

GRANITE RE, INC. V. NATIONAL CREDIT UNION ADMINISTRATION BOARD

Recently, the United States Court of Appeals for the Eighth Circuit ruled on a matter which concerned letters of credit issued to a surety. Letters of credit are a familiar source of collateral for a surety. The case is instructive for new comers and reacquaints more seasoned litigators with the issues that can arise from the use of the device. Moreover, as the case deals with the Uniform Commercial Code, it is of note to all practitioners in the United States.

Facts:

On July 8, 2015, Granite Re, Inc. (“Granite”) was issued a clean irrevocable letter of credit from Citizens Community Credit Union (“Citizens”) in the amount of \$385,000.¹ Granite is a corporation that provides surety bonds to contractors.² Upon receipt of the clean irrevocable letter of credit, Granite issued Vortex Drain Tiling, LLC (“Vortex”) payment and performance bonds for Vortex’s construction contracts.³ Granite provided surety credit in excess of \$4 million on the bonds issued on behalf of Vortex.⁴

On May 25, 2017, Citizens sent Granite a letter indicating that the clean irrevocable letter of credit would mature on July 6, and on July 3, Granite requested payment, but the funds were never issued.⁵ On July 6, Citizens’ CEO told Granite that the funds would not be paid and that the National Credit Union Administration Board (“NCUAB”) had appointed itself as conservator of Citizens.⁶ A few days later, on July 20, NCUAB informed Granite about its authority, that it

¹ *Granite Re, Inc. v. Nat’l Credit Union Admin. Bd.*, No. 18-2674, 2020 WL 1969403, at *1 (8th Cir. 2020).

² *Id.*

³ *Id.*

⁴ *Id.*

⁵ *Id.*

⁶ *Id.*

could repudiate contracts, and that it determined that the letter of credit was a burden to Citizens.⁷ Granite demanded payment of the funds but NCUAB refused.⁸

Procedural History and Court Rulings:

After Granite's request for damages was denied by NCUAB, Granite brought a lawsuit in federal district court (North Dakota) for wrongful repudiation and wrongful dishonor of letter of credit rights.⁹ NCUAB filed a motion to dismiss based upon a preemption argument.¹⁰ The district court dismissed the complaint, determined that Granite could not recover damages, and that 12 U.S.C. § 1787(c)(3) preempted North Dakota's Uniform Commercial Code § 41-05-11.¹¹ Granite appealed.¹²

Court's Analysis:

Granite made three claims upon appeal: (1) NCUAB could not repudiate the letter of credit, because it was not a contract under 12 U.S.C. § 1787(c)(1); (2) if the letter of credit is deemed to be a contract, then Granite is entitled to damages from the repudiation under § 1787(c)(3); and (3) that section 1787(c) is not in conflict with § 41-05-11, and therefore cannot be preempted.¹³

(1) "Applicability of § 1787(c)."¹⁴ The Eighth Circuit ruled that the letter of credit was indeed a contract.¹⁵ The promise set forth in the letter of credit between the parties met the common law definition of a contract.¹⁶ 12 U.S.C. section 1787(c)(1) authorizes a conservator of a credit union to repudiate a contract under certain circumstances. Therefore, NCUAB, as a conservator,

⁷ *Id.* at *2

⁸ *Id.*

⁹ *Id.*

¹⁰ *Id.*

¹¹ *Id.* See also Uniform Commercial Code, Article 5.

¹² *Id.*

¹³ *Id.*

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ *Id.* at *3.

has the authority to “repudiate any contract or lease to which [the] credit union is a party’ if the conservator determines performance would be ‘burdensome’ and that repudiation ‘will promote the orderly administration of the credit union’s affairs.’”¹⁷

(2) “**Damages.**”¹⁸ Having found that the letter of credit was a contract, the Eighth Circuit found that there were enough facts alleged to support a claim for damages for breach of contract.¹⁹ Under section 1787(c)(3), the conservator is liable for damages to the injured “limited to actual direct compensatory damages ... determined as of the date of the appointment of the conservator.”²⁰ A reason to allow for recoverable damages is because “the beneficiary of a valid letter of credit may realize actual direct compensatory damages prior to the date of the conservatorship as a result of its reliance on that letter of credit.”²¹ Without this safeguard, it would be easy for conservators to be appointed and repudiate letters of credit without liability, seriously harming the holder of the letter of credit.²²

(3) “**Preemption.**”²³ Even though section 1787(c)(3) appears to give a more limited remedy for damages than section 41–05–11 (under state law), the Eighth Circuit held that it was premature to reach the issue of whether the federal statute preempted the state statute.²⁴ At this point, the determination did not have to be made as it was not clear that recovery under section 41–05–11 would exceed the limits under section 1787(c)(3).²⁵

¹⁷ *Id.* (quoting 12 U.S.C. § 1787(c)(1)).

¹⁸ *Id.* at *4.

¹⁹ *Id.*

²⁰ *Id.* (quoting 12 U.S.C. § 1787(c)(3)(A)(i), (ii)(I)) (finding that “actual direct compensatory damages” does not include “punitive or exemplary damages,” “damages for lost profits or opportunity,” and “damages for pain and suffering”).

²¹ *Id.* (“[C]lean letters of credit, like the one issued by Citizens, operate as security devices which assure virtually unrestricted access to payment on demand.”).

²² *Id.* at *5.

²³ *Id.* at *5.

²⁴ *Id.*

²⁵ *Id.*

Lessons Learned:

This case demonstrates the potential response to a repudiation of a letter of credit by a financial institution's conservator. United States Code section 1787(c) does not prohibit damages, and quite the opposite, allows for "actual direct compensatory damages."²⁶ In this case, the plaintiff and beneficiary of the letter of credit has the right to pursue a claim for damages as a result of the repudiation by the conservator of the credit union (who issued the letter of credit prior to the conservator's appointment). If there is a repudiation of a letter of credit, there still is liability to the beneficiary. This case gives practitioners the "blue print" to pursue such claims should they arise.

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²⁶ 12 U.S.C. § 1787(c)(3) (2018).