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NOTE

Wysko Investment Company v. Great American Bank: A New Attack on the Usefulness of Letters of Credit

Robert Jay Gavigan

I. INTRODUCTION

The letter of credit has long been accepted as a valuable instrument of assured payment in international business. In *Wysko Investment v. Great American Bank*, however, an Arizona district court jeopardized the usefulness of the letter of credit transaction by enjoining payment to the beneficiary after the issuing party became insolvent.¹ This note addresses the issue of whether a bankruptcy court has the power to enjoin payment of a letter of credit issued by the debtor's principal, pursuant to 11 U.S.C. § 105(a), when the court finds the injunction necessary for the debtor's reorganization. Further, this note examines whether such an injunction represents an unreasonable burden on letters of credit as commercial devices. Although a valid argument can be made that the bankruptcy court has the power to issue this injunction, the *Wysko* decision represents an unreasonable expansion of the equitable powers of the bankruptcy court and an exception to the respect for the "independence principle"² historically afforded to letters of credit by other courts. The

¹ 131 B.R. 146 (Bankr. D. Ariz. 1991).

² JAMES W. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE 812 (3d ed. 1986).

policies behind the *Wysko* decision, if followed, will have a significant chilling effect on the uses of letters of credit.

II. UNDERSTANDING THE LETTER OF CREDIT TRANSACTION

Letters of credit represent the independent and irrevocable commitment of the payor, usually a major international bank, to make payment in accordance with the terms of the credit without regard to any dispute between the issuing party and the beneficiary on another contract. This feature has been called the "independence principle,"³ and can be most clearly explained in terms of a hypothetical international transaction. Assume that Seller, located in the United States, wants to sell goods to Buyer, located in Germany. Seller is unwilling to send the goods on open credit because it will face the risk of non-payment and subsequent litigation in Germany. Buyer does not want to pay in advance because it faces the risk of non-delivery or non-conforming goods and subsequent litigation in the U.S. The parties thus agree to a documentary sale backed by a letter of credit.

Buyer, the issuer,⁴ goes to its own bank and arranges for a letter of credit which commits the bank to pay a draft drawn by Seller, the beneficiary, upon proper presentment of the draft and certain documents required by the letter of credit. These might include the bill of lading, invoice, policy of insurance, certificate of inspection, and so on.⁵ Seller retains ownership of the goods until it presents the documents indicating shipment of the goods to Buyer's bank, at which time Seller is paid. Seller does not face any risk of non-payment. The bank assumes the risk of extending credit to Buyer until it is reimbursed, but banks evaluate that type of risk for their borrowers every day. Finally, the bank retains control of the goods through the ownership documents from Seller until it is reimbursed.

As long as the contract between Seller and Buyer and the promise by Buyer's bank to pay Seller remain completely independent, the letter of credit transaction shifts the risk of non-payment to the issuing bank. Herein lies the true usefulness of letters of credit, and the reason this arrangement is used for 90% of all international sales.⁶ Reliable letters of credit are essential for international commerce and finance.

³ *Id.*

⁴ For the purposes of this note, the party who establishes the letter of credit will be called the issuer, the issuer's bank will be identified as payor, and the recipient will be known as the beneficiary.

⁵ WHITE & SUMMERS, *supra* note 2, at 808.

⁶ Helen Dams Chaitman & Jeff Sovern, *Enjoining Payment on a Letter of Credit in Bankruptcy: A Tempest in a Twist Cap*, 38 BUS. LAW. 24 (1982).

The letter of credit as a means of commercial credit, as described above, dates back some 700 years.⁷ A more recent variation of that arrangement, the standby letter of credit, assures performance in a variety of situations by providing for payment if the principal means fails.⁸ To illustrate, assume that Buyer, located in Germany, wants Contractor, located in the United States, to build a factory for Buyer in Germany. Buyer insists on a performance guarantee, so Contractor applies for a letter of credit payable to Buyer upon presentment of a draft and a statement that Contractor has defaulted on its obligation. Again, the promise to build and the promise to pay are independent. Today "standbys" are widely used in domestic and international transactions.⁹

Commercial credits and standbys present different risks to the payor bank. While the commercial credit is the normal means of payment for a sale, the standby is only drawn upon following the default of the performing party. A bank paying a commercial credit need only analyze the buyer's ability to reimburse, which banks do every day. The bank retains control of the goods sold until it is paid, giving the bank an obvious collateral for security. In the standby context, on the other hand, the bank must analyze the issuing party's ability to perform within trade customs, industry norms, or professional standards little known to bankers.¹⁰ Furthermore, paying a standby does not present the bank with any obvious forms of collateral. For these reasons, federal banking authorities have subjected standbys to bank lending regulations.¹¹

III. ADVANTAGES OF LETTERS OF CREDIT IN THE COMMERCIAL SETTING

Letters of credit have advantages over other forms of performance assurances, such as surety bonds, guarantees, and third party contract arrangements. In a typical guarantee the guarantor will agree to make payments if, and only if, the customer has failed to fulfill his obligations on the underlying contract.¹² If his obligation has been avoided because of the acts of the beneficiary, typically there would be no obligation to guarantee and thus no duty on the guarantor to pay.¹³

⁷ Norman I. Miller, *Problems and Patterns of the Letter of Credit*, 1959 U. ILL. LAW F. 162 (1959).

⁸ Cassandra E. Joseph, *Letters of Credit: The Developing Concepts and Financing Functions*, 94 BANKING L. J. 816, 818-19 (1977).

⁹ WHITE & SUMMERS, *supra* note 2, at 811.

¹⁰ WHITE & SUMMERS, *supra* note 2, at 813.

¹¹ 12 C.F.R. §§ 7.1160, 208.8(d), 337.2 (1979).

¹² WHITE & SUMMERS, *supra* note 2, at 813-14.

¹³ WHITE & SUMMERS, *supra* note 2, at 813-14.

The letter of credit beneficiary has bargained for the right to be paid notwithstanding disputes on the underlying contract and hence to be a defendant at home in the ensuing litigation instead of a plaintiff abroad. A letter of credit beneficiary is not a third party beneficiary of another's contract in the important sense that defenses of a contracting party valid against the beneficiary of a letter of credit cannot be asserted by the payor.¹⁴ A surety bond is also normally subject to the defenses of the party who posted it, requires cash collateral, and is generally not regarded as an assured means of prompt payment.¹⁵ Letter of credit payments can be triggered merely by presenting certain corresponding documents or a simple statement that one party has breached a contract, and do not require a cash bond.¹⁶ The standby letter of credit is more cheaply and easily available than other performance guarantees for the same reasons as the commercial credit.¹⁷ Letters of credit thus effectively ensure prompt payment.

For both commercial credits and standbys, the purpose and essential function of the letter of credit is the same: to insulate the beneficiary from the risk of non-performance of the underlying contract. Both forms thus rely on the independence of payment from the underlying contract, and it is this independence that makes the letter of credit an advantageous commercial device. Enjoining payment of a letter of credit compromises the independence principle and negates the risk shift that the parties sought. Injunctions affect both commercial credits and standbys, and therein lies the potential damaging impact of the *Wyso* decision. As a precedent, *Wyso* represents a threat to the distinct and critical feature of the letter of credit, the independence principle.

IV. LETTERS OF CREDIT IN THE INTERNATIONAL CONTEXT

Letters of credit nearly always involve parties in different jurisdictions, often on different continents. Choice of law appears to be a necessary antecedent to resolving conflicts arising among the parties to the transaction. Courts generally respect provisions selecting the law that will govern the contract between the issuer and the beneficiary, as long as that choice bears a reasonable relationship to the jurisdiction selected.¹⁸ When a dispute arises, however, it nearly always centers on the credit

¹⁴ WHITE & SUMMERS, *supra* note 2, at 813-14.

¹⁵ Mark P. Zimmet, *Standby Letters of Credit in the Iran Litigation: Two Hundred Problems in Search of a Solution*, 16 LAW & POL'Y INT'L BUS. 927 (1984).

¹⁶ Peter R. Lloyd-Davies, *Survey of Standby Letters of Credit*, 65 FED. RESERVE BULL. 716 (1979).

¹⁷ WHITE & SUMMERS, *supra* note 2, at 813.

¹⁸ DOLAN, JOHN F., *THE LAW OF LETTERS OF CREDIT* 4-8 (2d ed. 1991).

transaction and not on the underlying contract.¹⁹ Although the parties disputing the credit transaction are the real parties of interest in the underlying contract, the choice of law in the underlying contract does not control the ensuing credit litigation.²⁰

The original U.S. rule seemed to favor the law of the jurisdiction where the parties entered the contract for the credit dispute.²¹ The more recent trend is to favor the law of the place of performance or payment.²² The rulings on choice of forum are consistent in that most of them use the law of the forum to uphold the credit.²³

The most interesting aspect of the choice and conflict of laws holdings surrounding letters of credit, however, is the fact that these commercial devices are treated with remarkable consistency in nearly all jurisdictions.²⁴ In fact, one commentator has concluded that "the uniformity of the theories . . . would justify an attempt to form some kind of *lex mercatoria* of private international law in the field of letters of credit. . . ."²⁵ Most international credits are subject to the Uniform Customs and Practice for Documentary Credits, and all U.S. jurisdictions have adopted the Uniform Commercial Code provisions governing credits.²⁶ In addition, bankers and courts of law continue to regard customary law as the primary source of letter of credit law.²⁷ For the purposes of this note, then, the focus will be on the chilling effect injunctions have on the use of letters of credit without further discussion of conflicts of law.

V. THE SCOPE OF SECTION 105 OF THE BANKRUPTCY CODE

The *Wysko* injunction was issued pursuant to the bankruptcy court's power under 11 U.S.C. § 105, which empowers the court to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title."²⁸ The purpose of this section is to assure the bankruptcy court's power to take whatever action is appropriate or nec-

¹⁹ *Id.*

²⁰ *Id.*

²¹ *Id.* at 4-5.

²² *Id.* at 4-6, 4-7.

²³ *Id.* at 4-6.

²⁴ MATT KURKELA, LETTERS OF CREDIT UNDER INTERNATIONAL TRADE LAW: UCC, UCP, AND LAW MERCHANT 128 (1985); see also DOLAN, *supra* note 18, at 4-3 and 4-7.

²⁵ KURKELA, *supra* note 24.

²⁶ WHITE & SUMMERS, *supra* note 2, at 881.

²⁷ Boris Kozolchik, *Letters of Credit*, in IX INTERNATIONAL ENCYCLOPEDIA OF COMPARATIVE LAW ch. 5, *Commercial Transactions and Institutions* 10 (J.S. Ziegel ed. 1979).

²⁸ 11 U.S.C. § 105(a) (1988).

essary to aid in the exercise of its jurisdiction.²⁹ Some definition of the power granted by this broad language emerges from an examination of the historical development of Section 105.

The grant of power in Section 105 is similar to that found in the All Writs Statute.³⁰ Bankruptcy courts were officially brought within the scope of the All Writs Statute by Section 213 of the Bankruptcy Reform Act of 1978.³¹ The All Writs Statute, in turn, authorizes federal courts to "issue all writs necessary or appropriate in aid of their respective jurisdictions and agreeable to the usages and principles of law."³² It enables the court to address situations for which no specific process has been provided by statute.³³ The All Writs Statute is not an independent source of jurisdiction, but rather it grants the courts flexibility to issue orders which preserve and protect their jurisdiction.³⁴

Section 105 replaced Section 2a(15) of the prior Bankruptcy Act, which provided that courts of bankruptcy could "make such orders, issue such process, and enter such judgments in addition to those specifically provided for, as may be necessary for the enforcement of the provisions of the Act. . ."³⁵ Section 2a(15) was viewed by most courts as an express sanction of the mandate of the bankruptcy court's power to enjoin actions of parties if "the proceeding sought to be enjoined interfered with the possession or custody of the bankruptcy court or unduly impeded or embarrassed the court in its administration under the Act."³⁶

Section 105 is broader than Section 2a(15), authorizing orders "*appropriate* to carry out the provisions of this title" in contrast to 2a(15)'s requirement that the order be "*necessary* for the enforcement of the provisions of this title."³⁷ Section 105's use of "provisions" instead of "purposes," however, suggests that the exercise of this power must be tied to another bankruptcy code section and not merely a general bankruptcy concept or objective.³⁸ Two schools of thought have emerged on the breadth of 105 in relation to the rest of the Bankruptcy Code. The broad view is that certain goals of the Code are implied but not stated in the statutory language, and that Section 105 grants the bankruptcy courts

²⁹ *In re James*, 20 B.R. 145, 150 (Bankr. E.D. Mich. 1982); *In re Howell*, 4 B.R. 102, 105 (Bankr. M.D. Tenn. 1980).

³⁰ 2 COLLIER ON BANKRUPTCY § 105.01, at 105-2 (Lawrence P. King ed., 15th ed. 1992).

³¹ *Id.*

³² 28 U.S.C. § 1651(a) (1988).

³³ COLLIER, *supra* note 30.

³⁴ COLLIER, *supra* note 30.

³⁵ COLLIER, *supra* note 30, citing 11 U.S.C. § 2(a)(15) (repealed 1978).

³⁶ COLLIER, *supra* note 30, at 105-3, citing *James*, 20 B.R. at 149.

³⁷ COLLIER, *supra* note 30, at 105-3.

³⁸ COLLIER, *supra* note 30, at 105-4.

authority to fill the gaps left by the statutory language; the narrow view is that Section 105 is not a broad writ and should be construed to fit only the express goals of the Code.³⁹

Section 213 of the Reform Act, which brought the power of the All Writs Statute to the bankruptcy courts, was repealed by the 1984 Amendments to the Bankruptcy Code.⁴⁰ Section 105 is thus the sole remaining authority for the exercise by the courts of the kinds of powers granted under the All Writs Statute.⁴¹ Whether Section 105 is broad enough to encompass equitable actions by a bankruptcy court involving the principal of a debtor is a matter of some dispute. The following sections of this paper will examine the validity of the *Wysko* decision and the scope of the Section 105 powers. The *Wysko* decision will then be compared to the treatment of letters of credit in other areas of the law to juxtapose the policies enunciated in *Wysko* with those currently extant.

VI. ANALYSIS OF *WYSKO INVESTMENT CO. V. GREAT AMERICAN BANK*

The facts behind the *Wysko* decision, as published in the district court opinion, are somewhat sparse. The case involved a standby letter of credit issued by Dalco Enterprises, a principal of Wysko Investment Company, to secure Wysko's promise in December, 1988, to buy Spring Meadows Apartment Complex from Great American Bank.⁴² Wysko filed for Chapter 11 protection on January 11, 1991.⁴³ Following the bankruptcy, Great American attempted to draw on the letter of credit, but Wysko objected and offered a certificate of deposit in place of the letter of credit at the bankruptcy hearings.⁴⁴ The bankruptcy court agreed with Wysko, and enjoined payment on the letter of credit.⁴⁵

On appeal, the district court analyzed two issues: whether a bankruptcy court can enjoin payment of a letter of credit under Section 105 of the Bankruptcy Code; and, if so, under what circumstances.⁴⁶ The court first rejected Great American's argument, strongly supported by prior cases, that letters of credit are not part of the debtor's estate. The court ignored the precedential weight of *In re Marine Distributors*,⁴⁷ *In the*

³⁹ COLLIER, *supra* note 30, at 105-4.

⁴⁰ Pub. L. No. 98-353, *reprinted in* 1984 U.S.C.A.N. 333.

⁴¹ COLLIER, *supra* note 30, at 105-3.

⁴² *Wysko*, 131 B.R. at 146.

⁴³ *Id.*

⁴⁴ *Id.*

⁴⁵ *Id.*

⁴⁶ *Id.*

⁴⁷ 522 F.2d 791 (9th Cir. 1975).

Matter of Compton Corp.,⁴⁸ and *In re Air Conditioning, Inc. of Stuart*,⁴⁹ holding that “these cases do not address the powers of the Bankruptcy Court under Section 105 of the Bankruptcy Code.”⁵⁰ The court did not distinguish *Wysko* from cases holding that letters of credit are not part of the debtor’s estate, and thus necessarily implied that Section 105 may be used to affect property that is not part of the debtor’s estate. The *Wysko* court explicitly acknowledged the aforementioned cases, holding that letters of credit “should ordinarily not be included in the bankruptcy estate,” and Great American’s argument that upholding the injunction “could create havoc in the financial world.”⁵¹

The *Wysko* court relied on *In re American Hardwoods*⁵² and *In re A.H. Robins Co., Inc.*,⁵³ to find that Section 105 authorizes injunctions against third parties, and held that the Bankruptcy Court can enjoin letters of credit, though cautioning, “but this should be confined to unusual circumstances.”⁵⁴ It read *American Hardwoods* only for the proposition that the Section 105 powers may not be used to provide relief in situations, such as a grant of attorney’s fees or a trustee’s attempt to recover expenses, when that relief is not specifically provided by statute.⁵⁵ Furthermore, the *Wysko* court found that an injunction had not been issued against third parties in *American Hardwoods* because that court did not find unusual facts or that an injunction was “essential to the reorganization plan.”⁵⁶

American Hardwoods concerned a Chapter 11 debtor who sought to permanently enjoin a creditor from enforcing a state court judgment against the debtor’s guarantors.⁵⁷ *American Hardwoods* did not involve a letter of credit. The *American Hardwoods* analysis does not include any discussion of the policies that support commercial transactions, policies which the *Wysko* court rejected when presented by Great American. The *Wysko* court sidestepped the arguments and decisions that had established a niche for letters of credit among the other objectives of the Bankruptcy Code,⁵⁸ holding that “the power of the Bankruptcy Court to assist in reorganization would be severely hampered if this court held

⁴⁸ 831 F.2d 586 (5th Cir. 1987).

⁴⁹ 845 F.2d 293 (11th Cir. 1988).

⁵⁰ *Wysko*, 131 B.R. at 147.

⁵¹ *Id.* at 147-48.

⁵² 885 F.2d 621 (9th Cir. 1989).

⁵³ 828 F.2d 1023 (4th Cir. 1987), *cert. denied*, 485 U.S. 969 (1988).

⁵⁴ *Wysko*, 131 B.R. at 147.

⁵⁵ *Id.*

⁵⁶ *Id.*

⁵⁷ 885 F.2d at 622.

⁵⁸ See *In re Marine Distributors*, 522 F.2d 791 (9th Cir. 1975); See also *In the Matter of*

that letters of credit are outside the Section 105 powers of the Bankruptcy Court.”⁵⁹ The *Wysko* court thus elevated the bankruptcy court’s goal “to assist in reorganization” above the independence of the contracts underlying the letter of credit transaction as recognized by other decisions.

The second part of the analysis in *Wysko* determined under what circumstances a bankruptcy court could enjoin payment on a letter of credit. The *Wysko* court appeared to read *American Hardwoods* as requiring only a finding of “unusual facts,” and that the injunction is “essential to the reorganization plan.”⁶⁰ The *Wysko* court then relied on the bankruptcy court finding that the letter of credit was essential to the reorganization as an “unusual circumstance which justifies use of the Bankruptcy Court’s Section 105 powers to enjoin a letter of credit.”⁶¹ *Wysko*, however, does not present the unusual facts that *American Hardwoods* suggests are necessary for an injunction.

The *American Hardwoods* court rejected the debtor’s request for an injunction against third parties because

its reorganization did not contemplate the balancing of some 195,000 tort claimants alleging injuries totaling approximately \$2.457 billion; the permanent injunction sought by American was not overwhelmingly approved by creditors; the injunctions would affect American’s most significant creditor, not merely 1.5% of its creditors; and American does not argue, nor did the district court find, that the permanent injunction is “essential to the plan” or that the entire reorganization “hinged” on it,⁶²

referring to the facts behind the *A.H. Robins* injunction. The *Robins* court enjoined plaintiff’s actions against Robins’ directors, Robins’ attorneys, and Robins’ insurers because

(1) the reorganization plan, which included the injunction, was approved by over 94% of the claimants; (2) the plan provided for full payment of creditors’ claims; (3) the injunction affected only about 1.5% of the claimants; (4) it was “essential” to the plan that claimants “either resort to the source of funds for them in the Plan . . . or not be permitted to interfere with the reorganization and thus with all other creditors”; and (5) “the entire reorganization hing[ed] on the debtor being free from indirect claims such as suits against parties who would have indemnity or contribution claims against the debtor.”⁶³

Furthermore, the plaintiffs in *A.H. Robins* had opted out of a settlement

Compton Corp., 831 F.2d 586 (5th Cir. 1987); *In re Air Conditioning, Inc. of Stuart*, 845 F.2d 293 (11th Cir. 1988).

⁵⁹ *Wysko*, 131 B.R. at 147.

⁶⁰ *Id.*

⁶¹ *Id.* at 148.

⁶² *American Hardwoods*, 885 F.2d at 627.

⁶³ *Id.* at 626 (citing *In re A.H. Robins Co.*, 880 F.2d 694 (4th Cir. 1989)).

made available by the "carefully designed reorganization of Robins."⁶⁴ The *Robins* court protected the principals of the debtor because "permitting a suit by [the plaintiffs] in violation of the Plan is a defeat of the Plan and a resulting defeat of the other creditors."⁶⁵ *Wysko* fails to present facts that compare in any way to the situation in *Robins*. Indeed, it is more similar to *American Hardwoods*, where the court refused to issue an injunction against third parties.⁶⁶

It could be argued that the *American Hardwoods* court would not issue the injunction against third parties because the plaintiffs in that case sought to *permanently* enjoin the defendant from enforcing its state court judgment against the debtor's guarantors.⁶⁷ The court in that case had already accepted the plaintiffs' argument that a *permanent* injunction amounted to a discharge of the debtor's obligation in violation of 11 U.S.C. § 524(e).⁶⁸ Distinguishing *American Hardwoods* on those grounds leaves *A.H. Robins* as the sole legitimate authority relied upon by the *Wysko* court to enjoin actions against the principal of the debtor.

In *A.H. Robins* the court held that a request for a Section 105 injunction against a co-debtor must show "irreparable harm to the bankruptcy estate if the injunction does not issue."⁶⁹ Even ignoring the factual inconsistencies between *Wysko* and *A.H. Robins*, the *Wysko* finding of "necessary for reorganization" falls somewhat short of showing "irreparable harm" to the estate.

In summary, the *Wysko* court ignored the precedents that afford the independence principle of letters of credit sufficient respect for the survival of those devices. The court then looked for authority to uphold the injunction of payment in cases that did not deal with these commercial devices, and engaged in a questionable reading of those cases. *Wysko* might thus be regarded as merely a poorly reasoned decision that is best overlooked by other courts. The actual treatment of the parties in the bankruptcy court itself, however, presents a different view of this case. It can be seen that Section 105 gives judges far too much freedom to pursue a debtor or creditor-friendly agenda, and to elevate the goals of the bankruptcy court above the policies established by previous judicial precedent.

The *Wysko* decision in the district court has been described as "more insidious than *Twist Cap*" based on the following facts not

⁶⁴ *In re A.H. Robins*, 880 F.2d 694, 701 (4th Cir. 1989).

⁶⁵ *Id.* at 702.

⁶⁶ *American Hardwoods*, 885 F.2d at 627.

⁶⁷ See *American Hardwoods*, 885 F.2d 621 (9th Cir. 1989).

⁶⁸ *American Hardwoods*, 885 F.2d at 626.

⁶⁹ *A.H. Robins*, 828 F.2d at 1026.

presented in the published opinion.⁷⁰ The bankruptcy judge, Tom Baum, was a former student of Arizona State University Law Professor Dale Furnish and a bankruptcy practitioner for 15 years.⁷¹ The bankruptcy court decision thus was not an uninformed oversight. The injunction was not issued without reflection, either; Judge Baum issued a temporary restraining order while the parties briefed the question of an injunction protecting co-debtor third parties, and Judge Baum issued the order after six hours of hearings on the issue.⁷²

Judge Baum pursues a debtor-friendly agenda as long as some indication exists that the debtor can reorganize.⁷³ If the debtor cannot establish a plan within the time allotted by the court, Baum then switches to a creditor-friendly attitude and dismantles the debtor for the same.⁷⁴ Judge Baum's policy for handling bankruptcy cases, arguably beneficial for both debtors and creditors because it promotes business successes, appears quite arbitrary. Bankruptcy judges have the power and flexibility to pursue such an agenda in part because Section 105 is too broad or too undefined.

Debtor Wysko first moved for the injunction under the automatic stay, 11 U.S.C. § 362.⁷⁵ Baum, initially wearing his debtor-friendly hat, pointed out that Section 362 is explicitly exempted from use on non-debtor property, and suggested "further research of more equitable powers."⁷⁶ Forty eight hours later Wysko made a motion under Section 105, and the judge authorized the injunction.⁷⁷ Upon issuing the order, Judge Baum explained that he was exceeding his authority to issue orders against non-debtor properties, and was moving quickly to give the debtor time to reorganize.⁷⁸ He recognized that appellant Great American would not be able to invoke the proper rule on appeal until after the debtor had been afforded sufficient time.⁷⁹

The "essential to reorganization" argument put forth in the bankruptcy court and accepted on appeal as not "clearly erroneous"⁸⁰ lacks

⁷⁰ Telephone Interview with Dale B. Furnish, Professor of Law, Arizona State University (September 28, 1992). Mr. Furnish, of Molloy, Jones & Donahue, P.C., in Phoenix, Arizona, served as counsel for appellant Great American Bank before the bankruptcy and district courts.

⁷¹ *Id.*

⁷² *Id.*

⁷³ *Id.*

⁷⁴ *Id.*

⁷⁵ *Id.*

⁷⁶ *Id.*

⁷⁷ *Id.*

⁷⁸ *Id.*

⁷⁹ *Id.*

⁸⁰ *Wysko*, 131 B.R. at 148.

serious merit. Don Allen, the owner of Dalco Enterprises and Wysko's principal in this case, had contributed \$175,000, the purchase price of the Spring Meadows apartment complex, to the debtor in the form of a certificate of deposit.⁸¹ Don Allen indicated his financial stability and that of Dalco Enterprises at deposition.⁸² In Baum's defense it should be mentioned that appellant Great American was not left without security by the injunction against payment of the debtor's letter of credit in Great American's favor: Baum forced Wysko to release that certificate of deposit as security for its bank to later pay Great American.⁸³ Wysko's bank then renegotiated and reissued Wysko's loan without including that \$175,000, further proof that the asset was not essential to the reorganization.⁸⁴

Appellant Great American filed an appeal immediately after the Bankruptcy Court Order was issued.⁸⁵ In the interim, the injunction was dissolved, Great American was paid as beneficiary of Wysko's letter of credit, and Wysko's bank cashed the \$175,000 certificate of deposit for reimbursement.⁸⁶ Mr. Furnish informed the district court of this disposition of the case, and upon hearing that court's intention to decide the case anyway, petitioned the court to accept oral argument.⁸⁷ The district court rejected oral arguments on the issue, and *Wysko Investment Co. v. Great American Bank* was decided on July 30, 1991.⁸⁸ The case is now unappealable as moot, and thus stands as a disconcertingly wide precedent for the bankruptcy court's jurisdiction over non-debtors under Section 105.

Note that the *Wysko* court relied on the bankruptcy court's finding of "essential to reorganization" because that finding was not "clearly erroneous."⁸⁹ The standard of review in the district court, however, depends on whether the bankruptcy court heard a core or non-core proceeding.⁹⁰ An injunction against a non-bankrupt third party, such as Wysko or Dalco's payor bank, is a non-core proceeding.⁹¹ Absent consent by the parties, district courts review *de novo* the findings of law and

⁸¹ Telephone Interview with Dale B. Furnish, *supra* note 70.

⁸² *Id.*

⁸³ *Id.*

⁸⁴ *Id.*

⁸⁵ *Id.*

⁸⁶ *Id.*

⁸⁷ *Id.*

⁸⁸ *Id.*

⁸⁹ *Wysko*, 131 B.R. at 148.

⁹⁰ 1 COLLIER ON BANKRUPTCY 3-39 to 3-40, 3-53 to 3-55, 3-200 to 3-202 (Lawrence P. King ed., 15th ed. 1992). See also 28 U.S.C. § 157 (1988).

⁹¹ COLLIER, *supra* note 90, at 3-39.

fact made by the district court in non-core proceedings.⁹² The *Wysko* court failed to review bankruptcy court findings *de novo* and did not mention consent by the parties.

VII. JURISDICTION OF THE BANKRUPTCY COURT OVER THIRD PARTIES

The *Wysko* Court issued an injunction against the debtor's payor bank, a non-debtor entity, to protect the assets of Dalco, the debtor's principal. The power of the bankruptcy court to affect co-debtors (such as Dalco) and non-debtors (the payor bank) is a hotly disputed area. The controversy arises from situations similar to that presented in *Wysko*, when a debtor's guarantor seeks protection from the debtor's creditor or the debtor seeks to protect a principal whose funds will finance the reorganization plan.⁹³ The question is whether the bankruptcy court has the jurisdiction necessary to affect these entities.

Under current law, district courts may refer to the bankruptcy judges "any or all cases under title 11 and any or all proceedings arising under title 11 or arising in or related to a case under title 11."⁹⁴ Bankruptcy judges to whom cases and proceedings are referred may "hear and determine . . . all core proceedings . . . and may enter appropriate orders and judgments."⁹⁵ A suit by a creditor against a co-debtor who is not herself in bankruptcy is a non-core proceeding under Section 157(c).⁹⁶ A bankruptcy judge can hear a non-core proceeding that is related to a bankruptcy case that was filed under title 11, but absent consent of all the parties she must submit proposed findings of fact and conclusions of law to the district court, which alone has the power to enter orders and judgments on non-core matters.⁹⁷ The district court reviews *de novo* any bankruptcy court's findings of law and fact to which any party has timely and specifically objected.⁹⁸

If the basis for obtaining a co-debtor stay is prevention of interference with the reorganization process, arguably the stay is part of the administration of the debtor's estate, or at least a type of "other proceedings affecting . . . the adjustment of the debtor-creditor or the

⁹² 28 U.S.C. § 157(c) (1988).

⁹³ Manuel D. Leal, *The Power of the Bankruptcy Court: Section 105*, 29 S. TEX. L. REV. 487, 514 (June 1988).

⁹⁴ 28 U.S.C. § 157 (1988).

⁹⁵ 28 U.S.C. § 157(b)(1) (1988).

⁹⁶ COLLIER, *supra* note 90, at 3-39.

⁹⁷ 28 U.S.C. § 157(c)(1) (1988).

⁹⁸ *Id.*

equity security holder relationship.”⁹⁹ A civil proceeding “related to a case under title 11” through the co-debtor’s argument that staying the direct action will aid the debtor’s reorganization effort (and thus have an effect on the bankruptcy case) grants the bankruptcy court jurisdiction to hear the co-debtor stay request.¹⁰⁰ Some courts have accepted this argument, while others are still skeptical of this expansion of the bankruptcy court’s jurisdiction under Section 105.¹⁰¹ It is at least plausible that the bankruptcy court can hear co-debtor stay requests.

VIII. CO-DEBTOR INJUNCTIONS IN THE BANKRUPTCY CODE

At least one commentator has suggested that a Section 105 injunction “based on the bankruptcy court’s supposed authority to guard the estate . . . stands in dangerous contradistinction to the Congressional mandate to the bankruptcy court to establish itself as an impartial court and dispute resolver, not an administrator of estates.”¹⁰² The legislative history of Section 105 does not explicitly indicate that Congress intended bankruptcy courts to have the power to affect co-debtors,¹⁰³ but some indication of that authority comes from the plain language of the Bankruptcy Code itself.

Co-debtor stays are explicitly authorized in Chapters 12¹⁰⁴ and 13¹⁰⁵ of the Bankruptcy Code and notably absent from the exhaustive provisions of Section 362.¹⁰⁶ One could argue that Congress was aware of the possible need for a co-debtor stay, chose not to include any such provision under Chapter 11, and chose to exclude co-debtors from Section 362.¹⁰⁷

The contrary argument can be made as well, as follows: (1) Congress did not explicitly reject the concept of a co-debtor stay in Chapter 11; (2) Congress intended for the courts to construe their Section 105 powers broadly; and (3) Congress did not include an *automatic* stay provision for co-debtors in Chapter 11 merely to put the burden on the

⁹⁹ Barry L. Zaretsky, *Co-debtor Stays in Chapter 11 Bankruptcy*, 73 Cornell L. Rev. 213, 222 n.31 (1988), citing 28 U.S.C.A. § 157(b)(2)(O) (West Supp. 1987).

¹⁰⁰ *Id.* at 222-23, citing *Pacor, Inc. v. Higgins*, 743 F.2d 984, 994 (3d Cir. 1984).

¹⁰¹ Compare *In re Monroe Well Serv.*, 67 B.R. 746, 753 (Bankr. E.D. Pa. 1986) with *In re Abousie Bros. Constr. Co.*, 8 B.R. 302 (Bankr. E.D. Mo. 1981).

¹⁰² Leal, *supra* note 93, at 501, citing H.R. Rep. No. 595, 95th Cong., 1st Sess. 10-12 (1977), reprinted in 1978 U.S.C.A.N. 5963, 5971-74.

¹⁰³ See Pub. L. No. 95-598, Nov. 6, 1978, 92 Stat. 2555; Pub. L. No. 98-353 Title I, § 118, July 10, 1984, 98 Stat. 344; Pub. L. No. 99-554 Title II § 203, Oct. 27, 1986, 100 Stat. 3097.

¹⁰⁴ 11 U.S.C. § 1201 (1988).

¹⁰⁵ 11 U.S.C. § 1301 (1988).

¹⁰⁶ 11 U.S.C. § 362 (1988).

¹⁰⁷ Leal, *supra* note 93, at 517-18.

debtor to move for such a stay.¹⁰⁸ The first and third of these premises cannot be proved or disproved because the legislative history is simply lacking. As to the first premise, we cannot assume that a power should be granted or an action allowed merely because Congress did not disallow it. There are many things that Congress does not explicitly disallow. Nonetheless, one normally looks to affirmative rather than negative grants of power. Premise three similarly appeals to things Congress might have intended or failed to preclude, but ignores the spectrum of provisions in the Bankruptcy Code that carefully define which party has the burden of making motions.¹⁰⁹ The second of these premises does carry some weight. It is clear that Congress intended for bankruptcy courts to have broad power and jurisdiction following the 1978 Reform Act, and that this power was in no way to be circumscribed by possession or custody of a res.¹¹⁰

Bankruptcy courts have issued Section 105 injunctions to protect third parties in certain situations. An early case featuring such an order is *In re Otero Mills, Inc.*,¹¹¹ where the court enjoined a party from proceeding in state court against a non-bankrupt party. The *Otero Mills* court required the debtor to show irreparable harm to the estate, likelihood of a successful reorganization, and no harm or minimal harm to the other party.¹¹² The court intended to prevent the creditor from adversely or detrimentally influencing and pressuring the debtor through a third party when he is forbidden to do so directly.¹¹³ The *Wysko* court did not rely on *Otero Mills*, nor could it: debtor Wysko did not make the requisite showing and Great American is not normally forbidden from drawing on a letter of credit which names it as beneficiary.

Courts have also issued injunctions to protect third parties in mass-tort litigation. In *A.H. Robins Co., Inc. v. Piccinin*,¹¹⁴ the court enjoined plaintiffs pursuant to Section 362(a)(1) and Section 105 because the debtor's insurance policies were part of the estate and likely proceeds for

¹⁰⁸ Zaretsky, *supra* note 99, at 225-26.

¹⁰⁹ See 11 U.S.C. §§ 362(d), 362(g), 1201(c), 1301(c). Interestingly, the author of this argument cites these provisions to argue upon whom the burden of moving would be assigned. Zaretsky, *supra* note 99, at 226. This author fails to acknowledge that if Congress had intended to allow co-debtor stays in Chapter 11 and wanted the debtor to have the burden of moving for that stay, Congress would have included such a provision.

¹¹⁰ Zaretsky, *supra* note 99, at 223 (citing 2 COLLIER ON BANKRUPTCY 105-3 (P. King ed., 15th ed. 1992) and S. Rep. No. 989, 95th Cong., 1st Sess. 54 (1977), reprinted in 1978 U.S.C.C.A.N. 5787, 5840).

¹¹¹ 21 B.R. 777 (Bankr. D.N.M. 1982), *aff'd*, 7 C.B.C.2d 1017 (D.N.M.).

¹¹² COLLIER, *supra* note 30, at 105-8.

¹¹³ COLLIER, *supra* note 30, at 105-7.

¹¹⁴ COLLIER, *supra* note 30, at 105-11.

damages. In *In re Johns-Manville Corp.*,¹¹⁵ the court enjoined actions against third parties because they were derivative of identical claims against the debtor and caused a massive drain on the time and energy of key personnel at a crucial hour of plan reformulation. As noted, *Wysko* simply does not present the extraordinary circumstances found in the mass-tort bankruptcies.¹¹⁶

The Section 105 powers are probably broad and undefined enough to enjoin actions against a co-debtor or non-debtor holding the debtor's assets in some situations. Although the courts invoking Section 105 for third party injunctions have required the debtor to show extreme circumstances, Section 105 itself does not require any such limit. This power should have limits, however, which recognize that the goals of the bankruptcy courts exist in tension with other policy goals. Some practical guidelines have been suggested by those cases, like the ones that *Wysko* bypassed,¹¹⁷ that have dealt with letters of credit.

IX. HISTORIC TREATMENT OF LETTERS OF CREDIT BY THE COURTS

The courts have historically acted to preserve the independence of the contracts underlying the letters of credit transaction, and in many cases explicitly acknowledged the need for policies supporting confidence in that principle. The cases establish a pattern of leaving the burden of an unfavorable result with the party to whom the letter of credit assigned risk. The exceptions to this pattern, where courts have enjoined payment of letters of credit, are illustrative of the impact those injunctions have on commerce.

A. Fraud in the Transaction

The first exception developed for fraud in the credit transaction itself. In *Sztejn v. Henry Schroeder Banking Corp.*, the court enjoined payment to the beneficiary because it was established that the seller had shipped merchandise that was not "merely inferior in quality," but rather merchandise that consisted of "worthless rubbish."¹¹⁸ The court recognized that the independence principle could be overridden where the seller actively engaged in fraud.¹¹⁹

The fraud exception makes a good deal of sense for both commercial credits and standbys. In both cases the letters are payable merely upon

¹¹⁵ COLLIER, *supra* note 30, at 105-12 to 105-14.

¹¹⁶ See *supra* pages 192-94.

¹¹⁷ See *supra* note 58.

¹¹⁸ 31 N.Y.S.2d 631 (N.Y. Sup. Ct. 1941).

¹¹⁹ *Id.*

presentation of certain documents, and the incentive will be strong for a beneficiary to present forged papers. Today the fraud in the transaction exception is codified as U.C.C. § 5-114(2), although a great deal of controversy exists about whether that section invites courts to look at the transaction between the issuer and the beneficiary.¹²⁰

The *Sztejn* decision, itself an exception to the independence principle, draws a very narrow rule in order not to wreak havoc on the letter of credit as a commercial device.¹²¹ The opinion holds that letters of credit will not work unless they are independent of the underlying contract; does not contemplate an alleged breach of contract; and does not grant an injunction on the basis of unsupported assertions that there was fraud, but rather because fraud was established by the proceedings.¹²²

One man's breach of contract is another man's fraud. The *Sztejn* exception could be construed so as to swallow the independence principle simply by characterizing breaching behaviors as fraudulent conduct. But the reach of *Sztejn* was sharply curtailed by its author, Justice Shientag, in *Asbury Park & Ocean Grove Bank v. Nat'l City Bank*.¹²³ The plaintiff in *Asbury Park* sued for damages based on the issuer's honor of the beneficiary's drafts, claiming that the events contemplated in the underlying contract had not occurred as planned and that the presentation of the drafts thus constituted fraud.¹²⁴ The court denied recovery and underscored the independence principle by holding that fraud in the underlying contract is "ineffective to void or suspend the operation of the letter of credit."¹²⁵

A comparison of *Sztejn* and *Asbury Park* reveals several points: the fraud exception must be limited and the independence principle upheld to preserve letters of credit as valuable commercial devices; only intentional fraud should be a basis for injunctions; and the fraud complained of should occur in the credit transaction, not the underlying contract.¹²⁶ *Sztejn* and *Asbury Park* appropriately balance the competing objectives of protection from fraud and enforcing a contract to shift risk.

B. Upheaval of Foreign Governments

The risk-shifting function of letters of credit serves to insulate a

¹²⁰ See DOLAN, *supra* note 18, at 7-29 to 7-48 for a complete discussion of the controversy between a narrow or broad reading of U.C.C. § 5-114(2), the commentators, and the cases.

¹²¹ DOLAN, *supra* note 18, at 7-34.

¹²² DOLAN, *supra* note 18, at 7-35.

¹²³ DOLAN, *supra* note 18, at 7-36, citing 35 N.Y.S.2d 985 (N.Y. Sup. Ct. 1942).

¹²⁴ *Asbury Park*, 35 N.Y.S.2d at 989.

¹²⁵ *Id.*

¹²⁶ DOLAN, *supra* note 18, at 7-37.

party from all perils, not just non-performance by the other party to the underlying contract. Letters of credit are used primarily in the international context, and the volume of litigation concerning letters of credit tracks closely to disruptions of international relations. "The start of every war, many revolutions, and realignments of a government of a country cause disruptions serious enough to lead to letter of credit litigation—although in peaceful times there is virtually none."¹²⁷ While more true of commercial credits than standbys, this statement certainly reflects how risk-shifting devices come under fire when an unforeseen external event, such as a civil war, comes to dominate a business relationship.

In most of the cases involving a disturbance in a foreign government, the courts have refused to enjoin payment on the ground that the parties had contracted to shift the risk of a foreign upheaval. The courts typically note the plaintiff's remedy against the other party on the underlying contract.¹²⁸ Some notable exceptions have arisen from foreign upheavals,¹²⁹ particularly from the Iranian Revolution in 1979.¹³⁰

The Iranian Revolution cases comprise the most injunctions against payment, including a number of modified devices like the notice injunction and the conditional indemnity.¹³¹ The actions against payment were authorized after the courts accepted the argument that suits against the Iranian government would prove futile.¹³² These actions preventing payment were generally disfavored by the banks paying credits, however, because an injunction in this country forced the bank to face the risk of asset seizure in the jurisdiction of the beneficiary.¹³³ The banks themselves opposed injunctive relief, arguing that the various contractors could pursue administrative remedies made available by an agreement between the U.S. and Iran.¹³⁴

The impact of injunctions in the Iranian cases could have a widespread commercial impact. Commentators have expressed concern that

¹²⁷ R. FOLSOM, *INTERNATIONAL BUSINESS TRANSACTIONS* 172 (1986).

¹²⁸ *Kingdom of Sweden v. New York Trust Co.*, 96 N.Y.S.2d 779 (N.Y. Sup. Ct. 1949); *Rosenfeld v. Banco Internacional*, 278 N.Y.S.2d 160 (N.Y. Sup. Ct. 1967); *KMW Int'l v. Chase Manhattan Bank, N.A.*, 606 F.2d 10 (2d Cir. 1979); *United Technologies Corp. v. Citibank, N.A.*, 469 F. Supp. 473 (S.D.N.Y. 1979); *American Bell Int'l, Inc. v. Islamic Republic of Iran*, 474 F. Supp. 420 (S.D.N.Y. 1979).

¹²⁹ *Republic of Panama v. Republic Nat'l Bank*, 681 F. Supp. 1066 (S.D.N.Y. 1988); *Republic of Panama v. Citizens & S. Int'l Bank*, No. 88-410.Civ.Aronovitz (S.D. Fla. Mar. 22, 1988).

¹³⁰ *Itek Corp. v. First Nat'l Bank*, 511 F. Supp. 1341 (D. Mass 1981); *Touche Ross & Co. v. Manufactures Hanover Trust Co.*, 434 N.Y.S.2d 575 (N.Y. Sup. Ct. 1980); *Harris Corp. v. National Iranian Radio & Television*, 691 F.2d 1344 (11th Cir. 1982).

¹³¹ Zimmet, *supra* note 15.

¹³² DOLAN, *supra* note 18, at 7-77 to 7-78.

¹³³ Zimmet, *supra* note 15.

¹³⁴ Zimmet, *supra* note 15.

attorneys may use the Iranian precedents to try to enjoin payment in the future, and foreign beneficiaries will speculate that U.S. courts will create further exceptions to payment.¹³⁵ When repeated injunctions destroy business confidence in letters of credit as effective performance assurances, businesses will seek other devices or other jurisdictions to work with.

C. Previous Bankruptcy Cases

Judge Baum in the *Wysko* bankruptcy court advised the debtor to look beyond Section 362 for an injunction of the letter of credit payment to Great American. It is well established that letters of credit, as independent from the underlying transaction, are not considered part of the debtor's estate.¹³⁶ Previous bankruptcy cases thus have upheld the independence principle by allowing parties to shift the risk of insolvency with letters of credit and respecting that allocation of risk by removing letters of credit from the bankruptcy estate.

A more contested point in bankruptcy is whether a draw on a letter of credit paid for a bankrupt constitutes a preferential transfer of the debtor's estate. An early precedent in this area upheld the independence principle by refusing to enjoin payment of the letter of credit.¹³⁷ *In re Marine Distributors, Inc.* concerned an issuing bank that was an unsecured creditor of the bankrupt, however, and left open the question whether a secured issuing bank could pay the credit contrary to the trustee's avoiding powers.¹³⁸ *Marine* was also decided under the more limited jurisdiction of the bankruptcy court that existed before 1978.

In 1979, under the expanded jurisdiction of the bankruptcy court, *Twist Cap, Inc. v. Southeast Bank (In re Twist Cap, Inc.)*, explored the question left open by *Marine*.¹³⁹ The court enjoined payment by a payor bank with secured creditor status to a beneficiary with unsecured creditor status, on the theory that the unsecured beneficiary received a preferential transfer.¹⁴⁰ This holding violated the risk-shifting independence principle not by tying the credit transfer to the underlying contract, but by subrogating that principle to the goal of preserving the debtor's estate under Section 547.¹⁴¹

¹³⁵ Zimmet, *supra* note 15.

¹³⁶ *In re Printing Dep't, Inc.*, 20 B.R. 677 (Bankr. E.D. Va. 1981); *In re Illinois-California Express, Inc.*, 50 B.R. 232 (Bankr. D. Colo. 1985).

¹³⁷ *In re Marine Distribs., Inc.*, 522 F.2d 791 (9th Cir. 1975).

¹³⁸ *Id.*

¹³⁹ 1 B.R. 284 (Bankr. D. Fla. 1979).

¹⁴⁰ *Id.*

¹⁴¹ 11 U.S.C. § 547 (1988).

Following the *Twist Cap* decision, the commercial paper market fell into some disarray. Credit agencies would not rate the commercial paper backed by standbys.¹⁴² Some indication that the reaction to *Twist Cap* was not an anomaly is given by the demand in the Arizona area after the *Wysko* decision that certificates of deposit be issued as security in place of letters of credit.¹⁴³ It is thus not mere speculation that threatening the independence principle of letters of credit could effectively destroy those devices and undermine the transactions they secure.

The *Twist Cap* reasoning was expressly rejected in *In re Page*,¹⁴⁴ and no circuit appears to follow it today. Furthermore, Justice Pakay, the author of *Twist Cap*, has subsequently held that letters of credit are not part of the debtor's estate and has taken pains to limit that holding to the narrow facts of the case.¹⁴⁵ *Twist Cap* did not represent the proper compromise between the need for an independence principle in letters of credit and the bankruptcy goal of protecting the debtor's estate.

*In re Air Conditioning Inc., of Stuart*¹⁴⁶ does represent a more realistic compromise of those goals. In *Air Conditioning*, the court reinstated payment of the letter of credit to the beneficiary but upheld the voiding of the transfer of a certificate of deposit securing the debt to the issuing bank because the bank had perfected its interest within the preferential transfer period.¹⁴⁷ Both the district and appellate courts took pains to protect letters of credit as valid commercial devices.¹⁴⁸ The *Air Conditioning* decision respects the bankruptcy policy of voiding preferential transfers within 90 days of bankruptcy,¹⁴⁹ and acknowledges that the bank has accepted the risk of the debtor's bankruptcy by issuing unsecured credit. *In re Compton Corp.* later cited and approved the *Air Conditioning* rule and endorsed an application of bankruptcy rules that does not interfere with letters of credit.¹⁵⁰ *Wysko* resembles *Twist Cap* more than *Air Conditioning* because it pursues the goals of bankruptcy without regard for the independence principle. *Air Conditioning* demon-

¹⁴² Chaitman & Sovern, *supra* note 6, at 22 n. 6 (referring to Baron, "LOC's and the 'Twist Cap' Problem," Standard & Poor's Credit Week (Jan. 25, 1982), wherein counsel to Standard & Poor's wrote: "... absent the resolutions of the 'Twist Cap' problem . . . S&P will not rate [letter of credit backed commercial paper] solely on the creditworthiness of the bank").

¹⁴³ Telephone Interview with Dale B. Furnish, *supra* note 70.

¹⁴⁴ 18 B.R. 713 (Bankr. D.D.C. 1982).

¹⁴⁵ DOLAN, *supra* note 18, at 7-13 n. 46.

¹⁴⁶ 55 B.R. 157 (Bankr. D. Fla. 1985).

¹⁴⁷ *Id.*

¹⁴⁸ *Id.*

¹⁴⁹ 11 U.S.C. § 547 (1988).

¹⁵⁰ 831 F.2d 586 (5th Cir. 1987).

strates a compromise between bankruptcy goals and letter of credit integrity.

X. CONCLUSION

Wysko Investment Co. v. Great American Bank represents a dangerous expansion of the bankruptcy court's equitable powers and a threatening precedent to ongoing confidence in and reliance upon letters of credit. *Wysko* is a poorly reasoned decision that ignores the line of cases removing letters of credit from the debtor's estate and adopts an extraordinary remedy, partly from mass-tort bankruptcy decisions, without presenting extraordinary facts. This third party injunction was created and survived district court scrutiny under the authority of Section 105 of the bankruptcy code, which gives bankruptcy judges great leeway to structure debtor-creditor relationships. In today's climate of many and complex bankruptcies, Section 105 must be more closely defined to effect reasonable compromises between bankruptcy goals and other business goals.

Whether and to what extent bankruptcy courts may enjoin third parties remains a difficult issue. While the exigencies of mass-tort litigation in *A.H. Robins* and *Johns-Manville* and the required debtor showing in *Otero Mills* present some justification for protecting principals of the debtor, Congress and the courts should be careful not to allow bankruptcy courts to enjoin third parties where letters of credit are concerned. The danger, of course, is that creditors who have deliberately contracted to avoid the risk of the debtor's insolvency will be subjected to that risk at the whims of bankruptcy judges.

Returning to the transaction presented above, if Seller in the U.S. fears an injunction blocking payment following Buyer's insolvency, Seller will not accept the letter of credit promise. Seller could still arrange the transaction, for instance by requiring Buyer to place the purchase amount in trust, but these arrangements are clearly more expensive. Letters of credit are the preferred performance assurance today, and simply require continued judicial recognition to remain useful.

History has shown that letters of credit will be abandoned, as in the wake of the Iranian revolution, *Twist Cap*, and *Wysko* itself. No district court decision by itself will sound the death knell of this instrument, of course, but *Wysko* represents the increasing tendency of courts to enjoin payment for a variety of reasons. Furthermore, while *Wysko* involves litigants in the same country, businesses in different countries face greater transactional and litigation costs, thus a greater threat from injunctions. Finally, while the authors of *Sztejn*, *Air Conditioning*, and *In*

re Compton Corp. shaped those decisions to respect precedent and policy, *Wysko* stands upon Section 105 and ignores both.

An appropriate balance between bankruptcy goals and letter of credit demands has already been reached in *Air Conditioning* and its progeny. Bankruptcy courts should respect the risk shift voluntarily assumed by the parties to a letter of credit transaction except when the risk of insolvency cannot be shifted by contract.¹⁵¹ Section 105 should not be used to overcome that line of cases which removes letters of credit from the debtor's estate, or to overturn other settled areas of law merely at a bankruptcy judge's discretion.

¹⁵¹ For example, within 90 days of the petition for bankruptcy. See 11 U.S.C. § 547 (1988) and *supra* pages 203-05.