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Beware of expired contracts

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A. Introduction

The situation is not unusual. A vendor selling products or performing services has included in its form contract robust limitations on liabilities or exclusions on damages. In addition, the vendor has excellent contracting discipline in rarely modifying these provisions during contract negotiations. As with many businesses providing low margin products and services, this vendor needs to limit its liability on any individual contract in order to remain profitable. What happens next is also not that unusual; the contract has a specified term length and it expires. Or perhaps it has an auto-renewal clause that (for reasons discussed below) is not enforceable. So either way the contract expires, but the parties continue to perform as if the contract they signed is still in place. Chances are that neither party has noticed that the contract has expired, or perhaps the parties are aware that it has expired, but have not gotten around to renewing it. Or it might be that one of the parties is aware that the contract has expired, but believes the contract has favorable terms that it would likely lose in a renewal negotiation. Thus, the party, with the favorable terms, opts to "let sleeping dogs lay."

What happens next is not an everyday occurrence but is known to happen now and again: there is a substantial breach of the contract by the vendor, possibly an injury caused by a defective product the vendor has supplied or by the service the vendor has performed.

And what happens after that might surprise you.

B. The Law Applicable to Expired Contracts

Although contracts are governed by applicable state law, courts have to date typically taken one of the following three approaches to expired written contracts when parties continue performing beyond the termination date: (1) the written contract continues to exist beyond the stated termination date for a reasonable time period; (2) the written contract is deemed expired and the parties will be deemed to have entered into a new contract implied-in-fact; or (3) no contract exists between the parties.

The first approach, with all of the terms of the written contract being extended for a reasonable period of time,[1] is the best-case scenario for the party seeking to enforce the terms of the contract. What constitutes a reasonable period of time varies from case to case.[2]

Under the second approach, rather than extending the terms of the written contract, the parties will be deemed to have entered into a contract implied-in-fact. A contract implied-in-fact arises where the intention of the parties is not expressed through a written or oral contract; rather, a contract in fact creating an obligation for each party is implied.[3] When such a contract is established, states differ on whether terms from a pre-existing written contract carry over to the subsequently-created contract implied-in-fact. In Illinois, when a court determines that parties have entered into a contract implied-in-fact, the terms of that contract include those terms that may be implied from the parties' conduct and actions[4] but exclude those terms that were not apparent from the parties' conduct. Therefore, terms such as liability caps, choice of law provisions, and indemnity provisions contained in the expired written contract will most likely not be included in an Illinois contract implied-in-fact. However, in other jurisdictions, such as New York, the terms and conditions of a contract implied-in-fact will include all of the terms contained in the expired written contract if the parties continue to perform in accordance with those terms after the written contract has expired.[5]

Under the third approach, where a determination is made that no contract exists, a party may nevertheless recover from the other by claiming the existence of a contract implied-in-law. A contract implied-in-law is not a contract at all; rather, it is a rule of law that requires one

party to provide restitution to another party for services rendered.[6] Though a contract implied-in-law may provide a remedy to a performing party, it would not seem to be of much help to a party seeking the protections from a pre-existing written contract.

Issues may also arise where a written contract contains a defective auto-renewal clause. This happens more than one might think. Many states have set forth specific statutory requirements that must be complied with in order to make an auto-renewal clause enforceable. In Illinois, the Illinois Automatic Contract Renewal Act requires service providers to provide a written reminder to non-business consumers, not less than 30 days after and not more than 60 days before the termination date, that their contracts will automatically renew, which reminder must include (1) that their contracts will automatically renew unless the consumers cancel; and (2) how they can obtain details of the automatic renewal provision and cancellation procedures.[7] Failing to comply with this Act may constitute an unlawful practice under the Illinois Consumer Fraud and Deceptive Business Practices Act.[8] For an unlawful practice committed under the Illinois Consumer Fraud and Deceptive Business Practices Act, Illinois courts may revoke or suspend the violator's business license and impose a civil penalty up to $50,000, and if the consumer is older than 65 years old, then an additional civil penalty up to $10,000 may be imposed.[9]

C. Conclusion

Companies need to have reliable systems in place for monitoring their outstanding contracts to ensure they are not performing under expired contracts. This is especially important for companies that include significant risk-mitigation terms in their contract templates, such as damage caps and exclusions on certain remedies and damages. Failing to do so exposes these companies to significant risk if a contract expires. ■

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1. *Double Diamond, Inc. v. Hilco Elec. Coop., Inc.*, 127 S.W.3d 260, 266 (Tex. App. Waco 2003).
2. *Sieber & Calicutt, Inc. v. La Gloria Oil & Gas Co.*, 66 S.W.3d 340, 347 (Tex. App. Tyler 2001).
3. *Brody v. Finch Univ. of Health Sciences/The Chicago Med. Sch.*, 298 Ill. App. 3d 146, 154 (Ill. App. Ct. 2d Dist. 1998).
4. *O'Neil & Santa Claus, Ltd. v. Xtra Value Imports, Inc.*, 51 Ill. App. 3d 11, 14 (Ill. App. Ct. 3d Dist. 1977).
5. *Tanton v Lefrak SBN Ltd. Partnership,* 2013 N.Y. Misc. LEXIS 261, *30 (N.Y. Sup. Ct. Jan. 23, 2013).
6. *Barry Mogul & Assocs. v. Terrestris Dev. Co.*, 267 Ill. App. 3d 742, 750 (Ill. App. Ct. 2d Dist. 1994).
7. 815 ILCS 601/10.
8. 815 ILCS 601/15.
9. 815 ILCS 505/7.