

A Lesson on Renewable Contracts

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For some companies, keeping track of all of their contracts can be a difficult task, particularly in today's economic climate when fewer employees are available to help shoulder the burden. While all contract provisions are important, some of those provisions, such as the expiration/termination provisions, need special attention. Some contracts are automatically renewed unless one party provides notice within a certain period of time before expiration. Other contracts require express action by one or both of the parties in order to renew. A recent federal case in the Eastern District of Pennsylvania highlights the unanticipated consequences associated with the failure to renew a contract.

In *Tinder Box International, Ltd., v. Patterson*, the court was faced with two parties, neither of whom was aware that their franchise agreement had expired. For approximately five months after the expiration, the parties continued their franchisor-franchisee relationship. Once the oversight was discovered, the franchisor offered to renew the agreement, but the franchisee declined. Eight months later, the franchisor filed a lawsuit, alleging, among other things, a violation of the one year non-compete provision contained in the franchise agreement.

The court ruled that the franchise agreement had not been implicitly renewed. The court acknowledged the general principle that when parties maintain their business relationship after a contract lapses, the provisions of the expired contract continue to govern the relationship. However, the court noted that the principle only applies in the absence of evidence that the parties intended a different result. In examining the evidence, the court found it persuasive that the contract stated that it could only be amended by written agreement and that the contract "anticipated its own expiration" by imposing obligations upon expiration, including the non-compete provision.

As a result, the franchisee was permitted to walk away from the contract and, perhaps most damaging to the franchisor, the court barred the franchisor's breach of contract claims (including the breach of the non-compete clause) ruling that the contract's one year limitation period on claims had begun to run from the date the contract's stated term expired. Perhaps not surprisingly, the court showed little sympathy to the franchisor's argument that the neglect of its employees should prevent the limitation period from running. Instead, the court decided that the franchisor, as a corporate entity, had "imputed" knowledge of the contract's terms when it was signed by the company's

president. Furthermore, the court was influenced by the fact that the franchisor had at least three employees that were involved in administering its franchise agreements.

This case highlights the prudence of a reliable docketing system for companies to stay abreast of their contract terms, so as to avoid unintended results. It also shows the importance of negotiating the expiration/termination provisions carefully. If the contract is one that is vital to your company's future, consider requiring affirmative action of some sort before permitting the agreement to expire.

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