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News & Types: Corporate, Finance & Acquisitions Update

Contract Says Terminable on 30 Days' Notice – But Court Says, Not Really

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Practices: Corporate, Finance & Acquisitions, Litigation

A recent case from the 7th Circuit Court of Appeals discussed an interesting issue of contract interpretation of termination provisions, denying summary judgment and requiring further proceedings. But the decision also provoked a vigorous dissent that was probably more consistent with the freedom of contract principles (including freedom to make a bad contract) frequently espoused by 7th Circuit judges. (*Life Plans, Incorporated v. Security Life of Denver Insurance Company*, 7th Circuit Court of Appeals, No. 14-1437, August 31, 2015)

Life Plans is a life insurance brokerage agency that developed a new and, as described by the court, "apparently exotic" method of financing life insurance policies called Arbitrage Life Payment Systems (ALPS). Although too complicated for the court to describe in its opinion, the court noted that the results are heavily dependent on market interest rates.

In 2009 and 2010 Life Plans discussed developing an ALPS-financed policy, called Peak, with Security Life, to be brokered by Life Plans and insured by Security Life. So the parties entered into a Joint Cooperation Agreement on June 7, 2011. Among other provisions, the Agreement included the following:

- The Agreement was to continue "indefinitely, until terminated by either party upon thirty (30) days written notice. . . . [Security Life] will complete processing of all applications received prior to notice of termination."
- In a section called "Commitments", the Agreement provided that Security Life "agrees to accept at least $100,000,000 of premium per twelve month period, excluding reallocations and client payments, from July 1, 2011 until June 30 2014 . . . . ."
- Security Life's obligation to offer the Peak policy was subject to the condition permitting Security Life to review and approve the Peak policy under Security Life's "Product Review and Approval Process."
- The Agreement was governed by Delaware law.

The fact that the parties are now in litigation is an indication as to what happened. Security Life terminated the Agreement in October, 2011, only four months after the Agreement was signed. Security Life said it was terminating the Agreement because the Peak policy had not been approved through Security Life's internal review process.

Of course, Life Plans sued Security Life for breach of contract and, in the alternative, breach of the implied covenant of good faith and fair dealing. Life Plans' first strategy was to prevail on the breach of contract and collect damages for at least the three year period. But, as a fallback, Life Plans argued that, even if Security Life could terminate the Agreement, it was required to complete pending applications up to the notice of termination.

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Security Life moved for summary judgment. The trial court granted summary judgment to Security Life, based on the provision granting either party the right to terminate the Agreement on 30 days written notice.

But Judge Hamilton, writing for the 7th Circuit, took a different view, but not without disagreement with other members of the panel. The court first had to decide if the Agreement was ambiguous, for, only in that case, could the court consider extrinsic evidence. Judge Hamilton concluded the Agreement was ambiguous – the ability to terminate on 30 days' notice could not be reconciled with Security Life's agreement to accept a specified premium amount for a three year period. Therefore, the court could consider extrinsic evidence. In this regard, as would be expected, the evidence was contradictory as to what the parties intended. Of course, Life Plans argued the parties intended a minimum three year agreement and the ability to terminate on 30 days' notice came into play only after the three years. There was also some deposition testimony and documents from Security Life management that Security Life expected to write $300 million of Peak policies over three years. There was even an unfortunate e-mail from Security Life's CEO stating, "We are not operating with integrity in this deal." Judge Hamilton cited other arguments and evidence in the 29 page opinion but, in the end, all of this further persuaded Judge Hamilton that the case was not appropriate for summary judgment.

So the trial court was tasked with determining whether a) Security Life could indeed terminate on 30 days' notice at such an early stage in the Agreement and b) if so, whether Security Life was required to process the pending applications at the time of termination.

Judge Rovner dissented and her dissent was probably closer to the freedom of contract principles cited by the 7th Circuit in other cases: "In my view, the Termination provision is not ambiguous: it granted an unfettered right to either party to terminate the agreement on thirty days' notice." So Judge Rovner would affirm the trial court's summary judgment in favor of Security Life on its ability to terminate on 30 days' notice.

Judge Rovner disagreed with the majority that the "Commitments" provided for a three year term. So, unlike Judge Hamilton, she asserted the two sections are not conflicting or ambiguous. Said Judge Rovner, "I simply do not see any language in the Commitments clause that binds either party to a particular term of years. Instead, the Commitments clause locks in financial terms that will govern the parties during the first three years of an indefinite relationship."

As an analogy, Judge Rovner cited a month-to-month lease that includes references to rent for 12 months. The reference to rent for 12 months did not transform the month-to-month lease into a one-year lease. Similarly, the reference to three years did not transform the Agreement from one that could be terminated on 30 days' notice to one that was for a minimum of three years. She noted how easy it would have been to draft a three year agreement that would override the 30 days' notice provision, but the parties, particularly Life Plans, did not do this, but allowed the 30 day notice provision to stand.

In one area, Judge Rovner agreed with the majority. Judge Rovner agreed that summary judgment was not appropriate on Life Plans' claim that Security Life was required to process pending claims on termination. Of course, the amount at stake on that claim (and Life Plans' potential recovery) was much less than the entire Agreement.

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The situation described in the *Life Plans* case is not so unusual. An employment agreement may have provisions for compensation for a period of time, yet still permit termination before the end of the period. A distributor agreement or sales representative agreement may have sales targets for future years, yet still permit termination before the end of those years. Of course, it is important to avoid ambiguity in this regard. This might be done by adding a "notwithstanding" modifier to make clear that an early termination provision will override any other provision referring to a specific time period. It could also be done by making clear that there is no requirement that the agreement continue for a specified period, using language such as "If this Agreement is still in effect . . . ."

But the most important lesson is to review carefully the interplay and relationship of sections in the agreement, even those that seem to have no connection with each other. Whether Life Plans or Security Life will prevail at trial is not known. In either case, by opening the claim up to extrinsic evidence, the 7th Circuit increased the stakes and the legal fees and costs to both parties.

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