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# Another Case Where Freedom of Contract Goes Too Far – A Perpetual Contract

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Practices: Commercial, Competition & Trade, Litigation

In an earlier Risk Management Update, we reported on a case in which a court refused to enforce what it perceived as an unenforceable liquidated damages provision. (*GK Development, Inc. v. Iowa Malls Financing Corporation*, 2013 IL App (1st) 112802, December 19, 2013) found here). A party entering into a contract was rescued from its bad bargain by a court which found that the money the party would be required to pay was so expensive as to be a penalty, which the court refused to enforce.

A recent Illinois case again illustrates that certain contracts will not be enforced, even though they have been negotiated and freely entered into by commercial businesses. This time the issue is whether a contract is "perpetual" and so unenforceable. (*Rico Industries, Inc. v. TLC Group, Inc.* 2014 IL App (1st) 131522, February 7, 2014).

Rico Industries (Rico) was an Illinois corporation manufacturing novelty products. TLC was an Arkansas corporation acting as Rico's sales representative. On December 17, 2007, Rico and TLC entered into an agreement that was two-thirds of a page long. Of course, neither party used legal counsel. Under the agreement, TLC had the right to serve as a sales representative for other companies that did not compete with Rico. But the kicker was the termination provision.

"Any change to, cancellation of, or termination of this Agreement shall be made in writing by TLC Group and Rico. Any change to, cancellation of, or termination of this Agreement shall be null and void *unless TLC Group and Rico mutually agree in writing to do so.*" (Emphasis added)

In September, 2012, Rico tried to terminate the Agreement, arguing that the Agreement it had negotiated and freely entered into was "null and void, unenforceable and against public policy." Basically, Rico argued that the Agreement was perpetual and so unenforceable. Would a court rescue Rico from its own folly? The answer is yes, it would.

Rico filed a complaint for declaratory judgment, basically asking the trial court to determine that the Agreement was unenforceable. The trial court found that the termination provision was not contrary to public policy. But the trial court granted Rico's motion for an immediate appeal to the Illinois Court of Appeals (Appeals Court) to decide the enforceability of the Agreement. The Appeals Court did not agree with the trial court. It found the termination provision was not enforceable, basically creating an Agreement terminable at will.Safeguard argued that the Act did not apply. The trial court agreed and Johnson's claim was dismissed. Johnson appealed to the Illinois Court of Appeals.

TLC first argued that Illinois law does not prohibit perpetual contracts. But the Appeals Court dismissed this in short order, citing Illinois cases holding that perpetual contracts are disfavored. Rather, perpetual contracts are treated as contracts of indefinite duration, generally terminable at the will of the parties. So the Appeals Court held that "perpetual contracts are contrary to public policy."

Then the Appeals Court got to the key issue: is an agreement that requires the consent of both parties to be terminated an unenforceable perpetual agreement and, therefore, an agreement that can be terminated at the will of either party?

The Appeals Court discussed several Illinois cases cited by the parties. For example, in *Jesperson v. Minnesota Mining & Manufacturing Co.* (183 Ill.2d 290 (1998)), the Illinois Supreme Court (the highest court in Illinois and the court above the Appeals Court) dealt with a termination provision in a sales representative agreement that permitted a sales representative for a company to terminate the agreement on 30 days' notice. But the company's ability to terminate was more limited. The agreement said the company "may" terminate the agreement for one of five specified reasons, based on breach or insolvency of the sales representative. The agreement did not provide for termination by the company at will. The Illinois Supreme Court held that the word "may" in the agreement was permissive and did not set forth the sole or exclusive reasons for termination. The Illinois Supreme Court distinguished cases that enforced agreements which "included an exclusive and specific right to terminate for cause." Providing that the company "may" terminate for specific reasons did not preclude termination by the company at will.

For additional support, the Appeals Court discussed another case involving an agreement between an employee and employer. (*Donahue v. Rockford Showcase & Fixture Co.*, 87 Ill.App.2d 47 (1967)) The employee sent a letter stating that "the agreement to run until cancelled by mutual consent of both parties or changed by mutual consent." The employer's president signed the letter. Two months later, the employee sent a second letter providing that the agreement would be automatically cancelled if shipments fell below a certain level. The employer's president signed this letter also. Later the employer tried to terminate the employee, but not for failing to reach the shipment level.

The *Donahue* appeals court made a decision, then flip-flopped. At first, it held that the agreement was terminable at will, since the only way it could be terminated was by mutual consent. But then the *Donahue* appeals court changed its decision. It found that adding the condition that the agreement could be terminated by failure to reach a specified shipment level "added a condition of termination that was not present in the first letter." So the *Donahue* appeals court upheld an agreement that it viewed as not terminable by either party "unless the contingency [failure to reach the shipment level] were met."

But the Agreement between TLC and Rico did not contain such a contingency. So the *Rico* Appeals Court found the Agreement, lacking such a contingency, to be an Agreement that was "terminable only by the mutual agreement of the parties", therefore, "of indefinite duration and, thus, terminable at will." Said the Appeals Court, "[A] contract terminable only upon the written agreement of the parties is indefinite because you cannot foresee when that will happen and it may never happen, and therefore it is of an indefinite duration."

So what lessons are we left with from the recent *Rico* case and the other Illinois cases it cites that decline to enforce termination provisions? The cases suggest the following lessons:

- 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. (the *Rico* court decision).
- But even 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. (the *Donahue* decision)
- Providing 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. (the *Jesperson* decision).
- But providing that the events that trigger termination are the exclusive reasons for termination may save the termination provision and permit it to be enforced. (the *Jesperson* decision)

We know that some of these agreements were prepared without advice of legal counsel and it seems quite likely that others were also. So perhaps the best lesson from the cases is to avoid indefinite agreements and permit the parties to periodically determine if they both want to continue the agreement – for example, permitting either party to terminate with or without cause or permitting parties to terminate on the contract's annual anniversary each year with or without cause. It is one thing to have to deal with an unfavorable contract for a specified period of time, but another to have no way out. A party to a contract should avoid a "forever" contract with no way out.