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# REPORT

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## “PERPETUAL” CONTRACTS UNDER CALIFORNIA LAW



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At common law, contracts with no express duration are terminable at the will of either party. From a practitioner’s standpoint, determining when parties are no longer bound by a contract without an express end date is thus a crucial task, since if a court cannot construe a contract to contain a definite duration, the common law default rule kicks in.

A contract with an indefinite duration—often termed a perpetual contract—generally has one of two characteristics. Either the contract may call for successive performances without specifying a final performance, or it may fail to specify a duration. Contracts of indefinite duration commonly include distributor and franchise arrangements, service contracts, and real property agreements.

Conversely, contracts not governed by the California Commercial Code that call for a set number of performances are terminable upon completion of the set of performances. Such contracts often involve a set number of deliveries or a specific quantity of goods—for instance, a yield of a crop planted on a specific plot of land, or all of the materials required to complete a particular project. Contracts of this type that specify that they continue until some event occurs are generally not indefinite: courts determine that the contractual obligations of the parties end upon occurrence of that specified event.

Even where a contract does not call for a set of performances and is not terminable upon completion, California courts will attempt to avoid construing the contract as perpetual. In *Consolidated Theatres, Inc. v. Theatrical Stage Employees Union, Local 16*, 69 Cal. 2d 713, 727 (1968), the California Supreme Court created a three-step analysis to cabin the duration of perpetual contracts. First, courts look to find an express term of duration in the contract. Second, if an express term is absent,

the court looks to the intention of the parties in order to imply a duration, if that is possible. In doing so, the court looks at whether duration can be inferred from the nature of the contract and the circumstances surrounding it. To show implied intent, parties may introduce extrinsic evidence which the court can use in construing the contract’s duration. *See Am. Indus. Sales Corp. v. Airscope, Inc.*, 44 Cal. 2d 393, 397 (1955) (“[W]hen the parties have not incorporated into an instrument all of the terms of their contract, evidence is admissible to prove the existence of a separate oral agreement as to any matter on which the document is silent and which is not inconsistent with its terms.”).

Third, if neither an express nor an implied term can be found, the term of duration will be construed to be a reasonable time. Obligations under the contract are terminable at the will of either party after that party gives reasonable notice to the other party and after a reasonable time has elapsed. However, California courts go to great lengths to avoid such a construction for multiple reasons. First, courts avoid this construction because it is often either illogical or against public policy. *See Cooper Cos. v. Transcon. Ins. Co.*, 31 Cal. App. 4th 1094, 1103-04 (1995) (deeming the “troubling ramifications” resulting from interpreting an insurance contract terminable at will “unreasonable”). Second, courts disfavor perpetual contracts because they permit courts to infer the contractual intent of parties for a contract of a “reasonable time”—often without any evidence that such intent was shared by the parties themselves at the time of contracting. Thus, where no express duration exists, courts will usually imply a duration under the second step based on the contracting parties’ intent. Courts conclude that a contract contains a perpetual term only if such a reading is compelled by the unequivocal language of the contract. *See Zimco Rests., Inc. v. Bartenders & Culinary Workers Union, Local 340*, 165 Cal. App. 2d 235, 238 (1958).

Despite their best efforts to avoid such a construction, there are instances in which California courts have found that a contract is perpetual. For example, in *Zee Medical Distributors Ass’n, Inc. v. Zee Medical, Inc.*, 80 Cal. App. 4th 1 (2000), an

association of distributors brought an action seeking a declaration that its contract with the supplier lacked a definite duration and was thus terminable at will. The Court of Appeal held that the plain, unambiguous language of the contract expressly provided for a term of indefinite duration and that the contract was therefore terminable at the will of either party. *Id.* at 13-14.

While the three-step analysis applies generally to all perpetual contracts, special issues present themselves in certain areas. For example, contracts governed by the California Commercial Code are subject to a different analysis. The California Commercial Code states that where a contract provides for successive performances but is indefinite in duration, the agreement is valid for a reasonable time, but unless otherwise agreed, the contract may be terminated at any time by either party. It also provides, however, that termination of a contract by one party, except on the happening of an agreed event, requires that reasonable notification be received by the other party. An agreement dispensing with notification is invalid if its operation would be unconscionable. *See* Cal. Com. Code § 2309 (West 2002).

Contracts addressing periodic payment situations also bedevil California courts. In determining whether a party must make periodic payments under a contract that provides no fixed date for termination of the party's obligation, the court looks at whether there is an ascertainable event that may supply a basis for implying a termination date. For example, in *Lura v. Multaplex, Inc.*, 129 Cal. App. 3d 410 (1982), an individual sued a corporation for breach of a contract under which he agreed to secure customer accounts for the corporation in exchange for commissions based on the corporation's sales to those accounts. The contract contained no provision specifying how long these commissions would be paid. The California Court of Appeal reversed the trial court's holding that the obligation was terminable at the will of either party so long as reasonable notice was given. *Id.* The plaintiff's only duty under the contract was to secure accounts. Once he had done so, the only obligation remaining was that of the corporation to pay the agreed-upon compensation. Because the plaintiff had already performed the services he was contractually obligated to perform, the defendant was thus obligated to continue paying the commissions to the plaintiff as long as it continued to benefit from the accounts plaintiff secured. The Court of Appeal thus held that the corporation could not terminate the agreement by simply giving reasonable and sufficient notice of its intent to cease making commission payments because the contract already contained an ascertainable event under which the termination would

necessarily be implied: the corporation's termination of sales to the accounts plaintiff procured. *Id.* at 415.

Another area in which California courts have addressed the issue of perpetual contracts is exclusive distributorships. In *Kolling v. Dow Jones & Co.*, 137 Cal. App. 3d 709 (1982), for example, the California Court of Appeal held that, absent a provision requiring cause for termination, an agreement creating an exclusive distributorship is, much like contracts with an indefinite duration, terminable by the supplier at will upon reasonable notice.

Real property contracts present another instance in which the perpetual contract issue can arise. In the landlord-tenant context, perpetual leases are complicated by both public policy and statutory guidance. For example, California Civil Code section 718 prohibits leases longer than ninety-nine years. However, more recent decisions have rejected the use of section 718 to limit the term of a lease unless it extends beyond ninety-nine years by its express terms. Further, courts also note that provisions allowing perpetual renewal of leases are disfavored because they potentially "put[ ] it in the power of one party to renew forever, and [are] therefore against the policy of the law," even if perpetual renewals would not violate the rule against perpetuities. *Ginsberg v. Gamson*, 205 Cal. App. 4th 873, 884 (2012).

Even though perpetual leases are disfavored, California courts may interpret a lease as perpetual where there is "peculiar and plain language" showing that parties intended to create such a lease. *Id.* at 885. *Ginsberg* is an example of a case that did not meet that standard. There, the California Court of Appeal stated that a lease containing language allowing extension of the lease for additional five-year periods failed to "demonstrate a clear intent to create a right to unlimited extensions." *Id.* at 890. The court noted that the ambiguous language referring to "additional periods" did not clearly show an intent to create the right to unlimited renewals. *Id.* at 891.

Without evidence of intent which can supply a basis to imply a duration or express language stating a definite duration, a contract may unintentionally become perpetual, and thus terminable at the will of either party. Accordingly, it is critical that attorneys drafting or reviewing contractual language ensure that their clients are aware of the duration for which the contract binds them.

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