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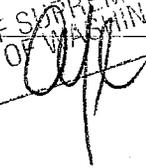
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DIVISION II

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STATE OF WASHINGTON

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CLERK OF SUPREME COURT
STATE OF WASHINGTON


No. 36340-2-II

COURT OF APPEALS, DIVISION II
OF THE STATE OF WASHINGTON

N. JACK ALHADEFF,

Respondent,

v.

**KITSAP COMMUNITY FEDERAL CREDIT UNION d/b/a KITSAP
CREDIT UNION, a federally chartered credit union,**

Petitioner.

PETITION FOR REVIEW PURSUANT TO RAP 13.4

Frank R. Siderius WSBA 7759
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ORIGINAL

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A. IDENTITY OF PETITIONER

Kitsap Community Federal Credit Union dba Kitsap Credit Union (hereafter KCU) was respondent in the Court of Appeals, Division II, and is petitioner in this proceeding.

B. COURT OF APPEALS DECISION

KCU seeks review of the Court of Appeals decision filed June 3, 2008. No motion for reconsideration was filed.

C. ISSUES PRESENTED FOR REVIEW

1. Did the Court of Appeals err by failing to apply UCC Article 5's specific warranty and statute of limitations provisions to respondent's claims?
2. Did the Court of Appeals err in ruling that a letter of credit itself cannot be the basis of an Article 5 warranty?
3. Did the Court of Appeals err in ruling that Article 5's one-year statute of limitations can be evaded by framing causes of action as other than a breach of Article 5 warranty claim?
4. Did the Court of Appeals err by choosing not to follow the only reported decision on point, *Krause v. Stroh Brewery Co.*, 240 F. Supp. 2d 632 (E.D. Mich. 2002)?

D. STATEMENT OF THE CASE

Petitioner KCU entered into a construction loan transaction with the Meridian on Bainbridge Island, LLC (hereafter "Meridian"). One condition of KCU's loan commitment was that Meridian contribute additional equity into the project by means of an irrevocable letter of credit in the amount of \$1 million. Respondent N. Jack Alhadeff caused his bank to provide KCU the letter of credit for the benefit of Meridian. Wells Fargo Bank issued the letter of credit on July 2, 2003. By its terms, the letter of credit expired June 24, 2004. (CP 41-42.) KCU took draws against the letter of credit on May 11, 2004, June 11, 2004 and July 8, 2004.

There is no contract or agreement between respondent and KCU separate and apart from the letter of credit document itself.

This lawsuit was filed April 18, 2006 and the Amended Complaint with allegations against KCU was filed August 30, 2006, more than two years after the final draw on the letter of credit. (CP 1.)

Respondent brings several causes of action against KCU premised on breach of contract, negligence, and equitable theories. (CP 8-11.)

All of respondent's claims arise under the letter of credit transaction set forth in the Amended Complaint. As the trial court observed, "The terms

of the letter of credit define all of the obligations the credit union had."

(RP 16.)

E. ARGUMENT

1. Reason Review Should Be Accepted

This Court should accept review because the issue presented is of substantial public interest. It is a case of first impression in Washington, and the decision of the Court of Appeals conflicts with the only other reported decision addressing the issue. That case correctly holds that UCC Article 5's one-year statute of limitations prevents a party from bringing causes of action in contract, tort, or equity which could have been brought as a breach of warranty cause of action arising under Article 5.

2. Respondent's Causes of Action Arise Under Article 5 of the UCC, and are Specifically Displaced by Article 5's Warranty and Statute of Limitations Provisions

RCW 62A.5-103 defines the scope of Article 5 of the UCC. Article 5 "applies to letters of credit and to certain rights and obligations arising out of transactions involving letters of credit." RCW 62A.5-103(1).

This is a case of first impression in Washington and involves two such "certain rights and obligations" within the scope of Article 5: RCW 62A.5-110(1)(b)'s warranty by the beneficiary (KCU) of a letter of credit to

the applicant (respondent), and RCW 62A.5-115's one-year statute of limitations for causes of action arising under Article 5. Here, petitioner was the beneficiary and respondent was the applicant in the parties' letter of credit transaction. RCW 62A.5-110(1)(b) provides:

(1) If its presentation is honored, the beneficiary warrants:
...(b) To the applicant that the drawing does not violate any agreement between the applicant and beneficiary or any other agreement intended by them to be augmented by the letter of credit.

The sole relationship of petitioner and respondent is as parties to a letter of credit transaction.

Common law principles apply where UCC provisions do not specifically displace them. However, in this case common law principles are specifically displaced by Article 5's warranty and statute of limitations provisions. "Normally Article 5 should not be considered to conflict with practice except when a rule . . . is different from a rule *explicitly stated in Article 5.*" RCW 62A.5-103, Official Comment 2 (emphasis added).

RCW 62A.5-110(1)(b) *explicitly* provides a cause of action for breach of the warranty by the beneficiary of a letter of credit to the applicant, and RCW 62A.5-115 *explicitly* provides that the statute of limitations in a lawsuit arising under Article 5 is one year. However, respondent attempts to evade

the effect of Article 5 by claiming that Article 5's warranty provisions are inapplicable because respondent has not asserted a breach of warranty claim under Article 5. Respondent brought multiple causes of action against petitioner, alleging that petitioner improperly drew on the letter of credit.

Respondent also alleges that KCU breached its agreement to assign sale proceeds of Meridian condo units to respondent. However, nowhere in the record is there any evidence of an assignment agreement. There is no contract, assignment or any agreement between the parties other than the letter of credit, which falls within the purview of Article 5 of the UCC.

Respondent also asserts common law tort claims. The actions alleged by respondent as negligent involve petitioner's alleged wrongful certifications upon drawing on the letter of credit. Respondent can point to no duty—*independent from or meaningfully different than any duty arising under Article 5—that may have been breached.* Because no duty arising *outside of Article 5* has been breached, there is no basis for a common law tort claim. Likewise, respondent cites no equitable claim that is meaningfully different than what respondent could have asserted as a breach of an Article 5 warranty claim.

This case comes before this Court following a summary judgment ruling in favor of KCU. The purpose of summary judgment is to avoid a useless trial when there is no genuine issue of any material fact. It is the trial court's function to determine whether such a genuine issue exists. See

LaPlante v. State of Washington, 85 Wn.2d 154, 158, 531 P.2d 299 (1975):

When a motion for summary judgment is supported by evidentiary matter, the adverse party may not rest on mere allegations in the pleadings, but must set forth specific facts showing that there is a genuine issue for trial. *W.G. Platts, Inc. v. Platts*, 73 Wn.2d 434, 438 P.2d 867, 31 A.L.R. 3d 1413 (1968); *Tait v. King Broadcasting Co.*, 1 Wn. App. 250, 460 P.2d 307 (1969); *McGough v. Edmonds*, 1 Wn.App. 164, 460 P.2d 302 (1969). If no genuine issue of material fact exists, it must then be determined whether the moving party is entitled to judgment as a matter of law. CR 56(c). See also *Brannon v. Harmon*, 56 Wn.2d 826, 355 P.2d 792 (1960).

In *American Linen Supply Co. v. Nursing Home Building Corporation*, 15 Wn.App. 757, 551 P.2d 1038 (1976), the court affirmed a summary judgment in favor of defendant. The court stated at pp. 767 and 768 as follows:

The moving party having made an adequate showing as to the balance owing on the contract, it became incumbent on the nonmoving party to respond with probative evidence. *W.G. Platts, Inc. v. Platts*, 73 Wn.2d 434, 443, 438 P.2d 867, 31 A.L.R. 3d 1413 (1968); *Bernal v. American Honda Motor Co.*, 11 Wn.App. 903, 906, 527 P.2d 273 (1974). This responding affidavit is required to set forth specific facts disclosing an issue of material fact and conclusionary

statements of fact will not suffice. *Washington Osteopathic Medical Ass'n v. King County Medical Serv. Corp.*, 78 Wn.2d 577, 582, 478 P.2d 228 (1970); *Hodgins v. State*, 9 Wn.App. 490, 513 P.2d 304 (1973).

Alleged wrongful certifications when drawing on the letter of credit form the substance of all of respondent's claims against petitioner, regardless of how they are framed. Respondent has brought no evidence or facts to support respondent's claim that respondent is entitled to contract, tort, or equitable relief. Respondent makes unsupported conclusionary statements that are not supported by any probative evidence. Respondent may not rest on these mere allegations.

3. *The Letter of Credit Itself is the Basis of this Article 5 Warranty.*

The Court of Appeals erred in its conclusion that the letter of credit itself cannot be the agreement between the applicant and the beneficiary. The Court of Appeals concluded that allowing the letter of credit itself to be the basis of the Article 5 warranty "strains the language of RCW 62A.5-110(b)." Opinion, p. 12.

The Court of Appeals reached this conclusion without any meaningful authority or analysis. The court cites *Kenney v. Read*, 100 Wn. App. 467, 997 P.2d 455 (2000) as authority for its position that "the letter of credit is a

relationship between the issuer and the beneficiary (here, Wells Fargo and the Credit Union), not the beneficiary and the applicant." Opinion, p. 12.

Notwithstanding that the Court of Appeals reads too much into *Kenney* ("a letter of credit *usually* involves three distinct relationships," *Kenney*, at 472, citing *Ensco Envtl. Services, Inc. v. United States*, 650 F. Supp. 583, 588 (W.D. Mo. 1986) and former RCW 62A.5-103(1) (emphasis added)), this application of *Kenney* is irrelevant to the issue before this Court. *Kenney* says nothing about whether the letter of credit itself can be the document that gives rise to the Article 5 warranties.

Kenney is not helpful precedent in this regard because the *Ensco* decision which that passage from *Kenney* is based on has nothing to do with Article 5's warranty and statute of limitations provisions. Whatever relationship is "usually" present in a letter of credit has no bearing on the beneficiary's warranty to the applicant, a warranty that is an aspect of *all* letter of credit transactions under revised Article 5. *Kenney* has nothing to do with the Article 5 warranty and statute of limitation issues before this Court.

RCW 62A.5-110(1)(b) applies to circumstances where there is no contract between the beneficiary and applicant. The comments indicate that the beneficiary's warranty to the applicant has primary application in "standby

letters of credit or *other circumstances where the applicant is not party to an underlying contract with the beneficiary.*" RCW 62A.5-110 Official Comment 2 (emphasis added).

If the Article 5 warranty applies "where the applicant is not party to an underlying contract with the beneficiary," then what is warrantied? The plain text of RCW 62A.5-110 provides the obvious answer: "*any* agreement between the applicant and the beneficiary or *any* other agreement intended by them to be augmented by the letter of credit." RCW 62A.5-110(1)(b). (Emphasis added.)

In the present case, this "agreement" is the letter of credit. The letter of credit itself sets forth all of KCU's obligations in the parties' Article 5 transaction. The letter of credit required petitioner to certify, in part, that

an 'Event of Default' [as defined in the construction loan promissory note between the credit union and Meridian] has not occurred, no even exists that may, with the passage of time, constitute an 'Event of Default', Borrower is currently not in default. . . (CP 41.)

This certification was a condition of drawing on the letter of credit. This certification, along with other certifications made upon each draw, represented the parties' agreement regarding the letter of credit transaction.

The conditions for drawing on the letter of credit were built into the letter of

credit itself. It is immaterial whether these were express conditions of the letter of credit, or of some other agreement augmenting or underlying the transaction. RCW 62A.5-110 and its Comment 2 are clear that regardless of the source of the obligation, violation of a draw condition is a breach of the beneficiary's warranty to the applicant.

By making certifications upon each letter of credit draw, KCU certified to respondent, to borrow language from RCW 62A.5-110(1)(b), that "the drawing does not violate any agreement between the applicant and beneficiary or any other agreement intended by them to be augmented by the letter of credit." In the present case, this can only be the letter of credit itself.

4. The Court of Appeals' Ruling Allows Respondent to Ignore Article 5 by Alleging the Warranty Breach as Different Causes of Action

The Court of Appeals' ruling below renders RCW 62A.5-110 and 62A.5-115 meaningless by allowing respondent to allege as contract, tort, and equitable claims—well outside of Article 5's one-year statute of limitations—what in reality are breach of warranty claims.

RCW 62A.5-115 provides:

An action to enforce a right or obligation arising under this Article must be commenced within one year after the expiration date of the relevant letter of credit or one year after the cause of action accrues, whichever occurs later. A cause

of action accrues when the breach occurs, regardless of the aggrieved party's lack of knowledge of the breach.

The Court of Appeals relied on Washington precedent holding that common law principles apply where UCC provisions do not specifically displace them. Opinion, p. 8. The Court of Appeals concluded, "Article 5's statute of limitations does not bar any of Alhadeff's claims that do not arise under the Article." Opinion, p. 9.

The problem with the Court of Appeals' approach is that respondent has not demonstrated that his claims arise outside of Article 5. The Court of Appeals simply stated: "In any event, Alhadeff has *alleged* that there was a contract between him and Credit Union. Article 5's statute of limitations does not prevent him from pursuing these separate claims." Opinion, p. 15 (emphasis added).

Even the Court of Appeals recognized that respondent's claims against petitioner credit union "may rely on the same alleged conduct that would be subject to an Article 5 warranty claim. . . ." Opinion, p. 15. The Court of Appeals would permit respondent to pursue his common law claims without recognizing that they are simply repackaged Article 5 warranty claims brought after the one-year statute of limitations. The Court of Appeals would allow respondent to evade the UCC entirely in what is clearly an Article 5

transaction, strip RCW 62A.5-115 of its meaning, and frustrate the statute's goal of uniformity.

RCW 62A.5-115's one-year statute of limitations is controlling in this case. Official Comment 2 to RCW 62A.5-115 confirms that this statute of limitations applies to claims made under RCW 62A.5-110. Official Comment 3 clarifies that "the statute of limitations, like the rest of the statute, applies . . . only to transactions, events, obligations, or duties *arising out of or associated with* such a letter." RCW 62A.5-115, Official Comment 3 (emphasis added).

Respondent argued below:

RCW 62A.5-115 does **not**, however, apply to 'claims [that] arose out of an Article 5 transaction,' as KCU argued, or to claims that arose under a 'relationship,' as the trial court concluded; instead, the statute applies to 'an action to enforce a right or obligation arising under' Article 5. (Brief of Appellant, p. 28.)

Respondent's position is without merit. It is apparent from the plain meaning of RCW 62A.5-115 and its Official Comment 3 that a cause of action brought more than one year after it accrues is time barred, regardless of whether the claim "arises under," "arose out of," or "is associated with" Article 5.

Respondent's position that he has not brought "an action to enforce a right or obligation arising under" Article 5, simply because respondent's causes of action are labeled "common law" is entirely without merit. Another of respondent's own admissions below reveals the weakness of his argument:

"Certainly, plaintiff's claims *arose out of* the LOC, and plaintiff *would not have had a 'relationship' with KCU but for the LOC...*" (Brief of Appellant, p. 28 emphasis in original.) Respondent effectively concedes that this is an Article 5 transaction.

UCC scholarship supports petitioner's argument that Article 5's statute of limitations must not be evaded by labeling the warranty claim as some other cause of action. Hawkland & Miller advise:

What is a right or obligation arising under Article 5 is somewhat problematic. . . . The answer should be that the fact any right or obligation under Article 5 is replicated in an agreement or in standard practice with the effect of an agreement is irrelevant as to the applicability of the statute of limitations in Article 5 which should apply; otherwise the uniformity goal of the statute will be compromised. Hawkland & Miller UCC Series § 5-115:1 (Rev Art 5).

...

Indeed, since the credit itself often is viewed as a contract any other analysis would render UCC § 5-115 without much if any function to perform. Hawkland & Miller UCC Series § 5-115:1, at footnote 11, (Rev Art 5).

L. Lawrence, Anderson on the Uniform Commercial Code, Vol. 7A

§5.115:5, p. 642, is also instructive:

This raises the question as to whether a right or obligation arises under Revised Article 5 when it arises from a contract that is entered into under the authority of Revised Article 5.

Example: If the applicant sues the issuer for breach of the contract between the applicant and the issuer, does such claim arise under Revised Article 5 or does it arise under ordinary contract law?

The Official Comments make it clear that Revised Article 5's statute of limitations applies to all suits on contracts that are authorized, recognized, or contemplated by Revised Article.

White & Summers (who are cited as authority in *Kenney* and other Washington State UCC opinions) explain Article 5's one-year statute of limitations as follows:

The statute of limitations governs not only suits against the issuer for wrongful dishonor but also claims against nominated persons, advising banks, and *others whose rights arise from or are associated with the letter of credit transaction*. It also governs the applicant's claim for wrongful honor, since that claim arising out of a letter of credit transaction and even though it is essentially a suit on a written contract—the reimbursement agreement. *The one-year statute of limitations should be widely applied so that no part of the same dispute finds its way outside of Article 5 while another portion of the same dispute is foreclosed by the one-year statute of limitations.* 3 James J. White and Robert S. Summers, Uniform Commercial Code, § 26-16, at 214 (4th ed. 1995) (emphasis added).

Thus, even if respondent could prove the existence of a contract between the parties, or even if the parties' letter of credit transaction could be deemed a contract, because the subject matter of that contract would involve rights and obligations expressly and specifically covered by Article 5, it follows that the contract would be subject to Article 5's one-year statute of limitations. Respondent conceded below that respondent could have asserted a breach of warranty claim. According to respondent, "what is important is that, even though plaintiff **could have** asserted a warranty claim against KCU, **he still has a direct cause of action against KCU for breach of the underlying agreement.**" (Brief of Appellant, p. 32, emphasis in original.) To the contrary, RCW 62A.5-115, its comments, and the above UCC scholars indicate that Article 5's statute of limitations provision should be read broadly so that no part of respondent's suit finds its way outside of Article 5.

5. The Court of Appeals Erred by Choosing Not to Follow the Only Reported Decision on Point

Krause v. Stroh Brewery Co., 240 F. Supp. 2d 632 (E.D. Mich. 2002) is the only reported decision analyzing the issue of whether claims arising out of an Article 5 transaction brought more than one year after the statute of limitations are time barred. That case also involved a dispute over an alleged

wrongful draw on a letter of credit. The plaintiffs brought several causes of action in contract and tort.

Krause held that the plaintiffs' claims arose under the warranty provisions of MCLS § 440.5110 (identical to UCC 5-110 and RCW 62A.5-110). *Krause* also held that "*Article 5 includes a one-year statute of limitations period for any 'action to enforce a right or obligation arising under this article'*" *Krause*, 240 F. Supp. 2d at 635, citing MCLS § 440.5115 (identical to UCC 5-115 and RCW 62A.5-115) (emphasis in original). The court concluded "the one-year statute of limitations applies to actions for wrongfully collecting upon letters of credit." *Krause*, 240 F. Supp. 2d at 635. Because the lawsuit was filed more than one year after the alleged wrongful collection upon the letter of credit, all of the plaintiffs' causes of action were time barred. *Krause*, 240 F. Supp. 2d at 636.

Krause is identical to the case before this court. Michigan and Washington have enacted identical versions of Article 5's warranty and one-year statute of limitations provisions. *Krause's* holdings are also consistent with the broad interpretation given to Article 5's statute of limitations by the UCC scholars cited above.

The Court of Appeals chose not to follow *Krause* because, according to the Court of Appeals, "the *Krause* court failed to recognize the separate nature of a contract underlying a letter of credit transaction." Opinion, p. 13. The Court of Appeals explained that Article 5 is supplemented by statutory and common law, including the statute of limitations on a contract action, so, "[b]ecause the *Krause* court's holding is contrary to the principles underlying Article 5, we do not follow it." Opinion, p. 14.

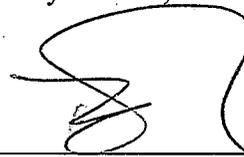
The Court of Appeals failed to recognize that the common law contract statute of limitations *is displaced* by Article 5's one-year limitation period for a claim arising under Article 5. The Court of Appeals failed to recognize that the *Krause* holding is not at all contrary to the principles underlying Article 5, but rather is based on the plain meaning of Article 5's warranty and statute of limitations provisions.

According to a plain reading of RCW 62A.5-110 and RCW 62A.5-115, their Official Comments, and the commentary of scholars such as White & Summers, Lawrence, and Hawkland & Miller, the Court of Appeals is incorrect. The one-year statute of limitations applies since no part of respondent's claims against petitioner credit union find their way outside of Article 5.

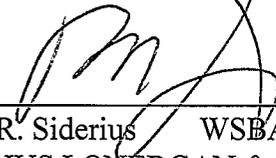
F. CONCLUSION

For all of the foregoing reasons, review should be accepted, the decision of the Court of Appeals should be reversed and this court should affirm the trial court's summary judgment in favor of petitioner.

Respectfully submitted this 30th day of June, 2008.



Brian C. Read WSBA 34091



Frank R. Siderius WSBA 7759
SIDERIUS LONERGAN & MARTIN LLP
Attorneys for Respondent Kitsap Community
Federal Credit Union, aka Kitsap Credit Union

APPENDIX

Appendix A: Published Opinion, No. 36340-2-II, Court of Appeals,
June 3, 2007

Appendix B: Copies of Statutes:

Washington: RCW 62A.5-103; 62A.5-110; 62A.5-115

Michigan: MCLS§440.5110; 440.5115

Appendix C: Copy of *Krause v. Stroh Brewery Co.*, 240 F. Supp.
2d 632 (E.D. Mich. 2002)

Appendix D: *Ensco Envtl. Services, Inc. v. United States*, 650 F.
Supp. 583, 588 (W.D. Mo. 1986)

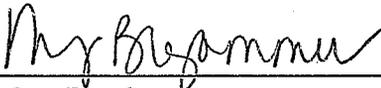
Declaration of Service

The undersigned declares under penalty of perjury under the Laws of the State of Washington that on the date below I sent by legal messenger and/or sent via U.S. Mail, first class, postage prepaid, a true copy of this document to:

Michael Daniel Ross
Ross Law Advisors PLLC
2010 - 156th Avenue NE, Ste 100
Bellevue, WA 98007-3826

John Joseph Mitchell
Attorney at Law
P.O. Box 11287
Bainbridge Island, WA 98110-5287

Dated this 30th day of June, 2008.



Mary Berghammer

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DIVISION II
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STATE OF WASHINGTON
BY _____
DEPUTY

Appendix A

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DIVISION II

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STATE OF WASHINGTON

BY
DEPUTY

IN THE COURT OF APPEALS OF THE STATE OF WASHINGTON

DIVISION II

N. JACK ALHADEFF,

Appellant,

v.

THE MERIDIAN ON BAINBRIDGE ISLAND, LLC, a Washington limited liability company; JAMES W. ANDRESEN and VIRGINIA R. ANDRESEN, husband and wife and the marital community composed thereof; JOHN M. ERICKSON and JANE DOE ERICKSON, husband and wife and the marital community composed thereof; T. DENNIS KIRKPATRICK and SUZANNE C. ANDRESEN, husband and wife and the marital community composed thereof; BRUCE A. McCURDY and CONNIE M. McCURDY, husband and wife and the marital community composed thereof; and KITSAP COMMUNITY FEDERAL CREDIT UNION d/b/a KITSAP CREDIT UNION, a federally chartered credit union,

Respondents.

No. 36340-2-II

PUBLISHED OPINION

ARMSTRONG, J.—N. Jack Alhadeff appeals a summary judgment order dismissing his claims against Kitsap Community Federal Credit Union in a case involving a letter of credit that Alhadeff authorized his bank to issue to the Credit Union. He argues that the trial court erred in finding that all his claims arise under Article 5 of the Uniform Commercial Code and that the

Article's one-year statute of limitations thus bars his claims. We hold that Article 5's one-year statute of limitations applies only to claims for breach of the specific warranty contained in Article 5; it does not bar Alhadeff's claims for breach of contract, negligent misrepresentation and failure to inform, promissory estoppel, conversion, money had and received, and negligent certification that the construction project was not in default. Accordingly, we reverse and remand.

FACTS

In June 2003, the Credit Union made a construction loan to The Meridian on Bainbridge Island, LLC (Meridian). Meridian had already contributed over \$2 million to the construction project, but it needed approximately \$5.5 million to complete it. The Credit Union agreed to loan Meridian \$4.5 million on condition that Meridian contribute an additional \$1 million to the project by means of an irrevocable letter of credit. Meridian then persuaded Alhadeff to provide the letter of credit.

Under the letter of credit agreement between Alhadeff and Meridian, Alhadeff authorized his bank, Wells Fargo Bank, to provide the Credit Union with a letter of credit for Meridian's benefit. The letter of credit required the Credit Union to accompany a draft drawing on the letter of credit with a signed and dated statement containing the following:

The undersigned, an authorized officer of Kitsap Community Federal Credit Union, ("Kitsap") hereby certifies, under penalty of perjury, that all funds have been advanced (less any interest reserve) to The Meridian on Bainbridge Island, LLC (the "Borrower") under or in connection with that certain construction loan promissory note (the "Note") dated as of June 27, 2003 in the aggregate amount of \$4,500,000 established by Kitsap in favor of the Borrower, an "Event of Default" (as defined in the Note) has not occurred, no event exists that may, with the passage of time, constitute an "Event of Default", Borrower is currently not in default, Kitsap has notified Mr. N. Jack Alhadeff of the intended drawing under the Wells Fargo Bank, N.A. Letter of Credit No. NZS488105, Kitsap will disburse the proceeds of this Letter of Credit to Borrower solely for

the development and construction of the Project and such funds shall not be used by Kitsap for any other purpose, including, without limitation, retiring any portion of the Note, and Kitsap is now drawing the sum of {insert amount}.

Clerk's Papers (CP) at 41. Wells Fargo issued the letter of credit on July 2, 2003; it expired on June 24, 2004.

Before Wells Fargo issued the letter of credit, Alhadeff sent the Credit Union an email with a "proposed side letter agreement" attached. CP at 69-70. The document provided:

3. Kitsap Community Federal Credit Union shall not draw upon the Letter of Credit in the event [Meridian] is in default under the Construction Loan or an event exists that may, with the passage of time, constitute a default under the Construction Loan.

....
5. All amounts otherwise available for disbursement to [Meridian] shall be paid to [Alhadeff] until [Alhadeff] is paid in full. In addition, ten percent (10%) of the net proceeds from the sale of any portion of the Project shall be released to [Alhadeff] in payment of the amount owed by [Meridian] to [Alhadeff].

CP at 70.

The Credit Union responded with a letter that did not contain either of these paragraphs.

In an accompanying e-mail, the Credit Union's director of commercial lending explained:

We have reviewed your proposed letter agreement and wish to make three changes:

....
2. Paragraph #5. We have eliminated this paragraph and suggest that the 10% net proceeds on the sale of units that was designated to Meridian be assigned by Meridian back to [Alhadeff]. This is much cleaner for us and we would honor that assignment. Using an assignment is a better method for us.

3. Paragraph #3[.] On each request for draws under the Letter of Credit we are required to affirm that there are no events of default and think this is sufficient protection.

CP at 72.

The Credit Union drew on the letter of credit three times: on May 11, 2004 for \$415,000; on June 11, 2004 for \$474,850; and on July 8, 2004 for \$110,150, thus drawing the full \$1

million. A signed statement containing the required language and specifying the amount drawn accompanied each draft.

By the spring of 2004, Meridian had increased the scope of the construction project, adding at least \$1 million to the construction costs. By May 11, 2004, the date the Credit Union first drew on the letter of credit, its officers knew about Meridian's expansion of the construction project and were concerned about Meridian's ability to pay for the costs. Yet they did not inform Alhadeff of the changes or their concerns. Meridian had also failed to pay its real estate taxes for the first half of 2004. In September 2004, after cost overruns had again increased, the Credit Union agreed to advance Meridian an additional \$1.35 million.

In November 2006, the Credit Union declared the construction loan to be in default. Meridian also defaulted on its letter of credit agreement with Alhadeff. Because the Credit Union holds the first position deed of trust on the unsold condominium units and Meridian has no other assets, Alhadeff is not likely to recover from Meridian the approximately \$1.6 million Meridian owes him under the letter of credit agreement.

Alhadeff filed this lawsuit in April 2007, and amended the complaint to assert claims against the Credit Union on August 30, 2007. He asserted breach of contract, tort, and equitable claims. The Credit Union moved for summary judgment, arguing that Alhadeff's claims all arose under the Uniform Commercial Code (U.C.C.)--Letters of Credit, chapter 62A.5 RCW, and were barred by the one-year statute of limitations in RCW 62A.5-115. The trial court agreed and granted the Credit Union's motion.

ANALYSIS

I. STANDARD OF REVIEW

We review an order granting summary judgment de novo. *Go2Net, Inc. v. FreeYellow.com, Inc.*, 158 Wn.2d 247, 252, 143 P.3d 590 (2006) (citing *Troxell v. Rainier Pub. Sch. Dist. No. 307*, 154 Wn.2d 345, 350, 119 P.3d 1173 (2005)). Summary judgment is appropriate where no genuine issues of material fact exist and the moving party is entitled to judgment as a matter of law. CR 56(c). We take all facts, and reasonable inferences from those facts, in the light most favorable to the nonmoving party. *Berrocal v. Fernandez*, 155 Wn.2d 585, 590, 121 P.3d 82 (2005) (citing *Wilson v. Steinbach*, 98 Wn.2d 434, 437, 656 P.2d 1030 (1982)).

The Credit Union moved for summary judgment only on the basis of U.C.C. Article 5's statute of limitations. Thus, we do not address the merits of any of Alhadeff's claims; we consider only whether they are time-barred.

II. LETTERS OF CREDIT

Parties often use letters of credit to "facilitate the financing of commercial transactions . . . by providing a certain and reliable means to ensure payment for goods delivered or services rendered." *Kenney v. Read*, 100 Wn. App. 467, 471, 997 P.2d 455, 4 P.3d 862 (2000) (quoting *Amwest Sur. Ins. Co. v. Republic Nat'l Bank*, 977 F.2d 122, 125 (4th Cir. 1992)).

A letter of credit is essentially

a tripartite arrangement under which one party establishes a credit, usually at a bank, on which it authorizes a third party to draw, provided certain conditions are met. The bank, as a mere stakeholder of the credit, issues a letter to the third party (known as the beneficiary) confirming the credit and stating the conditions for any draw to be made against it. In essence, the bank's promise to pay the beneficiary upon the beneficiary's timely presentation to the bank of documents

conforming to the conditions delimited in the letter replaces the promise of the party which established the credit.

Kenney, 100 Wn. App. at 471 (quoting *Amwest*, 977 F.2d at 125).

Washington has codified U.C.C. Article 5, governing letters of credit, in RCW 62A.5-101 through RCW 62A.5-118. Article 5 defines a letter of credit as “a definite undertaking . . . by an issuer to a beneficiary at the request or for the account of an applicant . . . to honor a documentary presentation by payment or delivery of an item of value.” RCW 62A.5-102(j). A letter of credit transaction typically involves three parties with three distinct relationships. The “applicant” is the “person at whose request or for whose account a letter of credit is issued.” RCW 62A.5-102(b). The “issuer” is the “bank or other person that issues a letter of credit.” RCW 62A.5-102(i). And the “beneficiary” is the “person who under the terms of a letter of credit is entitled to have its complying presentation honored.” RCW 62A.5-102(c). The underlying relationships are typically:

(1) the contract between the bank and its customer [the applicant] to issue a letter of credit; (2) the letter of credit in which the issuing bank agrees to pay the beneficiary when the conditions contained in the letter are complied with; and (3) the underlying contract between the customer and the beneficiary for which the letter of credit was obtained.

Kenney, 100 Wn. App. at 472 (quoting *Ensco Envtl. Servs., Inc. v. United States*, 650 F. Supp. 583, 588 (W. D. Mo. 1986)).

Although atypical, a four-party letter of credit may be valid. For example, in *Kenney*, Read and Rook Broadcasting entered into an agreement for a one-year lease of Read’s radio station pending sale of the station to Rook. *Kenney*, 100 Wn. App. at 469. Based on an agreement Rook entered into with Kenney, Kenney directed his bank to provide a letter of credit with Read as the beneficiary; Kenney did not directly communicate with Read. *Kenney*, 100

Wn. App. at 469-70. The first relationship was between Kenney, the applicant, and his bank, the issuer. *Kenney*, 100 Wn. App. at 472. The second relationship was the bank's obligation under the letter of credit to pay Read, the beneficiary. *Kenney*, 100 Wn. App. at 472. And the third relationship was the underlying lease agreement between Read, the beneficiary, and Rook (rather than between Read and Kenney, the applicant). *Kenney*, 100 Wn. App. at 472.

Similarly here, the first relationship was between Alhadeff, the applicant, and Wells Fargo, the issuer. The second relationship was Wells Fargo's obligation under the letter of credit to pay the Credit Union, the beneficiary.¹ And the third relationship was the underlying construction loan agreement between the Credit Union, the beneficiary, and Meridian (rather than between the Credit Union and Alhadeff, the applicant).²

III. ALHADEFF'S CLAIMS

Alhadeff contends that the trial court erred in finding that his claims against the Credit Union arise under Article 5 and are therefore barred by Article 5's one-year statute of limitations.

The trial court found that the sole relationship between Alhadeff and the Credit Union was the letter of credit, that Alhadeff's sole line of recovery is under Article 5's warranty provision, and that Article 5's statute of limitations barred all of Alhadeff's claims.

Article 5's statute of limitations section provides:

An action to enforce a right or obligation arising under [Article 5] must be commenced within one year after the expiration date of the relevant letter of credit or one year after the cause of action accrues, whichever occurs later. A

¹ Although the letter of credit required the Credit Union to disburse the proceeds to Meridian, it identified the Credit Union as the beneficiary.

² Just as Kenney provided the letter of credit in consideration of Rook's promises and inducements, *Kenney*, 100 Wn. App. at 470, Alhadeff provided the letter of credit under an agreement between him and Meridian. This agreement is not part of the record.

cause of action accrues when the breach occurs, regardless of the aggrieved party's lack of knowledge of the breach.

RCW 62A.5-115. Alhadeff does not dispute that he brought his claims more than one year after his causes of action accrued. Rather, he maintains that Article 5 does not displace all legal and equitable principles associated with letters of credit transactions and that he may therefore maintain his causes of action in contract, tort, and equity.

RCW 62A.5-103(1) defines the scope of Article 5: it "applies to letters of credit and to certain rights and obligations arising out of transactions involving letters of credit." The official comment to U.C.C. section 5-103 provides:

Like all of the provisions of the Uniform Commercial Code, Article 5 is supplemented by Section 1-103 and, through it, by many rules of statutory and common law. Because this article is quite short and has no rules on many issues that will affect liability with respect to a letter of credit transaction, law beyond Article 5 will often determine rights and liabilities in letter of credit transactions. Even within letter of credit law, the article is far from comprehensive; it deals only with "certain" rights of the parties.

U.C.C. § 5-103, cmt. 2.

Similarly, Washington's version of U.C.C. section 1-103 provides:

Unless displaced by the particular provisions of [the U.C.C.], the principles of law and equity, including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, or other validating or invalidating cause shall supplement its provisions.

RCW 62A.1-103. Washington courts have recognized that common law principles apply where U.C.C. provisions do not specifically displace them. *See, e.g., S.S. Kresge Co. v. Port of Longview*, 18 Wn. App. 805, 811, 573 P.2d 1336 (1977) (U.C.C. provisions "do not totally preempt the fields of law in which they speak"); *Gorge Lumber Co. v. Brazier Lumber Co.*, 6 Wn. App. 327, 334, 493 P.2d 782 (1972) ("We view [RCW 62A.1-103] as a general adoption of

common-law principles to commercial transactions, where the code provisions do not apply to replace them.”).

Article 5, by its very terms, does not govern every aspect of letter of credit transactions but only “certain rights and obligations” relating to letters of credit. As the official U.C.C. comments note, Article 5 “has no rules on many issues that will affect liability with respect to a letter of credit transaction,” and it contemplates that statutory and common law rules apply to and supplement its provisions. U.C.C. § 5-103, cmt. 2. Accordingly, Article 5’s statute of limitations does not bar any of Alhadeff’s claims that do not arise under the Article. The question then becomes whether his claims do in fact arise under Article 5.

Alhadeff brought eight claims against the Credit Union: (1) breach of contract for drawing on the letter of credit when Meridian was in default of the construction loan, (2) breach of contract for failing to pay Alhadeff 10 percent of the proceeds from the Credit Union’s sale of condominium units after it foreclosed on the construction loan, (3) promissory estoppel based on the Credit Union’s promise not to draw on the letter of credit if Meridian was in default, (4) negligence in certifying that Meridian was not in default, (5) negligent misrepresentation based on the Credit Union’s statement that it would honor Meridian’s assignment of 10 percent of the proceeds from the construction project, (6) conversion, (7) money had and received, and (8) negligence in failing to advise Alhadeff of changes in the scope of the construction project.

The Credit Union asserts that all of Alhadeff’s claims arise under the warranty provision in RCW 62A.5-110. It maintains that Alhadeff is attempting to evade Article 5’s statute of limitations by characterizing his claims as common law or equitable claims but that he has no basis for any cause of action outside of Article 5.

Article 5's warranty provides that, if the issuer honors the beneficiary's presentation, the beneficiary warrants to the applicant that "the drawing does not violate any agreement between the applicant and beneficiary or any other agreement intended by them to be augmented by the letter of credit." RCW 62A.5-110(1)(b). The official comments to U.C.C. section 5-110 explain:

In most cases the applicant will have a direct cause of action for breach of the underlying contract. This warranty has primary application in standby letters of credit or other circumstances where the applicant is not a party to an underlying contract with the beneficiary. It is not a warranty that the statements made on the presentation of the documents presented are truthful It is a warranty that the beneficiary has performed all the acts expressly and implicitly necessary under any underlying agreement to entitle the beneficiary to honor.

U.C.C. § 5-110, cmt. 2.

The comments provide two examples to illustrate the warranty's application. In the first example, a seller/beneficiary breaches an underlying sales contract by delivering defective goods. When the bank honors the beneficiary's draw on the letter of credit, the beneficiary has also breached its warranty to the applicant/buyer. U.C.C. § 5-110, cmt. 2. In this situation, the applicant has *both* a breach of warranty and a breach of contract claim against the beneficiary. In the second example, a beneficiary is authorized to draw on the letter of credit only upon the applicant's default under another agreement; the beneficiary breaches the warranty by drawing on the letter of credit when the applicant is not in default. U.C.C. § 5-110, cmt. 2. In this situation, the beneficiary has breached its warranty even in the absence of an underlying contract between the beneficiary and the applicant. In either case, the breach of warranty arises "not because the statements [in the documents presented to the issuer] are untrue but because the beneficiary's drawing violated its express or implied obligations in the underlying transaction."

U.C.C. § 5-110, cmt. 2.

The comment directly states that an applicant has a “direct cause of action” for breach of an underlying contract. This understanding comports with the tripartite nature of letters of credit: the underlying contract is a separate and distinct relationship in the typical three-party letter of credit transaction. *Kenney*, 100 Wn. App. at 472. Moreover, in discussing Article 5’s definition of “good faith,” the U.C.C. comments state: “The contract between the applicant and beneficiary is not governed by Article 5, but by applicable contract law, such as Article 2 or the general law of contracts.” U.C.C. § 5-102, cmt. 3. As Professors White and Summers have noted:

In most commercial letters of credit cases the warranty will not give the applicant more than it already has. In those cases the very same act that will be a breach of the warranty is likely also to be a breach of an underlying contract and so give the applicant a claim under Article 2 of the UCC or other law. Note, however, that the applicant’s rights under Article 5 are unlikely to be coextensive with those under Article 2. For example, . . . Article 5 has a one-year statute of limitations, Article 2 has a four-year statute.

3 JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE, § 26-9, at 164 (4th ed. 1995). The same reasoning applies to an underlying contract governed by common law contract rules: a party to an underlying contract has a separate cause of action for breach of that contract, governed by general principles of contract law, including the longer statute of limitations.³

Indeed, a key concept with letters of credit is what White and Summers have termed the “independence principle.” 3 WHITE & SUMMERS, *supra*, § 26-2, at 113. This principle states that the bank’s obligation to pay the beneficiary is independent of the beneficiary’s performance on

³ In Washington, the statute of limitations for actions on a written contract is six years, and for an oral contract is three years. RCW 4.16.040(1), .080(3).

the underlying contract.⁴ 3 WHITE & SUMMERS, *supra*, § 26-2, at 113. Accordingly, most of Article 5's provisions deal with the relationship between the beneficiary and the issuer and a few deal with the relationship between the applicant and the issuer. 3 WHITE & SUMMERS, *supra*, § 26-2, at 120. But Article 5 does not "deal at all with the underlying contract between the applicant and the beneficiary." 3 WHITE & SUMMERS, *supra*, § 26-2, at 120. These comments demonstrate that Article 5's warranty provision does not encompass a claim on a contract underlying a letter of credit transaction.

The Credit Union asserts that the warranty's reference to "any agreement" between the applicant and the beneficiary does not necessarily mean a contract separate from the letter of credit itself. But the letter of credit is a relationship between the issuer and the beneficiary (here, Wells Fargo and the Credit Union), not the beneficiary and the applicant. *Kenney*, 100 Wn. App. at 472. It strains the language of RCW 62A.5-110(b) to interpret "any agreement between the applicant and beneficiary" to include the letter of credit itself. *See Fraternal Order of Eagles, Tenino Aerie No. 564 v. Grand Aerie of Fraternal Order of Eagles*, 148 Wn.2d 224, 239, 59 P.3d 655 (2002) (court will avoid interpretation of a statute that results in "unlikely, absurd, or strained consequences"). Moreover, the warranty also applies to "any other agreement intended by [the applicant and beneficiary] to be augmented by the letter of credit." RCW 62A.5-

⁴ Accordingly, RCW 62A.5-103(4) provides that the rights and obligations of an issuer to a beneficiary are independent of the arrangements underlying a letter of credit. In other words, "the issuer must pay on a proper demand from the beneficiary even though the beneficiary may have breached the underlying contract with the applicant." 3 WHITE & SUMMERS, *supra*, § 26-2, at 113. For this reason, Wells Fargo was obligated to disburse funds to Kitsap Credit Union when the credit union presented a draft accompanied by a conforming statement. RCW 62A.5-108(1). Alhadeff makes no claims that Wells Fargo wrongfully honored Kitsap Credit Union's drafts.

110(1)(b). To interpret this language to include the letter of credit as augmented by the letter of credit would be just as strained. *Fraternal Order of Eagles*, 148 Wn.2d at 239.

The trial court relied on *Krause v. Stroh Brewery Co.*, 240 F. Supp. 2d 632 (E.D. Mich. 2002), to find that Alhadeff's sole line of recovery is Article 5's warranty. In *Krause*, Northland Beverage Corporation and Stroh Brewery Company entered into a contract brewing agreement. *Krause*, 240 F. Supp. 2d at 634. To secure the agreement, Northland gave Stroh a letter of credit through Northland's bank; Stroh later collected on the letter of credit. *Krause*, 240 F. Supp. 2d at 634. Northland's owners and shareholders, who secured the letter of credit with their personal assets, alleged that the collection was wrongful because the letter of credit agreement provided that Stroh agreed to not collect on the letter of credit unless Northland was in default. *Krause*, 240 F. Supp. 2d at 634. The shareholders brought conversion, breach of contract, unjust enrichment, promissory estoppel, and negligence claims. *Krause*, 240 F. Supp. 2d at 634.

The District Court for the Eastern District of Michigan concluded that Article 5's warranty "provides a cause of action for wrongfully collecting on a letter of credit." *Krause*, 240 F. Supp. 2d at 635 (citing MICH. COMP. LAWS § 440.5110(1)(b)). It held that the shareholders' breach of contract, unjust enrichment, and promissory estoppel claims arose under the letter of credit agreement and were barred by Article 5's one-year statute of limitations. *Krause*, 240 F. Supp. 2d at 636. It then dismissed their conversion and negligence claims after finding that they arose out of the same agreement as the other claims. *Krause*, 240 F. Supp. 2d at 636.

But the *Krause* court failed to recognize the separate nature of a contract underlying a letter of credit transaction. See *Kenney*, 100 Wn. App. at 472 (typical letter of credit transaction involves three separate and distinct transactions). As the comments to the U.C.C. make clear, Article 5 is supplemented by "many rules of statutory and common law." U.C.C. § 5-103 cmt. 2.

And Washington's version of the U.C.C. states that "[u]nless displaced by the particular provisions of [the U.C.C.], the principles of law and equity . . . shall supplement its provisions." RCW 62A.1-103. Professors White and Summers explain that in most letters of credit cases, "the warranty will not give the applicant more than it already has. In those cases the very same act that will be a breach of the warranty is likely also to be a breach of an underlying contract."

3 WHITE & SUMMERS, *supra*, § 26-9, at 164. Thus, a party that bargains for additional protections in an underlying contract is entitled to the benefit of that protection. And general principles of contract law, including the statute of limitations on a contract action, govern claims for breach of an underlying contract. 3 WHITE & SUMMERS, *supra*, § 26-9, at 164. Because the *Krause* court's holding is contrary to the principles underlying Article 5, we do not follow it.

The Credit Union points out that the comments to U.C.C. § 5-110 state that the warranty "has primary application in standby letters of credit or other circumstances where the applicant is not a party to an underlying contract with the beneficiary."⁵ U.C.C. § 5-110, cmt. 2. It argues that, because there was no contract between it and Alhadeff, the warranty applies to Alhadeff's claims and the statute of limitations thus bars them. Even if the warranty has "primary

⁵ A standby letter of credit guarantees a contractual obligation; typically, the issuing bank agrees to pay the beneficiary if the applicant defaults on its obligation. BLACK'S LAW DICTIONARY 923 (8th ed. 2004); *see also Brenntag Int'l Chems., Inc. v. Bank of India*, 175 F.3d 245, 251 (2nd Cir. 1999) ("A stand-by letter of credit is meant to be drawn upon only in the event that its applicant fails to make a direct payment to the beneficiary . . ."). At argument below, the Credit Union characterized the letter of credit as "sort of a stand-by arrangement," because the letter of credit required the Credit Union to disburse the entire \$4.5 million construction loan to Meridian before the Credit Union drew on the letter of credit. RP at 4-5. Alhadeff asserts that the letter of credit cannot be a standby letter of credit because it was not used as security for any party's contractual performance. In any event, the characterization of the letter of credit does not affect the analysis here because Alhadeff has alleged that there was a contract between him and the Credit Union.

application” to situations where there is no contract between the applicant and the beneficiary, it does not necessarily control all claims between the parties who have no contract. Both the U.C.C. comments and Washington’s adopted version plainly state that the Code is to be supplemented by legal and equitable principles. In any event, Alhadeff has alleged that there was a contract between him and the Credit Union. Article 5’s statute of limitations does not prevent him from pursuing these separate claims.

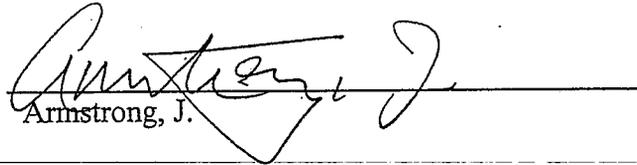
Alhadeff claims that the exchange of letters between him and the Credit Union created a contract that the credit union breached by (1) drawing on the letter of credit even though Meridian was in default on the construction loan, and (2) refusing to pay him 10 percent of the proceeds from the construction project. Although these claims may rely on the same alleged conduct that would be subject to an Article 5 warranty claim, the claims are based on the alleged contract, not Article 5’s warranty. If Alhadeff can prove an enforceable contract, he is entitled to its benefits. And these claims do not arise under Article 5. Rather, they supplement Alhadeff’s Article 5 warranty rights and the one-year statute of limitations does not bar them.⁶ The same analysis applies to Alhadeff’s equitable and tort claims. Because none of them are based on the

⁶ The Credit Union argues that Alhadeff’s breach of contract claims fail because there was no contract between them. But the Credit Union moved for summary judgment based on the statute of limitations only, and the trial court ruled only that the statute of limitations barred all of Alhadeff’s claims. Whether the contract in fact existed is beyond the scope of the Credit Union’s motion.

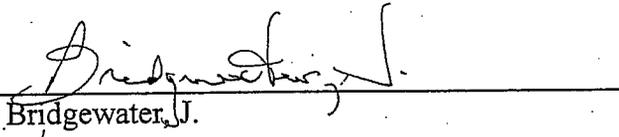
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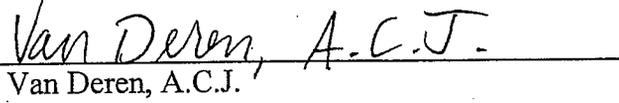
warranty, the warranty's statute of limitations does not bar them.

Reversed and remanded.


Armstrong, J.

We concur:


Bridgewater, J.


Van Deren, A.C.J.

Appendix B

1 of 1 DOCUMENT

ANNOTATED REVISED CODE OF WASHINGTON
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*** STATUTES CURRENT THROUGH ALL NEW 2008 LEGISLATION ***
*** EFFECTIVE THROUGH JUNE 11, 2008 ***
*** ANNOTATIONS CURRENT THROUGH APRIL 22, 2008 ***

TITLE 62A. UNIFORM COMMERCIAL CODE
ARTICLE 5. LETTERS OF CREDIT

GO TO REVISED CODE OF WASHINGTON ARCHIVE DIRECTORY

Rev. Code Wash. (ARCW) § 62A.5-103 (2008)

§ 62A.5-103. Scope

(1) This Article applies to letters of credit and to certain rights and obligations arising out of transactions involving letters of credit.

(2) The statement of a rule in this Article does not by itself require, imply, or negate application of the same or a different rule to a situation not provided for, or to a person not specified, in this Article.

(3) With the exception of this subsection, subsections (1) and (4) of this section, *RCW 62A.5-102(1) (i) and (j)*, *62A.5-106(4)*, and *62A.5-114(4)*, and except to the extent prohibited in *RCW 62A.1-102(3)* and *62A.5-117(4)*, the effect of this Article may be varied by agreement or by a provision stated or incorporated by reference in an undertaking. A term in an agreement or undertaking generally excusing liability or generally limiting remedies for failure to perform obligations is not sufficient to vary obligations prescribed by this Article.

(4) Rights and obligations of an issuer to a beneficiary or a nominated person under a letter of credit are independent of the existence, performance, or nonperformance of a contract or arrangement out of which the letter of credit arises or which underlies it, including contracts or arrangements between the issuer and the applicant and between the applicant and the beneficiary.

HISTORY: 1997 c 56 § 4; 1965 ex.s. c 157 § 5-103.

NOTES:

OFFICIAL COMMENT

1. Sections 5-102 (a) (10) and 5-103 are the principal limits on the scope of Article 5. Many undertakings in commerce and contract are similar, but not identical to the letter of credit. Principal among those are "secondary," "accessory," or "suretyship" guarantees. Although the word "guarantee" is sometimes used to describe an independent obligation like that of the issuer of a letter of credit (most often in the case of European bank undertakings but occasionally in the case of undertakings of American banks), in the United States the word "guarantee" is more typically used to describe a suretyship transaction in which the "guarantor" is only secondarily liable and has the right to assert the underlying debtor's defenses. This title does not apply to secondary or accessory guarantees and it is important to recognize the distinction between letters of credit and those guarantees. It is often a defense to a secondary or accessory guarantor's liability that the underlying debt has been discharged or that the debtor has other defenses to the underlying liability. In letter of credit law, on the other hand, the independence principle recognized throughout Article 5 states that the issuer's liability is independent of the underlying obligation. That the beneficiary may have breached the underlying contract and thus have given a good defense on that contract to the applicant against the beneficiary is no defense for the issuer's refusal to honor. Only staunch recognition of this principle by the issuers and the courts will give letters of credit the

continuing vitality that arises from the certainty and speed of payment under letters of credit. To that end, it is important that the law not carry into letter of credit transactions rules that properly apply only to secondary guarantees or to other forms of engagement.

2. Like all of the provisions of the Uniform Commercial Code, Article 5 is supplemented by Section 1-103 and, through it, by many rules of statutory and common law. Because this title is quite short and has no rules on many issues that will affect liability with respect to a letter of credit transaction, law beyond Article 5 will often determine rights and liabilities in letter of credit transactions. Even within letter of credit law, the title is far from comprehensive; it deals only with "certain" rights of the parties. Particularly with respect to the standards of performance that are set out in Section 5-108, it is appropriate for the parties and the courts to turn to customs and practice such as the Uniform Customs and Practice for Documentary Credits, currently published by the International Chamber of Commerce as I.C.C. Pub. No. 500 (hereafter UCP). Many letters of credit specifically adopt the UCP as applicable to the particular transaction. Where the UCP are adopted but conflict with Article 5 and except where variation is prohibited, the UCP terms are permissible contractual modifications under Sections 1-102 (3) and 5-103 (c). See Section 5-116 (c). Normally Article 5 should not be considered to conflict with practice except when a rule explicitly stated in the UCP or other practice is different from a rule explicitly stated in Article 5.

Except by choosing the law of a jurisdiction that has not adopted the Uniform Commercial Code, it is not possible entirely to escape the Uniform Commercial Code. Since incorporation of the UCP avoids only "conflicting" Article 5 rules, parties who do not wish to be governed by the nonconflicting provisions of Article 5 must normally either adopt the law of a jurisdiction other than a state of the United States or state explicitly the rule that is to govern. When rules of custom and practice are incorporated by reference, they are considered to be explicit terms of the agreement or undertaking.

Neither the obligation of an issuer under Section 5-108 nor that of an adviser under Section 5-107 is an obligation of the kind that is invariable under Section 1-102 (3). Section 5-103 (c) and comment 1 to Section 5-108 make it clear that the applicant and the issuer may agree to almost any provision establishing the obligations of the issuer to the applicant. The last sentence of subsection (c) limits the power of the issuer to achieve that result by a nonnegotiated disclaimer or limitation of remedy.

What the issuer could achieve by an explicit agreement with its applicant or by a term that explicitly defines its duty, it cannot accomplish by a general disclaimer. The restriction on disclaimers in the last sentence of subsection (c) is based more on procedural than on substantive unfairness. Where, for example, the reimbursement agreement provides explicitly that the issuer need not examine any documents, the applicant understands the risk it has undertaken. A term in a reimbursement agreement which states generally that an issuer will not be liable unless it has acted in "bad faith" or committed "gross negligence" is ineffective under Section 5-103 (c). On the other hand, less general terms such as terms that permit issuer reliance on an oral or electronic message believed in good faith to have been received from the applicant or terms that entitle an issuer to reimbursement when it honors a "substantially" though not "strictly" complying presentation, are effective. In each case the question is whether the disclaimer or limitation is sufficiently clear and explicit in reallocating a liability or risk that is allocated differently under a variable Article 5 provision.

Of course, no term in a letter of credit, whether incorporated by reference to practice rules or stated specifically, can free an issuer from a conflicting contractual obligation to its applicant. If, for example, an issuer promised its applicant that it would pay only against an inspection certificate of a particular company but failed to require such a certificate in its letter of credit or made the requirement only a nondocumentary condition that had to be disregarded, the issuer might be obliged to pay the beneficiary even though its payment might violate its contract with its applicant.

3. Parties should generally avoid modifying the definitions in Section 5-102. The effect of such an agreement is almost inevitably unclear. To say that something is a "guarantee" in the typical domestic transaction is to say that the parties intend that particular legal rules apply to it. By acknowledging that something is a guarantee, but asserting that it is to be treated as a "letter of credit," the parties leave a court uncertain about where the rules on guarantees stop and those concerning letters of credit begin.

4. Former Section 5-102 (2) and (3) of Article 5 are omitted as unneeded; the omission does not change the law.

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*** ANNOTATIONS CURRENT THROUGH APRIL 22, 2008 ***

TITLE 62A. UNIFORM COMMERCIAL CODE
ARTICLE 5. LETTERS OF CREDIT

GO TO REVISED CODE OF WASHINGTON ARCHIVE DIRECTORY

Rev. Code Wash. (ARCW) § 62A.5-110 (2008)

§ 62A.5-110. Warranties

(1) If its presentation is honored, the beneficiary warrants:

(a) To the issuer, any other person to whom presentation is made, and the applicant that there is no fraud or forgery of the kind described in *RCW 62A.5-109(1)*; and

(b) To the applicant that the drawing does not violate any agreement between the applicant and beneficiary or any other agreement intended by them to be augmented by the letter of credit.

(2) The warranties in subsection (1) of this section are in addition to warranties arising under Articles 3, 4, 7, and 8 because of the presentation or transfer of documents covered by any of those Articles.

HISTORY: 1997 c 56 § 11; 1965 ex.s. c 157 § 5-110.

NOTES:

OFFICIAL COMMENT

1. Since the warranties in subsection (a) are not given unless a letter of credit has been honored, no breach of warranty under this subsection can be a defense to dishonor by the issuer. Any defense must be based on Section 5-108 or 5-109 and not on this section. Also, breach of the warranties by the beneficiary in subsection (a) cannot excuse the applicant's duty to reimburse.

2. The warranty in Section 5-110 (a) (2) assumes that payment under the letter of credit is final. It does not run to the issuer, only to the applicant. In most cases the applicant will have a direct cause of action for breach of the underlying contract. This warranty has primary application in standby letters of credit or other circumstances where the applicant is not a party to an underlying contract with the beneficiary. It is not a warranty that the statements made on the presentation of the documents presented are truthful nor is it a warranty that the documents strictly comply under Section 5-108 (a). It is a warranty that the beneficiary has performed all the acts expressly and implicitly necessary under any underlying agreement to entitle the beneficiary to honor. If, for example, an underlying sales contract authorized the beneficiary to draw only upon "due performance" and the beneficiary drew even though it had breached the underlying contract by delivering defective goods, honor of its draw would break the warranty. By the same token, if the underlying contract authorized the beneficiary to draw only upon actual default or upon its or a third party's determination of default by the applicant and if the beneficiary drew in violation of its authorization, then upon honor of its draw the warranty would be breached. In many cases, therefore, the documents presented to the issuer will contain inaccurate statements (concerning the goods delivered or concerning default or other matters), but the breach of warranty arises not because the statements are untrue but because the beneficiary's drawing violated its express or implied obligations in the underlying transaction.

3. The damages for breach of warranty are not specified in Section 5-111. Courts may find damage analogies in Section 2-714 in Article 2 and in warranty decisions under Articles 3 and 4. Unlike wrongful dishonor cases -- where the damages usually equal the amount of the draw -- the damages for breach of warranty will often be much less than the amount of the draw, sometimes zero. Assume a seller entitled to draw only on proper performance of its sales contract. Assume it breaches the sales contract in a way that gives the buyer a right to damages but no right to reject. The applicant's damages for breach of the warranty in subsection (a) (2) are limited to the damages it could recover for breach of the contract of sale. Alternatively assume an underlying agreement that authorizes a beneficiary to draw only the "amount in default." Assume a default of \$200,000 and a draw of \$500,000. The damages for breach of warranty would be no more than \$300,000.

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TITLE 62A. UNIFORM COMMERCIAL CODE
ARTICLE 5. LETTERS OF CREDIT

GO TO REVISED CODE OF WASHINGTON ARCHIVE DIRECTORY

Rev. Code Wash. (ARCW) § 62A.5-115 (2008)

§ 62A.5-115. Statute of limitations

An action to enforce a right or obligation arising under this Article must be commenced within one year after the expiration date of the relevant letter of credit or one year after the cause of action accrues, whichever occurs later. A cause of action accrues when the breach occurs, regardless of the aggrieved party's lack of knowledge of the breach.

HISTORY: 1997 c 56 § 16; 1965 ex.s. c 157 § 5-115.

NOTES:

OFFICIAL COMMENT

1. This section is based upon Sections 2-725 (2) and 4-111.
2. This section applies to all claims for which there are remedies under Section 5-111 and to other claims made under this title, such as claims for breach of warranty under Section 5-110. Because it covers all claims under Section 5-111, the statute of limitations applies not only to wrongful dishonor claims against the issuer but also to claims between the issuer and the applicant arising from the reimbursement agreement. These might be for reimbursement (issuer v. applicant) or for breach of the reimbursement contract by wrongful honor (applicant v. issuer).
3. The statute of limitations, like the rest of the statute, applies only to a letter of credit issued on or after the effective date and only to transactions, events, obligations, or duties arising out of or associated with such a letter. If a letter of credit was issued before the effective date and an obligation on that letter of credit was breached after the effective date, the complaining party could bring its suit within the time that would have been permitted prior to the adoption of Section 5-115 and would not be limited by the terms of Section 5-115.

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CHAPTER 440 UNIFORM COMMERCIAL CODE
UNIFORM COMMERCIAL CODE
ARTICLE 5. LETTERS OF CREDIT

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MCLS § 440.5110 (2008)

MCL § 440.5110

§ 440.5110. Warranties on presentment or transfer.

Sec. 5110. (1) If presentation is honored, the beneficiary warrants:

(a) To the issuer, any other person to whom presentation is made, and the applicant that there is no fraud or forgery of the kind described in section 5109(1).

(b) To the applicant that the drawing does not violate any agreement between the applicant and beneficiary or any other agreement intended by them to be augmented by the letter of credit.

(2) The warranties in subsection (1) are in addition to warranties arising under articles 3, 4, 7, and 8 because of the presentation or transfer of documents covered by any of those articles.

HISTORY: Act 174, 1962, p 200; eff January 1, 1964.

Pub Acts 1962, No. 174, § 5110, by § 9991 eff January 1, 1964; amended by Pub Acts 1998, No. 488, imd eff January 4, 1999, by enacting § 1 eff January 1, 1999.

NOTES:

Effect of amendment notes:

The 1998 amendment rewrote the entire section.

Statutory references:

Section 5109, above referred to, is § 440.5109; articles 3, 4, 7 and 8 are §§ 440.3101 et seq., 440.4101 et seq., 440.7101 et seq. and 440.8101 et seq.

Comments of National Conference of Commissioners and American Law Institute

Prior Uniform Statutory Provision:

None.

Purposes:

1. The beneficiary may desire to draw more than one draft under the credit, each draft accompanied, for instance, by documents evidencing a single shipment under the underlying sales contract. Subsection (1) makes clear that unless otherwise specified he may do so. Of course, if he does, each draft and its accompanying documents must satisfy the

terms of the credit and their total must not exceed its amount. See comment to Section 5-108(3) on exhaustion of a credit on the rule governing the situation in which the total drafts drawn do total more than the maximum amount of the credit.

2. The entire purpose of the usual letter of credit transaction, from the customer's point of view, is to induce the beneficiary to deliver to him through the issuer the documents described in the credit. The buying customer wants the goods, and arranges the transaction in order to get the documents controlling the goods. Therefore, upon honor of the draft, the documents must be delivered free of claims even though the letter of credit is not for the full invoice price and any reservation of claim makes the draft noncomplying. A beneficiary who wishes to prevent such delivery must do so by agreement with the customer in the underlying contract and must treat the failure to provide a sufficient letter of credit as a breach of that contract (Section 2-325). So far as the issuer's duty to honor is concerned, the terms of the letter of credit are controlling and the rule of subsection (2) is applicable.

Cross-references:

Point 1: Section 5-108.

Point 2: Sections 2-325, 5-114.

Definitional Cross-references:

"Beneficiary." Section 5-103.

"Credit." Section 5-103.

"Document." Section 5-103.

"Documentary draft." Section 5-103.

"Draft." Section 3-104.

"Honor." Section 1-201.

"Person." Section 1-201.

Cross References:

Varying provisions of act by agreement, § 440.1102.

Definition of various terms used in this section, §§ 440.1201, 440.3104, 440.5103.

Failure to furnish letter of credit, § 440.2325.

Substitute performance or payment, § 440.2614.

Michigan Digest references:

Uniform Commercial Code § 245

LexisNexis(TM) Michigan analytical references:

Michigan Law and Practice, Banks and Banking § 35

Other LexisNexis(TM) analytical references:

Forms and Procedures Under the Uniform Commercial Code (Bender's UCC Service) §§ 52.17, 52.19, 52.25

ALR notes:

What constitutes compliance of documents presented with terms of letter of credit so as to require honor of draft under *UCC sec. 5-114*, 8 ALR5th 463.

Research references:

50 Am Jur 2d, Letters of Credit § 36

6A Am Jur Pl & Pr Forms, Rev, Commercial Code, Article 5, Letters of Credit §§ 5:40--5:46

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CHAPTER 440 UNIFORM COMMERCIAL CODE
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ARTICLE 5. LETTERS OF CREDIT

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MCLS § 440.5115 (2008)

MCL § 440.5115

§ 440.5115. Commencement of action.

Sec. 5115. An action to enforce a right or obligation arising under this article must be commenced within 1 year after the expiration date of the relevant letter of credit or 1 year after the cause of action accrues, whichever occurs later. A cause of action accrues when the breach occurs, regardless of the aggrieved party's lack of knowledge of the breach.

HISTORY: Act 174, 1962, p 200; eff January 1, 1964.

Pub Acts 1962, No. 174, § 5115, by § 9991 eff January 1, 1964; amended by Pub Acts 1998, No. 488, imd eff January 4, 1999, by enacting § 1 eff January 1, 1999.

NOTES:

Effect of amendment notes:

The 1998 amendment rewrote the entire section.

Comments of National Conference of Commissioners and American Law Institute

Prior Uniform Statutory Provision:

None.

Purposes:

1. Subsection (1) states the rights of a person entitled to honor, both with respect to any documents and against the issuer, when there is wrongful dishonor. Whether dishonor is wrongful and whether a particular person is entitled to honor depend on the terms of the credit and on the provisions of this Article, particularly Section 5--114 on the issuer's duty to honor and Section 5-116 on transfer and assignment.

2. Subsection (2) states the rights of the beneficiary upon repudiation of the credit, both against the issuer and with respect to any documents or goods. Note that wrongful dishonor of a draft for a portion of the credit is dishonor of the credit under Section 5-112(1), and makes applicable subsection (2) of this section as well as subsection (1).

3. Both subsections are limited to irrevocable credits. Since under Section 5-106(3) revocable credits may be modified or revoked without notice to the customer or the beneficiary, rights against the issuer like those here provided can hardly arise under them. The rights of innocent third persons under revocable credits are governed by Section 5-106(4) rather than by this section.

MCLS § 440.5115

Cross-references:

- Point 1: Sections 2-707, 2-710, 5-114 and 5-116.
 Point 2: Sections 2-610, 2-611, 2-703 through 2-706, and 5-112.
 Point 3: Section 5-106.

Definitional Cross-references:

- "Action." Section 1-201.
 "Beneficiary." Section 5-103.
 "Credit." Section 5-103.
 "Document." Section 5-103.
 "Draft." Section 3-104.
 "Issuer." Section 5-103.
 "Person." Section 1-201.
 "Rights." Section 1-201.

Cross References:

- Definition of various terms used in this section, §§ 440.1201, 440.3104, 440.5103.
 Deferral of honor of documentary draft, § 440.5112.
 Honor of draft or demand for payment, § 440.5114.
 Transfer or assignment of right to draw under credit, effect, § 440.5116.

Michigan Digest references:

- Uniform Commercial Code* § 245

LexisNexis(TM) Michigan analytical references:

- Michigan Law and Practice, Banks and Banking* § 35

Other LexisNexis(TM) analytical references:

- Forms and Procedures Under the Uniform Commercial Code (Bender's UCC Service)* §§ 24.41, 52.11, 52.25

ALR notes:

- Damages recoverable for wrongful dishonor of letter of credit under *UCC* § 5-115, 2 ALR4th 665.

Research references:

- 50 *Am Jur 2d, Letters of Credit* §§ 80, 81
 17 *Am Jur Proof of Facts* 3d 541, *Banking Negligence-Improper Dishonor of Letter of Credit*
 6A *Am Jur Pl & Pr Forms, Rev, Commercial Code, Article 5, Letters of Credit* §§ 5:70--5:74

CASE NOTES

One year statute of limitations in *MCLS* § 440.5115 barred certain shareholders' claim for wrongful collection of a letter of credit against a brewer, who had a contract, secured by the letter of credit, with the corporation owned by the shareholders. *Krause v Stroh Brewery Co.* (2002, *ED Mich*) 240 *F Supp 2d* 632, 48 *UCCRS2d* 1094.

LEXSEE 240 F. SUPP.2D 632

KURT W. KRAUSE, BETTE KRAUSE, RICHARD J. ETCHINSON, and ROSELEE ETCHINSON, Plaintiffs, v. STROH BREWERY COMPANY, an Arizona Corporation, Defendant.

CASE NO. 02-71622

UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF MICHIGAN, SOUTHERN DIVISION

240 F. Supp. 2d 632; 2002 U.S. Dist. LEXIS 14947; 48 U.C.C. Rep. Serv. 2d (Callaghan) 1094

July 18, 2002, Decided

July 18, 2002, Filed

DISPOSITION: [**1] Counts I -- V of Plaintiffs' complaint DISMISSED.

COUNSEL: For Kurt W Krause, Bette Krause, Richard J Etchinson, Roselee Etchinson, PLAINTIFFS: Elias Muawad, Muawad & Muawad, Southfield, MI USA.

For Stroh Brewery Company, DEFENDANT: Eugene H Boyle, Jr, Howard W Burdett, Jr, Butzel Long, Detroit, MI USA.

JUDGES: PRESENT: THE HONORABLE LAWRENCE P. ZATKOFF, CHIEF UNITED STATES DISTRICT JUDGE.

OPINION BY: LAWRENCE P. ZATKOFF

OPINION

[*634] OPINION AND ORDER

AT A SESSION of said Court, held in the United States Courthouse, in the City of Detroit, State of Michigan, on 18 JUL 2002

PRESENT: THE HONORABLE LAWRENCE P. ZATKOFF

CHIEF UNITED STATES DISTRICT JUDGE

I. INTRODUCTION

This matter is before the Court on Defendant's Motion to Dismiss. Plaintiffs responded. Plaintiffs also submitted a supplemental response. The Court finds that the parties have adequately set forth the relevant law and

facts, and that oral argument would not aid in the disposition of the instant motion. *See* E.D. MICH. L.R. 7.1(e)(2). Accordingly, the Court ORDERS that the motion be decided on the briefs submitted. For the reasons stated below, Defendant's Motion to Dismiss is GRANTED.

II. BACKGROUND

Defendant [**2] used to be in the business of brewing beer and other beverages. Defendant would also brew beer for other companies; a practice that is known as contract brewing. On April 6, 1998, Defendant entered into a contract brewing agreement (hereinafter "agreement") with the Northland Beverage Corporation (hereinafter "Northland"), in which Defendant agreed to manufacture and package two brands of malted beverages, respectively known as "Two Dogs" and "Hard Rock," for Northland. In order to secure this agreement, Northland gave Defendant a \$ 400,000 letter of credit through its bank, First Union National Bank. Plaintiffs, owners and shareholders of Northland, used their personal assets to secure the letter of credit.

On April 29, 1999, Defendant collected on the \$ 400,000 letter of credit. Plaintiffs allege in their five-count complaint that the collection was wrongful because, as part of the agreement, Defendant agreed to not collect on the letter of credit unless Northland was in default. The five counts are as follows: Conversion (Count I); Breach of Contract / Implied Contract / Third Party Beneficiary (Count II); Unjust Enrichment (Count III); Promissory Estoppel (Count IV); and Negligence [**3] (Count V).

Defendant counters that it was justified in collecting on the letter of credit because Northland was \$

327,767.16 past due on its payments. In addition, Defendant brings this motion pursuant to *FED. R. CIV. P. 12(b)(6)*, arguing that Plaintiffs failed to state a claim upon which relief may be granted. Defendant argues that Plaintiffs are barred by the statute of limitation, and that Plaintiffs, who are not parties to either the agreement or the letter of credit, have no standing to assert a claim.

III. LEGAL STANDARD

A motion brought pursuant to *FED. R. CIV. P. 12(b)(6)* for failure to state a claim upon which relief may be granted tests the legal sufficiency of Plaintiffs' claims. The Court must accept as true all factual allegations in the pleadings, and any ambiguities must be resolved in Plaintiffs' favor. See *Jackson v. Richards Med. Co.*, 961 F.2d 575, 577-78 (6th Cir. 1992). The [*635] Court, however, need not accept as true legal conclusions or unwarranted factual inferences. See *Morgan v. Church's Fried Chicken*, 829 F.2d 10, 12 (6th Cir. 1987). The Court may properly grant a motion to dismiss when no set of facts exists that would [**4] allow Plaintiffs to recover. See *Carter by Carter v. Cornwell*, 983 F.2d 52, 54 (6th Cir. 1993).

IV. ANALYSIS

A. Choice-of-Law

The Court begins its analysis with noting that the parties are from two different states: Plaintiffs are from Florida, and Defendant brewed beer in Michigan. The Court must therefore decide which state's law to apply. When sitting in diversity, this Court applies the choice-of-law provisions of the forum state. See *Davis v. Sears, Roebuck and Co.*, 873 F.2d 888, 892 (6th Cir. 1989). As for Plaintiffs' contract claims, Michigan law permits the parties to choose for themselves which state's law will govern their contracts, so long as the chosen state has some relationship to the parties or the transaction, and the law of the chosen state is not contrary to a fundamental policy of the forum state. See *Johnson v. Ventra Group, Inc.*, 191 F.3d 732, 738 (6th Cir. 1999).

In the present case, the agreement between Northland and Defendant contains a choice-of-law provision that states: "This agreement shall be governed by and construed in accordance with the provision of the laws of the State of Michigan." The [**5] Court finds that Michigan has a relationship with the parties and the transaction: Defendant was from Michigan, and brewed beer in Michigan for Northland. Further, the Court is aware of no other reason why it should not apply Michigan law to the present action. Therefore, the Court shall apply Michigan law to Plaintiffs' contract claims.

As for Plaintiffs' tort claims, the Court shall also apply Michigan law. For tort claims, Michigan presumes that the law of the forum state applies, unless there is a rational reason to apply another state's law. See *Sutherland v. Kennington Truck Serv., Ltd.*, 454 Mich. 274, 562 N.W.2d 466, 471 (Mich. 1997). There is a rational reason to apply another state's law if that state's interest in having its law applied outweighs the forum state's interest in having its own law applied. 562 N.W.2d at 470-71. Here, Plaintiffs are from Florida. That fact alone, however, does not justify the use of Florida law. See *id.* (citing *Home Ins. Co. v. Dick*, 281 U.S. 397, 408, 74 L. Ed. 926, 50 S. Ct. 338 (1930)). Even if it were, the Court finds that Michigan has an interest in applying its own laws because Defendant was a resident [**6] of Michigan, and conducted the allegedly tortious conduct while it was located within the state. Therefore, the Court shall apply Michigan tort law.

B. Statute of Limitations

Michigan's enactment of Article 5 of the Uniform Commercial Code governs transactions involving letters of credit. See *MICH. COMP. LAWS § 440.5101 et seq.* Article 5 includes a one-year statute of limitations period for any "action to enforce a right or obligation arising under this article" See *MICH. COMP. LAWS § 440.5115*. Article 5 also provides a cause of action for wrongfully collecting on a letter of credit. See *MICH. COMP. LAWS § 440.5110(1)(b)* ("If presentation is honored, the beneficiary warrants: (b) To the applicant that the drawing does not violate any agreement between the applicant and beneficiary . . ."). Therefore, the one-year statute of limitations applies to actions for wrongfully collecting upon letters of credit.

[*636] Plaintiffs allege that one condition of Northland's agreement with Defendant was that the latter would not collect upon the letter of credit unless Northland was in default, which Defendant allegedly violated. In other words, Plaintiffs allege that [**7] Defendant wrongfully collected upon a letter of credit. The Court finds that this action, which arises out of Northland's agreement with Defendant, is governed by Article 5. See *MICH. COMP. LAWS § 440.5102(1)* ("This article applies to letters of credit and to certain rights and obligations arising out of transactions involving letters of credit."). The alleged wrongful collection occurred on April 29, 1999, however, this action was not filed until nearly three years later, April 24, 2002. Consequently, all claims that arise pursuant to the agreement are barred by the one-year statute of limitations. Three of Plaintiffs' claims are based on this agreement: Breach of Contract / Implied Contract / Third Party Beneficiary (Count II); Unjust Enrichment (Count III); and Promissory Estoppel

(Count IV). Therefore, Counts II, III, and IV are DISMISSED.

C. Tort Claims

Plaintiffs' two tort claims shall also be DISMISSED. "As a general rule, there must be some active negligence or misfeasance to support a tort. There must be some breach of duty distinct from breach of contract." *Rinaldo's Const. Corp. v. Michigan Bell Tel. Co.*, 454 Mich. 65, 559 N.W.2d 647, 657 (Mich. 1997) [**8] (quoting *Hart v. Ludwig* 347 Mich. 559, 79 N.W.2d 895, 897 (Mich. 1956)). In other words, "the threshold inquiry is whether the plaintiff alleges violation of a legal duty separate and distinct from the contractual obligation." See 559 N.W.2d at 658. With regard to the tort claims -- Conversion (Count I), and Negligence (Count V) --

Plaintiffs' allege that they arise out of the same agreement as do Plaintiffs' Counts II -- IV. Therefore, Plaintiffs' tort claims shall be DISMISSED because they do not arise out of a separate and distinct legal duty as does the contractual obligation.

V. CONCLUSION

Therefore, for the reasons stated above, Counts I -- V of Plaintiffs' complaint are DISMISSED.

IT IS SO ORDERED.

LAWRENCE P. ZATKOFF

CHIEF UNITED STATES DISTRICT JUDGE

Dated 18 JUL 2002

Appendix D

LEXSEE 650 F. SUPP. 583

ENSCO ENVIRONMENTAL SERVICES, INC., Plaintiff v. UNITED STATES OF AMERICA; UNITED STATES OF AMERICA, DEPARTMENT OF THE ARMY; JOHN O. MARSH, JR., Secretary of the Army; and COLONEL ROBERT M. AMRINE, Defendants

No. 86-1264-CV-W-3

UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF MISSOURI, WESTERN DIVISION

650 F. Supp. 583; 1986 U.S. Dist. LEXIS 16288; 2 U.C.C. Rep. Serv. 2d (Callaghan) 1613

December 18, 1986, Decided

COUNSEL: **[**1]** Carl Helmstetter and Mark Thornhill of Spencer, Fane, Britt & Browne, for Plaintiffs.

Carlton M. Henson II and Gregg E. Bundschuh of Peterson, Young, Self & Asselin, for Defendants.

JUDGES: Elmo B. Hunter, Senior District Judge

OPINION BY:

OPINION

[*584] MEMORANDUM AND ORDER

The controversy in this case centers around an Army Corps of Engineers' contract to clean up a hazardous waste site in New Jersey. Plaintiff EnSCO Environmental Services, Inc. ("EES Inc.") was low bidder on the contract, but was not awarded the contract. The Corps of Engineers felt that its bid was unresponsive to the bid specifications because its bid guarantee was invalid. EES Inc. then filed this action seeking an injunction preventing the Corps of Engineers from allowing the second lowest bidder to proceed and a declaration that EES Inc. is to be awarded the contract. On December 1, 1986, a hearing was held to determine whether Plaintiff was entitled to preliminary relief. At the hearing, counsel on both sides indicated a willingness to go forward on the merits in the near future. Given the urgency in beginning the clean up of the hazardous waste at the project site and since very few important facts **[**2]** seemed to be in dispute, the Court agreed to hold a full trial on the merits during the following week if the parties would attempt to stipulate to as many facts as possible. The parties agreed to do so. The trial was held on December 9, 1986.

[*585] JURISDICTION AND VENUE

This Court has jurisdiction pursuant to 28 U.S.C. § 1331 and 5 U.S.C. § 702. Likewise, venue is proper in the Western District of Missouri under 28 U.S.C. § 1391(e).

BACKGROUND

The Army Corps of Engineers, Kansas City District, issued invitation for bid No. DACW41-86-B-0121 on April 22, 1986. The invitation sought bids from companies interested in working on a project described as "The Tank Farm Demolition, Bridgeport Rental Oil Services Site, Logan Township, New Jersey." ("Tank Farm Project"). The Bridgeport Rental Oil Services site consists of over 90 tanks and process vessels, drums and trucks and a twelve acre waste oil and waste water lagoon. The lagoon and many of the tanks contain significant quantities of polychlorinated biphenyls ("PCBs") and a number of other hazardous substances. The site is listed as number 35 on a list of 703 hazardous waste sites prioritized for cleanup under the Comprehensive **[**3]** Environmental Response Compensation and Liability Act ("CERCLA"), 42 U.S.C. § 9601 et seq. See 40 C.F.R. § 300 app. B (1986). The work to be done on the Tank Farm Project includes, *inter alia*, the removal and demolition of all tanks and other structures on the site and the removal of hazardous wastes stored on the site. The Corps of Engineers became involved in the project under an inter-agency agreement between the EPA and the Corps.

Sealed offers to bid on the project were to be delivered to the Army Corps of Engineers office in Kansas City, Missouri, by 3:00 p.m. Local Time on September 10, 1986. Each bid was to be accompanied by a bid guarantee. The bid solicitation provisions provided that fail-

ure to furnish "a bid guarantee in the proper form and amount, by the time set for opening of bids, may be cause for rejection of the bid." ¹ Tank Farm Project solicitation Provisions at SP-8. EES Inc. and three other companies submitted bids for the project. When the bids were opened on September 10, 1986, it was announced that EES Inc. had submitted the apparent low bid.

I The solicitation provision further provides:

The offerer (bidder) shall furnish a bid guarantee in the form of a firm commitment, such as a bid bond, postal money order, certified check, cashier's check, irrevocable letter of credit, or, under Treasury Department regulations, certain bonds or notes of the United States

Tank Farm Project Solicitation Provisions at SP-8. The guarantee ensures that the government is protected in the event the successful bidder fails to execute the necessary contractual documents or fails to give the bond(s) required for the project within the specified time. If either occurs and the successful bidder is held in default, the bidder is liable for the excess cost to the government of having someone else do the work.

[**4] At the bid opening, all bids were given a cursory examination by the Bid Opening Officer, Mr. Ralph E. Yaple, and by an Assistant District Counsel for the Corps, Mr. Mark Collins. They found that EES Inc. had submitted an irrevocable letter of credit as its bid guarantee. Both Mr. Yaple and Mr. Collins considered this to be a somewhat unusual form for a bid guarantee since bidders generally used bid bonds, rather than letters of credit as guarantees. Because of this, Mr. Collins later examined the letter of credit in more detail. He found that the applicant of the letter of credit was a company named Environmental Systems Company of Little Rock, Arkansas ("ESC"), not EES Inc. The bid listed EES Inc. as a New York Corporation ² located in North Tonawanda, New York. ENSCO, Inc. ("ENSCO") of Little Rock, Arkansas, was listed as EES Inc.'s parent corporation in the bid document. Thus, ESC, the applicant on the letter of credit was a third company, not otherwise referred to in the bid documents submitted by EES Inc. ³

² Mr. Frederic Schwartz, Vice President of Marketing at EES Inc., testified at trial that this was a mistake. He said that EES Inc. is an Arkansas Corporation that is registered to do business in New York.

[**5]

³ However, the letter of credit listed ESC's address as 1015 Louisiana, Little Rock, Arkansas. The bid documents listed this as ENSCO's address.

[*586] On September 15, 1986, Mr. Yaple called the office of EES Inc. in New York to find out the relationship, if any, between EES Inc. and ESC. He testified that he attempted to talk to Mr. Frederic M. Schwartz, the person who had signed the bid solicitation for EES Inc. However, Mr. Yaple did not reach Mr. Schwartz and instead talked with another person whose name he could not recall. ⁴ Mr. Yaple testified that the person he talked with confirmed that EES Inc. was a New York corporation and that ENSCO of Little Rock was the Parent company of EES Inc. He further testified that the person told him that ESC and ENSCO were one and the same company.

⁴ Plaintiff objected to Mr. Schwartz's testimony regarding the phone call to EES Inc. on hearsay grounds. The Court sustained the objection, but let the testimony in for the limited purpose of showing the state of mind of Col. Robert M. Amrine, the Contracting Officer, when he determined that the letter of credit was not a valid bid guarantee.

[**6] On September 15, 1986, Mr. Collins contacted MBank Dallas ("MBank"), the Bank that issued the letter of credit, in order to determine if the applicant on the letter of credit (ESC) and the bidder (EES Inc.) were the same legal entity. He spoke with a Mr. Regan Stewart who informed him that he should contact a Mr. Jim Dawson. The next day, Mr. Collins spoke with Mr. Dawson who informed him that ESC was his customer and that the letter of credit was issued at ESC's request. ⁵ Mr. Dawson also told him that ESC was a Delaware corporation headquartered in Little Rock, Arkansas. Mr. Collins further testified that Mr. Dawson told him that he did not know of and was not familiar with a company called ENSCO Environmental Services, Inc. of New York.

⁵ Again, the telephone conversation between Mr. Collins and Mr. Dawson was allowed into evidence only to show Colonel Amrine's state of mind in rejecting EES Inc.'s bid guarantee. See *supra*, note 4.

On September 18, 1986, Mr. Collins issued a legal opinion recommending [**7] that EES Inc.'s bid be rejected as nonresponsive because the applicant on the letter (ESC) of credit was not the same entity as the bidder (EES Inc.). In essence, his opinion stated that when the applicant and bidder are different entities, the bid

guarantee would not be effective as against the applicant should the bidder default. He cited several decisions of the Comptroller General of the United States which supported this position. *In re S&S Constructing*, Comp. Gen. No. B-214927, 84-1 CPD P 670 (1984); *In re Future Electric Co.*, Comp. Gen. No. B-212938, 84-1 CPD P 216 (1984); *In re A.D. Roe Co., Inc.*, Comp. Gen. No. B-181692, 74-2 CPD P 194 (1974).

On September 19, 1986, the Corps received an organizational chart from the bidder. The chart showed that ENSCO, Inc. was the parent company of EES Inc. and ESC was the parent company of ESC. ⁶ It is unclear whether Mr. Collins had access to this information prior to issuing his legal opinion. However, the legal opinion makes clear that his recommendation would be the same whether the applicant and bidder were parent-subsidiary corporations or entirely independent entities.

⁶ This information was sent to show that Mr. Schwartz, who signed the bid for the Plaintiff, had authority to legally bind the Plaintiff. Apparently, there was some question of this on the face of the bid documents.

[**8] On or around September 23, 1986, the Contracting Officer, Colonel Amrine, signed an internal document entitled "Determination and Findings" ⁷ which stated that he had determined that EES Inc.'s bid was nonresponsive because the letter of credit "was not made in favor of the principal which submitted the bid." Thereafter, on September 30, 1986, the Tank Farm contract was awarded to Rollins Environmental Services, F.S., Inc., the second lower bidder.

⁷ The document was not dated, but Mr. Yapple who prepared the document for Col. Amrine's signature stated that to the best of his knowledge the Colonel signed it on September 23, 1986.

[*587] EES Inc. telephoned the Corps on October 1, 1986, to inquire about the status of the contract and was informed that Rollins had been awarded the contract. ⁸ On October 2, 1986, EES Inc. filed a formal protest of the Corps' decision with the General Accounting Office (GAO) asking the GAO to either waive the error or to allow it to submit a corrected letter of credit. ⁹ [**9]

⁸ EES Inc. received a letter dated October 3, 1986, formally notifying it that its bid had been rejected.

⁹ An amendment to the letter of credit, changing the applicant's name to EES Inc., was received by the Corps on October 3, 1986.

The Comptroller General issued a decision on October 9, 1986, which dismissed the Plaintiff's protest as

being without merit. *In re ENSCO Environmental Services, Inc.*, Comp. Gen. No. B-224266 (Oct. 9, 1986). The decision stated that a bid guarantee which names a principal different from the bidder is materially deficient and cannot be waived as a minor error or corrected after opening. *Id.* Plaintiff then filed a request for reconsideration with the GAO. On October 24, 1986, the Comptroller General denied the Plaintiff's request for reconsideration of its earlier decision. The Comptroller noted that the letter of credit indicated that MBank Dallas agreed to be bond "only on behalf of [EES Inc.'s] parent company." *In re ENSCO Environmental Services, Inc.*, Comp. [**10] Gen. No. B-224266.2 (Oct. 24, 1986). Relying on suretyship principles, the decision stated: "it is doubtful whether the Corps could enforce the letter of credit if [EES Inc.] failed to carry out its obligations [and] as a result, the letter of credit is deficient." *Id.* Thereafter, on November 26, 1986, Plaintiff filed the instant action.

STANDARD OF REVIEW

It should first be noted that the Court is reviewing the actions of the Contracting Officer, not those of the Comptroller General. This is because the officer's action is considered the "final action" within the meaning of the Administrative Procedure Act. *5 U.S.C. § 500. See Simpson Electrical Co. v. Seaman*, 317 F. Supp. 684, 686 (D.D.C. 1970).

The parties seem to be in agreement, and the Court concurs, that the Contracting Officer's decision should not be overturned unless it was "arbitrary, capricious, an abuse of discretion or otherwise not in accordance with law." *5 U.S.C. § 706(1)(A). See M. Steinthal & Co. v. Seaman*, 147 U.S. App. D.C. 221, 455 F.2d 1289, 1301 (D.C. Cir. 1971). This is a narrow standard of review; "agency action is arbitrary and capricious only where it is not supportable on any rational [**11] basis." *Brotherhood of Ry. & Airline Clerks v. Burlington Northern, Inc.*, 722 F.2d 380, 381 (8th Cir. 1983). Under this standard the Court may not substitute its own judgment as that of the agency. *Id.*

ANALYSIS

I

The preliminary issue is whether the letter of credit issued by MBank was legally valid so as to bind the bank to pay the Corps of Engineers in the event that EES Inc. defaulted.

As mentioned, the Corps of Engineers relied on suretyship principles in finding the letter of credit invalid; the Defendants base their argument herein on the same rationale. They argue that MBank was only obliged to pay on the letter of credit if the applicant, ESC, defaulted on the beneficiary, the Corps of Engineers. And,

since *EES Inc.* was the bidder, the bank would not have to pay if *EES Inc.* defaulted. Therefore, they argue the letter of credit is not a valid bid guarantee. This is the rationale used by the Comptroller General in *In re S&S Contracting, supra*, which held that a letter of credit was an invalid bid guarantee if the applicant was not the bidder. *In re S&S Contracting*, adopted its analysis from Comptroller decisions which hold that a bid bond that names **[**12]** a principal different from the bidder is not a valid bid guarantee. See *In re A. D. Roe* **[*588]** *Co., Inc.*, 54 *Comp. Gen.* 271, 74-2 CPD P 194 (1974); *In re Future Electric Co.*, B-212938, 84-1 CPD P 216 (1984).

The Defendant's (and Comptroller General's) reliance on bid bond cases to analyze the enforceability of a letter of credit is misplaced. The legal operation of a letter of credit is distinct from that of a bid bond. A bid bond is a surety agreement. In a surety or guarantor situation, the surety is not primarily liable to the beneficiary. Its liability is governed by the liability of the principal on the underlying transaction. *Asociacion de Azucareros de Guatemala v. United States National Bank*, 423 F.2d 638, 641 (9th Cir. 1970). Thus, it is logical to hold that a bid bond is an insufficient guarantee when it has a principal different from the bidder. If the principal owes no liability to the beneficiary, then the surety does not either and the beneficiary is not protected by the bid bond.

However, a letter of credit, unlike a bid bond, is not a surety agreement. See J. White & R. Summers, *Handbook of the law Under The Uniform Commercial Code*, § 18-2 (1985). **[**13]** A letter of credit is "an engagement by a bank . . . made at the request of a customer . . . that the [bank] will honor drafts or other demands for payment upon compliance with the conditions specified in the credit." U.C.C. § 5-103(1)(A). A letter of credit is independent of the underlying transaction. See *Bossier Bank & Trust v. Union Planters National Bank*, 550 F.2d 1077, 1081 (6th Cir. 1977) Appendix A. (Memorandum Opinion Honorable Bailey Brown, Chief Judge W.D. Tenn.). The bank, upon issuance of the letter of credit, becomes primarily liable to the beneficiary of the credit. *Republic National Bank v. Northwest National Bank*, 578 S.W.2d 109, 114 (Tex. 1979). The beneficiary of the credit is entitled to payment upon compliance with the terms and conditions of the credit. See *East Girard Savings Association v. Citizens National Bank & Trust Company*, 593 F.2d 598, 602 (5th Cir. 1979). With narrow exceptions, the bank must honor the draft drawn on the letter unless the documents required to be presented are inconsistent on their face. U.C.C. § 5-109(2). The bank is not to make reference to the rights and obligations to the parties to the underlying contract in deciding **[**14]** whether to pay. See *Republic National Bank*, 578 S.W.2d at 114. From the above discussion, it is abundantly

clear that the principles of suretyship are not pertinent to an analysis of the force and effect of a letter of credit.¹⁰

10 Given this, the Court rejects the Comptroller General's decision in *S&S Contracting, supra*, insofar as it applies surety principles to letters of credit.

Unfortunately, because the credit in this action was somewhat unique, the case law on letters of credit does not provide an easy answer to the question of whether MBank was obligated to honor the letter if the Plaintiff breached its agreement with the Corps.

The typical letter of credit involves three parties (issuer, customer/applicant, and beneficiary) and three separate transactions: (1) the contract between the bank and its customer to issue a letter of credit; (2) the letter of credit in which the issuing bank agrees to pay the beneficiary when the conditions contained in the letter are complied with; and (3) the **[**15]** underlying contract between the customer and the beneficiary for which the letter of credit was obtained. See *Barclays Bank D.C.O. v. Mercantile National Bank*, 481 F.2d 1224, 1239 n. 21 (5th Cir. 1973), cert. dismissed, 414 U.S. 1139, 94 S. Ct. 888, 39 L. Ed. 2d 96 (1974).

This case is unique because it involves 4 parties: ESC, (applicant/customer), MBank (issuing Bank), the Corps of Engineers (beneficiary), and *EES Inc.* (the entity that used the letter of credit as a bid guarantee.) No case was found by either the Court or the parties which addressed the question of whether such a credit is valid. ¹¹ However, the Court is of the opinion **[*589]** that a "four party" letter of credit is not *per se* invalid. Nothing in the U.C.C. precludes the validity of a credit simply because the applicant is not involved in the underlying contract or otherwise in privity with the beneficiary. In fact, the primary purpose for using a letter of credit is to make payment from the bank independent of the underlying contract. See generally *White & Summers, supra*, § 18-1. ¹² As mentioned, this is accomplished by making the issuer of the credit primarily liable without regard to the **[**16]** underlying contract. *Republic Bank*, 578 S.W.2d at 114.

11 It is not unusual for a bank to issue a letter of credit at the request of a "fourth party", with the bank looking to the "fourth party" for reimbursement if it pays a draft drawn on the letter. In such cases, however, the person who needs the credit for his dealings with the beneficiary is usually listed as the applicant on the letter of credit. See, e.g., *East Girard Savings Association v. Citizens National Bank & Trust Co.*, 593 F.2d 598 (5th Cir. 1979).

12 Letters of credit were originally used to facilitate international transactions involving sales of merchandise by assuring payment for the goods. In a typical transaction, a seller in a distant country might wish to sell some goods to a buyer whose credit he did not trust. In order to ensure that the goods would be paid for, the seller could require the buyer to procure a letter of credit which would provide that upon presentation of certain documents -- normally bills of lading or air freights receipts -- evidencing title to the goods, the seller could draw on the letter of credit. The issuing bank would then take a security interest in the goods and deliver the title documents to the buyer, who would be obligated to repay the amount drawn on the letter of credit.

East Girard Savings Ass'n. 593 F.2d at 601 (citations omitted).

[**17] Since the four party nature of the credit does not preclude its enforceability, the next question is: Could the Corps have legally required MBank to honor the letter of credit?

A beneficiary of a letter of credit must strictly comply with its terms in order to receive payment under the credit *Consolidated Aluminum Corp. v. Bank of Virginia*, 704 F.2d 136, 168 (4th Cir. 1983); *Insurance Co. of North America v. Heritage Bank*, 595 F.2d 171, 173 (3d Cir. 1979). Without such strict compliance the bank is not required to pay. For example, if MBank's letter of credit had stated that it would only be paid if the applicant, ESC, breached its agreement with the Corps on the Tank Farm Project Bid, the government could not have received payment on the letter, because ESC did not bid on the project, *EES Inc. did*.

MBank's letter of credit provides in pertinent part: ¹³

We hereby issue our Clean Irrevocable Standby Letter of Credit in your favor available by your draft on us at sight bearing the clause "Drawn under MBank - Dallas, N.A. Letter of Credit No, 2596968-215 dated September 10, 1986," accompanied by this original Letter of Credit.

Special Instructions: Negotiations [**18] restricted to MBank - Dallas, N.A. PARTIAL DRAWINGS ARE NOT PERMITTED.

This Letter of Credit is for Fed. #DACW 41-86-B-0121.

13 The entire letter of credit is reprinted in full in the Appendix.

On its face, it only requires that a draft, accompanied by the original letter of credit, be presented to MBank. "However, the terms "Clean", "Irrevocable" and "Standby" are terms of art which may imply additional conditions on payment.

In essence, "irrevocable" means that once a letter of credit is sent to the beneficiary it cannot be modified or revoked without the consent of both the applicant and the beneficiary. *U.C.C. § 5-106(1)* and (2). A "clean" letter of credit "is payable merely upon presentation of a draft with no accompanying documents." *Apex Oil Co. v. Archem Co.* 770 F.2d 1353, 1355 (5th Cir. 1985). Clean letters of credit are distinguishable from "documentary" letters of credit which require presentation of a document of independent legal significance, such as a certificate of title [**19] or an invoice, in order to receive payment. *Id.*

[*590] A "standby" letter of credit is one that is only to be called upon if there is a default in the underlying contract. *First Empire Bank v. Federal Deposit Insurance Corp.*, 572 F.2d 1361, 1367 (9th Cir.) cert. denied, 439 U.S. 919, 58 L. Ed. 2d 265, 99 S. Ct. 293 (1978); *Temtex Products, Inc. v. Capital Bank & Trust Co.*, 623 F. Supp. 816 (D.La. 1985) aff'd, 788 F.2d 1563 (5th Cir. 1986). "Therefore, a standby letter of credit will often be a documentary letter of credit since the issuer will require some kind of accompanying documentation to indicate or establish that there has been a default, making it liable to pay." *Apex Oil Co.*, 770 F.2d at 1356. A letter of credit not expressly labeled as such can be treated as a standby letter because of other conditions contained in the letter. *Id.*

MBank's letter states that it is a "clean letter" and on its face it requires no explicit proof of notice of any default on the underlying obligation. One could argue that by labeling it standby and referring to the bid by number, the letter required documentation of default. And, the Corps could not document that [**20] ESC had defaulted, since it was not a bidder. A Fifth Circuit case, *United States v. Sun Bank of Miami*, 609 F.2d 832 (5th Cir. 1980), indicates otherwise.

In *Sun Bank*, the Bank issued a letter of credit which stated that the "funds are to be used and disbursed by [the beneficiary] as supplement funds to complete Camino Real Condominiums . . ." *Id.* at 833. The beneficiary drew a draft on the letter of credit payable to the United States Department of Treasury to pay delinquent taxes. The bank refused to pay the draft because it felt that "payment would contravene the designated purpose

of the letter of credit." *Id.* The Court stated: "Because the letter of credit in this case did not expressly require that the draft show the funds' intended use or that supporting documents accompany the letter of credit, the banks ought to have honored the otherwise unchallenged draft." *Id.* The Court emphasized that the letter clearly did not require any documentation showing that the funds were used for a specific purpose. The language in the credit which referred to the intended use of the funds, at best, created an ambiguity which had to be construed against the bank as drafter [**21] of the letter. *Id.*

MBank's letter clearly does not require any documentation that the applicant defaulted. The use of "standby" merely indicates that it is not expected to be used unless there is some sort of default. At best, the use of "standby" in conjunction with the reference to the Tank Farm bid number creates an ambiguity as to whether documentation of default on the project is needed. And, as mentioned in *Sun Bank*, any ambiguity is to be construed against the drafter, MBank. *Id. see also East Girard 593 F.2d at 602; Bossier Bank & Trust, 550 F.2d at 1082; Venizelos, S.A. v. Chase Manhattan Bank, 425 F.2d 461, 466 (2d Cir. 1970).* Thus, the Court finds that the letter of credit was enforceable by the government. If the government had presented a proper draft drawn under the letter of credit upon EES Inc.'s default, MBank could not have legally refused to honor it.

II

The final issue which must be addressed is whether the Contracting Officer's decision that the letter of credit was not a valid "bid guarantee" was arbitrary and capricious.

The fact that this Court would find the letter valid in a lawsuit between the Corps and MBank is a fact or to be considered [**22] in this inquiry, but it does not answer the question. The bid solicitation required each bidder to "furnish a bid guarantee in the proper form and amount." Solicitation Provisions at SP-8. The purpose of the bid guarantee was to ensure that the successful bidder executed all necessary contractual documents and timely furnished the bonds required by the solicitation. The Contracting Officer had a duty to make sure that the bid guarantee furnished "full and complete protection" to the Corps in the event of such default. It is against this [*591] background that his actions must be evaluated.

The Contracting Officer made his decision on the advice of the counsel who had recommended that the bid be rejected because the bid guarantee was invalid. Mr. Collins, the Corps' counsel, based his recommendation on a Comptroller General decision, *In re S&S Contracting, supra*. That decision, while based on dubious analysis, addresses the precise issue in question and holds that such a letter of credit is not a valid bid guarantee. While Comptroller decisions are not absolutely binding on the Corps, they are rightfully given great weight by the agency. The fact that the Contracting Officer [**23] relied on the Corps' counsel's recommendation and that the counsel's recommendation was based on a Comptroller decision directly on point weighs in favor of finding the decision rational and not arbitrary and capricious.

This is not to say that a Contracting Officer can blindly follow counsel's advice (and Comptroller's decisions) in awarding contracts when the advice is clearly incorrect and contrary to establish case law. However, that is not what happened here. As mentioned, neither the Court nor the parties could find any case law which directly answered the question of whether the letter of credit was enforceable by the government. The above analysis demonstrates that the answer was neither obvious nor easy to arrive at. It is not inconceivable that another court may have found the letter to be unenforceable by the government. A Contracting Officer is not required to "buy a lawsuit" by accepting a bid guarantee that may or may not be enforceable. In fact, the contrary is true; he is to ensure that the bid guarantee fully and completely protects the government in the event of default by the successful bidder. Given this, the Court finds that the Contracting Officer's decision [**24] that the bid of EES Inc. was nonresponsive because of its bid guarantee was not arbitrary and capricious.

It is, therefore, ordered that Judgment be entered for the Defendants, with costs to the Plaintiff.

SO ORDERED.

APPENDIX

(MBank Dallas Letterhead)

IRREVOCABLE STANDBY LETTER OF CREDIT NO. 2596968-215 DATE 9/10/86 LR

BENEFICIARY	APPLICANT
U.S. Army Engineer Dist. 757 Federal Bldg. 601 E. 12th St.	Environmental Systems Company 1015 Louisiana Little Rock, Arkansas 72202

650 F. Supp. 583, *; 1986 U.S. Dist. LEXIS 16288, **;
 2 U.C.C. Rep. Serv. 2d (Callaghan) 1613

Kansas City, MO 64106-2896	
AMOUNT \$1,600,000.00	EXPIRY
(One Million Six Hundred Thousand and 00/100 U.S. Dollars)	December 9, 1986 At our counters

Gentlemen:

We hereby issue our Clean Irrevocable Standby Letter of Credit in your favor available by your draft on us at sight bearing the clause "Drawn under MBank - Dallas, N.A. Letter of Credit No. 2596968-215 dated September 10, 1986," accompanied by this original Letter of Credit.

Special Instructions: Negotiations restricted to MBank - Dallas, N.A. PARTIAL DRAWINGS ARE NOT PERMITTED.

This Letter of Credit is for Fed. #DACW 41-86-B-0121.

[*592] We hereby agree with you that the draft drawn [**25] under and in compliance with the terms of

this credit shall be duly honored on due presentation to us.

Except as otherwise expressly stated herein, this Credit is subject to the Uniform Customs and Practices for Documentary Credits (1983 Revision) International Chamber of Commerce, Publication 400.*

* The Court examined the Uniform Customs and Practices for Documentary Credits and found that none of its provisions resolved the controversy in this case.

Very truly yours,

/s/

Authorized Signature(s)

MBank - Dallas, N.A.