

SPOTLIGHT

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The purpose of this column is to identify some of the most disconcerting judicial decisions interpreting the Uniform Commercial Code or related commercial laws. The purpose of the column is not to be mean. It is not to get judges recalled, law clerks fired, or litigators disciplined for incompetence. Instead, it is to shine a spotlight on analytical errors, and thereby provide practitioners and judges with reason to disregard the opinion.

Summit Resource Group, Inc. v. JLM Chemicals, Inc.,
2008 U.S. Dist. Lexis 104569 (E.D. Mo. 2008)

In this case Summit Resource Group caused the issuance of a standby letter of credit for the benefit of JLM Chemicals to support Summit's obligations to pay invoices issued by JLM for the sale of chemicals. There followed a dispute between Summit and JLM as to whether certain purchase orders placed by Summit had been cancelled. JLM threatened to draw down on the letter of credit to obtain payment for those orders, and Summit sought and obtained a TRO against such a draw. The reported decision is on the motion by Summit to convert the TRO into a preliminary injunction. In its decision on the preliminary injunction, the court very nicely went through the non-letter-of-credit requirements for an injunction, such as Summit's probability of success on the merits, the threat of irrevocable harm absent an injunction, and the balancing of the harm to the parties. The court then concluded that Summit had met its burden of proof and granted a preliminary injunction against JLM drawing on the letter of credit.

What is missing from the opinion is any mention whatsoever of Uniform Commercial Code Article 5 which has been adopted in all 50 states, including Missouri. Under UCC Section 5-109, on the facts as set forth in the court's opinion, the result should have been a denial of the preliminary injunction. The dispute between Summit and JLM appears to be a garden variety contract dispute, with no hint of the type of "material fraud" which is a prerequisite to the issuance of an injunction against honor of a letter of credit under Section 5-109. Usually it is the parties' responsibility to bring relevant law to the attention of the court. It is unclear from the opinion whether counsel did so. But the court should have discovered Article 5 on its own initiative even if counsel did not brief the point.

One of the main functions of a letter of credit is to put the proceeds of the letter of credit in the hands of the beneficiary while any dispute between the applicant and the beneficiary in the underlying contract is resolved separately. The only time that that mechanism should be enjoined is in the case of material fraud of the kind described in Section 5-109. Although the usual standards for the issuance of an injunction are still applicable in the letter of credit context (indeed they are set forth in clauses (1) and (4) of Section 5-109(b)), the primary issue is whether there has been material fraud by the beneficiary on the issuer or applicant.