

# Business Law & Governance

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## Evergreen Clauses: Be Aware of the Pitfalls

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### Introduction

One of the most basic, but important, elements of a contract is its term. Term indicates "the duration" for a contract or how long a contract remains in force. Terms of contracts, of course, vary widely in length and can be dictated by applicable law. Sometimes the parties to a contract sign the agreement, put the contract in a drawer, and go forward in the relationship not thinking about the consequences of the term until several years later when one party is looking to end the relationship even though neither party has breached the agreement. That party tells the other party that it is terminating the relationship immediately, but the latter directs the former back to the term clause in the contract and reminds the former that the term is still ongoing due to the inclusion of an evergreen clause. An evergreen clause, or automatic renewal provision, is a key term in many healthcare agreements.

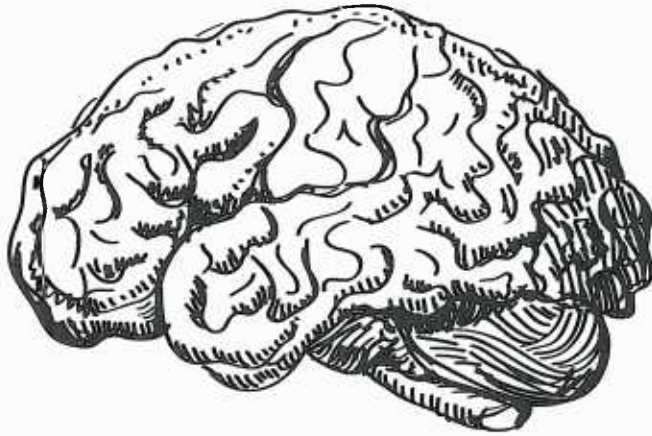
This article examines the intricacies of the evergreen clause, the possible benefits, the issues to be wary of, and its application in the healthcare world.

### What Is an Evergreen Clause?

As a general concept, an evergreen clause provides that the term of an agreement will automatically renew for some period of time unless one party provides the other party with notice before the end of the current term that it does not wish to renew the term of the agreement. An example of such a clause is as follows:

The initial term of this Agreement shall be one (1) year commencing as of the date hereof. Thereafter, the term of this Agreement shall automatically renew for successive one (1) year terms unless one party provides written notice to the other party at least ninety (90) days in advance of the end of the then existing term that it does not wish to renew the term of this Agreement.

Under the terms of the above clause, if neither party provides the appropriate advance notice, then the parties will be locked in for another year. Of course, all parties to an agreement can mutually agree in writing at any time to terminate the agreement, irrespective of the inclusion of an evergreen clause. There also may be additional termination clauses in the agreement that allow one party to terminate the agreement on the occurrence of certain triggers such as breach by the other party, subject to any applicable notice-and-cure periods.



The above is merely an example as evergreen clauses can take many shapes and forms. Further, automatic renewal periods can be longer than one year each and the advance notice required to terminate the agreement can be longer than 90 days.

## Why May Evergreen Clauses be Useful?

### Peace of Mind for Both Parties

The inclusion of an automatic renewal provision allows the parties to continue the relationship without having to renew the agreement in writing every time the term ends. While doing so would be a simple task, for those who are a party to countless agreements, the ability to affirmatively renew each and every agreement on time would likely be very difficult, resulting in relationships continuing with no agreement in force and possible litigation, among other consequences.

### Advantage to the Provider

If the term of the agreement continues to renew and the party who is making payments under the agreement is not constantly required to agree to renew the agreement, it is possible that such party may not be reminded to end the relationship and therefore continue to regularly pay the performing party without second thought. An example of this is monthly payments for information technology services.

## Key Issues for Evergreen Clauses

### Notice Transmission

If a party desires to provide notice of non-renewal of an agreement, such party must make sure that the notice complies in full with the notice provision of an applicable agreement. This will include who, where, and how notice must be sent. Failure to strictly abide by the notice provision may result in the other party having a strong argument that the agreement has, in fact, not been terminated. Most notice provisions will require a method by which the sender will receive some indication that the recipient has actually received the notice, such as certified mail—return receipt requested. If the

agreement does not require such a method, follow the notice provision in the agreement and send a duplicate copy of the notice via a method that does alert the sender to receipt.

### Notice Timeline

There is no one-size-fits-all approach to determining how much advance notice should be required of a non-renewing party. Generally, the thought process is how much time the parties reasonably need to unwind their relationship to prepare for termination. Each party to the agreement may have a different opinion on the amount of time, which can make this a heavily negotiated point of the agreement. Additionally, parties should be careful when negotiating this issue as short notice is not always as advantageous as it would appear on the surface.

### Termination for Special Circumstances

Certain parties may want to negotiate special circumstances under which they could terminate the agreement, other than for breach of the agreement, notwithstanding the inclusion of an evergreen clause. For example, managed care agreements, which often include evergreen clauses, also may permit payors to change reimbursement rates during the term of the agreement. With respect to a managed care agreement, providers should negotiate for both a period of advance notice pursuant to which the payor must disclose the new proposed rates to the provider well in advance of implementation and a period in which the provider has the ability to terminate the agreement due to such changes.

### Termination for Breach of Contract

Each party to an agreement with an evergreen clause should, nevertheless, still have an opportunity to terminate the agreement for breach of contract by the other party immediately. Depending on the services and performance required under the agreement, a cure period may be applicable, but the cure period should not be the remainder of the applicable term. This is especially important when the breach in question is nonpayment of compensation.

### Renegotiation

The inclusion of an evergreen clause in the agreement does not prohibit the parties from renegotiating the terms of the agreement. In fact, evergreen clauses can be helpful for renegotiation as the parties have set out for a long-term relationship, but have essentially designated periods along the way where they can revisit the terms of that relationship and determine if the terms continue to make sense in light of the relationship.

### Change in Terms

In the context of a provider of services under the agreement, if an evergreen clause is included, but there is no escalation in the compensation under the agreement, the provider may find himself/herself neglecting to renegotiate the terms of the agreement prior to

the conclusion of the notice period and obligated to provide services during the renewal period with no increase in compensation.

## Are Evergreen Clauses Enforceable?

Evergreen clauses are generally enforceable unless there is a statute in the state whose law governs the agreement prohibiting evergreen clauses or there is case law in such state that refuses to enforce it. It is important to research state law for the state whose law will govern the agreement before including and drafting an evergreen clause.

For example, New York has a statute that applies to contracts for services, maintenance, or repairs to real or personal property that have automatic renewal clauses for periods of greater than one month.<sup>1</sup> The statute provides that the provider of the service, maintenance, or repair must serve notice personally, or by certified mail, to the recipient at least 15 days, but not more than 30 days, prior to the notice period required by the automatic renewal clause in the contract calling the attention of the recipient to the existence of the automatic renewal clause.<sup>2</sup>

The failure to comply with statutes such as the foregoing New York statute may render an automatic renewal clause unenforceable and result in the contract being terminated at the end of the current term. Those doing business in states that have statutes regulating these clauses should be mindful of such statutes so as to ensure compliance with their provisions. On the other hand, parties who find themselves unwillingly bound to another contract term as a result of an evergreen clause should also be mindful of new legislation that may provide defenses to an automatic renewal claim.

Additionally, evergreen clauses should be carefully drafted, so as not to risk being unconscionable. For example, an agreement that contains a three-year initial term and then automatically renews for successive six-year renewal terms may not be enforceable.

## Evergreen Clauses in the Healthcare Fraud and Abuse World

Evergreen clauses can be helpful for parties entering into arrangements that must comply with an exception to the Physician Self-Referral Act, commonly known as the Stark Law.<sup>3</sup> Many exceptions to the Stark Law, such as the exception for the rental of office space and equipment, require a written agreement to continue to be in effect for the duration of the relationship for the relationship to continue to fall within the exception.<sup>4</sup> The inclusion of an evergreen clause in the written agreement allows the parties to always have a written agreement in place during the term of the relationship. The Stark Law does not prohibit the inclusion of evergreen clauses in agreements.

Nonetheless, while an evergreen clause may allow an agreement that needs to comply with an exception to the Stark Law to continue to meet the written agreement requirement, the parties

must constantly reevaluate the financial terms of the agreement to ensure that they continue to be fair market value (FMV), as FMV is a constantly evolving standard. The United States and the state of Delaware entered into a settlement agreement with Christiana Care Health System (CCHS) in 2010 to resolve allegations that CCHS violated federal and state false claims acts. The underlying complaint centered on agreements entered into between CCHS and neurologists pursuant to which CCHS paid the neurologists for services rendered to CCHS. The agreements dated back to 1989, but continued in place through 2003 due to the inclusion of evergreen clauses. However, the fees paid under the agreements were never adjusted and were alleged to be significantly above FMV. The settlement was for the amount of \$3 million.<sup>5</sup>

## Conclusion

Evergreen clauses are included in numerous agreements, including many healthcare agreements. While they can prove to be beneficial to both parties, each party should take care, when negotiating the agreement, to evaluate the merits of the automatic renewal provision on a long-term basis. Such clauses may appear benign at first glance, but after careful evaluation of the potential consequences of the relationship, a party may change its mind.

1 N.Y. GOB. Law § 5-903(3).

2 *Id.* at (3).

3 See 42 U.S.C. § 1395nn.

4 See e.g. 42 C.F.R. § 411.357(a) and (b).

5 See [www.justice.gov/usao/de/news/2010/Christiana%20Care%20PR.pdf](http://www.justice.gov/usao/de/news/2010/Christiana%20Care%20PR.pdf).

