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# A New Approach to the Identification and Enforcement of Open Quantity Contracts: Reforming the Law of Exclusivity and Good Faith

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## Articles

### A NEW APPROACH TO THE IDENTIFICATION AND ENFORCEMENT OF OPEN QUANTITY CONTRACTS: REFORMING THE LAW OF EXCLUSIVITY AND GOOD FAITH

Shelley Smith\*

#### I. INTRODUCTION

Among the many varieties of open term contracts, open quantity contracts have been particularly problematic for scholars, attorneys, and judges, especially in the areas of formation and breach. Courts are issuing decisions on whether the parties have entered into an enforceable requirements contract or an unenforceable indefinite quantity agreement at a pace that is troubling, given how long courts have been grappling with the formation issue.<sup>1</sup> Litigation also continues at a steady clip over whether the buyer in a requirements contract has breached the implied duty of good faith by reducing or eliminating his requirements.<sup>2</sup> The

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<sup>1</sup> See, e.g., *Keck Garrett & Assocs., Inc. v. Nextel Commc'n, Inc.*, 517 F.3d 476, 479 (7th Cir. 2008); *Propulsion Techs., Inc. v. Attwood Corp.*, 369 F.3d 896, 904 (5th Cir. 2004); *Brooklyn Bagel Boys, Inc. v. Earthgrains Refrigerated Dough Prods., Inc.*, 212 F.3d 373, 378 (7th Cir. 2000); *In re Modern Dairy of Champaign, Inc.*, 171 F.3d 1106, 1110 (7th Cir. 1999); *Merritt-Campbell, Inc. v. RxP Prods., Inc.*, 164 F.3d 957, 963 (5th Cir. 1999); *Orchard Group, Inc. v. Konica Med. Corp.*, 135 F.3d 421, 430 (6th Cir. 1998); *Essco Geometric v. Harvard Indus.*, 46 F.3d 718 (8th Cir. 1995); *Advanced Plastics Corp. v. White Consolidated Indus.*, No. 93-2155, 1995 U.S.App. LEXIS 1047 (6th Cir. 1995); *Advent Sys. Ltd. v. Unisys Corp.*, 925 F.2d 670, 679-80 (3d Cir. 1991); *Mid-South Packers, Inc. v. Shoney's, Inc.*, 761 F.2d 1117, 1120-22 (5th Cir. 1985); *Harvey v. Fearless Farris Wholesale, Inc.*, 589 F.2d 451, 461 (9th Cir. 1979); *Fisherman Surgical Instruments, LLC v. Tri-anim Health Servs., Inc.*, 502 F. Supp. 2d 1170, 1177, 1179 (D. Kan. 2007); *Boydston Metal Works, Inc. v. Cottrell, Inc.*, 519 F. Supp. 2d 1119, 1132-33 (D. Or. 2007); *TVI, Inc. v. Infosoft Techs., Inc.*, 2007 WL 3565208 at \*7-\*8 (E.D. Mo. 2007); *In re Anchor Glass Container Corp.*, 345 B.R. 765, 769-71 (M.D. Fla. 2006); *Embedded Moments, Inc. v. Int'l Silver Co.*, 648 F. Supp. 187, 192-93 (E.D. N.Y. 1986); *Arrotin Plastic Materials of Ind.v. Wilmington Paper Corp.*, 865 N.E.2d 1039, 1042 (Ind. Ct. App. 2007); *Billings Cottonseed, Inc. v. Albany Oil Mill, Inc.*, 328 S.E.2d 426, 429 (Ga. Ct. App. 1985); *Integrated Micro Sys., Inc. v. NEC Home Elecs. (USA), Inc.*, 329 S.E.2d 554, 556 (Ga. Ct. App. 1985).

<sup>2</sup> See, e.g., *Norfolk S. Ry. Co. v. Basell USA Inc.*, 512 F.3d 86, 95-96 (3d Cir. 2008); *Brewster of Lynchburg, Inc. v. Dial Corp.*, 33 F.3d 355, 367-68 (4th Cir. 1994); *U & W Indus. Supply, Inc. v. Martin Marietta Alumina, Inc.*, 34 F.3d 180, 185-88 (3d Cir. 1994); *Empire Gas Corp. v. Am. Bakeries Co.*, 840 F.2d 1333, 1338 (7th Cir. 1988); *Sourcecorp BPS, Inc. v.*

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decisions in these cases have been criticized for displacing the parties' own allocations of risk with misguided evaluations of business judgments based on an ill-defined standard.<sup>3</sup> Further, the fragmented open quantity contracts jurisprudence reveals that courts have failed to provide uniform standards and have inconsistently applied the standards in cases with comparable facts.

Scholars have yet to identify a workable set of solutions to address these issues. Some have argued that the implied duty of good faith is necessary to validate non-exclusive open quantity contracts,<sup>4</sup> but many criticize good faith as a performance standard because it undermines the contracting parties' efforts to allocate the quantity risk by agreement.<sup>5</sup> While one author suggests that non-exclusive open quantity contracts should be enforced as long as "they are the product of true bargaining between parties[.]" he offers no alternative to good faith as a performance standard.<sup>6</sup> My proposal would provide a principle for recognizing and policing non-exclusive as well as exclusive open quantity contracts without relying on the implied duty of good faith. When parties allocate quantity risks, their allocation should be enforced,

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Kenwood Records Mgmt., Inc., 548 F. Supp. 2d 673, 680-81 (S.D. Iowa 2008); Vulcan Materials Co. v. Atofina Chems. Inc., 355 F. Supp. 2d 1214, 1234-36 (D. Kan. 2005); Metal One Am., Inc. v. Ctr. Mfg., Inc., 2005 WL 1657128 at \*6-7 (W.D. Mich. 2005); MDC Corp. v. John H. Harland, Co., 228 F. Supp. 2d 387, 396-97 (S.D.N.Y. 2002); Sea Link Int'l, Inc. v. Osram Sylvania, Inc., 969 F. Supp. 781, 786 (S.D. Ga. 1997); Trimed, Inc. v. Sherwood Med. Co., 772 F. Supp. 879, 886-87 (D. Md. 1991); NCC Sunday Inserts, Inc. v. World Color Press, Inc., 759 F. Supp. 1004, 1012-15 (S.D.N.Y. 1991); Schawk, Inc. v. Donruss Trading Cards, Inc., 746 N.E.2d 18, 27 (Ill. App. Ct. 2001); Ind.-Am. Water Co., Inc. v. Town of Seelyville, 698 N.E.2d 1255, 1260-61 (Ind. Ct. App. 1998).

<sup>3</sup> Victor P. Goldberg, *Discretion in Long-Term Open Quantity Contracts: Reining in Good Faith*, 35 U.C. DAVIS L. REV. 319, 347-66 (2002). The same lack of clarity and consistency is found in the standard of good faith beyond the context of requirements and output contracts. See Teri J. Dobbins, *Losing Faith: Extracting the Implied Covenant of Good Faith from (Some) Contracts*, 84 OR. L. REV. 227, 229 (2005). As Professor Dobbins has observed, "Despite decades of attempts to clarify the good-faith duty and its application in various contracts, almost all acknowledge that the cases in which courts have applied the duty of good faith are rife with inconsistencies and confusion, even within single jurisdictions." *Id.* Dobbins advocates limiting the scope of the doctrine where it is used to impose obligations that are inconsistent with what the parties bargained for, to deny rights that are expressly conferred, and to inject uncertainty into otherwise unambiguous contracts to make them more "fair" or "just" in the eyes of the factfinder. *Id.* at 231.

<sup>4</sup> Travis W. McCallon, *Old Habits Die Hard: The Trouble with Ignoring Section 2-306 of the UCC*, 39 TULSA L. REV. 711, 735 (2004); Caroline N. Bruckel, *Consideration in Exclusive and Nonexclusive Open Quantity Contracts Under the UCC: A Proposal for a New System of Validation*, 68 MINN. L. REV. 117, 185-11 (1983).

<sup>5</sup> See Goldberg, *supra* note 3, at 347-66; Bruckel, *supra* note 4, at 191 n.301.

<sup>6</sup> Allen Blair, "You Don't Have To Be Ludwig Wittgenstein": How Llewellyn's Concept of Agreement Should Change the Law of Open-Quantity Contracts, 37 SETON HALL L. REV. 67, 115 (2006).

and when they fail to make an allocation of risk, courts should review the relevant evidence and employ analytical tools of contract interpretation such as the hypothetical bargain approach to determine how the parties would have allocated the quantity risk at issue had they anticipated and bargained for its allocation.

The criticism of good faith as a performance standard in the context of requirements and output contracts, and my response to this criticism, requires a brief discussion of a broader theoretical debate, as well as an inherent doctrinal conflict. The question is whether good faith is essentially a method of contract interpretation that courts use to protect the expectations of the parties, or whether, like the doctrine of unconscionability, it also makes certain conduct unlawful, regardless of the intent of the parties.<sup>7</sup> Under the former view, good faith could<sup>8</sup> and

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<sup>7</sup> See Harold Dubroff, *The Implied Covenant of Good Faith in Contract Interpretation and Gap-Filling: Reviling a Revered Relic*, 80 ST. JOHN'S L. REV. 559 (2006). Professor Dubroff explains that while Professor Allan Farnsworth and Professor Steven Burton view the implied duty of good faith performance as a mechanism for carrying out the intentions of the parties and for protecting their reasonable expectations, *id.* at 603, Professor Robert Summers's approach is "largely rooted in morality rather than in individual autonomy, and therefore may be used to support results contrary to the part[ies'] intentions[.]" *Id.* at 598. Dubroff also describes the confusion that this issue has created in applying the *Restatement (Second) of Contracts* and portions of the Uniform Commercial Code. Section 205 of the *Restatement (Second) of Contracts* follows Summers' approach, but is inherently inconsistent in attempting to apply both a good faith standard that would enforce the parties' intentions and one that would invalidate any provisions that violated community standards of fairness and decency: "[g]ood faith performance or enforcement of a contract emphasizes faithfulness to an agreed common purpose and consistency with the justified expectations of the other party; it excludes a variety of types of conduct characterized as involving 'bad faith' because they violate community standards of decency, fairness or reasonableness." *Id.* at 602. The Official Comments to UCC section 1-304 provide, "[T]he doctrine of good faith merely directs a court towards interpreting contracts within the commercial context in which they are created, performed, and enforced, and does not create a separate duty of fairness and reasonableness which can be independently breached." U.C.C. § 1-304 cmt. (2008). Dubroff argues that, if good faith is simply a basis for contract interpretation, the parties should be able to negate good faith as they can negate reliance on trade usage, course of dealing, or course of performance under the Comments to UCC section 2-202. Dubroff, *supra*, at 614-15. But the obligation of good faith cannot be disclaimed, *see* U.C.C. § 1-302(b), and because good faith also cannot be defined in the contract by the parties in a way that is determined *ex post* as "manifestly unreasonable," the concept of good faith will always impose an undefined standard that may conflict with the parties' intent.

<sup>8</sup> *See* Market Street Assocs. v. Frey, 941 F.2d 588, 596 (7th Cir. 1991).

We could of course do without the term 'good faith,' and maybe even without the doctrine. We could...speak instead of implied conditions necessitated by the unpredictability of the future at the time the contract was made. . . . But whether we say that a contract shall be deemed to contain such implied conditions as are necessary to make sense of the contract, or that a contract obligates the parties to

possibly should be eliminated whenever the expectations of the parties can be protected by applying the modern and inclusive, rather than formalistic, approaches to contract interpretation adopted by the Restatement Second and the Uniform Commercial Code (the "UCC" or the "Code").<sup>9</sup> Parties would not have to fear liability under the amorphous standard of good faith, but would still be subject to existing doctrines of fraud, misrepresentation, estoppel, waiver, unconscionability, duress, mistake, illegality, and other grounds for denying enforcement of contractual rights.<sup>10</sup> Scholars who take this view posit that using familiar methods of contract interpretation is preferable to good faith, a subjective and unprincipled standard that is often used to overturn the parties' rights and expectations rather than to enforce them.<sup>11</sup> Indeed, despite decades of sustained work in this area by highly

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cooperate in its performance in 'good faith' to the extent necessary to carry out the purposes of the contract, comes to much the same thing. They are different ways of formulating the overriding purpose of contract law, which is to give the parties what they would have stipulated for expressly if at the time of making the contract they had had complete knowledge of the future and the costs of negotiating and adding provisions to the contract had been zero.

*Id.*

<sup>9</sup> Dubroff, *supra* note 7, at 559 ("The Implied Covenant of Good Faith"). Dubroff argues that the standard of good faith should not be universally applied to all contracts because modern methods of contract interpretation make resort to good faith unnecessary for protecting the expectations of the parties (as it was under the Nineteenth Century formalist approach to contract interpretation) and because imposing an unbargained for covenant of good faith conflicts with the principle of party autonomy. *Id.* at 562-63, 615. He applies his point specifically to requirements and output contracts: "[i]n some of these instances, such as the obligation to exercise good faith in requirements and output contracts, the same criticisms that are suggested with respect to the general implied covenant of good faith apply with equal force; that is, the good faith requirement is simply a surrogate for the real question at issue, which is the interpretation of the contract." *Id.* at 563.

In a similar vein, Dobbins responds to Professor Michael Van Alstine's concerns regarding the rise of the "textualist" approach to good faith, which focuses on the parties' expressed intent, as "largely unfounded." Compare Dobbins, *supra* note 3, at 227, with Michael P. Van Alstine, *Of Textualism, Party Autonomy, and Good Faith*, 40 WM. & MARY L. REV. 1223 (1999). "Respecting the primacy of the parties' agreement does not mean relying exclusively on the agreement's text. Instead, it means that the agreement cannot be disregarded in favor of more equitable or "fairer" terms as determined ex post facto by the court or jury." Dobbins, *supra* note 3, at 275.

<sup>10</sup> Dobbins, *supra* note 3, at 232.

<sup>11</sup> Dubroff, *supra* note 7, at 586-87. "Moreover, it is submitted that the interpretation approach to the case offers a principled basis for determining the agreement of the parties [discussing *Fortune v. National Cash Register, Co.*, 364 N.E.2d 1251 (Mass. 1977)], while the good faith approach to the case invites the court to simply state conclusively a rule that seems proper to the individual judge." Dubroff applies his thesis to the analysis of requirements contracts under Professor Summer's identification of "evading the spirit of

accomplished scholars, including Professor Robert Summers, whose “excluder” analysis has been adopted by the Restatement Second,<sup>12</sup> and Professor Steven Burton, who formulated the “foregone opportunities” test,<sup>13</sup> the term “good faith” has, according to Judge Posner, no “settled meaning,” and remains, as he famously put it, “a chameleon.”<sup>14</sup> As a result, the doctrine could be undermining party autonomy by adding ambiguity, and hence uncertainty, which the parties cannot avoid by agreement, into the performance obligations imposed by all contracts.<sup>15</sup>

Returning to the subject of formation, a majority of courts<sup>16</sup> and commentators<sup>17</sup> take the position that a requirements contract is not

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the deal” as bad faith rather than under principles of contract interpretation in the following passage:

As examples of evasions of the spirit of the deal, Professor Summer offers cases in which a buyer who is a party to a requirements contract either attempts to avoid ordering what it really needs (say in the case of a falling market), or attempts to expand its requirements beyond its normal business needs (say, in the case of a rising market). Approaching these cases as matters of interpretation would involve inquiring into the negotiations and other contextual factors of the transaction (e.g., historical requirements of the buyer, course of dealing), and filling any gaps with court-determined fair and reasonable terms. At best, deciding these cases on whether the spirit of the deal has been evaded is a less accurate description of what the court should be doing—identifying the contract and enforcing it. At worst, such a method of deciding these cases is unprincipled and may lead to erroneous results in determining rights under the contract.

*Id.* at 597. See also Dobbins, *supra* note 3, at 254 (“Instead of viewing the implied covenant as an interpretive aid or gap-filler, these courts have implied obligations that add to or even contradict the obligations spelled out in the parties’ agreement in the name of fulfilling the parties’ (or at least one party’s) reasonable expectations.”).

<sup>12</sup> Robert S. Summers, “Good Faith” in *General Contract Law and the Sales Provision of the Uniform Commercial Code*, 54 VA. L. REV. 195 (1968). “In contract law, taken as a whole, good faith is an ‘excluder.’ It is a phrase without general meaning (or meanings) of its own and serves to exclude a wide range of heterogeneous forms of bad faith.” *Id.* at 201. (citations omitted). Summers’ approach was adopted by the *Restatement (Second) of Contracts*. RESTATEMENT (SECOND) OF CONTRACTS, § 205 cmt. d (1981).

<sup>13</sup> Steven J. Burton, *Breach of Contract and the Common Law Duty To Perform in Good Faith*, 94 HARV. L. REV. 369 (1980). “Bad faith performance occurs precisely when discretion is used to recapture opportunities forgone upon contracting—when the discretion-exercising party refuses to pay the expected cost of performance.” *Id.* at 373.

<sup>14</sup> *Empire Gas Corp. v. Am. Bakeries Co.*, 840 F.2d 1333, 1339 (7th Cir. 1988).

<sup>15</sup> Dubroff, *supra* note 7, at 617–18.

<sup>16</sup> See, e.g., *Simmons Foods, Inc. v. Hill’s Pet Nutrition, Inc.*, 270 F.3d 723, 726–27 (8th Cir. 2001); *Porous Media Corp. v. Midland Brake, Inc.*, 220 F.3d 954, 960 (8th Cir. 2000); *Brooklyn Bagel Boys, Inc. v. Earthgrains Refrigerated Dough Prods., Inc.*, 212 F.3d 373, 377–80 (7th Cir. 2000); *Zemco Mfg., Inc. v. Navistar Int’l Transp. Corp.*, 186 F.3d 815, 817–18 (7th Cir. 1999); *Merritt-Campbell, Inc. v. RxP Prods., Inc.*, 164 F.3d 957, 963–64 (5th Cir. 1999); *Essco Geometric v. Harvard Indus.*, 46 F.3d 718, 728–29 (8th Cir. 1995); *Modern Sys. Tech. v. United States*, 979 F.2d 200, 205 (Fed. Cir. 1992); *Harvey v. Fearless Farris Wholesale*,

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enforceable unless it places an obligation on the buyer to purchase all of the requirements of a particular product exclusively from the seller, and conversely, that an output contract is not enforceable unless the seller agrees to supply his output exclusively to the buyer. A minority of courts and commentators believe that this “exclusivity rule,” which was developed under the common law to enforce open quantity contracts, has been replaced under section 2-306(1) of the UCC by a “good faith” standard that requires buyers and suppliers to tender or demand quantities that are not “unreasonably disproportionate” to estimated or “normal” quantities.<sup>18</sup> Between these two extremes, many jurisdictions have adopted modified versions of the exclusivity rule as well as a whole host of exceptions.<sup>19</sup>

Exceptions to the exclusivity rule show that it is not, in its broadest formulation, necessary for validation. For example, requirements contracts are enforced in some jurisdictions when (1) the buyer sets a cap on the quantity of goods he is required to purchase from the seller; (2) the buyer purchases all of his requirements exclusively from the seller, but only for particular customers; or (3) when the buyer purchases his requirements exclusively from the seller, but only for a specific project. These variations of the exclusivity rule indicate that an alternative rule could be formulated that would satisfy the mutuality and definiteness doctrines while providing the flexibility to validate any requirements

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Inc., 589 F.2d 451, 461 (9th Cir. 1979); *Fisherman Surgical Instruments, LLC v. Tri-anim Health Servs., Inc.*, 502 F. Supp. 2d 1170, 1177 (D. Kan. 2007); *Boydston Metal Works, Inc. v. Cottrell, Inc.*, 519 F. Supp. 2d 1119, 1132-33 (D. Or. 2007); *Pepsi-Cola Co. v. Steak 'N Shake, Inc.*, 981 F. Supp. 1149, 1158-59 (S.D. Ind. 1997); *Upsher-Smith Labs., Inc. v. Mylan Labs., Inc.*, 944 F. Supp. 1411, 1426-27 (D. Minn. 1996); *Indus. Specialty Chems., Inc. v. Cummins Engine Co.*, 902 F. Supp. 805, 810 (N.D. Ill. 1995); *Propane Indus., Inc. v. Gen. Motors Corp.*, 429 F. Supp. 214, 218-21 (W.D. Mo. 1977); *Stacks v. F & S Petroleum Co., Inc.*, 641 S.W.2d 726, 727-28 (Ark. Ct. App. 1982); *Ind.-Am. Water Co., Inc. v. Town of Seelyville*, 698 N.E.2d 1255, 1259-61 (Ind. Ct. App. 1998); *Kirkwood-Easton Tire Co. v. St. Louis County*, 568 S.W.2d 267, 268-69 (Mo. 1978); *United Servs. Auto Ass'n v. Schlang*, 894 P.2d 967, 970-72 (Nev. 1995); *Wilsonville Concrete Prods. v. Todd Bldg. Co.*, 574 P.2d 1112, 1114-15 (Or. 1978).

<sup>17</sup> See, e.g., ALLAN E. FARNSWORTH, FARNSWORTH ON CONTRACTS § 2.15 (4th ed. 2004); 2 LARRY LAWRENCE, ANDERSON ON THE UNIFORM COMMERCIAL CODE § 2-306:39 (3d ed. Supp. 2005); 1 WILLIAM D. HAWKLAND, HAWKLAND'S UNIFORM COMMERCIAL CODE SERIES § 2-306:1 (Supp. 2005); 10 RICHARD A. LORD, WILLISTON ON CONTRACTS § 29:16 (4th ed. Supp. 2005); JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE § 3-9 (4th ed. 1995).

<sup>18</sup> See *Amber Chem Inc. v. Reilly Indus., Inc.*, 2007 WL 512410 at \*7 (E.D. Cal. 2007); *Gen. Motors Corp. v. Paramount Metal Prods. Co.*, 90 F. Supp. 2d 861, 873-74 (E.D. Mich. 2000); *Plastech Engineered Plastics v. Grand Haven Plastics, Inc.*, 2005 WL 736519 at \*6-\*7 (Mich. Ct. App. 2005); *Hoover's Hatchery, Inc. v. Utgaard*, 447 N.W.2d 684, 688 (Iowa Ct. App. 1989). See also *Bruckel*, *supra* note 4, at 185-211; *McCallon*, *supra* note 4, at 735.

<sup>19</sup> See *infra* Part IV.B.

contract in which the buyer agrees to purchase, or the seller agrees to supply, an ascertainable quantity of goods.

In all courts, regardless of whether they follow the exclusivity rule, and in decisions involving contracts for services as well as goods, courts imply a duty of good faith on sellers to generate output and on buyers to order requirements that are reasonably consistent with estimated or historical quantities, with the caveat that a buyer's needs can fall to zero as long as the decline is not due to the bad faith conduct of the buyer. The buyer in a requirements contract cannot order quantities that exceed estimates by an unreasonable extent because the buyer might be purchasing the products to resell them in a rising market, a risk the parties presumably would not have anticipated when they entered into the contract.<sup>20</sup> Conversely, while the buyer in a requirements contract can reduce his requirements to zero, he can do so only if he is acting in good faith.<sup>21</sup>

The implied duty of good faith serves two functions. First, in a minority of jurisdictions, the duty of good faith replaces the exclusivity rule as a validation principle for open quantity contracts. Second, in every jurisdiction, it supplies a definition of quantity that allows courts to determine if the quantity-determining party breached the contract through a tender or demand of an unreasonably high quantity or by a reduction or elimination of output or requirements that is not made in good faith. Accordingly, any alternative to the exclusivity rule that eliminates the implied duty of good faith should not be adopted unless it performs these functions at least as well as, if not better than, the implied duty of good faith.

This Article addresses whether open quantity contracts must be exclusive to satisfy the doctrines of mutuality of obligation and indefiniteness, and whether the good faith standard of the Code is sufficient to satisfy these doctrines without reliance on the exclusivity rule. In an effort to answer these questions, the Article discusses decisions recognizing open quantity contracts that are not entirely exclusive but come "close enough" to satisfy the principles of contract formation. From this discussion, a framework will arise for a new standard to recognize "partially-exclusive" open quantity contracts. This standard would require courts to enforce open quantity contracts whenever there is evidence of a quantity term sufficient to indicate that the seller in an output contract has agreed to produce all or an ascertainable portion of his output to the buyer, and that the buyer in a requirements contract has agreed to purchase all or an ascertainable

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<sup>20</sup> See *infra* pp. 881-83.

<sup>21</sup> *Id.* at 883.



portion of his requirements from the seller. Validation would neither rely on the implied duty imposed upon buyers and sellers in open quantity contracts under the common law and the Code not to reduce or eliminate their requirements or output unless they do so in “good faith,” nor would it rely on the implied duty not to tender or demand quantities that are unreasonably disproportionate to the parties’ estimates, or normal or historical quantities. Based on an examination of the formation cases, this Article also explores whether adoption of a new validation standard would be sufficient to address the current lack of predictability in the law, or whether new methods of interpretation are needed to correctly identify enforceable open quantity contracts. Turning to breach of contract cases, this Article examines whether there are reasons for retaining the implied duty of good faith, which sets upper and lower limits to a seller’s output and a buyer’s requirements, or whether the parties should be left to set their own limits when drafting their contracts.

In Part II, this Article briefly summarizes the historical basis for the recognition of requirements contracts and asks whether creating a requirement of exclusivity and an implied duty of good faith were necessary in this regard, or whether a more limited view of the promises exchanged in these contracts would have satisfied validation concerns, leaving the parties free to allocate the market price and quantity risks.

Part III examines how the concepts of exclusivity and good faith have been affected by the adoption of section 2-306 of the UCC. Specifically, this Article analyzes whether good faith is sufficient to satisfy the doctrines of mutuality and definiteness, as the Official Comments to UCC section 2-306 assert, the potential inconsistency between this claim and application of UCC section 2-306 as a gap-filler, and the ability of parties to avoid the application of UCC section 2-306 by agreement.

In Part IV, this Article reviews current case law addressing formation issues under the exclusivity rule, its variations, and the duty of good faith.

Part V examines the methods of interpretation used by courts to identify enforceable open quantity contracts, focusing on five problem areas and offering corrective action in each.

In Part VI, this Article explores cases in which the seller has alleged that the buyer breached a requirements contract by reducing or eliminating his requirements in “bad faith.” The goal of Part VI is to compare the results courts are achieving in these cases to the results that could be achieved if the parties drafted their own provisions for allocating these risks.

In Part VII, this Article explains why eliminating the implied duty of good faith from the law of open quantity contracts will not convert these contracts into buyer's options, as Judge Posner suggests in his decision in *Empire Gas Corp. v. American Bakeries Co.*<sup>22</sup>

Three specific proposals for reform are laid out in Part VIII. First, I propose a new exclusivity rule for courts to apply to the formation question. Second, I recommend a more disciplined approach to contract interpretation for courts to use in identifying valid open quantity contracts. To conserve judicial resources and avoid opportunistic behavior, private parties would be required to write contracts that state the buyer's or seller's commitment to purchase or supply the goods, and to allocate the risks of variable quantities in a trade-off between the interests of the judicial system and business sector that is long overdue. In the final proposal, I suggest adopting a revised version of UCC section 2-306(1) which removes the references to "good faith" and "unreasonably disproportionate" quantities. The purpose of this revision is to ensure that the quantity limitations imposed by these terms are not used as mandatory, but rather as default rules, and to recognize that without further agreement, all the parties to a requirements or output contract agree to is that to the extent they have any requirements or output, these quantities cannot be purchased from or supplied to one of the promisee's competitors.

## II. THE CREATION OF THE EXCLUSIVITY RULE AND THE IMPLIED DUTY OF GOOD FAITH FOR OPEN QUANTITY CONTRACTS

When first presented with open quantity contracts in the mid-nineteenth century, courts refused to enforce them based on the classic doctrines of mutuality of obligation and definiteness. The dilemma was that in output and requirements contracts, the promisor does not agree to buy or sell any minimum quantity of goods and could therefore theoretically perform his obligations without buying or selling any goods, making his performance completely discretionary. Given this unbridled discretion, courts found that the promise was illusory and that the lack of a quantity term made it too indefinite to be enforced.<sup>23</sup> As the use of these open-quantity contracts increased, courts eventually relented and began to enforce them, on one condition: the party with discretion over quantity had to promise to deal exclusively with the promisee for that quantity, so that the quantity under the contract could

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<sup>22</sup> 840 F.2d 1333, 1337-39 (7th Cir. 1988).

<sup>23</sup> See Blair, *supra* note 6, at 75-84 (providing a thorough description of the history of these cases).

be calculated based on the actual requirements of the buyer or the actual output of the seller.<sup>24</sup> In reaching this solution, courts relied on the adage, *id certum est quod certum reddi potest* (that is certain which can be made certain).<sup>25</sup>

Under the exclusivity rule, the essential obligation of the quantity-determining party is to deal solely with the promisee for any requirements or output the promisor may have. Thus, in a requirements contract, the buyer has breached the contract if the buyer purchases requirements from any other seller, and the seller in an output contract has breached the contract if he sells output to any other buyer. The buyer's promise to purchase his requirements, if any, from the seller, and from no other source, is also the promise that provides the requisite consideration to sustain the contract—there is no doctrinal need to impose an additional duty on the buyer to maintain requirements “in good faith,” as the Official Code Comments to UCC section 2-306(1) purport to do.<sup>26</sup> As Arthur Corbin explained, in making such a promise, the buyer does not undertake to “continue in business on its present scale or even run [a] business at all.”<sup>27</sup> The consideration that saves the contract is this: “The promise contains one very definite element that

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<sup>24</sup> *Id.* at 88–94.

<sup>25</sup> *Id.* at 88 n.89.

<sup>26</sup> One Code-era case that illustrates this point nicely is *City of Lakeland v. Union Oil Co.*, 352 F. Supp. 758 (M.D. Fla. 1973), where the court rejected a lack of consideration challenge to a requirements contract based on a 1935 case, *Jenkins v. City Ice & Fuel Co.*, 160 So. 215 (Fla. 1935), and on the section from *Corbin on Contracts* quoted above. The contract at issue in *City of Lakeland* left the buyer free to purchase as much or as little of the goods as he may “capriciously desire[.]” but the buyer was bound to purchase any of the goods he did desire from the seller. *Id.* at 764–65. The court did not rely on the buyer's implied duty of good faith to hold the buyer accountable for maintaining the requirements to sustain the contract, but rather on the pre-UCC *Jenkins* case validating, as supported by sufficient consideration, “[a]greements of the buyer to buy and the seller to sell all that the buyer may want during the terms of the contract, i.e., capriciously desire; the buyer agreeing not to buy elsewhere during a given time any of the articles covered by the contract.” *Id.* at 764 (quoting *Jenkins*, 160 So. at 218). Despite such authorities, scholars, such as Michael Van Alstine, continue to maintain that good faith is necessary to preserve the enforceability of open term contracts, including requirements contracts, on the grounds that the unfettered discretion of the discretion-exercising party would otherwise “dissolve the irreducible core of an enforceable contractual relationship.” Van Alstine, *supra* note 9, at 1294. As to requirements contracts, this position ignores the buyer's commitment that should it have requirements for the goods in question, it will not purchase them from any other supplier than the seller, a commitment that under any reasonably current view of consideration should be sufficient to support an enforceable contract. See, e.g., RESTATEMENT (SECOND) OF CONTRACTS § 71.

<sup>27</sup> *City of Lakeland*, 352 F. Supp. at 766 (quoting 1A CORBIN, CONTRACTS § 156 (1963)).

specifically limits the promisor's future liberty of action; he definitely promises that he will buy of no one else."<sup>28</sup>

The buyer's obligation to the seller is expanded significantly, however, by the rule that parties to requirements contracts must limit their demands to quantities that reasonably approximate the parties' expectations. In the 1903 decision, *New York Central Ironworks Co. v. United States Radiator Co.*,<sup>29</sup> the New York Court of Appeals was one of the first courts to apply the "implied duty of good faith and fair dealing" to reach this conclusion. In *New York Central*, the buyer sued the seller for breach of contract to supply the plaintiff "'with their entire radiator needs for the year 1899[,]'" on the terms and at prices specified.<sup>30</sup> The seller asserted the defense of mutual mistake when the plaintiff submitted orders for a total of 100,000 feet and the seller was unable to supply plaintiff's orders beyond 48,000 feet, the maximum number of feet the plaintiff had ever previously required in a year.<sup>31</sup> New York's highest court affirmed the appellate court's rejection of this defense, finding that the defendant "bound the plaintiff to deal exclusively in goods to be ordered from it under the contract, and to enlarge and develop the market for the defendant's wares so far as possible."<sup>32</sup> The quantity term was therefore intentionally left open, and the seller's failure to anticipate the rising price of iron and manufactured products of iron was not a defense. The needs of the buyer "could be indefinitely enlarged" when he had a favorable contract that would allow him to undersell his competitors.<sup>33</sup>

The only consideration that gave the court pause in reaching its decision in *New York Central* was the testimony from the plaintiff's manager concerning whether the goods ordered were required for the needs of the plaintiff's business.<sup>34</sup> This question drew an objection, and the decision does not record the witness' answer. The court nevertheless observed that "[t]he obligation of good faith and fair dealing towards each other is implied in every contract of this character."<sup>35</sup> Based on this implied duty, the defendant could have offered proof, in defense of his breach, that

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<sup>28</sup> *Id.*

<sup>29</sup> 66 N.E. 967, 968 (N.Y. Ct. App. 1903).

<sup>30</sup> *Id.* at 967.

<sup>31</sup> *Id.*

<sup>32</sup> *Id.* at 968.

<sup>33</sup> *Id.*

<sup>34</sup> *Id.*

<sup>35</sup> *Id.*

the orders were in excess of the plaintiff's reasonable needs, and were not justified by the conditions of business or the customs of the trade—in other words, that the plaintiff was not acting reasonably or in good faith, but using the contract for a purpose not within the contemplation of the parties; that is to say, for speculative as distinguished from regular and ordinary business purposes.<sup>36</sup>

The court in *New York Central* recognized that a party is normally entitled to the profits that accrue in a rising market because of a favorable contract, and that if the defendant fails to anticipate or provide for this risk, he must face the prospect of paying substantial damages for breach of such a contract.<sup>37</sup> What is puzzling is that the court fails to ask why, in a fixed quantity contract, the law sees no harm in imposing losses on a promisee who fails to anticipate market fluctuations when setting the price and quantity terms of his fixed term contracts, but relieves the promisee of these risks in the case of upside demands made in open quantity contracts. In both cases, contracting parties have a multitude of drafting choices for shielding themselves from the vagaries of the market. These provisions are well-known in long-term supply contracts, and can be used just as easily in requirements contracts. For example, in *New York Central*, if the seller did not have the capacity to sell the buyer more than the 48,000 feet annually, he could have stated in the contract that this was the maximum quantity of goods the buyer could demand. If the issue was price, the seller could have used a cost-plus or price escalation clause to account for any unanticipated market changes that would have made it economically impracticable to perform.

The implied duty of good faith developed in the common law of open quantity contracts into a rigid, un rebuttable presumption that the *New York Central* court did not contemplate. In *New York Central*, the court held that in a requirements contract, the seller should be given an opportunity to prove, as a defense to nonperformance, that the buyer demanded unusually large quantities of goods in a rising market for purposes of speculation, and was therefore not acting in good faith.<sup>38</sup> But the law eventually dispensed with the need for proof of the buyer's intent, and sustained the defense regardless of the buyer's actual

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<sup>36</sup> *Id.*

<sup>37</sup> *Id.*

<sup>38</sup> *Id.*

motive.<sup>39</sup> Decreases in quantity, on the other hand, were permitted under requirements contracts all the way down to zero, as long as the buyer was acting in good faith. In a frequently cited formulation of the common law rule, “the seller assumes the risk of all good faith variations in the buyer’s requirements even to the extent of a determination to liquidate or discontinue the business.”<sup>40</sup>

This lop-sided application of the rule was justified “based on a reliance on the self-interest of the buyer, who ordinarily will seek to have the largest possible requirements.”<sup>41</sup> This rationale is not persuasive, however, because it does not fit the rule and it assumes market conditions which may not exist. If market conditions do support the assumption, so that it is in the buyer’s self-interest to seek the largest possible requirements, he would be acting in bad faith, as a matter of law, if his requests exceed the parties’ estimates. The buyer cannot demand quantities above the “stated estimate” or the “normal or otherwise comparable prior” quantity under UCC section 2-306, no matter how pure his motives may be, because the law presumes that he intends to use the additional goods for speculation. The common law rationale also fails to explain why courts are not equally intolerant of demands that fall below the expected quantities. A self-interested buyer may seek to reduce or eliminate his requirements under many circumstances that are not out of the ordinary, especially under a long-term contract. These include changes in consumer preferences, advances in technology, market fluctuations, and other factors that could reduce the buyer’s need for the product or result in a decline in the buyer’s business.

### III. THE UCC RULE ON OPEN QUANTITY CONTRACTS—SECTION 2-306

Output and requirements contracts are addressed in UCC section 2-306, which incorporates the implied duty of good faith in requirements contracts, thus preventing a buyer from requesting a quantity of goods that is disproportionate to the quantity the parties had estimated. Section 2-306 does not expressly repeat the prior rule that a requirements contract is only enforceable if the buyer promises to buy all of his requirements exclusively from the seller.<sup>42</sup> Some commentators contend that section 2-306 implicitly adopts the exclusivity rule either because the phrase “the output of the seller or the requirements of the buyer” means

<sup>39</sup> See, e.g., *Fort Wayne Corrugated Paper Co. v. Anchor Hocking Glass Corp.*, 130 F.2d 471, 473 (3d Cir. 1942).

<sup>40</sup> See *HML Corp. v. Gen. Foods Corp.*, 365 F.2d 77, 81 (3d Cir. 1966).

<sup>41</sup> *Id.*

<sup>42</sup> U.C.C. § 2-306(1) (2008).

that the seller under an output contract must supply *all* his output to the buyer and the buyer under a requirements contract must purchase *all* his requirements from the seller, so that exclusivity is understood,<sup>43</sup> or simply because the parties are required to act in good faith.<sup>44</sup> As Part IV shows, courts have enforced output and requirements contracts under section 2-306 where the parties' contract for less than one-hundred percent of the seller's output or the buyer's requirements under exceptions and modifications to the exclusivity rule. Some commentators claim that the duty of good faith should be interpreted to replace, rather than to incorporate, the exclusivity rule.<sup>45</sup> While most

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<sup>43</sup> See LINDA J. RUSCH, 1 HAWKLAND UCC SERIES § 2-306:3 (1982) ("By their very nature, output and requirements contracts involve exclusive dealing, because if the seller agrees to deliver his entire output to the buyer, the seller can sell to no one else, and the converse is true in the requirements contract.").

<sup>44</sup> See 3 WILLISTON ON CONTRACTS § 7:12 (4th ed. 2008) ("A final note concerning the obligations of the parties under a requirements or output contract is in order. As was previously seen, output and requirements contracts are generally supposed to entail exclusivity; at common law, in order to establish mutuality or consideration, and under the Code by virtue of the obligation of good faith.").

<sup>45</sup> See Blair, *supra* note 6, at 95. Professor Blair writes that, "[s]ection 2-306, however, makes no reference to, and certainly does not require, exclusivity as a prerequisite to the validation of open-quantity agreements." *Id.* He argues that open-quantity contracts are validated by the standard of good faith which attaches without regard to exclusivity and that contracts will not fail for indefiniteness even without a quantity term as long as the parties intended to make a contract and there is a reasonably certain basis for giving an appropriate remedy. *Id.* Because one of the central difficulties posed by open quantity contracts is giving an appropriate remedy when contracts lack a quantity term, Blair's failure to identify what would constitute a reasonably certain basis for giving an appropriate remedy in the context of an open quantity contract leaves the core of the question unanswered. *Id.* at 94. In Professor Bruckel's formulation, the implied duty of good faith could provide a basis for supplying a remedy and determining performance, but only because she believes good faith should be used "as an instrument to conform the actual performance of the contract to the parties' largely unstated expectations[.]" and opposes attempts by courts to impose their own normative views of fairness on the parties. Bruckel, *supra* note 4, at 202. Because the quantity assumptions are "largely unstated[.]" and there must be some basis for determining performance and awarding a remedy, she would rely on parol evidence to demonstrate the parties' intent. *Id.* at 202, 207. There are at least three problems with this analysis. One is that Bruckel cannot take the janus-like position that the good faith standard of UCC section 2-306 is efficacious when using it as a validation device to replace the consideration provided by the promise of exclusivity and yet that the good faith standard is not efficacious and should be replaced with the intent of the parties as determined by parol evidence. The second problem is that consideration is a bargained for exchange, not an implied duty of law that cannot be disclaimed; thus, the UCC implied duty of good faith cannot take the place of consideration. Finally, Bruckel claims that good faith could supply the performance standard equally well for non-exclusive contracts on the grounds that exclusivity rarely plays a role in determining performance standards. *Id.* at 181. But her failure to support this assertion with examples or cases is not surprising—if there is no agreement on a formula for ascertaining the portion of requirements the buyer has promised to purchase from the seller, good faith

courts continue to apply the exclusivity rule, only a few actually rely on section 2-306 as authority for the rule.<sup>46</sup>

The only reference to exclusivity in section 2-306 is in 2-306(2), which relates to “exclusive dealing” agreements.<sup>47</sup> As the Official Comments indicate, “the principal is expected under such a contract to refrain from supplying any other dealer or agent within the exclusive territory.” This discussion of “exclusive dealing” agreements as a subset of output and requirements contracts has led several courts to conclude that the legislatures adopting this UCC provision intended that requirements contracts could be either exclusive or non-exclusive.<sup>48</sup> This assumption

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provides no basis for determining why a buyer should purchase any given quantity from the requirements seller rather than from another source.

<sup>46</sup> For example, in *Integrated Micro Systems, Inc. v. NEC Home Electronics (USA), Inc.*, 329 S.E.2d 554, 556 (Ga. App. 1985), the court stated,

There can be no true requirements contract unless the buyer is under an obligation to purchase all of its requirements from the seller. In the absence of such an obligation, there is no requirements contract and “the promise of the seller becomes merely an invitation for orders and a contract is not consummated until an order for a specific amount is made by the buyer.”

*Id.* (some quotation marks omitted). See also *Famous Brands, Inc. v. David Sherman Corp.*, 814 F.2d 517, 522 (8th Cir. 1987) (“Under the Uniform Commercial Code, the prospective buyer’s good faith in filling all of its requirements through the seller is deemed sufficient consideration to support the contract.”); *Stacks v. F & S Petroleum Co., Inc.*, 641 S.W.2d 726, 727 (Ark. Ct. App. 1982) (“Both at common law and under the Uniform Commercial Code, a requirements contract is simply an agreement by the buyer to buy his good faith requirements of goods exclusively from the seller.”).

<sup>47</sup> See U.C.C. § 2-306(2) (2006). Section 2-306(2) of the UCC provides: “A lawful agreement by either the seller or the buyer for exclusive dealing in the kind of goods concerned imposes unless otherwise agreed an obligation by the seller to use best efforts to supply the goods and by the buyer to use best efforts to promote their sale.” *Id.*

<sup>48</sup> In *General Motors Corp. v. Paramount Metal Products, Co.*, 90 F. Supp. 2d 861, 873–74 (E.D. Mich. 2000), the court reached the conclusion that “M.C.L. § 440.2306 expresses a legislative intent to enforce both exclusive and non-exclusive requirements contracts[.]” from the fact that “M.C.L. 440.2306(2) applies a standard to ‘exclusive dealing’ that is not applicable to the class of output requirements contracts referred to in M.C.L. 440.2306(1).” *Id.* See also *Amber Chem. Inc. v. Reilly Indus., Inc.*, 2007 WL 512410 at \*7 (E.D. Cal. 2007) (concluding that the rule of exclusivity is contrary to the plain language of UCC section 2-306 because it provides that a requirements contract can be either without exclusivity, UCC section 2-306(1), or in the form of an exclusive dealing arrangement, UCC section 2-306(2)); *Plastech Engineered Plastics v. Grand Haven Plastics, Inc.*, 2005 WL 736519 at \*6–7 (Mich. Ct. App. 2005) (reasoning that because UCC section 2-306 acknowledged “exclusive dealing” requirements contracts as a subset of “requirements contracts[.]” it followed that “exclusivity” was not a necessary element of a requirements contract). The United States Court of Appeals for the Third Circuit also appears to have confused the meanings of the terms. See *Advent Sys. Ltd. v. Unisys Corp.*, 925 F.2d 670, 674 (3d Cir. 1991). In *Advent*, a computer manufacturer entered into a distribution agreement to sell the buyer hardware products and software licenses “on a non-exclusive basis[.]” meaning of course, that the buyer would not be the exclusive distributor, and the manufacturer could sell the products



is problematic because the term “exclusive dealing” is not used in section 2-306(2) in the same sense that courts have traditionally used the term “exclusivity” as a necessary element for enforcing requirements contracts under the doctrines of mutuality and definiteness. “Exclusive dealing” in section 2-306(2) means what can be termed “mutual exclusivity,” in that it affects both the buyer and the seller. The term “exclusivity” as a requirement for validity is used in a unilateral sense to affect only the quantity-determining party.<sup>49</sup> For a requirements contract, “exclusive dealing” under section 2-306(2) binds the seller as well as the buyer to a promise of exclusivity. The seller agrees that he will sell product A to the buyer and to no other customers—at least in a defined geographic area or other specified market such as exclusive or partially exclusive dealerships—in an amount the buyer requires. If the buyer does not use his best efforts, the seller will sacrifice opportunities because he will have no other potential customers to whom he may sell product A, at least within the affected market.<sup>50</sup> For an output contract, “exclusive dealing”

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and software licenses to others. The Third Circuit correctly recognized that this language kept the contract from being one of “exclusive dealing” within the meaning of UCC section 2-306(2), so that the “best efforts” required when the buyer is the only distributor of the seller’s product do not apply. The court went further, however, and found that this language also made the contract a “non-exclusive” contract within the meaning of UCC section 2-306(1) for “good faith” requirements contracts. *Id.* at 678–80. This conclusion raised the issue of whether the statute of frauds could be satisfied with a contract containing a “non-exclusive” requirements term for the quantity because prior law had recognized a statute of frauds exception only for “exclusive” requirements contracts under UCC section 2-306. *Id.* In fact, the contract in *Advent* was simply a “non-exclusive” distribution agreement as contrasted with an “exclusive” distribution agreement, meaning that it did not prevent the seller from selling the same products through other distributors, making the exclusivity unilateral, rather than mutual.

<sup>49</sup> See FARNSWORTH, *supra* note 17, at 82 n.1 (“[A]s long as the seller is not bound to sell exclusively to the buyer, the fact that the buyer is to buy exclusively from the seller does not make the contract one for ‘exclusive dealing’ under U.C.C. 2-306(2)”; *MDC Corp. v. John H. Harland Co.*, 228 F. Supp. 2d 387, 392 (S.D.N.Y. 2002) (concluding that “the duty to use best efforts applies to exclusive agents only, and not to all requirements buyers”).

<sup>50</sup> As the court explained in *Tigg Corp. v. Dow Corning Corp.*, 962 F.2d 1119, 1125 (3d Cir. 1992):

This obligation [the best efforts obligation under UCC section 2-306(2)] is intended to protect the original seller, who in an exclusive arrangement depends solely upon the buyer to resell the goods.

In a non-exclusive arrangement the buyer’s efforts in reselling the product may have little effect on the original seller. If the buyer does not resell the product, the seller, without breaching the contract, may solicit orders from other potential buyers. By contrast, in an exclusive dealing arrangement the seller has only one outlet for its goods. It is obligated not to sell to anyone except the buyer. In such a situation, the seller’s interests are inextricably bound up with the success of the buyer in reselling the product. The obligation placed on the buyer to use best efforts reflects its monopoly power; the exclusivity

means that the buyer will only buy product A from the seller in the amount that the seller produces. If the seller does not use his best efforts to manufacture the product, the buyer would be vulnerable to sacrificed opportunities because he would have no other source for product A. In a “normal” output contract, only the seller would have an obligation to sell his output to the buyer, and if the seller failed to produce, the buyer would be free to purchase from other suppliers. This mutual type of “exclusive dealing” agreement is a sufficient, but not a necessary, condition for satisfying the element of “exclusivity” required to enforce open quantity contracts.<sup>51</sup>

It is somewhat more reasonable to infer, as at least one court has done,<sup>52</sup> that the legislatures adopting the UCC intended to revoke the exclusivity rule for requirements contracts, based on the omission from UCC section 2-306(1) of any reference to the exclusivity rule and the explanation in the Official Comments to UCC section 2-306 that the good faith obligations imposed under the section satisfy the doctrines of mutuality and definiteness. Even this inference is flawed, but it takes a bit more effort to discern the problem. As discussed in more detail in Part III.A, the argument in the Official Comments applies only to contracts involving one-hundred percent of the buyer’s requirements or the seller’s output, and therefore necessarily incorporates the exclusivity rule. Despite the debate among commentators and the ambiguity in the Code, the majority of courts are unmoved and continue to insist upon exclusivity as a condition for enforcing output and requirements contracts.<sup>53</sup>

For example, in a recent case involving an alleged output contract, *Arrotin Plastic Materials v. Wilmington Paper Corp.*,<sup>54</sup> the court refused to rely on section 2-306 to enforce the agreement without a commitment by the seller to sell all of his output to the buyer, and held that the

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arrangement makes the seller as subject to the decisions of the buyer as a subsidiary within the buyer’s firm.

*Id.* (citation omitted) (footnote omitted).

<sup>51</sup> See *Gestetner Corp. v. Case Equip. Co.*, 815 F.2d 806, 811–12 (1st Cir. 1987) (affirming a directed verdict for the seller, the First Circuit enforced a requirements contract despite the absence of a specific quantity term based on evidence that the parties’ contract was an exclusive dealer arrangement).

<sup>52</sup> In *Hoover’s Hatchery, Inc. v. Utgaard*, 447 N.W.2d 684, 688 (Iowa Ct. App. 1989), the court decided, as a matter of first impression, that under Iowa’s version of UCC section 2-306, exclusivity was not a prerequisite to a valid requirements contract. *Id.* The court noted that the statute did not contain any language suggesting exclusivity was necessary, but it did contain a separate section addressing exclusive dealing agreements and Official Comments distinguishing the two sections. *Id.*

<sup>53</sup> See *supra* note 16 and accompanying text.

<sup>54</sup> 865 N.E.2d 1039, 1042 (Ind. Ct. App. 2007).

agreement was illusory and therefore unenforceable. The agreement provided that the buyer was “pleased to purchase the following materials you have available for sale” and then listed categories of scrap plastic materials with the word “ALL” before each item.<sup>55</sup> If the court had applied section 2-306(1) as the “primary ‘gap filler’” for missing quantity term contracts, as several federal circuit courts have held is appropriate,<sup>56</sup> the court would have found that the seller’s good faith duty not to tender “unreasonably disproportionate” quantities to the buyer was sufficient to prevent the agreement from being illusory, and enforced the agreement as a valid output contract.<sup>57</sup> The court’s unwillingness to do so is representative of a broader reticence among the judiciary to replace the exclusivity rule for validating open quantity contracts with the good faith standard of the UCC.

In addition to the confusion over whether exclusivity has been incorporated or rejected as a condition for valid open quantity contracts, the language of section 2-306(1) has also raised questions concerning the intended nature and scope of the implied duty of good faith.<sup>58</sup> While the provision defines output and requirements quantity terms as the actual output or requirements that “may occur in good faith[.]” it also provides that no quantity that is “unreasonably disproportionate to any stated estimate or in the absence of a stated estimate to any normal or otherwise comparable prior output or requirements may be tendered or demanded.”<sup>59</sup> As Judge Posner has observed, a literal interpretation of this Section would place both an upper and a lower limit on the quantity of goods that could be tendered or demanded, regardless of the buyer’s or seller’s intent, and would therefore represent a departure from the common law rule permitting a buyer to decrease his requirements to

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<sup>55</sup> *Id.* at 1040.

<sup>56</sup> See *Zemco Mfg., Inc. v. Navistar Int’l Transp. Corp.*, 186 F.3d 815, 818 (7th Cir. 1999); *Gestetner*, 815 F.2d at 811; *Riegel Fiber Corp. v. Anderson Gin Co.*, 512 F.2d 784, 789 (5th Cir. 1975).

<sup>57</sup> U.C.C. § 2-306(1) (2008). Even courts that claim to accept the proposition that the exclusivity rule has been replaced by the “good faith” standard under UCC section 2-306(1) for output and requirements contracts, continue to invalidate open quantity contracts on the ground that the buyer is not obligated to purchase goods from the seller under the terms of the contract. See *United Servs. Auto Ass’n v. Schlang*, 894 P.2d 967, 971-72 (Nev. 1995) (reversing the trial court’s finding that a valid requirements contract had been reached and holding that because “there [w]as no basis for the implication of a reciprocal promise by either party[.] . . . no valid requirements contract existed[.]”).

<sup>58</sup> *Empire Gas Corp. v. Am. Bakeries Co.*, 840 F.2d 1333, 1337-39 (7th Cir. 1988).

<sup>59</sup> U.C.C. § 2-306(1) (2008).

zero as long as he was acting in good faith.<sup>60</sup> Several portions of the Official Comments support this view.

First, an obligation to maintain output and requirements is implied in Official Comment 2, which describes the interplay between the concepts of “good faith” and the ban on “unreasonably disproportionate” quantities by explaining that, “under this section, the party who will determine quantity is required to operate his plant or conduct his business in good faith and according to commercial standards of fair dealing in the trade so that his output or requirements will approximate a reasonably foreseeable figure.”<sup>61</sup> Second, symmetrical treatment of increased and decreased quantities is supported by Official Comment 3, which provides that “the agreed estimate is to be regarded as a center around which the parties intend the variation to occur.”<sup>62</sup> Third, Official Comment 2 also indicates that good faith is relevant to permitting what would otherwise be unreasonably disproportionate increases as well as decreases. For increases, the Official Comments provide that, “a sudden expansion of the plant by which requirements are to be measured would not be included within the scope of the contract as made but normal expansion undertaken in good faith would be within the scope of this [S]ection.”<sup>63</sup> In the case of decreases, “good faith variations from prior requirements are permitted even when the variation may be such as to result in discontinuance. A shut-down by a requirements buyer for lack of orders might be permissible when a shut-down merely to curtail losses would not.”<sup>64</sup> This reference to decreases has been relied on to support the view that the “unreasonably disproportionate” proviso does not apply to decreases, since extreme variations are permitted in “good faith,”<sup>65</sup> but in

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<sup>60</sup> *Empire Gas*, 840 F.2d at 1337 (“The proviso does not distinguish between the buyer who demands more than the stated estimate and the buyer who demands less, and therefore if read literally it would forbid a buyer to take (much) less than the stated estimate.”). In *Empire Gas*, Judge Posner held that it was error, although not reversible error, to read UCC section 2-306(1) to the jury verbatim, given its literal meaning. *Id.* at 1339. The statute’s “unreasonably disproportionate” language was interpreted in *Empire Gas* as a redundancy that simply provides an additional gloss on the nature of “good faith” by specifying that, in the requirements contract context, it is clearly an act of bad faith to make increased demands, given the possibility that the buyer may be exploiting opportunities created by rising prices to resell the seller’s goods. *Id.* at 1338. The unreasonably disproportionate language does not apply, according to Judge Posner, when the buyer takes less than the stated estimate. *Id.* at 1339.

<sup>61</sup> U.C.C. § 2-306 cmt 2.

<sup>62</sup> *Id.* § 2-306 cmt 3.

<sup>63</sup> *Id.* § 2-306 cmt 2.

<sup>64</sup> *Id.*

<sup>65</sup> See, e.g., *Empire Gas*, 840 F.2d at 1339.

the subsequent sentence the Official Comments apply the concept of good faith to permit significant increases in quantity.

Taking the Official Comments into account, the Code would require the factfinder to perform a two-step analysis, first deciding whether a particular increase or decrease was “unreasonably disproportionate” to the stated estimate or “normal” quantity, and then deciding whether the increase or decrease was the result of good faith. The Comments offer no suggestions on how to determine what degree of variation is “unreasonable” in a given case, and the examples they provide for determining whether the variations arise from good faith are of little value. Financial losses and sudden plant expansion—the impermissible reasons given for quantity variation—are foreseeable risks from which parties to open quantity contracts can protect themselves far better than judges and juries acting after the bargain has been made based on limited information and biases created by hindsight. It is also unclear how decreased quantities caused by financial losses or increased quantities caused by sudden plant expansion could be seen as examples of bad faith, even when contrasted with falling orders or “normal” expansion.

The majority view is that despite the provision’s seemingly parallel structure, the UCC, like the common law, permits a buyer to order an unreasonably disproportionate quantity that is below estimates or normal quantities as long as he acts in good faith, but does not allow him to order an unreasonably disproportionate quantity of goods that is above estimates or normal quantities, even in good faith.<sup>66</sup> In cases where the parties have not set a minimum or maximum quantity limit by agreement, courts use the “unreasonably disproportionate” test of UCC section 2-306(1) to place limits on the quantity of goods that sellers can supply in excess of the contract estimates in an output contract,

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<sup>66</sup> Many courts have held that under UCC section 2-306(1), a buyer cannot demand disproportionately more than the buyer’s anticipated requirements, as measured by a stated estimate or normal or otherwise comparable prior requirements, but may in good faith take disproportionately less. See *Brewster of Lynchburg, Inc. v. Dial Corp.*, 33 F.3d 355, 365 (4th Cir. 1994); *Atlantic Track & Turnout Co. v. Perini Corp.*, 989 F.2d 541, 544-45 (1st Cir. 1993) (output contract case); *Empire Gas*, 840 F.2d at 1339-40; *Godchaux-Henderson Sugar Co. v. Dr. Pepper-Pepsi Cola Bottling Co. of Dyersburg, Inc.*, 1985 WL 13561 at \*6 (6th Cir. 1985); *Angelica Uniform Group, Inc. v. Ponderosa Sys., Inc.*, 636 F.2d 232, 232 (8th Cir. 1980); *R. A. Weaver and Assocs., Inc. v. Asphalt Const., Inc.*, 587 F.2d 1315, 1321-22 (D.C. Cir. 1978); *G.D. Searle & Co. v. Fisons Corp.*, 1993 WL 54535 \*3-\*5 (N.D. Ill. 1993); *N. Pub. Serv. Co. v. Colo. Westmoreland, Inc.*, 667 F. Supp. 613, 635-36 (N.D. Ind. 1987), judgment aff’d without opinion, 845 F.2d 1024 (7th Cir. 1988); *Tenn. Valley Auth. v. Imperial Prof. Coatings*, 599 F. Supp. 436, 441 (E.D. Tenn. 1984) (applying UCC section 2-306 to a federal requirements contract); *Ind.-Am. Water Co. v. Town of Seelyville*, 698 N.E.2d 1255, 1260-61 (Ind. Ct. App. 1998).

regardless of the seller's good faith,<sup>67</sup> and on the amounts that buyers can demand in excess of the estimates in a requirements contract, again regardless of the buyer's good faith.<sup>68</sup>

In support of this approach, Judge Posner argued in *Empire Gas* that there is no indication that the UCC drafters were concerned with a case in which the buyer takes less than his estimated requirements, as long as he does not buy from anyone else, and that the purpose of the provision was solely to prohibit disproportionately large demands.<sup>69</sup> As previously indicated, the Official Comments contain language demonstrating that the drafters *were* concerned with cases in which a buyer took less than estimated requirements as a result of financial losses, surely not a rare occurrence, and one which the drafters felt would indicate bad faith.<sup>70</sup> There are several jurisdictions, however, that reject Judge Posner's view, resulting in a lack of uniformity in the interpretation of the "unreasonably disproportionate" as well as the "good faith" provisions of section 2-306(1).<sup>71</sup> Under the minority

<sup>67</sup> See *State of Wash. Dept. of Fisheries v. J-Z Sales Corp.*, 610 P.2d 390, 394 (Wash. App. 1980) (holding that the seller's tender of three times the estimate for salmon eggs and over two-thirds the estimate for salmon carcasses created a genuine dispute over the buyer's obligation to pay the contract price under an output contract for accord and satisfaction purposes).

<sup>68</sup> See *Shea-Kaiser Lockheed Healy v. Dept. of Water and Power of the City of L.A.*, 73 Cal. App. 3d 679, 686-90 (Cal. App. Ct. 1977); *Orange & Rockland Utilities, Inc. v. Amerada Hess Corp.*, 59 A.D.2d 110, 116-17 (N.Y. App. Div. 1977) (holding that buyer could not demand twice the estimated quantity because disproportionality, rather than good faith, is the test for excessive demands under UCC section 2-306(1)).

<sup>69</sup> *Empire Gas*, 840 F.2d at 1338. The court stated that

The proviso thus seems to have been designed to explicate the term 'good faith' rather than to establish an independent legal standard. And the aspect of good faith that required explication had only to do with disproportionately *large* demands. If the buyer saw an opportunity to increase his profits by reselling the seller's goods because the market price had risen above the contract price, the exploitation of that opportunity might not *clearly* spell bad faith; the provision was added to close off the opportunity. There is no indication that the draftsmen were equally, if at all, concerned about the case where the buyer takes less than his estimated requirements, provided, of course, that he does not buy from anyone else.

*Id.*

<sup>70</sup> U.C.C. § 2-306 cmt. 2 (2008) ("A shut-down by a requirements buyer for lack of orders might be permissible when a shut-down merely to curtail losses would not. The essential test is whether the party is acting in good faith.").

<sup>71</sup> See *Simcala, Inc. v. Am. Coal Trade, Inc.*, 821 So. 2d 197, 201-02 (Ala. 2001) (holding that under the clear language of UCC section 2-306(1), the drafters intended that buyers would not be entitled to increase *or* reduce their requirements to a level that was unreasonably disproportionate to a stated estimate regardless of their good faith); *Romine, Inc. v. Savannah Steel Co.*, 160 S.E.2d 659, 660-61 (Ga. Ct. App. 1968) (interpreting the statute to apply to deviations both above and below the stated estimate); *Orange &*

interpretation of the Section, the Alabama Supreme Court in *Simcala, Inc. v. American Coal Trade, Inc.* held that the buyer had breached his requirements contract by purchasing only forty-one percent of his estimated annual requirements for coal, despite a finding that the buyer had acted in good faith and was unable to use any more coal due to furnace problems.<sup>72</sup>

Given the ambiguity of the good faith standard under section 2-306(1), there should be sound policy reasons for the majority interpretation. A ceiling is necessary regardless of the buyer's good faith, according to the theory, because if the price became advantageous, the buyer would resell the goods at a profit in competition with the seller—a result which would be contrary to the intent of the parties.<sup>73</sup> It has been suggested that the economic justification for this position is that there is no limit to the potential losses from increased requirements, as compared to the losses to the seller from the buyer's decreased requirements down to zero.<sup>74</sup> This economic point is correct as far as it goes, but it does not explain why the parties cannot protect themselves by appropriate drafting from the unlimited upside risk. The theory supporting a ceiling on requirements, regardless of the buyer's intent, should be rejected because it rests upon several faulty assumptions.

One of these flawed assumptions is that all requirements contracts are between sellers and end users. For requirements contracts where the buyer is a distributor, dealer, jobber, or other "middleman," the seller knows that the buyer intends to resell the goods, so the theoretical basis

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*Rockland*, 59 A.D.2d at 115 (stating that, because a statute should be construed to give effect to every provision, it was clear that the phrase "unreasonably disproportionate" was not the equivalent of "lack of good faith[,]"" but rather was keyed to stated estimates or, if there was none, to "normal or otherwise comparable" requirements).

<sup>72</sup> *Simcala*, 821 So. 2d at 203.

<sup>73</sup> See *Empire Gas*, 840 F.2d at 1337. The court explained that  
If there were no ceiling, and if the price happened to be advantageous to the buyer, he might increase his 'requirements' so that he could resell the good at a profit . . . This would place him in competition with the seller—a result the parties would not have wanted when they signed the contract.

*Id.* (citing John C. Weistart, *Requirements and Output Contracts: Quantity Variations Under the UCC*, 1973 DUKE L.J. 599, 640-41 (1973)).

<sup>74</sup> Goldberg, *supra* note 3, at 347.

The preference for asymmetric treatment stems from the recognition that there is less opportunity for the quantity-determining party to take advantage of price variations by decreasing its requirements. A requirements buyer could increase its purchases without limit (if the contract placed no limit) to take advantage of a rising market, but it could only cut its requirements to zero to take advantage of a market price decline.

*Id.*

for placing a ceiling on quantity demands does not exist. The seller may not have anticipated the increase in the market price when it entered into the requirements agreement, but the fact that the buyer took advantage of that increase to purchase a greater quantity of goods than the parties estimated should hardly come as a shock to the seller when the buyer is a reseller of the goods. It is no secret under these circumstances that the buyer's demand will increase when the market price increases. Given this relationship, the law should not protect sellers from the risk of the buyer's increased demands any more than it protects sellers from the risk of increases in the market price. As with any foreseeable risk, the parties should be expected to bargain for protection from this quantity risk. Because section 2-306(1) applies to requirements contracts between sellers and resellers, as well as to contracts between sellers and end-users, it prohibits the buyer/reseller from ordering quantities that are unreasonably disproportionate to estimates or normal quantities, even though the seller anticipated or should have anticipated that the buyer would resell greater quantities of the goods if the market price increased.

Even in cases where the buyer is an end-user, such as a manufacturer who purchases component parts or raw materials from the seller to make other products, there are flaws in the assumption that the buyer will automatically begin selling the parts or raw materials in competition with the seller whenever the market price increases. Buyers who are not already competing in the market for the parts or raw materials may not find the increase in the market price a sufficient incentive to begin doing so if there are significant barriers to market entry. While entry may be relatively costless in some markets, as it appears to have been in the oil and gas cases,<sup>75</sup> it would be wrong to assume that end-users in every industry will routinely have the economic wherewithal and the motivation to enter the business of reselling goods in competition with their suppliers whenever changes in market prices may make it theoretically advantageous to do so. In addition, even when the buyer is an end-user, the buyer's demand will increase with the market price, but the degree of the relationship will depend on the impact the price of the seller's goods under the requirements contract has on the price of the end-user's final product. Since this relationship is foreseeable, as it is in the case where the buyer is a reseller of the goods, the seller should contract for protections from the risk that the buyer will increase its orders when the market price increases.

The majority interpretation of section 2-306 also tends to discourage conduct that our economic system would normally strive to promote.

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<sup>75</sup> See *City of Lakeland v. Union Oil Co.*, 352 F. Supp. 758, 762 (M.D. Fla. 1973); *Orange & Rockland*, 59 A.D.2d at 116-17.



For example, if the buyer's actual requirements exceed expectations because it hired a brilliant marketing director and an exceptional sales team, the buyer's requirements would violate the "unreasonably disproportionate" standard under the Code, despite the fact that the buyer is not only acting in good faith, but is running its business successfully. But courts have interpreted section 2-306 to mean that a buyer acts in *bad faith* if it takes advantage of an increase in the market price to expand its sales to new customers who were not included in the estimates of its requirements when the contract was formed.<sup>76</sup> If not for an increase in the market price or a capacity shortage, both of which are problems the seller could have guarded against with quantity limits, price adjustment clauses, termination provisions, or similar contract terms, the seller may well have profited if the buyer had operated its business so skillfully that its requirements were "unreasonably disproportionate" to the parties' estimates. No rationale is given in the Official Comments to explain why, in a case where the seller has excess capacity, the parties may not prefer a requirements contract in which an order for an "unreasonably disproportionate" quantity of goods compared to the estimate, or any "normal" or "otherwise comparable prior requirements," would not only be permitted, but welcomed. Similarly, the parties may prefer that in a business downturn, the buyer, acting in good faith and with no ill will towards the seller or intent to evade the contract, may purchase significantly fewer goods than its estimate or a normal or previously ordered quantity because it has decided to spend a larger portion of its marketing budget on products where losses can still be avoided, which it should be able to do as long as the requirements contract is not an exclusive dealing arrangement carrying with it a best efforts obligation.<sup>77</sup>

Without demonstrated social benefits to outweigh the costs, a wise policymaker would be hesitant to adopt the current rule. Under this rule, the buyer in a requirements contract has essentially surrendered its right to run its business according to its best business judgment given

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<sup>76</sup> See *Orange & Rockland*, 59 A.D.2d at 116.

<sup>77</sup> See *Gestetner Corp. v. Case Equip. Co.*, 815 F.2d 806, 811 (1st Cir. 1987). The court stated:

We recognize that the good faith obligation is not the same for a requirements contract and an exclusive dealing contract. Under a requirements contract the obligation is to use good faith in determining requirements. The good faith obligation under an exclusive dealing contract is for the seller to use "best efforts to supply the goods and the buyer to use best efforts to promote the sale."

*Id.* (citations omitted). See also *Bloor v. Falstaff Brewing Corp.*, 601 F.2d 609, 613-15 (2d Cir. 1979); *Feld v. Henry S. Levy & Sons, Inc.*, 335 N.E.2d 320, 322-23 (N.Y. 1975).

current market conditions, and must instead pursue the goal of producing requirements that are not “unreasonably disproportionate” to estimates or “normal” quantities on the upside, for any reason, or, on the downside, can no longer suspend operations simply because they are unprofitable, and may only do so for lack of orders or other “legitimate business reasons” that cannot be linked to the requirements contract.<sup>78</sup> Many courts, as well as the drafters of the Official Comments to UCC section 2-306, have taken the position that the duty of good faith deprives a buyer in a requirements contract of the right to eliminate its requirements by ceasing operations because they are unprofitable.<sup>79</sup> The buyer has made an implied promise to remain in business, even if the business is unprofitable, and can only cease doing business, and therefore eliminate its requirements under the contract, if the buyer is no longer receiving orders for the goods, or if the buyer can convince the factfinder that it has some other motivation for the shut-down that is not a ruse for avoiding the contract.

If this case law were more widely known, it might impact corporate conduct in two ways. First, if the buyer in a requirements contract was a public company, the exposure to lost profits damages that it would face if it closed down unprofitable plants or businesses that had requirements under the contract would arguably impose reporting requirements on the buyer under the securities laws, including Sarbanes-Oxley.<sup>80</sup> Second, a well-counseled buyer would be far more careful to include protections in its requirements contracts such as express minimum and maximum

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<sup>78</sup> *Schawk, Inc. v. Donruss Trading Cards, Inc.*, 746 N.E.2d 18, 26 (1st Dist. 2001). A related observation made by the court was as follows: “[a]bsent contract language, appreciable party reliance, or evidence of evasion, a requirements business does not give up its fundamental managerial right of disengaging from an unprofitable business, and the courts should avoid usurping that right through a restrictive interpretation of good faith.” *Id.* at 27.

<sup>79</sup> *See, e.g.*, *Cent. States Power & Light Corp. U.S. Zinc Co.*, 60 F.2d 832, 833-34 (10th Cir. 1932); *Metal One Am., Inc. v. Ctr. Mfg., Inc.*, 2005 WL 1657128 \*6-\*7 (W.D. Mich. 2005); *NCC Sunday Inserts, Inc. v. World Color Press, Inc.*, 759 F. Supp. 1004, 1010-11 (S.D.N.Y. 1991); *Feld v. Henry S. Levy & Sons, Inc.*, 335 N.E.2d 320, 322-23 (N.Y. 1975); 407 E. 61st Garage, Inc. v. Savoy Fifth Ave. Corp., 244 N.E.2d 37, 41-42 (N.Y. 1968); *Wigand v. Bachmann-Bechtel Brewing Co.*, 118 N.E. 618, 619-20 (N.Y. 1918); U.C.C. § 2-306 cmt. 2 (2008).

<sup>80</sup> Such a disclosure may be required, for example, under 15 U.S.C. § 7261(b)(1), so that pro forma financial information included in any periodic or other report filed with the Commission pursuant to the securities laws, or in any public disclosure or press or other release, shall be presented in a manner that—(1) does not contain an untrue statement of a material fact or omit to state a material fact necessary in order to make the pro forma financial information, in light of the circumstances under which it is presented, not misleading . . . .

15 U.S.C. § 7261(b)(1) (2004).

limits on the quantities that could be demanded, as well as notice of termination and liquidated damages provisions.

Section 2-306 also imposes inconsistent “good faith” duties on buyers in exclusive dealing/requirements contracts. These buyers are subject to both the good faith duty of section 2-306(1) not to order quantities that are “unreasonably disproportionate” to estimates or prior orders, and the duty to use their “best efforts” in the promotion and sale of the supplier’s goods under section 2-306(2).<sup>81</sup> No exception is made under current law for the case where the buyer’s “best efforts” in promoting the sale of the goods to his own customers exceed expectations so that his requirements from the seller also exceed expectations. One commentator who has recognized this conflict suggests that the solution lies in reading the “best efforts” obligation as synonymous and co-extensive with the “good faith” standard for any exclusive dealing agreements that are also output or requirements agreements.<sup>82</sup> This solution has not been adopted by courts. Even if it

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<sup>81</sup> There can be little doubt that the drafters of the Code intended to subject exclusive dealing agreements under UCC section 2-306(2) to the good faith obligations set forth in UCC section 2-306(1) given Official Comment 5. This Comment states that “[a]n exclusive dealing agreement brings into play all of the good faith aspects of the output and requirements problems of subsection (1).” U.C.C. § 2-306(1) cmt. 5 (2008).

<sup>82</sup> See LORD, *supra* note 17, at 300–01. Williston explains that

[S]ince, in an output contract, the seller may be obligated to sell exclusively to the buyer, and, in a requirements contract, the buyer may be obligated to buy exclusively from the seller, this would seem to impose yet another standard upon the quantity-determining party, and might even give rise to an argument that an output seller or requirements buyer should affirmatively undertake to expand significantly the amount of goods supplied or required. Such a reading would be inappropriate to the extent that it sought to displace the more particular good faith and proportionality rule set forth in subsection (1). Rather, in the output and requirements context, the seller's obligation to supply and the buyer's obligation to require should be governed by subsection (1), a result that can be achieved by reading subsection (2) as coextensive with the good faith and proportionality rule of the former subsection. Thus, the buyer, in using best efforts to promote the sale of the goods supplied under a requirements contract or the seller, in using best efforts to supply goods under an output contract, would have an obligation to do so in good faith and reasonably, that is, in an amount not unreasonably disproportionate to the parties' estimate or normal requirements or output. Read in this manner, it is not altogether clear whether subsection (2) adds much, if anything, to the obligations imposed under subsection (1), though at least one case has suggested, by emphasizing the best efforts language of subsection (2) that it does.

*Id.* Several courts have held that the best efforts obligation for exclusive dealing requirements and output contracts constitutes a different and more exacting standard than the duty of good faith. See *supra* note 77.

were adopted, buyers who must employ their best efforts to resell the goods will still have to restrain their efforts in light of their countervailing duty to refrain from demanding “unreasonably disproportionate” quantities from their supplier.

A. *The Code’s Use of Good Faith Quantity Controls To Validate Open Quantity Contracts*

The Official Comments claim that the concept of “good faith” set forth in UCC section 2-306(1) satisfies the formation requirements of definiteness and mutuality of obligation, thereby supporting the view that the good faith rule is intended to supplant the exclusivity rule for validating open quantity contracts.<sup>83</sup> According to the Official Comments, the promise of the buyer that satisfies the mutuality of obligation doctrine is not its promise to purchase all of its requirements exclusively from the seller, but its promise to operate its business in good faith and according to commercial standards of fair dealing in the trade so that its requirements will approximate a reasonably foreseeable figure.<sup>84</sup> But if the buyer has no obligation to purchase those requirements exclusively from the seller, rather than from other suppliers, in what sense does the buyer’s obligation to maintain its requirements at foreseeable levels satisfy the mutuality doctrine? If the seller has an obligation to supply the buyer with its requirements, but the buyer’s only obligation is to maintain its requirements at a foreseeable level, and it remains free to purchase its requirements from any source, the result is a buyer’s option, not a requirements contract.

The Official Comments also fail to explain how the doctrines of mutuality and definiteness are satisfied by the duty of good faith for contracts where the buyer purchases less than 100% of its requirements from the seller, or the seller supplies less than 100% of its output to the buyer. As we have seen,<sup>85</sup> if the Code applies only to contracts that cover 100% of the seller’s output or the buyer’s requirements, the exclusivity rule has been adopted by implication, not rejected. The seller in an output contract who must sell all of its output to the buyer must necessarily deal exclusively with the buyer for these goods, and the buyer in the requirements contract who must purchase all of its requirements from the seller must necessarily deal exclusively with the seller. If the Code is interpreted to apply to contracts that cover less than 100% of the seller’s output or the buyer’s requirements, the good faith

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<sup>83</sup> U.C.C. § 2-306 cmt.

<sup>84</sup> *Id.*

<sup>85</sup> See *supra* notes 43–44 and accompanying text.

duty of a business to maintain its output or requirements at foreseeable levels would not give the factfinder any standard for determining what portion of the total “reasonably foreseeable” output or requirements have been committed to by the parties under the contract, and would therefore fail as a validation tool. Whatever their intent, the drafters of the Official Comments did not succeed in replacing the exclusivity rule with good faith as a validation principle.

Another potential flaw in the theory that a requirements contract is validated by the buyer’s good faith obligation to maintain its requirements at reasonably foreseeable levels is that the parties could theoretically eliminate this obligation by agreement. As discussed in Part III.B below, if courts applied section 2-306(1) as a true gap-filler, the parties could avoid the good faith obligation regarding quantity risks by agreement. If they did so, the good faith obligation of maintaining reasonable requirements would no longer exist to validate the contract. In *Lenape Resources Corp. v. Tennessee Gas Pipeline Co.*,<sup>86</sup> where the parties did allocate the upside quantity risk, the court avoided this problem by holding that when the duty of good faith imposed under section 2-306(1) is disclaimed by agreement, the duty of good faith under section 1-203 steps in to fill the void. The court observed that section 2-306(1) is both a gap-filler that applies “only when a contract does not unambiguously specify the quantity of the output of the seller or the requirements of the buyer[.]” and a validation principle which “renders output and requirements contracts sufficiently definite as to quantity and enforceable by reading into such contracts a quantity that is the actual good faith output or requirements of the particular party.”<sup>87</sup>

In *Lenape*, the parties agreed that the buyer took the risk of accepting or paying for eighty-five percent of the seller’s capacity, and granted the seller unlimited discretion to increase its capacity. Although the seller had disclaimed its good faith duty under section 2-306(1), the court held that the buyer still had a duty not to increase its capacity in bad faith under the general duty of good faith applicable to all Code contracts under section 1-203. The court’s implication—that the good faith limitation on unreasonable quantities in UCC section 2-306(1) can be disclaimed but the good faith obligation under UCC section 1-203 cannot—is flawed. Section 1-302 states that the obligations of good faith and reasonableness prescribed by the Code cannot be disclaimed by agreement without referring to any specific sections in which these obligations are imposed, and should therefore apply with equal force to UCC section 2-306(1).

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<sup>86</sup> 925 S.W.2d 565, 584 (Tex. 1996).

<sup>87</sup> *Id.* at 570.

The Official Comments also claim that the principle of definiteness is satisfied for open quantity contracts by the “actual good faith output or requirements of a particular party.”<sup>88</sup> According to the *Restatement (Second) of Contracts*, the definiteness standard is satisfied if there is “a basis for determining the existence of a breach and for giving an appropriate remedy.”<sup>89</sup> The elusive standard that courts apply under section 2-306(1) to decide whether a buyer has demanded an “unreasonably disproportionate” quantity of goods provides little guidance in determining whether the buyer has breached the contract and if so, what remedy should be awarded. Judge Posner has observed that the Code does not contain a definition of “good faith” that seems applicable to the buyer’s decision, concerning how many goods to order under a requirements contract, or to the seller’s decision as to how many goods to produce under an output contract.<sup>90</sup> How indeed does a court or jury use “honesty in fact and the observance of reasonable commercial standards of fair dealing”<sup>91</sup> as a guide to quantify the buyer’s requirements in an open quantity contract? What if the buyer repudiates the contract before placing any orders, and there is no estimate or history of sales because the contract involves a new product? How does the concept of good faith assist the courts in defining the quantity of goods the buyer agreed to purchase under these circumstances?

Notions of “honesty and . . . fair dealing”<sup>92</sup> shed little light on the far reaching questions of whether the seller is running its plant to produce output or a buyer is running its business to create requirements that approximate a “reasonably foreseeable figure.” A legitimate operational goal of a business may be to generate the optimal level of output or requirements given current market conditions, whether that quantity is far higher, as may occur in good times, or far lower, as may occur in bad times, than the parties predicted. In a market where demand is rising, this goal may result in a buyer – who is acting in good faith, and with no intention of using the goods for unanticipated purposes – purchasing significantly more goods than its “stated estimate,” or, if there was no stated estimate, purchasing more than the “normal or otherwise comparable prior . . . requirements” as is prohibited under section 2-306(1).<sup>93</sup>

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<sup>88</sup> *Id.*

<sup>89</sup> RESTATEMENT (SECOND) OF CONTRACTS § 33(2) (1981).

<sup>90</sup> *Empire Gas Corp. v. Am. Bakeries Co.*, 840 F.2d 1333, 1339 (7th Cir. 1988).

<sup>91</sup> U.C.C. § 2-103(1)(j) (2008).

<sup>92</sup> *Id.* § 1-201(b)(20).

<sup>93</sup> *Id.* § 2-306(1). *See supra* note 66 and accompanying text. If the seller has no objection, the parties can agree to amend any estimates or caps on quantity set forth in the contract to accommodate the buyer’s increased requirements, but if they do not, the current default

The phrase “actual good faith output or requirements of a particular party[]” does satisfy the definiteness standard if you remove the words “good faith.” Using this definition of the quantity term, it would be simple to determine the existence of a breach and give an appropriate remedy in open quantity contracts, but only because you would be adopting the exclusivity rule. For a requirements contract, the buyer would breach the contract by purchasing the product from other suppliers. The remedy would be the seller’s lost profits based on the quantity of goods the buyer purchased from other suppliers. For an output contract, the seller would breach the contract if it sold the goods to other customers, and the remedy would be the lost expectations, or “cover” damages, that the buyer incurred based on the quantity of goods the seller sold to other customers.

By removing the implied duty of good faith from open quantity contracts, and measuring quantity by the “actual output or requirements” of the seller or buyer, the underlying promise made by the seller or buyer would undergo a fundamental change. Instead of promising to abide by an ill-defined duty to act in good faith to maintain output or requirements at estimated levels, the seller in an output contract would simply be promising not to sell its output to other customers and the buyer in a requirements contract would be promising not to purchase its requirements from other suppliers. They would not be promising to maintain a particular level of output or a particular level of requirements. Indeed, to make such a contract they would need to do so expressly, by setting the minimum and maximum levels of quantity they would sell or purchase.

*B. The Code’s Potentially Inconsistent Use of Good Faith Quantity Controls as a Gap-Filler and Validation Rule*

In addition to distorting the natural motivations of businesses to increase their profits by increasing sales when materials can be purchased at below-market prices, and to reduce losses by closing businesses when they are unprofitable, the use of good faith in UCC section 2-306(1) as a condition to the enforcement of open quantity contracts is inconsistent with the use of the provision as a gap-filler, in at least one important sense. If parties cannot limit by agreement the duty of good faith on the party with discretion over quantity in an open quantity contract without invalidating the contract, then the good faith

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rule is that the buyer has acted in bad faith by demanding greater quantities than those estimated or previously ordered. *See supra* note 66 and accompanying text.

duty in section 2-306(1) is not operating as a default rule, or gap-filler, but as an “immutable” or “mandatory” rule.

This inconsistency raises the related issue of whether parties may vary the good faith quantity limitations under section 2-306(1) by agreement, and if so, whether there are any restrictions on the extent to which they may do so. Specifically, is section 2-306(1) functioning as a gap-filler or default rule that applies only when the parties have not reached an agreement on the quantity term, or is it functioning as a mandatory rule for all open quantity contracts that cannot be disclaimed by agreement? Courts claim to treat section 2-306(1) as the “primary” gap-filler in the Code for missing quantity terms.<sup>94</sup> But the Section is both more and less than a traditional gap-filler—more because it is applied even when the parties have reached agreement on the quantity term, and less because it cannot be used when the parties have failed to reach agreement on the quantity term. Unlike gap-fillers such as section 2-305 for contracts with an open price term, which applies where the “price is not settled,” courts apply section 2-306(1) to open quantity contracts even when the parties have unambiguously stated their agreement that the quantity term would be defined as the buyer’s requirements or the seller’s output, with or without minimum or maximum limits, or as some portion thereof.<sup>95</sup> But this “gap-filler” cannot be used to supply a quantity term when there is no writing concerning quantity because quantity is a required term for enforcement under the Code’s statute of frauds, section 2-201(a).<sup>96</sup> It is more accurate to say that courts apply section 2-306(1) as a general rule of law applicable to all output and requirements contracts, including ambiguous contracts that the factfinder decides contain sufficient evidence to demonstrate that the parties intended to contract for the buyer’s requirements or the seller’s output.

The response of the courts may well be a reaction to the way the provision is drafted. As written, section 2-306(1) does not operate as a

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<sup>94</sup> See *Zemco Mfg., Inc. v. Navistar Int’l Transp. Corp.*, 186 F.3d 815, 818 (7th Cir. 1999); *Gestetner Corp. v. Case Equip. Co.*, 815 F.2d 806, 811 (1st Cir. 1987); *Riegel Fiber Corp. v. Anderson Gin Co.*, 512 F.2d 784, 789-90 (5th Cir. 1975).

<sup>95</sup> See, e.g., *Miami Packaging, Inc. v. Processing Sys., Inc.*, 792 F. Supp. 560, 563-64 (S.D. Ohio 1991); *Schawk, Inc. v. Donruss Trading Cards, Inc.*, 746 N.E.2d 18, 22-23, 25 (Ill. Ct. App. 2001).

<sup>96</sup> See *Simmons Foods, Inc. v. Hill’s Pet Nutrition, Inc.*, 270 F.3d 723, 727 (8th Cir. 2001) (“[W]here the writing relied upon to form the contract of sale is totally silent as to quantity, parol evidence cannot be used to supply the missing quantity term.”); *Merritt-Campbell, Inc. v. RxP Prods., Inc.*, 164 F.3d 957, 963 (5th Cir. 1999) (“While the quantity term in requirements contracts need not be numerically stated, there must be some writing which indicates that the quantity to be delivered under the contract is a party’s requirements or output.” (citations omitted)).



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classic gap-filler for a missing term, but as a rule that provides a set meaning for quantity terms that are stated in the contract. Section 2-306(1) is definitional, providing,

A term which measures the quantity by the output of the seller or the requirements of the buyer means such actual output or requirements as may occur in good faith, except that no quantity unreasonably disproportionate to any stated estimate or in the absence of a stated estimate to any normal or otherwise comparable prior output or requirements may be tendered or demanded.<sup>97</sup>

Thus, if a contract expressly states that the quantity is the “buyer’s requirements” or the “seller’s output” for the term of the agreement, these stated quantity terms are defined under section 2-306(1), despite the fact that the contract is not missing a quantity term that must be cured by resort to one of the Code’s gap-fillers. Given the Official Comments’ reliance on good faith to validate these contracts, can the parties, by agreement, define “the buyer’s requirements” or “the seller’s output” to avoid the duty of good faith in creating the actual output or requirements and the ban on making unreasonably disproportionate demands or offers that would otherwise be imposed under section 2-306(1)? Is the section a default, or conversely, a mandatory rule in this sense?

In decisions expressing the majority view of how section 2-306(1) should be applied as a gap-filler,<sup>98</sup> courts have enforced the implied duty of good faith as an “immutable” or “mandatory” rule, rather than a default rule, even when parties have been quite specific concerning the limits of the quantity term.<sup>99</sup> Indeed, Professor Victor Goldberg favors deleting section 2-306(1) from the Code partly because courts so often apply the implied duty of good faith to sabotage the parties’ own allocation of quantity risk in open quantity contracts.<sup>100</sup>

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<sup>97</sup> U.C.C. § 2-306(1) (2008).

<sup>98</sup> See *Zemco Mfg., Inc.*, 186 F.3d at 818; *Gestetner Corp.*, 815 F.2d, at 811-12; *Riegel Fiber Corp.*, 512 F.2d, at 789-90; *Lenape Res. Corp. v. Tenn. Gas Pipeline Co.*, 925 S.W.2d 565, 570 (Tex. 1996).

<sup>99</sup> See Goldberg, *supra* note 3, at 367-74 (citing *Utah Int’l, Inc. v. Colo.-Ute Elec. Ass’n, Inc.*, 425 F. Supp. 1093 (D. Colo. 1976); *City of Lakeland, Fla. v. Union Oil Co.*, 352 F. Supp. 758 (M.D. Fla. 1973), and *Orange & Rockland Utils., Inc. v. Amerada Hess Corp.*, 59 A.D.2d 110 (N.Y. App. Div. 1977)).

<sup>100</sup> *Id.* at 381. Because Goldberg believes deleting UCC section 2-306(1) “is not about to happen[.]” he proposes a number of new comments to the provision. *Id.* These comments would retain the full exclusivity rule to satisfy the mutuality doctrine (“It is now

An example of this misuse of the good faith doctrine is provided in *Canusa Corp. v. A&R Lobosco, Inc.*,<sup>101</sup> where the court refused to enforce the minimum quantity terms of an output contract on the grounds that these terms would convert the agreement into a fixed quantity agreement. In *Canusa*, the buyer sued for breach when the supplier failed to produce the minimum quantities required, and the seller argued that it was only liable for the quantity it actually produced.<sup>102</sup> The evidence from both parties, however, demonstrated that they understood the figures in the output contract to mean the minimum quantity that the seller was required to supply to the buyer.<sup>103</sup> The court instead treated these figures as estimates, and concluded: "An output agreement is not transformed into a fixed quantity contract by the insertion of an estimate. Thus, where an output contract provides for a certain amount of goods to be produced, the appropriate test for a seller's reduction in output is good faith rather than the estimate in the contract."<sup>104</sup> The court then decided that an estimate of quantity was necessary to measure the seller's good faith, but determined that the estimate in the parties' agreement did not provide the "appropriate yardstick," so it chose instead to rely on the testimony given at trial by the seller's president.<sup>105</sup> Despite quoting Comment 3's reference to the parties' right to set their own minimum or maximum quantity limits in open quantity contracts under section 2-306, the court invalidated the parties' minimum quantity provision.<sup>106</sup>

Even Professor Goldberg's suggestion of eliminating section 2-306 from the Code may not be sufficient to remedy this problem, because courts have also held that the duty of good faith implied in all Code contracts under section 1-304 would still constrain the ability of the quantity-determining party to increase quantities above the estimated or

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recognized that the invocation of good faith is not necessary for finding adequate consideration in a requirements (or full output) contract. It is sufficient that the promisor commits that if it has any requirements (or output) that it must obtain it from (deliver it to) the counterparty.") *See id.* The other comments are generally designed to convert the good faith rule from a mandatory rule into a default rule, so that it will not be used to "undo the decisions of the parties." *Id.* This suggestion is fine as far as it goes, but will not help the parties who did not want the good faith rule limiting quantities read into their contracts, but either neglected to include explicit minimums and maximums, or were justifiably concerned, based on decisions like *Agfa-Gevaert, A.G. v. A.B. Dick Co.*, 879 F.2d 1518, 1521 (7th Cir. 1989), that if they included these limits, the court may not interpret their agreement as a requirements contract.

<sup>101</sup> 986 F. Supp. 723, 730 (E.D.N.Y. 1997).

<sup>102</sup> *Id.* at 728.

<sup>103</sup> *Id.* at 726.

<sup>104</sup> *Id.* at 730.

<sup>105</sup> *Id.*

<sup>106</sup> *Id.* at 728-31.

normal amount even when the parties attempted to avoid the good faith limitation in section 2-306(1) by agreement. For example, in *Lenape*, discussed above, the parties agreed that the buyer would “take or pay” for 85% of the seller’s delivery capacity of gas, and that the seller had complete discretion to increase its capacity.<sup>107</sup> Since the parties had agreed on a quantity term that differed from the “unreasonably disproportionate” quantity limit imposed by section 2-306(1), the court held that this gap-filler provision did not apply.<sup>108</sup> As a result, the buyer had to increase the annual payments it had been making under the contract for the past 12 years of no more than \$300,000 to \$89 million.<sup>109</sup> When the buyer complained that the court’s ruling eliminated the seller’s duty of good faith, the court disagreed, holding that the seller’s ability to increase its capacity under the parties’ contract was still subject to its duty of good faith based on the Code’s general provision concerning good faith in UCC section 1-203.<sup>110</sup> While the court gave no examples, the fact that the seller’s conduct could still be challenged for lack of good faith even after the parties anticipated and expressly provided for the risk that the seller would increase its capacity indicates that good faith is being applied to open quantity contracts as a mandatory rule rather than a default rule, even when it has to come in through the back door of section 1-203.

The Court of Appeals for the Fifth Circuit took a similar position in *Riegel Fiber Corp. v. Anderson Gin Co.*,<sup>111</sup> where the court declined to decide whether the parties’ contract to purchase all the cotton produced on certain specified acreage was governed by section 2-306(1), but sustained the contract as sufficiently definite under section 2-204(3). As in *Lenape*, the court relied on the Code’s general good faith provision, section 1-203, to accomplish a section 2-306(1) result. In this case, the court concluded the contract unenforceable beyond a quantity not unreasonably disproportionate to the estimated yield in the contract, holding that this would obviate any difficulty with those individual contracts where no estimated yield was stated.<sup>112</sup> Thus, even if the parties could draft around the “unreasonably disproportionate” limitation on quantities in section 2-306(1), the general good faith

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<sup>107</sup> 925 S.W.2d 565, 571 (Tex. 1996).

<sup>108</sup> *Id.* An agreement that the buyer would purchase one-hundred percent of the seller’s committed gas reserves or “the seller’s reserves” would, of course, also provide an unambiguous “standard for determining a specific quantity[]” but would not provide a different standard than the UCC section 2-306(1) gap-filler. *Id.* at 570.

<sup>109</sup> *Id.* at 568, n.1.

<sup>110</sup> *Id.* at 571.

<sup>111</sup> 512 F.2d 784, 790 (5th Cir. 1975).

<sup>112</sup> *Id.* at 790 n.14.

provision in section 1-203 would, at least in the Fifth Circuit's view, create the same limitation.

In *Shea-Kaiser-Lockheed-Healy v. Department of Water and Power of the City of Los Angeles*,<sup>113</sup> a case that pre-dated *Lenape*, the California Court of Appeals took a different approach by applying section 2-306(1) to the parties' requirements contract even though the parties had agreed on a quantity term that differed from the "unreasonably disproportionate" quantity limit in that section. Specifically, the contract required the buyer to purchase a minimum quantity that was twenty percent lower than the estimate.<sup>114</sup> Despite this agreement, the court applied the section 2-306(1) "gap-filler[.]" and held that the buyer had breached the contract by demanding over twenty percent more than the estimate, on the theory that this demand was "unreasonably disproportionate" to the estimate.<sup>115</sup> In implying a corresponding maximum quantity from the agreed upon minimum, the court relied on the median theory set forth in Official Comment 3 to section 2-306(1), which states that "the agreed estimate is to be regarded as a center around which the parties intend the variation to occur."<sup>116</sup> The buyer argued that this definition of what an "estimate" means, and the "unreasonably disproportionate" language of section 2-306(1), had been avoided by contract, since the buyer had expressly stated a different purpose for the estimate when it was provided.<sup>117</sup> The court rejected this argument on the grounds that section 2-306(1) could not be avoided "so indirectly[.]" an odd rationale given that the purpose of the estimate was stated in the portion of the agreement that the court considered "at issue" in the case.<sup>118</sup> As additional grounds for its conclusion, the court stated that the obligation of reasonableness cannot be disclaimed by agreement, and that the "unreasonably disproportionate" obligation of section 2-306(1) is "but a specific application of the obligation of reasonableness running throughout the [C]ode."<sup>119</sup> Under this reasoning, it appears unlikely that the court would have ruled in the buyer's favor, regardless of whether

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<sup>113</sup> 73 Cal. App. 3d 679 (Cal. Ct. App. 1977).

<sup>114</sup> *Id.* at 685 n.4.

<sup>115</sup> *Id.* at 688-89.

<sup>116</sup> *Id.* at 688.

<sup>117</sup> *Id.* at 689. The portion of the agreement the court said was "at issue" stated that "[f]or the purpose of comparing bids to determine the lowest bidder, it will be assumed that the following respective quantities of aggregate will be purchased during the contractual period." *Id.* at 687. The buyer's minimum quantities were then stated. As for maximums, the contract stated that "the Department shall have the option of purchasing . . . additional quantities of aggregate up to the Department's maximum quantity requirements for operation and storage during the contractual period." *Id.*

<sup>118</sup> *Id.* at 687, 689.

<sup>119</sup> *Id.* at 689.

the contract expressly stated that there was no upper limit on the maximum quantity of goods the buyer could demand, or even if it had established a maximum higher than twenty percent.

Language in the Official Comments to section 2-306(1) and in section 1-302(b) supports the view that parties should be able to contract around the “good faith” and “reasonableness” limitations on quantity under the Code, whether they arise under UCC section 2-306(1) or under the general duty of good faith prescribed in UCC section 1-304.<sup>120</sup> The Official Comments to section 2-306 indicate that the parties can avoid by agreement the good faith ban on unreasonably high or unreasonably low or nonexistent requirements, stating that “[a]ny minimum or maximum set by the agreement shows a clear limit on the intended elasticity.”<sup>121</sup> Section 1-302(b) provides that while the obligations of good faith and reasonableness implied in all Code contracts cannot be disclaimed by agreement, the “parties, by agreement, may determine the standards by which the performance of those obligations is to be measured if those standards are not manifestly unreasonable.”<sup>122</sup> Taken together, these statements could be interpreted to mean that a buyer can enter into a requirements contract without assuming either the duty to act in good faith to maintain its requirements or to refrain from demanding quantities that are unreasonably high compared with the parties’ estimates.

As an example, the buyer could enter a requirements contract expressly disclaiming any duty to run its business to maintain its requirements at “normal” levels, either on the high side or the low side, promising not to buy any requirements it may have of a particular product from any other supplier until it had purchased a specified maximum quantity, at which time it would be free to buy the product from other suppliers, and promising to make a minimum payment to the seller if it had no requirements. These terms should satisfy UCC section 1-302(b)<sup>123</sup> by setting reasonable standards for measuring the buyer’s good faith. The buyer has disclosed upfront that he is not promising to stay in business, or conversely, that his requirements will not increase dramatically, but he has agreed to limit the seller’s exposure by making a minimum payment if his requirements are reduced below a certain level, for any reason, and by agreeing that he will not demand requirements above a certain level, for any reason. Sensible as this approach appears,

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<sup>120</sup> U.C.C. § 1-304 (2001) (“Every contract or duty within [the Code] imposes an obligation of good faith in its performance and enforcement.”); § 2-306, cmt. 2.

<sup>121</sup> *Id.* § 2-306, cmt. 2.

<sup>122</sup> *Id.* § 1-302(b).

<sup>123</sup> *Id.*

cases such as *Lenape*, *Riegel*, and *Shea-Kaiser* indicate that the courts may reject it on the grounds that even express allocations of quantity risk are insufficient to disclaim the good faith quantity limitations under the Code.

Termination clauses should also be given effect to avoid the quantity restrictions imposed by the implied duty of good faith under section 2-306(1). As with agreements on minimum and maximum quantity limits, parties should be able to modify the general obligation of good faith implied in all Code contracts under section 1-304(b) by providing that the good faith standard is satisfied by termination upon notice. If the parties have agreed that either side can terminate upon notice for any reason, the buyer should be able to terminate the contract even if its reasons would not otherwise satisfy the implied duty of good faith. For example, a buyer could terminate such a contract when the market price falls below the contract price, when another vendor offers discounts or other terms that are more attractive, when the buyer is able to obtain the goods from an affiliate, when the buyer begins to produce them in-house, or when the buyer shuts down its operations to “curtail losses” as would otherwise be prohibited under Official Comment 2.<sup>124</sup> The implied duty of good faith should play no role in protecting the reasonable anticipations of the parties under these circumstances because the parties were on notice of their reciprocal ability to terminate their agreement and could have bargained for a damages clause to protect them against any reliance losses arising from early termination, nor should courts undertake to provide post hoc relief for unknown risks when the parties expressly assumed such risks by agreeing to a provision for “termination for any reason.” The parties should not have to enumerate each type of risk assumed under such a clause, since the clause is as clear an assumption of unknown risks as can reasonably be required.

This reasoning was adopted by a federal court in Indiana in *Q.C. Onics Ventures, LP v. Johnson Controls, Inc.*<sup>125</sup> In *Q.C. Onics*, the buyer terminated a series of requirements contracts for automobile parts, in the form of purchase orders, in order to shift the business to another supplier. The purchase orders contained provisions that permitted the buyer to terminate at any time and covered the seller’s costs through a termination claims procedure.<sup>126</sup> The seller’s first argument was that because requirements under a requirements contract must be set in good faith under section 2-306(1), the seller was obligated to continue

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<sup>124</sup> *Id.* § 2-306 cmt. 2.

<sup>125</sup> 2006 WL 1722365, at \*4 (N.D. Ind. 2006).

<sup>126</sup> *Id.* at \*3-4.

purchasing from the buyer as long as it had requirements.<sup>127</sup> In support, the seller relied on two cases—*General Motors Corp. v. Paramount Metal Products, Co.*<sup>128</sup> and *Plastech Engineered Plastics v. Grand Haven Plastics, Inc.*<sup>129</sup>—discussed below,<sup>130</sup> which hold that requirements contracts are validated by the good faith duty that prevents the buyer from unilaterally terminating the contract.<sup>131</sup> The court in *Q.C. Onics* distinguished these cases as formation decisions, and held that where the buyer is not relying on its reduced requirements as a defense, the buyer's good faith duty to order estimated requirements is not inconsistent with its right to end the contracts under the termination clauses in the contracts.<sup>132</sup>

The problem the court's position in *Q.C. Onics* raises for the Code's validation theory, as applied in cases like *General Motors* and *Plastech*, is that if the parties can eliminate the implied duty of good faith that prevents the buyer from unilaterally terminating the contract simply by adding a termination clause, and the exclusivity rule has been discarded, the Code is left without a validation principle for requirements contracts that contain termination clauses. For these contracts, the quantity-determining party can terminate the contract whenever its demand or tender would otherwise violate the ban on unreasonably disproportionate or bad faith quantities, down to zero. By doing so, the quantity-determining party effectively eliminates the implied duty to operate its business to maintain its output or requirements at a "reasonably foreseeable figure"—the very duty that satisfies the mutuality doctrine according to the Official Comments.<sup>133</sup>

The court in *Q.C. Onics* was also presented with a Michigan decision, *Metal One America, Inc. v. Center Mfg., Inc.*,<sup>134</sup> discussed in more detail below,<sup>135</sup> where the court refused to enforce a termination clause in a requirements contract. In *Metal One*, the court held that the buyer acted in bad faith when it terminated a requirements contract to avoid losing money. The court in *Q.C. Onics* declined to follow the "unpublished [decision]" in *Metal One*, where "the court did not give any reason why termination pursuant to an expressly stated right to terminate was not

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<sup>127</sup> *Id.* at \*7.

<sup>128</sup> 90 F. Supp. 2d 861 (E.D. Mich. 2000).

<sup>129</sup> 2005 WL 736519, at \*5 (Mich. Ct. App. 2005).

<sup>130</sup> See *infra* text accompanying notes 213–20.

<sup>131</sup> *Q.C. Onics*, at \*7–8.

<sup>132</sup> *Id.*

<sup>133</sup> U.C.C. § 2-306 cmt. 2 (2008).

<sup>134</sup> 2005 WL 1657128 (W.D. Mich. 2005).

<sup>135</sup> See *infra* text accompanying notes 306–12.

allowed, and it addressed the breach of contract claim without discussing the effect of the termination clause."<sup>136</sup>

The seller's second argument in *Q.C. Onics* was that the buyer's right to terminate was limited by the duty of good faith implied in every contract under UCC section 1-203<sup>137</sup> and by the common law.<sup>138</sup> Based on its findings that the express termination clause in the contract was bargained for in good faith, the court held that the buyer could not violate good faith by exercising its rights under the clause because the exercise of fairly bargained for termination rights "does not defeat the reasonable expectations of the parties, and is not a violation of the duty of good faith and fair dealing."<sup>139</sup> In reaching this conclusion, the court relied heavily on a Sixth Circuit exclusive dealing arrangement case, *Cloverdale Equip. Co. v. Simon Aerials, Inc.*,<sup>140</sup> which held, "If properly bargained for, the right [to terminate a contract] is given full effect and may be exercised for any reason."<sup>141</sup> The majority rule for open quantity contracts that take the form of distribution agreements, such as the agreement at issue in *Cloverdale*, is that the general rule of good faith implied in all contracts under section 1-304 does not prevent arbitrary termination.<sup>142</sup>

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<sup>136</sup> *Q.C. Onics*, at \* 10.

<sup>137</sup> UCC section 1-203 is the pre-2001 version of UCC section 1-304. Revised Article I of the Code also expands the definition of "good faith" from "honesty in fact in the conduct or transaction concerned," the pre-2001 definition contained in UCC section 1-201(19), to the current definition of good faith: "honesty in fact and the observance of reasonable commercial standards of fair dealing." U.C.C. § 1-201(20) (2001). Although courts have not placed significant reliance on the Code definitions of good faith in the open quantity contract context, this change would tend to make the standard less predictable because it moves from a narrow, subjective standard of good faith to a standard that takes into account the objective, but ill-defined factor of "fair dealing."

<sup>138</sup> *Q.C. Onics*, at \* 6.

<sup>139</sup> *Id.* at \*6-7.

<sup>140</sup> 869 F.2d 934, 938 (6th Cir. 1989).

<sup>141</sup> 2005 WL 736519, at \*6 (Mich. App. 2005).

<sup>142</sup> See *Grand Light & Supply Co. v. Honeywell Co.*, 771 F.2d 672, 679 (2d Cir. 1985) (reversing a ruling that the manufacturer/buyer had violated its implied duty of good faith under UCC section 1-203 by exercising its rights under the termination provision of its distribution agreement in bad faith, and holding that the "U.C.C. good faith provision [UCC section 1-203] may not be used to override explicit contractual terms[]"); *Cardinal Stone Co. v. Rival Mfg. Co.*, 669 F.2d 395, 396-97 (6th Cir. 1982) (affirming summary judgment for defendant-buyer on the grounds that the duty of good faith implied in all contracts under UCC section 1-203 did not prevent the buyer from arbitrarily terminating its purchase orders with the seller under express provisions giving the buyer the right to terminate at any time or override the provisions in the purchase orders for stipulated damages upon termination); *Frank Lyon Co. v. Maytag Corp.*, 715 F. Supp. 922, 924 (E.D. Ark. 1989) (holding that a distribution agreement allowing termination by either party, with 60 days notice, would not be interpreted as requiring good cause under the common law or the Code's implied duty of good faith absent evidence of unequal bargaining power



In *Corenswet, Inc. v. Amana Refrigeration, Inc.*,<sup>143</sup> an early case on the subject that has been widely followed,<sup>144</sup> the court dealt with the ban on disclaiming the duty of good faith set forth in section 1-102(3), by noting that the provision allows the parties to determine the standards of good faith, and would therefore permit the parties to stipulate that termination “without cause” or “for any reason” was not in bad faith.<sup>145</sup> Corenswet had filed suit to prevent Amana from terminating its exclusive dealership agreement for the sale of appliances in southern Louisiana. The district court entered judgment for Corenswet, finding that Amana’s real reasons for its termination decision were its desire to switch distributors and its animosity towards a Corenswet executive.<sup>146</sup> Based on these findings, the lower court held that Amana had violated the general obligation of good faith under section 1-203, despite the contract’s language, which allowed Amana to terminate the relationship “at any time and for any reason[.]”<sup>147</sup> The Fifth Circuit reversed, holding that “[w]hen a contract contains a provision expressly sanctioning termination without cause[,] there is no room for implying a term that bars such a termination.”<sup>148</sup> The court also held that cases of economic overreaching through the use of unequal bargaining power could be

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because “the U.C.C. good faith provision may not be used to override explicit contractual terms[.]”); *Blalock Mach. & Equip. Co. v. Iowa Mfg. Co.*, 576 F. Supp. 774, 777 (N.D. Ga. 1983) (holding that “the court declines to conclude that the UCC prohibits arbitrary termination of distributorship contracts[.]”); *Mason v. Farmers Ins. Cos.*, 281 N.W.2d 344, 347 (Sup. Ct. Minn. 1979) (holding that the doctrine of unconscionability, not the implied duty of good faith under UCC section 1-203, limits an express contractual right of termination); *Contra Valley Liquors, Inc. v. Renfield Imps., Ltd.*, 822 F.2d 656, 670 (7th Cir. 1987) (affirming the trial court’s grant of summary judgment dismissing a breach of contract claim on the grounds that 27-year distributorship could be modified and narrowed under a 10-day notice-to-terminate clause, where the distributor had not presented evidence to support an inference of bad faith which was defined as “actual or constructive fraud or sinister motive[.]”); *B.E. deTreville, Jr. v. Outboard Marine Corp.*, 439 F.2d 1099, 1100 (4th Cir. 1971) (reversing the trial court’s dismissal of a claim for wrongful exercise of termination clause under a dealership agreement where the defendant failed to repurchase inventory on the grounds that under common law “regardless of broad unilateral termination powers, the party who terminates a contract commits an actionable wrong if the manner of termination is contrary to equity and good conscience[.]”).

<sup>143</sup> 594 F.2d 129, 131 (5th Cir.), *cert. denied*, 444 U.S. 938 (1979).

<sup>144</sup> See *Grand Light*, 771 F.2d at 679; *Cardinal Stone*, 669 F.2d at 396-97; *Blalock Machinery*, 576 F. Supp. at 777 (following *Corenswet*, affirming defendant-buyer’s motion for summary judgment in a suit for wrongful termination of a 27-year distributorship agreement, where distributor argued that the manufacturer violated the UCC’s implied duty of good faith by exercising an express right to terminate under the agreement).

<sup>145</sup> *Corenswet*, 594 F.2d at 138 n.10.

<sup>146</sup> *Id.* at 133.

<sup>147</sup> *Id.* at 135-36.

<sup>148</sup> *Id.* at 138.

addressed through the unconscionability doctrine, which can be used to override express contract terms.<sup>149</sup>

By enforcing termination clauses in open quantity contracts, the courts in *Q.C. Onics* and in the majority of distribution contract cases allow the parties to set the time period and damages remedies best tailored to protect the seller's reliance interest. Similarly, enforcing minimum and maximum quantity limitations would encourage the parties to allocate the risks, *ex ante*, based on the best available information. Neither exercise should be defeated by enforcing the "good faith" and "unreasonably disproportionate" standards of section 2-306(1) as mandatory rather than as default rules, or by insisting that the general duties of good faith and reasonableness implied in all Code contracts under section 1-304 cannot be varied by agreement under section 1-302(b).

Since the seller in a requirements contract can protect its transaction-specific reliance interest in the negotiation process with a minimum purchase requirement, cancellation fee, take or pay clause, liquidated damages provision, or termination clause, the burden should be on the seller to prove that had the parties anticipated the quantity risk that has materialized, they would have placed it on the buyer, rather than the seller. So, if a seller sues to enforce a requirements contract when the market price has fallen below the contract price so that the buyer can no longer sell its own products using the seller's materials and still cover its costs, or when new technology is developed that makes the seller's goods obsolete and unmarketable for a buyer who purchased the goods for resale, the question will be, had the parties anticipated these eventualities, would they have agreed that the buyer would continue to purchase the same quantity of goods for the term of the contract, as many courts would hold under the "good faith" test, or would the parties agree, at most, to cover the seller's transaction-specific reliance investments?

#### IV. RESOLVING FORMATION ISSUES UNDER THE EXCLUSIVITY RULE, ITS EXCEPTIONS, AND THE CODE'S DUTY OF GOOD FAITH

With this understanding of the Code's section on open quantity contracts, the questions become, (1) what function is the exclusivity rule performing today?; (2) can and should the implied duty of good faith take its place?; (3) is there a better alternative for validating open quantity contracts?; and (4) if so, how would this alternative be used to

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<sup>149</sup> *Id.* at 138-39.

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identify enforceable open quantity contracts and determine when they have been breached?

As to the first issue—the purpose served by the exclusivity rule—the case law demonstrates that exclusivity is often used as a stand-in for the buyer’s reciprocal obligation to buy the goods from the seller in response to the seller’s promise to sell the goods to the buyer. As such, the rule plays a critical role in differentiating requirements contracts from buyer’s options, where the buyer has no obligation to purchase the goods subject to the option. The reason there are so many variations on the exclusivity rule is that the existence of this reciprocal obligation does not require that the buyer promise to purchase *all* of its requirements exclusively from the seller, and from no other source, because any ascertainable portion of its requirements would be equal. Below, Part IV discusses cases applying both the exclusivity rule and its variations, followed by an analysis of the views of commentators and courts concerning the use of good faith, rather than the exclusivity rule, as a validation device.

A. *The Exclusivity Rule*

Generally, when courts refer to the need for exclusivity in requirements contracts, they refer to the buyer’s promise to buy exclusively from the seller,<sup>150</sup> as it is this exclusivity that permits the court to determine the quantity term and to ensure that the promise is not illusory.<sup>151</sup> The exclusivity doctrine is not often discussed in connection with output contracts, although these contracts are generally defined as agreements in which the buyer promises to buy and the seller to sell all of the goods or services that a seller can supply, so that the seller is necessarily required to sell its goods or services exclusively to the buyer.<sup>152</sup> The promise of exclusivity is also used to distinguish an

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<sup>150</sup> See Willard, *Sutherland & Co. v. United States*, 262 U.S. 489, 493 (1923); *In re Anchor Glass Container Corp.*, 345 B.R. 765, 770 (M.D. Fla. 2006); *Mattei v. Hopper*, 330 P.2d 625, 626 (Cal. 1958).

<sup>151</sup> See, e.g., *Fisherman Surgical Instruments, LLC v. Tri-Anim Health Servs., Inc.*, 502 F. Supp. 2d 1170, 1177 (D. Kan. 2007) (“For a requirements contract to be valid, the buyer must promise to buy the goods exclusively from the seller.”); *Embedded Moments, Inc. v. Int’l Silver Co.*, 648 F. Supp. 187, 192 (E.D.N.Y. 1986) (holding that a contract that did not contain a promise that the buyer would buy exclusively from the seller and left the buyer free to purchase from other suppliers was unenforceable as a requirements contract, where even the plaintiff’s representative recognized it as an option contract).

<sup>152</sup> See *Arrotin Plastic Materials v. Wilmington Paper Corp.*, 865 N.E.2d 1039, 1042 (Ind. Ct. App. 2007) (affirming summary judgment on the grounds that the contract was an illusory indefinite quantity contract rather than a valid output contract, where nothing in the document indicated that the buyer had agreed to purchase “ALL[]” of the products that the seller had procured). Courts will, however, enforce output contracts for less than all a

enforceable commitment from a voluntary one, especially a voluntary relationship that has been exclusive for many years. Reliance on the parties' prior course of dealing may be misleading when their history of exclusive dealing reflects the buyer's continued satisfaction with the seller's goods or services rather than the buyer's contractual commitment to purchase those goods or services from the seller.<sup>153</sup> As a result, some courts have held that "there can be no partial performance in the context of a requirements contract . . . for it is the promise of exclusivity that provides the consideration to the seller."<sup>154</sup>

Upon closer analysis, the requirement of "exclusivity" may mean no more than the reciprocal obligation on the part of the buyer to purchase the goods that the seller is required to sell to the buyer.<sup>155</sup> A frequently cited definition of requirements contracts that includes the element of exclusivity provides that a requirements contract exists only when the contract "(1) obligates the buyer to buy goods, (2) obligates the buyer to buy goods exclusively from the seller, and (3) obligates the buyer to buy

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seller's output, as long as the quantity term is sufficiently ascertainable to satisfy the definiteness doctrine. *See, e.g., Sw. Dairy Prods., Co. v. Coffee & Moore*, 62 F.2d 174 (5th Cir. 1932) (holding that an output contract for all the dairy's milk production up to a maximum of 150 gallons per day was not void for lack of mutuality); *Am. Original Corp. v. Legend, Inc.*, 652 F. Supp. 962, 966-67 (D. Del. 1986) (denying motion to dismiss claims under an output contract for all the surf clams caught by defendant in certain waters as well as all quahogs up to 1000 cages); *Fort Hill Lumber Co. v. Ga.-Pac. Corp.*, 493 P.2d 1366, 1368 (Or. 1972) (holding that a contract providing that the buyer would purchase all hemlock timber located in a stated area was enforceable because it contained a sufficiently definite quantity term); *Lenepe Res. Corp. v. Tenn. Gas Pipeline Co.*, 925 S.W.2d 565 (Tex. 1996) (enforcing contract requiring buyer to "take or pay" for eighty-five percent of plaintiff's gas capacity).

<sup>153</sup> *See Billings Cottonseed, Inc. v. Albany Oil Mill, Inc.*, 328 S.E.2d 426, 429 (Ga. Ct. App. 1985) (citing *Loizeaux Bldrs. Supply Co. v. Donald B. Ludwig Co.*, 366 A.2d 721, 724 (N.J. 1976)). *See generally* 2 ANDERSON, UNIFORM COMMERCIAL CODE §§ 2-306:9-2-306:12 (3d Ed. 1982).

<sup>154</sup> *Billings Cottonseed*, 328 S.E.2d at 429-30 (citing *Harvey v. Fearless Farris Wholesale, Inc.*, 589 F.2d 451 (9th Cir. 1979)). *See also Omega Eng'g, Inc. v. Eastman Kodak Co.*, 908 F. Supp. 1084, 1091 (D. Conn. 1995) (holding that an alleged requirements contract could not be enforced under the statute of frauds based on partial performance because partial performance would only permit enforcement of the specific purchase orders that had been filled).

<sup>155</sup> This point was made in *Harvey v. Fearless Farris Wholesale, Inc.*, 589 F.2d 451 (9th Cir. 1979), where the defendant was obligated to sell to plaintiffs while plaintiffs were free to purchase from any supplier. The *Harvey* court held that the contract was invalid under Idaho law, explaining,

Mutuality of obligation as it pertains to an executory contract requires that each party to the agreement be bound to perform; if it appears that one party was never bound on his part to do the acts which form the consideration for the promise of the other, there is a lack of mutuality of obligation, and the other party is not bound[.]

*Id.* at 460 n.12 (quoting *McCandless v. Schick*, 380 P.2d 893, 898 (Idaho 1963)).

all of its requirements for goods of a particular kind from the seller.”<sup>156</sup> One can remove the second element from this definition without changing its substance because an obligation of the buyer to buy goods “exclusively” from the seller adds nothing to the buyer’s obligation to “buy all of its requirements for goods of a particular kind *from the seller.*”<sup>157</sup>

To determine whether exclusivity means more than the reciprocal obligation of the buyer necessary to satisfy mutuality, compare the promise of the buyer in a requirements contract to the promise of a buyer in a fixed quantity contract. The difference is that a buyer in a fixed quantity contract purchases “X” quantity of goods “exclusively” from the seller while in a requirements contract the buyer purchases “all its requirements” “exclusively” from the seller. The concept of exclusivity therefore performs two functions: (1) it represents the reciprocal obligation of the buyer to purchase the goods that the seller is required to supply, thereby satisfying the mutuality of obligation doctrine; and (2) it assists in defining quantity when there is no other means of determining quantity, by providing that the buyer will deal only with the seller for the procurement of *all* the goods the buyer may require, thereby satisfying the requirement of definiteness. The point is that there is “exclusivity” in every sales contract for the quantity of goods agreed upon to the extent that the buyer agrees to purchase a certain number of items from the seller rather than from other suppliers. When understood in this fashion, it becomes clear that “fully” exclusive rights are not necessary to adequately define the quantity term. Indeed, courts have recognized exceptions to the general rule in an ad hoc fashion, but have not articulated a unifying principle for the exceptions. For example, the quantity term can be supplied by agreeing that the buyer will buy all of his requirements from the seller up to a maximum quantity, at which point he will be free to buy from others. It can be supplied by agreeing that the buyer will buy all of his requirements to fill orders for specific customers, or to fill the needs of particular plants, or for particular projects. The options for determining the quantity term are no doubt endless; the point is that the parties must agree on some calculation method, so that a court can decide the issues of breach and damages should a dispute arise.

Exclusive dealing arrangements are perhaps the ultimate example of requirements contracts where there is no doubt as to the buyer’s obligation to purchase the goods exclusively from the seller. Under

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<sup>156</sup> *Zemco Mfg., Inc. v. Navistar Int’l Transp., Corp.*, 186 F.3d 815, 817 (7th Cir. 1999) (citing *WHITE & SUMMERS*, *supra* note 17, at § 3-9); *FARNSWORTH*, *supra* note 17, at 135-37.

<sup>157</sup> *Zemco Mfg.*, 186 F.3d at 817 (emphasis added).

these contracts, the buyer cannot purchase any of its requirements for the goods from any other supplier and the supplier cannot sell the goods to any other buyer, at least within an agreed upon geographic area, so there is no question as to the mutuality of the parties' obligations or the ability to eventually define the quantity term.<sup>158</sup> A similar contract exists where the buyer agrees to purchase all of its requirements of a trademarked or brand-named product from the manufacturer of that product. In cases where the manufacturer is the only entity authorized to supply the brand-named product, the contract is inherently exclusive to the extent that the buyer cannot obtain its supply of the product from any other source.<sup>159</sup>

One serious downside to using the exclusivity rule as an indispensable condition for enforcing requirements contracts is that courts may be unwilling to recognize requirements contracts that the parties tailor to match their allocation of risks, by, for example, placing their own express minimum or maximum limits on the buyer's requirements. A case in point is *Agfa-Gevaert, A.G. v. A.B. Dick Co.*,<sup>160</sup> in which the parties carefully drafted a requirements contract with express limits on the buyer's discretion, only to find that their care was rewarded by a determination that these limits raised a fact issue for the jury as to whether the contract could be enforced as a requirements contract. The contract provided that the seller would furnish the buyer with 16,000 A-1 copiers in 1980 and in subsequent years with "its requirements for A-1 Copier Machines in accordance with [buyer's] orders . . . but not more, without [seller's] consent[,] than . . . (20,000) machines in any one year[.]" and that after 1980, the buyer's orders could not be fifteen percent higher or lower than its order the preceding month.<sup>161</sup> Here the parties are expressly stating the requirements that the seller would find excessive, as well as a minimum below which purchases could not fall. There was evidence in *Agfa-Gevaert* that the seller was unable to provide the capacity of 20,000 copiers a year without increasing its price. Setting the fifteen percent monthly deviation in quantity may well have been used as a way of implementing the language in Official Comment 3 to UCC section 2-306(1)—that parties can set a "clear limit on the intended elasticity" by including minimum and maximum figures in their agreement. The trial court held, as a matter of law, that the contract

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<sup>158</sup> See *O.N. Jonas Co., Inc. v. Badische Corp.*, 706 F.2d 1161 (11th Cir. 1983).

<sup>159</sup> See *Fisherman Surgical Instruments, LLC v. Tri-Anim Health Servs., Inc.*, 502 F. Supp. 2d 1170 (D. Kan. 2007).

<sup>160</sup> 879 F.2d 1518, 1520 (7th Cir. 1989).

<sup>161</sup> *Id.*

language required the buyer to purchase its requirements of low-volume plain-paper copiers from the seller.

Judge Posner reversed a judgment entered upon a jury verdict for damages to the plaintiff, and sent the case back to a jury, finding the contract too ambiguous to be decided as a matter of law. Despite finding that the “natural reading” of the contract’s language required the seller to provide the buyer’s “requirements for A-1 Copier Machines[,]” Judge Posner concluded that in light of the quantity caps and monthly limits, “the agreement is perfectly intelligible and [is] *not* a requirements contract[] [that] obligates the buyer to buy all his requirements from the seller.”<sup>162</sup> This insistence on adherence to the complete exclusivity rule ignores the case law recognizing requirements contracts that set minimum and maximum quantity limits.<sup>163</sup> It also ignores Official Comment 3 to section 2-306(1), which allows parties to set their own parameters limiting the quantities that are considered “unreasonably disproportionate” to estimates provided. This decision highlights the need for reform because Judge Posner, of all our jurists, is sensible to the benefits of allowing contracting parties to allocate the business risks in their transactions in an economically efficient manner.

While the topic of exclusive dealing arrangements is beyond the scope of this Article, it appears that courts are divided on the related issue of whether exclusive dealership agreements governed by section 2-306(2) are enforceable based on the dealer’s obligation to exercise his “best efforts.” In some jurisdictions, the buyer’s duty in an exclusive dealership contract to use “best efforts” to promote the seller’s product is considered “too indefinite and uncertain to be an enforceable standard[]” and such contracts are held void for lack of mutuality unless the buyer is

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<sup>162</sup> *Id.* at 1521. Judge Posner was concerned, it seems, that the seller was not willing to sell the buyer all of its requirements, even at a higher price. This logic seems to contradict the notion of unreasonably disproportionate demands that are too high, which is a concern that Judge Posner believes warrants an asymmetrical reading of UCC section 2-306(1), so that unreasonably low demands are not treated with the same level of concern. It is also difficult to accept Judge Posner’s claim that “[l]ooked at from the seller’s side, a requirements contract guarantees him a market for his good; in exchange he must offer the buyer a price break,” when he also takes the position that the buyer can reduce his requirements to zero as long as the buyer acts in good faith. *Id.*

<sup>163</sup> *See, e.g.,* Brooklyn Bagel Boys, Inc. v. Earthgrains Refrigerated Dough Prods., Inc., 212 F.3d 373 (7th Cir. 2000); U & W Indus. Supply, Inc. v. Martin Marietta Alumina, Inc., 34 F.3d 180, 182, 187 (3d Cir. 1994) (holding that under the parties’ requirements contracts, the buyer was only obligated to place one order within the first ninety days, and the contracts placed a maximum level on quantities the buyer could order without written agreement by the parties).

required to sell a specific quantity or meet a quota.<sup>164</sup> While the best efforts obligation should provide sufficient consideration to satisfy the need for mutuality, and to distinguish the contract from a buyer's option, because the buyer with a buyer's option has no such obligation, it may not be sufficient for definiteness. An appropriate remedy may be calculated if the parties have a prior course of dealing, have agreed on estimates of sales, or can offer evidence of comparable distributors' sales. If, however, the contract involves the sale of a new product, the best efforts obligation may not provide "a reasonably certain basis for giving an appropriate [remedy,]" as required under section 2-204(3).<sup>165</sup>

*B. Exceptions and Modifications to the Exclusivity Rule*

1. Performance Standards

Courts have held that a requirements contract will not fail for lack of exclusivity if the buyer's promise to purchase its requirements exclusively from the seller is conditioned on the seller meeting quality standards, *Porous Media Corp. v. Midland Brake, Inc.*,<sup>166</sup> or the buyer gives the provider, in a service contract, an opportunity to perform before contacting other providers, *Ceredo Mortuary Chapel, Inc. v. United States*.<sup>167</sup> In *Porous Media*, the Eighth Circuit held that under Minnesota law, the exclusivity necessary to enforce the parties' requirements contract was satisfied despite a provision giving the buyer the right to purchase the goods from other suppliers if the seller failed to meet the contract's

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<sup>164</sup> See *Ryan v. Wersi Elecs. GmbH & Co.*, 3 F.3d 174, 181 (7th Cir. 1993); *A.T.N., Inc. v. McAirlaid's Vliesstoffe GmbH & Co.*, 2008 WL 696916 at \*4 (N.D. Ill. 2008); *Kraftco Corp. v. Kolbus*, 274 N.E.2d 153, 156 (Ill. App. Ct. 1971). In *Kolbus*, the court explained that [i]n this case, there was no obligation upon Kolbus other than to use his best efforts. He had no obligation to sell any specific quantity and no obligation to meet any quotas. The operation of this contract was totally dependent upon the actions of Kolbus. The mere allegation of best efforts is too indefinite and uncertain to be an enforceable standard. As such, the contract was lacking in mutuality of obligation and unenforceable.

*Id.* Cf. *Brewster Wallcovering Co. v. Blue Mountain Wallcoverings, Inc.*, 864 N.E.2d 518, 533 (Mass. App. Ct. 2007) (holding that the parties had entered into an exclusive oral requirements contract that was exempt from the statute of frauds under UCC section 2-306(1) and was not void for indefiniteness despite the lack of a quantity term, based on the evidence of Brewster's long history as the sole distributor of the products in the mid-Atlantic region).

<sup>165</sup> See *TAS Distrib. Co. v. Cummins Engine Co.*, 491 F.3d 625 (7th Cir. 2007).

<sup>166</sup> 220 F.3d 954 (8th Cir. 2000).

<sup>167</sup> 29 Fed. Cl. 346, 353 (1993) (holding that a requirements contract was enforceable where the government reserved the right to seek services from another source if the contractor failed to provide them).



quality standards or delivery deadlines.<sup>168</sup> Performance standards restrict the buyer's discretion, since the buyer must purchase the goods or services exclusively from the seller unless the seller's performance falls below the standards. The contract's conditions also provide a method for ascertaining quantity sufficient to determine breach and damages, because the buyer will be in breach if it purchases its requirements from another source when the seller has satisfied the conditions, and those purchases will serve to calculate the seller's damages.

## 2. Maximum Quantity Limitations

The Court of Appeals for the Fifth Circuit, applying the law of Texas, has held that a requirements contract must include the promise of a buyer to purchase exclusively from the seller either the buyer's total requirements or its requirements up to a specified amount.<sup>169</sup> Courts offer no rationale for this modified version of the exclusivity rule, but the reason it satisfies the validation function of the rule seems clear. The buyer's discretion is limited and the quantity is ascertainable because the buyer promises that he will not turn to any other suppliers to satisfy his requirements before he has purchased the maximum quantity from the seller. If the buyer purchases from other suppliers before purchasing the set maximum from the seller, he has breached the contract.

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<sup>168</sup> *Porous Media*, 220 F.3d at 960; *cf.* *Polyad Co. v. Indopco, Inc.*, No. 06-C-5732, 2007 WL 2893638 (N.D. Ill. Sep. 25, 2007) (holding that under Illinois law a requirements contract exists only when the contract "obligates the buyer to buy all of its requirements for goods of a particular kind from the seller." (citing *Zemco Mfg., Inc. v. Navistar Int'l Transp. Corp.*, 186 F.3d 815, 817 (7th Cir. 1999))).

<sup>169</sup> *See* *Merritt-Campbell, Inc. v. RxP Prods., Inc.*, 164 F.3d 957, 963 (5th Cir. 1999); *Mid-South Packers, Inc. v. Shoney's, Inc.*, 761 F.2d 1117, 1120-21 (5th Cir. 1985). *See also* *Ind.-Am. Water Co., Inc. v. Town of Seelyville*, 698 N.E.2d 1255, 1260 n.1 (Ind. Ct. App. 1998) (enforcing a requirements contract that required the buyer to purchase all of its needs for water from the seller up to one million gallons per day and permitted the buyer to purchase amounts in excess of one million gallons a day from other suppliers). In *Propulsion Technologies, Inc. v. Attwood Corp.*, 369 F.3d 896, 904 (5th Cir. 2004), the court relied on *Mid-South* in refusing to enforce a purported requirements contract on statute of frauds grounds, despite testimony that the parties intended the contract to be exclusive. The contract provided that the buyer "agrees to establish minimum order requirements which are suitable to [seller] and [buyer] . . . on an annual basis, beginning in June of 1997." *Id.* The court found that "because it lacks any promise by [the buyer] to purchase an ascertainable quantity, the agreement is not enforceable for lack of consideration or mutuality." *Id.* The court cited approvingly its own prior precedent in *Mid-South* that a requirements contract fails for want of consideration unless the buyer commits to purchase exclusively from the seller either the buyer's entire requirements or the buyer's requirements up to a specified amount.

This rule was also used by the Supreme Court of New Hampshire in *PMC Corp. v. Houston Wire & Cable Co.*,<sup>170</sup> a case which has been described by Professor Blair as a “remarkable” example of the enforcement of a non-exclusive open quantity contract.<sup>171</sup> Professor Blair claims that the “[c]ourt fashioned an exception to the exclusivity rule[.]” consisting of “some sort of sliding scale of exclusivity[.]” which “is either so ill-defined as to be useless as a normative standard or . . . so expansive that it subsumes the general rule.”<sup>172</sup> He also contends that the only example of the exception the court provided was of a contract in which the “requirements buyer will purchase up to a certain amount of the product from the seller[.]” and that because the example was not present in the case, the court could not have relied on the exception it articulated.<sup>173</sup> My review of the case suggests that this description may not be accurate.

In *PMC*, the disputed letter agreement contained estimates of Houston’s annual requirements for thermocouple products, and stated that Houston intended to purchase a “major portion” of these products from PMC. The jury entered a verdict enforcing the agreement as a requirements contract. The court affirmed, holding that the terms “major portion” and “major share” in the letter were sufficiently precise to satisfy the need for a quantity term under the statute of frauds, and that parol evidence was properly admitted to show what the parties intended as to the exact quantity.<sup>174</sup> The court also rejected Houston’s claim that the trial judge erred by failing to instruct the jury that exclusivity is a prerequisite to a valid requirements contract. Relying on *White & Summers, Uniform Commercial Code*, rather than on a newly-fashioned exception to the exclusivity rule, the court held that a requirements contract may be sufficiently exclusive to be enforced, despite the presence of another supplier, “where a purchaser agrees to purchase exclusively from a seller up to a certain quantity.”<sup>175</sup> This exception is not “ill-defined” since the maximum quantity set by the parties establishes the “mechanism for deciding when to stop[.]” on the “sliding scale[.]”<sup>176</sup> and therefore addresses Professor Blair’s concerns.

The court in *PMC* also found as the basis for two of its rulings that the exception to the exclusivity rule applied to the facts of the case, again contrary to Professor Blair’s analysis. First, the court held that the letter

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<sup>170</sup> 797 A.2d 125 (N.H. 2002).

<sup>171</sup> See Blair, *supra* note 6, at 71.

<sup>172</sup> *Id.* at 112–13.

<sup>173</sup> *Id.* at 113.

<sup>174</sup> *PMC*, 797 A.2d at 128–29 (emphasis omitted).

<sup>175</sup> *Id.* at 130 (quoting *WHITE & SUMMERS, supra* note 17, at § 3-9).

<sup>176</sup> See Blair, *supra* note 6, at 113.

agreement contained language from which the jury could have determined that Houston agreed “to purchase exclusively from PMC up to a certain quantity,” indicating that the jury instructions on requirements contracts were not improper.<sup>177</sup> Second, the court denied the buyer’s motion for a judgment notwithstanding the verdict on the grounds that there was sufficient evidence to support the jury’s verdict on the issue of contract formation, including testimony that “Houston had committed to purchasing thermocouple products from PMC except in the rare circumstance that PMC could not meet an order.”<sup>178</sup> Thus, while Professor Blair is correct that no specific numerical quantity was established, the parties did agree on an ascertainable maximum by agreeing that Houston would obtain all of its requirements from PMC except in a case where PMC was unable to provide them. On this evidence, the court may not have needed to apply an exception to the exclusivity rule because limitations on the buyer’s capacity to satisfy the buyer’s requirements will always be an implied exception to the exclusivity rule. If the seller is unable to provide the buyer’s total requirements, so that the buyer must look elsewhere to satisfy those requirements, the seller can hardly hold the buyer to the exclusivity term. Either way, the doctrines of mutuality and definiteness are satisfied under such a contract because the buyer has to purchase all of its requirements from the seller unless the seller is unable to supply them, and the buyer will be in breach if it purchases any of its requirements from others before the seller has indicated its inability to provide those requirements.

### 3. Minimum and Percentage Quantity Limitations

Conversely, the Court of Appeals for the Seventh Circuit, applying Illinois law, held in *Brooklyn Bagel Boys, Inc. v. Earthgrains Refrigerated Dough Products, Inc.*, that “an essential element of a requirements contract is the promise by the buyer to purchase all of its requirements, or at least a minimum quantity, from the seller.”<sup>179</sup> This formulation

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<sup>177</sup> *PMC*, 797 A.2d 125 at 130. The court also observed that the requirement of exclusivity was implicit in the court’s instructions. The instruction that the jurors could measure quantity either by the actual requirements of the buyer “or such proportion thereof as was reasonably contemplated by the parties[]” reasonably informed “the jury that the parties can specify all requirements or a specific portion of the buyer’s requirements.” *Id.* at 131. Because this instruction fairly presented the law concerning the exclusivity rule, it was not erroneous. *Id.*

<sup>178</sup> *Id.*

<sup>179</sup> 212 F.3d 373, 379 (7th Cir. 2000). See also *Slocomb Indus., Inc. v. Chelsea Indus.*, 1983 WL 160582, \*4 (E.D. Pa. 1983) (rejecting a statute of frauds defense to a contract that defined quantity as the buyer’s requirements with minimum purchases of \$500,000).

does not state an exception to the exclusivity rule because a non-exclusive requirements contract with a promise to purchase a fixed quantity of goods, at a minimum, would satisfy the doctrines of mutuality and definiteness based on the promise for the fixed quantity. Thus, even a court that rejects the exclusivity rule may sustain a requirements contract on the grounds that the buyer has agreed to purchase a minimum fixed quantity of goods.<sup>180</sup>

In the services context, courts have held that an agreement on sales terms that does not require the buyer to purchase either its requirements or a minimum quantity from the seller is an unenforceable indefinite quantity arrangement. As the court explained in *Ceredo*,<sup>181</sup> the cases involving contracts for the procurement of services and supplies define three types of enforceable contracts—definite quantity contracts, indefinite quantity contracts with an ascertainable minimum, and requirements contracts—and one kind of unenforceable agreement, described as follows: “[I]ndefinite quantity arrangements with no ascertainable minimum are unenforceable even if they are mutually agreed upon, having the legal status of a price list or proposal.”<sup>182</sup> Even this statement is too definitive, however, because at least one court has enforced indefinite quantity contracts with no stated minimums that are not requirements or output contracts. In *Howell v. United States*, the court enforced service contracts that referred to a minimum quantity, but did not actually contain a minimum quantity term, by supplying a minimum purchase of \$1,000 worth of services, relying on section 2-204 to supply an essential missing term, and on the *Restatement (Second) of Contracts* section 204 to derive a minimum quantity term that was “reasonable in the circumstances.”<sup>183</sup>

Courts have also sustained requirements contracts against invalidity attacks when the contract defines quantity as a percentage of the buyer’s total requirements. In *R. E. Phelon Co. v. Clarion Sintered Metals, Inc.*, the court entered summary judgment for the seller on the issues of enforceability and breach when the buyer purchased less than eighty to ninety percent of its annual requirements of the specified products as set forth in the parties’ agreement.<sup>184</sup>

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<sup>180</sup> See *Amber Chem. Inc. v. Reilly Indus., Inc.*, 2007 WL 512410 at \*7-8 (E.D. Cal. 2007) (rejecting the exclusivity rule as contrary to UCC section 2-306, but holding that the requirements contract at issue was supported by consideration because the buyer had promised to purchase a minimum quantity of goods).

<sup>181</sup> 29 Fed. Cl. 346 (Fed. Cl. 1993).

<sup>182</sup> *Id.* at 349.

<sup>183</sup> 51 Fed. Cl. 516, 523 (Fed. Cl. 2002).

<sup>184</sup> 2006 WL 2573136, at \*4-6 (D.S.C. 2006).

#### 4. Project Exclusivity

In some jurisdictions, the exclusivity rule has been supplemented by an exception for contracts, whereby the buyer promises to purchase all of its requirements for a particular project on the theory that the parties could ultimately learn whether the buyer had purchased any goods for the project from another source. Courts began recognizing the exception in pre-Code cases, such as the Fifth Circuit's 1930 decision in *Tampa Shipbuilding & Engineering Co. v. General Construction Co.*<sup>185</sup> In *Tampa Shipbuilding*, the court enforced a contract for "the rock needed for 22nd Street Bridge and Causeway[,]” on the grounds that, “[a] contract for one’s needs for a particular enterprise is sufficiently definite, and is not unilateral.”<sup>186</sup> There is no need for exclusivity in the classic sense to satisfy the definiteness or mutuality doctrines in these cases because the buyer has promised to purchase the quantity of materials needed for a particular project and that quantity will be ascertainable and certain once the project has been completed. Damages are not an issue because the court can award the profits the seller lost on the materials that the buyer purchased for the project from another source. This exception is often applied in the construction contracting context, where the initial request for bids sets the estimates of the materials needed for the project, and the contracts quantify the requirements by referring to the project.<sup>187</sup>

#### 5. Customer List Exclusivity

New York and Michigan recognize an exception to the exclusivity rule that applies when the buyer has promised to purchase all of the goods it needs for certain customers from the seller. The buyer has still constrained its freedom to purchase goods from whomever it chooses to the extent that it cannot fill the orders of particular customers from any source other than the seller. The factfinder can decide the issues of breach and damages by asking whether the buyer purchased any of its requirements for customers who were covered by the agreement with goods from other suppliers. A federal district judge recognized this

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<sup>185</sup> 43 F.2d 309 (5th Cir. 1930).

<sup>186</sup> *Id.* at 310-11.

<sup>187</sup> See *Port City Const. Co., Inc. v. Henderson*, 266 So. 2d 896, 900 nn.10-11 (Ala. Civ. App. 1972) (holding that a contract to furnish “all concrete for slab” was sufficient to enforce a requirements contract); *Md. Sup. Corp. v. Blake Co.*, 279 Md. 531, 369 A.2d 1017 (Md. 1977) (noting that writing the phrases “for the above mentioned project[]” and “throughout the job” were sufficient quantity terms); *Century Ready-Mix Co. v. Lower & Co.*, 770 P.2d 692, 694 (Wyo. 1989) (holding that the statute of frauds was satisfied by a subcontractor’s purchase order for concrete to be delivered “as called for[]” for the project of expanding a high school).

point in a recent decision in which he reversed himself on reconsideration after realizing that leaving some customers outside of the scope of the buyer's obligation did not render the quantity term in a requirements contract too uncertain to enforce.

In *Corning, Inc. v. VWR International, Inc.*,<sup>188</sup> the parties' agreement provided that "VWR [would] catalog inventory and sell only Corning's Pyrex reusable glass product line, except as warranted by Tier II customers, to the exclusion of other non-Corning brands, including private label reusable glass."<sup>189</sup> Corning argued that VWR had agreed to buy all of its requirements of reusable glass from Corning except when VWR's Tier II customers asked VWR to fill their orders from other suppliers.<sup>190</sup> The court initially granted VWR's motion to dismiss on the grounds that the contract failed to satisfy the statute of frauds because it was not an exclusive requirements contract. In its reconsideration decision, the court referred to the maximum quantity exception discussed in *PMC* and *White & Summers*, concluding that a contract may be "sufficiently exclusive[.]" despite the presence of another supplier, where a purchaser agrees to purchase exclusively from a seller up to a certain quantity, at which point he may begin buying from others.<sup>191</sup> The court also discussed the minimum quantity exception and then applied these principles to hold that the contract at issue was sufficiently exclusive because it set both a maximum and a minimum standard for the quantity the buyer would purchase from the seller.<sup>192</sup> In explaining its changed position, the court stated that in its original ruling it had found it significant that the parties' agreement "provided no way of knowing or even estimating how much or how little reusable glass the Tier II customers might buy, and therefore the Court found that the memorandum lacked a sufficient quantity term."<sup>193</sup> This difficulty was resolved when the memorandum was understood to require VWR to purchase exclusively from Corning for all of its non-Tier II customers, at a minimum, and even to require VWR to purchase from Corning for its Tier II customers who did not ask for goods from other suppliers.<sup>194</sup>

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<sup>188</sup> 2007 WL 841780 (W.D.N.Y. 2007).

<sup>189</sup> *Id.* at \*1.

<sup>190</sup> *Id.*

<sup>191</sup> *Id.* at \*6.

<sup>192</sup> *Id.*

<sup>193</sup> *Id.*

<sup>194</sup> *Id.* See also *Ind.-Am. Water Co., Inc. v. Town of Seelyville*, 698 N.E.2d 1255, 1260 (Ind. Ct. App. 1998) (noting that a requirements contract is illusory and unenforceable without a guaranteed minimum quantity that the buyer must purchase from the seller).

Similarly, in *GRM Corp. v. Miniature Precision Components, Inc.*,<sup>195</sup> the defendant issued a request for quotations (“RFQ”) for a five-year contract to supply thermostats for engine components that the defendant would, in turn, sell to Chrysler. This RFQ estimated annual quantity needs and asked the bidders to state whether they could meet “all specified requirements at the volume levels[.]” While the parties did not discuss exclusivity, and their “blanket [purchase] orders” did not require the buyer to purchase all of its requirements from the seller but were to be followed by delivery schedules requesting specific quantities, the seller understood that the orders would fluctuate based on the orders Chrysler placed with the defendant. The court held that while Michigan law was unsettled as to whether exclusivity was necessary to enforce a requirements contract, the parties’ contract writings contained sufficient language indicating the existence of a requirements contract, and therefore a valid quantity term, to permit sending the case to the jury for consideration of parol evidence.<sup>196</sup> Even if Michigan law did not require exclusivity, the parties agreed that the seller would supply the buyer with the quantity of products required by Chrysler. Thus, the validation came from a limited exclusivity agreement that the buyer would buy from the seller all of the products it needed to fill Chrysler’s orders, which was considered to be an ascertainable quantity. Here, the buyer had decided to start making the thermostats itself, and the issue was therefore whether it acted in good faith in doing so.<sup>197</sup>

C. *The Code’s Duty of Good Faith for Open Quantity Contracts*

As discussed above, the Official Comments to UCC section 2-306 take the position that output and requirements are validated by the implied duty of good faith imposed on the quantity-determining party to run its business and to maintain quantities at reasonably foreseeable levels, and they do not mention the exclusivity rule.<sup>198</sup> In 1983, Professor

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<sup>195</sup> 2008 WL 82224 (E.D. Mich. 2008).

<sup>196</sup> *Id.* at \*5-6.

<sup>197</sup> See also *Trimed, Inc. v. Sherwood Med. Co.*, 772 F. Supp. 879, 886 (D. Md. 1991) (holding that a requirements contract for the buyer to distribute a particular brand of surgical instruments could give the buyer the right to sell competitors’ brands without being illusory because the buyer’s customers’ choice of product was the determining factor, such that the buyer was obligated to fulfill its requirements needed to satisfy its own customers’ orders for that particular brand from the seller).

<sup>198</sup> See generally *supra* Part III.A-B. At least one court has relied on the Official Comments to UCC section 2-306 to find that the duty of good faith provides a basis for validating output and requirements agreements while also interpreting UCC section 2-306(1) to incorporate the exclusivity requirement. In *Stacks v. F & S Petroleum Co., Inc.*, 641 S.W.2d 726, 727 (Ark. Ct. App. 1982), the court found that, like the common law, UCC section 2-306(1) defines requirements contracts as contracts under which the buyer agrees to

Bruckel wrote an article asserting that the effect of section 2-306(1) was to replace the exclusivity rule with good faith as the validation device for open quantity contracts.<sup>199</sup> Professor McCallon sought to “reaffirm” her claim in a 2004 comment based on his observation that the “use of exclusivity as a validating device appears to be as accepted today as it was prior to Professor Bruckel’s article and prior to the enactment of the UCC.”<sup>200</sup>

Professor Goldberg has taken the opposite position, arguing that it was a mistake for the drafters of section 2-306(1) to use good faith to address the enforcement issue, which he characterizes as a lack of consideration under the illusory contract doctrine, without addressing the indefiniteness issue.<sup>201</sup> He does not offer an alternative to good faith or the exclusivity rule, but claims that the discretion of the quantity-determining party in open-quantity term contracts will not be unbounded in any case because these contracts typically relate the quantity to physical constraints, such as the capacity of a particular plant of the buyer or seller.<sup>202</sup> He offers no empirical support for this claim, and the cases discuss many significant contracts that do not include such provisions. Either way, enforcement surely should not depend on whether the contract contains an express cap on the quantity term.

Finally, Professor Blair would require courts to enforce non-exclusive requirements contracts based on an inquiry into whether the parties intended to enter into a bargain.<sup>203</sup> Blair argues that, for open quantity contracts, “[c]ourts do not need to find mutuality of obligation, either through exclusivity or good faith.”<sup>204</sup> According to Blair, “nonexclusive open-quantity agreements are capable of being validated so long as there is sufficient evidence to persuade a factfinder that the parties actually bargained for such a contract.”<sup>205</sup> He emphasizes that for validation, nonexclusive open-quantity agreements must be “the product of true bargaining between the parties[.]”<sup>206</sup> and that there must be sufficient evidence that the contract was actually bargained for, indicating that the factfinder must conduct a fact-intensive examination

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purchase all of its requirements exclusively from the seller, and then relied on the Official Comments to conclude that the duty of good faith is sufficient to defeat the defenses of lack of mutuality and indefiniteness. *Id.*

<sup>199</sup> Bruckel, *supra* note 4, at 117.

<sup>200</sup> McCallon, *supra* note 4, at 712.

<sup>201</sup> Goldberg, *supra* note 3, at 103.

<sup>202</sup> *Id.* at 104.

<sup>203</sup> Blair, *supra* note 6, at 110.

<sup>204</sup> *Id.*

<sup>205</sup> *Id.* at 125.

<sup>206</sup> *Id.* at 115.



of parol evidence to determine whether negotiations took place over the contract terms and whether each party received something in exchange for the concessions given. Viewed this way, the concept of “bargained for” exchanges appears to be little more than the mutuality doctrine in disguise. It would be difficult to imagine a requirements contract surviving this “bargained for” test if the seller did not seek, in exchange for his promise to sell the buyer its requirements, a reciprocal promise from the buyer to purchase its requirements from the seller.

Blair also criticizes a decision by the Court of Appeals for the Fifth Circuit, *Mid-South Packers, Inc. v. Shoney's, Inc.*,<sup>207</sup> for its reliance on the exclusivity rule,<sup>208</sup> but this decision actually demonstrates the importance of the doctrine of mutuality in real world business transactions. Business people take very seriously the distinction between business documents that do not impose a commitment on the buyer to purchase goods from the seller, such as price lists, proposals, or options, and business documents that require the buyer to purchase its requirements exclusively from the seller, and not from any other source, for the duration of the agreement. In *Mid-South*, the business people involved in the transaction for the buyer understood this distinction, but their attorneys apparently did not. The seller in *Mid-South* gave the buyer a proposal for the sale of pork products at prices that could be changed upon forty-five days notice. The proposal did not list specific quantities or refer to the buyer's requirements, but the buyer had given the seller an estimate of its requirements at the parties' initial meeting. The buyer claimed that it accepted the seller's proposal as a requirements contract when it began filling all of its needs from the seller, based on purchase orders or phone calls, which were followed by shipments and invoices from the seller. The buyer's agent, however, testified that the buyer was free to purchase from other suppliers, that it continued to purchase exclusively from the seller because it was satisfied with the seller's service and the quality of its goods, and that the only commitment it made was based on its individual purchase orders. The Court of Appeals for the Fifth Circuit held that under the common law and the Code, “an essential element of a requirements contract is the promise of the buyer to purchase exclusively from the seller either the buyer's entire requirements or up to a specified amount.”<sup>209</sup> Based on the lack of exclusivity, the court found that the parties' agreement was a section 2-205 firm offer rather than a requirements contract.

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<sup>207</sup> 761 F.2d 1117, 1120–21 (5th Cir. 1985).

<sup>208</sup> Blair, *supra* note 6, at 99.

<sup>209</sup> *Id.* at 98–99.

Courts have encountered a number of difficulties when attempting to validate requirements contracts using the concept of good faith without evidence that would satisfy the exclusivity rule or one of its exceptions. One is that the standards of good faith and reasonableness cannot satisfy the doctrines of mutuality and definiteness when the buyer in a requirements contract has made no commitment to purchase any quantity of goods that can be ascertained by a factfinder. One early case involving this issue is *City of Louisville v. Rockwell Manufacturing Co.*,<sup>210</sup> a 1973 decision by the Court of Appeals for the Sixth Circuit, where the court sustained a contract in which the seller was to furnish only “part of the City’s requirement for parking meters,” with no further aids in establishing an ascertainable quantity.<sup>211</sup> Relying on UCC section 2-306(1), the court held that

[t]he further provision for furnishing “part” of the City’s requirements likewise does not render the agreement illusory or lacking in mutuality, both in light of the full record upon the trial and in light of the further provision in the agreement for furnishing “approximately 7650” parking meters. The word “approximately” when used in this context merely indicates that precision in quantity is not intended, but rather a margin is intended either for excess or deficiency in the quantity stated.<sup>212</sup>

Providing an estimate is not sufficient to satisfy the mutuality and definiteness doctrines, however, when the buyer has promised to purchase an unascertainable quantity such as “part” of its requirements. Saying that the City promised to purchase a “part” of its requirements from Rockwell does not tell you, for example, that the City promised to purchase eighty percent of its requirements from Rockwell, and all the court can do under the UCC is to determine whether the quantity the City actually purchased is “unreasonably disproportionate” to the estimate of 7,650 meters.

Some courts have extended the reach of good faith as a validation principle even further, applying it to enforce purported requirements contracts when the buyer has not promised to purchase any portion of its

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<sup>210</sup> 482 F.2d 159 (6th Cir. 1973). See also *Hoover’s Hatchery, Inc. v. Utgaard*, 447 N.W.2d 684, 688 (Iowa Ct. App. 1989) (holding that the inclusion of defendant’s expected requirements in the correspondence, which constituted the agreement, provided a sufficient standard to measure the defendant’s good faith in purchasing its requirements under the contract).

<sup>211</sup> *City of Louisville*, 482 F.2d at 164.

<sup>212</sup> *Id.*

requirements from the seller, ascertainable or not. In *General Motors*,<sup>213</sup> the seller moved for summary judgment dismissing the buyer's claims on the grounds that the purchase orders were terminable at will and did not require the buyer to order any seat frames, the purchase orders were not exclusive, and the purchase orders became effective only when the buyer issued releases authorizing the seller to build and ship a specific number of seat frames.<sup>214</sup> Without identifying evidence to contradict any of these points, the court denied the buyer's motion on the grounds that UCC section 2-306 rejects the exclusivity rule<sup>215</sup> and that under Official Comment 2, requirements contracts are validated by the duty of good faith.<sup>216</sup> Specifically, the court found that the buyer would be in breach of the contract if "in bad faith or inconsistent with commercial standards of fair dealing, the plaintiffs exercised a unilateral right not to purchase seat frames or to terminate the purchase orders[]" or had "acted in bad faith and not issued a release."<sup>217</sup> So without evidence that the buyer had promised to purchase any goods from the seller, the court found that section 2-306 provides a sufficient basis for the factfinder to determine when the buyer has breached its duties of good faith and fair dealing by failing to purchase goods from the seller. The court then sent the case back to the jury, expressing no concern over how it was to decide what quantity the buyer was required to purchase from the seller under this good faith standard when the purchase orders were not exclusive and provided no method of calculating the buyer's quantity commitment.

The Michigan Court of Appeals followed the *General Motors* decision in *Plastech*,<sup>218</sup> reversing a summary judgment ruling for the buyer when the seller's purchase order stated, "Scheduled Purchase Order to cover 100% Johnson Controls requirements[,] but the seller was only one of buyer's "preferred providers[,] and the contract was not exclusive.<sup>219</sup> As to quantities, which were not set forth in the purchase order, the court relied on the good faith duty of the buyer not to order quantities unreasonably disproportionate to the estimates contained in the parties'

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<sup>213</sup> 90 F. Supp. 2d 861 (E.D. Mich. 2000).

<sup>214</sup> *Id.* at 873.

<sup>215</sup> *Id.* at 874 ("The statute and official comments simply do not support Paramount's assertion that all requirements contracts are exclusive requirements contracts; a requirements contract may exist where 'all or some of' the purchaser's requirements are purchased from the seller.").

<sup>216</sup> *Id.* at 873.

<sup>217</sup> *Id.*

<sup>218</sup> 2005 WL 736519 at \*5 (Mich. Ct. App. 2005).

<sup>219</sup> *Id.* at \*6, 2.

communications.<sup>220</sup> But if the buyer has not undertaken a commitment to purchase all or any ascertainable portion of its requirements from the seller, as was the case in *Plastech*, it is unclear how the buyer's implied duty of good faith to operate its business so that its requirements will be maintained at reasonably foreseeable levels—the duty the Official Comments rely on to satisfy the doctrines definiteness and mutuality—can create such a commitment.

A buyer should be able to enter into valid requirements contracts with a group of suppliers for a particular product, but there is an alternative to the approach taken in *Plastech*. Rather than providing an estimate of the requirements, around which the buyer cannot demand quantities that are “unreasonably disproportionate,” as the parties did in *Plastech*, the buyer could simply promise to buy a percentage of its actual requirements from each supplier.<sup>221</sup> An estimate could be given, if appropriate, but would not be necessary. This form of “exclusivity” would be sufficient to satisfy the mutuality and consideration doctrines because the buyer would be obligated to buy a specific percentage of any needs it had for the product from the seller. The definiteness requirement would also be met because courts could determine the existence of a breach and an appropriate remedy by reviewing evidence of the buyer's total purchases of the goods to see whether the buyer purchased the requisite percentage from the seller.

Another difficulty with using good faith as a validation device is that if the contract does not contain a quantity estimate, and there is no evidence of “normal” quantities, the courts have no device for ascertaining quantity. This issue arose in *Orchard Group, Inc. v. Konica Medical Corp.*,<sup>222</sup> a decision by the Court of Appeals for the Sixth Circuit, where the court reversed a jury verdict for the plaintiff-buyer. The buyer was a new company with no history of purchases from the seller or any other suppliers. The purported requirements agreement did not include an estimate of the buyer's requirements or a promise that the buyer would purchase its requirements exclusively from the seller. Instead, it described the discount and rebates available for certain products and

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<sup>220</sup> *Id.* at \*7.

<sup>221</sup> Although the issue in this case was a breach, rather than the formation of a contract, the parties in *Fort Wayne Corrugated Paper Co. v. Anchor Hocking Glass Corp.*, 130 F.2d 471, 473 (3d Cir. 1942), entered into requirements contracts whereby the buyer agreed to purchase not less than seventy-five percent of its requirements of glass containers from the seller, and estimated that its requirements would not exceed 800 carloads a year. *Id.* Similarly, in *HML Corp. v. General Foods Corp.*, 365 F.2d 77, 79 (3d Cir. 1966), the buyer agreed to purchase seventy-five percent of its salad dressing requirements from the seller, and a cap was placed on the buyer's requirements of 5,000 gallons per day. *Id.*

<sup>222</sup> 135 F.3d 421 (6th Cir. 1998).

stated that the seller was “pleased to offer these terms in return for a firm commitment of 36 mos.”<sup>223</sup> Based on the reference in section 2-306(1) to quantities that are unreasonably disproportionate to a “stated estimate,” the court in *Orchard Group* concluded that the agreement “fails as a requirements contract because it lacks a specific quantity term—estimate or otherwise—and there is no prior course of dealings from which a quantity term could be implied.”<sup>224</sup> The court also rejected the argument that under Official Comment 2 the buyer’s duty of good faith in maintaining requirements that approximate a reasonably foreseeable figure was sufficient to satisfy the quantity term, concluding that without an identifiable quantity term, an exclusive relationship must exist.<sup>225</sup>

The facts of *Orchard Group* set up Professor Blair’s thesis nicely because the parties’ agreement reflected their intent to reach a bargain for the buyer’s “firm commitment of 36 months” in exchange for the seller’s discounted pricing terms, but the agreement did not contain language showing that the buyer committed to purchasing any ascertainable quantity of goods. What the court sensibly held under these circumstances was that even if the parties intend to enter into a binding supply agreement, and exchange promises to do so, if they do not provide the courts with any method for ascertaining the quantity of goods that they have agreed to buy and sell, they cannot expect the courts to enforce their agreement. The situation calls to mind Judge Posner’s comments on the doctrine of definiteness in *Goldstick v. ICM Realty*:

If people want courts to enforce their contracts[,] they have to take the time to fix the terms with reasonable definiteness so that the courts are not put to an undue burden of figuring out what the parties would have agreed to had they completed their negotiations. The parties have the comparative advantage over the court in deciding on what terms a voluntary transaction is value-maximizing; that is a premise of a free-enterprise system.<sup>226</sup>

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<sup>223</sup> *Id.* at 423.

<sup>224</sup> *Id.* at 428.

<sup>225</sup> *Id.* Along these lines, the court distinguished the *City of Louisville* decision on the grounds that it dealt with a non-exclusive requirements agreement that contained a specific numeric quantity term. *Id.*

<sup>226</sup> 788 F.2d 456, 461 (7th Cir. 1986).

The Third Circuit appears to have recognized the importance of preserving the exclusivity rule to satisfy the doctrines of definiteness and mutuality, even while finding the rule unnecessary for statute of frauds purposes. In *Advent Systems Ltd. v. Unisys Corp.*,<sup>227</sup> the parties' distribution agreement provided that "Unisys desires to purchase, and Advent desires to sell, on a non-exclusive basis, certain of Advent hardware products and software licenses for resale worldwide[.]" and later included a mutual obligation of sale and purchase provision whereby, "Advent agrees to sell hardware and license software to Unisys, and Unisys agrees to buy from Advent the products listed in Schedule A."<sup>228</sup> The seller was free to sell to other distributors, and the buyer could purchase competing products, but the buyer was required to purchase its requirements of the products described in the contract exclusively from the seller, as the sole supplier of these products.<sup>229</sup> Thus, the agreement was sufficiently "exclusive" to satisfy courts that have required exclusivity as a condition for enforcing requirements contracts, but it was not an "exclusive dealing" arrangement within the meaning of section 2-306(2).

The Third Circuit was correct in *Advent* in finding that the statute of frauds was satisfied, but *Advent* has caused considerable confusion by holding that "non-exclusive" requirements contracts automatically satisfy the statute of frauds because in *Advent* the contract at issue *was* exclusive under the exclusivity rule required for validation. The Fifth Circuit has declined to follow the Third Circuit's holding in *Advent* that, as interpreted by the Fifth Circuit, "a specific quantity term is not needed to satisfy the statute of frauds in a non-exclusive requirements contract[.]" and instead applies section 2-201 to require a writing indicating that the quantity term is defined by the buyer's requirements or up to a specified quantity.<sup>230</sup>

Although the Fifth Circuit in *Advent* was willing to go along with Professor Bruckel's recommendation to apply good faith as a substitute

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<sup>227</sup> 925 F.2d 670, 671, 678 (3d Cir. 1991).

<sup>228</sup> *Id.* at 674.

<sup>229</sup> The only suggestion in the facts of *Advent* that this may not have been a completely exclusive distribution contract is that the hardware products and software licenses that were the subject of the distribution agreement were developed by Advent as part of a new proprietary electronic document management system, so that the "products listed on Schedule A" of the agreement may have been described as Advent trademarked products. If so, the case would be comparable to *Trimed, Inc. v. Sherwood Medical Co.*, 772 F. Supp. 879, 886 (D. Md. 1991), where the exclusivity was limited to a particular brand name product and the buyer was free to purchase similar products from the seller's competitors. The definiteness problem is still solved by the limited exclusivity inherent in the buyer's promise to purchase all of the seller's brand name products only from the seller.

<sup>230</sup> See *FFP Mktg. Co. v. Medallion Co.*, 31 Fed. Appx. 159 n.2 (5th Cir. 2001).

for exclusivity in dealing with the statute of frauds defense,<sup>231</sup> the court was unwilling to extend the theory to the formation defense of indefiniteness under section 2-204. The court explained that “unlike the statute of frauds issue discussed earlier, the definiteness required to provide a remedy rests on a very solid foundation of practicality. A remedy may not be based on speculation and an award cannot be made if there is no basis for determining if a breach has occurred.”<sup>232</sup> In this case, Unisys underwent a restructuring, in the midst of which it decided to develop its own document system, and terminated the distribution agreement with Advent.<sup>233</sup> The court noted that Unisys could stop devoting resources to the project, and therefore eliminate its requirements for Advent’s products, without necessarily breaching its duty of good faith. The court therefore remanded the case, commenting that “[w]hether Advent can establish the definiteness required to sustain a remedy is a serious question.”<sup>234</sup>

Other courts have also shied away from the full implications of jettisoning the exclusivity rule in favor of the good faith standard, retaining the need for either an explicit or implicit promise that the buyer will purchase either its actual requirements, the stated estimate of its requirements, or quantities within a reasonable variation of the estimate. In *Cyril Bath Co. v. Winters Industries*,<sup>235</sup> the Sixth Circuit recognized that a requirements contract could be upheld under the Ohio version of UCC section 2-306(1),<sup>236</sup> either because the buyer made an implied promise to purchase the goods exclusively from the seller or on the alternative ground that the buyer made an explicit promise to purchase a portion of

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<sup>231</sup> *Advent*, 925 F.2d. at 679 (citing Bruckel, *supra* note 4, at 171). It is important to note here that other circuits have interpreted the statute of frauds and UCC section 2-201(1) to require more than just written evidence that the parties intended to enter into an agreement that had some quantity term, even if that quantity term may be too indefinite for enforcement, and enforced the language in section 2-201(1) that “the contract is not enforceable under this subsection beyond the quantity of goods shown in the record.” *Id.* In *Nora Beverages, Inc. v. Perrier Group of America, Inc.*, 164 F.3d 736, 749 (2d Cir. 1998), the Court of Appeals for the Second Circuit reversed summary judgment and held that the statute of frauds under UCC section 2-201 was satisfied by a writing stating a requirements range because the agreement could be enforced for the minimum quantity stated. *Id.*

<sup>232</sup> *Advent*, 925 F.2d at 679.

<sup>233</sup> *Id.* at 672.

<sup>234</sup> *Id.* at 680.

<sup>235</sup> 892 F.2d 465 (6th Cir. 1989). See also *Harvey v. Fearless Farris Wholesale, Inc.*, 589 F.2d 451, 461–62 (9th Cir. 1979) (rejecting the argument that the Official Comment to UCC section 2-306 displaces Ohio law on the doctrine of mutuality by expressly stating that requirements contracts have mutuality, and holding that “the provision for ‘good faith’ in § 28-2-306 cannot stretch the statute to make such a one-sided [non-exclusive] executory agreement enforceable[.]”).

<sup>236</sup> OHIO REV. CODE ANN. § 1302.19(A) (West 2001).

its requirements from the supplier, up to a specified figure, subject to good faith variation in the buyer's requirements. In *Cyril*, the seller's revised quotation specifically stated that the prices "are based on a three year program with annual production requirements" of 800,000 tubes in each of the first two years and 400,000 tubes in the third year.<sup>237</sup> In response, the buyer sent a confirming purchase order calling for a delivery date of March 1984, "As Released." Noting its holding in *City of Louisville*,<sup>238</sup> the court found that the buyer in this case was explicitly obligated under the agreement to purchase its tubes from the seller, "at least up to the number specified, subject to good faith variation in the buyer's requirements."<sup>239</sup> Since the seller's prices were specifically based on the stated requirements, and the buyer accepted those prices in its purchase order, the court could also have chosen to protect the seller's expectation interests by holding that the buyer had entered into a contract for at least the minimum of the stated requirements necessary to receive the price discount.<sup>240</sup>

#### V. IDENTIFYING ENFORCEABLE OPEN QUANTITY CONTRACTS

Although the exclusivity rule is preferable to the implied duty of good faith as a validation tool for open quantity contracts, courts have not succeeded in using the rule to achieve predictable or even-handed results. Part of the difficulty arises from the propensity of many courts to interpret purported open quantity contracts as if there are only two possibilities: either the document is an enforceable output or requirements contract, or it is not an enforceable contract and is therefore, from the court's perspective, meaningless. But the contested document could also be a price list, a proposal, a response to a request for proposals, a letter of intent, a buyer's option or "[f]irm [o]ffer[]" under UCC section 2-205, or a blanket purchase order or master purchase agreement that merely sets out the terms of the parties' future dealings and disclaims any liability of the seller for the purchase of goods. Because courts fail to consider the breadth of non-contractual business documents that may exist, and the utility of these documents, they often strain to interpret them as contracts.

Even among the two options courts tend to focus on, the chances are much greater than courts seem willing to acknowledge that business people will engage in prolonged negotiations that do not result in

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<sup>237</sup> *Cyril*, 892 F.2d at 466.

<sup>238</sup> 482 F.2d 159 (6th Cir. 1973).

<sup>239</sup> *Cyril*, 892 F.2d at 467.

<sup>240</sup> See *Detroit Radiant Prods. Co. v. BSH Home Appliances Corp.*, 473 F.3d 623 (6th Cir. 2007).



binding agreements. While there is an enormous practical and legal difference between the two scenarios, the documentation is often remarkably similar for: Case (1) the “we’ll give you the business” deal, meaning that we will start ordering from you rather than your competitors under these terms and will continue ordering from you until we become dissatisfied or find a better deal elsewhere; and Case (2) the contract under which, “we promise to give you the business and to be liable for breach if we go to a competitor for the duration of our contract.” Given the size and market significance of the buyer, a seller may find the first option very appealing, despite the fact that it does not represent a binding contract.<sup>241</sup> The trick for the seller is to ensure he does not unwittingly enter into a binding requirements contract at overly favorable pricing terms.

In some jurisdictions, courts will find an implied promise by the buyer to purchase its requirements exclusively from the seller based on the thinnest of evidentiary grounds (such as the parties’ history of exclusive dealing that could be explained as easily by voluntary rather than contractually mandated motives),<sup>242</sup> or will squeeze every possible ambiguity out of the parties’ agreement to send the issue of enforceability to the jury for consideration based on parol evidence<sup>243</sup> and reject statute of frauds defenses on any mention of quantity in a writing, no matter how imprecise or uncertain.<sup>244</sup> Other courts will take a firmer stance, insisting on some indication in writing that the buyer actually committed itself to purchase at least an identifiable portion of its

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<sup>241</sup> See *infra* text accompanying notes 295–98 (discussing *Tingstol Co. v. Rainbow Sales, Inc.*, 218 F.3d 770 (7th Cir. 2000)).

<sup>242</sup> See *Universal Power Sys., Inc. v. Godfather’s Pizza, Inc.*, 818 F.2d 667, 670–71 (8th Cir. 1987); *Kan. Power & Light Co. v. Burlington N. Ry. Co.*, 740 F.2d 780, 788–89 (10th Cir. 1984).

<sup>243</sup> See *Zemco Mfg., Inc. v. Navistar Int’l Transp. Corp.*, 186 F.3d 815, 817–18 (7th Cir. 1999); *Cryovac Inc. v. Pechiney Plastic Packaging, Inc.*, 430 F. Supp. 2d 346, 360 (D. Del. 2006).

<sup>244</sup> For example, in *Nora Beverages, Inc. v. Perrier Group*, 164 F.3d 736, 748–49 (2d Cir. 1998), the court held that the statute of frauds was satisfied by a letter claiming to serve as an agreement for plastic bottles that included the price and estimated the buyer’s needs from one-half to a million cases of bottles but did not contain any indication that the buyer had agreed to purchase all or an ascertainable portion of its requirements from the seller. The court also found that the evidence was sufficient to present a material issue of fact on validity, based largely on the possibility that the letter’s reference to an estimated range of the buyer’s possible product needs could be interpreted as an agreement to purchase a minimum of 500,000 cases. *Id.* at 749. See also *Kline, Inc. v. Lorillard, Inc.*, 878 F.2d 791, 795 (4th Cir. 1989) (finding that the term “direct basis” was insufficient to satisfy the statute of frauds for an alleged requirements contract, but holding that plaintiff’s claim failed not because the writing contained no reference to the buyer’s requirements, but because “there is a lack of something, anything, in the writing that might evidence the quantity dimension of Kline’s claim[]”).

requirements from the seller, and on some basis for awarding a remedy.<sup>245</sup> These discrepancies obviously frustrate one of the principal purposes of the UCC, which, as section 1-103(a)(3) indicates, is to make the law uniform among the various jurisdictions, thereby providing greater certainty to transactions conducted by parties located in multiple states.

This discussion of the methods of interpretation courts are using to identify valid open quantity contracts will focus on five areas where flawed methods are leading to inconsistent results. The first deals with the rule that a promise from the buyer to purchase its requirements exclusively from the seller can be implied based on the seller's promise to sell the buyer its requirements. The second discusses cases in which courts base the buyer's promise of exclusivity on an expression of intent that would not, under other circumstances, constitute a binding agreement. The third section covers cases involving agreements that expressly state that the buyer has no obligation to purchase goods until it issues individual orders to the seller and the seller accepts them. The fourth section discusses cases concerning agreements offering volume discounts with no express promise by the buyer to purchase its requirements from the seller, and the fifth analyzes cases involving opportunistic contracting behavior by buyers.

My goal will be to determine whether courts' assumptions are justifiable based on current law, whether their methods achieve the correct balance between the need for predictable results, on the one hand, and the need for equity in particular circumstances, on the other, and whether these methods permit parties, especially buyers, to speculate on litigation outcomes. I suggest that a better methodology for

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<sup>245</sup> See *Propulsion Techs., Inc. v. Attwood Corp.*, 369 F.3d 896, 904 (5th Cir. 2004) (holding that a purported requirements contract was unenforceable under the statute of frauds because there was no writing to support the testimony of an agreement to exclusivity); *FFP Mktg. Co. v. Medallion Co.*, 31 Fed. Appx. 159 (5th Cir. 2001) (affirming summary judgment dismissing breach of alleged requirements contract under the statute of frauds because there was no writing indicating the quantity was the buyer's requirements); *Merritt-Campbell, Inc. v. RxP Prods., Inc.*, 164 F.3d 957, 963 (5th Cir. 1999) ("While the quantity term in requirements contracts need not be numerically stated, there must be some writing which indicates that the quantity to be delivered under the contract is a party's requirements or output."); *Zayre Corp. v. S.M. & R. Co., Inc.*, 882 F.2d 1145 (7th Cir. 1989) (affirming summary judgment under UCC section 2-306(1) that letter agreements were unenforceable under the statute of frauds where there was no express or implied written promise by the buyer to purchase its requirements exclusively from the seller); *Robart Mfg. Co. v. Loctite Corp.*, 1986 WL 893, at \*11 (N.D. Ill. Jan. 9, 1986) ("To meet the statute's [statute of fraud's] prerequisites, therefore, requirements contracts must state that it is a requirements contract or that the quantity will be defined by the buyer's needs or contain similar language."); *Cardiovascular Servs., Inc. v. W. Houston Health Care Group, Inc.*, No. 01-94-01075, 1995 WL 523615, at \*6 (Tex. App. Sept. 7, 1995) (same).

deciding these cases would be to place the risk on the party who could most easily have allocated that risk through proper drafting, assuming the courts would enforce the contract language, rather than replace their allocation with a distribution based on the good faith rule. In most cases, this will mean that to create an enforceable requirements contract, the duty should be placed on the buyer to expressly state, in either the supply agreement or its individual purchase order or release, that it has promised to purchase all or an ascertainable portion of its requirements from the seller and the seller has promised to supply those goods to the buyer. For “battle of the forms” transactions, the buyer’s purchase orders should expressly limit acceptance to these terms.<sup>246</sup>

A. *Implied Promises of Exclusivity and Buyer’s Options*

The buyer’s promise of “exclusivity” may be either express or implied.<sup>247</sup> Courts will generally find that the buyer has made an implied promise to purchase all of its requirements from the seller in situations where, (1) the contract is an exclusive dealing agreement involving goods that are available only from the seller;<sup>248</sup> (2) the contract contains language that for some other reason suggests that it is a “sole-source” contract;<sup>249</sup> and (3) the contract includes an express promise by the seller to supply all of the buyer’s requirements and there is evidence

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<sup>246</sup> See U.C.C. § 2-207(2)(a) cmt. 3.

<sup>247</sup> See, e.g., *Essco Geometric v. Harvard Ind.*, 46 F.3d 718, 728 (8th Cir. 1995); *O.N. Jonas Co. v. Badische Corp.*, 46 F.3d 718, 728–29 (11th Cir. 1983).

<sup>248</sup> See *Famous Brands, Inc. v. David Sherman Corp.*, 814 F.2d 517 (8th Cir. 1987) (enforcing a requirements contract based on an implied promise to buy under the terms of the contract, which consisted of an exclusive dealership arrangement, under which a liquor bottler gave exclusive distribution rights within a state for a brand of liquor to a wholesaler); *O.N. Jonas*, 706 F.2d at 1161 (holding that an implied promise that the seller would be the buyer’s exclusive supplier could be found where the buyer would be purchasing the seller’s yarn pursuant to a trademark licensing agreement and the seller stated in a memorandum that the seller would supply the yarn for the program if certain conditions were met); *Brewster Wallcovering Co.*, 864 N.E.2d at 533 n.37 (holding that an oral distribution agreement giving the buyer the exclusive right to sell the supplier’s wallpaper brands in certain mid-Atlantic states was enforceable as a requirements contract without an express quantity term or promise of exclusivity).

<sup>249</sup> In *Laclede Gas Co. v. Amoco Oil Co.*, 522 F.2d 33, 38 (8th Cir. 1975), the court implied a buyer’s promise to purchase propane exclusively from the seller from a contract provision requiring the plaintiff to attach all of its distribution facilities to the seller’s header piping to obtain its supply of propane. See also *Pepsi-Cola Co. v. Steak 'N Shake, Inc.*, 981 F. Supp. 1149 (S.D. Ind. 1997) (holding that a factual question existed as to whether the parties had created a requirements contract sufficient to satisfy the statute of frauds where exclusivity could be implied from language in the contract indicating that the buyer, a restaurant chain, would undergo a “transition” from its current soft drink supplier to Pepsi-Cola and that it could add additional Pepsi-Cola products).

that the parties intended to be bound.<sup>250</sup> The reasons for implying a promise of exclusivity in the first two cases are evident, but in the third case the inference is not justified because a binding promise by the seller to provide the buyer with its requirements may be a buyer's option rather than a requirements contract, as demonstrated in *In re Modern Dairy of Champaign, Inc.*<sup>251</sup>

In *Modern Dairy*,<sup>252</sup> the Court of Appeals for the Seventh Circuit reversed a summary judgment ruling for two school districts seeking to recover damages for breach of requirements contracts that specified they had to purchase milk from a dairy that had fallen into bankruptcy. None of the contract documents included any express agreement by the dairy to supply the districts with their milk requirements. The court held that the seller's obligation could be implied if the contracts required the districts to purchase their requirements exclusively from the dairy.<sup>253</sup> When the court reviewed the evidence, however, it found that the premise for this inference was missing, concluding, "So far as the contractual documents are concerned, all there is is the dairy's agreement to sell milk to the districts at a specified price that it cannot raise during the school year: in other words, a buyer's option."<sup>254</sup> As options, the contracts were unenforceable because section 2-205 puts a three-month time limit on firm offers unsupported by consideration, and the common law, though lacking a deadline, also requires consideration.<sup>255</sup> Because neither the intrinsic nor the extrinsic evidence provided a reasonable factfinder with a basis to infer either that the

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<sup>250</sup> *Propane Indus., Inc. v. General Motors Corp.*, 429 F. Supp. 214, 219 (W.D. Mo. 1977) ("In construing a contract in which only the seller has agreed to sell, a court may find an implied reciprocal promise on the part of the buyer to purchase exclusively from the seller, at least when it is apparent that a binding contract was intended." (citing *City of Holton v. Kan. Power & Light Co.*, 9 P.2d 675, 679 (Kan. 1932)); *Hutchinson Gas & Fuel Co. v. Wichita Natural Gas Co.*, 267 F. 35, 39 (8th Cir. 1920); *Cold Blast Transp. Co. v. Kan. City Bolt & Nut Co.*, 114 F. 77, 81 (8th Cir. 1902). See also *Pittsburgh Plate Glass Co. v. Jarrett*, 42 F. Supp. 723, 728 (M.D. Ga. 1942) ("In a requirements contract, an agreement by the seller to sell imports an agreement by the buyer to buy."). But cf. *Brem-Rock, Inc. v. Warnack*, 624 P.2d 220 (Wash. App. Ct. 1981) (finding an implied agreement by the buyer to purchase all of its good faith requirements from the seller in an agreement that gave the buyer the exclusive right to purchase gravel from the seller's gravel pit, although the seller could sell to others with the buyer's consent).

<sup>251</sup> 171 F.3d 1106 (7th Cir. 1999).

<sup>252</sup> *Id.*

<sup>253</sup> *Id.* at 1108 ("The contracts do not expressly obligate the dairy to supply the districts with their requirements for milk. But such an obligation can be implicit as well as express, and the inference would be compelling if the contracts forbade the districts to turn elsewhere for milk." (citation omitted)).

<sup>254</sup> *Id.*

<sup>255</sup> *Id.* at 1109-10.

districts made the required promise of exclusivity or that the option was supported by consideration, the court reversed, finding that the districts “lose.”<sup>256</sup>

What is interesting in *Modern Dairy*, for our purposes, is Judge Posner’s analysis of why it would be appropriate to infer a seller’s promise to sell from a buyer’s promise to purchase, juxtaposed with his recognition of a buyer’s option in that case. He explains,

A buyer would be unlikely to commit to take all his requirements for some good from the seller if the seller had no reciprocal obligation to supply those requirements . . . Contract law, in inferring an obligation to sell in these circumstances, would be performing its frequent office of interpolating a contractual term to which the parties would almost certainly have agreed expressly had they thought about the matter.<sup>257</sup>

The same logic would apply to the statement that, “a seller would be unlikely to commit to sell to the buyer all of its requirements if the buyer had no reciprocal obligation to buy those requirements.” The reason this inference is not equally valid as a legal matter is that a seller can commit to sell the buyer all of its requirements without expecting a reciprocal promise from the buyer to purchase them if the seller is making a buyer’s option or firm offer under section 2-205. Because this alternative is more than theoretically possible,<sup>258</sup> courts should not infer the obligation of the buyer to purchase based on the seller’s obligation to sell. Thus, the existence of the buyer’s option supports rejecting the rule, articulated in *Propane Industrial, Inc. v. General Motors Corp.*, that “[i]n construing a contract in which only the seller has agreed to sell, a court

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<sup>256</sup> *Id.* at 1110. The *Modern Dairy* decision was followed in this respect by the Third Circuit in *Masda Corp. v. Empire Comfort Sys., Inc.*, 69 Fed. Appx. 85 (3d Cir. 2003), where the court affirmed summary judgment for the defendant on the grounds that “the evidence purporting to establish a requirements contract does so neither explicitly nor by implication and therefore could present no genuine, material issue to a factfinder.”

<sup>257</sup> *Modern Dairy*, 171 F.3d 1108.

<sup>258</sup> See *McCallon*, *supra* note 4, at 733 n.191 (“A requirements-type contract wherein a buyer/offeree purports to provide consideration beyond its promise to buy goods, however, is scarce at best.”) (footnote omitted). Such consideration was provided by the buyer in *Merritt-Campbell, Inc. v. RxP Products, Inc.*, 164 F.3d 957 (5th Cir. 1999), where the buyer claimed the contract reciting consideration of \$10 paid to guarantee a price for five years was a requirements agreement. The court found it was an options agreement, which was void under the Code’s statute of frauds for lack of a written quantity term. *Id.* “To be binding, an option contract must: (1) be signed by the offeror; (2) recite a purported consideration for making the offer; and (3) propose an exchange on fair terms within a reasonable time.” *Id.* at 964 (citing RESTATEMENT (SECOND) CONTRACTS § 87 (1979)).

may find an implied reciprocal promise on the part of the buyer to purchase exclusively from the seller, at least when it is apparent that a binding contract was intended."<sup>259</sup> Because a buyer's option can be a binding contract if consideration is provided, or even if consideration is not provided, for three months,<sup>260</sup> such an inference is unfounded.

Several years after *Modern Dairy*, the Supreme Court of Mississippi issued a decision that applied the *Propane Industrial* inference to enforce as a requirements contract a document that the *Modern Dairy* court would have considered to be a buyer's option. In *G.B. "Boots" Smith Corp. v. R. Cobb, Jr.*,<sup>261</sup> the contract provided that the seller would sell the buyer "all fill dirt" for a specific road construction project, specified the price per cubic yard, and gave an estimate of the quantity that would be needed.<sup>262</sup> The buyer purchased some of its requirements from the seller, but also purchased fill dirt for the project from one of the seller's competitors. In affirming the trial court's finding that the contract implied a promise of exclusivity, the court relied on *Propane Industrial*, and found that "[w]hile the contract does not contain the phrase 'buyers agree to buy all fill dirt for the Project,' there would be no reason to include the wording 'all fill dirt for [the] project' unless Smith intended to buy all the fill dirt needed for the project from these particular sellers."<sup>263</sup> The court did not consider the possibility that a seller's promise to supply the buyer with its requirements at a particular price was also consistent with the creation of a buyer's option, even when the buyer's course of performance indicated that this is how he interpreted the parties' agreement.

The rule that a buyer's promise to purchase his requirements exclusively from the seller may be inferred from the seller's promise to supply the buyer with all of his requirements is unsound, is inconsistently applied,<sup>264</sup> and should therefore be given the prompt burial it deserves.

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<sup>259</sup> *Propane Indus.*, 429 F. Supp. at 219 (citing *City of Holton*, 9 P.2d at 679) (emphasis omitted); *Hutchinson Gas*, 267 F. at 39; *Cold Blast*, 114 F. at 81.

<sup>260</sup> U.C.C. § 2-205 (2004).

<sup>261</sup> 860 So. 2d 774 (Miss. 2003).

<sup>262</sup> *Id.* at 776.

<sup>263</sup> *Id.* at 777-78.

<sup>264</sup> The court properly refused to find an implied obligation to purchase on the part of the buyer from an express obligation on the part of the seller to sell the buyer all of its requirements in *Seaside Petroleum Co., Inc. v. Steve E. Rawl, Inc.*, 339 S.E.2d 601(Ga. App. Ct. 1985). The court declined to find an implied obligation on the part of a gasoline dealer to buy all of his requirements for gasoline from the seller where the parties' agreement was silent on this point. The parties' contract stated that the seller, a wholesaler of a particular brand of gasoline, would sell and deliver the buyer's requirements of the stated brand of gasoline for a 10-year period but said nothing about a corresponding promise to purchase

B. *Letters of Intent*

Courts have also issued inconsistent decisions based on whether to enforce the rule that, as with fixed quantity contracts, statement of future intent are insufficient to create a binding contract. Some courts rely on contract language that expresses the buyer's future intent to purchase its requirements from the seller, rather than on any evidence that the buyer has actually agreed to purchase its requirements from the seller, even though the same language would be rejected if viewed in a preliminary agreement or agreement to agree context. In *PMC*,<sup>265</sup> for example, the court enforced a requirements contract based on a document which began as a draft letter of intent from PMC to Houston with a cover sheet explaining that it was "'an intent to purchase' that in no way locks [Houston] into purchases from PMC but merely indicates an intent."<sup>266</sup> Houston's president had the letter of intent to purchase letter retyped, and added some details, but was meticulous in avoiding any language indicating that he was making a commitment to buy. He consistently used words of intent, not agreement, writing that, Houston "expects" to purchase, it is Houston's "intent" to purchase, and Houston is "projecting future . . . business" at certain levels.<sup>267</sup>

Similarly, in *Universal Power Systems, Inc. v. Godfather's Pizza, Inc.*,<sup>268</sup> the Court of Appeals for the Eighth Circuit rejected the buyer's argument that the parties' letter agreement was unenforceable as a requirements contract because it did not state that the buyer promised that the seller would be its exclusive supplier for the goods at issue (deep-dish pizza

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on the part of the buyer. After the buyer began purchasing a different brand of gasoline and notified the seller that it would not require any further goods and services from the seller, the seller brought suit, claiming that there was an unexpressed obligation on the part of the buyer to buy all of his requirements of gasoline and not just his requirements of the stated brand from the seller. The court found that not only was there no obligation on the buyer's part to buy all gasoline from the seller, but there was not even an obligation to buy the named brand of gasoline. Since there was likewise no promise to sell only the seller's particular brand of gasoline in the contract, the court found that the buyer had made no agreement to purchase any products from the seller and had properly been found not to be in breach of the contract. *Id.* See also *Dedoes Indus., Inc. v. Target Steel, Inc.*, 2005 WL 1224700 (Mich. App. May 24, 2005) (holding that a three-year price guarantee indicating that the defendant would satisfy the plaintiff's steel needs, where the parties had done business for 18 months, was unenforceable because it did not contain a quantity term); *Acemco, Inc. v. Ryerson-Tull Coil Processing*, 2008 WL 140982 (Mich. Ct. App. Jan. 15, 2008). *Contra Hutchinson Gas*, 267 F. at 39; *Cold Blast*, 114 F. at 81; *Propane Indus.*, 429 F. Supp. at 219; *City of Holton*, 9 P.2d at 679; *Brem-Rock, Inc. v. Warnack*, 624 P.2d 220 (Wash. Ct. App. 1981).

<sup>265</sup> *PMC Corp. v. Houston Wire & Cable Co.*, 797 A.2d 125 (N.H. 2002).

<sup>266</sup> *Id.* at 127.

<sup>267</sup> *Id.*

<sup>268</sup> 818 F.2d 667 (8th Cir. 1987).

pans), but only its “intention” to use the seller as a supplier. The court relied on the fact that the seller had been the buyer’s sole supplier for the goods for the last three and a half years as evidence of the buyer’s intent to be bound,<sup>269</sup> and the contract’s use of the words “confirm” and “intention” to show the buyer’s intent to purchase the pans. The court did not address the evidence that the contract was also contingent on two factors, both of which were mentioned in the letter agreement: final approval of the deep dish pizza concept, and acceptance of the seller’s products by the non-company owned franchises.<sup>270</sup>

Faced with similar “letters of intent” that did not contain an agreement from the buyer to purchase all or any portion of its requirements from the seller, but only a statement of its “intention to purchase” the goods described, the court in *Cabot Corp. v. AVX Corp.*,<sup>271</sup> properly concluded that the letters were not binding contracts.<sup>272</sup> Similarly, in *Acemco, Inc. v. Ryerson-Tull Coil Processing*,<sup>273</sup> the Michigan Court of Appeals awarded summary judgment for the defendant-seller where the parties’ supply agreement provided that

the Seller agrees to sell to the Buyer and the Buyer agrees to buy from the Seller such quantities of the Products as the Buyer *may specify* in its purchase orders, the estimated volume of which will be a total of 33,950,000 pounds for all of the Products, plus or minus 20%, over the term of the Agreement.<sup>274</sup>

Even if the validation mechanism is modified to cover all agreements that provide a method for determining an ascertainable quantity, the courts should still be consistent in distinguishing between enforceable agreements to purchase goods and unenforceable statements of intention to reach an agreement in the future.

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<sup>269</sup> *Id.* at 669.

<sup>270</sup> *Id.* at 671.

<sup>271</sup> 863 N.E.2d 503, 507-08 & n.3 (Mass. 2007).

<sup>272</sup> *Id.* at 513 (citations omitted). *See also* *Quality Croutons, Inc. v. George Weston Bakeries, Inc.*, 2008 WL 373181 (N.D. Ill. Feb. 12, 2008) (holding that a letter of intent stating that the seller would “confirm” the buyer’s “intention” to enter into a contract whereby the seller would be the buyer’s exclusive supplier for three years, was unenforceable, where the letter of intent contained a provision indicating that parties would not be bound unless they entered into a written agreement, despite evidence that the buyer proceeded to purchase exclusively from seller under purchase orders for the next year and a half).

<sup>273</sup> 2008 WL 140982 (Mich. App. Ct. 2008).

<sup>274</sup> *Id.* (emphasis added).



C. *Master Purchase Agreements and Blanket Purchase Orders*

Courts fall into at least two camps in their approaches to interpreting business documents that contain the general terms and conditions that the parties agree will govern their future business transactions. These documents are often known as “Blanket Purchase Orders” or “Master Purchase Agreements,” (referred to collectively as “MPAs”). These documents are often presented on a “take it or leave it basis” by large buyers to suppliers, and state expressly that they do not commit the buyer to any estimated quantity, and that firm orders are only made when purchase orders are submitted. Their purpose is to set out the terms by which the parties will do business, or give authorization for expenditures of a maximum amount, as long as signed purchase orders are provided, but they do not purport to impose any obligation on the buyer to buy any product or on the seller to sell any product. Once the purchase order is issued, the purchase order may incorporate by reference the terms and conditions of the MPA.

In one set of cases, courts enforce the disclaimer of liability in MPAs, finding that they are unambiguous in expressing the parties’ intent that the buyer has not committed to purchasing its requirements from the seller. In another set of cases, courts interpret the disclaimer as raising an ambiguity as to the buyer’s intent, and send the formation issue to the jury to decide. If the MPA does not contain a disclaimer or a promise by the buyer to purchase its requirements from the seller, courts will either infer a promise by the buyer to purchase its requirements from the seller and enter judgment enforcing the MPA as a requirements contract, or send the case to the jury for a determination of enforceability.

An example of decisions from courts that enforce disclaimers of liability in MPAs includes *James L. Gang & Associates, Inc. v. Abbott Laboratories, Inc.*,<sup>275</sup> where the seller offered course of dealing evidence in support of its claim that Abbott’s “Purchase Agreement 855” represented a commitment, not a mere estimate of its future requirements. The court refused to consider the course of dealing evidence on the grounds that the agreement was unambiguous, based on language in the contract stating, “Seller understands and agrees that Buyer has made no guarantee or commitment hereunder to purchase any minimum quantity of these Products[,] . . . the quantities of Products actually purchased may vary from the estimates listed in Table One[,]” and that “firm orders shall only be on purchase orders issued hereunder.”<sup>276</sup> The Sixth

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<sup>275</sup> 198 S.W.3d 434, 437–38 (Tex. Ct. App. 2006). See also *In re Anchor Glass Container Corp.*, 345 B.R. 765 (M.D. Fla. 2006).

<sup>276</sup> *James L. Gang*, 198 S.W.3d at 437.

Circuit also takes this approach, and assumes that when the blanket purchase order requires the buyer to submit releases governing supply and delivery, the blanket purchase order does not constitute a requirements contract, and that the only contracts between the parties are the releases that are issued by the buyer and accepted by the seller.<sup>277</sup>

In two cases decided by the Seventh Circuit, *Brooklyn Bagel Boys*,<sup>278</sup> and *Keck Garrett & Associates, Inc. v. Nextel Communications, Inc.*,<sup>279</sup> the courts strained to interpret MPAs with disclaimers as enforceable agreements, even when they correctly found that these documents could not be enforced as requirements contracts. In *Brooklyn Bagel Boys*, Earthgrains entered into a "Contract Packaging Agreement (the "MPA Contract")" in 1996 with Brooklyn Bagel Boys to supply "ordered quantit[ies]" of bagels for Earthgrains' Fort Payne, Alabama facility based on a set price schedule.<sup>280</sup> The MPA Contract also provided that Earthgrains would supply a non-binding forecast of its orders every three months and that either party could terminate the MPA Contract on ninety days written notice.<sup>281</sup> In 1997, Earthgrains began installing equipment to manufacture bagels at its Fort Payne facility. When the installation was complete, Earthgrains gave Brooklyn Bagel Boys notice of its intent to terminate the MPA Contract. Upon termination, Brooklyn Bagel Boys sued Earthgrains for breach of contract. The district court granted summary judgment for Earthgrains, finding that the terms of the MPA Contract were unambiguous and did not obligate Earthgrains to purchase its bagel needs from Brooklyn Bagel Boys.<sup>282</sup>

On appeal, Judge Williams held that the MPA Contract was not a requirements contract, as a matter of law, because it did not, "expressly obligate Earthgrains to purchase all, or any specified quantity, of its requirements of bagels for the Fort Payne facility from Brooklyn Bagel."<sup>283</sup> Because the MPA Contract did commit the seller to firm prices that could only be changed at six month intervals, the court held that it was enforceable under UCC section 2-205, as a buyer's option, which "is enforceable even though Earthgrains made no reciprocal commitment to

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<sup>277</sup> See *Urban Assocs., Inc. v. Standex Elec., Inc.*, 216 Fed. Appx. 495, 496 (6th Cir. 2007); *Advanced Plastics Corp. v. White Consol. Indus., Inc.*, No. 93-2155, 1995 U.S. App. LEXIS 1047 (6th Cir. Jan. 18, 1995); *Precision Rubber Prods. Corp. v. George McCarthy, Inc.*, 872 F.2d 187, 189 (6th Cir. 1989); *Harris Thomas Indus., Inc. v. ZF Lemforder Corp.*, 2007 WL 3071676 at \*5 (S.D. Ohio 2007).

<sup>278</sup> 212 F.3d 373, 379 (7th Cir. 2000).

<sup>279</sup> 517 F.3d 476 (7th Cir. 2008).

<sup>280</sup> *Brooklyn Bagel Boys*, 212 F.3d at 375-76.

<sup>281</sup> *Id.*

<sup>282</sup> *Id.* at 376-77.

<sup>283</sup> *Id.* at 378.

buy all of its bagel needs from Brooklyn Bagel.”<sup>284</sup> In reaching this conclusion, the court relied on an incomplete quotation from *Modern Dairy*, stating that “[a] seller’s firm offer to supply the buyer’s needs for some good at a specified price and other terms is enforceable . . . even though the buyer makes no reciprocal commitment to buy all its needs from [the] seller . . . [.]” The complete version of the quote adds, “[B]ut unless the offer is supported by consideration, it is revocable after three months.”<sup>285</sup> As in *Modern Dairy*, Judge Williams should have found that the purported requirements contract was unenforceable as a buyer’s option because the parties had not identified any additional consideration to support extending the buyer’s option beyond the three-month deadline set forth in section 2-205.

Rather than finding that the MPA Contract was an enforceable buyer’s option, the court should have held that it was not enforceable, and did not need to be. Each order placed by Earthgrains and accepted by Brooklyn Bagel Boys when it shipped the goods constituted an enforceable contract for the sale of goods, subject to the terms and conditions incorporated by reference from the MPA Contract. The district court judge had reached an alternative holding that the parties entered into a series of contracts, each of which related back to the original MPA Contract, when each order was placed.<sup>286</sup> Judge Williams noted that this characterization was “consistent with a buyer’s option” because the MPA Contract could be viewed as an offer, and each order an acceptance.<sup>287</sup> But the MPA Contract did not contain a quantity term, so an acceptance could not have created an enforceable contract. Thus, the better view is to consider each order as an offer, incorporating the terms of the MPA Contract, which was accepted when the goods were shipped, as permitted under section 2-206(b).

In the second case, *Keck Garrett*,<sup>288</sup> Keck, a marketing agency, sued Nextel, a telecommunications company, for breach of Nextel’s \$1 million blanket purchase order. Nextel issued the blanket purchase order during the course of the parties’ discussions concerning a new design project that would be undertaken the upcoming year. The function of the blanket purchase order was to authorize Nextel representatives to assign work to vendors up to a maximum amount by signing estimates of the cost of requested work submitted by the vendors.<sup>289</sup> The blanket

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<sup>284</sup> *Id.* at 379.

<sup>285</sup> *In re Modern Dairy of Champaign Inc.*, 171 F.3d 1106, 1110 (7th Cir. 1999).

<sup>286</sup> *Brooklyn Bagel Boys*, 212 F.3d at 379 n.4.

<sup>287</sup> *Id.*

<sup>288</sup> 517 F.3d 476 (7th Cir. 2008).

<sup>289</sup> *Id.* at 480.

purchase order did not describe any particular projects that would be performed and stated that the “Supplier shall be paid upon the submission of proper invoices or vouchers, the prices stipulated herein for work completed and/or Articles delivered and accepted, less any proper deductions or setoffs.”<sup>290</sup> Four months later, Nextel informed Keck that it would not be using Keck’s services for the project.

The Court of Appeals for the Seventh Circuit reached the proper conclusion on the main issue in *Keck Garrett*, affirming summary judgment for Nextel, based on its finding that the blanket purchase order did not guarantee any minimum payments to Keck and “simply authorized specific Nextel employees to release funds to Keck Garrett against the purchase order, up to a total of \$1 million over the course of 2003.”<sup>291</sup> No terms in the blanket purchase agreement required Nextel to assign any work to Keck, or required Keck to perform any services for Nextel, or prohibited Keck from working for Nextel’s competitors.<sup>292</sup>

The court’s doctrinal detour occurred when it responded to Keck’s claims that the court’s analysis rendered the contract illusory, and Keck would have a claim for quantum meruit if the contract was unenforceable.<sup>293</sup> Despite having several solid reasons for rejecting Keck’s quantum meruit claim, the court made the additional argument that the blanket purchase order was enforceable in the sense that it would function as a guarantee of payment and as a recitation of applicable terms and conditions if Nextel ever assigned any work to Keck.<sup>294</sup> Neither the purported “guarantee” that Nextel would stand behind estimates of work signed by its representatives nor the terms and conditions contained set forth in the blanket purchase order would be enforceable unless Nextel asked Keck to perform specific services, Keck made an offer to perform those services for an estimated price, and Nextel’s representative accepted that offer by signing the estimate. Since the court seems to acknowledge as much, its argument that the blanket purchase order will have some effect once a contract is created by other means is perplexing. A more appropriate response, given the evidence, would have been that as a matter of law Keck was entitled to recover on the contract any estimates of work that were submitted by Keck and signed by Nextel. As in *Modern Dairy*, the MPA did not contain a promise from the buyer to purchase any goods or services, and the

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<sup>290</sup> *Id.*

<sup>291</sup> *Id.* at 485.

<sup>292</sup> *Id.*

<sup>293</sup> *Id.* at 486. Keck claimed that it incurred \$145,000 in investment-specific costs on the project, but the court determined that none of this work had been requested by Nextel or had any value to Nextel. *Id.* at 484.

<sup>294</sup> *Id.* at 486.

subsequent communications and actions between the parties authorized the purchase and sale of a specific quantity of goods or services. One would need to read the MPA together with the subsequent documents to understand the total agreement, but one would not conclude that the MPA was enforceable without these documents.

The *Keck Garrett* facts also provide a template for testing the theory of commentators who advocate applying the Code's gap-filling remedies to contracts for the sale of services and eliminating the exclusivity rule for validation. Using this approach, the court could have applied section 2-306(1) as a gap-filler for the missing quantity term and held that the blanket purchase order was a requirements contract for Nextel's new design project up to \$1 million at the prices and on the other terms and conditions set forth. Other supporting evidence would include the parties' extensive history of prior dealings, Nextel's initial oral assurances that Keck would secure the contract, and the parties' lengthy negotiations on the new design project. The language in the blanket purchase order that Nextel used to protect itself from such exposure would be found ambiguous, in favor of parol evidence, thereby encouraging costly litigation and strategic behavior.

The decision that gets it just right, in keeping true to commercial realities, is *Tingstol Co. v. Rainbow Sales Inc.*<sup>295</sup> The supplier's representative in *Tingstol* described how such "blanket order[s]" are used in business: "[A]s 'the carrot that [the buyer] waves in front of you. 'This is what we think we're going to use.' You jump on that. Business is business.'" When asked whether the blanket order was a commitment, the witness answered, "No. It's [the buyer's] way out when they want to."<sup>296</sup> Consistent with this testimony, the blanket order expressly limited the buyer's liability to the parts it scheduled for release.<sup>297</sup> The Court of Appeals for the Seventh Circuit correctly held that the blanket order was not a requirements contract, on the one hand, because it did not bind the buyer and that also was not a buyer's option because it was not supported by consideration.<sup>298</sup>

In 1999, the Seventh Circuit's Judge Ripple wrote a decision in *Zemco Manufacturing, Inc. v. Navistar International Transportation Corp.*<sup>299</sup> that is largely irreconcilable with *Modern Dairy*, which was decided a few months before *Zemco*, and with Judge Williams' opinion in *Brooklyn Bagel*

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<sup>295</sup> 218 F.3d 770, 773 (7th Cir. 2000).

<sup>296</sup> *Id.*

<sup>297</sup> *Id.* at 772.

<sup>298</sup> *Id.* at 773 ("Because it did not bind UTA and there was no element of exclusivity, the blanket order was not a requirements contract.").

<sup>299</sup> 186 F.3d 815 (7th Cir. 1999).

*Boys*, which was decided a year after *Zemco*. In *Zemco*, the district court had held that the parties' contract was not a requirements contract, as a matter of law, because the buyer had not agreed to purchase all of its requirements from the seller. The contract provided that the buyer would purchase "such quantities of the items listed herein as [it] might order or schedule[.]" but that "the Buyer shall not be obligated to take any goods, the delivery of which has not been specified in such shipping schedules[.]"<sup>300</sup> Although the Seventh Circuit acknowledged this language, the court nevertheless found the contract sufficiently ambiguous to reverse summary judgment,<sup>301</sup> noting that "in the absence of any explicit agreement as to quantity, the section of the Code authorizing requirements contracts is 'the primary 'gap filler' in the Code for quantity terms.'"<sup>302</sup> But there are many other forms of commonly utilized contracts and business documents that do not contain quantity terms, such as price sheets, proposals, buyer's options, and non-binding blanket purchase orders, and the express language of the contract in *Zemco* indicated that the buyer was *not* committing itself to a specific quantity. So why should the court have concluded that there was ambiguity concerning whether the parties intended to form a requirements contract? The court's answer was that the affirmative statements and omissions rendered the contract ambiguous in this regard,<sup>303</sup> but the affirmative statements and omissions could not have created an ambiguity in this case. The omission was a missing quantity term, and that term was explained by language stating that the buyer's commitment was limited to quantities the buyer "might order or schedule" and by the express statement that the buyer would not be obliged to accept any goods that were not "specified in such shipping schedules[.]"

What may actually have been the most persuasive factor in the court's analysis was the parol evidence that Navistar had purchased all of its requirements from *Zemco* for the past twelve years.<sup>304</sup> Indeed, the court distinguished *Modern Dairy* on the grounds that the parties in that

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<sup>300</sup> *Id.* at 817.

<sup>301</sup> *Id.* Finding ambiguity in this language, the court noted that while it could be read to give the buyer complete authority over how many goods to purchase, it could also be interpreted as an articulation of the manner in which parts would be ordered. *Id.* The court also relied on a provision stating that the seller would give the buyer's orders priority under UCC section 2-615, as creating additional ambiguity. If anything, this provision would appear to undercut the concept that the seller was obliged to sell the buyer all its requirements, regardless of the orders placed by other customers. *Id.*

<sup>302</sup> *Id.* at 818.

<sup>303</sup> *Id.* at 817.

<sup>304</sup> *Id.*

case only had a two-month history of exclusive dealing.<sup>305</sup> But Navistar could just as easily have been a repeat customer because it was satisfied with Zemco's goods and service, and courts have warned against relying on a prior course of dealing to establish the existence of a requirements contract for this very reason. When the buyer expressly reserves its rights not to be bound to its requirements in the contract, its prior dealings should not be sufficient to send the case to a jury.

Another decision on this side of the divide was issued in 2005 by a federal court in Michigan in *Metal One*.<sup>306</sup> In *Metal One*, the court entered summary judgment for the seller enforcing the buyer's blanket purchase order as a requirements contract despite the order's express disclaimer of liability. The seller, Metal One, was a trading company that sold custom steel bars to the defendant, the Center, for resale to Sony for making TV frames.<sup>307</sup> The Center's blanket purchase orders provided that the volumes stated were estimates and did not constitute a firm commitment.<sup>308</sup> These estimates indicated the number of steel bars the Center predicted it would need for the next few months, but Metal One never shipped any steel until it received a "firm release" from the Center.<sup>309</sup> Because Sony and the Center operated on a "just-in-time" inventory system, Metal One had to keep three or four months of the custom inventory on hand to satisfy the Center's needs. The Center protected Metal One's reliance interest through a cancellation provision in the blanket purchase order whereby the Center would reimburse Metal One for any goods the Center cancelled before delivery that could not be resold.<sup>310</sup> The Center's position was that it had complied with this provision by cancelling its latest order, made in a July 30, 2003 firm release, within five days.<sup>311</sup> The court rejected this argument, holding that because the blanket purchase order was a requirements contract, the Center was liable for the entire inventory Metal One had procured to fill the Center's needs, and that the Center had breached the contract by shutting down its plant due to financial losses.<sup>312</sup>

The court's interpretation of the blanket purchase orders began with a citation to *General Motors*,<sup>313</sup> for the proposition that section 2-306 expresses a legislative intent to enforce non-exclusive as well as exclusive

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<sup>305</sup> *Id.* at 817 n.3.

<sup>306</sup> 2005 WL 1657128 (W.D. Mich. 2005).

<sup>307</sup> *Id.* at \*1.

<sup>308</sup> *Id.* at \*2.

<sup>309</sup> *Id.*

<sup>310</sup> *Id.*

<sup>311</sup> *Id.* at \*7.

<sup>312</sup> *Id.*

<sup>313</sup> 90 F. Supp. 2d 861, 873 (E.D. Mich. 2000).

requirements contracts.<sup>314</sup> But while the buyer in a non-exclusive requirements contract does not have to promise to purchase all of its requirements exclusively from the seller, it must still promise to purchase *some* portion of its requirements from the seller, and the court does not explain how the blanket purchase orders can be interpreted as non-exclusive requirements contracts when they expressly state that their estimates are non-binding, and the orders apparently contained no references to the buyer's requirements.

The court also relied on course of performance evidence that the parties had done business using these blanket purchase orders and firm releases for a year and a half, during which time the Center was aware that Metal One had to keep sufficient inventory on hand, not only of the steel bars but also of the hot roll bars used to make them.<sup>315</sup> Based entirely on Metal One's reliance interest, the court held that all these blanket purchase orders somehow constituted a single requirements contract not only for the steel bars, but also for the hot roll bars that were held by third-party suppliers for Metal One.<sup>316</sup> The court's reasoning appears to be that if Metal One did not protect its reliance interest by including the necessary language in the contract documents when the deal was struck, then the documents must be interpreted in light of the subsequent evidence of Metal One's reliance to protect that interest. By ignoring the cancellation provision, the court's approach destroys parties' incentives to bargain for specific risks and rewards. Metal One may well have assumed the risk of losing custom inventory beyond the goods covered by the cancellation policy as a condition of obtaining the Center's business. That was most likely the case because Metal One could not have reasonably understood that it would receive cancellation damages for its entire inventory, including raw materials for goods the Center had not ordered in firm releases, especially where the Center had expressly stated that it made no firm commitment for the volume estimates in the blanket purchase orders.

These cases illustrate why it is so important for courts to insist on evidence that the buyer has agreed to purchase all or an ascertainable portion of its requirements from the seller before concluding that the parties have entered into a requirements contract. A valid requirements contract should include an agreement by the purchaser to purchase all or an ascertainable portion of its requirements from the seller for the term of the contract, thereby providing consideration for the seller to maintain its prices and other terms of sale for the duration of the contract. If the

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<sup>314</sup> *Metal One*, 2005 WL 1657128, at \*5.

<sup>315</sup> *Id.* \*1, \*5.

<sup>316</sup> *Id.*



buyer has not promised to purchase all or an ascertainable portion of its requirements from the seller, but has only provided estimates of its needs, and has expressly stated that it will be liable only for released quantities, the seller should not be bound to the terms of sale for the duration of the contract when it has received no return promise from the buyer to purchase all or any ascertainable part of its requirements from the seller for the duration of the contract.

In a document that included both a disclaimer of liability except for released quantities and an express promise by the buyer to purchase all of its requirements from the seller, one could argue that the disclaimer would be inconsistent with the express promise because the disclaimer would arguably cover any requirements above those identified in specific purchase orders or releases. As long as the buyer has made an express promise to purchase its requirements from the seller, the disclaimer should be interpreted to mean that the buyer is liable only for the ordered quantity of requirements, rather than for estimated quantities. The disclaimer should not be interpreted to contradict the buyer's express promise by denying liability for the seller's lost profits damages based on the buyer's requirements through the end of the contract term, should the buyer perform an anticipatory breach. As one court put it, albeit under different circumstances, the parties' purchase order contract was "in essence, a 'requirements' contract, in which [the buyer] was liable to purchase only those quantities of [the product] that it actually required in its production operations."<sup>317</sup> Here the court was discussing a situation where there was no evidence that the buyer promised to purchase its requirements from the seller, and the court's reasoning is unclear. The conclusion is correct, however, that as between estimates and actual orders, the buyer is only liable to pay for its actual orders, even in a requirements contract. As long as the document contains language indicating that the buyer has undertaken an obligation to purchase its requirements from the seller, a provision stating that the buyer is liable not for the forecasted amount, but only for the quantities it orders, should not change the classification of the agreement as a requirements contract. But if the document does not reflect the buyer's commitment to purchase its requirements from the seller, and consists only of an agreement on the terms that will govern any subsequent orders the buyer may make in the future, the agreement should not be enforced as a requirements contract.

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<sup>317</sup> Sea Link Int'l, Inc. v. Osram Sylvania, Inc., 969 F. Supp. 781, 785 (S.D. Ga. 1997).

*D. Pricing Proposals, Volume Discounts, and Course of Dealing Evidence*

As in *Zemco*, courts have also placed undue reliance on the parties' history of exclusive dealing to enforce MPAs as requirements contracts, where the only mention of quantity in the MPAs is an offer of volume discounts and the buyer has not committed to purchasing all or any identifiable portion of its requirements from the seller. In *Kansas Power & Light Co. v. Burlington Northern Railroad Co.*,<sup>318</sup> for example, the Court of Appeals for the Tenth Circuit reversed the trial court's denial of a plea for a declaratory judgment by Kansas Power & Light Co. ("KPL") to enforce a purported requirements agreement with the Burlington Northern Railroad ("BN") to transport coal. The agreement consisted of a letter from the BN stating that it served as "an outline of intent and understanding" that BN had regarding movement of coal from a mine to KPL's proposed plant site.<sup>319</sup> The letter attached a proposed rate sheet that would be filed with the ICC and contained an escalation formula that would be applied to these rates.<sup>320</sup> After transporting KPL's coal for nine years under the rate sheet, BN applied for and was granted an increase by the ICC that raised rates above the list prices, which led to the lawsuit.<sup>321</sup> Despite the absence of any language in the letter indicating that KPL was required to use BN's services to transport all or any part of its coal, the court held that the letter's incentive pricing system based on tonnage provided a sufficient reference to quantity to support enforcing the price list as a requirements contract.<sup>322</sup>

When BN pointed out that the alleged contract left KPL free to use other transportation providers, the court relied on the fact that KPL had not explored alternatives until BN raised its price, and on the implied promise that the buyer's requirements must be maintained in good faith.<sup>323</sup> KPL's implied promise of good faith was also the answer to BN's argument that under KPL's long term contract with the coal mine, the mine could supply coal from multiple locations which might be serviced from a carrier other than BN, so that KPL would have to ship

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<sup>318</sup> 740 F.2d 780 (10th Cir. 1984).

<sup>319</sup> *Id.* at 782.

<sup>320</sup> *Id.*

<sup>321</sup> *Id.* at 782-83.

<sup>322</sup> *Id.* at 789-90. The court also relied on the letter's provision stating, "In those years when KP&L's coal requirements from Belle Ayr to Delia become less than 2,000,000, carriers will seek to amend the tariff to reduce the annual minimum tonnage requirement, but not less than 1,500,000 tons, to apply only in KP&L's cars." *Id.* at 789. This provision could just as plausibly be read to mean that the minimum volume needed to trigger a discount will be amended, rather than that KPL must ship that quantity or be in breach of the agreement.

<sup>323</sup> *Id.*

via a different carrier.<sup>324</sup> Since BN might not service these other locations, KPL's "good faith" obligations to maintain its requirements would put KPL in a difficult position if KPL's coal supplier insisted on its contractual right of delivering the coal to a location that BN did not service.<sup>325</sup> In cases like this one, the contract and surrounding circumstances are so ambiguous that each party is essentially given an option to wait and see how the other behaves, and how the market changes, and then take a position on contract formation based on their financial interests.<sup>326</sup>

Courts have also relied on the parties' history of exclusive dealings combined with an offer of volume discounts to support a requirements contract even when that history included the buyer's practice of routinely accepting bids for the business and negotiating for better terms from the seller's competitors. This was the case in *Cryovac Inc. v. Pechiney Plastic Packaging, Inc.*,<sup>327</sup> where Pechiney successfully bid for a supply contract with buyer, National Beef, and was sued by the seller, Cryovac, for tortious interference with its alleged requirements contract with National Beef. Pechiney moved for summary judgment on the grounds that the alleged agreement between Cryovac and National Beef was not an enforceable requirements contract, because it did not contain a commitment by National Beef to purchase its requirements, or any specific quantity of goods, from Cryovac.<sup>328</sup> The court in *Cryovac* denied Pechiney's motion and sent the issue to the jury, holding that the jury would be entitled to find an enforceable agreement based on letter agreements listing the minimum quantities National Beef had to purchase to receive reductions of the purchase price in the form of discounts and rebates.<sup>329</sup> In support, the court relied on *Zemco, Kansas Power* and *O.N. Jonas*<sup>330</sup> as cases in which under similar situations, courts had found either that a requirements contract did exist or that there were

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<sup>324</sup> *Id.* at 789 n.3

<sup>325</sup> The key to the decision is most likely an internal memo from BN referring to the alleged letter agreement, which stated, "BN's revenue in shipper cars for the 30 year term of the contract will be \$479,250,000." *Id.* at 788. KPL did not have access to this letter, however, and the court failed to identify any other evidence signifying agreement.

<sup>326</sup> See George S. Geis, *An Embedded Options Theory of Indefinite Contracts*, 90 MINN. L. REV. 1664, 1669 (2006) (presenting the thesis that "indefinite contracts are sometimes created because an imprecise term—combined with judicial willingness to fill gaps—can generate an embedded option[']").

<sup>327</sup> 430 F. Supp. 2d 346, 359-60 (D. Del. 2006). I represented the defendant, Pechiney Plastic Packaging, Inc. in this matter.

<sup>328</sup> *Id.* at 354-55.

<sup>329</sup> *Id.* at 360.

<sup>330</sup> *O.N. Jonas Co. v. Badische Corp.*, 706 F.2d 1161 (11th Cir. 1983).

material issues of fact sufficient to deny summary judgment.<sup>331</sup> But the decisions in *Zemco* and *Kansas Power* were wrongly decided. The buyer in *Zemco* unambiguously stated it had not promised to purchase any goods from the seller, and the buyer in *Kansas Power* made no promise to purchase its requirements from the seller in response to its price list. The decision in *O.N. Jonas* was irrelevant because it involved a sole source trademarked product where the exclusivity term was properly implied from the parties' agreements, which the court compared to exclusive dealership agreements.<sup>332</sup>

The court in *Cryovac* also relied, without explanation, on a provision in one of the alleged agreements stating that "[i]n the event National Beef's packaging purchases fall short of 2003 minimum volume targets due to market conditions other than the use of competitive supply, Cryovac will consider the minimum volume target to have been met."<sup>333</sup> This language demonstrates that the parties anticipated that National Beef's packaging purchases might fall short of the minimum volume "targets" due to the use of "competitive supply," and that the consequence would be that National Beef would forfeit its right to the rebates and discounts, not that it would be liable for breach of a requirements contract. Like the decisions issued in *Kansas Power*, *Zemco*, and *Metal One*, the decision in *Cryovac* ignored the parties' own allocations of risk, which, in all these cases, left the seller with the risk as to any reliance damages it incurred in preparing to supply estimates beyond those the buyer had ordered.

A different case is presented, however, when a supplier has to incur tooling and research and development expenses to offer the buyer a discount on specially manufactured goods, and informs the buyer that the discount can only be provided if the buyer purchases a minimum quantity. If the buyer accepts such an offer, it has entered into an agreement to purchase the minimum quantity required to provide the discount, rather than a requirements contract. In *Detroit Radiant Products Co. v. BSH Home Appliances Corp.*,<sup>334</sup> the buyer rejected the seller's initial quote of a range of prices based on the buyer's estimated usage of 30,000 custom-made stove burners and asked for a specific quote for 30,000 units.<sup>335</sup> The seller then agreed to a unit price based on 30,000 units, indicating that for this volume it would absorb all tooling and R&D

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<sup>331</sup> *Cryovac*, 430 F. Supp. 2d at 360.

<sup>332</sup> *O.N. Jonas*, 706 F.2d at 1165.

<sup>333</sup> *Cryovac*, 430 F. Supp. 2d at 360.

<sup>334</sup> 473 F.3d 623 (6th Cir. 2007).

<sup>335</sup> *Id.* at 625.

costs.<sup>336</sup> The buyer accepted this quote by submitting two purchase orders, one for 15,000 units and one for 16,000 units, each at the discount price offered for 30,000 units.<sup>337</sup> The purchase orders called for shipments to be made pursuant to “release schedules[.]”<sup>338</sup> Litigation ensued when the seller issued a release schedule showing orders dwindling down to zero and began buying its burners from another company, allegedly as a cost-savings measure.<sup>339</sup> The Court of Appeals for the Sixth Circuit correctly concluded that the use of the term “Blanket Order[.]” for one of the two purchase orders and the existence of an unsigned “[s]upplier [a]greement” stating that only the first month’s orders were binding did not convert the parties’ initial agreement for a minimum fixed quantity order of 30,000 necessary for the seller to provide the discount into a requirements contract.

*E. Intentionally Ambiguous Supply Contracts*

Another reason courts should insist upon some modicum of evidence of a buyer commitment as a condition for enforcing requirements contracts is to avoid the danger that buyers will engage in opportunistic conduct by drafting intentionally ambiguous open quantity contracts. Given the confused state of the case law in this area, if the market price goes up, the buyer can take advantage of the below market contract price by arguing that an MPA is an enforceable requirements contract, based on *Zemco* and *Metal One*, but if the market price goes down, they can avoid the contract and take advantage of the low market prices by arguing, based on *Brooklyn Bagel Boys* and *Tingstol*, that they only agreed to be liable on an individual purchase order basis. Three cases that demonstrate this point, *Modern Dairy*, *Zemco*, and *Kansas Power*, have already been discussed above. In all three cases, the buyers sued to enforce purported requirements contracts, thereby holding the sellers to their quoted sale prices, without any evidence that the buyers had promised to purchase their requirements from the sellers.

Buyers utilizing requirements contracts have been at this game for some time, as evidenced by the Supreme Court’s 1903 decision in *Willard Sutherland & Co. v. United States*.<sup>340</sup> In *Willard*, the Navy issued a request for bids for all of its requirements of coal at ten different ports or stations, including a request for 600,000 tons at Hampton Roads, Virginia

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<sup>336</sup> *Id.*

<sup>337</sup> *Id.*

<sup>338</sup> *Id.*

<sup>339</sup> *Id.* at 625–26.

<sup>340</sup> 262 U.S. 489 (1923).

at \$2.85 per ton.<sup>341</sup> The plaintiff submitted a winning bid for 10,000 tons of the 600,000 ton total.<sup>342</sup> The Navy later advised the plaintiff that its requirements had increased by approximately ten percent.<sup>343</sup> The plaintiff supplied the additional coal to the Navy at the contract price, under protest, and then sued to recover the market price, which had risen to \$6.50.<sup>344</sup>

In its decision, the Court relied on language that was included in the Navy's request for bids, and its contract, as follows:

It shall be distinctly understood and agreed that \* \* \* the contractor will furnish any quantity of the coal specified (*i.e.*, of the kind and quality specified) that may be needed \* \* \* irrespective of the quantities stated, *the government not being obligated to order any specific quantity*; \* \* \* and that the stated quantities are estimated and are not to be considered as having *any bearing* upon the quantity which the government may order under the contract; \* \* \* the right is also reserved to make such distribution of tonnage among the different bidders \* \* \* as will be considered for the best interests of the government.<sup>345</sup>

Based on this language, the Court held, "There is nothing in the writing which required the government to take, or limited its demand to, any ascertainable quantity. It must be held that, for lack of consideration and mutuality, the contract was not enforceable."<sup>346</sup> If the Navy had promised to purchase its requirements exclusively from the plaintiff, the contract would have been enforceable as a valid requirements contract. Alternatively, if the Navy had agreed to purchase a percentage of its total requirements from the plaintiff, the indefiniteness issue would have been resolved without limiting the Navy to a single supplier. As it was, the Navy could not disclaim any liability for its requirements to any contractor in the agreement and still hold the contractor to its bid price for all or any portion of its requirements.

Moving forward over a hundred years, courts dealing with the same issue demonstrate less sophistication than the Court in *Willard*. In a 2007 case decided by a federal court in Michigan, *Johnson Controls, Inc. v. TRW*

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<sup>341</sup> *Id.* at 490.

<sup>342</sup> *Id.* at 490-91.

<sup>343</sup> *Id.* at 491.

<sup>344</sup> *Id.* at 492.

<sup>345</sup> *Id.* at 493 (internal quotation marks omitted).

<sup>346</sup> *Id.*

*Vehicle Safety Sys., Inc.*,<sup>347</sup> Johnson Controls (“JC”) ordered component parts for several years from TRW for seat assemblies for two GM vehicle platforms under annual purchase orders. Based on the “just-in-time” supply system that has become standard in the automotive industry,<sup>348</sup> the purchase orders contained prices but no quantities.<sup>349</sup> The quantities ordered were dependent on GM’s production schedule, and would be requested, as needed, in material releases submitted to TRW.<sup>350</sup> Each purchase order expressly incorporated by reference JCs’ “Global Terms of Purchase[,]” which was available on the company’s website.<sup>351</sup> The Global Terms described the purchase order as an offer to purchase that was conditioned upon the seller’s acceptance, which allegedly occurred when TRW shipped goods in response to material releases.<sup>352</sup> Where the quantity term in the purchase order was left blank, or provided “see release[,]” the Global Terms provided that TRW granted JC an irrevocable option for one year, supported by recited consideration of \$10 and a minimum purchase of at least one part of each of the described supplies.<sup>353</sup> The releases were not to be considered separate contracts but were part of the purchase order and were governed by the Global Terms.<sup>354</sup> JC would purchase no more than 100% of its requirements of the supplies.<sup>355</sup>

With its ruling, the court gave JC the upper hand by sending the case to the jury rather than interpreting the contract it drafted as a matter of law. As a result, JC was able to advance beyond the summary judgment stage of the litigation, often a fatal blow in high-stakes cases, with a contract that was essentially a buyer’s option that included the word “requirements[.]”<sup>356</sup> Noting that a promise to buy exclusively from the seller is not required to enforce requirements contracts under Michigan law, the court denied summary judgment because questions of fact existed as to whether the contract “could be construed as *permitting* JCI to purchase its requirements from TRW for the duration of the purchase order.”<sup>357</sup> JC would be in breach, according to the court, if it failed to act

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<sup>347</sup> 491 F. Supp. 2d 707 (E.D. Mich. 2007).

<sup>348</sup> For an economic analysis of these contracts, see Omri Ben-Shahar & James J. White, *Boilerplate and Economic Power in Auto Manufacturing Contracts*, 104 MICH. L. REV. 953 (2006).

<sup>349</sup> *Johnson Controls*, 491 F. Supp. 2d at 709.

<sup>350</sup> *Id.*

<sup>351</sup> *Id.* at 710.

<sup>352</sup> *Id.*

<sup>353</sup> *Id.*

<sup>354</sup> *Id.*

<sup>355</sup> *Id.*

<sup>356</sup> *Id.*

<sup>357</sup> *Id.* at 719. The court noted that the parties’ past dealings “may” indicate a requirements contract, but mentioned no actual evidence. *Id.* at 720. The court also stated

in good faith or consistently with commercial standards of fair dealing in ordering parts it was “permitted” to order under this contract.<sup>358</sup>

Even as articulated by the court, and certainly as drafted by JC, the contract was no more than a buyer’s option, which should not have been enforced beyond one part for each of the supplies listed. Agreements that “permit” the buyer to purchase goods are at most buyer’s options, they are not requirements contracts. And under the agreement as drafted, JC did not obligate itself to purchase more than one part. Nor did JC present any evidence to raise a material issue of fact as to whether it promised to purchase all or an ascertainable portion of its requirements from TRW. Without such a promise the buyer has not made a reciprocal commitment to purchase goods from the seller, and the problems of mutuality, consideration and definiteness remain. JC wrote the contract as a buyer’s option, with enough intentional ambiguity to argue that it was a requirements contract, and then enforced it as a requirements contract when TRW tried to increase its prices to reflect the increased cost of materials. This type of gamesmanship was not tolerated by the Supreme Court in *Willard* and should not be tolerated today.

An example of how such cases should be handled is provided by *Penncro Associates, Inc. v. Sprint Spectrum, L.P.*<sup>359</sup> In *Penncro*, Sprint retained Penncro to provide collections services, in an arrangement whereby calls from Sprint customers would automatically be routed to Penncro or to one of two other vendors.<sup>360</sup> Their agreement was governed by a Master Services Agreement (“MSA”), a Contract Order with an Attachment A and an Addendum.<sup>361</sup> The MSA contained general terms and conditions but did not obligate either party to perform and expressly stated that the scope and specific terms of the services to be provided were governed by contract orders.<sup>362</sup> Under the terms of the parties’ three year Contract Order, Penncro would maintain staffing levels sufficient to provide Sprint with “80,625 productive hours” per month, represented by call center staff available at Sprint’s disposal.<sup>363</sup> Sprint would “pay for 80,625 productive hours per month” at a set

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that there was conflicting evidence of whether JC’s contract with its own customer required it to buy the product from TRW. *Id.* While relevant, this evidence would not prove whether JC promised to purchase its requirements from TRW, an issue the court had already determined, in its discussion of exclusivity, was irrelevant. *Id.*

<sup>358</sup> *Id.* at 719.

<sup>359</sup> 499 F.3d 1151 (10th Cir. 2007).

<sup>360</sup> *Id.* at 1152.

<sup>361</sup> *Id.* at 1153.

<sup>362</sup> *Id.*

<sup>363</sup> *Id.*



rate.<sup>364</sup> Attachment A provided that poor performance for three consecutive months could result in reduction of the productive hours by twenty percent, and six months of poor performance allowed Sprint to terminate the contract.<sup>365</sup> The 80,625 hour level was never supplied, billed, or paid for, due to problems on both sides, but well before a year into the contract, Sprint gave notice of termination under the six-month poor performance clause.<sup>366</sup> Penncro sued for breach on the grounds that its performance did not meet the conditions for termination, and won summary judgment on liability.<sup>367</sup> Sprint went to trial on damages and lost.<sup>368</sup>

On appeal, Sprint argued that the contract was ambiguous as to the quantity of productive hours for which it was obligated, and that the court should consider the extrinsic evidence of the parties' course of performance, which showed that Penncro supplied and accepted payment for a much lower number of hours than the 80,624 provided for in the contract.<sup>369</sup> The court found that the contract order was an unambiguous agreement to pay for a set capacity figure, regardless of Sprint's actual use, based in part on Penncro's agreement to "maintain staffing levels" and Sprint's agreement "to pay for 80,625 productive hours per month[.]"<sup>370</sup> In reaching this conclusion, the court excluded the extrinsic evidence of the parties' course of performance because the contract was unambiguous and because the MSA included an integration clause.<sup>371</sup> The buyer was therefore required to abide by its express agreement to purchase its full maximum capacity requirements from the supplier.<sup>372</sup>

#### VI. USING THE DUTY OF GOOD FAITH TO DETERMINE BREACH IN DIMINISHING REQUIREMENTS CASES

As we have seen, under current law, the buyer has an implied duty of good faith to maintain reasonably foreseeable requirements for the product under a requirements contract, and the seller has an implied

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<sup>364</sup> *Id.*

<sup>365</sup> *Id.*

<sup>366</sup> *Id.* at 1154.

<sup>367</sup> *Id.*

<sup>368</sup> *Id.* at 1154-55.

<sup>369</sup> *Id.* at 1158.

<sup>370</sup> *Id.* The court noted, however, that Sprint could have contested liability on the grounds that Penncro failed to maintain staffing at the required level, but instead Sprint made a tactical decision not to defend liability on any basis but to limit its case at trial to an attack on the plaintiff's claim for damages. *Id.* at 1159.

<sup>371</sup> *Id.*

<sup>372</sup> *Id.* at 1162.

duty of good faith to maintain a reasonably foreseeable supply of the product under an output contract. Thus, both the common law and the UCC have given the parties to these contracts the dubious advantage of taking each other to court so that the factfinder can decide whether the allegedly breaching party acted in good faith in running its business so that it would produce the appropriate output or requirements for the product, even if it did not produce the product for other buyers or purchase the product from other suppliers. Because I advocate eliminating the mandatory rule of good faith, allowing the parties to set their own upper and lower quantity limits by contract, and using other tools like provisions for termination and liquidated damages to allocate quantity risks, I will examine the duty of good faith cases to determine what would be lost if this duty were eliminated and whether leaving the issue of quantity risk as one for the parties to resolve is a realistic option.

In his *Empire Gas* decision, Judge Posner commented on the lack of authority on how good faith is to be measured in determining when a buyer may decrease or eliminate its orders under a requirements contract, saying that this paucity of case law is “a good sign” because it suggests that parties have ongoing relationships that give them strong incentives to work out their disputes without resorting to litigation.<sup>373</sup> My research indicates that there is now a considerable body of case law on the issue, but few defensible standards. Beginning with *Empire Gas*, Judge Posner articulates a rule under which American Bakeries Company, a buyer that had not purchased the product from any other supplier, and had not produced the product itself or acquired the product through an inter-company transaction, was nevertheless required to convince a jury that it had a legitimate business reason, unconnected to its assessments of the merits of the contract itself, for the reduction or elimination of its requirements.<sup>374</sup> The business judgment made by American Bakeries’ new management in *Empire Gas*—that its capital would be better employed in an investment rather than converting to the new equipment necessary to use the seller’s goods—would not, in Judge Posner’s view, be a legitimate business reason, on the grounds that this risk was not one the seller implicitly agreed to take on as part of the parties’ bargain.<sup>375</sup> But it is unclear why he concluded that the risk of a change in the buyer’s management or business judgment was not one the seller implicitly assumed, especially where the buyer had not made the investment in equipment necessary to begin procuring propane when the contract was made, and therefore had no

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<sup>373</sup> *Empire Gas Corp. v. Am. Bakeries Co.*, 840 F.2d 1333, 1340 (7th Cir. 1988).

<sup>374</sup> *Id.* at 1342.

<sup>375</sup> *Id.* at 1340.

present requirements for the product in its ongoing business, as is normally the case, and where there was no evidence that the seller had incurred any reliance expenses in preparing to perform under the contract.

Using Judge Posner's formulation, "[t]he essential ingredient of good faith in the case of the buyer's reducing his estimated requirements is that he not merely have had second thoughts about the terms of the contract and want to get out of it."<sup>376</sup> Stated this way, it sounds quite reasonable, and many courts have adopted his analysis as the legitimate business purpose test, perhaps in reliance on his comment that the seller is entitled to expect that the buyer will purchase "something like the estimated requirements unless it has a valid business reason for buying less."<sup>377</sup> There are two problems with the test. One is that avoiding serious economic losses due to market changes is presumably a "valid business reason for buying less[]" under a requirements contract, but the buyer's motivation for reducing or eliminating its requirements under these circumstances is a desire to avoid the terms of the contract, which have become disadvantageous as a result of changes in the market. As Judge Posner himself perceived, this distinction between permissible, good faith motivations and impermissible, bad faith motivations is a distinction not in kind, but in degree, since the issue is "how exigent the buyer's change in circumstances must be to allow him to scale down his requirements[;]" they "need not be so great as to give him a defense under the doctrines of impossibility, impracticability, or frustration, or under a *force majeure* clause[;]" but "more than whim is required[.]"<sup>378</sup> Under a requirements contract, the "seller assumes the risk of a change in the buyer's business that makes continuation of the contract unduly costly[.]"<sup>379</sup> Thus, this analysis of "good faith" rests on a quantitative evaluation of the losses sustained by the quantity-determining party, not on whether that party was having second thoughts about the contract and wanted to get out of it, since this test for bad faith would always be

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<sup>376</sup> *Id.* at 1340-41.

<sup>377</sup> *Id.* at 1340. In the following cases, courts found that the general test for determining whether a buyer has acted in good faith in determining the amount of its requirements is whether the buyer has exercised valid business judgment, acted pursuant to a valid business purpose, or set its requirements with a valid business reason, rather than basing its decision on a desire to avoid what has turned out to be an unfavorable contractual obligation: *Brewster of Lynchburg, Inc. v. Dial Corp.*, 33 F.3d 355, (4th Cir. 1994); *Schawk, Inc. v. Donruss Trading Cards, Inc.*, 746 N.E.2d 18, 24 (Ill. App. Ct. 2001); *Abrasive-Tool Corp. v. Cystic Fibrosis Foundation*, 1991 WL 97445 at \*4 (W.D.N.Y. 1991); *Ind.-Am. Water Co., Inc. v. Town of Seelyville*, 698 N.E.2d 1255, 1261 (Ind. Ct. App. 1998), and *N. Nat. Gas Co. v. Conoco, Inc.*, 986 S.W.2d 603, 608 (Tex. 1998).

<sup>378</sup> *Empire Gas*, 840 F.2d at 1340.

<sup>379</sup> *See id.*

satisfied where the party was incurring losses as a result of the contract based on changes in its business.

Judge Posner's use of the phrase "unduly costly" offers little guidance, but more than any other courts have provided, in the way of a standard for determining when the buyer's losses are sufficient to excuse him from his obligations under a requirements contract. In Professor Goldberg's analysis of the early New York Court of Appeals case, *Feld v. Henry S. Levy & Sons, Inc.*, where the court reversed summary judgment for the defendant on the issue of good faith, he finds that the evidence before the court proved that the contract price would not cover the quantity-determining party's variable costs, and that it would have been cheaper for that party to close the operation.<sup>380</sup> Other decisions in this area which are discussed below, *NCC Sunday Inserts, Inc. v. World Color Press, Inc.*, *Schawk, Inc. v. Donruss Trading Cards, Inc.*, and *Miami Packaging, Inc. v. Processing Systems, Inc.*, reveal the lack of principled analysis by courts when asked to determine whether the losses the buyer has sustained in a requirements contract are sufficient to provide a good faith basis for reducing or eliminating its requirements.

As articulated in *Empire Gas*, the second problem with the test is that it is too narrow. The test imposes a standard "which requires at a minimum that the reduction in requirements not have been motivated *solely* by a reassessment of the balance of advantages and disadvantages under the contract to the buyer."<sup>381</sup> The court expressly declined to decide whether any greater obligation was required to satisfy the duty of good faith.<sup>382</sup> If this test of bad faith accounts only for the cases where the *only* reason for the requirements-reducing decision is a desire to avoid the contract, in whole or in part, and courts were to apply it this way, the test would apply in very few cases. In most cases, the buyer should be able to prove that it reduced or eliminated its requirements for at least one reason that was unrelated to its evaluation of the merits of its requirements contract. The facts in *Empire Gas*, however, suggest that the court actually held that when a buyer eliminates or reduces its requirements under a requirements contract, it must come up with a rationale that is completely untainted by any consideration of the terms of the contract—a far more difficult standard to meet.

In *Empire Gas*, the court found that the facts indicated that the buyer acted in bad faith under its test because the buyer's only reason for the change was that it had been taken over by new management, which had

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<sup>380</sup> See Goldberg, *supra* note 3, at 353 (discussing *Feld v. Henry S. Levy & Sons, Inc.*, 335 N.E. 2d 320 (N.Y. 1975)).

<sup>381</sup> *Empire Gas*, 840 F.2d at 1341 (emphasis added).

<sup>382</sup> *Id.*

decided that the company's capital was better allocated to another investment than to the conversion units needed to utilize the seller's propane.<sup>383</sup> This evidence should have satisfied the minimum standard, considering that the buyer did provide a reason for its decision that was not based *solely* on an evaluation of the merits of the requirements contract when it explained that its new management had decided that its capital was better spent on another investment. When the parties entered the requirements contract in *Empire Gas*, the buyer had no requirements for propane, and had not even contracted to purchase the conversion units necessary to utilize propane.<sup>384</sup> Thus, the court essentially held that the buyer had made an implied promise to enter the contract to make the investment necessary to generate requirements for the goods, and could not simply say it had changed its mind about that investment, even if it had changed its mind for reasons unrelated to the terms of the requirements contract.<sup>385</sup> Either the test is so narrow that it applies in very few cases—perhaps not even in *Empire Gas*—or it is so broad that any business justification for reducing or eliminating requirements can be second-guessed on the grounds that at least one motivation for the decision was the savings to be derived from avoiding all or part of the expense of the requirements contract.

There are many reasons a buyer may reduce or eliminate its requirements, and the trick may be to identify those which the courts can justifiably claim represent risks that have been assumed by the seller in agreeing to the requirements contract. The following is a non-exhaustive list of the reasons a buyer may lower or eliminate its requirements:

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<sup>383</sup> *Id.* at 1340.

The seller assumes the risk of a change in the buyer's business that makes continuation of the contract unduly costly, but the buyer assumes the risk of a less urgent change in his circumstances, perhaps illustrated by the facts of this case where so far as one can tell the buyer's change of mind reflected no more than a reassessment of the balance of advantages and disadvantages under the contract. American Bakeries did not agree to buy conversion units and propane for trucks that it got rid of, but neither did Empire Gas agree to forgo sales merely because new management at American Bakeries decided that its capital would be better employed in some other investment than conversion to propane.

*Id.*

<sup>384</sup> *Id.* at 1335.

<sup>385</sup> Under the minimum standard announced in *Empire Gas*, the buyer should have been able to satisfy the standard even if the buyer's decision was based on its evaluation of the terms of the contract for acquiring the conversion units, rather than the terms of the requirements contract. Instead, the court wrapped the two contracts into one, holding that a requirements contract does not simply require a buyer to maintain its existing requirements, but to enter into other contracts necessary to generate requirements contemplated under the requirements contract.

- 1) the buyer is purchasing some of its requirements from one of the seller's competitors;
- 2) the buyer has found a way to do business more efficiently or profitably by reducing its use of the seller's product;
- 3) the buyer has obtained new technology that reduces its requirements for the seller's goods;
- 4) the buyer has acquired the equipment to produce the product internally;
- 5) the buyer has acquired or been acquired by a company that makes the same product or has affiliates that make the same product;
- 6) for requirements used in connection with a new or experimental project or product, the buyer is unable to overcome technological, commercial, or competitive challenges to the success of the project or product;
- 7) the buyer has sold its business; or
- 8) the buyer has gone out of business.

Of these, only the first represents a risk that is expressly allocated to the buyer under a requirements contract when the buyer promises to purchase its requirements from the seller.<sup>386</sup> The others are risks that the seller should foresee and be expected to bargain for protections from because they are not expressly or logically provided for under the bare bones terms of a basic agreement whereby the buyer purchases its requirements of certain goods or services from the seller. Current law, however, is based on the flawed reasoning that the duty of good faith not to reduce requirements for these reasons is justified because the buyer must have assumed these risks when it signed the contract, despite the fact that they are all foreseeable risks that the parties are perfectly capable of allocating as part of the bargaining process. That said, the courts are strikingly inconsistent in their application of the standard of good faith to reductions in requirements.

Even as to the risk that the buyer will not purchase its requirements from other suppliers, courts have come to different conclusions under the good faith standard. In *Abrasive-Tool Corp. v. Cystic Fibrosis Foundation*,<sup>387</sup> the court found that the buyer had acted in good faith in terminating the agreement, assuming it was a requirements contract, based on a valid business judgment that it was "economically superior"

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<sup>386</sup> This would not be true of course in those jurisdictions that sustain requirements contracts that do not contain promises from the buyer to purchase his requirements from the seller, and instead rely solely on the buyer's implied duty of good faith to maintain his requirements at foreseeable levels.

<sup>387</sup> 1991 WL 97445 (W.D.N.Y. 1991).

to purchase the goods directly from the manufacturer rather than through a supplier such as the plaintiff. One could simply view this case as wrongly decided, or dismiss the relevant language as dicta, but it is nonetheless evidence of how useless the duty of good faith has become as a legal standard capable of producing reasonably predictable results.

Corporate reorganizations and technological improvements leading to reductions in requirements are foreseeable changes relating to the buyer's management of its business from which the seller could protect against by using appropriate contractual provisions. Despite the fact that vertical integration is a well-recognized practice for maximizing profits, and merger and acquisition activities can hardly be described as unforeseeable events in today's business climate, courts generally find that buyers have acted in bad faith when their diminished requirements are a result of a corporate reorganization.<sup>388</sup> And both the corporate reorganization and the technological change cases would satisfy Judge Posner's "bad faith[]" test because the buyer in these cases would be having "second thoughts about the terms of the contract[,]" based on its new understanding that it can run its business more profitably either by reducing or eliminating its requirements for the seller's product.

Indeed, Judge Posner's "second thoughts" test is inconsistent with the judgments he makes in *Empire Gas* concerning requirements cases where the change in the buyer's situation occurred due to technological innovations. In *Empire Gas*, Judge Posner cites *Southwest Natural Gas Co. v. Oklahoma Portland Cement Co.*, as a case that demonstrates the distinction between the risks of changes in the buyer's circumstances that the seller does and does not assume in a requirements contract.<sup>389</sup> According to Judge Posner, the court in *Southwest Natural Gas* held that when the buyer reduced its requirements for gas by eighty percent seven years into a fifteen-year requirements contract because it purchased a more efficient new boiler, this was a "bona fide" change in the buyer's requirements because it would have been "unreasonable" to prevent the

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<sup>388</sup> In *MDC Corp. v. John H. Harland Co.*, 228 F. Supp. 2d 387, 397 (S.D.N.Y. 2002), the court held that the defendant had adequately pled its counterclaim that the plaintiff acted in bad faith and had no legitimate business purpose for its actions by alleging that after the plaintiff was acquired by another company, it began purchasing the goods from affiliates of its parent rather than from the defendant. Evidence that the buyer entered into an agreement for the sale of its company under which the acquirer would not assume the requirements contract was sufficient in *Kock Materials Co. v. Shore Slurry Seal, Inc.*, 205 F. Supp. 2d 324 (D.N.J. 2002), to raise a fact issue as to the buyer's good faith, despite the contract's silence on successor liability or the buyer's duty to ensure successor liability.

<sup>389</sup> 102 F.2d 630 (10th Cir. 1939) (holding that the buyer did not act in bad faith when it reduced its requirements for gas by eighty percent by replacing its old boiler with a more efficient, modern unit).

buyer from replacing its equipment with a modern unit.<sup>390</sup> Unreasonable or not, the seller could certainly argue that the buyer was having “second thoughts” about its contract, as evidenced by the fact that it made the decision to buy a more modern replacement boiler that allowed it to avoid its contractual obligation to buy eighty percent of its prior coal requirements from the seller. If the motivation for the action is to avoid what, based on changed circumstances, have now become disadvantageous terms under the requirements contract, why does it matter whether the changed circumstances are changes in technology rather than a simple drop in the market price for the product? Certainly both are equally foreseeable given the rapid pace of technology.

A special case was nevertheless recognized for technological change in *Indiana-American Water Co., Inc. v. Town of Seelyville*,<sup>391</sup> where the court held that it was not a breach for the buyer to develop its own well for water, thereby diminishing its requirements from the seller. The court in *Indiana-American* relied in part on the “well-settled” rule under *Southwest National Gas* that “it is not bad faith to take advantage of a technological advance which reduces the buyer’s requirements.”<sup>392</sup> The rule is not, however, evenly applied. In *Empire Gas*, Judge Posner cited as a reduction that was unexcused, unexplained, and therefore made in bad faith, the case of *Chalmers & Williams v. Bledsoe & Co.*,<sup>393</sup> where the buyer converted its facilities from the use of coal to electricity.<sup>394</sup> Why was it as “unreasonable” to expect the buyer in *Chalmers & Williams* to refrain from updating its facilities to the latest energy source as it was unreasonable to expect the buyer in *Southwest National Gas* to refrain from installing the most up-to-date replacement boiler? Judge Posner claims that in the *Chalmers & Williams*, case the buyer gave no explanation for its decision,<sup>395</sup> but the explanation was undoubtedly the same one that motivated the buyer in *Southwest National Gas* – more advanced technology was available that reduced or eliminated the buyer’s requirements for the seller’s product. There is no evidence the buyer in *Southwest National Gas* listed all the reasons a modern boiler is better than an obsolete one, and no reason the buyer in *Chalmers & Williams* should have had to explain why electricity is preferable to coal.

One of the examples Judge Posner gives in *Empire Gas* of when a buyer would “clearly” be “acting in bad faith” by eliminating its

<sup>390</sup> *Empire Gas Corp. v. Am. Bakeries Co.*, 840 F.2d 1333, 1340 (7th Cir. 1988).

<sup>391</sup> 698 N.E.2d 1255 (Ind. Ct. App. 1998) (citing *S.W. Natural Gas*, 102 F.2d 630).

<sup>392</sup> *Id.* at 1261.

<sup>393</sup> 218 Ill. App. 363 (1920) (holding that the buyer was in breach of its requirements contract for coal when the buyer converted its facilities from the use of coal to electricity).

<sup>394</sup> *Empire Gas*, 840 F.2d at 1339–40.

<sup>395</sup> *Id.* at 1340.



requirements is when the buyer begins producing its own products.<sup>396</sup> As with other applications of the good faith standard to open quantity contracts, the courts' decisions on this point are a model of inconsistency. Courts have permitted this conduct in connection with requirements contracts for services,<sup>397</sup> they have condemned it when the product is produced by the buyer's newly acquired corporate affiliates,<sup>398</sup> and they have reached inconsistent results when the buyer produced the product internally. For example, in *Indiana-American*,<sup>399</sup> the court held that the Town of Seelyville, which had a twenty-five-year contract to purchase its requirements of water from the plaintiff, did not act in bad faith when it announced a plan to sell bonds to finance the construction of improvements necessary to obtain water from its own undeveloped well field in order to reduce its requirements for water from the plaintiff under the contract.<sup>400</sup> Before reaching this result, the court considered *Andersen v. La Rinconada Country Club*,<sup>401</sup> a decision holding that a golf course which had agreed to buy water under a requirements contract acted in bad faith by purchasing a well field to obtain its own supply of water.<sup>402</sup> The court distinguished *Andersen* on the grounds that the golf course in that case had to purchase its well field, while Seelyville had owned the well field before entering into the requirements contract.<sup>403</sup> Applying the *Empire Gas* test, the court held that Seelyville's decision to develop its preexisting well field could therefore be viewed as a "legitimate, long-term business decision, and not merely a desire to

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<sup>396</sup> *Id.* at 1338-39 (emphasis omitted).

<sup>397</sup> In cases involving requirements contracts for services, the majority of courts have rejected claims that such contracts are illusory when the buyer has retained the right to perform an indefinite amount of the work itself. Compare *Ralph Constr. Inc. v. United States*, 4 Cl. Ct. 727, 733 (1984) (holding that for a requirements contract, "the unfettered right of the government to perform work in-house renders the contract unenforceable because of the lack of mutuality"), with *Locke v. United States*, 283 F.2d 521, 524 (1960) (stating that "nothing in the [requirements] contract would have prevented the Government from enlarging its own repair facilities to fill completely its needs."); *Dynamic Science, Inc.*, 85-1 BCA 17,710 at 88,383, 1984 WL 13911 (A.S.B.C.A. 1984) (holding enforceable an agreement to provide services beyond those which the government could provide for itself); *Maya Transit Co.*, 75-2 BCA 11,552 at 55,125, 1975 WL 1551 (A.S.B.C.A. 1975) (same); *Alamo Automotive Services, Inc.*, 1964 BCA 4354 at 21,043, 1964 WL 306 at \*5 (A.S.B.C.A. 1964) (same).

<sup>398</sup> See *MDC Corp. v. John H. Harland Co.*, 228 F. Supp. 2d 387, 397 (S.D.N.Y. 2002); *Kock Materials Co. v. Shore Slurry Seal, Inc.*, 205 F. Supp. 2d 324 (D.N.J. 2002); *Miami Packaging, Inc. v. Processing Sys., Inc.*, 792 F. Supp. 560 (S.D. Ohio 1991).

<sup>399</sup> 698 N.E.2d 1255.

<sup>400</sup> *Id.* at 1259.

<sup>401</sup> 40 P.2d 571 (Cal. Ct. App. 1935).

<sup>402</sup> *Ind.-Am.*, 698 N.E.2d at 1261.

<sup>403</sup> *Id.*

avoid the terms of its contract with [the] Water Company.”<sup>404</sup> There was no evidence, however, that the investment requiring the sale of municipal bonds that Seelyville had to make was any less significant or unanticipated than the investment the golf course had to make to acquire the well field in *Andersen*.

The attempt by the court in *Indiana-American* to distinguish *Andersen* on the grounds that Seelyville’s decision was not “merely a desire to avoid the terms of its contract with [the] Water Company[.]” also suggests that good faith can be established even if the buyer’s legitimate business decision has been influenced by impermissible factors.<sup>405</sup> The court appears to recognize that, like the golf course in *Andersen*, Seelyville undoubtedly took the costs of purchasing water under its requirements contract into account when it decided to invest in the improvements necessary to access water from its own well field. Thus, when the court applied the *Empire Gas* “second thoughts” test of good faith, it did not interpret that test to require proof that Seelyville had not been motivated by a desire to avoid the terms of its requirements contract when it made the decision to begin producing its own water, only that Seelyville was not *merely* or solely motivated by this desire. Even with this modification, however, the test is a poor one, as the court’s analysis of the facts in *Andersen* and *Indiana-American* demonstrates; the timing of the purchase of the asset should not separate good faith from bad.

When the buyer eliminates its requirements because it has closed the plant or business that generated the requirements, courts appear to have followed, at least to some extent, the distinction made in the Official Comments to UCC section 2-306 between a “lack of orders[.]” which serves as a good faith basis for a discontinuance of the buyer’s business and presumably also for a reduction in its requirements, and a desire to “curtail losses[.]” which does not.<sup>406</sup> This distinction has been criticized as nonsensical from an economic perspective,<sup>407</sup> and its purpose is unclear. If it is designed to place the same market risk on the buyer under a requirements contract that the buyer bears under a fixed quantity contract, the analogy is a poor one. In a fixed quantity contract, the buyer is taking a risk that by the time of delivery, use, or resale, the price and/or demand for the product or for goods made using the

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<sup>404</sup> *Id.*

<sup>405</sup> *Id.* (emphasis added).

<sup>406</sup> U.C.C. § 2-306 cmt. n.2 (2004).

<sup>407</sup> Goldberg, *supra* note 3, at 382. Goldberg’s proposed Official Comments to UCC section 2-306(1) would eliminate this distinction as follows: “[t]his distinction, which makes no economic sense, is superseded under the current Code.” *Id.*

product will drop below the contract price. In a requirements contract, the parties have agreed that the buyer will purchase its requirements, or some portion of its requirements from the seller, and the seller will assume the risk of “good faith” reductions in those requirements. If the buyer’s “good faith” were not interpreted to include some market-based limitations, the buyer could incur damages equal to the entire contract price of its estimated or normal quantity of goods for the duration of the contract, assuming the price and/or demand for the product dropped to zero.

The Official Comments do not solve this dilemma because there is no logical distinction between a shutdown to curtail losses and a shutdown due to the lack of orders. Both spring from the same source—lack of demand—and the only distinction is whether the seller offers the goods for a low enough price to obtain orders, thereby incurring losses. In the case of a decline in the market price below the contract price for the goods, for example, the Code Comment gives the buyer the choice of (1) selling its goods at noncompetitive prices which will result in a “lack of orders” but will allow the buyer to terminate its requirements contract; or (2) selling its goods at a competitive price which will result in losses and will not allow the buyer to terminate the requirements contract.<sup>408</sup> Creating such a perverse and useless incentive hardly seems in alignment with the Code’s goal of facilitating sensible business practices. Factors other than price also affect demand, such as new technology that makes the goods obsolete or less desirable, but even here there is no reason for distinguishing between losses due to a market decline and losses due to other factors. In Judge Posner’s words, the contract will still be “unduly costly[]” for the buyer to perform, regardless of the cause.

In the “lack of orders” cases, courts have been relatively consistent in sustaining reductions in requirements.<sup>409</sup> Courts have come to a wide array of conclusions, however, when called upon to decide whether a buyer in a requirements contract has acted in “bad faith[]” by closing a plant or a business to curtail losses. In some cases, such as *Brewster of*

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<sup>408</sup> U.C.C. § 2-306 cmt. n.2.

<sup>409</sup> For example, a distributor in a requirements contract for a particular brandname product may reduce its requirements to zero if its customers stop ordering the branded product. See *Trimed, Inc. v. Sherwood Med. Co.*, 772 F. Supp. 879, 886 (D. Md. 1991). See also *Sea Link Int’l, Inc. v. Osram Sylvania, Inc.*, 969 F. Supp. 781, 784 (S.D. Ga. 1997) (granting the buyer’s motion for summary judgment on seller’s action for breach of a requirements contract for component parts, where the buyer had notified the seller that the buyer’s own customer for the parts would no longer be ordering them).

*Lynchburg, Inc. v. Dial Corp.*,<sup>410</sup> and *U & W Industrial Supply, Inc. v. Martin Marietta Alumina, Inc.*,<sup>411</sup> courts have accepted the buyer's explanation that they closed or sold their businesses because they were unprofitable, and have not conducted any analysis into whether the buyer was attempting to avoid the terms of the contract. Depending on how central the requirements contract is to the business, the price the seller was charging for the goods under the requirements contract could be a contributing, if not the primary, factor leading to the businesses' losses and therefore could be a contributing, if not a primary, factor in the buyer's decision to close the business.

In two cases where the cost of the goods under the requirements contract with the seller *was* a significant factor the buyers considered in deciding to eliminate their requirements, the courts came to opposite conclusions as to whether the buyers acted in good faith. In *NCC Sunday Inserts, Inc. v. World Color Press, Inc.*,<sup>412</sup> the plaintiff, NCC, sought a declaratory judgment that it did not violate its contract to purchase its requirements of coupon inserts from the defendant, WCP, a printing company, when its assets were sold by its parent corporation to an entity that had its own in-house printing capabilities. The court denied NCC's motion for summary judgment, based on testimony from WCP's expert that while NCC might have upwards of \$35 million in losses for the next two years under the requirements contract with WCP, there would be a resurgence in the market thereafter, and NCC would turn a significant profit if it remained in business.<sup>413</sup> This speculation, no matter how well founded, on a resurgence in the market three years hence, hardly seems sufficient to create a fact issue as to whether the buyer was acting in good faith in selling the business rather than incurring \$35 million in losses, especially when the seller had not included a minimum take or pay clause in the contract. And what would the jury instructions be in

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<sup>410</sup> 33 F.3d 355 (4th Cir.1994). In *Brewster*, the buyer terminated its requirements contract for plastic bottles with the supplier when it closed its plant, as part of the corporate parent's decision to shut down the division of which the plant was a part, because it was unprofitable. *Id.* at 362. The court did not discuss whether the unprofitability of the plant provided a sufficient justification unrelated to a desire to avoid the contract, as required under *Empire Gas*, but summarized the case with the note that a buyer may eliminate its requirements in the face of a drop in demand. *Id.*

<sup>411</sup> 34 F.3d 180, 182 (3d Cir. 1994). In *U & W Industrial Supply*, the court held that the buyer did not act in bad faith when, based on a plant closing, it canceled orders and then terminated its requirements contracts with the seller. *Id.* The court did not question the reasons for the plant closing to find out whether they were related to the economics of the requirements contract but stated simply that the risk that a buyer will go out of business is one of the risks inherent in requirements contracts. *Id.* at 188.

<sup>412</sup> 759 F. Supp. 1004 (S.D.N.Y. 1991).

<sup>413</sup> *Id.* at 1010.

such a case? That the jury could enter a finding of bad faith if the evidence showed the buyer would incur multimillion losses in the next two years under the requirements contracts, just because the business *might* return to profitability thereafter? Without any evidence of reliance interests of this magnitude on the seller's side, what possible basis does the factfinder have for such a conclusion? How does the factfinder, using the standard of "good faith," decide what losses are sufficient to release the buyer from its obligations under a requirements contract, or how likely a future recovery must be to require the buyer to sustain those losses?

In the second case involving losses attributable to the contract, *Schawk*,<sup>414</sup> the plaintiff had a five-year contract to provide graphic arts services to the defendant, a corporation that manufactured and sold sports trading cards.<sup>415</sup> About a year and a half into the contract, the defendant sold its trading card business, based on a record of declining sales for the past four years and a loss in the prior year of \$7 million.<sup>416</sup> When the plaintiff filed suit to enforce the contract, the defendant filed a summary judgment motion on the grounds that its sole purpose in selling its business was to curtail losses.<sup>417</sup> The district court granted the motion, finding that the defendant had acted in good faith.<sup>418</sup> The appellate court affirmed, despite evidence that in evaluating its losses, the defendant "determined its profit margins were burdened by the fixed nature of prepress expenses on such considerably reduced sales quantities."<sup>419</sup> In addition to the defendant's recognition of the role the requirements contract played in causing its losses, the other similarity to *NCC Sunday Inserts* was that in *Schawk*, the defendant estimated a future turnaround whereby its sales would increase from \$47 million in 1995 to almost \$70 million in 1996.<sup>420</sup> The appellate court distinguished *NCC Sunday Inserts* on the grounds that this increase still did not reach the \$134 million sales mark that the defendant enjoyed in 1991.<sup>421</sup> The court did not attempt to compare the \$7 million loss to the \$35 million loss in the two cases, or consider the fact that unlike in *NCC Sunday Inserts*, in *Schawk*, the defendant admitted that its parent could have provided the

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<sup>414</sup> 746 N.E.2d 18 (Ill. App. Ct. 2001).

<sup>415</sup> *Id.* at 25.

<sup>416</sup> *Id.* at 21.

<sup>417</sup> *Id.* at 20.

<sup>418</sup> *Id.*

<sup>419</sup> *Id.* at 21.

<sup>420</sup> *Id.* at 26-27.

<sup>421</sup> *Id.* at 25.

financing necessary to keep it in business, but preferred to use its resources to concentrate on its food packaging businesses.<sup>422</sup>

The primary rationale for the court's opinion in *Schawk* appears to have been its reliance on Judge Posner's "unduly costly[]" test. As the court explained, "[T]he seller under a requirements contract assumes the risk of a change in the buyer's business that makes a continuation unduly costly. If a seller wishes to reallocate some of the risks inherent in such a contract, however, it may specify some minimum requirement."<sup>423</sup> Thus, the court identified two of the many inherent defects in the Official Comment's distinction between financial losses and a lack of orders. One is that the seller in a requirements contract has arguably assumed the risk of changes in the buyer's business that result in the seller's goods being priced so far above the market price that the buyer would sooner go out of business than pay for them, as well as changes in the buyer's business that reduce orders for the buyer's goods such that the buyer cannot remain in business. The other is that the parties can allocate such risks by specifying a minimum requirement in the agreement, so there is no need for applying a mandatory good faith rule to requirements contracts.

At the other extreme, the absurdity of a rigid application of the Code's losses/lack of orders distinction is demonstrated by the decision in *Metal One*,<sup>424</sup> where the court held that the buyer acted in bad faith when it terminated a requirements contract as part of a plant shut-down because its incoming orders had not been reduced to zero.<sup>425</sup> The court in *Metal One* granted summary judgment for the seller on blanket purchase orders for specially manufactured steel bars used to manufacture two sizes of TV screen frames for Sony.<sup>426</sup> After a year and a half of purchasing all of its requirements from the seller, the buyer stopped issuing "firm releases" for the steel because it had closed its manufacturing plant.<sup>427</sup> Sony had been reducing its orders from the buyer over the past several years, and when Sony stopped making the 21-inch sets, the buyer's plant began losing between \$150,000 and \$200,000 a month.<sup>428</sup> Thus, the buyer stopped purchasing steel bars from the seller due to its financial losses caused by the decline of orders from Sony. While there was no evidence that the buyer closed the plant because it was having "second thoughts" about any specific terms of the

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<sup>422</sup> *Id.* at 26-27.

<sup>423</sup> *Id.* at 26.

<sup>424</sup> 2005 WL 1657128 (W.D. Mich. 2005).

<sup>425</sup> *Id.* at \*7.

<sup>426</sup> *Id.*

<sup>427</sup> *Id.* at \*5.

<sup>428</sup> *Id.* at \*3.

requirements contract, it was no longer economically feasible to run the plant that generated the buyer's requirements. Relying on Official Comment 2 to UCC section 2-306 and the evidence that Sony continued to order steel bars for the 29-inch frames, the court held, "Because [the buyer] shut down the plant to 'curtail losses,' [the buyer] breached the contract in bad faith as a matter of law."<sup>429</sup>

In a more recent decision by the Court of Appeals for the Third Circuit, *Norfolk Southern Railway Co. v. Basell USA Inc.*,<sup>430</sup> the court decided the issue of a buyer's breach of a requirements contract under the Restatement's five factor test for material breach, and discussed good faith only as the last of these factors.<sup>431</sup> In *Basell*, the seller had agreed to provide a discount if the buyer used the seller for ninety-five percent of its carriage needs, and sued for breach when the buyer used the seller for only eighty percent of its needs.<sup>432</sup> The court reversed the summary judgment ruling for the buyer, noting that determining whether breach is material is "inherently problematical where, as here, the materiality analysis may well turn on subjective assessments as to the state of mind of the respective parties."<sup>433</sup> This observation was specifically addressed to the good faith inquiry, which "calls for an evaluation of what motivated [the buyer's] conduct[.]"<sup>434</sup> As in *NCC Sunday Inserts*, the court found that the buyer's explanation that its diminished requirements were the result of "good faith[.]" in this case due to a business decision made to serve the buyer's operational needs, was insufficiently credible to warrant summary judgment.<sup>435</sup>

Part of the difficulty in using a good faith test that asks whether the buyer's motive for reducing or eliminating its requirements is related to the terms of the contract lies in the impossibility of separating market factors from the variability of demand in an open quantity contract. If the buyer is a distributor, its requirements will track the market price because its demand will inevitably fall, potentially to zero, if it cannot offer a competitive resale price. This relationship between the market price and the buyer's requirements was actually the reason some early

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<sup>429</sup> *Id.* at \*7.

<sup>430</sup> 512 F.3d 86, 93 (3d Cir. 2008).

<sup>431</sup> *Id.* at 92 ("[T]he extent to which the behavior of the party failing to perform or to offer to perform comports with standards of good faith and fair dealing." (citing RESTATEMENT (SECOND) OF CONTRACTS § 241(e) (1981))).

<sup>432</sup> *Id.* at 89.

<sup>433</sup> *Id.* at 96.

<sup>434</sup> *Id.*

<sup>435</sup> *Id.* at 95.

courts found these “middleman” contracts illusory.<sup>436</sup> While the market-demand relationship is not as direct, it also exists when the buyer is an end-user. Manufacturers or other end-users of the goods will also have lower requirements if the contract price is so far above what all of the buyer’s competitors are paying for their materials that the buyer can no longer sell its finished goods at a competitive price. In either case, the buyer does not have requirements within the reasonable anticipation of the parties if the seller’s price is so far above market that the buyer cannot pay those prices and earn a return that will cover its costs of doing business. Even if factors other than price have resulted in the decline in demand, such as introduction of new technology or changing consumer preferences, the seller’s price will still be relevant if it is too high for any customers to purchase the obsolete products.

If the seller’s prices are so far above market that the buyer will actually close the plant or business that generates the requirements to avoid the contract, the exigencies of the buyer’s situation, as Judge Posner put it, would seem to have reached the point where a requirements contract buyer should be released from its obligation. But some courts,<sup>437</sup> and commentators,<sup>438</sup> see this situation as a ruse and believe that courts should not permit the buyer to avoid the contract by going out of business. If the concern is that the buyer could simply reincorporate as a new entity, and continue in the same business with a new supplier, principles of successor liability should, however, be sufficient to address the issue without resorting to the implied duty of good faith.

The duty of good faith has also been used to compel a buyer in a requirements contract to spend inordinate amounts of time and money supporting the project necessary to sustain its requirements. In *Miami Packaging*,<sup>439</sup> Miami, a manufacturer of wax paper products, entered into a twenty-five-year contract to supply Hollymatic, a manufacturer and distributor of food processing equipment and supplies, with all the wax

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<sup>436</sup> See FARNSWORTH, *supra* note 17, at § 2.15 (explaining that in several early cases, such as *Crane v. C. Crane & Co.*, 105 F. 869, 871–72 (7th Cir. 1901), courts held that requirements contracts with “middlemen” were illusory because the buyers’ requirements would fluctuate with the market).

<sup>437</sup> See *Vulcan Materials Co. v. Atofina Chem. Inc.*, 355 F. Supp. 2d 1214, 1236 (D. Kan. 2005) (granting motion for summary judgment to seller and finding that buyer acted in bad faith, where its principal reason for closing its plant was the losses it incurred arising from the high prices it was paying under the requirements contract).

<sup>438</sup> See WHITE & SUMMERS, *supra* note 17, at § 3–9 (“A buyer may go out of business altogether and hope to escape a burdensome requirements contract in this way. But if he only reorganizes the form of his business, a court will surely see through this and hold him liable on the contract.”).

<sup>439</sup> 792 F. Supp. 560 (S.D. Ohio 1991).



paper it would require for use on a new machine for processing sheets of wax paper to wrap hamburger patties once the machine was built.<sup>440</sup> Miami's president admitted that he knew Hollymatic's needs were dependent on production of a new, innovative machine, and that this project may fail.<sup>441</sup> Undisputed evidence was also introduced to show that even after Hollymatic spent over thirty months of work and almost double its estimate of \$425,000 in an attempt to make the machine fully operational, it "never produced proper patty paper[.]" but only "a relatively small amount of interleaver paper[.]"<sup>442</sup> Despite this evidence, the court denied summary judgment on the issue of Hollymatic's good faith in terminating the requirements contract.<sup>443</sup>

The only reason the court gave for its decision to deny Hollymatic's summary judgment motion was that the company may have acted in bad faith if it "made no purchases of wax paper in order to aid [the investor's] interest in [Miami's competitor,]" rather than "because of the time delays and cost overruns."<sup>444</sup> Nine months into the contract, an investor who owned one of Miami's competitors had purchased a controlling interest in Hollymatic.<sup>445</sup> Hollymatic did not terminate the patty paper converter project immediately, but continued working on the project for another six months before reaching the conclusion that it would never be operational.<sup>446</sup> The court made two flawed assumptions in reaching its decision. The first was that Hollymatic could have had only one reason for its decision to terminate the project—either the permissible reason or the impermissible reason—when the undisputed evidence already presented to the court established that Hollymatic did have the permissible reason; it was undisputed that the company believed the project would never be operational when it terminated the project.<sup>447</sup> If the presence of one legitimate business justification were sufficient to show good faith, the possibility of an additional motive should have been immaterial. What the court's holding therefore suggests is that it was applying a test that forbids the quantity-reducing party from having even a single bad faith motive for its decision. This test would represent an application of the broadest interpretation of the *Empire Gas* test, where the buyer acts in bad faith if one of its reasons for reducing or eliminating its requirements is a desire to avoid the contract,

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<sup>440</sup> *Id.* at 566.

<sup>441</sup> *Id.* at 565.

<sup>442</sup> *Id.* at 562.

<sup>443</sup> *Id.* at 564.

<sup>444</sup> *Id.*

<sup>445</sup> *Id.*

<sup>446</sup> *Id.*

<sup>447</sup> *Id.*

even if it has many other unrelated business justifications for the decision.

In finding evidence of a possible bad faith motive, the court in *Miami Packaging* made a second flawed assumption that Hollymatic diverted requirements it had committed to Miami to the company owned by Hollymatic's investor. In fact, Miami had no right to expect it would receive Hollymatic's business unless the new patty paper converter generated requirements for Miami's paper. The agreement with Miami included a sub-lease of the equipment, and the requirements were based on the paper needs of the new equipment.<sup>448</sup> Thus, there was no basis for concluding that it was an act of bad faith for Hollymatic to purchase paper from a company owned by its investor when it believed that the converter equipment the parties knew was necessary to generate requirements for the seller's paper could never be made operational.

Commentators have decried the lack of principled reasoning in quantity-reducing cases, and have expressed concern over how the court's application of the good faith standard upsets the parties' own allocation of risks, punishes buyers for making economically sound decisions to shut down businesses, and provides a windfall to sellers that exceeds any reliance damages they may have incurred in investment specific expenses.<sup>449</sup> Since one of these cases is *Empire Gas*, authored by Judge Posner, one of our most preeminent legal economists, what we need is not a judiciary with more sophistication in its understanding of economic theory, but a reformation of the law of open quantity contracts to eliminate the good faith standard.

The heart of the problem with respect to breach is that open quantity contracts are designed for situations in which the parties are not willing to commit themselves to liability for a specific quantity of goods due to various uncertainties in the market and in their respective business prospects. Yet the law steps in and creates a cause of action for breach of contract to give them rights that it is not clear they bargained for, but could easily have contracted for, using the nebulous concept of "good faith." Thus, with the goals of implementing the intent of the parties, and decreasing unnecessary burdens on our judicial system, we should ask whether the businesses that enter these requirements contracts, often for multi-year terms, actually intend to enter into implicit agreements for the rights the courts create for them. If they were given an opportunity to reflect on the matter, would they agree to ban the buyers from reducing their requirements based on financial losses, no matter how

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<sup>448</sup> *Id.*

<sup>449</sup> Goldberg, *supra* note 3, at 347-66; M. Finch, *Output & Requirements Contracts: The Scope of the Duty to Remain in Business*, 14 UCC L.J. 347, 366 (1982).

great, as opposed to declining orders, as the Official Comments to UCC section 2-306 indicate? Can we assume they are agreeing that for the life of the contract, the buyer must continue the business, and cannot sell it, unless it can prove that the contract played no part in its decision? Are they likewise agreeing that if the requirements are dependent on development of a new technology, the buyer will devote unlimited resources to the success of that technology? Is the buyer surrendering its business judgment so that it cannot, even acting in good faith, increase its requirements above what is "reasonable" in light of prior estimates? Even if it were appropriate to make these assumptions about the parties' intent in specific cases, the concept of good faith is a poor tool for carrying out their intent because the Code posits a system whereby the parties' ability to define the implied duty of good faith is restricted by their inability to disclaim it.

Rather than making dubious assumptions about the parties' implied intent in open quantity contracts to create a duty with liability ramifications of such great and uncertain magnitude, courts should interpret open quantity contracts as promises by the quantity-determining party not to deal with any other party for all or an ascertainable portion of the identified goods or supplies. The mandatory good faith rule should be replaced with the principle of personal autonomy, under which the parties could protect themselves from risk by bargaining for the appropriate contractual provisions, with far more precision and certainty than the good faith standard could ever provide.

#### VII. THE BUYER'S OPTION PROBLEM

In *Empire Gas*, Judge Posner asked "a fundamental question . . . in the law of requirements contracts[]" <sup>450</sup> that must be answered by anyone advocating the position, as I do, that requirements contracts should be interpreted to prevent the buyer from purchasing all or an ascertainable portion of its requirements from other sellers, but should not subject the buyer to implied duties of good faith that limit the quantities he may demand. Judge Posner's question is whether a requirements contract is

essentially a buyer's option, entitling him to purchase all he needs of the good in question on the terms set forth in the contract, but leaving him free to purchase none if he wishes, provided that he does not purchase the good

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<sup>450</sup> *Empire Gas Corp. v. Am. Bakeries Co.*, 840 F.2d 1333, 1334 (7th Cir. 1988).

from anyone else and is not acting out of ill will toward the seller[.]<sup>451</sup>

The question itself suggests that the only difference between a buyer's option and a requirements contract would be exclusivity and good faith. In a buyer's option, unless the buyer made a reciprocal promise to buy exclusively from the seller, the buyer would be free to purchase the goods from another supplier. This assumption is incorrect, however, because it fails to disaggregate the issues of quantity and the buyer's reciprocal obligation to buy.

To deconstruct these aspects of the distinction between options and requirements contracts, I will begin by considering four hypothetical buyers' options. In the first, the seller agrees to supply the buyer with a fixed quantity of goods for a set price for the term of the option, and the buyer provides consideration for the option. The differences between this option and a requirements contract are that in the options contract the buyer may choose not to exercise the option, he may buy as many products as he likes from other suppliers or may buy none, and there is no implied duty of good faith that restricts his discretion in making these choices.

In the second hypothetical, if the option was for the buyer's requirements, rather than for a fixed quantity, the same distinctions would hold, since the option would not include a reciprocal promise from the buyer to purchase its requirements from the seller, or an implied duty of good faith restricting the buyer's discretion in exercising its option.

In the third hypothetical, the buyer's option requires the seller to supply the buyer with only fifty percent of his requirements, and the buyer provides consideration for the option but does not promise to buy any of his requirements from the seller. This case is still distinguishable from a requirements contract because the buyer may choose not to purchase any of his requirements from the seller and may purchase all of his requirements from other suppliers. In a comparable requirements contract, the buyer would have to buy fifty percent of his requirements from the seller, and would have a good faith duty in connection with any reduction in his requirements, and a duty not to demand an "unreasonably disproportionate" quantity above the estimate. Under this hypothetical, however, the requirements contract is not differentiated from a buyer's option because the requirements contract buyer "could not purchase the good[s] from anyone else[.]" as in Judge Posner's question, because in both contracts the buyer can purchase up

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<sup>451</sup> *Id.* at 1334-35.

to fifty percent of his requirements from other suppliers. Thus, exclusivity, in the sense that Judge Posner appears to use the concept, is not necessary to distinguish requirements contracts from options.

In the fourth hypothetical, the seller agrees to supply fifty percent of the buyer's requirements for a set term at the prices stated, and the buyer promises to buy fifty percent of his requirements from the seller. This arrangement is more than a firm offer under UCC section 2-205, or an offer made irrevocable beyond the three-month period set forth in UCC section 2-205 by the exchange of recited consideration. The contract has now become a promise to sell in exchange for a promise to buy. There is still no need to add an implied duty of good faith other than to avoid quantity and market risks that the parties can deal with more effectively by allocating these risks in their agreement. Exclusivity is also unnecessary because the agreement includes a method for ascertaining the quantity of goods the buyer has agreed to purchase. Thus, my proposal for eliminating the implied duty of good faith and the exclusivity rule could be implemented without converting a requirements contract into a buyer's option. The requirements contract would, unlike a buyer's option, include a promise by the buyer to purchase all, or an ascertainable portion of, its requirements, if any, from the seller.

In *Empire Gas*, Judge Posner discusses the interpretation of a requirements contract, explaining "that the buyer need only refrain from dealing with a competitor of the seller," and concluding that it would still constitute an option.<sup>452</sup> As he explains:

If no reason at all need be given for scaling back one's requirements even to zero, then a requirements contract is from the buyer's standpoint just an option to purchase up to (or slightly beyond, i.e., within the limits of proportionality) the stated estimate on the terms specified in the contract, except that the buyer cannot refuse to exercise the option because someone offers him better terms. This is not an unreasonable position, but it is not the law.<sup>453</sup>

The law Judge Posner refers to, however, is the questionable case law preventing buyers from reducing their requirements based on well-founded business judgments, including the nonsensical distinction in the Official Comments to UCC section 2-306 between plant shut downs

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<sup>452</sup> *Id.* at 1339.

<sup>453</sup> *Id.*

made to curtail losses and those made as a result of a lack of orders, and pre-Code cases holding that a buyer breaches a requirements contract even when its requirements have been eliminated based on a fundamental change in its operations, or because it has become cheaper to buy the finished product rather than the goods to manufacture it.<sup>454</sup> In addition, other courts that have held that the alleged requirements contracts were actually options have emphasized that the distinguishing feature of a requirements contract is that it is a contract that, “although it does not establish the amount that a buyer must purchase from the seller, *prohibits the buyer from purchasing from other sellers.*”<sup>455</sup>

Conversely, viewing a requirements contract as an option that the buyer cannot refuse to exercise just because someone else offers him better terms, as Judge Posner puts it,<sup>456</sup> takes the agreement so far outside the real world of options that the analogy no longer assists the analysis. The whole purpose of an option from the buyer’s perspective is to give him the ability to compare the seller’s offer to the offers made by the seller’s competitors before the option expires so that he can exercise the option or not, as best serves his interests. Once you eliminate the “option” aspect of the agreement, it becomes an agreement by the buyer to purchase any needs it may have for a particular product from the seller on the terms stated. The critical distinction between an option and a requirements contract still exists under my proposal because the buyer under a requirements contract has given up the right it would have had under an option to accept other competitive offers for its requirements, and is bound to purchase any requirements it has from the seller on the seller’s terms for the duration of the contract.

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<sup>454</sup> *Id.* at 1339–40 (citing *Minnesota Lumber Co. v. Whitebreast Coal Co.*, 43 N.E. 774 (Ill. 1896)) (holding that the contract did not violate a statute against options as a form of gambling because the buyer had agreed to purchase all of its requirements for coal from the seller, up to a maximum amount, and the reasonable assumption was that the buyer would remain in business, so the promise was not illusory); *Nat’l Furnace Co. v. Keystone Mfg. Co.*, 110 Ill. App. 363 (1920) (holding that requirements are more than “wants[.]” and that the contract was not void for lack of mutuality because the buyer agreed to purchase its requirements from the seller and could not purchase them from other sources); *Chalmers & Williams v. Bledsoe & Co.*, 218 Ill. App. 363 (1920) (holding that the buyer’s decision to switch from coal to electricity did not excuse it from its obligation to purchase its coal requirements from the seller); *Loudenback Fertilizer Co. v. Tenn. Phosphate Co.*, 121 Fed. 298, 303 (6th Cir. 1903) (holding that the buyer breached its requirements contract when it stopped purchasing raw materials to make fertilizer when it became cheaper to buy the finished product for resale because otherwise the contract would be an unenforceable option).

<sup>455</sup> *Merritt-Campbell, Inc. v. RxP Prods., Inc.*, 164 F.3d 957, 963 (5th Cir. 1999) (emphasis added). See also *Mid-South Packers, Inc. v. Shoney’s, Inc.*, 761 F.2d 1117, 1120 (5th Cir. 1985).

<sup>456</sup> *Empire Gas*, 840 F.2d at 1339.

Accordingly, as long as open quantity contracts include language under which the quantity term can be determined at the time the parties' dispute is adjudicated, the difference between a buyer's option and a requirements contract should be that in an options contract the buyer receives the option of buying a fixed quantity of goods at a set price from the seller until the option expires,<sup>457</sup> and remains free to purchase the goods from other suppliers rather than exercise the option, but in a requirements contract the buyer promises that it will purchase all, or an ascertainable portion of, its requirements, if any, from the seller.

### VIII. PROPOSALS FOR CHANGE

#### A. *A Uniform Rule for Validating Open Quantity Contracts*

Based on the foregoing analysis, I have formulated three proposals for reforming the current law of open quantity contracts. The first is for courts to adopt a uniform validation rule for open quantity contracts. This rule would replace the following: (1) the exclusivity rule that the quantity-determining party must deal exclusively with the contracting party for all the goods or services under contract; (2) all of the modifications and exceptions to the exclusivity rule (except to the extent they are incorporated in the new rule); (3) the approach taken from Comment 2 to UCC section 2-306 that validation is accomplished by the quantity-determining party's duty to run its business so that its "output or requirements will approximate a reasonably foreseeable figure[]";<sup>458</sup> and (4) any other attempts to substitute the common law requirement of exclusivity with the duty of good faith. Because this lack of uniformity has arisen from judicial interpretations of the Code, courts should be able to remedy the situation without a statutory amendment.

The approach I recommend has been foreshadowed in a number of decisions recognizing various exceptions to the exclusivity doctrine but has not been developed into a uniform rule. It would address the doctrines of mutuality and definiteness and provide a flexible method for defining quantities that could be adapted to suit businesses' needs. It would also give the seller in requirements contracts assurance that the buyer has made a commitment to buy all or a portion of its requirements from the seller in exchange for the seller's promise not to change its terms for the duration of the contract. At its core, the key to this new validation rule is an attempt to satisfy the mutuality and definiteness requirements for contract formation by requiring that the buyer promise

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<sup>457</sup> Consideration is necessary if the option is held open for longer than three months under UCC section 2-205.

<sup>458</sup> U.C.C. § 2-306 cmt. 2 (2004).

to purchase its requirements of an uncertain, but ultimately ascertainable, quantity of goods from the seller.

Using this approach, courts should enforce open quantity contracts for the sale of goods or services as long as, for a requirements contract, the buyer is obligated to purchase all, or an ascertainable portion of, its requirements, if any, from the seller, and, for an output contract, the seller is obligated to sell all, or an ascertainable portion of, its output, if any, to the buyer. The parties may define an "ascertainable portion" of requirements or output in many of the ways already recognized as exceptions to the exclusivity doctrine, although these methods should not be seen as limitations on the scope of the doctrine. So, for example, a valid requirements contract could provide that the buyer will purchase a percentage of his requirements from the seller, that the buyer will purchase all of his requirements needed to fill the orders of particular customers from the seller, or that he will purchase all of his requirements needed for a specific project from the seller. Either in combination with such provisions, or alone, the parties could also apply minimum and maximum limits on the buyer's requirements, so that the buyer will purchase all of his requirements from the seller up to a maximum amount, after which he will be free to obtain his requirements from other sources, and the buyer will pay the seller for a minimum quantity to cover his reliance expenses if the buyer has no requirements.

*B. Rules of Interpretation Concerning Implied Promises*

My second recommendation is to end the methods of contract construction which permit the courts to imply the required promise by the buyer in a requirements contract to purchase all, or an ascertainable portion of, its requirements from the seller based on:

- (1) the seller's promise to sell the buyer his requirements, which could be intended to serve as a price list, an offer, or a buyer's option;
- (2) a statement of intention concerning future purchases, which could be intended to serve as a non-binding letter of intent rather than as an agreement to purchase;
- (3) an MPA containing a disclaimer providing that the buyer is liable only for the goods ordered on individual purchase orders or firm releases accepted by the seller, or words to that effect, where there is no other language in the MPA to indicate that the buyer agrees to purchase all or an identifiable portion of his requirements from the seller for the duration of the MPA; or
- (4) a pricing proposal or volume discount combined with a history of prior exclusive dealings between the parties.



In each of these cases, the implied promise by the buyer is not well-founded without evidence of the buyer's intent to commit him to purchasing an identifiable quantity of goods, given the many other, equally plausible explanations of the parties' intent. The party in the best position to solve the ambiguity, at the lowest cost, is the buyer. The buyer can state, in either the MPA or its individual purchase order or release, that his promise to purchase all, or an identifiable portion, of his requirements from the seller and the seller's obligation to supply those goods to the buyer are terms of his offer, and that his offer is expressly limited to acceptance of these terms.

As we have seen, the buyer also stands to gain from the ambiguity if courts continue to apply loose standards to enforcement of open quantity contracts. If the buyer's obligation is left unstated, the buyer is free to argue that the contract is either enforceable as a requirements contract, or enforceable only for the quantities ordered, depending on the prevailing market price for the goods. If the buyer will not state expressly that he is making a commitment to purchase his requirements from the seller, he should not have the benefit of the ambiguity he has created, given the costs this ambiguity imposes on the seller, on our judicial system, and the frustration of the flow of commerce that occurs when the private intentions of contracting parties become critical to understanding their contracts.

*C. A New Version of UCC Section 2-306(1) Designed To Eliminate the Implied Duty of Good Faith in Open Quantity Contracts*

The final change I would make to current law is to eliminate good faith as a limitation on the quantity of goods that could be tendered or demanded under open quantity contracts. Unlike my first two recommendations, this reform would require amending the Code, now that it has adopted the common law duty of good faith for open quantity contracts. While amending UCC section 2-306(1) would not be as pressing if good faith were applied as a default rule, courts often apply the duty of good faith regardless of how carefully parties attempt to allocate the quantity risks by agreement. Even where parties do not allocate quantity risks, good faith is a poor tool compared with other methods used to discern the parties' intent. I therefore propose replacing the current good faith rule with a default rule providing that in an output or requirements contract, all that the promisor obtains from the promisee is the promise not to purchase or sell the specified quantity from or to another entity. The revised version of UCC section 2-306(1) to

incorporate my first two changes to the current law would read as follows:

Unless otherwise agreed, a term that measures quantity by the output of the seller or the requirements of the buyer means the actual output, or an ascertainable portion of that output, that the seller agrees to sell to the buyer, or the actual requirements, or an ascertainable portion thereof, that the buyer agrees to purchase from the seller.

Under this revised version of UCC section 2-306(1), there would be no breach of an open quantity contract for output or requirements that were either too high or too low as compared to estimates or “normal” quantities, and the parties could not violate the contract by terminating or selling their businesses. The primary forms of breach would be violating any minimum or maximum quantity limits set forth in the contract and selling their output to, or purchasing their requirements from, third parties. There is no need to revise UCC section 2-306(2) because the “best efforts” standard in that section would no longer create a conflict with the good faith standard under UCC section 2-306(1) that was used to apply to those output and requirements contracts that were also exclusive dealing contracts.

The only right the promisor would give up in such open quantity contracts, when contrasted to fixed quantity contracts, is the right to claim breach for nonperformance based on the promisee’s failure to produce or order goods when the goods were not produced for or ordered from another party within the terms of the agreement. Thus, while a seller in a fixed quantity contract can sue for breach when the buyer does not purchase the goods from the seller even if the buyer did not purchase them from any other supplier, the seller would not have this right in a requirements contract.

As described above, this new rule would not require exclusivity. For example, if a requirements contract provided that the buyer had to purchase all of its requirements of product *A* from the seller that were needed for buyer’s customer *B*, the seller will only be able to sue for breach if the buyer stops buying product *A* because it is filling the orders of customer *B* for product *A* through another supplier. For an output contract, if the contract states that the buyer will buy all of the seller’s output of product *A* at facility *1*, the buyer will not be able to claim breach if the seller stops producing product *A* at facility *1* for the buyer for any reason other than supplying it to another customer.

The risk of a loss of business through vertical integration is a foreseeable one that should be dealt with by agreement, but the default rule should leave the risk with the seller; after all, the idea is that the party that does not determine quantity assumes the risk that the required quality will change. Thus, unless otherwise agreed, no breach would occur if the output of a seller was eliminated because the seller begins to use the product for inter-company sales to the seller's own new subsidiary. Similarly, no breach would occur if the requirements of a buyer were eliminated because the buyer began to source the product from its own newly acquired subsidiary or used its own equipment to manufacture the product. What the seller in such a requirements contract would gain would be an award of the buyer's business as against the seller's competitors, not protection from the benefits the buyer may gain from vertical integration. Vertical integration is hardly an action demonstrating the buyer's "bad faith" or its "ill will" towards the seller, especially when the buyer is a publicly traded company.

Parties can also avoid the risk of speculation that good faith caps on requirements were designed to prevent if they use field of use or customer restriction provisions. For example, in a case such as *Orange & Rockland Utilities, Inc. v. Amerada Hess Corp.*,<sup>459</sup> where the court found that the defendant-utility company had acted in bad faith by taking advantage of rising market prices to purchase large quantities of gas to resell to new utility customers that were included in the calculations for the estimates in the contract, defined as "nonfirm" customers, the seller could have protected itself by limiting the contract to the buyer's requirements for sale to its "firm" customers.<sup>460</sup> Similarly, a buyer that uses a product as a component or material could be prevented from entering into competition with the seller by limiting the contract to the buyer's requirements for its own manufacturing business, and by excluding purchases made for resale in competition with the seller. In this way, the seller could refuse to supply any amounts a manufacturer-buyer ordered in a rising market in order to compete with the seller, rather than in the normal course of the buyer's business. If the seller is concerned that the buyer may stockpile goods, or order quantities in excess of the seller's capacity, periodic caps can always be placed on the buyer's requirements. Enforcement of express contractual language placing these limitations on buyer's demands should not be an issue, as courts already use the doctrine of good faith to prevent buyers from demanding more quantities than are justified by their current needs.<sup>461</sup>

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<sup>459</sup> 59 A.D.2d 110 (N.Y. App. Div.1977).

<sup>460</sup> *Id.* at 116.

<sup>461</sup> See *Homestake Mining Co. v. Wash. Pub. Power Supply Sys.*, 476 F. Supp. 1162, 1169

While somewhat less common, courts have also suggested that the upper quantity limits will be placed on output contracts.<sup>462</sup> Here, the danger of speculative conduct could be prevented by using provisions stating that the seller will only tender the output it has manufactured, so the seller could not obtain supplies from third parties in excess of its capacity to take advantage of a drop in market prices. Maximum quantity limits, or even quantity limits tied to market prices could also be used for this purpose.

In addition to “take-or-pay” minimum quantity provisions, another drafting remedy for solving the problem of diminishing requirements is to add a termination clause to the contract with a provision for paying the seller for any materials acquired before the termination notice was received, such as the clause enforced in *Q.C. Onics*.<sup>463</sup> For the “just-in-time” inventory buyers who refuse to enter long-term requirements contracts but still want prompt delivery of goods on an individual purchase order basis, the seller might consider insisting on other types of contracts to cover his inventory risk. If the seller wants the buyer to keep six months of inventory on hand, a guaranty could be obtained from the buyer for any losses sustained if the seller does not place a purchase order for that inventory. Or, a buyer’s option could be entered, for consideration, with a termination date that equals the inventory period.

#### IX. CONCLUSION

The UCC section 2-306(1) imposes a mandatory “good faith” rule governing quantity that makes courts, but more often juries, the overseers of how the businesses of the parties entering into requirements or output contracts must be run to generate acceptable orders or supplies. Under the Official Comments to section 2-306(1), the parties to such contracts must operate their companies so that their output or requirements approximate those that would result from businesses run in “good faith” such that they cannot tender or demand goods under these contracts that are “unreasonably disproportionate” to either a

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(N.D. Cal. 1979), *aff’d* 652 F.2d 28 (9th Cir. 1981) (holding that a supplier was not required to sell the buyer more uranium than needed for the initial nuclear core requirement of nuclear reactor, where the buyer had no good faith requirements for uranium based on concerns that proposed regulations may require additional uranium). There is also a line of cases supporting the proposition that a buyer cannot attempt to nullify the effect of the seller’s termination of a requirements contract by ordering so many goods as to effectively extend the term of the contract. See *Mass. Gas & Elec. Light Supply Corp. v. V-M Corp.*, 387 F.2d 605, 606 (1st Cir. 1967); *G.D. Searle & Co. v. Fisons Corp.*, 1993 WL 54535 at \*4 (N.D. Ill. 1993).

<sup>462</sup> *Atlantic Track & Turnout Co. v. Perini Corp.*, 989 F.2d 541, 545 (1st Cir. 1993).

<sup>463</sup> 2006 WL 1722365 (N.D. Ind. 2006).

“stated estimate,” or the “normal” or “comparable” quantities. Too little attention has been paid to whether the costs are worth the benefits of this type of oversight of business by courts and lay juries. It may well be incompatible with the duties of a publicly traded company to enter into an output or requirements contract under these conditions, given the Official Comments that “bad faith” by a requirements buyer may consist of shutting down a plant to avoid losses or of a “sudden expansion” of a plant to take advantage of rising prices.<sup>464</sup> In open quantity contracts that give one party control over the quantity term, both sides should be sensitive to the risks this arrangement entails and should not be relieved of the obligation of bargaining for an allocation of these risks by using an equitable doctrine such as the implied duty of good faith.

Sophisticated businesses are much better served by crafting their own protections from the risk of requirements or output quantities that are either far higher or lower than expectations, than by leaving this question to be decided, usually by a jury, as an issue of fact. After decades of scholarship analyzing the law of contracts in the context of the “efficient breach,” it seems a legal anachronism for courts to distinguish between cases when parties are failing to perform a contract for “valid business reasons” unrelated to the terms of the contract, which is not a breach, and when they are failing to perform because the contract has become disadvantageous, which is a breach. Even when courts make the right calls, which they sometimes do, the fact that disputes rise to the appellate court level over whether, for example, a requirements buyer acted in bad faith by closing its business after incurring millions of dollars in losses, is ample evidence of the need for change.<sup>465</sup>

Unlike other areas of law, the law of contracts should give private parties the ability to write the rules, to a considerable extent, that will govern any disputes that result in litigation. In a broader sense, a social bargain is struck in contract, whereby the courts, which must also resolve many other disputes of importance to the community, are available to private parties to enforce their agreements, provided those agreements meet certain standards. Decisions are published by the courts, and studied by lawyers. Private parties then rely on their counsel’s advice in drafting their agreements, so that if there is a dispute as to formation, breach, or damages, counsel will have a better than 50/50 chance of successfully predicting the outcome. If all goes well, many disputes that arise despite careful drafting will still be resolved without resorting to litigation because one side will be able to convince the other of the probable outcome of litigation given the legal

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<sup>464</sup> U.C.C. § 2-306 cmt. n.2 (2004).

<sup>465</sup> See *Schawk, Inc. v. Donruss Trading Cards, Inc.*, 746 N.E.2d 18 (Ill. App. Ct. 2001).

precedents. A large percentage of the disputes that do result in litigation should be resolved on summary judgment, with the court interpreting the contract as a matter of law. This vision may be overly optimistic, but it is nevertheless what society has a right to expect from the law of contracts and what the legal system should strive to provide.

As applied to open quantity contracts, the doctrine of good faith has been taken too far, and is now constricting the parties' ability to allocate the quantity risk of their transactions. While a dialectic may be constantly unfolding in the courts between the forces of law and equity, adjustments are in order when the balance tips so far on the side of equity that the law risks losing its legitimacy as well as its utility.