wrongfulness as follows:

> "Where loss sustained is purely economic the question must be asked whether public policy, or the convictions of the community, require that there should be such a duty. That an action does lie for pure economic loss, provided that public policy requires that it should, is now settled law. It is not necessary to enumerate the authorities. However, courts have been circumspect in allowing a remedy because of the possibility of unlimited liability: the economic consequences of an act may far exceed its physical effect. There is a spectre of limitless liability. It is established thus that a court, in deciding to impose liability on an actor, must consider whether it is legally and socially desirable to do so, having regard to all relevant policy considerations, including whether the loss is finite and whether the number of potential plaintiffs is limited. Where the success of an action could invite a multitude of claims, sometimes for incalculable losses, an action will generally be denied. But in each case the imposition of liability must turn on whether, in the circumstances, liability should be imposed. That will in turn depend on public or legal policy, consistent with constitutional norms… To ensure that the question of legal or public policy is not determined arbitrarily, or unpredictably, a court is not required to react intuitively, but to have regard to the norms of society that are identifiable."[29]

Loubser et al list a number of circumstances which the courts take into consideration to establish whether a legal duty existed on a person not to cause pure economic loss on a person. In the context of this article only the relevant circumstances will be quoted:

> "Knowledge: The fact that the defendant knew or subjectively foresaw that his conduct would cause damage to the plaintiff is an important and often decisive factor. Such knowledge… could arise… from the fact that one party of necessity relies on the conduct, statement or information of the other.
>
> Ability to protect oneself against liability: Could the person who suffered loss have taken preventative measures against the loss.
>
> A special relationship: Was there a relationship of dependence or trust between the parties?"[30]

And further

> "Policy considerations: a plaintiff must not only show that that the loss was negligently and wrongfully caused but also that considerations of public policy gave rise to a legal duty on the side of the defendant. In this regard a number of policy considerations are considered. The relevant ones for the purposes of this article are first of all courts are not willing to impose liability if it would lead to liability in an indeterminate amount for an indeterminate time to an indeterminate class. Secondly courts will more easily impose liability for a single loss that affects one party who can be identified, that occurs once and that is unlikely to cause a large number of actions. Thirdly the extent of possible liability and the economic or social consequences of imposing liability: If liability could lead to indeterminate liability or to a multiplicity of actions the courts will be reluctant to impose a legal duty on a defendant."[31]

The issue highlighted by the abovementioned quotations from recent cases and a text book concerns the legal duty which rests on the alleged wrongdoer towards the person who has suffered pure economic loss. It would appear that South African courts are still very wary of implying a legal duty on a person to prevent economic loss to another unless it is very clear that such a duty

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28 2010 4 SA 455 (SCA)
29 Para 6
30 Loubser et al *Delict in South Africa* 230
31 232

existed and it is submitted that this requirement may be the most difficult requirement for a plaintiff to prove. The legal duty will only be imposed in very specific categories of circumstances although the court has stated that there is not a closed list of categories.

In the next section the legal nature of letters of comfort will be discussed in the context of a holding company issuing such letter to a lender of money of its subsidiary. The purpose of the investigation is to determine whether the principles or test laid down by our courts in respect of the imposition of a legal duty to not cause pure economic loss could be applied where a holding company issued a letter of comfort to a creditor of its subsidiary and the subsidiary cannot repay the loan to the creditor and thus causes harm to the creditor.

3 Letters of comfort

The effect of a letter of comfort by a holding company which induces a party to enter into an agreement with the subsidiary could be relevant in the context of the law of delict. *Prima facie* one would assume that a letter of comfort creates an impression of creditworthiness of the subsidiary and that the holding company gives comfort to a potential creditor of a subsidiary that the subsidiary will be able to perform. Typically a letter of comfort is issued by a holding company in which it confirms that it is "its policy that its subsidiaries are at all times able to meet their liabilities… but is usually designed to provide no more than moral re-assurance".[32] According to Goode a letter of comfort will typically be issued where the holding company refuses to provide a guarantee or stand surety for the liabilities of the subsidiary company.[33]

In *Kleinwort Benson Ltd v Malaysia Mining Corporation Berhad*[34] ("*Kleinwort Benson*") Malaysia Mining incorporated a wholly owned subsidiary, MMC Metals Ltd with a start-up capital of £1.5 million, which was insufficient to trade on the London Metal Exchange. MMC Metals sought to obtain funds from Kleinwort Benson, a merchant bank. Kleinwort Benson needed some form of assurance from Malaysia Mining, the holding company of MMC Metals, that MMC Metals would repay the loan amount. Malaysia Mining issued a letter of comfort as part of an acceptance of a credit/multi-currency cash loan facility which Kleinwort Benson granted to MMC Metals to a maximum of £5 million. The letter of comfort included the statement that it was the policy of Malaysia Mining to ensure that the business of MMC Metals was at all times in a position to meet its obligations to Kleinwort Benson in terms of the cash loan facility. The cash loan facility was later increased to a maximum of £10 million in reliance upon a second letter of comfort from Malaysia Mining which was couched in substantially identical terms to the first letter of comfort. MMC Metals defaulted on its obligations,

[32] R Goode *Commercial Law* (2004) 802
[33] 820
[34] [1989] 1 WLR 379 (CA)

was liquidated and "Malaysia Mining" refused to perform the outstanding obligations of MMC Metals towards Kleinwort Benson. Kleinwort Benson subsequently sought to obtain judgment for damages against Malaysia Mining and based its claim on the statement in the letter of comfort referred to above. The court *a quo*[35] granted judgment in favour of Kleinwort Benson.

The thrust of the appeal of Malaysia Mining was that it did not enter into any contractual obligations to Kleinwort Benson. The court of first instance considered a number of authorities[36] and accepted the following principles:

> "(i) An agreement, even though it is supported by consideration, is not binding as a contract if it was made without any intention of creating legal relations.
> (ii) In the case of an ordinary commercial transaction it is normally not necessary to prove that the parties in fact intended to create legal relations: the onus of proving that there was no such intention 'is on the party who asserts that no legal effect was intended, and the onus is a heavy one:' *per* Megaw J in *Edwards v Skyways Ltd* [1964] 1 W.L.R 349, 355.
> (iii) To decide whether legal effect was intended, the courts normally apply an objective test; for example, where the sale of a house is *not* 'subject to contract,' either party is likely to be bound even though he subjectively believed that he would not be bound until the usual exchange of contracts had taken place.
> (iv) The court will, in deciding that question, attach weight (a) to the importance of the agreement of the parties, and (b) to the fact that one of them has acted in reliance upon it.
> (v) In the search for agreed terms of a commercial transaction, businessmen may adopt language of deliberate equivocation in the hope that all will go well. It may, therefore, be artificial to try to ascertain the common intention of the parties as to the legal effect of such a claim if in fact their common intention was that the claim should have such effect as a judge or arbitrator should decide: see Staughton J in *Chemco Leasing S.p.A v Rediffusion Plc*, on 19 July 1985, cited by Hirst J [1988] 1 W.L.R 799, 806G. Nevertheless, the court's task is to ascertain what common intentions should be ascribed to the parties from the terms of the documents and the surrounding circumstances."[37]

The court of first instance followed the principles as set out above and came to the conclusion that Malaysia Mining could not prove that the parties did not intend that the relevant paragraph in the letter of comfort would have effect as a contractual term. The judge in the court of first instance held that it was clear that there was an undertaking on the side of Malaysia Mining that it was its policy to ensure that MMC Metals was in a position to meet its liabilities towards Kleinwort Benson in terms of the cash loan facility.

The Court of Appeal held that Malaysia Mining made a statement as to what their policy was, and did not in the relevant paragraph of the two letters of comfort expressly promise that the policy in respect of ensuring that its subsidiary would comply with its obligations would be continued in future. The Court of Appeal held that the words in question were a statement in respect of the present fact and not a promise of future conduct. Furthermore the Court of Appeal held that the concept of a letter of comfort was known to the parties in their negotiations, especially after Malaysia Mining refused to assume joint and several liability and also refused to give a guarantee for the

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35 [1988] 1 WLR 799

36 *Rose and Frank Co v JR Crompton and Brothers Ltd* [1923] 2 KB 261; *Edwards v Skyways Ltd* [1964] 1 All ER 494; *Prenn v Simmonds* [1971] 1 WLR 1381; *Chemco Leasing SpA v Rediffusion Plc* (QBD) (19-07-1985) affirmed [1987] 1 FTLR 201 (CA); J Chitty & AG Guest *Chitty on Contracts* 25 ed (1983) para 123

37 *Kleinwort Benson Ltd v Malaysia Mining Corporation Berhad* [1989] 1 WLR 379 (CA) 383-384

obligations of MMC Metals. The intention was therefore clearly that Malaysia Mining would give moral comfort for the obligations of its subsidiary and not undertake any legal liability for those obligations towards Kleinwort Benson. Since the preceding paragraph to the relevant paragraph expressly mentioned that Malaysia Mining would not reduce its financial interest in MMC Metals without the consent of Kleinwort Benson, the Court of Appeal held that this constituted a legally binding undertaking by the holding company. The holding company admitted in any event that the preceding paragraph to the paragraph in question was meant to be a legally binding undertaking. The Court of Appeal held that the paragraphs preceding the offending paragraph would have been superfluous if the intention of the parties was to create a legally binding undertaking in the offending paragraph.

The factual circumstances under which the letters of comfort were given were also very relevant. The holding company refused to be bound jointly and severally as co-principal debtor and refused to issue a guarantee that the subsidiary would comply with its obligations. The intention was merely to confirm that the policy of the holding company was to ensure that the obligations would be met but nothing prevented it to change that policy if circumstances changed in the future.

In *Bouygues SA v Shanghai Links Executive Community Ltd*[38] the Hong Kong court confirmed the principles as set out by the Court of Appeal in the *Kleinwort Benson* case. It held that the test was whether the written statements by a party amounted to simple statements of fact or whether they were contractual promises as to future conduct. The court further held that:

> "The letter of comfort was a tool of commerce developed to provide an alternative to a guarantee or surety. The writer was normally a parent company unwilling to give security for its subsidiary's liabilities. Thus, letters of comfort were issued when the parent company did not want to incur legal liability, it wished to protect its own credit rating or it wanted to avoid showing a contingent liability on its balance sheet."[39]

The court held further that:

> "The question was whether the letters contained simply statements of fact regarding the parent company's current policy or whether they amounted to contractual promises as to the parent company's future conduct. If the former, the letter is a letter of comfort with no legal effect. If the latter, the promise it contains is enforceable (provided that the other elements of enforceability are satisfied, such as consideration). If the letter contains express words of promise, no difficulty arises… since the issue is ultimately one of construction, the absence of express words of promise means that it is necessary to consider carefully the context in which the letters were written."[40]

So-called letters of awareness can in principle be described as regards their legal effect in similar terms to a letter of comfort. This boils down to a notice from the issuer that it is aware of the fact that a lender of money has made an offer to make a loan facility available to a prospective borrower.[41] In *Hong Kong and Shanghai Banking Corporation Ltd v Jurong Engineering Ltd*[42] the

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38 [1998] 2 HKLRD 479
39 490I-J
40 491B-E
41 Goode *Commercial Law* 802
42 [2000] 2 SLR 54

Singapore High Court had to decide on the legally binding status of a letter of awareness. The plaintiff instituted an action for damages in the amount of approximately $9 million against the defendants. Huge Corporation Pte (Ltd) was an associate company of the first defendant for a period of time, then became a subsidiary company of the first defendant for a period of two years and then became an associate company again. When Huge was wound up it owed money to the plaintiff in terms of the credit facilities which the plaintiff had granted to it.

The facts *in casu* were fairly similar to the letters of comfort cases discussed above. The plaintiff wanted to lend money to Huge. The first defendant refused to give a guarantee as security for any loans to Huge but instead was willing to give a letter of awareness. The plaintiff drafted the letter. In one of the paragraphs of the draft letter the word "undertake" was replaced with the word "ensure" by the first defendant, to which the plaintiff did not object. Two further letters of awareness were issued by the first defendant in substantially similar terms as the first one. In the next two, however, the word "undertake" was not replaced by the word "ensure". Huge started encountering financial difficulties and was eventually wound up. The plaintiff based their claim against the first defendant on the breach of the third letter of awareness.

The court *in casu* dismissed the plaintiff's claim since no legal obligations were undertaken by the first defendant.[43] The court held that a court must look at the substance of the agreement and not just at the terminology used by the parties.[44] The court must furthermore look at the surrounding circumstances and the text of the letter of awareness to determine the intentions of the respective parties to the agreement.[45]

If these letters of comfort or awareness do not constitute legally enforceable obligations between the lender and the holding company, could they in any manner be used in a delictual action for pure economic loss which the lender has suffered? The elements of a delict will have to be proved for the claim to be successful. It is submitted that the three difficult elements will be fault, causation and wrongfulness. The question of causation will be addressed briefly later. Fault was arguably present on the side of the holding company through negligently creating the impression that it would stand in for the obligations of the subsidiary company to the lender of the funds in terms of a loan agreement. The negligence could also lie in the holding company not informing the recipient that its policy *vis-à-vis* the subsidiary has changed. Had it done so the recipient could have mitigated its losses by calling up its loan to the subsidiary earlier or refusing to extend further credit to the subsidiary company.

Since there is no legally binding contract between the parties to the letters of comfort in respect of the payment of the loan by the holding company, a legal duty could more easily be implied especially where the holding company is intimately involved in the management and policies of the

[43] 77
[44] 71
[45] 71

subsidiary company. The holding company is privy to the financial position of the subsidiary and should be aware at a very early stage that the subsidiary company is in financial difficulties. An ongoing duty to disclose the financial position of the subsidiary company could be placed on the holding company, not only due to the fact that it has financial information in respect of the subsidiary which is not readily available, but also because some form of close, but non-contractual, relationship exists between the lender and the holding company. This is not just a tenuous link which exists between the parties but a strong one which probably had been nurtured over time by means of protracted negotiations. The usual reluctance of the courts to imply a legal duty due to the possible proliferation of actions against the holding company would also not be of relevance here since the relationship is strictly between the lender and the holding company and not a faceless indeterminable number of faceless potential claimants.

When one considers the South African cases which dealt with pure economic loss and then specifically the cases referred to above and academic material, it would appear to be apt in the context of letters of comfort and letters of awareness. Since there is no contract between the holding company and the bank or recipient of the letter of awareness or letter of comfort, the problematic aspect of a delictual claim based on contract which the South African courts have been battling with, should not then enter the discussion. If the status of a letter of comfort and letter of awareness imposes merely moral obligations it still cannot be denied that some form of unique (fiduciary) relationship comes into existence between the holding company and the recipient or holder of the letter of comfort or awareness. It is questionable whether this relationship is purely moral in its nature. It is submitted that the relationship between the holding company and the recipient or holder of the letter of awareness or comfort is at best a *quasi* contractual one or at least a *sui generis* one. It is further submitted that, irrespective of the name of the relationship between the respective parties, due to this relationship which has come into existence between the holding company and the recipient of the relevant letter of comfort or awareness, a legal duty has arisen towards the recipient of that letter.

What would the content of this duty be, or put differently, what would constitute wrongful behaviour which would lead to the duty of care being breached? Should the wrongful act be the failure of the holding company to pay the debts of the subsidiary which then causes the holder of the letter of comfort loss - or should it be restricted to a situation where there was a duty on the holding company to inform the recipient of the letter of comfort of the precarious position of the subsidiary to enable that party to mitigate its losses by, for example, halting the provision of credit to the subsidiary? It is submitted that, at the very least, there rests a positive duty on the holding company, under these circumstances, to inform the holder of the letter of comfort or awareness of the financial position of the subsidiary or that its policy has changed, ie that it is not the policy of the holding company anymore to ensure that the subsidiary meets its obligations. From the moment that the holding company realises that there is a risk that the subsidiary company may

not be capable of performing its obligations and until this danger is realised the holding company moves from being negligent to being possibly reckless.

In *Philotex (Pty) Ltd v Snyman*[46] the court held that if the directors are of the opinion that there is a risk that a company may not repay its debts and it incurs new debts, they could be found to have acted negligently. The position would be no different here where the holding company is aware that the subsidiary company is in financial trouble and that there is a (real) risk that it will not be capable of repaying any existing debt, let alone new debt. The silence of the holding company, namely not informing the holder of the letter of the impending financial difficulties of the subsidiary or that its policy has changed could be considered to be negligent.

The courts[47] have held that the moral obligation that the holding company undertakes is in respect of its current policy in respect of the solvency of the subsidiary and that it ensures that the subsidiary will perform its obligations. But what is this "current policy"? Is it the policy for one financial year, or for two, or just until the subsidiary becomes a business liability? If the policy is only for one year, should there then not be a duty on the holding company to inform the holder of the letter of comfort or awareness that the policy of the company *vis-à-vis* its subsidiary has changed? Surely the holder of the letter of comfort will be under the (mistaken) belief that until it is notified to the contrary, the policy of the holding company is still as set out in the letter of comfort. Any debts therefore incurred after a change of policy or after the moment the holding company realises the risk of non-payment of debts, should be considered to be incurred through its negligence.

It should then be asked whether it would be against public policy to impose or imply a duty of care on the holding company towards the holder of the letter of comfort or awareness. There can be no convincing public policy argument against delictual liability. First of all there is not an indeterminate class of potential plaintiffs who may attempt to hold the holding company liable. The only plaintiff it had a legal duty to was the holder of the letter of comfort or awareness. Furthermore, the duty of care is based or founded on the existing relationship between the parties where the holder of the letter of comfort relies strongly on the good faith of the holding company in the absence of security for the debts of the subsidiary. The holding company is or should reasonably be aware of this reliance. The duty of care does therefore not arise casually but because of the prior or existing relationship between the holding company and the holder of the letter of comfort or awareness. The content of the duty is also not onerous on the holding company. It merely has to inform the holder of the letter of comfort or awareness that its policy towards the subsidiary has changed or that the subsidiary company is finding itself in financial difficulties. The holder of the letter of comfort or awareness can then take steps to either prevent or at least mitigate its losses.

Where the holding company is actively involved in the management and policies of the subsidiary company without necessarily having the same

[46] 1998 2 SA 138 (A)

[47] *Kleinwort Benson Ltd v Malaysia Mining Corporation Berhad* [1989] 1 WLR 379 (CA)

directors of its own board on the board of the subsidiary company this could strengthen the imposition of a legal duty which could arise based upon a letter of comfort which has been issued. In these cases the holding company is aware or at the very least should be aware of the damages which a creditor bank will incur should the subsidiary company incur any further debts where the financial position of the subsidiary is precarious. A reasonable person would under these circumstances foresee that a creditor may suffer loss and would refrain from incurring further liabilities under these circumstances. Under these circumstances there should be no policy considerations which should impede a successful action by a creditor bank against a holding company which has issued a letter of comfort or awareness and has not warned the bank that it has changed its policy towards the subsidiary company or that the subsidiary company is hovering precariously on the precipice of bankruptcy.

Another argument of public policy imposing delictual liability on the holding company could be the principles of separate juristic personality and limited liability in company law. Could it be argued that these two company law principles constitute policy arguments against the imposition of a legal duty on the holding company in the envisaged circumstances? It is submitted that these principles could not cause an impediment to the imposition of a legal duty. Here is no attempt to pierce the corporate veil between the holding company and the subsidiary company. Instead there is reliance by the plaintiff on the negligent and wrongful conduct of the holding company. It cannot be argued that a remedy is sought to circumvent the potentially more onerous requirements for the piercing of the corporate veil.[48] The delictual requirements are not necessarily less strict and in any event a comparison could and should not be made between two unrelated causes of actions although the outcomes of both may be the same.

In respect of legal causation the court in the *Fourway Haulage* case stated that the question is whether the negligent conduct of the wrongdoer is linked closely enough to the loss suffered for legal liability to arise or whether the loss is too remote. Public policy according to the court determines the question of remoteness. One can also have regard to *International Shipping Co (Pty) Ltd v Bentley*[49] ("*Bentley*") and *Standard Chartered Bank of Canada v Nedperm Bank Ltd*[50] ("*Standard Chartered*") in which cases there were negligent misstatements made which led to factual causation between the negligent misstatement and the loss suffered. In the *Bentley* matter, however, the court found the loss to be too remote from the misstatement whereas the loss in the *Standard Chartered* matter was not too remote. As in those two matters one could argue within the context of a letter of comfort that had the holding company informed the holder of the letter that its policy *vis-à-vis* its subsidiary had changed that the creditor would have taken steps to avert any losses. The question, however, is whether the loss is too remote. Naturally

[48] See *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* 1995 4 SA 790 (A) and *Hülse-Reutter v Gödde* 2001 4 SA 1336 (SCA)
[49] 1990 1 SA 680 (A)
[50] 1994 4 SA 747 (A)

this will be a question of fact. In principle it could be argued that it is not necessarily too remote. In the *Fourways Haulage* case the court confirmed that the test for remoteness is a flexible one. With flexibility is meant that factors such as the absence of a *novus actus interveniens*, proximate cause, direct cause, forseeability and sufficient causation are considered but not one of them is necessarily conclusive.[51]

4 Conclusion

This article attempted to show that there could be alternative means for creditors of a subsidiary company which has gone insolvent to hold the holding company liable for its losses other than having to try to pierce the corporate veil. The law of delict could provide a remedy in the form of an action for pure economic loss. The article focused on the element of wrongfulness and whether a creditor would be able to satisfy this element. It was shown that for wrongfulness to exist that there had to be a legal duty on the holding company not to cause the creditor loss. The article used the letter of comfort as a means to illustrate that in certain specific cases there could be a legal duty on the holding company due to its knowledge of the reliance which the creditor puts on the letter as well as the special relationship which came into existence between the holding company and the creditor once the letter was issued by the holding company. The elements of negligence and especially legal causation may, however, be difficult to prove. A discussion of the success or not of proving those elements is beyond the scope of this article.

SUMMARY

A holding company often issues a letter of comfort to a creditor of its subsidiary company. The subsidiary company often then defaults on its obligations to that creditor. The courts generally have held that a letter of comfort does not create binding contractual obligations between the holding company and the creditor. This article investigates whether the creditor could hold the holding company liable in delict for the losses that the creditor suffered due to the default of the contractual obligations by the subsidiary company to that creditor. The article specifically considers the element of wrongfulness and whether there could be a legal duty on the holding company not to cause pure economic loss to the creditor of its subsidiary in circumstances where the holding company issued a letter of comfort to the creditor. This article investigates the requirements of a legal duty in cases of pure economic loss as well as the nature of a letter of comfort. The article concludes that a legal duty could be placed on a holding company not to cause pure economic loss to the creditor of its subsidiary depending on the wording of the letter of comfort and without sacrificing the principle of separate juristic personality that exist between the holding company and subsidiary company.

[51] *International Shipping Co (Pty) Ltd v Bentley* 1990 1 SA 680 (A) 701A-F and *Fourway Haulage SA (Pty) Ltd v SA National Roads Agency Ltd* 2009 2 SA 150 (SCA) 165A