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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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Introduction

Among the many varieties of missing or open term contracts, open quantity contracts have been particularly problematic for judges, scholars, and attorneys called upon to provide counsel to their clients, 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.[2] Litigation also continues at a steady clip over whether the buyer in a requirements contract has breached its implied duty of good faith by reducing or eliminating its requirements under an open quantity contract.[3] The 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.[4] The formation and breach decisions achieve neither an acceptable level of uniformity in the standards courts apply nor an acceptable level of consistency in the rulings made based on comparable facts.

On the subject of formation, a majority of courts[5] and commentators[6] take the position that a requirements contract is not enforceable unless it places an obligation on the buyer to purchase all of its requirements of a particular product exclusively from the seller, and conversely, that an output contract is not enforceable unless the seller agrees to supply its 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 Uniform Commercial Code 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.[7] Between these two extremes, many jurisdictions have adopted modified versions of the exclusivity rule as well as a whole host of exceptions.[8] As a result, there are now states that apply the strict version of the exclusivity rule, states that apply one of the many modified versions of the exclusivity rule or its exceptions, and states that apply the Uniform Commercial Code's (referred to hereinafter as the "UCC" or the "Code"), good faith rule. The application of so many different standards for validating open quantity contracts suggests that an examination of the rationale behind these rules is overdue, and that a uniform rule should be adopted to replace the broad set of formation principles that are now being applied across the country.

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 is obligated to purchase its requirements of a particular brand of product exclusively from the seller, but may continue to purchase other brands of the product from the seller's competitors; when 2) the buyer purchases all of its requirements exclusively from the seller, but only for particular customers, or 3) when the buyer purchases its requirements exclusively from

the seller, but only for a specific project. Many “exclusivity rule” courts also modify the rule by providing that the buyer may promise to purchase all of its requirements exclusively from the seller up to a maximum quantity, and may purchase goods above that quantity from other suppliers. 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 open quantity 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, the courts imply a duty of good faith on sellers to generate outputs, and buyers to order requirements, that are reasonably consistent with estimated or historical quantities, with the caveat that buyers’ needs can fall to zero as long as their needs did not decline due to any bad faith conduct on the part of the buyers. 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.[9] Conversely, while the buyer in a requirements contract can reduce its requirements to zero, it can only do so if it is acting in good faith.[10] The implied duty of good faith serves two functions. In a minority of jurisdictions, it replaces the exclusivity rule as a validation principle for open quantity contracts. In every jurisdiction, it supplies a definition of quantity that allows courts to determine when the quantity-determining party has breached the contract through a tender or demand of an unreasonably high quantity or by a reduction or elimination of quantity 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 if not better than the implied duty of good faith.

This article will address the questions of 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 UCC is sufficient to satisfy these doctrines without reliance on the exclusivity rule. In an effort to answer these questions, the article will discuss decisions recognizing open quantity contracts that are not entirely exclusive, but come “close enough” to satisfy the validation principles of contract formation. From this discussion, a framework will arise for a standard that has been evolving slowly, but has not been clearly articulated, for recognizing “partially-exclusive” open quantity contracts. I will explore reasons why a modified rule should be adopted which would permit enforcement of open quantity contracts as long as 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 its output to the buyer, and that the buyer in a requirements contract has agreed to purchase all or an ascertainable portion of its requirements from the seller. This rule would not incorporate the implied duty imposed upon buyers and sellers in open quantity contracts under the common law and the UCC not to reduce or eliminate

their requirements or output unless they do so in "good faith," or 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, I will also consider 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, I will examine 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 I, I will briefly summarize the historical basis for the recognition of requirements contracts, and ask 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 II will involve an examination of how the concepts of exclusivity and good faith have been affected by the adoption of Section 2-306 of the UCC. Specifically, I will analyze the claim made in the Official Comments to UCC § 2-306 that good faith is sufficient to satisfy the doctrines of mutuality and definiteness, the potential inconsistency between this claim and application of UCC § 2-306 as a gap-filler, and ability of parties to avoid the application of UCC § 2-306 by agreement.

In Part III, I will review the current case law addressing formation issues under the exclusivity rule, its variations, and the duty of good faith.

Part IV examines methods of interpretation courts are using to identify enforceable open quantity contracts, focusing on five problem areas and offering corrective action in each.

In Part V, I study cases in which the seller has alleged that the buyer breached a requirements contract by reducing or eliminating its requirements in "bad faith." The goal of this section 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 VI, I will explain why eliminating the implied duty of good faith from the law of open quantity contracts will not convert them into buyer's options, as Judge Posner suggested in his decision in *Empire Gas Corp. v. American Bakeries Co.*[11]

My specific proposals for reform are laid out in Part VII. In this section, I will make three recommendations. First, I will propose a new exclusivity rule for courts to apply to the formation question. Second, I will recommend a more disciplined approach to contract interpretation for courts to use in identifying valid open quantity contracts. To conserve judicial

and private resources and avoid opportunistic behavior, private parties would be required to write contracts that state the buyer 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. Finally, I will also suggest adopting a revised version of UCC § 2-306(1) which removes the references to "good faith" and "unreasonably disproportionate" quantities. The purpose of the revision is to ensure that the quantity limitations imposed by these terms are not used as mandatory, rather than default rules, and 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.

Part I. 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 its obligations without buying or selling any goods, making its performance completely discretionary. Given this unbridled discretion, the courts found that the promise was illusory, and that the lack of a quantity term made it too indefinite to be enforced.[12] 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 be calculated based on the actual requirements of the buyer or the actual output of the seller.[13] In reaching this doctrinal solution, the courts relied on the adage, id certum est quod certum reddi potest ("that is certain which can be made certain").[14]

Viewing the exclusivity rule in isolation, 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 it purchases its requirements from any other seller, and the seller in an output contract has breached the contract if it sells its output to any other buyer.[15] This obligation is expanded significantly, however, by the rule that parties to requirements contracts must also limit their demands to quantities that reasonably approximate the parties' expectations. A 1903 decision by the New York Court of Appeals in *New York Central Ironworks Co. v. United States Radiator Co.*,[16] was one of the first to apply the "implied duty of good faith and fair dealing" to reach this conclusion. In *New York Central*, the seller sued the defendant for breach of a contract to supply the seller "with their entire radiator needs for the year 1989," on the terms and at prices specified.[17] The defendant asserted the defense of mutual mistake when it was unable to supply seller's orders beyond 48,000 feet, which was the maximum the seller had ever previously required in a year, and

submitted orders for a total of 100,000 feet.[18] 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."[19] The quantity term was therefore intentionally left open, and the sellers' failure to anticipate the rising price of iron, and of manufactured products of iron, was not a defense, since the needs of the plaintiff-buyer "could be indefinitely enlarged" when it had a favorable contract that would allow it to undersell its competitors.[20]

The only consideration that gave the court pause in reaching its decision in *New York Central* was the testimony in the record from the plaintiff's manager as to whether the goods ordered were required for the needs of the plaintiff's business.[21] This question drew an objection, and the decision does not record the witness' answer. The court nevertheless observed that, "The obligation of good faith and fair dealing towards each other is implied in every contract of this character."[22] Based on this implied duty, the defendant could have offered proof, in defense of his breach, that "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."[23]

The court in *New York Central* recognized that a party is normally entitled to the profits that accrue to him in a rising market if he makes 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.[24] What is puzzling is that the court fails to ask why, in a fixed quantity contract, the law has no trouble with the losses the defendant must bear from failing to anticipate market fluctuations in negotiating the terms of his contracts, but it must supply the good faith exception in the case of indefinite 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 efficiently in requirements contracts. For example, in *New York Central*, the seller apparently did not have the capacity to sell the buyer more than the 48,000 feet annually, and therefore 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, as opposed to logistically, impracticable to perform.

The implied duty of good faith was to develop in the common law of open quantity contracts into a rigid, unrebuttable presumption that the *New York Central* opinion 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.[25] 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 motive.[26] 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."[27] 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."[28] The rationale is not persuasive, but interesting. The self-interest of the buyer is apparently relied upon under this good faith framework until the buyer's demands reach the parties' estimate. Above this point, the buyer cannot demand additional quantities no matter how pure his motives may be, since the law presumes that he intends to use the additional goods for speculation. The common law rationale also fails to explain why the courts are not equally intolerant of demands that fall below the expected quantities. A self-interested buyer may seek to reduce or eliminate its requirements under many circumstances that are not out of the "ordinary," especially under a long-term contract. These include changes in consumer preferences, advancements in technology, market fluctuations, and any number of other factors that could reduce the buyer's need for the product or result in a decline in the buyer's business.

Part II. The UCC Rule on Open Quantity Contracts – Section 2-306

The UCC section on output and requirements contracts, UCC § 2-306, incorporates the implied duty of good faith in requirements contracts that prevents a buyer from requesting a quantity of goods that is disproportionate to the quantity the parties had estimated. The section does not, at least expressly, repeat the prior rule that a requirements contract is only enforceable if the buyer promises to buy all its requirements exclusively from the seller.[29] Some commentators contend that UCC § 2-306 implicitly adopts the exclusivity rule, either because the seller under an output contract must necessarily supply *all* its output to the buyer and the buyer under a requirements contract must purchase *all* its requirements from the seller, so that exclusivity is understood,[30] or simply because the parties are required to act in good faith.[31] The first argument points out an ambiguity in the language of the section – does the section imply the word "all" when it says "the output of the seller" and "the requirements of the buyer" – but it is not definitive. As we will see in Part III, courts have enforced output and requirements contracts under UCC § 2-306 where the parties contract for less than 100% of the seller's output or the buyer's requirements under exceptions and modifications to the exclusivity rule. The second argument has also been disputed by commentators who claim that the duty of good faith should be interpreted to replace, rather than to incorporate, the exclusivity rule.[32] While most courts continue to apply the exclusivity rule, only a few actually rely on the UCC § 2-306 as authority for the rule.[33]

The only reference to exclusivity in UCC §2-306 is in 2-306(2), which relates to "exclusive dealing" agreements.[34] 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.[35] The assumption is problematic because the term "exclusive dealing" is not being used in UCC § 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 UCC § 2-306(2) is used to mean what I will call "mutual exclusivity," which 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.[36] For a requirements contract, "exclusive dealing" under UCC § 2-306(2) binds the seller as well as the buyer to a promise of exclusivity. The seller agrees that it will sell Product A to the buyer, and to no other customers, at least in a defined geographic area or other specified market, as in exclusive or partially exclusive dealerships, in an amount the buyer requires. If the buyer does not use its best efforts the seller will be subject to hold up opportunities because it will have no other potential customers to whom it may sell Product A, at least within the affected market.[37] For an output contract, "exclusive dealing" 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 its best efforts to manufacture the product, the buyer would be vulnerable to hold up because it would have no other source for Product A. In a "normal" output contract, only the seller would have an obligation to sell its output to the buyer, and if the seller failed to produce, the buyer would be free to purchase its needs 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.[38]

It is somewhat more reasonable to infer, as at least one court has done,[39] that the legislatures adopting the UCC intended to revoke the exclusivity rule for requirements contracts based on the omission from UCC § 2-306(1) of any reference to the exclusivity rule, combined with the explanation in the Official Comments to UCC § 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 II(A), the argument in the Official Comments applies only to contracts involving 100% 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.[40]

For example, in a recent case involving an alleged output contract, *Arrotin Plastic Materials v. Wilmington Paper Corp.,*[41] the court refused to rely on UCC § 2-306 to enforce the agreement without a commitment by the seller to sell all of its output to the buyer, and held that the

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. If the court had applied UCC§ 2-306(1) as the "primary gap filler" for missing quantity term contracts, as several federal circuit courts have held is appropriate,[42] it 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.[43] 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 Code.

In addition to the confusion over whether exclusivity has been incorporated or rejected as a condition for valid open quantity contracts, the language of UCC § 2-306(1) has also raised questions concerning the intended nature and scope of the implied duty of good faith.[44] While the provision defines output and requirement 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."[45] 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 or seller's intent, and would therefore represent a departure from the common law rule that a buyer could decrease its requirements to zero as long as it was acting in good faith.[46] 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."[47] 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."[48] 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 section."[49] 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."[50] 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,[51] but in the following 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 fact finder 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 (15%? 20%?), 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 that parties to open quantity contracts can protect themselves from far better than judges and juries acting after the bargain has been made based on limited information and biases created by hindsight. Nor is it clear 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 a buyer cannot order an unreasonably disproportionate quantity of goods that is above estimates or normal quantities, even in good faith.[52] In cases where the parties have not set a minimum and/or maximum quantity limit by agreement, the courts use the “unreasonably disproportionate” test of UCC § 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, regardless of the seller’s good faith,[53] and on the amounts that buyers can demand in excess of the estimates in a requirements contract, again regardless of buyer’s good faith.[54]

In support of this approach, Judge Posner argued in *Empire Gas* that there is no indication that the drafters were concerned with the case where 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.[55] As we have seen, the Official Comments contain language indicating that the drafters *were* concerned with cases where the 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.[56] 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 UCC § 2-306(1).[57] Under the minority interpretation of the statute, the Alabama Supreme Court affirmed a judgment in *Simcala, Inc. v. American Coal Trade, Inc.*, that the buyer had breached its requirements contract by purchasing only 41% of its 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 problems it was having with its furnace.[58]

Given the ambiguity of the good faith standard under UCC § 2-306(1), there should at least 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.[59] 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.[60] 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 inaccurate assumptions is that all requirements contracts are between sellers and end users. For requirements contracts where the buyer is a distributor, dealer or other "middleman," the seller knows the buyer intends to resell the goods, so the entire theoretical basis for placing a ceiling on quantity demands is missing. 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 the risk of increased quantities. Since UCC § 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, not as a speculator, but as part of its normal business.

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 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,[61] 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 requirement 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 if and when there is an increase in the market price.

The majority interpretation of UCC § 2-306 also tends to discourage conduct our economic system would normally strive to promote. For example, if the buyer's actual requirements exceed expectations because it hired a brilliant marketing director and a crack sales team, the buyer's requirements would violate the "unreasonably disproportionate" standard under the UCC, despite the fact that the buyer is not only acting in good faith, but is running its business successfully. But courts have interpreted UCC § 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 calculations of the estimates of its requirements when the contract was formed.[62] Courts following this rationale purport to be protecting one party from letting the other order quantities that could not have been anticipated by the parties when they entered into the contract, but this is simply not the case. If not for an increase in the market price or a capacity shortage, both 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.[63]

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 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.[64] Many courts, as well as the Official Comments to UCC § 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.[65] 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 fact finder it has some other motivation for the shut-down that is not a ruse for attempting to avoid 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. [66] Second, well-counseled buyers would be far more careful to include protections in their requirements contracts such as express minimum and maximum limits on the quantities that could be demanded, as well as notice of termination and liquidated damages provisions.

The section also mishandles buyers in exclusive dealing/requirements contract who are subject to both the good faith duty of UCC § 2-306(1) not to order quantities that are "unreasonably disproportionate" to estimates or prior orders, and the duty to use its "best efforts" in the promotion and sale of the supplier's goods under UCC § 2-306(2).[67] What if the buyer's "best efforts" exceed expectations? No exception is made under current law to the strict cap placed on requirements that are too high, regardless of the buyer's good faith, even if the requirements contract is also an exclusive dealing contract. 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.[68] This solution has not been adopted by the courts. Even if it were, it would not solve the deeper problem, which is that buyers who want to use their best efforts to resell as many of the products purchased under the requirements contract as they can, regardless of any legal obligation to do so, may be prevented from doing so by the implied duty of good faith which is based on the assumption that any demands for unreasonably high quantities of the product are made for speculative purposes in bad faith.

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 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. [69] Its explanation is, however, ultimately unconvincing. 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.[70] 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,[71] 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 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 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 duty of a business to maintain its output or requirements at foreseeable levels would not give the fact finder 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 validation principle by agreement. As I will discuss in Section II(B) below, if courts applied UCC § 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 *Lenepe Resources Corp. v. Tennessee Gas Pipeline Co.*,[72] 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 UCC § 2-306(1) is disclaimed by agreement, the duty of good faith under UCC § 1-203 steps in to fill the void. The court observed that UCC § 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." 925 S.W.2d at 570. In *Lenepe*, the parties agreed that the buyer took the risk of accepting or paying for 85% of the seller's capacity, and granted the seller unlimited discretion to increase its capacity. Although the seller no longer had a good faith duty barring it from tendering "unreasonably disproportionate" quantities under UCC § 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 in UCC § 1-203. The court's implication that the good faith limitation on unreasonable quantities in UCC § 2-306(1) can be disclaimed but the good faith obligation under UCC § 1-203 cannot is flawed, since UCC § 1-302 states that the obligations of good faith and reasonableness prescribed by the UCC 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 § 2-306(1).

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."[73] 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."[74] The elusive standard that courts apply under UCC § 2-306(1) to decide whether a buyer's demands are unreasonably high despite his good faith, or whether a buyer has reduced or eliminated his requirements in good faith provides little guidance in determining whether a breach has occurred or what remedy should be awarded. Judge Posner has observed that the UCC does not contain a definition of "good faith" that seems applicable to the buyer's decision on how many goods to order under a requirements contract, or it could easily be added, to the seller's decision on how many goods to produce under an outputs contract.[75] How indeed does a court or jury use "honesty in fact and the observance of reasonable commercial standards of fair dealing,"[76] 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?

The truth is that notions of "honesty and fair dealing"[77] imply dealings between the two contracting parties and have little light to shed on the far reaching questions of whether the seller is running its plant to produce outputs 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 quantity of outputs or requirements given current market conditions, whether that figure 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, failing

an estimate, the "normal or otherwise comparable prior . . . requirements" as prohibited under Section 2-306(1).[78]

The phrase the "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. For a requirements contract, the buyer would breach the contract by purchasing the product from other suppliers, and 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, 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, however, 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 outputs 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. To make such a contract they would do so expressly, by setting the minimum and maximum levels of quantity they would sell or purchase, and by agreeing to pay damages for any breach of those limits.

B. The Code's Potentially Inconsistent Use of Good Faith Quantity Controls as a Gap-Filler

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

This inconsistency raises an issue of equal significance to the issue of whether good faith should replace exclusivity as a validation principle. That issue is whether parties are in fact permitted to vary the good faith quantity limitations under UCC § 2-306(1) by agreement, and if so, whether there any restrictions on the extent to which they may do so. More specifically, is UCC § 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 as a general rule of law governing all open

quantity contracts that cannot be disclaimed by agreement. Courts claim to treat UCC § 2-306(1) as the "primary" gap-filler in the Code for missing quantity terms.[79] 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 UCC § 2-305 for contracts with an open price term, which applies where the "price is not settled," courts apply UCC § 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.[80] 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 UCC's statute of frauds, UCC § 2-201(a).[81] It is more accurate to say that courts apply UCC § 2-306(1) as a general rule of law applicable to all output and requirements contracts, including ambiguous contracts that the fact finder decides contain sufficient evidence to demonstrate that the parties intended to contract for the buyer's requirements or the seller's output.

The courts' response may well be a reaction to the way the provision is drafted. As written, UCC § 2-306(1) does not operate as a 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 that, "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 estate or in the absence of a stated estimate to any normal or otherwise comparable prior output or requirements may be tendered or demanded." 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 UCC§ 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 UCC'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 UCC§ 2-306(1)? Is the section a default or a mandatory rule in this sense?

In decisions expressing the majority view of how the UCC § 2-306(1) should be applied as a gap-filler,[82] courts have enforced the implied duty of good faith in the manner of an "immutable" or "mandatory" rule, rather than a default rule, even when parties have been quite specific concerning the limits of the quantity term.[83] Indeed, Professor Victor Goldberg favors deleting UCC § 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.[84] One example of a court frustrating the parties' attempt to limit the quantity risk in an open quantity

contract is the decision in *Canusa Corp. v. A&R Lobosco, Inc.*,[85] where the court refused to enforce the minimum quantity terms of an output contract on the grounds that such a term would convert the agreement into a fixed quantity agreement. The buyer sued for breach when the supplier failed to produce the minimum quantities, and the seller argued that it was only liable for the quantity it actually produced.[86] Both parties, however, presented evidence that they understood the figures in the output contract to mean the minimum quantity that the seller was required to supply to the buyer.[87] The court instead treated these figures as estimates, and concluded that: "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."[88] The court then decided that an estimate of quantity was necessary to measure the seller's good faith, but that the estimate in the parties' agreement did not provide the "appropriate yardstick," and chose instead to rely on the testimony given at trial by the seller's president.[89] Despite quoting Comment 3's reference to the parties' right to set their own minimum or maximum quantity limits in open quantity contracts under UCC § 2-306, the court invalidated the parties' minimum quantity provision.[90]

Even Professor Goldberg's suggestion of eliminating UCC § 2-306 from the Code may not be sufficient, however, since courts have also held that the duty of good faith implied in all UCC contracts under UCC § 1-304 would still constrain the ability of the quantity-determining party to increase quantities above the estimated or normal amount even when the parties attempted to avoid the good faith limitation in UCC § 2-306(1) by agreement. For example, in *Lenepe Resources Corp. v. Tennessee Gas Pipeline Co.*,[91] 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. Since the parties had agreed on a quantity term that differed from the "unreasonably disproportionate" quantity limit imposed by UCC § 2-306(1), the court held that this gap-filler provision did not apply. [92] 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. 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 UCC's general good faith provision in UCC § 1-203.[93] 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 of the seller increasing its capacity suggests that under current law, 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 UCC § 1-203.

The Fifth Circuit took a similar position in *Riegel Fiber Corp. v. Anderson Gin Co.,*[94] where the court declined to decide whether the parties' contract to purchase all the cotton produced on certain specified acreage was governed by UCC § 2-306(1), but sustained the contract as

sufficiently definite under UCC § 2-204(3). As in *Lenepe*, the court relied on the Code's general good faith provision, UCC § 1-203, to accomplish a UCC § 2-306(1) result, in this case to make 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.[95] Thus, even if the parties could draft around the "unreasonably disproportionate" limitation on quantities in UCC § 2-306(1), the general good faith provision in UCC § 1-203 would, at least in the Fifth Circuit's view, create the same limitation.

In a case that pre-dated *Lenepe*, *Shea-Kaiser-Lockheed-Healy v. Department of Water and Power of the City of Los Angeles*,[96] the California Court of Appeals took a different approach by applying UCC § 2-306(1) to the parties' requirement 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 20% lower than the estimate.[97] Despite this agreement, the court applied the UCC § 2-306(1) "gap-filler," and held that the buyer had breached the contract by demanding over 20% more than the estimate, on the theory that this demand was "unreasonably disproportionate" to the estimate.[98] 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 UCC § 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."[99] The buyer argued that this definition of what an "estimate" means, and the "unreasonably disproportionate" language of UCC § 2-306(1), had been avoided by contract, since the buyer had specifically stated a different purpose for the estimate when it provided the estimate.[100] The court rejected this argument on the grounds that UCC § 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 the court considered "at issue" in the case.[101] 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 UCC § 2-306(1) is "but a specific application of the obligation of reasonableness running throughout the code."[102] Under this reasoning, it appears unlikely that the court would have ruled in the buyer's favor, regardless of whether the contract expressly stated that there was no upper limit on the maximum quantity of goods the buyer could demand, or even stated a maximum higher than 20%.

Language in the Official Comments to UCC § 2-306(1) and in UCC § 1-203 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 § 2-306(1) or under the general duty of good faith prescribed in UCC § 1-203.[103] The Official Comments to UCC § 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, "Any minimum or maximum set by the agreement shows a clear limit on the intended elasticity."[104] Section 1-302 (b) provides that while the

obligations of good faith and reasonableness implied in all UCC 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." [105] 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 expressly disclaim any duty to run its business to maintain its requirements at "normal" levels, either on the high side or the low side, promise 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 promise to make a minimum payment to the seller if it had no requirements. These terms should satisfy UCC § 1-302(b)[106] 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 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, cases such as *Lenepe, 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 UCC § 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 UCC § 1-304(b) by providing that the good faith standard is satisfied by termination upon notice. If the parties have agreed that either side could 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 fell below the contract price, when another vendor offered discounts or other terms that were more attractive, when the buyer was able to obtain the goods from an affiliate, when the buyer began to produce them in-house, or when the buyer shut down its operations to "curtail losses", as would otherwise be prohibited under Official Comment 2.[107] The implied duty of good faith has no role to play in protecting the reasonable anticipations of the parties under these circumstances, since 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 losses arising from early termination.

This reasoning was adopted by a federal court in Indiana in *Q.C. Onics Ventures, LP v. Johnson Controls, Inc.*[108] 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.[109] The seller's first argument was that because requirements under a requirements contract must be set in good faith under UCC § 2-306(1), the seller was obligated to continue purchasing from the buyer as long as it had requirements.[110] In support, the seller relied on two cases – *General Motors Corp. v. Paramount Metal Products, Co.*[111] and *Plastech Engineered Plastics v. Grand Haven Plastics, Inc.*[112] – discussed below,[113] which hold that requirements contracts are validated by the good faith duty that prevents the buyer from unilaterally terminating the contract.[114] The court in *Q.C. Onics* distinguishing these cases as formation decisions, and held that where the buyer is not relying on a reduction in 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.[115] The problem this 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.[116]

The court in *Q.C. Onics* was also presented with a Michigan decision *Metal One America, Inc. v. Center Mfg., Inc.,*[117] discussed in more detail below[118], 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 the expressly stated right to terminate was not allowed, and it addressed the breach of contract claim without discussing the effect of the termination clause."[119]

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 § 1-203[120] and by the common law.[121] 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, since 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."[122] In reaching this conclusion, the court relied heavily on a Sixth Circuit exclusive dealing arrangement case, *Cloverdale Equip. Co. v. Simon Aerials, Inc.*,[123] which held that, "If

properly bargained for, the right [to terminate a contract] is given full effect and may be exercised for any reason."[124] 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 UCC § 1-304 does not prevent arbitrary termination.[125]

In *Corenswet, Inc. v. Amana Refrigeration, Inc.*,[126] an early case on the subject that has been widely followed,[127] the court dealt with the ban on disclaiming the duty of good faith set forth in UCC § 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.[128] 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.[129] Based on these findings, the lower court held that Amana had violated the general obligation of good faith under UCC § 1-203, despite the contract's language, which allowed Amana to terminate the relationship "at any time and for any reason."[130] 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."[131] The court also held that cases of economic overreaching through the use of unequal bargaining power could be addressed through the unconscionability doctrine, which can be used to override express contract terms.[132]

By enforcing termination clauses freely bargained for by the parties to 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 UCC § 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 UCC § 1-304 cannot be varied by agreement under UCC § 1-302(b).

Part III. Resolving Formation Issues under the Exclusivity Rule, Its Exceptions, and the Code's Duty of Good Faith

With this understanding of the UCC'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 it be used to identify enforceable open quantity contracts and determine when they have been breached?

As to the first issue, 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, since any ascertainable portion of its requirements will serve as well. This section will discuss cases applying the exclusivity rule and its variations, followed by an analysis of the views of commentators and the courts concerning the use of good faith, rather than the exclusivity rule, as a validation device.

A. The Exclusivity Rule

Generally speaking, when the courts refer to the need for exclusivity in requirements contracts, they refer to the buyer's promise to buy exclusively from the seller,[133] since it is this exclusivity that permits the court to determine the quantity term and to ensure that the promise is not illusory.[134] 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 all the goods or services that a seller can supply, so that the seller is necessarily required to sell its goods or supplies exclusively to the buyer.[135] The promise of exclusivity is also used to distinguish an enforceable commitment from a voluntary, albeit long-standing history of exclusive commercial dealings. Reliance on the parties' prior course of dealing may be misleading when trying to identify a valid open quantity contract because a history of exclusive dealing between the parties may reflect the buyer's continued satisfaction with the seller's goods or services rather than the buyer's contractual commitment to purchase the goods or services from the seller.[136] 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."[137]

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.[138] 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 all of its requirements for goods of a particular kind from the seller."[139] One can remove the second element from this definition without changing its substance, since 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.*"[140]

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 seller 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 its requirements from the buyer up to a maximum quantity, at which point it will be free to buy from others. It can be supplied by agreeing that the buyer will buy all its 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 are no doubt endless; the point is that the parties must agree on a method whereby quantity can be identified 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 buyer. Under 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.[141] A closely related contract exists where the buyer agrees to purchase all 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.[142]

One serious downside to using the exclusivity rule as an indispensible 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.,*[143] where 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 in any one year," and that after 1980 the buyer's orders could not be 15% higher or lower than its order the preceding month.[144] 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, so there is no reason to think this quantity limit was arbitrary. Setting the 15% monthly deviation in quantity may well have been used as a way of implementing the language in Official Comment 3 to UCC § 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 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 not a requirements contract, which obligates the buyer to buy all his requirements from the seller."[145] This insistence on adherence to the complete exclusivity rule ignores the case law recognizing requirements contracts that set minimums and maximums quantity limits.[146] It also ignores Official Comment 3 to UCC § 2-306(1), which allows parties to set their own parameters on the limits of what quantities are considered "unreasonably disproportionate" to estimates provided. This decision is particularly useful in highlighting the need to reform the complete exclusivity rule because its author is perhaps one of the most sensitive of our jurists to the benefits of encouraging private parties to draft their contracts in ways that allocate the risks of their business transactions.

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 UCC § 2-306(2) are enforceable based on the dealer's obligation to exercise its "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 void for lack of mutuality unless the buyer is required to sell a specific quantity or meet a quota.[147] 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, since 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 UCC § 2-204(3).[148]

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.*,[149] or the buyer gives the provider, in a service contract, an opportunity to perform before contacting other providers, *Ceredo Mortuary Chapel, Inc. v. U.S.*.[150] In *Porous Media*, for example, 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 quality standards or delivery deadlines.[151] Performance standards such as these impose real restrictions on the buyer's discretion, since the buyer must purchase the goods or services exclusively from the seller unless the seller fails to meet the conditions, thereby satisfying the doctrine of mutuality. The conditions also provide a method for ascertaining quantity sufficient to determine breach and damages, since 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 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.[152] The 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 ascertainable because the buyer promises to buy all its requirements from the seller until it reaches a set maximum, after which the buyer may purchase the goods from other suppliers. If the buyer purchases from other suppliers before it reaches the set maximum, it has breached the contract.

This rule was also used by the Supreme Court of New Hampshire in *PMC Corp. v. Houston Wire & Cable Co.,*[153] a case which has been described by Professor Blair as a "remarkable" example of the enforcement of a non-exclusive open quantity contract.[154] Professor Blair claims that "the court 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."[155] 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 since the example was not present

in the case, the court could not have relied on the exception it articulated.[156] My review of the case suggests that these assertions are at least partially incorrect.

In *PMC Corp.*, the disputed letter agreement contained estimates of Houston's annual requirements for thermocouple products, and stated that Houston intended to purchase the "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.[157] 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, 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.'"[158] 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,"[159] and therefore addresses Professor Blair's concerns.

The court in *PMC Corp.* 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 agreement contained language from which the jury could have determined that Houston agreed "to purchase exclusively from PMC up to a certain quantity," so the jury instructions on requirements contracts were not improper.[160] 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."[161] 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 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, since limitations on the buyer's capacity to satisfy the buyer's requirements will always be an implied exception to the exclusivity rule. In other words, 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 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 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."[162] But if all the buyer promises is to purchase a minimum quantity from the seller, the contract is indistinguishable from a fixed quantity contract. It would therefore be more accurate to say, as the court appears to do in *In re Anchor Glass Container Corp.*,[163] that a purported requirements contract is unenforceable as an indefinite quantity contract if it does not contain a definite minimum quantity amount and does not require the buyer to purchase any ascertainable quantity of goods from the seller.

In the services context, 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 Mortuary Chapel, Inc. v. U.S.*,[164] 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."[165] Even this statement is too definitive, however, since at least one court has enforced indefinite quantity contracts with no stated minimums that are not requirements or output contracts. In *Howell v. U.S.*[166], 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 UCC §2-204 to supply an essential missing term, and on the Restatement (Second) of Contracts § 204 to derive a minimum quantity term that was "reasonable in the circumstances."

If the buyer makes both promises – to purchase all its requirements from the seller and to purchase a minimum quantity – the promise to purchase a minimum quantity would not serve a validation function, but to insure the seller against the risk that the buyer, acting in good faith, will have no requirements. Because the courts are in such disarray concerning the exclusivity rule, even this statement is too definitive. In *Amber Chemical, Inc. v. Reilly Industries, Inc.,*[167] a California federal court held that the exclusivity rule was contrary to UCC § 2-306, but that the requirements contract at issue was supported by consideration because the buyer had promised to purchase a minimum quantity of goods.

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.,*[168] the court entered summary judgment for the seller on the issues of

enforceability and breach when the buyer purchased less than 80-90% of its annual requirements of the specified products as set forth in the parties' agreement.

4. Project Exclusivity

In some jurisdictions, the exclusivity rule has been supplemented by an exception for contracts whereby the buyer promises to purchase all 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 Const. Co.*.[169] 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."[170] 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 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.[171]

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

In *Corning Inc. v. VWR Internat'l, Inc.*,[172] the parties' agreement provided that, "VWR will 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."[173] Corning argued that VWR had agreed to buy all its requirements of reusable glass from Corning except when VWR's Tier II customers asked VWR to fill their orders them from other suppliers.[174] 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 Corp.* 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.[175] 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.[176] In explaining its change of heart, 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."[177] This difficulty was resolved when the memorandum was understood to require VWR to purchase exclusively from Corning for all 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.[178]

Similarly, in *GRM Corp. v. Miniature Precision Components, Inc.*,[179] 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 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 Chrysler's orders to the defendant. The court held that while Michigan law was unsettled on whether exclusivity is 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.[180] Even if Michigan law did not require exclusivity, the parties agreed the seller would supply the buyer with the quantity of products required by Chrysler. Thus, the validation came from a limited exclusivity that the buyer would buy from the seller all 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 would therefore be whether it acted in good faith in doing so.[181]

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

As discussed above, the Official Comments to UCC § 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 to maintain quantities at reasonably foreseeable levels, and do not mention the exclusivity rule.[182] Commentators have advocated that the courts should replace the exclusivity rule with the good faith standard, [183] or with an inquiry into whether the parties intended to enter into a bargain.[184] Professor Blair argues that, for open quantity

contracts, “Courts do not need to find mutuality of obligation, either through exclusivity or good faith.”[185] According to Professor 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.”[186] But this is either a tautology or a rule that is just as exacting as the mutuality doctrine. On the one hand, the problem of contract validation is easy if you define validation as the act of entering into a contract. On the other, Professor Blair emphasizes that for validation, nonexclusive open-quantity agreements must be “the product of true bargaining between the parties,”[187] and that there must be “sufficient evidence” that the contract was “actually bargained for,” indicating that the factfinder must conduct a fact-intensive examination 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. If viewed this way, what is the concept of “bargained for” exchanges but the mutuality doctrine in disguise? It would be difficult to image a requirements contract surviving this “bargained for” test if the seller’s promise to sell the buyer its requirements had not been “bargained for” the reciprocal promise of the buyer to purchase all its requirements from the seller.

Professor Blair also criticizes a Fifth Circuit decision, *Mid-South Packers, Inc. v. Shoney’s, Inc.*[188] for its reliance on the exclusivity rule,[189] when this decision actually provides evidence of why the doctrine of mutuality is of critical importance 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, such as price lists, proposals, or options, and business documents that require the buyer to purchase its requirements exclusively from the buyer, and not from any other source, for duration of the agreement. In *Mid-South*, the businesspeople 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 with 45 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 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 testified, however, that the buyer was free to purchase from other suppliers, and 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 Fifth Circuit held that under the common law and the UCC, “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.”[190] Based on the lack of exclusivity, the court found that the parties’ agreement was a firm offer under UCC § 2-205 rather than a requirements contract.

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. Perhaps the most fundamental 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 that provides an excellent example of this dilemma is *City of Louisville v. Rockwell Mfg. Co.*,[191] a 1973 Sixth Circuit decision 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.[192] Relying on UCC § 2-306(1), the court held that:

> [T]he 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.[193]

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. In *Rockell Mfg.*, the City's promise to purchase "part" of its parking meter requirements from Rockwell could mean anything from one parking meter up to one meter less than the City's total requirements. If the City did not promise to purchase some ascertainable portion of its requirements from Rockwell, its implied duties under UCC § 2-306(1) to demand only reasonably proportionate quantities and to maintain its requirements in good faith do not assist the factfinder in discovering the quantity term agreed upon by the parties or in confirming that the buyer has made a reciprocal promise.

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 requirements from the seller, ascertainable or not. In *General Motors Corp. v. Paramount Metal Products, Co.*[194] the seller moved for summary judgment dismissing the buyer's claims on the grounds that the purchase orders will terminable at will and did not require the buyer to order any seat frames, they were not exclusive, and they became effective only when the buyer issued releases authorizing the seller to build and ship a specific number of seat frames.[195] Without identifying evidence to contradict any of these points, the court denied the buyer's motion on the grounds that UCC § 2-306 rejects the exclusivity rule,[196] and that under Official Comment 2, requirements contracts are validated by the duty of good faith.[197] 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."[198] So without evidence that the buyer had promised to purchase any goods from the seller, the court found that UCC § 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 a quantity commitment.

The Michigan Court of Appeals followed the *General Motors* decision in *Plastech Engineered Plastics v. Grand Haven Plastics, Inc.*,[199] 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.[200] 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' communications.[201] But if the buyer has not undertaken a commitment to purchase all or any portion of its requirements from the seller, as was the case in *Plastech*, it is unclear how the implied duties of good faith that require the buyer to maintain its requirements at foreseeable levels and prevent the buyer from making unreasonably disproportionate demands can make the buyer liable to the seller for any specific quantities.

A buyer should be able to enter into valid requirements contracts with a group of suppliers for a particular product, but there is a better 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.[202] An estimate could be given, if appropriate, but it would not be necessary for enforcement. This form of "exclusivity" would be sufficient to satisfy the mutuality doctrine, since 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 no longer have a device for ascertaining quantity, and cannot determine whether the buyer has committed a breach or award an appropriate remedy. This issue arose in *Orchard Group, Inc. v. Konica Medical Corp.*,[203] a Sixth Circuit case where the court reversed a jury verdict for the plaintiff-buyer. The buyer was a new company with no prior course of dealing with 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 stated that the seller was "pleased to offer these terms in return for a film commitment of 36 mos."[204] Based on the reference in UCC § 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 quantity term – estimate or otherwise – and there is no prior course of dealing from which a quantity term could be implied."[205] 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.[206]

The facts of *Orchard Group* set up Professor Blair's thesis nicely, since the parties' agreement in this case 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 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 the premise of a free enterprise system.[207]

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 Sys. Ltd. v. Unisys Corp,*[208] 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."[209] 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.[210] Thus, the agreement was sufficiently "exclusive" to satisfy the

courts that have required exclusivity as a condition for enforcing requirements contracts, but it was not an "exclusive dealing" arrangement within the meaning of UCC § 2-306(2).

The Third Circuit was correct in *Advent* in finding that the statute of frauds was satisfied, but it has caused considerable confusion by holding that "non-exclusive" requirements contracts automatically satisfy the statute of frauds, since the contract at issue *was* exclusive under the exclusivity rule required for validation. The Fifth Circuit has declined to follow the 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 UCC § 2-201 to require a writing indicating that the quantity term is defined by the buyer's requirements or up to a specified quantity.[211]

Although the Fifth Circuit in *Advent* was willing to go along with Professor Bruckel's recommendation to apply good faith as a substitute for exclusivity in dealing with the statute of frauds defense,[212] the court was unwilling to extend the theory to the defense of indefiniteness under UCC § 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."[213] 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.[214] 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, and concluded by remanding the case with the comment that, "Whether Advent can establish the definiteness required to sustain a remedy is a serious question."[215] Accordingly, while the implied duty of good faith performance was sufficient for statute of frauds purposes, it did not provide a reasonably certain basis for providing a remedy under UCC § 2-204, and the jury was required to determine whether there was evidence in the record sufficient to resolve the indefiniteness problem.[216]

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*,[217] the Sixth Circuit recognized that a requirements contract could be upheld under the Ohio version of UCC § 2–306(1),[218] 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 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. In response, the buyer sent a confirming purchase order calling for a delivery date of

March 1984-"As Released." Noting its prior decision in *City of Louisville*,[219] that a contract to furnish only "part" of the buyer's requirements along with an approximate number of the identified goods is sufficient to be a requirements contract under UCC § 2-306(1), 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."[220] 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.[221]

Part IV. Identifying Enforceable Open Quantity Contracts

Although the exclusivity rule is preferable to the standards of good faith and reasonableness as a validation tool for open quantity contracts, the 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 not an agreement and is essentially meaningless, or the parties entered into an output or requirements contract. But the cases demonstrate that the contested document could be a price list, a proposal, a response to a request for proposals, a letter of intent, a buyer's option or "firm offer" under UCC § 2-205, or a blanket purchase order or master purchase agreement that merely sets out the terms of the parties expected future dealings, but disclaims any liability of the seller for the purchase of any goods. Because courts fail to consider breadth of alternative transactional documents, they often strain to enforce the document as a contract.

Even among the two options courts tend to focus on, the chances are much higher than courts seem willing to acknowledge that business people will engage in prolonged negotiations that do not result in binding agreements. While there is an enormous practical and legal difference between the two scenarios, the documentation is often remarkably similar between the documentation used for: Case 1) the "we'll give you the business" deal, meaning that we will start ordering from you 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.[222] The trick for the seller is to ensure he does not mistakenly enter into a binding requirements contract at overly favorable pricing terms.

In some jurisdictions, the 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,[223] 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,[224] and will reject statute of frauds defenses on any mention of quantity in a writing, no matter how imprecise or uncertain.[225] 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 requirements from the seller, and some basis for awarding a remedy.[226] These discrepancies obviously frustrate one of the principal purposes of the UCC, which is to make the law uniform among the various jurisdictions, UCC § 1-103(a)(3), 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 the courts' assumptions are justifiable based on current law, whether the courts' methods achieve the correct balance between the need for predictable results, for certainty, and for conserving judicial resources against the need for equity in particular circumstances, and whether these methods permit parties, especially buyers, to speculate on litigation outcomes. I will also suggest that a better method for reaching correct and predictable decisions in 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 plain meaning of the contract language. In most cases, this will mean that to create a 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 its promise to purchase all or an ascertainable portion of its requirements from the seller and the seller's obligation to supply those goods to the buyer are conditions to contract formation, and to suspend its own performance if the seller sends an acknowledgement or invoice with contradictory terms.[227]

A. Implied Promises of Exclusivity and Buyer's Options

The buyer's promise of "exclusivity" may be either express or implied.[228] 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 only available from the seller;[229] 2) the contract contains language that for some other reason

suggests that it is a "sole-source" contract;[230] and 3) the contract includes an express promise by the seller to supply all the buyer's requirements and there is evidence that the parties intended to be bound.[231] The reasons for implying a promise of exclusivity in the first two cases are plain enough, 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.* [232]

In *Modern Dairy* [233] the Seventh Circuit reversed a summary judgment ruling for two school districts seeking to recover damages for breach of requirements contracts 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. Without referring to any case law precedents, 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.[234] When the court reviewed the evidence, however, it found that the premise for this inference was missing, concluding that, "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."[235] As options, the contracts were unenforceable because the UCC puts a three-month time limit on firm offers unsupported by consideration, UCC § 2-205, and the common law, though lacking a deadline, also requires consideration.[236] Since neither the intrinsic nor the extrinsic evidence provided a reasonable fact finder with a basis to infer either that the districts made the required promise of exclusivity or that the option was supported by consideration, the court reversed, finding that the districts "lose."[237]

What is interesting in *Modern Dairy,* for our purposes is to examine 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 that, "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."[238] The same logic would apply to the statement that, "A seller would be unlikely to commit to sell to the buyer all its requirements if the buyer had no reciprocal obligation to buy those requirements." The reason this inference is not equally valid is that a seller can commit to sell the buyer all 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 UCC § 2-205. Since this alternative is more than theoretically possible,[239] 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 Indus., Inc. v. General Motors Corp.,* that, "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."[240] Since a buyer's option can be a "binding contract" if consideration is provided, or even without consideration, for three months,[241] such an inference is unfounded.

Several years after *Modern Dairy*, the Supreme Court of Mississippi issued a decision that applied the *Propane Indus.*, 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.*[242] The contract in *G.B.* "*Boots"* provided that the seller would sell the buyer "all fill dirt" for a specific road construction project, provided the price per cubic yard and gave an estimate of the quantity that would be needed. 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 included an implied promise by the buyer to purchase its requirements exclusively from the seller, the court relied on *Propone Indus.*, and found that, "While the contract does not contain the phrase 'buyers agree to buy all fill dirt for the Project,' the wording implied exactly that. There would be no need to 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."[243] 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.

Since the rule that courts may infer a promise from the buyer to purchase its requirements from the seller if the seller has promised to supply them is unsound, and is followed by some courts and rejected by others,[244] it should be given the prompt burial it deserves.

B. Letters of Intent

Courts have also issued inconsistent decisions based on whether or not they enforce the rule that, as with fixed quantity contracts, a buyer's statements of future intent to purchase are not sufficient to constitute a binding agreement to purchase. Those that get it wrong have based the necessary promise of exclusivity from the buyer based on contract language that expresses its future intent to purchase its requirements from the seller, rather than its present agreement to purchase its requirements from the seller, when the same language would be rejected if presented in a preliminary agreement or agreement to agree context. The *PMC Corp.* decision[245] discussed earlier provides one example, where 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."[246] 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 its business" at certain levels.[247]

Similarly, in *Universal Power Systems, Inc. v. Godfather's Pizza, Inc.*,[248] 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 pans), but only its "intention" to use the seller as a supplier. The court relied on the parties' prior course of dealings showing that the seller had been the buyer's sole supplier for the goods for the last three and a half years to provide evidence of the buyer's intent to be bound,[249] and the contract's use of the words "confirm" and "intention" of 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.[250]

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.*,[251], properly concluded that the letters were not binding contracts.[252] In a similar vein, in *Acemco, Inc. v. Ryerson-Tull Coil Processing,*[253] the Michigan Court of Appeals awarded summary judgment for the defendant-seller on a the grounds that the contract lacked mutuality and violated the statute of frauds for lack of a specific quantity term. In *Acemco*, 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."[254] Even if the validation mechanism is modified to cover all agreements that provide a method for determining an ascertainable quantity, the courts must still distinguish between enforceable agreements to purchase goods and unenforceable statements of intention to reach an agreement in the future.

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 any business transactions they may conduct in the future. These documents are often known as "Blanket Purchase Orders" or "Master Purchase Agreements," but I will refer to them collectively as "Term Sheets," 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 provide authorization for expenditures of a maximum amount, provided signed purchase orders are provided, but they do not 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 Term Sheet.

In one set of cases, courts enforce the disclaimers of liability in Term Sheets and find 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 for determination. If the Term Sheet does not contain a disclaimer, but also lacks a promise by the buyer to purchase its requirements from the seller, the courts will either infer a promise by the buyer to purchase its requirements from the seller and enter judgment enforcing the Term Sheet as a requirements contract, or send the case to the jury for a determination of enforceability.

Examples of decisions from courts that enforce disclaimers of liability in Term Sheets include *James L. Gang & Associates, Inc. v. Abbott Laboratories, Inc.*,[255] 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 that stated that, "'Seller understands and agrees that Buyer has made no guarantee or commitment hereunder to purchase any minimum quantity of these Products and that 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.'"[256] The Sixth 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.[257]

In two cases decided by the Seventh Circuit, *Brooklyn Bagel Boys, Inc. v. Earthgrains Refrigerated Dough Products, Inc.*,[258] and *Keck Garrett & Associates, Inc. v. Nextel Communications, Inc.*,[259] the courts strained to interpret Term Sheet with disclaimers as enforceable agreements, even when they correctly find that these documents cannot be enforced as requirements contracts. In *Brooklyn Bagel*, Earthgrains entered into a "Contract Packaging Agreement" (the "Contract") in 1996 with Brooklyn Bagels to supply "ordered quantities" of bagels for Earthgrains' Fort Payne, Alabama facility based on a set price schedule.[260] The contract also provided that Earthgrains would supply a non-binding forecast of its orders every three months and that either party could terminate the Contract on ninety days written notice.[261] In 1997, Earthgrains began installing equipment to manufacture bagels at its Fort Payne facility. When the installation was complete, Earthgrains gave Brooklyn Bagel notice of its intent to terminate the Contract. Upon termination, Brooklyn Bagel sued Earthgrains for breach of contract. The district court granted summary judgment for Earthgrains, finding that the terms of the contract were unambiguous, and did not obligate Earthgrains to purchase its bagel needs from Brooklyn Bagel.[262]

On appeal, Judge Williams held that the 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."[263] Because the Contract did commit the seller to firm prices that could only be changed at six month intervals, it was enforceable under UCC § 2-205, as a buyer's option, "which is enforceable even though Earthgrains made no reciprocal commitment to buy all its bagel needs from Brooklyn Bagel."[264] In support of its 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, "but unless the offer is supported by consideration, it is revocable after three months." [265] As in *Modern Dairy*, Judge Williams should have found that the purported requirements contract was unenforceable as a buyer's option because the parties did not identify any additional consideration that had been provided for the extending the buyer's option beyond the three-month deadline set forth in UCC § 2-205.

Rather than finding that the Contract was an enforceable buyer's option, when it did not qualify as such under UCC § 2-205, 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 Bagels 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 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 "Contract," when each order was placed.[266] Judge Williams noted that this characterization was "consistent with a buyer's option" since the Contract could be viewed as an offer, and each order an acceptance.[267] But the 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 Contract, which was accepted when the goods were shipped, as permitted under UCC § 2-206(b).

In the second case, *Keck Garrett & Associates, Inc. v. Nextel Communications, Inc.*,[268] 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 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.[269] The blanket 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." [270] Four months later, Nextel informed Keck that it would not be using its services for the project.

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."[271] There were no terms in the blanket purchase agreement that required Nextel to assign any work to Keck, that required Keck to perform any services for Nextel or that prohibited Keck from working for Nextel's competitors.[272]

The court's detour into faulty thinking occurred when it responded to Keck's claims that the court's analysis rendered the contract illusory, and that if the contract was unenforceable, Keck would have a claim for quantum meruit.[273] Even though the court had several solid reasons for rejecting Keck's quantum meruit claim, it 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.[274] Neither the purported "guarantee" that Nextel would stand behind estimates of work signed by its representatives or 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 even 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 Keck was entitled to recover in contract on any estimates of work that were submitted by Keck and signed by Nextel. Like *Modern Dairy*, the Term Sheet did not contain a promise from the buyer to purchase any goods or services, and the 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 subsequent documents to understand the total agreement, but one would not conclude that the Term Sheet 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 UCC § 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.*[275] The supplier's representative in *Tingstol* described how such "blanket orders" are used in business: "'[They are] the carrot that [the buyer] waves in front of you. 'This

is what we are 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 their [the buyer's] way out when they want to." [276] Consistent with this testimony, the blanket order expressly limited the buyer's liability to the parts it scheduled for release.[277] The Seventh Circuit correctly held that the blanket order was not a requirements contract because it did not bind the buyer and there was no exclusivity, and that it was not a buyer's option because there was no consideration.[278]

In the opposite camp, the Seventh Circuit issued a decision after *Modern Dairy* and before *Brooklyn Bagels* that is largely irreconcilable with these decisions in *Zemco Mfg., Inc. v. Navistar Internat'l Transportation Corp.*[279] In *Zemco*, the district court held that the parties' contract was not a requirements contract, as a matter of law, because the buyer had not agreed to purchase all 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 obliged to take any goods, the delivery of which has not been specified in such shipping schedules."[280] Although the Seventh Circuit acknowledged this language, the court nevertheless found the contract sufficiently ambiguous to reverse summary judgment,[281] 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.'"[282] 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 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,[283] 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 purchased all its requirements from Zemco for the past twelve years.[284] Indeed, the court distinguished *Modern Dairy* on the grounds that the parties in that case only had a two month history of exclusive dealing.[285] 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 it expressly reserved 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 America, Inc. v. Center Mfg., Inc.*[286] 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.[287] The Center's blanket purchase orders provided that the volumes stated were estimates only and did not constitute a firm commitment.[288] These estimates indicated the number of steel bars the Center predicted it would need for the next few months, but Metal One would never ship any steel until it received a "firm release" from the Center.[289] 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, in part, 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.[290] 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.[291] The court rejected this argument, holding that because the blanket purchase order was a requirements contract, the Center was liable for all the 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,[292] a point I will discuss in more detail in the section on default cases.

The court's interpretation of the blanket purchase orders began with a citation to *General Motors Corp. v. Paramount Metal Products, Co.,*[293] for the proposition that UCC § 2-306 expresses a legislative intent to enforce non-exclusive as well as exclusive requirements contracts.[294] But although the buyer in a non-exclusive requirements contract does not have to promise to purchase all 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 requirement 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 of "hot roll bars" used to make them.[295] 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 used to make them that were held by third-party suppliers for Metal One.[296] 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. The court could not have parsed the language of the contract documents and reached this result. Its approach destroys parties' incentives to bargain for specific risks and rewards. What if Metal One assumed the risk of losing custom inventory beyond the goods covered by the cancellation policy to get the Center's business? That was most likely the case here, since 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, when 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 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 only be liable 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 an ascertainable part 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 its requirements from the seller, one could argue that the disclaimer would be inconsistent with the express promise, since the disclaimer would arguably cover any requirements above those identified in specific purchase orders or releases. I disagree with this position, and suggest that 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."[297] 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, but consists only of 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.

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

As in *Zemco*, courts have also relied on the parties' history of exclusive dealing to enforce Term Sheets as requirements contracts when the only mention of quantity in the Term Sheets 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 R.R. Co.,*[298] for example, 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. 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. After transporting its coal with BN 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. 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 document as a requirements contract.[299]

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 prices, and on the implied promise that the buyer's requirements must be maintained in good faith.[300] 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 KPL might have to ship via a different carrier.[301] 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.[302] 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 whatever position on contract formation that best suits their financial interests.[303]

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.,*[304] 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, since it did not contain a commitment by National Beef to purchase its requirements, or any

specific quantity of goods, from Cryovac. 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. In support, the court relied on *Zemco, Kansas Power* and *O.N. Jonas*[305] as cases in which under similar situations, courts had found that a requirements contract either did exist or there were material issues of fact as to whether a requirements contract existed.[306] But the decisions in *Zemco* and *Kansas Power* were wrongly decided because the buyer in the *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 discount offer. And the decision in *O.N. Jonas* was irrelevant since 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.[307]

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.'"[308] 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 in specific quantities.

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.,*[309] 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.[310] 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 costs. 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. The purchase orders called for shipments to be made pursuant to "release schedules."[311] 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.[312] 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 "supplier agreement" 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

These cases suggest that 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 a Term Sheet is an enforceable requirements contract, based on *Zemco* and *Metal One*, but if market price goes down, they can avoid the contract and take advantage of the low market prices by arguing, based on *Brooklyn Bagel* 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 have been at this game for some time, as the Supreme Court's 1903 decision in *Willard Sutherland & Co. v. United States*[313] will attest. This case provides insight into how the requirement that the buyer promise to purchase its requirements exclusively from the seller, and the mutuality doctrine which inspired it, have been used to defeat such efforts. In *Willard*, the Navy issued a request for bids for all its requirements of coal at ten different ports or stations, including a request for 600,000 tons at Hampton Roads, Virginia at $2.85 per ton. The plaintiff submitted a winning bid for 10,000 tons of the 600,000 ton total. The Navy later advised the plaintiff that its requirements had increased by approximately 10%. 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.

In its decision, the Supreme 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.'"[314] Based on this language, the Supreme Court held that, "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."[315] 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 are not so savvy. In a 2007 case decided by a federal court in Michigan, *Johnson Controls, Inc. v. TRW Vehicle Safety Sys., Inc.,*[316] 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 a standard in the automotive industry,[317] the purchase orders contained prices but no quantities, since the quantities ordered were dependent on GM's production schedule, and would be requested, as needed, in material releases submitted to TRW. Each purchase order expressly incorporated by reference JCs' "Global Terms of Purchase" available on the company's website. 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. 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.[318] The releases were not to be considered separate contracts but were part of the purchase order and were governed by the Global Terms. JC would purchase no more than 100% of its requirements of the supplies.[319]

With its ruling, the court gave JC, the party with all the bargaining power, 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." 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."[320] JC would be in breach, according to the court, if it failed to act in good faith or consistently with commercial standards of fair dealing in ordering parts it was "permitted" to order under this contract.

Even as articulated by the court, and certainly as drafted by JC, the contract was no more than a buyer's option supported by consideration, 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 that 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 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 Sutherland* and it 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.*[321] 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.[322] Their agreement was governed by a Master Services Agreement ("MSA"), a Contract Order with an Attachment A, and an Addendum.[323] 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.[324] 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, and Sprint would "pay for 80,625 productive hours per month" at a set rate.[325] Attachment A provided that poor performance for three consecutive months could result in reduction of the productive hours by 20%, and six months of poor performance allowed Sprint to terminate the contract.[326] 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.[327] Penncro sued for breach on the grounds that its performance did not meet the conditions for termination, and won summary judgment on liability. Sprint went to trial on damages and lost.

On appeal, Sprint argued that the contract was ambiguous as to the quantity of productive hours it was obligated for, 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.[328] The court found that the contract order was an unambiguous agreement to pay for a set capacity, 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 a month.[329] 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.[330] The buyer was therefore required to abide by its express agreement to purchase its full maximum capacity requirements from the supplier.

Part V. 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 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 fact finder 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. Since I advocate eliminating the mandatory rule of good faith, and would allow the parties to set their own upper and lower quantity limits by contract, and use other tools like provisions for termination and liquidated damages to allocate quantity risks, I will examine the duty of good faith cases in order 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 well-studied *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.[331] My own research suggests that there is a great deal of litigation arising from the issue, but few defensible standards. Beginning with *Empire Gas*, Judge Posner articulates a rule under which American Bakeries Company, a buyer who 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. The decision of the buyer's new management in *Empire Gas* that its capital would be better employed in another investment than conversion to the 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.[332] 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 when the buyer had not made the investment in equipment necessary to begin procuring propane when the contract was made, and therefore had no present requirements for the product in its ongoing business, as is normally the case, and when there was no evidence that the seller had incurred any reliance expenses in preparing to perform under the contract.

Using Judge Posner's formulation, "the 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."[333] 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." [334] 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, yet it is also presents a situation where the buyer's central motivation for reducing or eliminating its requirements is a desire to avoid the terms of the contract. 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 as 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."[335] 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."[336] 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 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. For example, is compliance with the contract "unduly costly" if the buyer can no longer cover its variable costs? An issue related to this one was raised by Professor Goldberg in his analysis of the facts of *Feld v. Henry S. Levy & Sons, Inc.,* where he demonstrated that New York's highest court reversed summary judgment on the issue of good faith even though the evidence before the court proved that the contract price would not even cover the quantity-determining party's variable costs, and it would have been cheaper for that party to close the operation.[337] 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.*, demonstrate 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." (emphasis added)[338] The court expressly declined to decide whether any greater obligation was required to satisfy the duty of good faith.[339] 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 that had decided that the company's capital was better allocated to another investment than for the conversion units needed to utilize the seller's propane.[340] This evidence should have satisfied the minimum standard, since the buyer had not entered into a contract to purchase the conversion units, and 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.[341] 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.[342] Either the test is so narrow that it applies in very few cases – perhaps not even in *Empire Gas*, the case in which it was created – or it is so broad that any business justification or 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:

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 need for the seller's goods;

4) the buyer has acquired the equipment to produce the product internally;

5) 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;

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) the buyer has sold its business; or

7) the buyer has gone out of business.

Of these, only the first is expressly allocated to the buyer under a requirements contract when the buyer promises to purchase its requirements from the seller. [343] All the others are based on circumstances that the seller should foresee and be expected to bargain for protections from, since they are not expressly or logically provided for under the bare bones terms of a basic agreement that the buyer will purchase 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 astonishingly 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*,[344] 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" 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 it 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 both foreseeable changes relating to the buyer's management of its business that the seller could protect itself against with the 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, the courts generally find that buyers have acted in bad faith when a corporate reorganization is the reason for their diminished requirements.[345] And both the corporate reorganization and the technological change cases would satisfy Judge Posner's "bad faith" test, since 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*, he 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.[346] According to Judge Posner, the court in *Southwest Natural Gas* held that when the buyer reduced its requirements for gas by 80 percent seven years into a 15 year requirements contract because it purchased a more efficient new boiler, this was a "bona fide" change in the buyer's requirements, since it would have been "unreasonable" to prevent the buyer from replacing its equipment with a modern unit.[347] Unreasonable or not, the seller could certainly argue that the buyer was "having second thoughts about its contract," when it made the decision to buy a more modern replacement boiler that allowed it to avoid its contractual obligation to buy 80 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 in this age of rapid technological advancements.

A special case was nevertheless recognized for technological change in *Indiana-American Water Co., Inc. v. Town of Seelyville*,[348] 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 Natural Gas* that "it is not bad faith to take advantage of a technological advance which reduces the buyer's requirements."[349] 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.*,[350] where the buyer decided to convert its facilities from the use of coal to the newer technology of electricity.[351] 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 Nation Gas* to refrain from installing the most up-to-date replacement boiler? Judge Posner claims that in the *Chalmers & Williams* case no explanation was given for the decision,[352] but the explanation was the same one that motivated the buyer in *Southwest National* – more advanced technology was available. There is no evidence the buyer in *Southwest National* 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 requirements was when the buyer began producing its

own products.[353] As with other applications of the good faith standard to open quantity contracts, the courts' decisions are a model of inconsistency. Courts have permitted this conduct in connection with requirements contracts for services, [354] they have condemned it when the product is produced by the buyer's newly acquired corporate affiliates,[355] and they have reached inconsistent results when the buyer produced the product internally. For example, in *Indiana-American Water Co.,* [356] the court held that the Town of Seelyville, which had a 25-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. Before reaching this result, the court considered *Andersen v. La Rinconada Country Club*,[357] 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.[358] The court distinguished *Anderson* on the grounds that the golf course in that case had to purchase its wellfield, while Seelyville had owned the wellfield before entering into the requirements contract. Applying the *Empire Gas* test, the court held that Seelyville's decision to develop its preexisting wellfield could therefore be viewed as a "legitimate, long-term business decision, and not merely a desire to avoid the terms of its contract with the Water Company."[359] This distinction is unpersuasive, since there was no evidence 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 wellfield in *Anderson*.

The court's attempt to distinguish the case on the grounds that Seelyville's decision was not "*merely* a desire to avoid the terms of its contract with the Water Company," (emphasis added), also suggests that good faith can be established even if the buyer's legitimate business decision has been influenced by impermissible factors. 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 wellfield. 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, the courts appear to have followed, at least to some extent, the distinction made in the Official Comments to UCC § 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.[360] This distinction has been criticized as nonsensical from an economic perspective, [361] 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 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 for a 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 UCC Comment gives the buyer the choice of 1) selling its goods at noncompetitive price 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. Creating such a perverse and useless incentive hardly seems in keeping with the UCC's goal of promoting sound business practices. Some may argue that factors other than price also affect demand, such as a new technology that makes the goods obsolete or less desirable, but even here there is no reason for distinguishing between the 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, the courts have been relatively consistent in sustaining reductions in requirements.[362] 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.[363] In some cases, such as *Brewster of Lynchburg, Inc. v. Dial Corp.,*[364] and *U & W Industrial Supply, Inc. v. Martin Marietta Alumina, Inc.*[365] the 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 had terminated their contracts in good faith. In *NCC Sunday Inserts, Inc. v. World Color Press, Inc.*,[366] 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.[367] 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 proper jury instructions be in 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 fact finder have for such a conclusion? How does the fact finder, 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, Inc. v. Donruss Trading Cards, Inc.,*[368] the plaintiff had a five-year contract to provide graphic arts services to the defendant, a corporation that manufactured and sold sports trading cards. 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. 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. The district court granted the motion, finding that the defendant had acted in good faith. 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."[369] 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 $69,800,000 in 1996.[370] 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. 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 *NCC Sunday Inserts*, in *Schawk*, the defendant admitted that its parent could

have provided the financing necessary to keep it in business, but preferred to use its resources to concentrate on its food packaging businesses.[371]

The primary rationale for the court's opinion in *Schawk* appears to have been its reliance on Judge Posner's "unduly costly" test, stating that, "the 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."[372] 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 there is no reason that the seller in a requirements contract has not 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 America, Inc. v. Center Mfg., Inc.,*[373] 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. As discussed above, 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. After a year and a half of purchasing all its requirements from the seller, the buyer stopped issuing "firm releases" for the steel because it had closed its manufacturing plant. 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.[374] 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 requirements contract, it was no longer economically feasible to run the plant which generated the buyer's requirements. Relying on Official Comment 2 to UCC § 2-306 and the evidence that Sony continued to order steel bars for the 29-inch frames, the court held that, "Because [the buyer] shut down the plant to 'curtail losses,' [the buyer] breached the contract in bad faith as a matter of law."[375]

In a more recent Third Circuit decision, *Norfolk Southern Railway Co. v. Basell USA Inc.,*[376] 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 only discussed good faith as the last of these factors.[377] In *Basell*, the seller had agreed to provide a discount if the buyer used the seller for 95% of its carriage needs, and sued for breach when the buyer used the seller for only 80% of its needs.

The Third Circuit 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."[378] This observation was specifically addressed to the good faith inquiry, which "calls for an evaluation of what motivated [the buyer's] conduct."[379] 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.[380]

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, since 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 courts found these "middleman" contracts illusory.[381] 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 price that will cover its costs. 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,[382] and commentators,[383] see this situation as a ruse, and believe that courts should not allow the buyer go out of business to avoid the contract. If the concern is that the buyer simply reorganizes and continues in the same business with a new supplier, principles of successor liability should be sufficient to address these situations.

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 the requirements. In *Miami Packaging, Inc. v. Processing Systems, Inc.*,[384] Miami, a manufacturer of wax paper products, entered into a 25-year contract to supply Hollymatic, a manufacturer and distributor of food processing equipment and supplies, with all the wax 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. Miami's president admitted that he knew Hollymatic's needs were dependent on production of a new, innovative machine, and that the project might not come to fruition. 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."[385] Despite this evidence, the court denied summary judgment on the issue of Hollymatic's good faith in terminating the requirements contract.

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 to aid [the investor's] interest in [Miami's competitor]," rather than "because of the time delays and cost overruns."[386] Nine months into the contract, an investor who owned one of Miami's competitors had purchased a controlling interest in Hollymatic.[387] 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.[388] 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.[389] 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 be comparable to the narrowest version 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, 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. But 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.[390] 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 exceed any reliance damages they may have incurred in investment specific expenses.[391] Since one of these cases is *Empire Gas*, authored by one of our most preeminent legal economists, Judge Posner, I believe that what we need is not a judiciary with more sophistication in its understanding of economic theory and business transactions, 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 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, are really entering into implicit agreements for the rights the courts give them. If they were given an opportunity to reflect on the matter, would they really agree to ban the buyers from reducing their requirements based on financial losses, no matter how great, as opposed to declining orders, as the Official Comments to UCC § 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 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?

It may be that if businesses and the taxpayers who support our court system had a choice, they would elect to have courts interpret open quantity contracts as promises by the quantity-determining party, the buyer in a requirements contract or the seller in an output contract, not to deal with any other party for all or an ascertainable portion of the identified goods or supplies. The mandatory good faith rule would be replaced with the principle of personal autonomy, under which the parties could protect themselves from all the risks the good faith test was designed for by bargaining for the appropriate contractual provisions, with far more precision and certainty than the good faith standard could ever provide.

Part VI. The Buyer's Option Problem

In *Empire Gas*, Judge Posner asked "a fundamental question . . . in the law of requirements contracts"[392] 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 goods 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 from anyone else and is not acting out of ill will toward the seller?"[393] 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 buyer's 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 50% of its requirements, and the buyer provides consideration for the option, but does not promise to buy any of its requirements from the seller. This case is still distinguishable from a requirements contract because the buyer may chose not to purchase any of its requirements from the seller, and may purchase all of its requirements from other suppliers. In a comparable requirements contract, the buyer would have to buy 50% of its requirements from the seller, and would have a good faith duty in connection with any reduction in its 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 goods from anyone else" as in Judge Posner's question, because in both contracts the buyer can purchase up to 50% of its 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 50% of the buyer's requirements for a set term at the prices stated, and the buyer promises to buy 50% of its requirements from the seller. This arrangement is more than a firm offer under UCC § 2-205, or an offer made irrevocable beyond the three-month period set forth in UCC § 2-205 by the exchange of recited

consideration provided specifically for the option. 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 requirement that the buyer agree to purchase all its requirements from the seller 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, "that the buyer need only refrain from dealing with a competitor of the seller," and concludes that it would still constitute an option. 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."[394] 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 § 2-306 between plant shut downs 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 than the goods to manufacture it.[395] 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*."[396]

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,[397] 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 its competitors' offers 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.

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 particular quantity of goods at a set price until the option expires, and must provide separate consideration for options exceeding three months,[398] but in a requirements contract the buyer promises that it will purchase all or an ascertainable portion of its requirements of the product, if any, from the seller.

Part VII. Proposals for Change

A. A Uniform Rule for Validating Open Quantity Contracts

Based on the foregoing analysis, I have three specific 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 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 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 § 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,"[399] and 4) any other attempts to substitute the common law requirement of exclusivity with the duty of good faith. Since this lack of uniformity has arisen from judicial interpretations of the Code, and the language of UCC § 2-306 does not address the validation issue in any direct or unambiguous manner, courts should be able to remedy the situation without a statutory amendment.

The approach I recommend has been suggested in a number of decisions recognizing exceptions to the exclusivity doctrine but has not been developed or applied as a uniform rule. It would address the doctrines of mutuality and definiteness, provide a flexible method for defining quantities that could be adapted to suit businesses' needs, and give courts grounds for identifying breach and awarding damages. It would also give the seller in requirements contracts assurance that the buyer has made a commitment to buy an identifiable quantity of goods in exchange for the buyer's promise to hold its terms open for the duration of the contract. At its core, the key to this "modified" exclusivity rule is an attempt to satisfy the mutuality and definiteness requirements for contract formation by requiring that the buyer promise 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 from the seller, and, for an outputs contract, the seller is

obligated to sell all or an ascertainable portion of its output 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 its requirements from the seller, that the buyer will purchase all its requirements needed to fill the orders of particular customers from the seller, or that it will purchase all its 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 its requirements from the seller up to a maximum amount, after which it will be free to obtain its requirements from other sources, and the buyer will pay the seller for a minimum quantity to cover its 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 its 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) a Term Sheet 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 Term Sheet to indicate that the buyer agrees to purchase all or an identifiable portion of its requirements from the seller for the duration of the Term Sheet; 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 itself to purchasing an identifiable quantity of goods, given the many other, equally plausible explanations of the nature of the parties' relationship. The party in the best position to solve the ambiguity, at the lowest cost, is the buyer. The buyer can state, in either the Term Sheet or its individual purchase order or release, that its promise to purchase all or an identifiable portion of its requirements from the seller and the seller's obligation to supply those goods to the buyer are conditions to contract formation, and to suspend its own performance if the seller sends an acknowledgement or invoice with contradictory 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. A buyer that is unwilling to state expressly in the parties' contract that it is making a commitment to purchase its requirements from the seller should not have the benefit of the ambiguity it has created, given the costs to the judicial system, to the seller, and to our system of commerce, which relies on the ability of third parties such as creditors to obtain some understanding of contracts based on their plain meaning.

C. A New Version of UCC § 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 one would require a statutory change, since the common law duty of good faith in open quantity contracts has now been adopted by the UCC. While one can argue that the duty of good faith under UCC § 2-306(1) should be applied as a default rule, so that statutory change would not be necessary, the success of this argument appears doubtful, since courts apply the duty to all requirements and output contracts, regardless of how carefully parties attempt to allocate the quantity risks by agreement. I therefore propose replacing the current mandatory 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 § 2-306(1) to incorporate my first two changes to the current law would read:

> 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 § 2-306(1), there would be no breach of an open quantity contract for outputs 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 outputs to or purchasing requirements from third parties. There is no need to revise UCC § 2-306(2), since the "best efforts" standard in that section would no longer create a conflict with the good faith standard under UCC§ 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 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 outputs contract, if the contract states that the buyer will buy all of the seller's output of product A at facility B, the buyer will not be able to claim breach if the seller stops producing the product A at facility B 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, since the idea is that the party that does not determine quantity assumes the risk it 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 include "field of use" or customer restrictions in the contract. For example, in a case such as *Orange & Rockland Utilities, Inc. v. Amerada Hess Corp.*,[400] where the court found that the defendant-utility had acted in bad faith by taking advantage of rising market prices to purchase large quantities of gas to resell to new utility customers which had not been included in the calculations for the estimates in the contract, defined as "non-firm" customers, the seller could have protected itself by limiting the contract to the buyer's requirements for sale to its "firm" customers. 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 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 the buyer is stockpiling goods, or ordering 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, since courts already use the doctrine of good faith to prevent buyers from demanding more quantities than are justified by their current needs.[401]

While somewhat less common, courts have suggested that the same upper quantity limits will also be placed on output contracts.[402] Here, the danger of speculative conduct could be prevented by using provisions stating that the seller will only tender outputs 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.*[403] 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 another type of contract to cover its 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 purchase order for that inventory. Or, a buyer's option could be entered, for consideration, with a termination date that equals the inventory period.

Conclusion

The UCC § 2-306(1) approach 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 outputs contracts must be run to generate acceptable orders or supplies. Under the Official Comments to UCC § 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 "stated estimate," or the "normal" or "comparable" quantities. Too little attention has been paid to whether the costs are worth the price 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. In open quantity contracts that give one party control over the

quantity term, both sides should be perfectly sensible of 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 requirement or supply 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 analyzing the law of contract in the context of the "efficient breach," making sure not to punish parties for their intent, with the goal of increasing economic welfare, its seems incongruous for courts to attempt to distinguish between cases when parties are failing to perform a contract for "valid business reasons" unrelated to 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 acts in bad faith by closing its business after incurring millions of dollars in losses, is ample evidence of the need for change.[404]

Unlike other areas of law, the law of contract should give private parties the ability to write the rules, to a considerable extent, that will govern any disputes that may later land them in court. In a broader sense, a social bargain is struck in contract, whereby the courts, supported by tax dollars, that must also pay for resolving 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, who advise parties on how to draft their agreements. The private parties may then rely on counsel to be guided by the courts' decisions 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 not be litigated because one side will be able to convince the other of the probable outcome of litigation given the legal 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 is a description of utopia, you may say, but it is nevertheless what society arguably has a right to expect from its legal system when it comes to the law of contract and what a legal system should strive to provide. While rigid formalism certainly has its defects, and should be modified with equitable exceptions to achieve just results, when every case is evaluated by such a highly subjective, fact intensive standard as "good faith," the balance has tipped too far and adjustment is needed.

One might argue that without the good faith standard as a validating principle, the court will not recognize agreements that the parties intended to be binding, simply because they did not add the "magic words" indicating that the buyer was agreeing to purchase a quantifiable amount of goods or services from the seller. But I believe that the distinction between a case in which the

parties intended to enter into a binding contract, and one in which the parties committed themselves to buy and sell a quantifiable number of items is a false one. In a sale of goods, what does it mean to say, "We intend to enter into a binding contract for the sale of goods, despite the fact that if one of us disappoints the other, and we seek relief in court, the court would have no reliable way, even after expending extensive resources, to determine whether the buyer promised to purchase any goods, and if so, in what quantity." As long as we are speaking of contracts courts are expected to enforce, we should not enforce them where the parties do not take even minimal steps towards facilitating their enforcement, regardless of the parties' desire that they be enforced.[405] Unlike other terms, such as price and delivery, quantity cannot be supplied with a gap filler without any evidence of the parties' agreement, since even UCC § 2-306(1) would not assist the court in determining, for example, whether the parties had agreed upon an output as opposed to a requirements term. We should not tolerate the externalities created by frivolous and preventable litigation arising from contracts intentionally drafted with such ambiguities to create strategic opportunities based on the rise and fall of the market price for the goods under contract.

If parties expect their contracts to be enforced by the courts, they should be encouraged to draft them using plain language that demonstrates the buyer's commitment to purchase the desired goods or services and provides some method of ascertaining the quantity of goods or services involved so that if a dispute should arise, the court can determine breach and award damages. This is the bargain, as it were, between business entities and the courts. Courts have limited, publicly-provided resources with which to decide these private disputes, and should not be expected to spend these resources by parsing limitless amounts of extrinsic evidence to decide the meaning of the parties' contracts. In addition, the error rate may actually be increased by extensive and costly reliance on extrinsic evidence. When the judge or the jury must chose from competing "private language" versions of a term, some of which may be based on purported trade usage, backed by rival experts, and by contrary evidence contained in the parties' prior course of dealing, in prior drafts of the document, or in their course of performance, the room for error is arguably far greater than it would be when relying on the dictionary or plain meaning of a term.[406]

I suggest that a balance must be struck between law and equity, that a dialectic is constantly being played out in the courts between the two, and that a readjustment is needed based on the current application of the doctrine of good faith to open quantity contracts. When the balance tips too far on the side of equity, people lose faith in the law's consistency, predictability and evenhandedness. At that point, the law has lost legitimacy and a great deal of its utility for society, and a corrective adjustment is long overdue.

End Notes

[1] Visiting Assistant Professor, Florida State University of Law. Columbia University School of Law, 1988, J.D. I would like to thank Donald R. Cassling for his comments.

[2] *See e.g., Keck Garrett & Associates, Inc. v. Nextel Communications, Inc.*, 517 F.3d 476 (7th Cir. 2008); *Propulsion Technologies, Inc. v. Attwood Corp.*, 369 F.3d 896, 904 (5th Cir. 2004); *Brooklyn Bagel Boys, Inc. v. Earthgrains Refrigerated Dough Products, Inc.*, 212 F.3d 373 (7th Cir. 2000); *In re Modern Dairy of Champaign, Inc.*, 171 F.3d 1106 (7th Cir. 1999); *Merritt-Campbell, Inc. v. RxP Products, Inc.*, 164 F.3d 957 (5th Cir. 1999); *Orchard Group, Inc. v. Konica Medical Corp.*,135 F.3d 421 (6th Cir. 1998); *Essco Geometric v. Harvard Industries*, 46 F.3d 718 (8th Cir. 1995); *Advanced Plastics Corp. v. White Consolidated Indus., Inc.*, No. 93-2155, 1995 U.S.App. LEXIS 1047 (6th Cir. Jan. 18, 1995); *Advent Sys. Ltd. v. Unisys Corp.*, 925 F.2d 670, 671, 680 (3rd Cir. 1991) (reversing jury verdict on requirements contract and requiring jury to determine, on retrial, whether contract was sufficiently definite to be enforced); *Mid-South Packers, Inc. v. Shoney's, Inc.*, 761 F.2d 1117, 1120-21 (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 Services, Inc.*, 502 F. Supp. 2d 1170 (D. Kan. 2007) (holding that for a requirements contract to be valid under Kansas law, the buyer must promise to buy the goods exclusively from the seller); *Boydstun Metal Works, Inc. v. Cottrell, Inc.*, 519 F. Supp. 2d 1119 (D. Or. 2007) (refusing to recognize a requirements contract because the buyer retained the right to purchase the goods from other manufacturers); *TVI, Inc. v. Infosoft Technologies, Inc.*, 2007 WL 3565208 at *7 (E.D. Mo. 2007); *In re Anchor Glass Container Corp.*, 345 B.R. 765 (M.D. Fla. 2006); *Embedded Moments, Inc. v. International Silver Co.*, 648 F. Supp. 187, 192 (E.D.N.Y. 1986); *Arrotin Plastic Materials v. Wilmington Paper Corp.*, 865 N.E.2d 1039, 1042 (Ind. Ct. App. 2007); *Billings Cottonseed, Inc. v. Albany Oil Mill, Inc.*, 173 Ga. App. 825, 328 S.E.2d 426 (1985); *Integrated Micro Systems, Inc. v. NEC Home Electronics (USA), Inc.*, 174 Ga. App. 197, 329 S.E.2d 554 (1985).

[3] *See e.g., Norfolk Southern Railway Co. v. Basell USA Inc.*, 512 F.3d 86 (3d Cir. 2008); *Brewster of Lynchburg, Inc. v. Dial Corp.*, 33 F.3d 355 (4th Cir. 1994); *U & W Industrial Supply, Inc. v. Martin Marietta Alumina, Inc.*, 34 F.3d 180 (3d Cir. 1994); *Empire Gas Corp. v. American Bakeries Co.*, 840 F.2d 1333 (7th Cir. 1988); *Sourcecorp BCS, Inc. v. Kenwood Records Management, Inc.*, ___ F. Supp.2d ___, 2008 WL 1922987 (S.D. Iowa 2008); *Vulcan Materials Co. v. Atofina Chemicals Inc.*, 355 F. Supp. 2d 1214 (D. Kan. 2005); *Metal One America, Inc. v. Center Mfg., Inc.*, 2005 WL 1657128 (W.D. Mich. 2005); *MDC Corp. v. John H. Harland, Co.*, 228 F. Supp. 2d 387 (S.D.N.Y. 2002); *Sea Link Int'l, Inc. v. Osram Sylvania, Inc.*, 969 F. Supp. 781, 784 (S.D. Ga. 1997); *Trimed, Inc. v. Sherwood Medical Co.*, 772 F. Supp. 879 (D. Md. 1991); *NCC Sunday Inserts, Inc. v. World Color Press, Inc.*, 759 F. Supp. 1004 (S.D.N.Y. 1991); *Schawk, Inc. v. Donruss Trading Cards, Inc.*, 319 Ill. App. 3d 640, 651, 746 N.E.2d 18, 27 (1st Dist. 2001); *Indiana-American Water Co., Inc. v. Town of Seelyville*, 698 N.E.2d 1255 (Ind. Ct. App. 1998).

[4] Victor P. Goldberg, *Discretion in Long-Term Open Quantity Contracts: Reining in Good Faith*, 35 U.C. Davis Law Review 319, 347-366 (January, 2002).

[5] The following decisions have defined requirements contracts as those in which the seller has agreed to provide, and the buyer has agreed to buy exclusively from the seller, a quantity of goods to be measured by the buyer's actual requirements during the period of the contract. *Simmons Foods, Inc. v. Hill's Pet Nutrition, Inc.*, 270 F.3d 723 (8th Cir. 2001); *Porous Media Corp. v. Midland Brake, Inc.*, 220 F.3d 954 (8th Cir. 2000); *Brooklyn Bagel Boys, Inc. v. Earthgrains Refrigerated Dough Products, Inc.*, 212 F.3d 373 (7th Cir. 2000) (holding 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); *Zemco Mfg., Inc. v. Navistar Intern. Transp. Corp.*, 186 F.3d 815 (7th Cir. 1999) (stating that a

requirements contract is one in which the purchaser agrees to buy all of its needs for a specified material exclusively from a particular supplier and the supplier agrees in turn to fill all of the purchaser's needs during the period of the contract); *Merritt-Campbell, Inc. v. RxP Products, Inc.*, 164 F.3d 957 (5th Cir. 1999); *Essco Geometric v. Harvard Industries*, 46 F.3d 718 (8th Cir. 1995) ; *Modern Sys. Technology v. U.S.,* 979 F.2d 200, 206 (Fed. Cir. 1992) ("Thus, an essential element of a requirements contract is the promise by the buyer to purchase the subject matter of the contract exclusively from the seller."); *Harvey v. Fearless Farris Wholesale, Inc.*, 589 F.2d 451, 461 (9th Cir. 1979) ("It is elementary that a requirements contract is one in which the buyer 'expressly or implicitly promises he will obtain his goods or services from the (seller). Exclusively.'" quoting *Bank of America Nat'l. Trust & Savings Ass'n v. Smith*, 336 F.2d 528, 529 n. 1 (9th Cir. 1964) (emphasis added)); *Fisherman Surgical Instruments, LLC v. Tri-anim Health Services, Inc.*, 502 F. Supp. 2d 1170 (D. Kan. 2007) (holding that for a requirements contract to be valid under Kansas law, the buyer must promise to buy the goods exclusively from the seller); *Boydstun Metal Works, Inc. v. Cottrell, Inc.*, 519 F. Supp. 2d 1119 (D. Or. 2007) (refusing to recognize a requirements contract because the buyer retained the right to purchase the goods from other manufacturers); *Pepsi-Cola Co. v. Steak 'N Shake, Inc.*, 981 F. Supp. 1149 (S.D. Ind. 1997); *Industrial Specialty Chemicals, Inc. v. Cummins Engine Co.,* 902 F. Supp. 805, 810 (N.D. Ill. 1995) ("However, requirements contracts must be exclusive to be enforceable-that is, the purchaser must agree to buy all of its requirements from the seller."); *Propane Indus., Inc. v. General Motors Corp.*, 429 F. Supp. 214 (W.D. Mo. 1977); *Upsher-Smith Laboratories, Inc. v. Mylan Laboratories, Inc.*, 944 F. Supp. 1411 (D. Minn. 1996); *Indiana-American Water Co., Inc. v. Town of Seelyville*, 698 N.E.2d 1255 (Ind. Ct. App. 1998); *Stacks v. F & S Petroleum Co., Inc.*, 641 S.W.2d 726, 727 (Ark. Ct. App. 1982); *Kirkwood-Easton Tire Co. v. St. Louis County*, 568 S.W.2d 267 (Mo. 1978) (recognizing rule without specific reference to § 2–306); *United Services Auto Ass'n v. Schlang*, 111 Nev. 486, 894 P.2d 967 (1995); *Wilsonville Concrete Products v. Todd Bldg. Co.*, 281 Or. 345, 574 P.2d 1112 (1978); *United Services Auto Ass'n v. Schlang*, 111 Nev. 486, 894 P.2d 967 (1995).

[6] *See e.g.*, E. Allan Farnsworth, Farnsworth on Contracts § 2.15, at 81-82; 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, 119 (4th ed. 1995).

[7] *See Amber Chemical Inc. v. Reilly Industries, Inc.,* 2007 WL 512410 at *8 (E.D. Cal. 2007); *Plastech Engineered Plastics v. Grand Haven Plastics, Inc.*, 2005 WL 736519 at *5 (Mich. Ct. App. 2005); *General Motors Corp. v. Paramount Metal Products, Co.,* 90 F. Supp. 2d 861 (E.D. Mich. 2000); *Hoover's Hatchery, Inc. v. Utgaard*, 447 N.W.2d 684, 688 (Iowa Ct. App. 1989). *See also* 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 (1983); Travis W. McCallon, *Old Habits Die Hard: The Trouble with Ignoring Section 2-306 of the UCC*, 39 Tulsa L. Rev. 711 (2004).

[8] See *infra* Part III(B).

[9] *See infra* notes 23-24, 40.

[10] *See infra* notes 23-24, 40.

[11] 840 F.2d 1333, 1334-35 (7th Cir. 1988).

[12] Professor Blair has provided a thorough description of the history of these cases in "*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, 75-84 (2006).

[13] 37 Seton Hall L. Rev. 67, 88-94 (2006).

[14] 37 Seton Hall. L. Rev. 67 88 n. 89.

[15] This definition of a requirements contract as a buyer's agreement to purchase its requirements, if any, exclusively from the seller, without a good faith duty to maintain any requirements, has been adopted in a few decisions. In a Code-era case, *City of Lakeland v. Union Oil Co.*, 352 F. Supp. 758 (M.D. Fla. 1973), 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 (1935), and on a section from Corbin on Contracts, where the contract left the buyer free to purchase as much or as little of the goods as it may "capriciously desire," but was bound to purchase any of the goods it did desire from the seller. *Id.* at 764-65. The court did not rely on buyer's implied duty of good faith duty to maintain its requirements to sustain the contract, but on the pre-Code *Jenkins* case validating as supported by sufficient consideration, "'Agreements 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 v. City Ice & Fuel Co.,* 160 So. 215, 218 (1935). This view was echoed by even more explicit comments from Professor Corbin, stating that in such a promise, the buyer does not undertake to "continue in business on its present scale or even run a business at all." *Id.* at 766, quoting 1A Corbin, Contracts, § 156, p. 33 (1963). The consideration that saves the contract is this: "The promise contains one very definite element that specifically limits the promisor's future liberty of action; he definitely promises that he will buy of no one else." *Id.*

[16] 174 N.Y. 331, 66 N.E. 967 (N.Y. Ct. App. 1903).

[17] 174 N.Y. at 333.

[18] *Id.*

[19] *Id.* at 333-34.

[20] *Id*. at 335-36.

[21] *Id.*

[22] *Id.* at 335.

[23] *Id.*

[24] 174 N.Y. 334.

[25] 174 N.Y. at 335.

[26] *See e.g., Fort Wayne Corrugated Paper Co. v. Anchor Hocking Glass Corp.*, 130 F.2d 471, 473 (1942).

[27] *See HML Corp. v. General Foods Corp.*, 365 F.2d 77, 81 (3d Cir. 1966).

[28] 365 F.2d at 81.

[29] Section 2-306(1) of the UCC provides: "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."

[30] *See* Linda J. Rusch, 1 Hawkland UCC Series § 2-306:3 ("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.").

[31] *See* 3 Williston on Contracts § 7:12 (4th ed. May 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.").

[32] Professor Blair writes that, "Section 2-306, however, makes no reference to, and certainly does not require, exclusivity as a prerequisite to the validation of open-quantity agreements." 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. "*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, 98 (2006).

[33] For example, in *Integrated Micro Systems, Inc. v. NEC Home Electronics (USA), Inc.*, 174 Ga. App. 197, 329 S.E.2d 554 (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.' " 2 Anderson, Uniform Commercial Code § 2-306:9 at 513, 514 (3rd ed. 1982) . . .OCGA § 11-2-306." *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.").

[34] 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."

[35] In *General Motors Corp. v. Paramount Metal Products, Co.,* 90 F. Supp. 2d 861 (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.* at 873-74. *See also Amber Chemical Inc. v. Reilly Industries, Inc.,* 2007 WL 512410 at *8 (E.D. Cal. 2007) (concluding that the rule of exclusivity is contrary to the plain language of UCC § 2-306 because it provides that a requirements contract can be provided either under UCC § 2-306(1), without exclusivity, or under UCC § 2-306(2), in the form of an exclusive dealing arrangement); *Plastech Engineered Plastics v. Grand Haven Plastics, Inc.*, 2005 WL 736519 at *5 (Mich. Ct. App. 2005) (reasoning that since UCC 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 Third Circuit also appears to have confused the meanings of the terms in *Advent Sys. Ltd. V. Unisys Corp.*, 925 F.2d 670, 671, 680 (3rd Cir. 1991), where a computer manufacturer entered into a distribution agreement to sell the buyer its 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 and software licenses to others. The court correctly recognized that this language kept the contract from being one of "exclusive dealing" within the meaning of UCC § 2-306(2), so that the "best efforts" required when the buyer is the only distributor of the seller's product do not apply, 925 F.2d at 679, but went further, and found that it also made the contract a "non-exclusive" contract within the meaning of UCC § 2-306(1) for "good faith" requirements contracts. This raised a question as to whether the statute of frauds could be satisfied with a contract containing a "non-exclusive" requirements term for the quantity, since prior law had only recognized a statute of frauds exception for "exclusive" requirements contracts under UCC § 2-306, and the seeming breakthrough of the court's decision to apply the exception to a "non-exclusive contract." Viewed more straightforwardly, 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.

[36] *See* E. Farnsworth, Contracts §2.15 at 82 n.1(4th ed. 2004) ("As 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 UCC 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")."

[37] As the court explained in *Tigg Corp. v. Dow Corning Corp.*, 962 F.3d 1119, (3d Cir. 1992):

> This obligation [the best efforts obligation under UCC 2-306(2)] is intended to protect the original seller, who in an exclusive arrangement depends solely upon the buyer to resell the goods. *See Wood v. Lucy, Lady Duff-Gordon,* 222 N.Y. 88, 118 N.E. 214 (1917). 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 arrangement makes the seller as subject to the decisions of the buyer as a subsidiary within the buyer's firm.

[38]*See Gestetner Corp. v. Case Equipment Co.,* 815 F.2d 806, 811-812 (1st Cir. 1986) (affirming a directed verdict for the seller enforcing a requirements contract despite the absence of a specific quantity term based on evidence that the parties' contract was an exclusive dealer arrangement).

[39] 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 § 2-306, exclusivity was not a prerequisite to a valid requirements contract. 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, together with Official Comments on the differences between the two sections. *Id.*

[40] *See supra* note 3. Outputs contracts are also still held illusory and unenforceable, despite adoption of the good faith stand in for the quantity term in UCC § 2-306(1), where the seller is not required to sell the product on an exclusive basis to the buyer, but is left with discretion as to how much or how little it will sell to the buyer. *See Arrotin Plastic Materials v. Wilmington Paper Corp.,* 865 N.E.2d 1039, 1042 (Ind. Ct. App. 2007).

[41] 865 N.E.2d 1039, 1042 (Ind. Ct. App. 2007).

[42] *See Zemco Mfg., Inc. v. Navistar International Transportation Corp.,* 186 F.3d 815, 817 (7[th] Cir. 1999); *Riegel Fiber Corp. v. Anderson Gin Co.*, 512 F.2d 784, 789 (5[th] Cir. 1975); *Gestetner Corp. v. Case Equip. Co.*, 815 F.2d 806, 811 (1[st] Cir. 1987).

[43] Even courts that claim to accept the proposition that the exclusivity rule has been replaced by the "good faith" standard under UCC § 2-306(1),for output and requirements contracts continue to invalidate open quantity contracts on the grounds that the buyer is not obligated to purchase goods from the seller under the terms of the contract. *See United Services Auto Ass'n v. Schlang*, 111 Nev. 486, 894 P.2d 967, 971-72 (Nev. 1995) (reversing finding that a valid requirements contract had been reached and holding that "there is no basis for the implication of a reciprocal promise by either party," and that, "We must therefore conclude that no valid requirements contract existed. . ").

[44] *Empire Gas Corp.,* 840 F.2d at 1337-39.

[45] UCC § 2-306(1).

[46] *Empire Gas Corp.,* 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 § 2-306(1) to the jury verbatim, given its literal meaning. 840 F.2d 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 chance the buyer may be exploiting opportunities created by rising prices to resell the seller's goods. 840 F.2d 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.

[47] Official Comment 2 to UCC § 2-306.

[48] Official Comment 3 to UCC § 2-306.

[49] *Id.*

[50] Official Comment 2 to UCC § 2-306.

[51] *See, e.g., Empire Gas Corp.*, 840 F.2d at 1338.

[52] In the following cases, the courts have held that under UCC § 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: *Brewster of Lynchburg, Inc. v. Dial Corp.*, 33 F.3d 355 (4th Cir. 1994); *Atlantic Track & Turnout Co. v. Perini Corp.*, 989 F.2d 541, (1st Cir. 1993) (output contract case); *Empire Gas Corp. v. American Bakeries Co.*, 840 F.2d 1333, 1339-40 (7th Cir. 1988); *Godchaux-Henderson Sugar Co., Inc. v. Dr. Pepper-Pepsi Cola Bottling Co. of Dyersburg, Inc.*, 772 F.2d 906 (6th Cir. 1985); *Angelica Uniform Group, Inc. v. Ponderosa Systems, Inc.*, 636 F.2d 232 (8th Cir. 1980); *R. A. Weaver and Associates, Inc. v. Asphalt Const., Inc.*, 587 F.2d 1315 (D.C. Cir. 1978); *G.D. Searle & Co. v. Fisons Corp.*, 1993 WL 54535 (N.D. Ill. 1993); *Northern Indiana Public Service Co. v. Colorado Westmoreland, Inc.*, 667 F. Supp. 613, 636 (N.D. Ind. 1987), *judgment aff'd without opinion*, 845 F.2d 1024 (7th Cir. 1988); *Tennessee Valley Authority v. Imperial Professional Coatings*, 599 F. Supp. 436 (E.D. Tenn. 1984) (applying UCC

§ 2–306 to a federal requirements contract); *Indiana-American Water Co., Inc. v. Town of Seelyville*, 698 N.E.2d 1255 (Ind. Ct. App. 1998).

[53] *See State of Washington Dept. of Fisheries v. J-Z Sales Corp.*, 610 P.2d 390, (Wash. App. 1980) (holding that 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).

[54] *See Shea-Kaiser Lockheed Healy v. Dept. of Water and Power of the City of Los Angeles*, 73 Cal. App. 3d 679 (Cal. App. Ct. 1977); *Orange & Rockland Utilities, Inc. v. Amerada Hess Corp.*, 59 A.D.2d 110, 116 (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 § 2-306(1)).

[55] *Empire Gas Corp.*, 840 F.2d at 1338 ("The proviso thus seems to have been designed to explicate the term 'good faith' rather than to establish an independent 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.").

[56] Official Comment 2 to UCC § 2-306 ("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.").

[57] *See Simcala, Inc. v. American Coal Trade, Inc.*, 821 So. 2d 197, 201-202 (Ala. 2001) (holding that under the clear language of UCC § 2-306(1) the drafters intended that buyers were not entitled to increase *or* reduce their requirements to a level that was unreasonably disproportionate to a stated estimate regardless of their good faith); *Orange & Rockland Utilities, Inc. v. Amerada Hess Corp.*, 59 A.D.2d 110, 115 (N.Y. App. Div. 1977) (stating that, since 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); *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).

[58] 821 So. 2d 197, 203 (Ala. 2001).

[59] *See Empire Gas Corp.*, 840 F.2d at 1337 ("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," citing, Weistart, *Requirements and Output Contracts: Quantity Variations under the UCC*, 1973 Duke L.J. 599, 640-41).

[60] Victor P. Goldberg, *Discretion in Long-Term Open Quantity Contracts: Reining in Good Faith,* 35 U.C. Davis Law Review 319, 347 (January, 2002) ("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.")

[61] *See City of Lakeland v. Union Oil Co.*, 352 F. Supp. 758, 762 (M.D. Fla. 1973); *Orange & Rockland Utilities, Inc.*, 59 A.D.2d at 116.

[62] *See Orange & Rockland Utilities, Inc.*, 59 A.D.2d at 116.

[63] *See Gestetner Corp. v. Case Equipment Co.,* 815 F.2d 806, 811 (1st Cir. 1987) ("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.'")(citations omitted). *See also*, *Bloor v. Falstaff Brewing Corp.*, 601 F.2d 609 (2d Cir. 1979); *Feld v. Henry S. Levy & Sons, Inc.*, 37 N.Y.2d 466, 373 N.Y.S.2d 102, 335 N.E.2d 320 (1975).

[64] A related observation was made in *Schawk, Inc. v. Donruss Trading Cards, Inc.,* 319 Ill. App. 3d 640, 651, 746 N.E.2d 18, 27 (1st Dist. 2001), where the court noted, "Absent 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."

[65] *See e.g.*, *Central States Power & Light v. United States Zinc. Co.,* 60 F.2d 832, 833-34 (10th Cir. 1932); *Metal One America, Inc. v. Center Mfg., Inc.*, 2005 WL 1657128 (W.D. Mich. 2005); *NCC Sunday Inserts, Inc. v. World Color Press, Inc.,* 759 F. Supp. 1004 (S.D.N.Y. 1991); *Feld v. Henry S. Levy & Sons, Inc.,* 335 N.E. 2d 320 (N.Y. 1975); *407 E. 61st Garage, Inc. v. Savoy Fifth Ave., Corp.,* 244 N.E.2d 37 (N.Y. 1968); *Wigand v. Bachmann-Bechtel Brewing Co.,*118 N.E. 618 (N.Y. 1918); UCC § 2-306, Official Comment 2.

[66] Such a disclosure may be required, for example, under 15 U.S.C.A. § 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--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. . ."

[67] There can be little doubt that the drafters of the Code intended to subject exclusive dealing agreements under UCC § 2-306(2) to the good faith obligations set forth in UCC § 2-306(1) given Official Comment 5, which states that "An exclusive dealing agreement brings into play all of the good faith aspects of the output and requirements problems of subsection (1)."

[68] Williston explains that, "Since, 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." 3 Williston on Contracts § 7:12 (4th ed. May 2008). Several courts have held that the best efforts obligation for exclusive dealing requirements and outputs contracts constitutes a different, and more exacting standard, than the duty of good faith. *See* footnote 63, *infra*.

[69] The relevant portion of the Official Comments states as follows: "Under this Article, a contract for output or requirements is not too indefinite since it is held to mean the actual good faith output or requirements of the particular party. Nor does such a contract lack mutuality of obligation since, 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." Official Comment 2 to UCC § 2-306.

[70] *Id.*

[71] *See* discussion *supra* at 8, footnote 30. [Linda J. Rusch, 1 Hawkland UCC Series § 2-306:3]

[72] 925 S.W.2d 565 (Tex. Sup. Ct. 1996).

[73] *Id.*

[74] Restatement (Second) of Contracts § 33(2).

[75] *Empire Gas Corp. v. American Bakeries Co.*, 840 F.2d 1333, 1339 (7th Cir. 1988).

[76] UCC § 2-103(1)(j); UCC § 1-201-(b)(20).

[77] *Id.*

[78] 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 rule is that the buyer has acted in bad faith by demanding greater quantities than those estimated or previously ordered. *See supra*, n. 57

[79] *See Zemco Mfg., Inc. v. Navistar Internat'l Trans. 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 (5th Cir. 1975).

[80] *See e.g., Miami Packaging, Inc. v. Processing Sys., Inc.*, 792 F. Supp. 560, 562-563 (S.D. Ohio 1991); *Schawk, Inc. v. Donruss Trading Cards, Inc.,* 746 N.E.2d 18, 20, 25 (Ill. Ct. App. 2001).

[81] *See Simmons Foods, Inc. v. Hill's Pet Nutrition, Inc.*, 270 F.3d 723, 727 (8th Cir. 2001)("Where 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 Products, 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).

[82] *See Zemco Mfg., Inc. v. Navistar Internat'l Trans. 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 (5th Cir. 1975); *Lenepe Resources Corp. v. Tennessee Gas Pipeline Co.*, 925 S.W.2d 565 (Tex. Sup. Ct. 1996).

[83] *See* Professor Victor Goldberg's discussion of representative cases, *Utah Internat'l, Inc. v. Colorado-Ute Elec. Ass'n, Inc.*, 425 F. Supp. 1093 (D. Colo. 1976), *City of Lakeland, Florida v. Union Oil Co.*, 352 F. Supp. 758 (M.D. Fla. 1973), and *Orange and Rockland Utilities, Inc. v. Amerada Hess Corp.,* 59 A.D.2d 110 (N.Y. App. Div. 1977), in Victor P. Goldberg, *Discretion in Long-Term Open Quantity Contracts: Reining in Good Faith,* 35 U.C. Davis Law Review 319, 367-375 (January, 2002).

[84] Victor P. Goldberg, *Discretion in Long-Term Open Quantity Contracts: Reining in Good Faith,* 35 U.C. Davis Law Review 319 (January, 2002). Since Professor Goldberg believes deleting Section 2-306(1) "is not about to happen," he proposes a number of new comments to the provision. These comments would retain the full exclusivity rule to satisfy the mutuality doctrine ("It is now 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." *Id.* at 381), which I believe is unnecessary. 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 them the court may not interpret the contract as a requirements contract.

[85] 986 F. Supp. 723 (E.D.N.Y. 1997).

[86] 986 F. Supp. at 728.

[87] *Id.* at 726.

[88] *Id.* at 730.

[89] *Id.*

[90] *Id.* at 728.

[91] 925 S.W.2d 565 (Tex. Sup. Ct. 1996).

[92] 925 S.W.2d at 570. An agreement that the buyer would purchase 100% 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 § 2-306(1) gap-filler.

[93] 925 S.W.2d at 571.

[94] 512 F.2d 784, 790 (5th Cir. 1975).

[95] *Id.* at 790 n. 14.

[96] 73 Cal. App. 3d 679 (Cal. Ct. App. 1977).

[97] *Id.* at 685 n.4.

[98] *Id.* at 688-89.

[99] *Id.* at 688.

[100] *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: "'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.*

[101] *Id.* at 687.

[102] *Id.*

[103] UCC § 1-304 (2001) ("Every contract or duty within [the Uniform Commercial Code] imposes an obligation of good faith in its performance and enforcement.").

[104] UCC § 2-306, Official Comment 2.

[105] UCC § 1-302(b) (2001).

[106] *Id.*

[107] Official Comment 2 to UCC § 2-306.

[108] 2006 WL 1722365 (N.D. Ind. 2006) at *4.

[109] *Id.* at 3-4.

[110] *Id.* at 7.

[111] 90 F. Supp. 2d 861 (E.D. Mich. 2000).

[112] 2005 WL 736519 at *5 (Mich. Ct. App. 2005).

[113] *See* discussion *infra* at 33-34.

[114] *Id.* at *7-8.

[115] *Id.*

[116] Official Comment 2 to UCC § 2-306.

[117] 2005 WL 1657128 (W.D. Mich. 2005).

[118] *See* discussion *infra* at 45.

[119] *Id.* at 8.

[120] UCC § 1-203 is the pre-2001 version of UCC § 1-304.

[121] *Id.* at 6.

[122] *Id.* at 6-7.

[123] 869 F.2d 934, 938 (6th Cir. 1989).

[124] 2005 WL 736519 at *6.

[125] *See Cloverdale Equip. Co. v. Simon Aerials, Inc.*, 869 F.2d 934, 938 (6th Cir. 1989); *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 § 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 § 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 § 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 distribution agreement allowing termination by either party with 60 days notice would not be interpreted as requiring good cause based either on the common law or the UCC implied duty of good faith absent evidence of unequal bargaining power and that the "the U.C.C. good faith provision may not be used to override explicit contractual terms"); *Blalock Machinery and Equipment 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. Companies*, 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 § 1-203, limits an express contractual right of termination). *Contra, Valley Liquors, Inc. v. Renfield Importers, Ltd.*, 822 F.2d 656, 670 (7th Cir. 1987) (affirming summary judgment dismissing breach of contract claim on the grounds that 27-year distributorship could be modified and narrowed under 10-day notice to terminate clause where distributor had not presented evidence to support an inference of bad faith, 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 dismissal on summary judgment of suit for wrongful exercise of termination clause under dealership agreement where 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").

[126] 594 F.2d 129, 131 (5th Cir.), *cert. denied,* 444 U.S. 938 (1979).

[127] *See Grand Light & Supply Co. v. Honeywell Co.*, 771 F.2d 672, 679 (2d Cir. 1985); *Cardinal Stone Co. v. Rival Mfg. Co.*, 669 F.2d 395, 396-97 (6th Cir. 1982); *Blalock Machinery and Equipment Co. v. Iowa Mfg Co.,* 576 F. Supp. 774, 777 (N.D. Ga. 1983) (following *Corenswet* to affirm defendant-buyer's motion for summary judgment in suit for wrongful termination of 27-year distributorship agreement where distributor argued that manufacturer violated UCC's implied duty of good faith by exercising express right to terminate under the agreement).

[128] 594 F.2d at 138 n. 10.

[129] *Id.* at 133.

[130] *Id.* at 135-36.

[131] *Id.* at 138.

[132] *Id.* at 138-39.

[133] *See Willard, Sutherland & Co. v. U.S.*, 262 U.S. 489, 493 (1923); *In re Anchor Glass Container Corp.*, 345 B.R. 765, 770 (M.D. Fla. 2006); *Mattei v. Hopper,* 51 Cal.2d 119, 330 P.2d 625, 626 (1958).

[134] *See e.g., Fisherman Surgical Instruments, LLC v. Tri-Anim Health Serv., 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. International Silver Co.*, 648 F. Supp. 187, 192 (E.D.N.Y. 1986)(holding that contract lacking a promise that buyer would buy exclusively from the seller, and leaving the buyer free to purchase from other suppliers was unenforceable as a requirements contract, noting that even plaintiff's representative recognized it as an option contract).

[135] *See Arrotin Plastic Materials v. Wilmington Paper Corp.*, 865 N.E.2d 1039, 1042 (Ind. Ct. App. 2007) (affirming summary judgment that contract was an illusory indefinite quantity contract rather than a valid output contract where nothing in the document indicating 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 100% of a seller's output, as long as the quantity term is sufficiently ascertainable to satisfy the definiteness doctrine. *See, e.g.*, *Southwest Dairy Products, Co. v. Coffee & Moore*, 62 F.2d 174 (5th Cir. 1932) (holding that output contract for all the dairy's milk production up to a maximum of 150 gallons of per day was not void for lack of mutuality); *The American 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); *Lenepe Resources Corp. v. Tennessee Gas Pipeline Co.*, 925 S.W.2d 565 (Tex. Sup. Ct. 1996) (enforcing contract requiring buyer to "take or pay" for 85% of plaintiff's gas capacity); *Fort Hill Lumber Co. v. Georgia-Pacific Corp.*, 493 P.2d 1366, 1368 (Sup. Ct. Or. 1972) (holding that contract that buyer would purchase all hemlock timber located in stated area provided a quantity term that was sufficiently definite for enforcement).

[136] *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(1) (N.J. Sup. Ct. 1976). *See generally* 2 Anderson, Uniform Commercial Code, §§ 2-306:9-2-306:12 (3d Ed. 1982).

[137] *Billings Cottonseed, Inc. v. Albany Oil Mill, Inc.*, 328 S.E.2d 426, 429-30 (Ga. Ct. App. 1985), citing *Harvey v. Fearless Farris Wholesale, Inc.*, 589 F.2d 451 (9th Cir. 1979). *See also Omega Engineering, Inc. v. Eastman Kodak Co.*, 908 F. Supp. 1084, 1091 (D. Conn. 1995) (holding that 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).

[138]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 that, "Mutuality of obligation as 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," quoting, *McCandless v. Schick,* 85 Idaho 509, 380 P.2d 893, 898 (1963)). *Id.* at 460 n.12.

[139] *Zemco Mfg., Inc. v. Navistar Internat'l Transportation, Corp.,* 186 F.3d 815, 817 (7th Cir. 1999), *citing* James J. White & Robert S. Summers, *Uniform Commercial Code* § 3-9, at 154-55 (1995); *see also* E. Allan Farnsworth, *Farnsworth on Contracts* § 2-15, at 135-37 (1990).

[140] *Id.* (emphasis added).

[141] *See O.N. Jonas Co., Inc. v. Badische Corp.*, 706 F.2d 1161 (11th Cir. 1983).

[142] *See Fisherman Surgical Instruments, LLC v. Tri-Anim Health Services, Inc.*, 502 F. Supp. 2d 1170 (D. Kan. 2007).

[143] 879 F.2d 1518, 1520 (7th Cir. 1989).

[144] *Id.* at 1520.

[145] *Id.* at 1521. Judge Posner was concerned, it seems, that the seller was not willing to sell the buyer all its requirements, no matter how great, even at a higher price. This logic seems to contradict the notion of unreasonably disproportionate demands that are too high, however, a concern that Judge Posner believes warrants an asymmetrical reading of UCC § 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 "Looked 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 holds that the buyer can reduce his requirements to zero as long as it acts in good faith. 840 F.2d at 1521.

[146] *See e.g. U & W Industrial 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); *Brooklyn Bagel Boys, Inc. v. Earthgrains Refrigerated Dough Products, Inc.*, 212 F.3d 373 (7th Cir. 2000).

[147] *See Ryan v. Wersi Electronics GmbH and 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 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."); *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 Section 2-306(1), and was not unenforceable for indefiniteness due to 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).

[148] *See TAS Distributing Co. v. Cummins Engine Co.*, 491 F.3d 625 (7th Cir. 2007).

[149] 220 F.3d 954 (8th Cir. 2000).

[150] 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).

[151] *Porous Media Corp.*, 220 F.3d at 960. *Cf. Polyad Co. v. Indopco, Inc.*, Slip Copy, 2007 WL 2893638 (N.D. Ill. 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).

[152] *See Merritt-Campbell, Inc. v. RxP Products, 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 Indiana-American 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 its needs for water from the seller up to one million gallons per day, and permitting 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." 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.* In support, 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 buyer's entire requirements or its requirements up to a specified amount.

153 797 A.2d 125 (N.H. 2002).

154 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, 71(2006).

155 Blair, 37 Seton Hall L. Rev. at 112-113.

156 *Id.* at 113.

157 797 A.2d at 128-29.

158 797 A.2d at 130, quoting J. White & R. Summers, Uniform Commercial Code § 3-9, at 156.

159 Blair, 37 Seton Hall L. Rev. at 113.

160 *Id.* Interestingly, 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. Since this instruction fairly presented the law concerning the exclusivity rule, it was not erroneous. *Id.*

161 797 A.2d 125, 131.

162 212 F.3d 373, 379 (7th Cir. 2000). *See also Slocomb Indus., Inc. v. Chelsea Indus.,* 1983 WL 160582, *4 (E.D. Pa. 1983) (rejecting statute of frauds defense to contract that defined quantity as the buyer's requirements with minimum purchases of $500,000).

163 345 B.R. 765, 770-71 (M.D. Fla. 2006) ("When there is nothing in a writing which requires a party to take, or limits its demand to, any ascertainable quantity, a contract is not enforceable for lack of consideration and mutuality. In contract parlance, this type of contract may be referred to as an indefinite quantities contract. The Amended Agreement is tantamount to an indefinite quantity supply contract, since it contains no definite minimum purchase amount and Encore was clearly free to purchase nothing from CPI and Anchor.").

164 29 Fed. Cl. 346 (1993).

165 *Id.* at 349.

[166] 51 Fed. Cl. 516, 523 (Ct. Cl. 2002).

[167] 2007 WL 512410 *8 n.1 (E.D. Cal. 2007).

[168] 2006 WL 2573136 at *4-6 (D.S.C. 2006).

[169] 43 F.2d 309 (5th Cir. 1930).

[170] *Id.* at 311.

[171] *See Century Ready-Mix Co. v. Lower & Co.,* 770 P.2d 692, 694 (Wyo. 1989) (holding that the statute of frauds was satisfied by subcontractor's purchase order referring to concrete to be delivered "as called for" for the project of expanding a high school); *Maryland Supreme Corp. v. The Blake Co.,* 279 Md. 531, 369 A.2d 1017 (1977) (written phrases "for the above mentioned project" and "throughout the job" were sufficient quantity terms); *Port City Const. Co., Inc. v. Henderson*, 48 Ala. App. 639, 266 So. 2d 896 (Ala. Civ. App. 1972) (holding that a contract to furnish "all concrete for slab" was sufficient to enforce a requirements contract).

[172] 2007 WL 841780 (W.D.N.Y. 2007).

[173] *Id.* at *1.

[174] *Id.*

[175] *Id.* at *6.

[176] *Id.*

[177] *Id.* at *6-7.

[178] *Id.* at *6. *See also Indiana-American Water Co., Inc.*, 698 N.E.2d at 1260 (noting that a requirements contract is illusory and unenforceable without a guaranteed minimum quantity that the buyer must purchase from the seller).

[179] 2008 WL 82224 (E.D. Mich. 2008).

[180] *Id.* at *5-6.

[181] *See also Trimed, Inc. v. Sherwood Medical 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 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 customer's orders for that particular brand from the seller).

[182] *See* discussion *supra* in Part II(A). At least one court has relied on the Official Comments to find that the duty of good faith provides a basis for validating output and requirements agreements while also interpreting UCC § 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 § 2-306(1) defines requirements contracts as contracts under which the buyer agrees to purchase all 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.

[183] 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 (1983).

[184] Travis W. McCallon, *Old Habits Die Hard: The Trouble with Ignoring Section 2-306 of the UCC*, 39 Tulsa L. Rev. 711, 733 n. 191 (2004); 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, 110 (2006).

[185] 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, 110 (2006).

[186] *Id.* at 125.

[187] *Id.* at 115.

[188] 761 F.2d 1117, 1120-21 (5th Cir. 1985).

[189] 37 Seton Hall L. Rev. at 99.

[190] *Id.* at 1120.

[191] 482 F.2d 159 (6th Cir. 1973). *See also Hoover's Hatchery, Inc. v. Utgaard*, and 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).

[192] *Id.* at 164.

[193] *Id.*

[194] 90 F. Supp. 2d 861 (E.D. Mich. 2000).

[195] *Id.* at 873.

[196] *Id.* at 864 ("The state 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.").

[197] *Id.* at 873.

[198] *Id.*

[199] 2005 WL 736519 at *5 (Mich. Ct. App. 2005).

[200] *Id.* at *2, *6.

[201] 2005 WL 736519 at *7.

[202] Although the issue in this case was breach, rather than formation, the parties in *Fort Wayne Corrugated Paper Co. v. Anchor Hocking Glass Corp.*, 130 F.2d 471, 473 (1942) entered into requirements contracts whereby the buyer agreed to purchase not less than 75% of its requirements of glass containers from the seller, and estimated that

its requirements would not exceed 800 carloads a year. Similarly, in *HML Corp. v. General Foods Corp.*, 365 F.2d 77, 79 (3d Cir. 1966), the buyer agreed to purchase 75% of its salad dressing requirements from the seller, and a cap was placed on buyer's requirements of 5,000 gallons per day.

[203]135 F.3d 421 (6th Cir. 1998).

[204]135 F.3d at 423.

[205]135 F.3d at 428.

[206]*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.*

[207] 788 F.2d 456, 461 (7th Cir. 1986).

[208] 925 F.2d 670, 671, 678 (3rd Cir. 1991).

[209] 925 F.2d at 674.

[210] 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, rather than generically. 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.

[211] *See FFP Marketing Co. v. The Medallion Co.*, 31 Fed. Appx. 159 n. 2 (5th Cir. 2001).

[212] 925 F.2d at 679, citing, 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 (1983).

[213] 925 F.2d at 679.

[214] *Id.* at 672.

[215] *Id.* at 680.

[216] It is important to note here that other Circuits have interpreted the statute of frauds, UCC § 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." In *Nora Beverages, Inc. v. Perrier Group of America, Inc.*, 164 F.3d 736, 749 (2d Cir. 1998), the Second Circuit reversed summary judgment and held that the statute of frauds under UCC § 2-201 was satisfied by a writing stating a requirements range because the agreement could be enforced for the minimum quantity stated.

[217] 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 § 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 s 28-2-306 cannot stretch the statute to make such a one-sided [non-exclusive] executory agreement enforceable.").

[218] Ohio Rev. Code Ann. § 1302.19(A) (West 2001).

[219] 482 F.2d 159 (6th Cir. 1973).

[220] 892 F.2d at 467.

[221] *See Detroit Radiant Products Co. v. BSH Home Appliances Corp.*, 473 F.3d 623 (6th Cir. 2007).

[222] *See* discussion *infra* of *Tingstol Co. v. Rainbow Sales Inc.*, 218 F.3d 770, 773 (7th Cir. 2000), at 44.

[223] *See Universal Power Sys., Inc. v. Godfather's Pizza, Inc.,* 818 F.2d 667, 670-71 (8th Cir. 1987); *Kansas Power & Light Co. v. Burlington N. Ry. Co.*, 740 F.2d 780, 788-89 (10th Cir. 1984).

[224] *See Zemco Mfg., Inc. v. Navistar Internat'l Trans. Corp.*, 186 F.3d 815, 817-818 (7th Cir. 1999); *Cryovac Inc. v. Pechiney Plastic Packaging, Inc.*, 430 F. Supp. 2d 346, 360 (D. Del. 2006).

[225] 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 buyer's needs at 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 failed to mention 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.").

[226] *See Propulsion Technologies, Inc. v. Attwood Corp.*, 369 F.3d 896, 904 (5th Cir. 2004) (holding that 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 Marketing Co. v. The 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); *Zayre Corp. v. S.M. & R. Co., Inc.*, 882 F.2d 1145 (7th Cir. 1989) (affirming summary judgment under UCC§ 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); *Merritt-Campbell, Inc. v. RxP Products, 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); *Cardiovascular Services, Inc. v. W. Houston Health Care Group, Inc.,* No. 01-94-01075, 1995 WL 523615 at *6 (Tex. App. Sept. 7, 1995)) (same); *Robart Mfg. Co. v. Loctite Corp.,* 1986 WL 893 at *8 (N.D. Ill. 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.").

[227] *See* UCC § 2-207, Official Comment 2.

[228] *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).

[229]*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 Co., Inc. v. Badische Corp.*, 706 F.2d 1161 (11th Cir. 1983) (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 trademarked 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).

[230]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).

[231] *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. Kansas Power & Light Co.,* 9 P.2d 675, 679 (Kan. Sup. Ct. 1932), *Hutchinson Gas & Fuel Co. v. Wichita Natural Gas Co.,* 267 F. 35, 39 (8th Cir. 1920), *Cold Blast Transp. Co. v. Kansas City Bolt & Nut Co.*, 114 F. 77, 81 (8th Cir. 1902); *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."). *Compare Brem-Rock, Inc. v. Warnack*, 624 P.2d 220 (Wash. App. Ct. 1981) (finding an implied agreement by the buyer to purchase all 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).

[232]171 F.3d 1106 (7th Cir. 1999).

[233] *Id.*

[234] *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, [citations omitted], and the inference would be compelling if the contracts forbade the districts to turn elsewhere for milk.")

[235] *Id.*

[236] *Id.* at 1109-1110.

[237] *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."

[238] *Id.* at 1108.

[239] *See* Travis W. McCallon, *Old Habits Die Hard: The Trouble with Ignoring Section 2-306 of the UCC,* 39 Tulsa L. Rev. 711, 733 n. 191 (2004) ("A requirements-type contract wherein a buyer/offeree purports to provide consideration beyond its promise to buy goods, however, is scarce at best."). Such consideration was provided by the buyer in *Merritt-Campbell, Inc. v. RxP Products, Inc.*, 164 F.3d 957 (5th Cir. 1999), a case in which the buyer claimed the contract reciting consideration of $10 paid to guarantee a price for five years was a requirements agreement, but the court found it was an options agreement, which was void under the UCC statute of frauds for lack of a written quantity term . 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 and exchange on fair terms within a reasonable time." Restatement (Second) Contracts § 87 (1979).

[240] *Propane Indus., Inc. v. General Motors Corp.*, 429 F. Supp. 214, 219 (W.D. Mo. 1977), citing *City of Holton v. Kansas Power & Light Co.,* 9 P.2d 675, 679 (Kan. Sup. Ct. 1932); *Hutchinson Gas & Fuel Co. v. Wichita Natural Gas Co.,* 267 F. 35, 39 (8th Cir. 1920); *Cold Blast Transp. Co. v. Kansas City Bolt & Nut Co.*, 114 F. 77, 81 (8th Cir. 1902).

[241] UCC § 2-205.

[242] 860 So. 2d 774 (Sup. Ct. Miss. 2003).

[243] *Id.* at 778.

[244] 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 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 as to any such obligation. 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 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 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. *See also Dedoes Indus., Inc. v. Target Steel, Inc.,* 2005 WL 1224700 (Mich. App. 2005) (reversing denial of summary judgment and remanding for entry of judgment for defendant, holding that three-year price guarantee indicating the defendant would satisfy plaintiff's steel needs, under which 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. App. 2008). *Contra Hutchinson Gas & Fuel Co. v. Wichita Natural Gas Co.,* 267 F. 35, 39 (8th Cir. 1920); *Cold Blast Transp. Co. v. Kansas City Bolt & Nut Co.*, 114 F. 77, 81 (8th Cir. 1902); *Propane Indus., Inc. v. General Motors Corp.*, 429 F. Supp. 214, 219 (W.D.

Mo. 1977); *City of Holton v. Kansas Power & Light Co.,* 9 P.2d 675, 679 (Kan. Sup. Ct. 1932);.*Brem-Rock, Inc. v. Warnack*, 624 P.2d 220 (Wash. App. Ct. 1981)

[245] *PMC Corp. v. Houston Wire & Cable Co.*, 797 A.2d 125 (N.H. 2002).

[246]797 A.2d at 127.

[247] *Id.*

[248] 818 F.2d 667 (8th Cir. 1987).

[249] *Id.* at 669.

[250] *Id.* at 671.

[251] 863 N.E.2d 503, 507 n. 3 (Mass. 2007).

[252] 863 N.E.2d at 513 (citations omitted). *See also Quality Croutons, Inc. v. George Weston Bakeries, Inc.,* Slip Copy, 2008 WL 373181 (N.D. Ill. Feb. 12, 2008) (holding that letter of intent stating that it would "confirm" the buyer's "intention" to enter a contract whereby seller would be the buyer's exclusive supplier for three years was not enforceable, despite evidence that buyer proceeded to purchase exclusively from seller under purchase orders for the next year and a half, where the letter of intent contained a provision indicating that parties would not be bound unless they entered into a written agreement).

[253] 2008 WL 140982 (Mich. App. Ct. 2008).

[254] *Id.* (emphasis added).

[255] 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).

[256] 198 S.W.3d at 437.

[257] *See Urban Assocs., Inc. v. Standex Electronics, Inc.*, 216 Fed. Appx. 495, 496 (6th Cir. 2007); *Advanced Plastics Corp. v. White Consolidated Indus., Inc.*, No. 93-2155, 1995 U.S. App. LEXIS 1047 (6th Cir. Jan. 18, 1995); *Precision Rubber Products 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).

[258] 212 F.3d 373, 379 (7th Cir. 2000).

[259] 517 F.3d 476 (7th Cir. 2008).

[260] 212 F.3d at 375-76.

[261] *Id.*

[262] *Id.* at 376-77.

[263] *Id.* at 378.

[264] *Id.* at 379.

[265] *Modern Dairy*, 171 F.3d at 1110.

[266] 212 F.3d at 379 n.4.

[267] *Id.*

[268] 517 F.3d 476 (7th Cir. 2008).

[269] *Id.* at 480.

[270] *Id.*

[271] 517 F.3d at 485.

[272] *Id.*

[273] *Id.* at 486. Keck claimed that it incurred $145,000 in investment specific sunk 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.

[274] *Id.* at 486.

[275] 218 F.3d 770, 773 (7th Cir. 2000).

[276] *Id.* at 773.

[277] *Id.* at 772.

[278] *Id.* at 773. ("Because it did not bind UTA and there was no element of exclusivity, the blanket order was not a requirements contract.").

[279] 186 F.3d 815 (7th Cir. 1999).

[280] *Id*. at 817.

[281] In finding an 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.* at 817. The court also relied on a provision stating that the seller would give the buyer's orders priority under UCC § 2-615, as creating additional ambiguity, but 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.*

[282] *Id.*

[283] *Id.* at 817.

[284] *Id.* at 817.

[285] *Id.* at 817 n.3.

[286] 2005 WL 1657128 (W.D. Mich. 2005).

[287] 2005 WL 1657128 at *1.

[288] *Id.* at *2.

[289] *Id.* at *1-2.

[290] *Id.* at *2.

[291] *Id.* at *7.

[292] *Id.*

[293] 90 F. Supp. 2d 861, 873 (E.D. Mich. 2000).

[294] 2005 WL 1657128 at *5.

[295] *Id.* at *5.

[296] *Id.*

[297] *Sea Link Int'l, Inc. v. Osram Sylvania, Inc.,* 969 F. Supp. 781, 784-85 (S.D. Ga. 1997).

[298] 740 F.2d 780 (10th Cir. 1984).

[299] *Id.* at 789-90. The court also relied on the letter's provision stating that, "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, however, 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.

[300] *Id.* at 789.

[301] *Id.* at 789, n.3

[302] The key to the decision is most likely an internal memo from BN referring to the alleged letter agreement, which stated that, "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.

[303] *See* George S. Geis, *An Embedded Options Theory of Indefinite Contracts*, 90 Minn. L. Rev. 1664, 1669 (June, 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.").

[304] 430 F. Supp.2d 346, 359-60 (D. Del. 2006). I was one of the trial attorneys who represented the defendant, Pechiney Plastic Packaging, Inc. in this matter.

[305] *O.N. Jonas Co. v. Badische Corp.*, 706 F.2d 1161 (11th Cir. 1983).

[306] 430 F. Supp.2d at 360.

[307] 706 F.2d at 1165.

[308] 430 F. Supp.2d at 360.

[309] 473 F.3d 623, 631-32 (6th Cir. 2007).

[310] 473 F.3d at 625.

[311] *Id.*

[312] *Id.* at 625-26.

[313] 262 U.S. 489 (1923).

[314] 262 U.S. 493. (emphasis in original)

[315] *Id.*

[316] 491 F. Supp.2d 707 (E.D. Mich. 2007).

[317] For an 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).

[318] 491 F. Supp. 2d at 710.

[319] *Id.*

[320] *Id.* at 719 (emphasis added). The court noted that the parties past dealing "may" indicate a requirements contract, but mentioned no actual evidence. The court also stated that there was conflicting evidence of whether JC's contract with its own customer required it to buy the product from TRW. 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.* at 720.

[321] 499 F.3d 1151 (10th Cir. 2007).

[322] *Id.* at 1152.

[323] *Id.*

[324] *Id.*

[325] *Id.*

[326] *Id.* at 1153.

[327] *Id.* at 1154.

[328] 499 F.3d at 1158.

[329] *Id.* at 1158. The court noted, however, that Sprint could have contested liability on the grounds that Penncro failed to maintain staffing at the required level, but 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.

[330] *Id.* at 1159.

[331] *Empire Gas Corp. v. American Bakeries Co.*, 840 F.2d at 1340.

[332] *Id.* at 1340.

[333] *Id.* at 1340-41.

[334] *Id.* at 1340. In the following cases, the courts found that the general test 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 merely 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.*, 319 Ill. App. 3d 640, 746 N.E.2d 18, 24 (1st Dist. 2001); *Abrasive-Tool Corp.. v. Cystic Fibrosis Foundation*, 1991 WL 97445 at *4 (W.D.N.Y. 1991); *Indiana-American Water Co., Inc.*, 698 N.E.2d at 1261; *Northern Nat. Gas Co. v. Conoco, Inc.*, 986 S.W.2d 603, 608 (Tex. 1998), *reh'g of cause overruled*, (Apr. 1, 1999).

[335] 840 F.2d at 1340.

[336] *See Empire Gas,* 840 F.2d at 1340.

[337] *See,* 35 U.C. Davis Law Review 319, 353 (January, 2002), discussing *Feld v. Henry S. Levy & Sons, Inc.*, 335 N.E. 2d 320 (N.Y. 1975).

[338] *Id.* at 1341.

[339] *Id.*

[340] *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.").

[341] *Id.* at 1335.

[342] 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.

[343] This would not be true of course, in those jurisdictions that sustain requirements contracts that do not contain promises from the buyer to purchase its requirements from the seller, and rely solely on the buyer's implied duty of good faith to maintain its requirements at foreseeable levels.

[344] 1991 WL 97445 (W.D.N.Y. 1991).

[345] 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 acquiror 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 contract's silence on successor liability or buyer's duty to ensure successor liability.

[346] 102 F.2d 630 (10th Cir. 1939) (holding that buyer did not act in bad faith when it reduced its requirements for gas by 80% by replacing its old boiler with a more efficient, modern unit).

[347] 840 F.2d 1340.

[348] 698 N.E.2d 1255 (Ind. Ct. App. 1998), citing *Southwest Natural Gas Co. v. Oklahoma Portland Cement Co.*, 102 F.2d 630 (10th Cir. 1939).

[349] *Id.* at 1261.

[350] 218 Ill. App. 363 (1920) (holding that it was a breach to cease purchasing coal under its requirements contract when it converted its facilities from the use of coal to electricity).

[351] 840 F.2d at 1339-40.

[352] *Id.* at 1340.

[353] *Id.* at 1339.

[354] 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. U.S.*, 151 Ct. Cl. 262, 266-67, 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 (ASBCA 1984) (holding enforceable an agreement to provide services beyond those which government could provide for itself); *Maya Transit Co.*, 75-2 BCA ¶ 11,552 at 55,125, 1975 WL 1551 (ASBCA 1975) (same); *Alamo Automotive Services, Inc.*, 1964 BCA ¶ 4354 at 21,043, 1964 WL 306 at *5 (ASBCA 1964) (same).

[355] *See infra* note 347 and discussion of *Miami Packaging, Inc. v. Processing Systems, Inc.,* 792 F. Supp. 560 (S.D. Ohio 1991), at 62.

[356] 698 N.E.2d 1255 (Ind. Ct. App. 1998).

[357] 4 Cal.App.2d 197, 40 P.2d 571 (1935).

[358] 698 N.E.2d at 1261.

[359] *Id.*

[360] UCC § 2-306, Official Comment 2.

[361] Professor Goldberg's proposed Official Comments to UCC 2-306(1) would eliminate this distinction as follows: "This distinction, which makes no economic sense, is superseded under the current Code." 35 U.C. Davis Law Review 319, 382 (January, 2002).

[362] For example, a distributor in a requirements contract for a particular brand-name product may reduce its requirements to zero if its customers stop ordering the branded product. *See Trimed, Inc. v. Sherwood Medical 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 buyer's motion for summary judgment on seller's action for breach of a requirements contract for component parts where buyer had notified the seller that the buyer's own customer for the parts would no longer be ordering them).

[363] Courts appear to be more consistent in following the Official Comment's guide in upholding reductions that are caused by a lack of orders. Thus, a distributor in a requirements contract for a particular brand-name product may reduce its requirements to zero if its customers stop ordering the branded product. *See Trimed, Inc. v. Sherwood Medical 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 buyer's motion for summary judgment on seller's action for breach of a requirements contract for component parts where buyer had notified the seller that the buyer's own customer for the parts would no longer be ordering them).

[364] 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. 33 F.3d 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 that case with the note that a buyer may eliminate its requirements in the face of a "demand drop." *Id.*

[365] 34 F.3d 180, 182 (3^{d} Cir. 1994). In *U & W Industrial Supply, Inc. v. Martin Marietta Alumina, Inc.,* 34 F.3d 180, 182 (3^{d} Cir. 1994), 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. 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 the buyer will go out of business is one of the risks inherent in requirements contracts. 34 F.3d at 188.

[366] 759 F. Supp. 1004 (S.D.N.Y. 1991).

[367] 759 F. Supp. 2d at 1010.

[368] 746 N.E.2d 18, 25 (Ill. App. Ct. 2001).

[369] *Id.* at 21.

[370] *Id.* at 26-27.

[371] *Id.*

[372] *Id.* at 26.

[373] 2005 WL 1657128 (W.D. Mich. 2005).

[374] *Id.* at *3.

[375] *Id.* at *7.

[376] 512 F.3d 86, 93 (3d Cir. 2008).

[377] 512 F.3d at 92, citing *Restatement (Second) of Contracts* § 241(e) (1981) ("the 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.").

[378] *Id* at 96.

[379] *Id.*

[380] *Id.* at 95.

[381] *See* E. Farnsworth, Contracts §2.15 at 83(4th ed. 2004)(explaining that in several early cases, such as *Crane v. C. Crane & Co.*, 105 F. 869, 871-72 (7th Cir. 1901), the courts held that requirements contracts with "middlemen" were illusory because the buyers' requirements would fluctuate with the market).

[382] *See Vulcan Materials Co. v. Atofina Chemicals Inc.*, 355 F. Supp. 2d 1214, 1236 (D. Kan. 2005)(granting motion for summary judgment to seller 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).

[383] *See* James J. White & Robert S. Summers, UNIFORM COMMERCIAL CODE § 3-9, at 155 (1995) ("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.").

[384] 792 F. Supp. 560 (S.D. Ohio 1991).

[385] *Id.* at 562.

[386] *Id.* at 564.

[387] *Id.*

[388] *Id.*

[389] *Id.* at 562.

[390] *Id.* at 562.

[391] Victor P. Goldberg, *Discretion in Long-Term Open Quantity Contracts: Reining in Good Faith*, 35 U.C. Davis Law Review 319, 347-366 (January, 2002); [M. Finch, Output & Requirements Contracts: The Scope of the Duty to Remain in Business, 14 UCCL.J. 347, 366 (1982).].

[392] *Empire Gas Corp. ,* 840 F.2d at 1334.

[393] *Id.* at 1334-35.

[394] *Id.* at 1339.

[395] *Id.* at 1339-1340, citing Official Comments to UCC 2-306, *Minnesota Lumber Co. v. Whitebreast Coal Co.,* 160 Ill. 85, 96-97, 43 N.E. 774(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 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); *National 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 buyer's decision to switch from coal to electricity did not excuse it from its obligation to purchase its requirements of coal from the seller); *Loudenback Fertilizer Co. v. Tennessee Phosphate Co.*, 121 Fed. 298, 303 (6th Cir. 1903) (holding that buyer breached 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).

[396] *Merritt-Campbell, Inc. v. RxP Products, 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).

[397] *Empire Gas Corp.,* 840 F.2d at 1339.

[398] Consideration is necessary if the option is held open for longer than three months under UCC § 2-205.

[399] Official Comment 2 to UCC § 2-306.

[400]59 A.D.2d 110, 116 (2d Dep't 1977).

[401] *See Homestake Mining Co. v. Washington Public Power Supply Sys.,* 476 F. Supp. 1162,1169 (N.D. Cal. 1979), *aff'd* 652 F.2d 28 (9th Cir.) (entering judgment that supplier was not required to sell buyer more uranium than needed for initial nuclear core requirement of nuclear reactor where 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 providing authority for 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 Massachusetts 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).

[402] *Atlantic Track & Turnout Co. v. Perini Corp.*, 989 F.2d 541, 545 (1st Cir. 1993).

[403] 2006 WL 1722365 (N.D. Ind. 2006).

[404] *See Schawk, Inc. v. Donruss Trading Cards, Inc.*, 746 N.E.2d 18 (Ill. App. Ct. 2001).

[405] I refer here to commercial contracts between businesses, not consumer contracts.

[406] Professors Schwartz and Scott recommend that courts interpret contracts based on the assumption that the parties used "majority talk" when drafting their contracts and that the majority of parties would prefer this default rule because it would reduce contracting costs, minimize opportunities for strategic behavior, reduce the risk of judicial error and expand the set of efficient contracts the parties could write. Alan Schwartz and Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 Yale L.J. 541, 584 (Dec., 2003.) They also discuss the importance of setting up known meaning of terms from court decisions that can be used by parties in drafting contracts and can be relied upon by third parties who read and rely on contracts. *Id.* n. 95.