

ABA UCC/ComFin Newsletter

Letter of Credit Subcommittee

September 2008

The focus of this article is on recent cases dealing with forum and procedural issues.

1. Forum and Procedural Issues. (a) In *Setzer v. Natixis Real Estate Capital, Inc.*, 537 F.Supp.2d 876 (E.D.Ky. 2008) the applicant sued the issuer and the beneficiary claiming fraud by the beneficiary and seeking to enjoin the issuer from paying on the letter of credit and the beneficiary from drawing on the letter of credit. The beneficiary moved to dismiss on the grounds that the underlying contract had a forum selection clause which required that each party submit to the exclusive jurisdiction of the courts in the State of New York for any legal action or proceeding resulting from the underlying transaction. The court concluded that there was no fraud in the inducement of the underlying contract and that the fraud alleged as grounds for enjoining payment or any draw on the letter of credit did not taint the validity of the underlying contract (or the forum selection clause therein). Accordingly, the court granted the beneficiary's motion to dismiss without prejudice.

The court was silent as to the impact on the issuer. Presumably the issuer was also dismissed from the action. Otherwise the lawsuit would continue in Kentucky as to the applicant's request for a preliminary injunction against the issuer, while the applicant would have had to sue the beneficiary separately in New York. It is also unclear whether the issuer (Fifth Third Bank) was subject to jurisdiction in New York. Clearly the issuer was not a party to the underlying transaction and the forum selection clause.

This case is reminiscent of the facts in three related cases in which three different courts came to different conclusions as to whether the forum selection clause in the underlying contract precluded the court from enjoining the payment under various letters of credit issued to support the obligations in the underlying contract. See *Hendricks v. Bank of America, N.A.*, 408 F.3d 1127 (9th Cir. 2005) (affirming injunction against an issuer despite forum selection clause in underlying contract choosing a different forum); *American Patriot Insurance Agency, Inc. v. Mutual Risk Management, Ltd.*, 364 F.3d 884 (7th Cir. 2004) (affirming dismissal of the injunction action against a second issuer) *aff'g* 248 F.Supp.2d 779, 781 (N.D.Ill. 2003); *Hendricks v. Comerica Bank*, 122 Fed.Appx. 820 (6th Cir. 2004) (vacating injunction issued by trial court). In case of a fraud on the beneficiary, an applicant does not want to be delayed in getting a preliminary injunction based on procedural issues dealing with forum selection clauses. Hence, an applicant needs to consider the impact of a forum selection problem in both the drafting of the underlying contract and in the choice of the issuer.

(b) One can also forum shop as between federal and state court. In that context, the three-party arrangement which constitutes the basic letter of credit scenario also raises issues as to who is a required party in litigation and on what side the issuer is placed.

In *Holiday Isle, LLC v. Clarion Mortgage Capital, Inc.*, 2008 U.S. Dist. LEXIS 30561 (S.D. Ala.2008), the beneficiary under a letter of credit sued Clarion, the alleged issuer, for dishonoring a presentation under the letter of credit. The beneficiary was a citizen of the state of

Alabama, and Clarion was a Colorado corporation. The original complaint was filed in Alabama state court, and Clarion removed the action to federal court on the basis of diversity. Clarion took the position that it was not in fact the issuer of the letter of credit. Based upon this assertion and other facts that came to light after the filing of the initial complaint, the beneficiary sought to amend the complaint to add additional parties who purportedly had misled the beneficiary into believing that the letter of credit was issued by Clarion. One of the additional defendants was an Alabama citizen, and the addition of that potential defendant to the case would destroy diversity jurisdiction. The court granted beneficiary's motion to remand the case to Alabama state court.

In *Graddick, et al. v. BankTrust, et al.*, 2008 U.S. Dist. LEXIS 26826 (S.D. Ala. 2008), the applicant on a letter credit sought a temporary restraining order against the issuer to prevent payment under the letter of credit. Both the applicant and the issuer were citizens of Alabama. The complaint alleged that subject matter jurisdiction in federal court rested on diversity of citizenship on the basis that the "true Defendants are residents of Florida and Tennessee", the "true Defendants" being the escrow agent (the beneficiary), a real estate developer and its principal. Although those persons were not named as defendants in the complaint, they were the only entities from which the applicant sought relief. The court dismissed the complaint on the basis of lack of diversity between the applicant and the issuer.

In *Titan Aviation, LLC v. Key Equipment Finance, Inc.*, 2006 WL 3040923 (N.D. Tex. 2006), Titan, a Texas LLC, the applicant under a letter of credit, sued the issuer and the beneficiary to enjoin payment. The complaint was initially filed in Texas state court, and was removed to federal district court based on the citizenship of the beneficiary, who contended that the issue of Texas citizenship of the issuer could be ignored because the issuer was a nominal defendant who had been improperly joined. The court concluded that the issuer was not a necessary party and that complete relief could be accorded to Titan even if the issuer was not a party to the suit. An injunction preventing the beneficiary from drawing or accepting the proceeds of the LC would provide Titan complete relief. On that basis the court refused to remand the case to state court.