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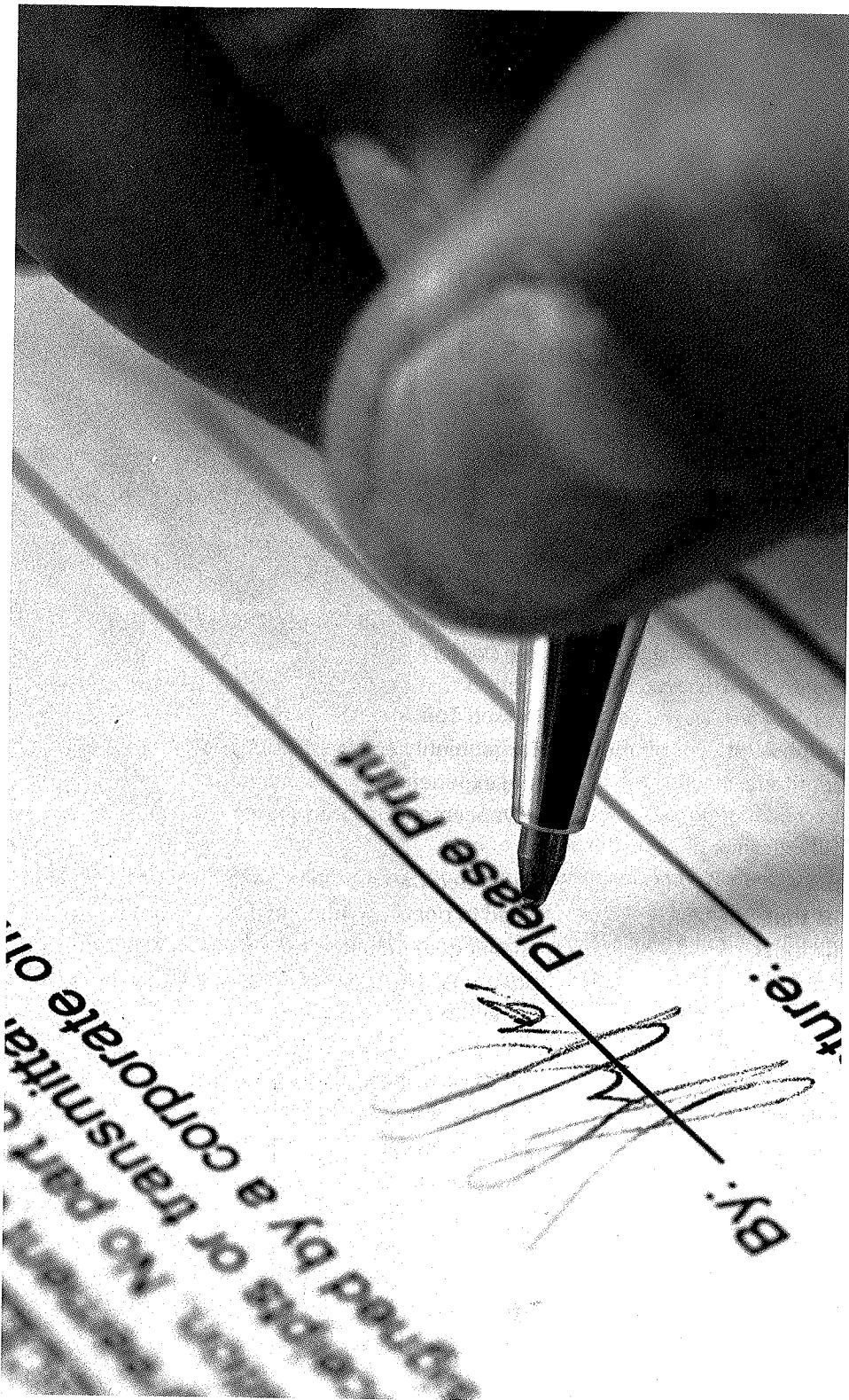
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A POTENTIAL RISK WITH LITTLE REWARD

Mutual Termination Clauses

By Daniel Saeedi



Lawyers often include the following boilerplate provision in their clients' business contracts: "This contract cannot be terminated or modified except by written agreement of both parties." This language is referred to here as a "mutual termination clause." Despite the frequency of their use, such provisions render little benefit to parties and, in certain circumstances, can cause harm by rendering contracts terminable at will. Lawyers should understand the meaning of a mutual termination clause before considering its inclusion in form contracts. Lawyers should also consider alternative clauses that better help define the rights and responsibilities of the parties.

Does a mutual termination clause actually benefit a party?

In one sense, a mutual termination clause states a redundancy. Illinois law already forbids unilateral modifications of contracts. *See Ross v. May Co.*, 377 Ill. App. 3d 387, 391 (1st Dist. 2007) ("No contract can be modified or amended in *ex parte* fashion by one of the contracting parties without the knowledge and consent of the remaining party to the agreement.") This is because a "valid modification must satisfy all criteria essential for a valid contract, including offer, acceptance, and consideration." Specifying in a contract that a party cannot unilaterally modify a contract does not provide for anything more or less than what is already a matter of law in Illinois.

As to termination, a mutual termination clause provides an empty promise. There are several scenarios that could eviscerate a contract. Frustration of purpose, act of God, impossibility, unfulfilled conditions, material breach, violation of public policy and even time can all, in the right circumstances, cause a contract to be terminated.

They can also nullify a mutual termination clause. Thus, a mutual termination clause promises more than it can deliver.

Some might argue that a mutual termination clause provides a benefit by ensuring that all modifications to the contract are in writing. But this is incorrect. Illinois courts consistently have held that a written contract can be modified by a subsequent oral agreement, even though the written contract precludes oral modifications. *Tadros v. Kuzmak*, 277 Ill. App. 3d 301, 312, 660 N.E.2d 162, 170 (1995); *A.W. Wendell & Sons, Inc. v. Qazi*, 254 Ill. App. 3d 97, 105, 626 N.E.2d 280, 287 (1993); *Berg & Associates, Inc. v. Nelsen Steel & Wire Co.*, 221 Ill. App. 3d 526, 535, 580 N.E.2d 1198, 1204 (1991). Others might argue that a mutual termination clause at least provides an optical benefit to non-lawyer parties by discouraging breach. But, as discussed below, parties have little fear of legally challenging contracts with such clauses.

Thus, a mutual termination clause provides little benefit to parties. Admittedly, in many circumstances, it will not do much harm either, and have no function other than taking up space. But, where the parties intentionally do not wish to provide for specific termination dates and instead contemplate a flexible contract for continuing services, a mutual termination provision, on its own, can be troublesome. Given the right circumstances, it can render the contract terminable at will.

How a mutual termination clause can do more harm than good

Consider the recent case of *Rico Industries, Inc. v. TLC Group, Inc.*, 2014 Ill App (1st) 131522. *Rico* concerned a representation contract that made a company the exclusive Wal-Mart sales representative of a manufacturer's products. The agreement contained a mutual termination clause. Nine months after entering into this contract, the manufacturer attempted to unilaterally terminate it as void against public policy and subsequently filed a complaint for declaratory judgment. The trial court granted the representative's motion for judgment on the pleadings and

held that the contract was not contrary to public policy. The manufacturer sought certification of the issue under Supreme Court Rule 308(a).

The trial court certified the issue, and the appellate court considered whether a continuing sales representation contract containing a mutual termination clause was specific enough in its terms to render the agreement sufficiently definite in duration and not terminable at will. The court answered "no" to this question, and held that the contract at issue was indefinite, violated public policy and could be terminated at will. The court focused on the mutual termination clause as evidence for why, without more detail, the contract was indefinite. Citing the Illinois Supreme Court in *Jespersen v. Minnesota Mining & Mfg. Co.*, 183 Ill. 2d 290 (1998), the court noted that contracts of indefinite duration were void as against public policy: "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." Thus, the contract was terminable at will.

Rico is an example of the type of harm that can occur where a Mutual Termination Provision is construed to render a contract terminable at will. Indeed, after *Rico*, where a continuing service contract does not provide for specific termination dates,

including a Mutual Termination Provision is risky.

Candidly, there are instances where a mutual termination clause will not be harmful. *Rico* cited *Donahue v. Rockford Showcase & Fixture Co.*, 87 Ill. App. 2d 47 (1967), an example of a mutual termination clause coupled with an ability to terminate the contract if commissions fell below a set amount. The latter requirement was objective enough to save the contract from being terminated at will. However, as *Donahue* acknowledged, had the mutual termination clause existed on its own, the contract would have also been terminable at will.

Courts will scrutinize all contracts that appear to be indefinite. Mutual termination clauses help to give the impression of perpetuity. As the Illinois Supreme Court in *Jespersen* noted, "Forever" is a long time and few commercial concerns remain viable for even a decade. Advances in technology, changes in consumer taste and competition mean that once profitable businesses perish-regularly. Today's fashion will tomorrow or the next day inevitability fall the way of the buggy whip, the eight-track tape and the leisure suit."

Alternatives

What is the preferred alternative? If a lawyer is going to draft a contract with a mutual termination clause, the lawyer

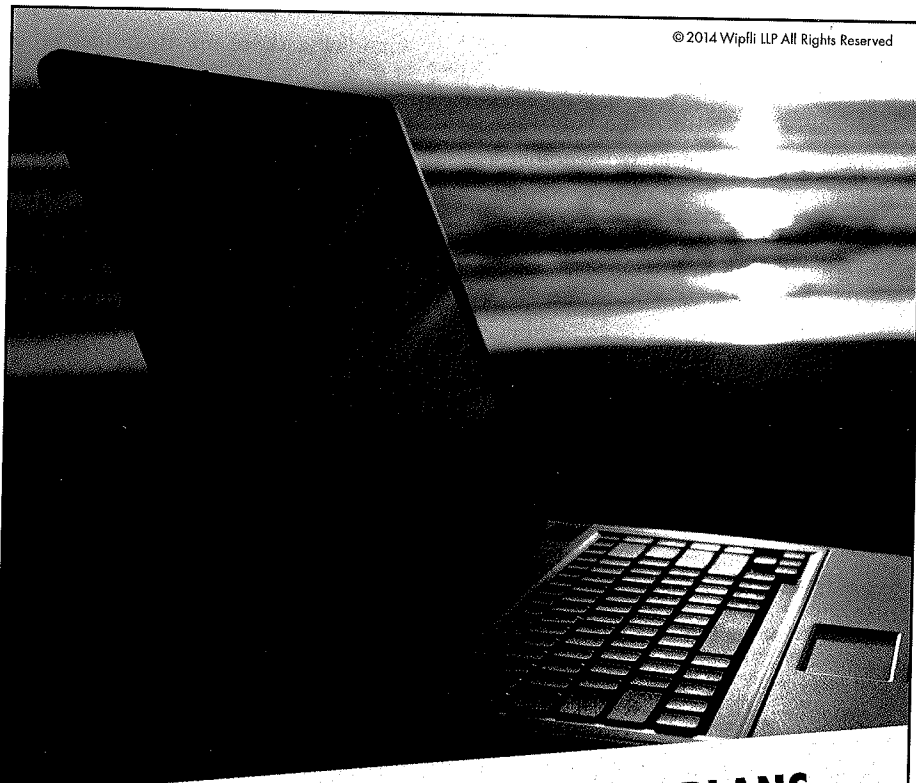


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should take steps to ensure that the contract has a definite end date. And, if the contract is open-ended, then it should have, as the courts in *Jespersen* and *Donahue* recognized, defined termination events that are objective. These objective events should not merely be described generally as "the event of breach," but rather should have some factual detail as to the scenarios where the contract will be terminated. And, as to events of breach, lawyers should focus on adding strong contractual language as to the specific factual circumstances of material breach, as well as the specific procedure for default. These provisions can provide clarity and help remove the impression of indefiniteness. Lawyers can also include several other types of contractual clauses that help dissuade a party from breaching its obligations. These include, but are not limited to, favorable liquidated damages clauses, arbitration clauses and limitations on liability. Savvy lawyers can use these provisions to craft effective contracts that provide flexibility to their client, while also ensuring that the other side has sufficient incentive to keep its end of the bargain.

But for those lawyers who prefer using their boilerplate language, when it comes to relying solely on a mutual termination clause, they do so with little benefit to their clients and, at times, some potential risk. ■

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