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Commercial Law—Injunctive Relief for the Letter-of-Credit Customer—Shaffer v. Brooklyn Park Garden Apartments, ____ Minn. ____, 250 N.W.2d 172 (1977)

RECENT MINNESOTA CASES

Commercial Law—INJUNCTIVE RELIEF FOR THE LETTER-OF-CREDIT CUSTOMER—*Shaffer v. Brooklyn Park Garden Apartments*, ___ Minn. ___, 250 N.W.2d 172 (1977).

The protections afforded a Minnesota letter-of-credit customer under article 5 of the Uniform Commercial Code (U.C.C.) were expanded in a 1977 decision of the Minnesota Supreme Court. In *Shaffer v. Brooklyn Park Garden Apartments*,[1] a case of first impression in Minnesota, the court enjoined the honoring of a letter of credit where the beneficiary of the letter had committed fraud in presenting the letter for honor to the issuer.

In *Shaffer*, First National Bank of Minneapolis (First National) issued two irrevocable letters of credit[2] to defendant Brooklyn Park Garden Apartments (Brooklyn Park) upon request of the plaintiff customers, Shaffer and Severson. The letters were to be used as a security device for two promissory notes, given by the plaintiffs to Brooklyn

1. ___ Minn. ___, 250 N.W.2d 172 (1977).

2. The classic letter of credit is an instrument by which the bank permits a seller of goods, upon the seller's performance, to draw against an account of the buyer. The letter is simply a stipulation by the bank, in legal form, that all such bills drawn under the account will be honored. Another form of letter of credit is the standby letter of credit, which assures payment to the beneficiary should the customer fail to perform. *See* Harfield, *The Increasing Domestic Use of the Letter of Credit*, 4 U.C.C. L.J. 251, 258 (1972). Technically, the letters of credit issued by First National were standby letters of credit.

The development of the "standby" letter of credit reflects an extension of the letter of credit into the field of commercial credit as a financing mechanism. The issuer bank promises to pay a sum of money upon certification from the beneficiary that the customer has defaulted on an underlying obligation. The purposes for which a standby letter of credit is used, therefore, are basically the same as those for which a contract of surety or guaranty is used. *See* Jarvis, *Standby Letters of Credit—Issuer's Subrogation and Assignment Rights* (pt. 2), 10 U.C.C. L.J. 38, 45 (1977). *See generally* Katskee, *The Standby Letter Of Credit Debate—The Case for Congressional Resolution*, 92 BANKING L.J. 697, 701 (1975). Unlike the duty of a guarantor, however, the issuers of a letter of credit has no duty to insure the fulfillment of the underlying agreement. *See* Comment, *Commercial Letters of Credit: Development and Expanded Use in Modern Commercial Transactions*, 4 CUM.-SAM. L. REV. 134, 142-43 (1973).

A federal court in the 1974 case of Wichita Eagle & Beacon Pub. Co. v. Pacific Nat'l Bank, 493 F.2d 1285 (9th Cir. 1974) (per curiam) held that a contract entitled a "letter of credit" was in fact a guaranty contract because the responsibilities of the issuer included determining whether the underlying obligations of the parties had been fulfilled. The court stated: "The instrument involved here strays too far from the basic purpose of letters of credit, namely, providing a means of assuring payment cheaply by eliminating the need for the issuer to police the underlying contract." *Id.* at 1286. Although the instrument was called a letter of credit, the issuer was required to deal not simply in documents alone but also in facts relating to the performance of the underlying contract. This invited protracted and expensive litigation which, according to the court, was "the very evil that letters of credit are meant to avoid." *Id.* at 1286-87.

Park, as a portion of their investment in an apartment project being developed by Brooklyn Park. Brooklyn Park subsequently pledged the letters of credit to defendant Wayzata Bank and Trust Company (Wayzata) as security for a loan to Brooklyn Park. The letters would be honored by First National only upon certification by Brooklyn Park that the plaintiffs had defaulted on their obligations under the promissory notes. The notes were payable by the plaintiffs only upon the happening of one of two conditions precedent.[3] Neither of the conditions precedent, which related to the completion of the apartment complex, ever occurred.[4] Therefore, the plaintiffs never incurred any liability on the agreement underlying the letters of credit.

When Brooklyn Park fell into serious financial difficulties, the plaintiffs reminded both Brooklyn Park and Wayzata that demand under the letters would not be proper because of the failure of the promissory notes to become due and payable. Notwithstanding this written notice, drafts were drawn along with certifications which fraudulently stated that the plaintiffs had failed "to meet payment of authorized loans *which are payable*."[5] The drafts were negotiated to Wayzata, who in turn presented both the drafts and the certifications to First National for payment. Because the defendants' claim that the plaintiffs had defaulted on the promissory notes was false, the certifications presented with the drafts were fraudulent.[6] The plaintiffs therefore attempted to enjoin First National from honoring the letters of credit. The district court denied the request but the injunction was subsequently granted by the Minnesota Supreme Court. The result reached in *Shaffer* raises the question, already considered by a few courts,[7] of whether injunctive relief is an appropriate remedy to be utilized by the courts in letter-of-

3. The promissory notes constituted the final one-fourth capital contribution of the plaintiffs. The notes were payable only upon the occurrence of either of two events: 90% occupancy of the apartment complex or the expiration of 12 months following F.H.A. endorsement of the project. ___ Minn. at ___, 250 N.W.2d at 175.

4. Construction on the project had stopped, a mortgagee was threatening foreclosure, and foreclosure had begun on $400,000 in mechanics liens. *Id.*

5. *Id.* at ___, 250 N.W.2d at 176 (emphasis added).

6. Each letter of credit provided that demand for payment could be made by presenting a draft, a promissory note endorsed to the order of First National, and certification by Brooklyn Park that funds drawn under the letters were payable because of a default in the underlying agreement by Shaffer and Severson. *Id.* at ___, 250 N.W.2d at 175. The certifications made by Brooklyn Park were clearly fraudulent because the conditions to Shaffer's and Severson's liability on the promissory notes had not been fulfilled. *See* notes 3-4 *supra* and accompanying text.

7. *See, e.g.*, Dynamics Corp. of America v. Citizens & S. Nat'l Bank, 356 F. Supp. 991, 1000 (N.D. Ga. 1973) (customer might be entitled to a permanent injunction; therefore, preliminary injunction against honor of the letter of credit granted); Sztejn v. J. Henry Schroder Banking Corp., 177 Misc. 719, 31 N.Y.S.2d 631 (Sup. Ct. 1941) (pre-U.C.C. case involving a letter-of-credit dispute; court held injunctive relief was appropriate where the documents presented to issuer were fraudulent and where issuer had knowledge of fraud prior to presentment).

credit controversies.

Generally, a letter of credit is an engagement by a bank or other financing agency to pay the beneficiary a sum of money upon presentment of documents which comply with terms set out on the face of the letter.[8] The transaction involves three parties: the issuer (a bank or other financing agency), the customer (the party who requests that the letter be issued), and the beneficiary (the party to whom the letter guarantees payment of a specified sum of money subject to conditions set out in the letter).[9] The issuer may dishonor the demand if there has not been strict compliance with the terms of the letter by the beneficiary, but the issuer need not be concerned with the performance of the underlying agreement by the other two parties.[10]

Article 5 of the U.C.C., governing letter-of-credit transactions, was adopted by the Minnesota Legislature in 1965.[11] As adopted, article 5 constitutes a well-accepted set of rules upon which the business world and courts rely in order to make use of the letter of credit as a certain, accepted medium of commercial finance.[12] However, the U.C.C. does

8. Examples of the types of documents commonly required include: the commercial invoice, bills of lading, insurance policies, weighing certificates, certificates of quality or analysis, and customs and clearance receipts. For example, in the sale of goods the letter of credit would list the specific items to be sold and the draft demanding payment would be accompanied by an invoice or a bill of lading covering those specific items. *See* Comment, *supra* note 2, at 143. In *Shaffer,* the letters of credit required certifications that the plaintiffs had failed "to meet payment of authorized loans which are payable." ___ Minn. at ___, 250 N.W.2d at 175.

9. The transaction also involves three separate and distinct contracts. First, there is the agreement between the customer and the beneficiary which creates the obligation underlying the letter of credit. Secondly, the customer and the issuer have a contract between themselves whereby a line of credit is established in favor of the beneficiary, with agreement by the customer to pay the issuer for any payments made upon this line of credit. Finally, the letter of credit itself is a promise by the issuer to pay the beneficiary a sum of money upon the beneficiary's compliance with specified conditions set out in the letter of credit. *See* Justice, *Letters of Credit: Expectations & Frustrations* (pt. 1), 94 BANKING L.J. 424, 425 (1977).

10. *See* MINN. STAT. § 336.5-114(1) (1976), *as amended by* Act of Mar. 28, 1978, ch. 695, § 2, 1978 Minn. Sess. Law Serv. 472 (West), which provides:

> An issuer must honor a draft or demand for payment which complies with the terms of the relevant credit regardless of whether the goods or documents conform to the underlying contract for sale or other contract between the customer and the beneficiary. The issuer is not excused from honor of such a draft or demand by reason of an additional general term that all documents must be satisfactory to the issuer, but an issuer may require that specific documents must be satisfactory to it.

11. *See* Act of May 26, 1965, ch. 811, 1965 Minn. Laws 1399 (codified at MINN. STAT. §§ 336.5-101 to -117).

12. One commentator has stated:

> The draftsmen of Article 5 set out to codify the legal framework of letters of credit without attempting so comprehensive a treatment as to hinder the development of new practices and uses or to impede the flexibility of the letter of credit . . . [and] without attempting to codify the practices and mechanical

not answer all questions which arise out of letter-of-credit transactions.[13] Specifically, the question of the appropriateness of granting equitable relief in letter-of-credit disputes has been left to the courts.[14]

Historically, courts have been hesitant to apply equitable principles to letter-of-credit controversies.[15] This reluctance arose out of a desire for certainty in the marketplace. Today, at least one leading authority in the field continues to contend that letters of credit should be honored as long as the documents presented by the beneficiary comply on their face with the terms of the letter of credit.[16] Such a policy, theoretically,

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operations followed by banks dealing in letters of credit. The draftsmen apparently felt, and rightly so, that to attempt to include detailed treatment of such practices would stymie the development of new practices and the further streamlining of letter-of-credit transactions. The result, produced through many cycles of drafting, criticism, and redrafting, is a relatively clear, general statutory statement of the nature of letters of credit and of the rights and obligations of the parties. Article 5 makes no attempt to restrict, redirect, or revolutionize letter of credit law and practice; rather, the Article organizes and sets out existing law in a clear and concise manner.

Comment, *supra* note 2, at 161 (footnote omitted).

13. The existence of unanswered questions in article 5 was quite clearly the intent of the drafters. In a comment to section 5-101, the drafters stated that the article was limited in scope and intended by its terms "to set an independent theoretical frame for the further development of letters of credit." U.C.C. § 5-101, comment. The drafters reiterated their desire to instill flexibility into the article in later comments. Their fear apparently was that a statute which attempted to codify all aspects of letter-of-credit law would hamper the development of the letter as a financing device. Therefore, the product presented to the states for adoption embodied the underlying theories of letter-of-credit law, leaving further development of the area to the courts. *See id.* § 5-102, comment 2.

14. *See* notes 21-27 *infra* and accompanying text.

15. Henry Harfield, in discussing the evolution of letter-of-credit law, states the reasoning behind this reluctance:

> I fear that the sacred cow of equity may trample the tender vines of letter-of-credit law. . . .
>
> The basic tenets of letter-of-credit law derive from the necessities of the marketplace and not from the aspirations of the cloister. Literal compliance with the terms of a letter of credit lies at the root of the letter-of-credit transaction. There is no room for "just as good."
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> In commercial credit cases, the courts have very consistently recognized this principle, even in those instances in which a court, sitting as a court of equity, has enjoined the completion of a letter-of-credit transaction.

Harfield, *Code, Customs and Conscience In Letter-of-Credit Law*, 4 U.C.C. L.J. 7, 11-12 (1971) (footnote omitted).

16. Henry Harfield, who has been a most ardent opponent of the application of equitable principles to letter-of-credit controversies, has stated:

> The cases that I see on tomorrow's calendar are those in which the constructive ingenuity of lawyers and bankers has used the letter-of-credit device to accomplish results that previously had to be accomplished by performance bonds, or repurchase agreements, or in other ways will use the letter-of-credit device to solve problems that hitherto have not been, but should be, solved. It is in this class of case, in which the facts are sufficiently different from the facts in the case that made the law, and in this atmosphere of instant equity, that the courts

would make issuers more willing to issue letters of credit without fear that liability might arise on their part for honoring the letters[17] and, if strictly adhered to, would preclude the application of equitable principles in resolving disputes arising therefrom.

Assuming that a total "hands-off" policy is not adopted, the court, in fashioning equitable relief, is faced with considerations above and beyond the particular hardship facing the parties to the litigation. The letter of credit has become a heavily utilized adjunct to commercial transactions.[18] Consequently, the court must determine the economic ramifications of subjecting such transactions to the jurisdiction of the equity court.[19] The decision becomes one which may have a substantial impact upon commercial policy and upon the use of and reliance upon the letter of credit as a finance medium. The question becomes one of balancing the protection of the customer from the beneficiary's fraud against the potential ramifications upon the usefulness of the letter of credit as a commercial instrument and credit device.[20]

The U.C.C. provides some guidance for the court in its determination of whether equitable relief is appropriate in letter-of-credit disputes.[21] Under the U.C.C., a draft presented by a holder in due course or a bona fide purchaser of a security must be honored by the issuer.[22] However, in all other cases the issuer, in its discretion, may honor or dishonor a draft after being notified by the customer of the existence of "fraud, forgery or other defect not apparent on the face of the document."[23] Notwithstanding notice to the issuer of fraud in the documents, subsequent honor of the drafts is not considered wrongful unless the issuer fails to exercise reasonableness and care in examining the documents presented.[24] Therefore, in order to avoid liability for wrongful dishonor

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will find what I fear may be an almost irresistible opportunity to go wrong. *Id.* at 14.

17. *See* U.C.C. § 5-114, comment 2.

18. Letters of credit are used in conjunction with, and in some cases as substitutes for, construction contracts, the issuance of commercial paper, performance bonds, escrows, stock transfers, leases of real or personal property, customs entries, and steamship guaranties. No doubt, the letter of credit has many other uses. One author has even asserted that the charge card is "nothing more than a plastic letter of credit." Harfield, *supra* note 2, at 252.

19. *See* Harfield, *supra* note 15, at 8-10.

20. *See* Shaffer v. Brooklyn Park Garden Apts., ___ Minn. ___, ___, 250 N.W.2d 172, 180 (1977).

21. *See* MINN. STAT. § 336.5-114(2) (1976), *as amended by* Act of Mar. 28, 1978, ch. 695, § 2, 1978 Minn. Sess. Law Serv. 472 (West) (court may enjoin honor of draft or demand for payment when fraud, forgery, or other defect not apparent on face of instrument exists and when issuer is so notified).

22. *See* MINN. STAT. § 336.5-114(2)(a) (1976), *as amended by* Act of Mar. 28, 1978, ch. 695, § 2, 1978 Minn. Sess. Law Serv. 472 (West).

23. *See* MINN. STAT. § 336.5-114(2)(b) (1976), *as amended by* Act of Mar. 28, 1978, ch. 695, § 2, 1978 Minn. Sess. Law Serv. 472 (West).

24. MINN. STAT. § 336.5-109(2) (1976).

of the credit, the issuer typically honors demands for payment. Under article 5, the issuer has nothing to gain by accepting the risks involved in making a factual determination as to any alleged fraud present in the documents. Consequently, when fraud is present in the documents presented to the issuer, the customer must look to the courts for relief.

Under the U.C.C., a court of appropriate jurisdiction may enjoin the issuer from making payment under the letter and therefore the issuer must dishonor the demand for payment.[25] Beyond vesting the court with the power to enjoin payment, however, article 5 offers no suggestion as to when the exercise of such power would be justified. The obvious inference is that the drafters intended that the courts make the necessary factual determinations and then afford equitable relief when "appropriate."[26] Unfortunately, the vagueness of article 5 leaves the customer, like the plaintiffs in *Shaffer*, in the precarious position of not knowing whether protection against the fraudulent activities of the beneficiary will be granted by the court.[27]

In *Shaffer*, the court found that the district court had abused its discretion in denying the plaintiffs' request for temporary injunctive relief as a protection against Brooklyn Park's fraud.[28] Because of Brooklyn Park's precarious financial position, honor of the letters of credit would have denied the plaintiffs an adequate remedy at law. Had the letters been honored, the plaintiffs would have been required, under their contract with First National, to reimburse First National for the monies paid to Wayzata under the letters of credit.[29] Because the promissory notes had not in fact become due, the plaintiffs then would have been entitled to recover this amount from Brooklyn Park, who had falsely certified that the letters were payable.[30] However, Brooklyn Park

25. *Id.* § 336.5-114(2)(b), *as amended by* Act of Mar. 28, 1978, ch. 695, § 2, 1978 Minn. Sess. Law Serv. 472 (West).

26. The apparent intent of the drafters was to codify the common law dealing with the letter of credit. *See* Comment, *supra* note 2, at 161-62; note 13 *supra*. This left both the practices of letter-of-credit transactions and the evolution of their legal bases free to develop in new areas. *See* Comment, *supra* note 2, at 161-62. One commentator has thus been led to predict an increasing use of the courts to resolve disputes arising from the adaptations of the letter of credit. *See* Harfield, *supra* note 15, at 8.

27. Unless the issuer fails to exercise reasonableness and care in examination of the documents required by U.C.C. § 5-109(2), the customer has no valid claim upon which to sue the issuer, but is left solely to pursue his rights in the underlying agreement between the beneficiary and himself. *See* J. WHITE & R. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE § 18-7 (1972).

28. ___ Minn. at ___, 250 N.W.2d at 181-82.

29. *See* note 9 *supra*.

30. By presenting the demand documents to First National and executing the certifications that the conditions of the letters of credit had been satisfied, Brooklyn Park became subject to the provisions of U.C.C. § 5-111(1). Under that section, the beneficiary presenting a demand under a letter of credit is held to warrant that the certifications are true and the letter is in fact payable. This warranty clearly applies to situations where the issuer may honor or dishonor a demand under section 5-114. The comments to section 5-114 provide:

was essentially judgment-proof and the exercise of an available remedy at law would have been useless. Furthermore, the trial court's finding that Wayzata was a holder in due course of the letters of credit was erroneous because letters of credit are not negotiable instruments.[31] This finding of error, coupled with the Minnesota Supreme Court's finding that Wayzata was not a holder in due course of the *drafts* presented under the letters, removed an additional obstacle to the granting of the temporary injunction.[32] Based on these facts, the granting of a temporary injunction, pending a trial on the merits, was warranted.[33]

By the *Shaffer* decision, the Minnesota Supreme Court has determined that the desire to prevent fraud must at times override the economic concern for certainty in letter-of-credit law.[34] Thus, a customer, in seeking injunctive relief, may prevent the beneficiary of the letter of credit from securing the guaranteed payment otherwise promised by the

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> The issuer may, however, refuse honor. In the event of honor, an action by the customer against the beneficiary will lie by virtue of either the underlying contract or Section 5-111(1) of this Article. In the event of dishonor, if the presenter is a person who has parted with value, he also may recover against the beneficiary under Section 5-111(1).

Id. § 5-114, comment 2.

31. *See, e.g.*, J. WHITE & R. SUMMERS, *supra* note 27, § 18-2, at 608. Therefore, Wayzata could not become a holder in due course of the letters by accepting them as security for its loans. ___ Minn. at ___, 250 N.W.2d at 176-77.

32. Unlike letters of credit, drafts drawn under the letters can be negotiable instruments. The court recognized that Wayzata had become a holder of the drafts upon receiving them from Brooklyn Park, but held that Wayzata was not a holder in due course. ___ Minn. at ___, 250 N.W.2d at 177-78. The attorney for the plaintiffs had sent letters to both Wayzata and Brooklyn Park's general partner, stating the fact that neither of the conditions precedent had occurred and that, consequently, demand could not be made under the letters of credit. *Id.* at ___, 250 N.W.2d at 178. Despite this notice, Wayzata intentionally rewrote Brooklyn Park's notes in order to present them to First National for payment. Brooklyn Park then drew drafts for the amount payable under the letters of credit and negotiated the drafts to Wayzata, who, in turn, presented them to First National with the required certifications that the plaintiffs had defaulted in the underlying obligations. *Id.* at ___, 250 N.W.2d at 176. Because of these actions and because of the notice it had received from the plaintiffs, Wayzata could not claim the status of a holder in due course. *See* MINN. STAT. § 336.3-302 (1976) (defining holder in due course of a negotiable instrument).

33. The court stated:

> It seems quite clear that denial of injunctive relief will leave Shaffer and Severson [plaintiffs] with no recourse against Brooklyn Park or Wayzata. Brooklyn Park, because of admitted financial difficulties, will not be able to compensate the plaintiffs for the alleged fraudulent certification. Affirmance of the trial court's conclusion that Wayzata is a holder in due course would serve to establish Wayzata's good faith and lack of notice, thereby precluding any remedy the plaintiffs might have for bad faith presentment.

___ Minn. at ___, 250 N.W.2d at 181.

34. The court pointed out that because the plaintiffs would be required to post a bond before the injunction would be issued, Wayzata's loss would be nominal if it prevailed in the subsequent trial on the merits. *Id.* at ___, 250 N.W.2d at 181-82.

terms of the letter.[35] Although availability of injunctive relief raises the possibility that a given beneficiary may be denied payment unjustifiably,[36] this possibility is insignificant because of two factors. First, stringent requirements of proof must be met by the party seeking injunctive relief before honor of the letter of credit will be enjoined.[37] Secondly, the availability of injunctive relief is conditioned on the requirement that the presenter of the drafts drawn under the letter of credit not be a holder in due course.[38] It would be rare, therefore, for an innocent third party to be denied payment under a letter of credit by the use of injunctive relief.

The question remains whether the court will broaden the *Shaffer* decision in the future and extend the availability of injunctive relief to other letter-of-credit disputes. In *Shaffer,* the injunction was granted because fraudulent presentment of documents to the issuer occurred and because the presenter of the documents was not a holder in due course. Will the *Shaffer* decision be construed to require that courts exercise their discretion and grant injunctive relief where the fraud oc-

35. *See also* text accompanying note 10 *supra* (in addition, beneficiary will not receive payment if terms of the letter have not been satisfied).

36. The resulting burden imposed on a beneficiary who is wrongfully denied payment under a letter of credit is alleviated somewhat by the requirement that the customer post security before an injunction will be issued by the court. *See* MINN. R. CIV. P. 65.03. The court in *Shaffer* recognized this, stating: "[I]f injunctive relief is granted and Wayzata prevails in the subsequent trial, Wayzata's inconvenience and loss will be nominal since any potential loss of interest is protected by a supersedeas bond." ___ Minn. at ___, 250 N.W.2d at 182. The supersedeas bond is posted upon appeal from a judgment or order of the district court. *See* MINN. R. CIV. APP. P. 108 (1978). Had the district court granted the requested injunctive relief, the beneficiary would have been protected by the security required under MINN. R. CIV. P. 65.03, whereas the beneficiary is protected by the supersedeas bond when the injunctive relief is granted by the supreme court upon an appeal. *Compare* MINN. R. CIV. P. 65.03 *with* MINN. R. CIV. APP. P. 108 (1978).

37. Several criteria must be met by the party seeking injunctive relief before an injunction will issue. The Minnesota court, in the case of Dahlberg Bros. v. Ford Motor Co., 272 Minn. 264, 137 N.W.2d 314 (1965) held the following factors to be relevant in the decision of the propriety of affording injunctive relief:

> (1) The nature and background of the relationship between the parties preexisting the dispute giving rise to the request for relief.
>
> (2) The harm to be suffered by the plaintiff if the temporary restraint is denied as compared to that inflicted on the defendant if the injunction issues pending trial.
>
> (3) The likelihood that one party or the other will prevail on the merits when the fact situation is viewed in light of established precedents fixing the limits of equitable relief.
>
> (4) The aspects of the fact situation, if any, which permit or require consideration of public policy expressed in the statutes, State and Federal.
>
> (5) The administrative burdens involved in judicial supervision and enforcement of the temporary decree.

Id. at 274-75, 137 N.W.2d at 321-22 (footnotes omitted).

38. *See* MINN. STAT. § 336.5-114(2) (1976), *as amended by* Act of Mar. 28, 1978, ch. 695, § 2, 1978 Minn. Sess. Law Serv. 472 (West).

curs in the underlying contract although no fraud is present in the documents? The court, in dicta, answers no: "It should be noted that where injunctive relief is sought, *the fraud alleged must be in respect to the documents presented and not as to the underlying transaction.*"[39]

Existing case law dealing with letter-of-credit controversies generally supports restricting the availability of injunctive relief to those cases where the fraud is found in the demand documents.[40] Injunctive relief generally is not afforded where the fraud exists in the underlying contract.[41] Furthermore, the article 5 provision concerning honor of the letter of credit by the issuer supports such a limitation. The issuer is explicitly prohibited under article 5 from basing its decision to honor or dishonor a demand made under a letter of credit upon the terms of the underlying contract.[42] The reason for such a restriction is twofold. First, the issuer should not have to shoulder the undue burden of determining whether the underlying obligation has in fact been fulfilled.[43] Secondly, and perhaps more importantly, such a restriction preserves a substantial degree of the certainty of payment that is an inherent and vital

39. ___ Minn. at ___, 250 N.W.2d at 180 (emphasis added).

40. *See, e.g.,* Moss v. Old Colony Trust Co., 246 Mass. 139, 140 N.E. 803 (1923) (pre-U.C.C. case; refusal of issuer to make payment under letter of credit justified where seller failed to comply with material terms of the letter without regard to actual performance of underlying agreement); Sztejn v. J. Henry Schroder Banking Corp., 177 Misc. 719, 31 N.Y.S.2d 631 (Sup. Ct. 1941) (pre-U.C.C. case; temporary injunction granted where fraud was alleged in the documents presented to issuer under letter of credit for payment).

41. *See* Intraworld Indus., Inc. v. Girard Trust Bank, 461 Pa. 343, 364, 336 A.2d 316, 327 (1975) (preliminary injunction denied where documents presented to issuer were in conformity with letter of credit; issuer had no obligation to ascertain performance of the underlying agreement); *cf.* Prudential Ins. Co. of America v. Marquette Nat'l Bank, 419 F. Supp. 734, 736 (D. Minn. 1976) (issuer may not assert illegality of underlying contract in attempting to deny payment to the beneficiary). *But see* United Bank Ltd. v. Cambridge Sporting Goods Corp., 41 N.Y.2d 254, 360 N.E.2d 943, 392 N.Y.S.2d 265 (1976) (grant of injunctive relief by lower court to preclude honor of a letter of credit where fraud was proved in the underlying transaction not questioned on appeal); NMC Enterprises, Inc. v. CBS, Inc., 14 U.C.C. Rep. Serv. 1427 (N.Y. Sup. Ct. 1974) (upon prima facie showing of intentional fraud in underlying transaction, customer was entitled to temporary injunctive relief).

42. *See* MINN. STAT. § 336.5-114(1) (1976), *as amended by* Act of Mar. 28, 1978, ch. 695, § 2, 1978 Minn. Sess. Law Serv. 472 (West).

43. The official comments of the drafters are instructive in assessing the issuer's duty to honor a letter of credit where an innocent third party is involved:

> The risk of the original bad-faith action of the beneficiary is thus thrown upon the customer who selected him rather than upon innocent third parties or the issuer. So, too, is the risk of fraud in the transaction placed upon the customer.
>
> When, however, no innocent third parties as defined in subsection (a) are involved the issuer is no longer under a duty to honor; but since these matters frequently involve situations in which the determination of the fact of the nonconformance may be difficult or time-consuming, the issuer if he acts in good faith is given the privilege of honoring the draft as against its customer, that is to say, with a right of reimbursement against him.

U.C.C. § 5-114, comment 2.

characteristic of the letter of credit.[44]

The application of equitable principles to letter-of-credit controversies where fraud is involved is a welcome event in Minnesota. Under the law developed in *Shaffer,* a holder in due course of drafts drawn under a letter of credit will have an absolute right to demand honor of those drafts. The issuer, furthermore, may honor a draft even after receiving notice from the customer that there may be fraud, forgery, or other defects in the documents presented by the beneficiary or an assignee of the beneficiary as long as the documents appear on their face to be proper. The burden of determining whether a demand document has been fraudulently presented falls upon the court rather than the issuer. Therefore, the issuer faces the possibility of wrongfully honoring a letter of credit only if it fails to exercise reasonableness and care in examining the documents presented to it. Finally, a substantial portion of the desired element of certainty in letter-of-credit transactions is preserved by restricting the availability of injunctive relief to those situations where the beneficiary, or an assignee who is not a holder in due course, has presented fraudulent documents to the issuer in demanding payment under a letter of credit. Payment under the letter of credit will be certain unless the beneficiary wrongfully attempts to evade fulfillment of the conditions of the letter of credit itself. The decision of the Minnesota Supreme Court in *Shaffer* is a reasoned one, which effectively balances both the interests of the customer and the beneficiary while protecting the issuer who must honor the letter of credit it issues.

Indian Law—STATE JURISDICTION OVER INDIAN RESERVATIONS—*Red Lake Band of Chippewa Indians* v. *State*, ___ Minn. ___, 248 N.W.2d 722 (1976).

Indian law in Minnesota is not a relic of the past as it is in some states.[1] The tribal groups of Indian people which inhabit Minnesota's Indian reservations, both as organized bodies and as individual persons, interact on a daily basis with Minnesota's various governmental bodies and non-Indian population. In the course of these interactions, disputes arise which occasionally end in litigation, thus expanding the body of

44. *See* Harfield, *supra* note 2, at 258-59; Kozolchyk, *The Legal Nature of the Irrevocable Commercial Letter of Credit,* 14 AM. J. COMP. L. 395, 421 (1965).

1. As used in the context of this comment, Indian law relates to the interaction between a state and the Indian peoples within that state. The states of Alabama, Arkansas, Delaware, Georgia, Hawaii, Illinois, Indiana, Kentucky, Maryland, Missouri, New Hampshire, New Jersey, Ohio, Pennsylvania, Rhode Island, South Carolina, Tennessee, Vermont, and West Virginia no longer have recognized federal or state Indian reservations. *See* U.S. DEP'T OF COMMERCE, FEDERAL AND STATE INDIAN RESERVATIONS AND INDIAN TRUST AREAS (1974) (listing all existing Indian reservations in the United States).