

News & Types: Commercial, Competition & Trade Update

Contract With One-Sided Termination Enforced – Not a Perpetual Contract

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In an earlier Risk Management Update, we reported on an Illinois case in which the court declined to enforce what it considered to be a perpetual contract. (*Rico Industries, Inc. v. TLC Group, Inc.* 2014 IL App (1st) 131522, February 7, 2014). In the *Rico* case, the Illinois Court of Appeals determined that an agreement that could only be terminated with the consent of both parties would be treated as an agreement of indefinite duration, thus terminable at will by either party.

A recent federal case dealt with a similar situation, with a variation that led to a different result. (*Burford v. Accounting Practice Sales, Inc. and Gary Holmes*, 7th Circuit Court of Appeals, No. 14-2692, May 13, 2015)

Accounting Practice Sales, Inc. (APS), as the name implies, was in the business of brokering the purchase and sale of accounting practices. APS hired Burford as its independent sales representative to market and facilitate the purchase and sale of these accounting practices. The parties had a written contract under which Louisiana was Burford's territory. Later, through an oral modification, Burford's territory included Alabama, Mississippi, Tennessee, and Kentucky. For purposes of the appeal, the court treated the parties' relationship as governed by the written agreement.

APS terminated its contract with Burford. Burford fought the termination in Illinois state court, later removed to federal court. The federal trial court granted APS' motion for summary judgment, analyzing the Agreement as an unenforceable perpetual agreement. Therefore, APS could terminate the Agreement at will.

But Judge Hamilton, for the 7th Circuit, disagreed, reversing the grant of summary judgment.

According to Judge Hamilton, Illinois law disfavors perpetual contracts. Rather than enforcing a perpetual contract, the courts will consider it a contract of indefinite duration terminable at the will of either party. But courts also favor freedom of contract. So a party to a contract can limit its ability to terminate a contract except on specified conditions or specified causes. So what kind of agreement was the APS Agreement?

Judge Hamilton agreed with the trial court that the APS Agreement was of indefinite duration. After it became effective, the Agreement "renews automatically on each anniversary date of this agreement for another period of twelve months." The Agreement had no provision for termination or optional renewal on each anniversary, so it continued indefinitely. The court concluded "there appears to have been no way for the parties to prevent automatic renewal." It can be asked whether this is what the parties intended, as this interpretation renders the one year anniversary meaningless. But, given the language in the Agreement, the court felt bound to call it an indefinite contract.

The APS Agreement permitted Burford to terminate at any time on thirty days' notice. But it also held Burford to a one year non-compete requirement after termination.

In contrast, this is how APS could terminate the Agreement: "APS cannot terminate this Agreement unless it is violated by Burford." The appeals court found it significant that Burford's contract violation was the exclusive basis under which APS could terminate the Agreement. To the trial court, the provision was superfluous – of course, a party can terminate an agreement when the other party breaches. But to Judge Hamilton, this violated a canon of contract construction to interpret contracts to give every provision meaning. By making this the exclusive basis for termination, APS gave up its right to terminate at will, which might have been implied otherwise.

In our Risk Management Update on the *Rico* case (referenced above), we classified agreements as follows:

1. Agreements that simply provide that they can only be terminated with the consent of both parties will be treated as agreements of indefinite duration, thus being terminable at will by either party.
2. Agreements that provide that they can be terminated with the consent of both parties might be enforced if a contingency is added that permits termination, which would make the termination provision more definite and more likely to be enforced.
3. Agreements that provide that a party "may" terminate upon a certain event (not just at will) may permit that party to terminate at will, since "may" suggests that the events are not exclusive.
4. Agreements providing that the events that trigger termination are the exclusive reasons for termination may save the termination provision and permit it to be enforced.

Apparently the trial court classified the APS Agreement in the first category – an agreement that could only be terminated with the consent of both parties.

But Judge Hamilton took a different view. His analysis was that the parties had used their freedom of contract to balance their risks and benefits.

- APS agreed that it could only terminate if Burford violated the Agreement. This limited APS but protected Burford from the risk of building goodwill in his territory, only to be terminated by APS, which could then take advantage of Burford's efforts. Notably, poor performance was a violation of the Agreement and could be a basis for termination.
- Burford could terminate at any time, with or without cause. This gave Burford flexibility, but the non-competition provision also limited Burford after termination and protected APS.

So, Judge Hamilton would likely classify the APS Agreement in the fourth category – an indefinite agreement that included exclusive reasons for termination.

The *Burford* case illustrates the balance the courts strike between the policy that disfavors perpetual contracts versus the policy that allows parties freedom of contract. Courts will strike down perpetual contracts (as in the *Rico* case). But courts will allow parties to restrict their ability to terminate an agreement (as in the *Burford* case).

In the *Rico* case, legal counsel did not prepare the agreement. Although not noted by Judge Hamilton, it seems likely legal counsel did not prepare the APS Agreement either. But even experienced legal counsel should be sensitive to how renewal and termination provisions would be analyzed by a court so as to avoid unintended results, as seems to have happened in both the *Rico* and the *Burford* cases.