

Notice of Nonrenewal of an "Evergreen" Letter of Credit Must Be "Clear and Unequivocal"

By Michael Evan Avidon, David Rabinowitz and Michael Judd Richter*

In a recent decision, the U.S. District Court for the Southern District of New York held that notice of nonrenewal of an "evergreen" letter of credit must be "clear and unequivocal."¹

Moses & Singer, LLP, had the privilege of representing the successful plaintiff, 3Com Corporation, in this case. The decision is one of the few reported decisions dealing with evergreen clauses (also sometimes referred to as "auto renewal" or "automatic extension" clauses) in letters of credit. This article discusses the court's decision.

Background

The case arose out of a commercial transaction. 3Com sells and licenses computer hardware and software. In October 1993, 3Com entered into a distributor agreement with Comp Service Ltda., a Brazilian company, and Expasa Florida Inc. Comp Service became an authorized distributor of 3Com products in Brazil; Expasa Florida was Comp Service's purchasing agent in the United States.

In November 1994, Comp Service had Banco de Brasil ("Banco") issue a \$250,000 standby letter of credit to 3Com to back up Comp Service's credit. The letter of credit was advised to 3Com by Bank of America.

The letter of credit had an original expiration date of May 20, 1995. However, the letter of credit contained an evergreen clause, providing that the letter of credit automatically renewed itself, without written amendment, a year at a time, unless Banco sent 3Com "written notice that we [Banco] have elected not to renew the letter of credit beyond such date." The letter of credit provided that it was subject to the Uniform Customs and Practice for Documentary Credits (1993 Revision), International Chamber of Commerce Publication No. 500 (the UCP).²

The letter of credit renewed automatically from the original expiration date of May 20, 1995, to May 20, 1996. Then, between July 1995 and April 1996, Banco sent several telexes to Bank of America requesting it to "please obtain authorization to cancel [the letter of credit]." Bank of America notified 3Com of Banco's requests, but 3Com denied Banco's requests for cancellation.

In early May 1996,² Banco sent a telex to Bank of America, stating in pertinent part:

YOUR STANDBY L/C NBF. LASB
222099 OUR GUARANTEE NBR. GBT
2681001696 USD 250,000.00 FAVORING
3COM CORP., SANTA CLARA, CA

REQUESTED BY COMP SERVICE
LTDA., SAO PAULO, SP PLS CANCEL
A/M STANDBY L/C AND RELEASE US
FROM LIABILITIES REGARDING A/M
GUARANTEE.

On June 13, 1996, more than two weeks after the May 20, 1996, expiration/automatic renewal date, Banco sent a telex to Bank of America stating:

A/M STANDBY WAS PREVIOUSLY DUE
ON [MAY] 20, 1995 AND AUTOMATI-
CALLY RENEWED UNTIL MAY 20,
1996. PLEASE CONSIDER OUR SWIFT
MT 799 DD 96[MAY]13 AS A NOTICE
OF TERMINATION AND RELEASE US
FROM LIABILITIES.

Bank of America, in turn, wrote to 3Com, relaying Banco's request to "have the letter of credit cancelled." 3Com refused. Bank of America then sent Banco a July 6, 1996 telex, which stated in pertinent part:

WE WISH TO INFORM YOU THAT BEN-
EFICIARY DECLINES YOUR REQUEST.
SUBJECT LETTER OF CREDIT IS
THEREFORE IN FULL FORCE AND
EFFECT UNTIL MAY 20, 1997 OR ITS
FUTURE EXPIRATION DATE AS LONG
AS AUTOMATIC RENEWAL CLAUSE IS
IN EFFECT.

Banco then claimed that its May telex requesting cancellation was actually a notice of termination and that the letter of credit had expired May 20, 1996, which Bank of America denied.

Meanwhile, on July 19, 1996, 3Com drew on the letter of credit. Banco dishonored the draw, stating that the letter of credit had expired.

3Com sued Banco for wrongful dishonor and moved for summary judgment. Banco cross-moved, arguing that the letter of credit had expired.³

Notice of Nonrenewal

The principal issue on the summary judgment motion was whether Banco's May 13, 1996, telex stating "Please cancel the standby letter of credit and release us from liabilities" was notice of Banco's "election not to renew" under the letter of credit's evergreen clause, which would have caused the letter of credit to expire one week later.⁴

3Com argued that the May 13, 1996, telex was not a notice of nonrenewal but, instead, was just another request for cancellation, which required 3Com's consent to be effective. 3Com contended that, since the telex was not an adequate notice of nonrenewal, the letter of credit automatically renewed for another year and, consequently, Banco was required to pay 3Com's draws.

In opposition, Banco argued that its May 13 telex was a notice of nonrenewal in compliance with the letter of credit. In particular, Banco argued that the word "cancel" used in the telex was, in plain meaning, equivalent to the word "terminate," and that the language of its May 13 telex was materially different from its three previous requests for 3Com's permission to "cancel" the letter of credit. Banco also argued that the three prior requests for cancellation helped give 3Com the message that Banco did not wish to renew the letter of credit.

The court crystallized the issue as being the clarity of notice required for the issuer to stop further automatic renewals of the letter of credit. The court framed the question as being who bears the risk of an ambiguous notice.

The court placed the risk on the issuing bank. Indeed, the court found that, while the UCP is silent with respect to both evergreen clauses and notices of nonrenewal of letters of credit, the terms, general principles and policies underlying the UCP all support a requirement of "clear and unequivocal" notice of nonrenewal.

In particular, the court found that it is apparent from Articles 5 and 12 of the UCP that "businesses engaged in letter of credit transactions expect precision and clarity in terms and instructions relating to the letter of credit." And since, under those articles, an irrevocable letter of credit cannot be amended without clear notice, a notice of termination should also require clear notice.

The court also reasoned that requiring clear and unambiguous notice of nonrenewal—i.e., notice which is not susceptible to different reasonable interpretations—is consistent with the UCP's policy that there should be no confusion or ambiguity as to whether a document is timely, as evidenced by the UCP's strong preference for firm expiry dates in Article 42. Similarly, the court pointed out that a clear and unequivocal notice standard is consistent with the "strict compliance" standard applied elsewhere in letter of credit transactions.

Finally, the court also reasoned that placing the burden of nonrenewal on Banco, such that the credit automatically renewed unless Banco acted to prevent it, amounted to placing the risk associated with ambiguous notice on Banco.

Applying the "clear and unequivocal" standard to the case, the court concluded, as a matter of law, that Banco's notice was not clear and unequivocal, and could easily have

been construed as a request for immediate cancellation as opposed to a notice of nonrenewal. While the court acknowledged that in many contexts the word "cancel" may encompass the meaning "terminate," in this case there were *two* types of termination envisioned by the letter of credit: an immediate termination, which required 3Com's consent; and a nonrenewal, which did not. Since Banco had used the term "cancel" in its three telexes prior to the May 13 telex to refer exclusively to the consensual kind of cancellation, it was "eminently reasonable" for Bank of America and 3Com to ascribe that same meaning to the word "cancel" in the May 13 telex.

Finally, the court noted that it was apparent from a subsequent Banco telex to 3Com that asked 3Com to "please consider our May 13 telex as a notice of termination" that Banco itself thought the May 13 telex was unclear. Accordingly, the court granted 3Com's motion for summary judgment.

Lesson of the Case

The *3Com* case highlights the need for clarity and precision in letters of credit, particularly in drafting evergreen clauses and notices of nonrenewal. A well-crafted letter of credit will specify precisely what the issuer must do to end automatic extensions of the letter of credit. A careful issuer will follow the procedures specified in its letter of credit when it wishes to stop automatic extensions. Parties dealing with the letter of credit, such as the beneficiary and any confirming bank, will then know whether the letter of credit is still in effect or has expired.

Endnotes

1. *3Com Corp. v. Banco de Brasil, S.A.*, 2 F. Supp. 2d 452 (S.D.N.Y. 1998).
2. The parties disputed whether the date of the telex was May 10, 1996, or May 13, 1996. The court found that the exact date was not a material fact or relevant to the decision, and referred to the telex as the May 13 telex.
3. Banco also argued unsuccessfully that 3Com's drawing was fraudulent.
4. The letter of credit's evergreen clause provided: "[The letter of credit] shall be automatically extended, without written amendment, in each successive calendar year unless we [Banco] send you [3Com] written notice that we have elected not to renew the letter of credit beyond such date" (emphasis added).

***Messrs Avidon and Rabinowitz are partners in and Mr. Richter is an associate of Moses & Singer, LLP in New York. They handled the subject case on behalf of the successful plaintiff, 3Com Corporation. Mr. Avidon chairs the Subcommittee on Letters of Credit of the New York State Bar Association's Banking Law Committee and is well-known in the letter of credit field, both for transactional work and litigation. Mr. Rabinowitz chairs the Moses & Singer Litigation Practice Group and handles a wide range of civil disputes.**