

Tulsa Law Review

Volume 39
Number 3 *The Scholarship of Frank I.
Michelman*

Volume 39 | Number 3

Spring 2004

Old Habits Die Hard: The Trouble with Ignoring Section 2-306 of the UCC

Travis W. McCallon

Follow this and additional works at: <https://digitalcommons.law.utulsa.edu/tlr>



Part of the [Law Commons](#)

Recommended Citation

Travis W. McCallon, *Old Habits Die Hard: The Trouble with Ignoring Section 2-306 of the UCC*, 39 Tulsa L. Rev. 711 (2004).

Available at: <https://digitalcommons.law.utulsa.edu/tlr/vol39/iss3/12>

This Casenote/Comment is brought to you for free and open access by TU Law Digital Commons. It has been accepted for inclusion in Tulsa Law Review by an authorized editor of TU Law Digital Commons. For more information, please contact megan-donald@utulsa.edu.

COMMENT

OLD HABITS DIE HARD: THE TROUBLE WITH IGNORING SECTION 2-306 OF THE UCC

I. INTRODUCTION

“It is not unusual for a producer to undertake to furnish a jobber or other purchaser with all of a certain article that he shall require in his business or with all that he shall require up to a stipulated quantity.”¹ The undertaking, in contractual form, is a “requirements contract.”² Instead of defining the amount of a good a buyer will purchase in strict numerical terms, a requirements contract defines quantity in terms of the “output” of the seller or the “requirements” of the buyer, whatever such output or requirements might be.³ Requirements contracts are highly valued in commercial enterprise, as they offer valuable assurances to both a buyer and a seller.⁴ A buyer, although unsure of its precise future needs, receives an assurance of a continuous supply of goods at a fixed price.⁵ The seller, of course, receives the ever-valued assurance of a continuous customer.⁶ Another benefit attributed to requirements contracts is the reduction of contractual costs stemming from renegotiation and the identification of new contractual partners.⁷ In the end, flexibility is the overarching principle and benefit of requirements contracts.⁸

Although the Uniform Commercial Code (“UCC” or “Code”) now governs requirements contracts, or open-quantity term contracts, in an overwhelming

1. *Wakem & McLaughlin, Inc. v. Culver*, 28 F.2d 942, 943 (6th Cir. 1928).

2. See U.C.C. § 2-306(1) (U.L.A 2003); William D. Hawkland, *Uniform Commercial Code Series* § 2-306 (West 2002). It is often said that a valid requirements contract carries with it (1) an obligation upon the buyer to buy goods, (2) an obligation upon the buyer to buy goods exclusively from the contractual seller, and (3) an obligation upon the buyer to buy all the goods of a particular variety from the contractual seller. James J. White & Robert S. Summers, *Uniform Commercial Code* § 3-9, 119 (4th ed., West 1995).

3. U.C.C. § 2-306(1).

4. See *Orchard Group, Inc. v. Konica Med. Corp.*, 135 F.3d 421, 429 (6th Cir. 1998); Stacy A. Silkworth, *Quantity Variation in Open Quantity Contracts*, 51 U. Pitt. L. Rev. 235, 238 (1990).

5. See *Orchard Group*, 135 F.3d at 429; Silkworth, *supra* n. 4, at 238.

6. See *Orchard Group*, 135 F.3d at 429; Silkworth, *supra* n. 4, at 238.

7. Silkworth, *supra* n. 4, at 239.

8. See Hawkland, *supra* n. 2, at § 2-306:1, Art. 2-438; Silkworth, *supra* n. 4, at 239.

majority of jurisdictions,⁹ courts recognized the potential validity of requirements contracts long before the enactment of the Code.¹⁰ Prior to the adoption of the UCC, the primary problem courts faced in upholding requirements contracts revolved around the so-called “mutuality of obligation” between the buyer and seller.¹¹ Pre-Code courts often upheld requirements contracts by recognizing the existence of an exclusive relationship between the buyer and seller.¹² The requirement of exclusivity served as a detriment to the buyer and thus validated the contract. The Code and its commentary purport to solve the problem of “mutuality of obligation” by requiring the buyer “to operate his plant or conduct his business in good faith and according to commercial standards of fair dealing in the trade”¹³

Twenty years ago, Professor Caroline Bruckel wrote an article regarding the enforcement of requirements contracts under the UCC.¹⁴ Professor Bruckel asserted that, under section 2-306(1) of the UCC, good faith replaced exclusivity as the primary validation device in requirements contracts, yet courts had almost unanimously continued to require exclusivity when enforcing such contracts.¹⁵ Today, it seems that not much has changed. The use of exclusivity as a validating device appears to be as accepted today as it was prior to Professor Bruckel’s article and prior to the enactment of the UCC.¹⁶ In the meantime, buyer’s option contracts have emerged in some courts’ attempts to avoid invalidating contracts where the existence of exclusivity is difficult, if not impossible, to fully flesh out.

9. See U.C.C. § 2-306(1). Fifty-two jurisdictions have adopted the UCC, including Guam, the Virgin Islands, and the District of Columbia. Hawklund, *supra* n. 2, at § 1-101:1, Art. 1-5. Louisiana has only adopted portions of the UCC and has not adopted Article 2. *Id.*; *Uniform Commercial Code Reporting Service: State UCC Variations*, at Louisiana—Page 1 (Pike & Fischer, Inc. ed., West 2001).

10. See e.g. *McMichael v. Price*, 58 P.2d 549 (Okla. 1936).

11. See Hawklund, *supra* n. 2, at § 2-306:1, Art. 2-440; *infra* nn. 18-24 and accompanying text.

12. See *infra* nn. 25-30 and accompanying text.

13. U.C.C. § 2-306 cmt. 2.

14. See Caroline N. Bruckel, *Consideration in Exclusive and Nonexclusive Open Quantity Contracts under the U.C.C.: A Proposal for a New System of Validation*, 68 Minn. L. Rev. 117 (1983).

15. *Id.* at 119-21.

16. A vast majority of courts and commentators have indicated that a valid requirements contract first requires that the buyer and seller display, either implicitly or explicitly, evidence that they have created an exclusive commercial relationship. See e.g. *C & S Door Corp. v. Morgan Prods. Ltd.*, 23 F.3d 399 (table), 1994 WL 177284 at *3 n. 2 (4th Cir. May 11, 1994); *Merritt-Campbell, Inc. v. RxP Prods., Inc.*, 164 F.3d 957 (5th Cir. 1999); *Brooklyn Bagel Boys, Inc. v. Earthgrains Refrigerated Dough Prods., Inc.*, 212 F.3d 373 (7th Cir. 2000); *Simmons Foods, Inc. v. Hill’s Pet Nutrition, Inc.*, 270 F.3d 723 (8th Cir. 2001); *Sea Link Intl., Inc. v. Osram Sylvania, Inc.*, 969 F. Supp. 781 (S.D. Ga. 1997); *Indus. Specialty Chems., Inc. v. Cummins Engine Co.*, 902 F. Supp. 805 (N.D. Ill. 1995); *Pepsi-Cola Co. v. Steak ‘N Shake, Inc.*, 981 F. Supp. 1149 (S.D. Ind. 1997); *Upsher-Smith Laboratories, Inc. v. Mylan Laboratories, Inc.*, 944 F. Supp. 1411 (D. Minn. 1996); *Abrasive-Tool Corp. v. Cystic Fibrosis Found.*, 1991 WL 97445 (W.D.N.Y. May 6, 1991); Hawklund, *supra* n. 2, at § 2-306:1; White & Summers, *supra* n. 2, at § 3-9, 119-20. For a more exhaustive analysis of courts, including state courts, requiring the element of exclusivity in requirements contracts, see James Lockhart, *Establishment and Construction of Requirements Contracts under § 2-306(1) of Uniform Commercial Code*, 94 A.L.R.5th 247 (2001 & Supp. 2003). For a contrary minority view, see for example *General Motors Corp. v. Paramount Metal Products Co.*, 90 F. Supp. 2d 861, 873-74 (E.D. Mich. 2000) (distinguishing section 2-306(1) from 2-306(2) and asserting that all requirements contracts may not be exclusive in nature) and *Hoover’s Hatchery, Inc. v. Utgaard*, 447 N.W.2d 684, 688 (Iowa App. 1989) (noting that “[n]othing in the statutory language of section [2-306], or in the official comments to that section, suggests that exclusivity is a prerequisite to the establishment of a requirements contract”).

Unfortunately, such contracts not only strain recognized contractual principles, they often disable one or both of the parties involved. This comment seeks to reaffirm the benefit of utilizing good faith as a requirements contract validation device by evidencing the ineptitude of the buyer's option contract, an open-quantity term contract wherein exclusivity does not expressly exist.

In order to bear out the current trouble with ignoring section 2-306, a brief assessment of courts' historical treatment of requirements contracts, exclusivity, and good faith is required. Accordingly, this comment will discuss: (1) the historical problems courts have faced in addressing requirements contracts; (2) section 2-306 of the UCC and its good faith provisions, including a brief synopsis of Professor Bruckel's assertion that good faith should serve as a requirements contract's primary validation device; and (3) courts' current application of the exclusivity analysis and the consequences of applying an exclusivity analysis in lieu of a good faith analysis, with a focus upon the buyer's option contract.

II. DEVELOPING HABITS: A BRIEF HISTORY OF REQUIREMENTS CONTRACTS

Despite the lack of statutory provisions, courts long recognized the validity of requirements contracts prior to the enactment of the UCC.¹⁷ As noted above, the primary stumbling block courts encountered in the enforcement of requirements contracts was the "mutuality of obligation."¹⁸ One court summed the concept of mutuality of obligation aptly:

The general rule is that in construing a contract where the consideration on the one side is an offer or an agreement to sell, and on the other side an offer or agreement to buy, the obligation of the parties to sell and buy must be mutual, to render the contract binding on either party, or, as it is sometimes stated, if one of the parties, not having suffered any previous detriment, can escape future liability under the contract, that party may be said to have a "free way out" and the contract lacks mutuality.¹⁹

In the context of requirements contracts, a buyer contracting for its requirements from a seller could have allegedly chosen not to require any amount of goods.²⁰ Although such a buyer could have been said to have a "free way out," courts nonetheless sought to give operation to contractual requirements language

17. See e.g. *McMichael*, 58 P.2d at 552-53 (citing *Manhattan Oil Co. v. Richardson Lubricating Co.*, 113 F. 923 (2d Cir. 1902); *Wakem*, 28 F.2d 942; *Marx v. Am. Malting Co.*, 169 F. 582 (6th Cir. 1909); *Lima Locomotive & Mach. Co. v. Natl. Steel Castings Co.*, 155 F. 77 (6th Cir. 1907); *Golden Cycle Mining Co. v. Rapson Coal Mining Co.*, 188 F. 179 (8th Cir. 1911); *T.W. Jenkins & Co. v. Anaheim Sugar Co.*, 247 F. 958 (9th Cir. 1918); *Minn. Lumber Co. v. Whitebreast Coal Co.*, 43 N.E. 774 (Ill. 1895); *Edison Electric Illuminating Co. of Brooklyn v. Thacher*, 128 N.E. 124 (N.Y. 1920); *Baker v. Murray Tool & Supply Co.*, 279 P. 340 (Okla. 1929)).

18. See e.g. *id.* at 551-52.

19. *Id.*

20. *Id.* at 552 (discussing *Baker*, 279 P. 340).

and often upheld such contracts.²¹ Consequently, the concept of mutuality of obligation served more to focus courts upon the language of an agreement than to invalidate potential requirements contracts.²² In this regard, courts were reluctant to place upon a buyer the vast freedom (in requiring goods) a literal reading of a requirements contract might suggest.²³ Instead, unless the language of an agreement necessitated a contrary result, courts sought to give active operation to potential requirements contracts.²⁴

Among courts' justifications for upholding pre-Code requirements contracts was the fact that the buyer had promised to purchase its requirements exclusively from the seller.²⁵ Courts held that the promise of exclusivity constituted a detriment to the buyer, which in turn operated to support the contract.²⁶ The buyer's establishment of mutuality through a promise of exclusivity eliminated the uncertainty inherent in the quantity term of a requirements contract, so long as the language of the agreement was clear and capable of operative construction.²⁷ Likewise, the downward fluctuation of a buyer's requirements, even to zero, was likely to be an inherent detriment to a buyer operating exclusively with a seller.²⁸ As such, absent statutory guidance, courts found the element of exclusivity to be essential to a requirements contract in avoiding invalidation on the basis of mutuality of obligation.²⁹ However, although exclusivity may, in some situations, ultimately continue to provide a similar assurance as it did historically, a requirements buyer today—through the operation of the UCC—promises far more than simply exclusivity in the way of consideration.³⁰

III. A POSSIBLE ATTEMPT TO BREAK THE HABITS: UCC § 2-306

Consistent with its attempt to conform the law to the reality of everyday business practice, the UCC provides for requirements contracts.³¹ Section 2-306(1) of the Code specifically states:

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

21. See e.g. *McMichael*, 58 P.2d 549 (citing *Manhattan Oil Co.*, 113 F. 923; *Wakem*, 28 F.2d 942; *Marx*, 169 F. 582; *Lima Locomotive*, 155 F. 77; *Golden Cycle Mining*, 188 F. 179; *T.W. Jenkins & Co.*, 247 F. 958; *Minn. Lumber Co.*, 43 N.E. 774; *Edison Electric*, 128 N.E. 124; *Baker*, 279 P. 340).

22. See *infra* n. 25 and accompanying text.

23. *Texas Co. v. Pensacola Maritime Corp.*, 279 F. 19, 25 (5th Cir. 1922).

24. *Id.*; *McMichael*, 58 P.2d at 552.

25. *McMichael*, 58 P.2d at 552-53 (citing *Pensacola Maritime*, 279 F. 19; *Lima Locomotive*, 155 F. 77; *Minn. Lumber Co.*, 43 N.E. 774).

26. See e.g. *id.* (citing *Pensacola Maritime*, 279 F. 19).

27. *Pensacola Maritime*, 279 F. at 24.

28. *Id.* (“[A] buyer by going out of business may avoid performance, while still observing the terms of an agreement . . . these results can be obtained only by doing something which is in itself a legal detriment, namely, the cessation of business.”).

29. See *McMichael*, 58 P.2d at 552-53 (citing *Pensacola Maritime*, 279 F. 19; *Lima Locomotive*, 155 F. 77; *Minn. Lumber Co.*, 43 N.E. 774).

30. See *infra* nn. 37-82 and accompanying text discussing the meaning and application of good faith.

31. See U.C.C. § 2-306(1).

the absence of a stated estimate to any normal or otherwise comparable prior output or requirements may be tendered or demanded.³²

Unfortunately, the language of the section makes one thing clear: the drafters did not intend to set forth, in checklist form, the elements necessary to create a requirements contract. The section's official commentary lends clues toward this end, however, by explicitly stating that a buyer's "requirements" mean "the *actual* good faith . . . requirements of the [buyer]."³³ In addition, section 2-306(1) eliminates the problem of "mutuality of obligation" between the buyer and seller through the imposition of a requirement of good faith upon the buyer.³⁴ Indeed, a perceptive reader of section 2-306(1) and its commentary will quickly realize that good faith is the primary element of a requirements contract under the Code.³⁵ Good faith permeates all elements of a requirements contract. This fact makes intuitive sense, considering section 2-306(1) governs contracts envisioning a degree of flexibility and ambiguity.³⁶ Both parties to such a contract must exercise good faith in order to ensure an honest and fruitful relationship, as not all of the details of their understanding may appear on paper.

A. *The Good Faith Requirement*

It should be noted that the Code, in Article I, defines good faith as "honesty in fact and the observance of reasonable commercial standards of fair dealing."³⁷ This definition expressly incorporates ideas of both subjective and objective good faith.³⁸ For example, the Code's requirement of honesty in fact would seem to disallow subjective misrepresentation. Conversely, the Code's requirement of reasonable "fair dealing" represents an objective standard that would seem to broaden the scope of good faith significantly.³⁹ Additionally, section 1-304 of the UCC mandates that all contracts formed under the UCC carry the implied obligation of good faith.⁴⁰ However, in order to understand the thrust of this comment—and the thrust of Professor Bruckel's article—one must also recognize the potential dual role of good faith in the specific context of requirements contracts. As Professor Bruckel noted, good faith can act as both a validation device and a performance standard.⁴¹ As a validation device, good faith would

32. *Id.*

33. U.C.C. § 2-306 cmt. 2 (emphasis added).

34. *See id.*

35. *See id.* (noting that when variance of quantity is at issue, "[t]he essential test is whether the party is acting in good faith").

36. *See* U.C.C. § 2-306 cmts. 1, 2.

37. U.C.C. § 1-201(b)(20) (U.L.A. 2003). Prior to a series of revisions completed in 2001, Article 2 of the Code contained its own definition of "good faith." That definition was not unlike the current definition under Article 1. The prior definition contained in Article 1 only required honesty in fact, without the requirement of commercial reasonableness. Commercial reasonableness is now required in all articles of the Code, save Article 5. U.C.C. § 1-201 cmt. 20.

38. U.C.C. § 1-201 cmt. 20.

39. The Code does not set forth a more specific definition regarding "fair dealing."

40. U.C.C. § 1-304.

41. Bruckel, *supra* n. 14, at 120-21 ("The good faith obligation is already generally recognized as a measure of the limitations upon permissible tender or demand when ascertaining whether a breach of

serve to replace exclusivity as the buyer's promise—the “detriment” to the buyer—a necessary element in order to render the contract enforceable. As a performance standard, good faith serves as a benchmark used to measure the particular actions of the parties in determining the existence of a breach.

1. Good Faith as a Validation Device⁴²

The very same provisions that make good faith a performance standard under section 2-306(1) also form the basis for good faith acting as a validation device. “In its role as a validating mechanism, however, the good faith obligation must be defined differently, as giving *affirmative* substance to the obligation of the [buyer].”⁴³ In essence, the promise of a requirements buyer to conform to the good faith performance standards of the UCC and section 2-306(1) serves as an obligation sufficient to validate the contract. Under an exclusivity analysis, it is the buyer's promise to buy its requirements exclusively from the seller that serves to validate the contract.⁴⁴ Although ambiguous, a buyer's promise of good faith in a requirements contract is sure to be far more expansive than a mere promise of exclusivity.⁴⁵ In addition, there is nothing in the express language of section 2-306 or its commentary mandating that exclusivity be the sole source of consideration in a requirements contract. Indeed, there is no express indication that exclusivity should play a role in the validation process whatsoever.

Significantly, if good faith is to act as a validation device, “[n]o inquiry into good faith's presence is necessary, because it is implied by law The inquiry into enforceability is reduced to whether section 2-204(3) of the Code applies.”⁴⁶

contract has occurred. But the good faith standard's potential as the source of an affirmative obligation of the quantity-determining party makes it a useful vehicle for validating as well as policing.”).

42. Professor Bruckel devotes extensive discussion to good faith's utility as a validation device. This comment concerns itself more with the application of some of the principles set forth there and the general clarification of the complex role of good faith in the requirements contract context. As such, see Bruckel, *supra* note 14, at 202-11, for a comprehensive discussion of good faith as a validation device.

43. *Id.* at 205.

44. See *supra* nn. 25-30 and accompanying text.

45. Bruckel, *supra* n. 14, at 206 (“The general substance of the obligation of good faith is considerably less capable of complete particularization than are more orthodox promissory obligations. But that does not render the obligation of good faith less real or a less reasonable basis from which the other parties' expectations may emanate.”).

46. *Id.* at 120 (footnote omitted). Section 2-204 of the Code governs the formation of a contract in general and reads:

(1) A contract for the sale of goods may be made in any manner sufficient to show agreement, including conduct by both parties which recognizes the existence of such a contract.

(2) An agreement sufficient to constitute a contract for sale may be found even though the moment of its making is undetermined.

(3) Even though one or more terms are left open a contract for sale does not fail for indefiniteness if the parties have intended to make a contract and there is a reasonably certain basis for giving an appropriate remedy.

Subsection (3) is readily applicable to requirements contracts, where the quantity term is left open and requires intent to be bound and the availability of a remedy in the formation of such contracts.

Thus, the only affirmative inquiry a court must make regarding good faith arises solely in the context of determining whether or not a breach occurred, under which the good faith provisions of section 2-306(1) serve as performance standards. Quite to the contrary, a court seeking to validate a requirements contract through the presence of exclusivity must inquire as to exclusivity's presence.⁴⁷ Under such an analysis, the fact that a contract complies with section 2-204 and falls directly within the provisions of section 2-306(1) would still not be enough to render it valid. Such a result is not only counterintuitive, but likely ignores the parties' intentions and can lead to the mischaracterization of the contract to the detriment of one or both parties.

2. Good Faith as a Performance Standard

Importantly, the commentary to section 1-304 states that the implied obligation of good faith "does not support an independent cause of action for failure to perform or enforce in good faith."⁴⁸ Thus, the drafters of the Code intended good faith to serve as a contract interpretation tool.⁴⁹ However, when good faith attaches to "a specific duty or obligation under the contract,"⁵⁰ it helps to guide the determination of whether a breach of such a duty or obligation has occurred.⁵¹ This caveat is particularly important in the context of requirements contracts because, unlike many contracts, the parties' convey their ultimate expectations in ambiguous terms. As such, and as we will see, good faith is the guiding principle of section 2-306(1) and therefore plays a heightened role in the operation of the section.⁵² It courses through every aspect of a requirements contract. Thus, while the absence of good faith in and of itself may not provide an independent cause of action, the fact that good faith attaches to nearly all actions under section 2-306(1) effectively lends a court the flexibility to turn to good faith in considering the issue of breach. In this way, good faith as a performance standard goes hand in hand with good faith as a validation device. If in order to properly play its role as a validation device good faith must serve as an affirmative obligation of the parties, that affirmative obligation is given teeth as a performance standard when good faith attaches to the specific duties of the parties.

a. *Good Faith in the Specific Context of § 2-306(1)*

"[A] contract for . . . requirements is not too indefinite since it is held to mean the actual good faith . . . requirements of the particular party."⁵³ Section 2-

47. Exclusivity, unlike the good faith obligation under the UCC, is not implied by law.

48. U.C.C. § 1-304 cmt. 1. Other courts agree. See e.g. *Baxter Healthcare Corp. v. O.R. Concepts, Inc.*, 69 F.3d 785, 792 (7th Cir. 1995).

49. See U.C.C. § 1-304 cmt. 1.

50. *Id.*

51. *Id.*

52. See generally Bruckel, *supra* n. 14, at 185-211.

53. U.C.C. § 2-306 cmt. 2.

306(1) arose, practically speaking, in order to provide a foundation for validating contracts that do not provide a definite, numerical quantity term.⁵⁴ Recognizing the inherent ambiguity of such contracts, the UCC requires a buyer's requirements to reflect subjective honesty and the idea of reasonable fair dealing.⁵⁵ As regards subjective honesty, if a buyer requires a certain quantity of a good in the operation of its business, it would seem that the buyer must demand that same quantity from its requirements seller. Professor Bruckel suggested that the "honesty in fact" prong of good faith takes on a diminished role in the requirements contract context.⁵⁶ She further recognized, however, that honesty in fact might be useful in establishing an effective maximum quantity.⁵⁷ This author might place more importance upon honesty in fact, given the additional fact that a party's requirements constitute "the *actual* good faith . . . requirements of the particular party."⁵⁸ In the end, such heightened importance might result in a requirements contract effectively requiring an exclusive relationship (though not for validation purposes), because a tender of the buyer's honest and actual requirements would leave the buyer with no additional requirements to be supplied by another seller. Ultimately, this conclusion is beyond the scope of this comment. However, it is important to note that the application of the UCC's regular meaning for good faith to the language of section 2-306(1) seems to require the buyer to make an honest, accurate communication of its actual requirements to the contractual seller. In practical application, of course, resort to a comparison of actual requirements and tendered requirements would be unnecessary unless a dispute arose between the parties. And if such a comparison became necessary, proving a party's actual requirements may become difficult.⁵⁹ Nevertheless, the subjective prong of the good faith requirement would seem to establish a sufficient theoretical foundation for giving teeth to the good faith performance standard, as a buyer's actual requirements must always translate into a numerical requirement at some point during the transaction (e.g., when the buyer orders a certain quantity of goods from the seller).

The objective fair dealing prong of good faith has most often been used to establish the buyer's minimum allowable tender of requirements.⁶⁰ Thus, if a

54. U.C.C. § 2-201 sets forth the Statute of Frauds requirement regarding the definiteness of a contract. Official Comment 1 provides that "[t]he only term which must appear is the quantity term which need not be accurately stated but recovery is limited to the amount stated." This section of the Code is clearly outside the scope of this comment; however, it is important to note that section 2-306 eliminates any enforceability problem potentially arising as a result of section 2-201.

55. See U.C.C. §§ 1-304, 2-306(1).

56. Bruckel, *supra* n. 14, at 168, 186-87.

57. *Id.* at 186-87.

58. U.C.C. § 2-306(1). The American Heritage College Dictionary defines "actual" as "[e]xisting and not merely potential or possible" or "[b]ased on fact." *American Heritage College Dictionary* 14 (3d ed., Houghton Mifflin 1993). The obligation of honesty in fact in the communication of "existing and not merely potential" requirements would seem to result in all of the requirements of a particular buyer being accounted for. Professor Bruckel, however, asserted that the use of the term "actual" within section 2-306(1) could only be understood if referenced with the expectations of the parties. Bruckel, *supra* n. 14, at 187 n. 281.

59. See Bruckel, *supra* n. 14, at 187.

60. See *infra* nn. 83-98 and accompanying text.

buyer's actual requirements decrease from a prior level of requirements, a determination must be made as to whether such a decrease occurred in good faith.⁶¹ Taken together, then, the subjective and objective prongs of good faith in the requirements contract scenario appear in two distinct contexts: (1) the buyer's actual requirements must be based upon a good faith operation of its business,⁶² and (2) the buyer must, in good faith, make an accurate communication of such actual requirements to the contractual seller.⁶³ Accordingly, under the language of the Code, it would seem that a buyer may not represent fewer requirements to its seller than it actually has, nor may a buyer manipulate its actual operations in order to avoid making purchases from its contractual seller.

b. Good Faith and "Reasonable Elasticity"

Despite the requirement of good faith, the Code specifically envisions "reasonable elasticity" in a buyer's requirements.⁶⁴ Rather than operating contrary to the allowance of reasonable elasticity, however, the requirement of good faith actually serves to help realize this vision. The good faith element allows a buyer to reduce its requirements so long as it is operating its business in good faith.⁶⁵ If the buyer must always communicate its actual requirements to the contractual seller, however,⁶⁶ the buyer's right to "reasonable elasticity" in its requirements must be grounded in the buyer's obligation to operate its business according to "reasonable commercial standards of fair dealing,"⁶⁷ rather than in its obligation to communicate its actual requirements to the contractual seller. The buyer's obligation to communicate its actual requirements to the contractual seller does not leave room for "reasonable elasticity" because a buyer's failure to demand its actual requirements may constitute bad faith.⁶⁸ Accordingly, a buyer may not simply "choose" the requirements it wishes to demand from the seller.⁶⁹ Of course, the buyer may respond to its business needs and the business environment, as the Code expressly makes clear.⁷⁰ This scheme effectively serves to level the playing field and eliminate the buyer's seemingly inherent power position in the relationship. However, it does not serve to limit a buyer's benefits

61. See *infra* nn. 83-98 and accompanying text.

62. See U.C.C. § 2-306 cmt. 2 (A buyer "is required to operate his plant or conduct his business in good faith and according to commercial standards of fair dealing in the trade . . .").

63. See *id.* ("[A] contract for . . . requirements is not too indefinite since it is held to mean the actual good faith . . . requirements of the [buyer].").

64. See *id.* ("Reasonable elasticity in the requirements is expressly envisaged by this section and good faith variations from prior requirements are permitted . . .").

65. See *id.*; *infra* nn. 83-98.

66. See U.C.C. § 2-306 cmt. 2; *supra* nn. 53-63 and accompanying text.

67. U.C.C. § 1-201(20).

68. See U.C.C. § 2-306(1) & cmt. 2; Hawkland, *supra* n. 2, at § 2-306:2, Art. 2-443 to 2-444 (asserting "it is the deviation from the reasonably expected output or requirements that most strongly suggests the presence of bad faith"); *infra* nn. 96-98 and accompanying text (discussing the *Empire Gas* court's conclusion that buying outside of a contractual relationship constitutes bad faith).

69. But see generally Bruckel, *supra* n. 14.

70. See U.C.C. § 2-306 cmt. 2 ("A shut-down by a requirements buyer for lack of orders might be permissible when a shut-down merely to curtail losses would not.").

under a requirements contract.⁷¹ A requirements buyer is not “locked in” to a precise quantity, and may enjoy a continuing contractual relationship without being forced to identify its precise needs far in advance.⁷²

c. *Good Faith and the Inclusion of Estimates*

Parties to a requirements contract may seek to add a numerical estimate to guide the requirements of the buyer.⁷³ Although parties including an estimate as to quantity within a requirements contract add an element of certainty,⁷⁴ such an addition does not, in any way, undermine the role of good faith.⁷⁵ Should a buyer choose to set forth an estimate of its requirements, such an estimate becomes the “center around which . . . parties intend . . . variation to occur.”⁷⁶ Such variation, however, may only occur within the limits set by good faith.⁷⁷ Alternatively, should the buyer choose not to set forth an estimate of quantity, its latitude in asserting requirements is similarly bounded by the outer limits of good faith.⁷⁸ As a result, *any* variation in quantity from a stated estimate or any prior requirements must be within the limits set by good faith. It makes no difference per se under the language of the Code whether a buyer’s variance in quantity comes as a result of its lack of business or as a result of the buyer finding cheaper prices elsewhere.⁷⁹ The essential inquiry, by the very language of the Code, is whether the buyer is acting within the bounds of good faith.⁸⁰

3. Final Thoughts Concerning Good Faith

Under the language and commentary of section 2-306(1), good faith is the guiding principle in all open-quantity term contracts. Neither the section language itself nor the commentary make mention of exclusivity in any form. Indeed, the commentary expressly makes clear that the requirement of good faith now resolves the mutuality of obligation problem, a problem previously solved by the requirement of exclusivity. Viewed as a standard of honesty and reasonableness

71. See *supra* nn. 4-8 and accompanying text.

72. See U.C.C. § 2-306 cmt. 3 (using permissive rather than mandatory language when discussing the inclusion of estimates in requirements contracts).

73. See *id.*

74. See *id.* (“[T]he agreed estimate is to be regarded as a center around which the parties intend the variation to occur.”).

75. U.C.C. § 2-306(1) mandates that “no quantity unreasonably disproportionate to any stated estimate . . . may be tendered or demanded.” This “unreasonably disproportionate” issue involves its own arm of the objective element of the good faith requirement, as discussed at length within *Empire Gas Corp. v. Amercian Bakeries Co.*, 840 F.2d 1333 (7th Cir. 1988). See *infra* nn. 83-98 and accompanying text.

76. U.C.C. § 2-306 cmt. 3.

77. See *supra* nn. 64-72 and accompanying text.

78. See U.C.C. § 2-306(1) (noting that “the requirements of the buyer means such actual output or requirements as may occur in good faith”).

79. The language of U.C.C. § 2-306(1) makes no mention of the means by which acceptable, or unacceptable, variation in quantity may or may not occur. Official Comment 2 provides examples of acceptable and unacceptable quantity variation, but ultimately asserts that “[t]he essential test is whether the party is acting in good faith.”

80. See U.C.C. § 2-306 cmt. 2.

attaching to nearly all of the statutorily regulated actions of parties to a requirements contract, good faith is clearly a weighty obligation in the context of section 2-306(1)—one that far outweighs the obligation of mere exclusivity. Thus, despite the often ambiguous interplay of exclusivity and good faith, nothing in the last twenty years seems to have lessened the argument that the drafters of the UCC intended to replace exclusivity with good faith as the primary requirements contract validation device under section 2-306(1). This, of course, has not been the practical effect of section 2-306(1). Instead, courts have rather consistently continued to require exclusivity in requirements contracts.⁸¹ Often times, if a court finds exclusivity lacking in a requirements-type scenario, it simply invalidates the contract and never reaches the issue of good faith.⁸² The section that follows attempts to show the damaging and unnecessary consequences of such a result by examining exclusivity and good faith in light of the buyer's option contract.

IV. OLD HABITS DIE HARD: THE CONTINUING PRESENCE OF EXCLUSIVITY

A. *The Ambiguous Interplay of Good Faith and Exclusivity in Requirements Contracts: Empire Gas*

In a widely recognized opinion, Judge Posner in the Seventh Circuit provided extensive commentary concerning the good faith element of section 2-306(1).⁸³ The buyer in that case, American Bakeries, contracted with the seller, Empire Gas, to buy “approximately three thousand (3,000) [propane conversion] units, more or less depending upon requirements of Buyer”⁸⁴ American Bakeries did not purchase any units from Empire Gas, and the court addressed American Bakeries's actions and liability in light of section 2-306(1) and its good faith element.⁸⁵ The court described the issue in that case:

Is [a requirements] contract essentially a buyer's option, entitling him to purchase all he needs of the good in question on the terms set forth in the contract, but leaving him free to purchase none if he wishes *provided that he does not purchase the good from anyone else* and is not acting out of ill will toward the seller?⁸⁶

While it is certainly apparent from the case that the issue before the court involved how section 2-306(1) of the Code purports to deal with decreases in quantity, the court's framing of the issue assumed an element that should have been overtly considered within the analysis. A reasonable reading of the court's phrasing of the issue evidences that the court essentially assumed that a decrease

81. *See supra* n. 16.

82. *See Bruckel, supra* n. 14, at 141, 157 (noting that a lack of exclusivity often results in invalidation).

83. *Empire Gas*, 840 F.2d 1333.

84. *Id.* at 1335 (quoting contract language) (internal quotations omitted).

85. *Id.* at 1334-35.

86. *Id.* (emphasis added). For a complete discussion of the ability of the quantity-determining party to vary its requirements in requirements contracts, see generally Silkworth, *supra* note 4.

in the requirements of a buyer could not rightfully come as a result of the buyer acquiring its goods from a seller other than its contractual seller. Presumptively, non-exclusive requirements contracts were not within the court's sphere of valid contracts. In thoroughly considering the Code's provisions for situations involving a decrease in the buyer's requirements, however, it would seem necessary to consider *all* of the various situations in which a decrease in quantity might arise. Instead, the *Empire Gas* court chose to consider the inverse situation where a buyer seeks to exploit the seller by demanding excessive goods and re-selling such goods for a profit.⁸⁷

The *Empire Gas* court correctly pointed out that the drafters of the Code seemingly duplicated the good faith requirement within the body of section 2-306(1) by adding the subsequent provision stating that "no quantity unreasonably disproportionate to any stated estimate . . . may be . . . demanded."⁸⁸ The court determined that the intent of such a redundancy was to shed light upon the good faith requirement.⁸⁹ The court then concluded that "the aspect of good faith that required explication had only to do with disproportionately *large* demands."⁹⁰ Ironically, the court overlooked the fact that at that very moment it was being called upon to explain the previously unexplained effect of good faith upon disproportionately *small* demands. Nevertheless, the court felt that, apart from the buyer purchasing from a seller outside the contract, the drafters of the Code were not concerned with buyers taking disproportionately small amounts of goods.⁹¹ Upon this foundation, the court held that a buyer may take a disproportionately small amount of goods, even zero, provided that such buyer does so in good faith.⁹² In making such a finding, the court expressly indicated that the "unreasonably disproportionate" provision within section 2-306(1) does not apply to situations where a buyer takes fewer requirements than estimated or previously demanded.⁹³ The obligation of good faith, however, obviously remains in place.⁹⁴

Although the Seventh Circuit's reasoning was somewhat skewed, the very conclusion the court reached lends significant weight to the idea that exclusivity in a requirements contract is not a necessary element in and of itself to validate such a contract. The court made numerous references to the necessity of exclusivity, despite the fact that the validation of the contract was not at issue. Indeed, the contract was a valid requirements contract; the question of its breach was at issue.⁹⁵ Nevertheless, the court stated:

87. *Id.* at 1338.

88. *Empire Gas*, 840 F.2d at 1338 (quoting U.C.C. § 2-306(1)) (internal quotations omitted).

89. *Id.*

90. *Id.*

91. *Id.*

92. *Id.*

93. *Empire Gas*, 840 F.2d at 1339.

94. *Id.*

95. *Id.* at 1336.

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 . . . 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.⁹⁶

As the court held, it is good faith that requires that a reason "need be given for scaling back one's requirements."⁹⁷ Without good faith, then, a requirements contract would, in the court's mind, amount to a buyer's option that still carries with it the obligation of exclusivity. Thus, the court viewed good faith and exclusivity as being mutually exclusive. The court noted, however, that so far as the performance standards of the contract were concerned, the obligation of good faith fully encompassed an obligation of exclusivity:

Clearly, [the buyer] was acting in bad faith if during the contract period it bought propane conversion units from anyone other than [the contractual seller], or made its own units, or reduced its purchases because it wanted to hurt [the contractual seller] (for example because they were competitors in some other market).⁹⁸

If good faith serves to require at least as much as exclusivity in the performance of contractual obligations, it stands to reason that good faith may act as a proper validation device under section 2-306(1). Nevertheless, the *Empire Gas* opinion is representative of courts' failure to view good faith as both a validation device and a performance standard, despite the breadth and depth good faith adds to section 2-306(1)'s obligations.

B. *Old Habits Lead to the Buyer's Option*

1. *Modern Dairy and Brooklyn Bagel*

The Seventh Circuit Court of Appeals has decided two cases within the past five years wherein it found alleged requirements contracts to actually constitute buyer's option contracts.⁹⁹ This is an alarming trend for sellers everywhere, as buyer's option contracts generally place fewer restrictions upon buyers than do requirements contracts.¹⁰⁰ A buyer's option contract is essentially a seller's promise to provide a buyer's needs¹⁰¹ at a fixed price for a specific period of

96. *Id.* at 1339.

97. *Id.*

98. *Empire Gas*, 840 F.2d at 1339.

99. See *Brooklyn Bagel*, 212 F.3d 373; *In re Modern Dairy of Champaign, Inc.*, 171 F.3d 1106 (7th Cir. 1999). In both of these cases, it was apparently the court that brought the buyer's option contract into the equation. Although the true issue in both cases involved whether or not a requirements contract existed, the two courts shaped their rulings around their belief that a buyer's option was an alternative to a requirements contract.

100. Compare *infra* nn. 146-99 and accompanying text (discussing the buyer's option) with *supra* n. 2 and accompanying text (discussing the requirements contract).

101. The Seventh Circuit's decisions regarding buyer's options are curiously vague when it comes to defining a buyer's "needs." In the author's opinion, "needs" sounds dangerously like "requirements." Certainly, "needs" are not "wants"; "requirements" would appear to be more closely akin to "needs," in that a buyer requires them. Noting the ambiguities involved in all of these references, the *Empire*

time.¹⁰² According to the Seventh Circuit's reasoning, however, the absence of exclusivity in a buyer's option contract is the primary difference between a buyer's option and a requirements contract.¹⁰³ In finding the existence of a buyer's option contract, the court in *In re Modern Dairy of Champaign, Inc.*, expressly acknowledged that the contract at issue did not actually *require* the buyers to take any amount of goods from the contractual seller.¹⁰⁴ The court in *Brooklyn Bagel Boys, Inc. v. Earthgrains Refrigerated Dough Products, Inc.* likewise labeled the contract there a buyer's option upon the same ground.¹⁰⁵

In *Modern Dairy*, two school districts contracted with Modern Dairy for the supply of milk during the school year.¹⁰⁶ The districts contracted with Modern Dairy "for milk products for the 1996/97 year as per [Modern Dairy's] bid [and] for milk to be ordered throughout the 1996-97 school year . . . as per . . . [Modern Dairy's] bid quotation."¹⁰⁷ In soliciting bids for the milk, the districts provided specifications asserting that the demands were to be determined in the future; the specifications also contained estimates of likely demands.¹⁰⁸ Modern Dairy subsequently fell into bankruptcy and was unable to fill the necessary milk orders.¹⁰⁹ The trustee in bankruptcy attempted to recover payment for deliveries previously made to the districts, and the districts sought to offset that amount from alleged damages stemming from the dairy's failure to continue deliveries.¹¹⁰ The trustee argued that the contracts were not requirements contracts and thus did not obligate the dairy to continue supplying milk to the districts.¹¹¹

The court ultimately determined that the districts' case for damages depended upon the existence of a requirements contract between the parties.¹¹² The court held, however, that the contract at issue was akin to a buyer's option contract—as opposed to a requirements contract—and, as a result, the districts were not entitled to continued delivery or damages for failure to deliver.¹¹³ In finding a buyer's option, the court asserted that the districts were not "obligated to buy all their milk requirements from Modern Dairy."¹¹⁴ The court found the contract to be a buyer's option upon the additional fact that Modern Dairy "was willing to supply all the milk that the [buyers] wanted during the . . . year, that it

Gas court nevertheless noted that "[r]equirements' are more than purely subjective 'needs,' which would be the equivalent of 'wants.'" 840 F.2d at 1339.

102. *Modern Dairy*, 171 F.3d at 1108-09.

103. The courts in *Brooklyn Bagel* and *Modern Dairy* never expressly distinguish buyer's options and requirements contracts. *But see infra* nn. 124-46 and accompanying text.

104. 171 F.3d at 1108.

105. 212 F.3d at 378.

106. 171 F.3d at 1107-08.

107. *Id.* at 1108.

108. *Id.*

109. *Id.* at 1107.

110. *Id.*

111. *Modern Dairy*, 171 F.3d at 1107. This case represents one in which the court's analysis disadvantaged the buyers.

112. *Id.* at 1110.

113. *Id.*

114. *Id.*

did supply milk in the quantities ordered . . . and that when it stopped supplying milk the [buyers] turned to other [sellers]”¹¹⁵

Although the precise reasoning supporting the *Modern Dairy* court’s holding is unclear, the most logical reading of the opinion evidences that the court felt that the contract at issue was a buyer’s option, rather than a requirements contract, because the contract lacked exclusivity. An alternate, though less persuasive, argument can be made that the court held the contract to be a buyer’s option because the contract failed to reference quantity according to the buyer’s “requirements.” The court began by noting that “[t]he contracts do not expressly obligate the dairy to supply the districts with their requirements for milk. But such an obligation can be implicit as well as express, and the inference would be compelling if the contracts forbade the districts to turn elsewhere for milk.”¹¹⁶ Although this statement itself is not clear, the addition of the final clause implies that it is the use of the term “requirements” that is determinative, and that exclusivity is somehow tied to that term. The court additionally framed the issue as being whether “the [buyers] obligated themselves to buy their milk requirements from the [seller].”¹¹⁷ In answering that question, however, the court stated that “[n]othing in the . . . documents . . . explicitly requires the school districts to take all, or indeed any, of their milk *needs* from the dairy.”¹¹⁸ Thus, in the midst of its substantive discussion, the court used the terms “needs” and “requirements” interchangeably. Indeed, the court used yet a third term to describe the quantity term under the contract: “the dairy was willing to supply all the milk that the districts *wanted* during the school year”¹¹⁹ The court’s inconsistent reference to the quantity term yields only two possible conclusions. The court was either utterly careless in its verbiage, or it felt that semantics did not bear upon the distinction between a buyer’s option and a requirements contract. Giving the benefit of the doubt to the court, the logical inference from *Modern Dairy* is that buyer’s options are requirements-type contracts lacking exclusivity—in other words, buyer’s options would be requirements contracts, but for their lack of exclusivity.¹²⁰

115. *Id.* at 1108-09. Although the court found this situation to be “consistent with the hypothesis of a buyer’s option,” *Modern Dairy*, 171 F.3d at 1109, it would seem that such a situation accurately describes the hypothesis of a requirements contract, as well. The mere fact that the buyers were forced to go elsewhere to meet their needs does not shift the contract to within the realm of buyer’s options, as a requirements buyer may also be forced, in certain circumstances, to buy from other sellers. Indeed, if a requirements seller entered bankruptcy, as the *Modern Dairy* seller did, the buyer would naturally turn to other sellers.

116. *Id.* at 1108 (citations omitted).

117. *Id.*

118. *Id.* (emphasis added).

119. *Id.* (emphasis added).

120. Supportive of the conclusion that buyer’s options and requirements contracts are distinguished on the basis of exclusivity is the Northern District of Illinois’s statement that “it is true that the UCC does not require any ‘magic’ words to enforce a requirements contract” *Brooklyn Bagel Boys, Inc. v. Earthgrains Refrigerated Dough Prods., Inc.*, 1999 WL 528499 at *6 (N.D. Ill. July 19, 1999), *aff’d*, 212 F.3d 373 (7th Cir. 2000).

In *Brooklyn Bagel*, the bagel company agreed to process and package bagels for a particular facility operated by Earthgrains.¹²¹ The contract between the parties stated that Brooklyn Bagel “was to process and package the ‘ordered quantity’ of bagels.”¹²² Earthgrains subsequently began processing its own bagels at the particular facility and terminated its processing and packaging relationship with Brooklyn Bagel.¹²³ Brooklyn Bagel filed suit alleging a wrongful termination of a requirements contract, which would have obligated Earthgrains to order its bagel requirements from Brooklyn Bagel.¹²⁴

The court of appeals in *Brooklyn Bagel* held that “the Contract is not a requirements contract as it does not expressly obligate Earthgrains to purchase all, or any specified quantity, of its requirements of bagels . . . from Brooklyn Bagel.”¹²⁵ The court noted the decision in *Modern Dairy* and went on to state 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.”¹²⁶ Again citing *Modern Dairy*, the court concluded that the contract at issue was a buyer’s option contract.¹²⁷ In the court’s words, “the Contract provided an agreement by Brooklyn Bagel to manufacture bagels for Earthgrains at a specified price, within an agreed period, subject to Earthgrains’ bagel needs.”¹²⁸ As such, the court held that Earthgrains had no continuing obligation to order its bagel requirements from Brooklyn Bagel.

In addition to making relatively clear that buyer’s options differ from requirements contracts because they do not require exclusivity, the court’s opinion in *Brooklyn Bagel* discusses several other relevant issues. Because the court required the existence of a requirements contract in order for Brooklyn Bagel to prevail, Brooklyn Bagel sought to prove that Earthgrains was required to purchase all of its bagel requirements from them. The parties’ contract, however, failed to state explicitly that the parties contracted for a quantity of “requirements,” and failed to provide that the contract was exclusive.¹²⁹ As such, Brooklyn Bagel sought to introduce extrinsic evidence to prove the existence of a requirements contract.¹³⁰ The court noted that such evidence is allowable only if the terms of the contract are ambiguous.¹³¹ Additionally, the court noted that parties may not use extrinsic evidence to contradict their written agreement.¹³²

121. 212 F.3d at 375-76.

122. *Id.* at 376.

123. *Id.*

124. *Id.* at 376-77.

125. *Id.* at 378.

126. *Brooklyn Bagel*, 212 F.3d at 379.

127. *Id.* at 378.

128. *Id.* at 380.

129. *Id.* As in *Modern Dairy*, the court’s opinion seems to wed the terms “requirements” and “exclusivity.”

130. *Id.* at 380-81.

131. *Brooklyn Bagel*, 212 F.3d at 380. Such evidence is additionally only allowable if it goes to course of performance, course of dealing, or usage of trade. See U.C.C. § 2-202.

132. *Brooklyn Bagel*, 212 F.3d at 380.

The purpose of the evidence that Brooklyn Bagel provided was to show that the parties actually intended a requirements contract, under which Brooklyn Bagel would be Earthgrains's sole supplier of bagels.¹³³ The court, however, felt that such evidence was "inconsistent with the unambiguous terms of the Contract."¹³⁴ As a result, Brooklyn Bagel was unable to prove the existence of a requirements contract.

The *Brooklyn Bagel* court also addressed Brooklyn Bagel's claim that Earthgrains breached the duty of good faith imposed by the UCC.¹³⁵ The court asserted that the obligation of good faith under the UCC "merely 'guides the construction of contracts and does not create independent duties of the contracting parties.'"¹³⁶ Consequently, Brooklyn Bagel was unable to assert claims based solely upon the good faith provisions of the UCC.

2. Revisiting *Empire Gas*

Judge Posner and the *Empire Gas* court also briefly addressed the relationship between an option contract and a requirements contract.¹³⁷ That court likened an option contract to a requirements contract wherein a buyer need not give any reason for scaling back its requirements, even to zero.¹³⁸ In the eyes of that court, then, a buyer's option does not require the buyer to observe "reasonable commercial standards of fair dealing,"¹³⁹ or to refrain from demanding unreasonably disproportionate amounts of goods.¹⁴⁰ The court referred to option contracts in order to bolster its holding that a requirements buyer must act in good faith in decreasing its requirements under a requirements contract, but the comparison raises striking similarities to the Seventh Circuit's subsequent decisions upholding buyer's option contracts in lieu of requirements contracts.¹⁴¹

As previously noted, the Seventh Circuit's later decisions appear to imply that the nonexistence of *exclusivity* primarily distinguishes a buyer's option from a requirements contract.¹⁴² On its surface, the *Empire Gas* court's comparison implies that the primary difference between such contracts is the absence or presence of the particular requirements of *good faith*.¹⁴³ A closer look at *Empire Gas*, however, evidences that the court simply would not apply the sweeping good faith requirements of section 2-306(1) to an option contract. Given that the court

133. *Id.* at 380-81 n. 7.

134. *Id.* at 380 n. 7.

135. *Id.* at 381.

136. *Id.* (quoting *Echo, Inc. v. Whitson Co.*, 121 F.3d 1099, 1106 (7th Cir. 1997)).

137. *Empire Gas*, 840 F.2d at 1339.

138. *Id.* Unlike a true buyer's option, however, the buyer under the court's example "modified requirements contract" could not "refuse to exercise the option because someone offers him better terms." *Id.*

139. U.C.C. § 1-201(b)(20).

140. *See* U.C.C. § 2-306(1).

141. *See Brooklyn Bagel*, 212 F.3d 373; *Modern Dairy*, 171 F.3d 1106.

142. *See supra* nn. 103-28 and accompanying text.

143. *See supra* nn. 97-98 and accompanying text.

felt as though exclusivity was a necessary element to a requirements contract triggering section 2-306(1) and its specific good faith provisions, it is logical to draw the conclusion that the *Empire Gas* court also ultimately distinguished buyer's options and requirements contracts on the basis of exclusivity. At an absolute minimum, the *Empire Gas* decision and the language regarding option contracts therein evidences that, absent certain elements, courts are capable of construing requirements-type agreements as option agreements.¹⁴⁴ *Empire Gas* and the Seventh Circuit's subsequent decisions further make clear that the interpretation of the elements of good faith and exclusivity primarily guide the construction and characterization of such contracts.¹⁴⁵

V. THE INEPTITUDE OF THE BUYER'S OPTION

Interpreting a requirements-type¹⁴⁶ agreement to actually constitute a buyer's option is unacceptable for several reasons. First, such a construction plainly ignores the good faith provisions of the Code.¹⁴⁷ If courts focused upon the express good faith provisions of the Code, they would not have the opportunity to find the existence of a buyer's option. Second, the mere presence of the idea of a buyer's option requires courts to arrive at a forced interpretation of the meaning of "requirements" and "exclusivity."¹⁴⁸ Finally, an option contract exists as its own entity within the law, and is therefore governed by separate principles.¹⁴⁹ Parties intending to enter into an option contract generally make such intent clear, and the option (i.e., the offer) is often supported by separate consideration.

A. A Buyer's Option Ignores the Language of § 2-306(1)

As Professor Bruckell asserted, and as this comment re-asserts, the element of exclusivity is not an element separately envisioned by section 2-306(1) of the Code.¹⁵⁰ As such, it follows that the characterization of a contract under section 2-306(1) as a requirements contract does not depend upon the absence or presence of exclusivity. By eliminating the inquiry into exclusivity, courts could effectively eliminate the buyer's option as a potential outcome in a requirements-type situation, absent express intention by the parties. This is true because section 2-306(1) would be triggered by the existence of "[a] term which measures the quantity by the . . . requirements of the buyer"¹⁵¹ within the contract and the intention of the parties to be bound, not by the additional existence of a showing

144. See *Empire Gas*, 840 F.2d at 1339.

145. See *supra* nn. 103-36 and accompanying text (discussing the Seventh Circuit's buyer's option decisions in *Brooklyn Bagel* and *Modern Dairy*).

146. For the purposes of this comment, a "requirements-type" agreement means a contract wherein a seller purports to provide a buyer's requirements, needs, or any quantity of goods not specifically delineated apart from any estimate and that otherwise meets the general UCC requirements for the formation of a contract.

147. See *infra* nn. 150-64 and accompanying text.

148. See *infra* nn. 165-79 and accompanying text.

149. See *infra* nn. 180-97 and accompanying text.

150. See Bruckel, *supra* n. 14, at 120-21.

151. U.C.C. § 2-306(1).

of exclusivity. The obligation of good faith would then serve to validate the contract.¹⁵² Because good faith is implied by law, no affirmative inquiry would be required at this point.¹⁵³ Depending upon the circumstances, of course, a buyer not operating exclusively with its requirements seller may be acting in bad faith and, as a result, could be in violation of section 2-306(1).¹⁵⁴ However, such a buyer has *breached* a requirements contract, not created a buyer's option.

A buyer's option, as it exists in some courts, can potentially act as a "safety net" for a buyer by establishing a requirements-type situation in which the UCC's good faith provisions do not attach in the specific context of requirements contracts.¹⁵⁵ Likewise, a seller would not be protected by section 2-306(1)'s language prohibiting unreasonably disproportionate demands.¹⁵⁶ The *Empire Gas* court's discussion of option contracts bears this out precisely.¹⁵⁷ Under that court's likely formulation of a buyer's option, a buyer need give no reason in reducing its requirements, even to zero.¹⁵⁸ The same result would likely follow under both *Modern Dairy* and *Brooklyn Bagel*.

The good faith requirement of section 2-306(1) is *the* law governing contracts containing quantity terms based upon the requirements of the buyer.¹⁵⁹ The section requires good faith at all times.¹⁶⁰ The buyer's option contract essentially allows courts undertaking an exclusivity analysis to deprive the seller of the good faith provisions of section 2-306(1)¹⁶¹ in situations where the parties' contract contains an open-quantity term but contains no express requirement of exclusivity. By enforcing any potential need for exclusivity—or a potential bad faith lowering of requirements—through the performance standards of section 2-306(1), as enhanced by the good faith requirement, however, courts would eliminate this "safety net" argument on behalf of the buyer because the absence of a showing of exclusivity would not remove the contract from section 2-306(1). Instead, the presence of an open-quantity term, as required by section 2-306(1), would trigger the UCC's good faith provisions regarding both validation and enforcement of requirements contracts.

152. See *supra* nn. 42-47 and accompanying text.

153. See U.C.C. §§ 1-304, 2-306(1); Bruckel, *supra* n. 14, at 120.

154. See Hawkland, *supra* n. 2, at § 2-306:2, Art. 2-443 to 2-444 (asserting "it is the deviation from the reasonably expected output or requirements that most strongly suggests the presence of bad faith"); *supra* nn. 97-98 and accompanying text (discussing the *Empire Gas* court's conclusion that buying outside of a contractual relationship constitutes bad faith).

155. Under section 2-306(1), subjective and objective good faith specifically applies to the buyer's determination of its actual requirements. The buyer is also forbidden from demanding "unreasonably disproportionate" amounts.

156. See U.C.C. § 2-306(1).

157. See *supra* nn. 83-98, 137-45 and accompanying text.

158. *Empire Gas*, 840 F.2d at 1339.

159. In this sense, section 2-306(1) should not be viewed as merely an interpretational guide, but as the defining source of affirmative obligations, triggered by the existence of an open quantity term.

160. See U.C.C. §§ 1-304, 2-306(1), 2-306 cmt. 2. The primary function of section 2-306(1)—defining and giving meaning to open quantity terms—is specifically shaped by good faith.

161. Although parties to a buyer's option contract are presumably afforded the protection of section 1-304's implied good faith obligation, the obligation takes on special meaning within the context of section 2-306(1). See *supra* nn. 42-82 and accompanying text.

To reiterate, any affirmative inquiry under this proposed scheme goes to whether a party is in breach of a requirements contract; the inquiry does not go to what *sort* of contract the parties have created. The parties themselves, through the operation of section 2-306(1), determine the sort of contract they intend to enter the moment they agree that the quantity at issue shall be determined by the requirements¹⁶² of the buyer.¹⁶³ Once the parties trigger the provisions of section 2-306(1) in such a manner, an inquiry as to the performance standards of section 2-306(1) as judged through good faith would simply determine a party's compliance with or breach of the contract. Thus, a buyer's option should only be triggered by express language or intent by the parties to create such a contract.¹⁶⁴

B. A Buyer's Option Forces the Interpretation of Exclusivity

Undertaking the exclusivity inquiry in order to characterize the type of contract the parties entered often leads courts into forced interpretations as to the meaning of both "exclusivity" and "requirements." The *Modern Dairy* case provides a representative example of just such a situation—one in which the court held the parties' contract to be a buyer's option based upon its interpretation of "exclusivity."¹⁶⁵ In *Modern Dairy*, the buyers contracted with the seller for "milk products for the 1996/97 year as per [the seller's] bid"¹⁶⁶ and for milk "to be ordered throughout the 1996-97 school year . . . as per . . . [the] bid quotation."¹⁶⁷ In soliciting bids for the milk, the buyers provided specifications asserting that their demands were to be determined in the course of business.¹⁶⁸ The specifications also contained estimates of likely demands, however.¹⁶⁹ The court seemed to recognize, as have other courts,¹⁷⁰ that parties may evidence exclusivity in a requirements contract either explicitly or implicitly.¹⁷¹ Nevertheless, in ultimately finding the contract to be a buyer's option, the court stated:

Nothing in the scanty documents that record the parties' deal explicitly requires the [buyers] to take all, or indeed any, of their milk needs from the [seller]. If in the course of the school year another [seller] offered to supply the [buyers'] needs at a

162. An analysis of the meaning of 'requirements' likely deserves its own comment; however, courts have recognized requirements contracts without the explicit use of the word "requirements." See e.g. *City of Louisville v. Rockwell Mfg. Co.*, 482 F.2d 159 (6th Cir. 1973).

163. U.C.C. § 2-306(1).

164. See *infra* nn. 180-97 and accompanying text (discussing the substantive law of option contracts).

165. Although the court in *Orchard Group*, 135 F.3d 421, did not ultimately find the existence of a buyer's option, that case is also representative of the effects of a strained construction of "exclusivity."

166. 171 F.3d at 1108.

167. *Id.*

168. *Id.*

169. *Id.*

170. See e.g. *Cyril Bath Co. v. Winters Indus.*, 892 F.2d 465, 467 (6th Cir. 1989); *Goodyear Tire & Rubber Co. v. Chiles Power Supply, Inc.*, 7 F. Supp. 2d 954, 959 (N.D. Ohio 1998); see *White & Summers*, *supra* n. 2, at 120.

171. *Modern Dairy*, 171 F.3d at 1108.

lower price, [the seller] could not point to any contractual language indicating that it would be a breach of contract for the [buyers] to switch.¹⁷²

Thus, despite the court's recognition that parties may evidence exclusivity implicitly or explicitly, its holding that the parties had not created an exclusive relationship was apparently founded solely upon the parties' showing of an *explicitly* exclusive relationship, or lack thereof.¹⁷³

Although courts may be quick to point out that exclusivity can be implicit, it is often too easy for those courts to ultimately resort to the express language of the contract in ruling upon exclusivity.¹⁷⁴ Common sense would seem to dictate that conclusively determining the exclusive nature of the parties' relationship is decidedly more difficult when there is no express statement of exclusivity within the parties' agreement but the evidence reveals that one or both parties have not behaved in a manner inconsistent with the existence of an exclusive relationship. Including exclusivity as an element necessary to the formation of a requirements contract, as we have seen, forces courts to make just such a decision—a decision as to the *type* of contract two or more parties have created. As a result of the nature of this inquiry, courts may resort to relying predominantly on the written words of the parties regarding exclusivity, rather than focusing on the parties' intention to include an open-quantity term.¹⁷⁵

The *Brooklyn Bagel* opinion further displays the difficulty parties may face in achieving the true benefits of their bargain when the court insists upon an exclusivity analysis. That court recognized the ability of a party to introduce extrinsic evidence to bring meaning to contractual ambiguities.¹⁷⁶ The court, however, treated the absence of an express exclusivity provision in the contract not as an ambiguity, but as an affirmative indication that the contract was not a requirements contract.¹⁷⁷ Thus, as mentioned previously, the court held that Brooklyn Bagel's attempt to show that the parties intended exclusivity was "inconsistent with the unambiguous terms of the Contract."¹⁷⁸ Logically, then, if a lack of an express indication of exclusivity is never ambiguous, extrinsic evidence will never be admitted to clarify the contract. The parties' true expectations may

172. *Id.* While the school districts may not have been obligated, the court seemed to think that the dairy might have been obligated to supply the districts' needs: "There is language, particularly in [the] request for bids, suggesting that Modern Dairy committed not only to a price, but also to satisfying the school district's school-year milk needs . . ." *Id.* at 1109. This conclusion is certainly consistent with the Seventh Circuit's general holdings regarding buyer's options, and it notably commits the seller to performance—with no reciprocal promise flowing from the buyer.

173. *See id.* at 1108.

174. *See e.g. Modern Dairy*, 171 F.3d 1106.

175. Professor Bruckel notes that contracts often lack "readily ascertainable promissory terms which courts expect to see in the guise of the covenant of exclusivity." Bruckel, *supra* n. 14, at 141. She further notes that, despite the absence of terms of exclusivity and the presence of open quantity terms, "the proper inference may be that . . . some actual exchange under the agreement is expected." *Id.* at 207.

176. *Brooklyn Bagel*, 212 F.3d at 380.

177. *See id.* at 379, 380-81 n. 7.

178. *Id.* at 380 n. 7.

never be realized—an alarming result considering the full extent of the parties' expectations are never completely expressed within the contract.¹⁷⁹

By examining all issues of validity through good faith in a requirements-type situation, courts can give *active* effect to the (good faith) provisions of the Code. If the requirement of good faith would effectively require an exclusive relationship under a given contract, an analysis as to the duties and obligations of the parties as judged according to good faith would be capable of enforcing such a requirement without resort to a separate inquiry into exclusivity. Indeed, it would likely be much easier for courts to establish whether or not good faith exists because good faith can and should be judged through the manifest actions of the parties in furtherance of their duties and obligations (and the buyer in particular). In such case, the written words of the parties would only be determinative to the extent that the parties' agreement defines the parties' expectations regarding, for example, exclusivity.

C. *A Buyer's Option Ignores the Law of Option Contracts*

Classifying a requirements-type contract as a buyer's option also fails to take into account the greater legal principles underlying option contracts.¹⁸⁰ "An option contract is a promise which meets the requirements for the formation of a contract and limits the promisor's power to revoke an offer."¹⁸¹ Because an option contract limits the power of the promisor/offeree to revoke an offer,¹⁸² the offeree, under the common law, must provide consideration in support thereof.¹⁸³ The UCC attempts to expand the opportunities available to parties seeking to make irrevocable offers, however, by accounting for firm offers, which create irrevocable offers despite a lack of consideration.¹⁸⁴ A firm offer must simply provide a written assurance by the offeror that such an offer will remain open.¹⁸⁵ The only catch, however, is that—unless supported by further consideration—such an offer remains irrevocable for only three months, despite any contractual language lengthening the period of irrevocability.¹⁸⁶ It follows, then, that an

179. Indeed, the expectation of the parties regarding the very substance of the contract (the amount of goods to be purchased by the buyer) is purposely left ambiguous, so as to gather meaning throughout the course of the parties' relationship.

180. Compare U.C.C. § 2-306(1) with *Restatement (Second) of Contracts* § 25 (1981).

181. *Restatement (Second) of Contracts* § 25.

182. *Id.* § 25 cmt. d.

183. *Id.* §§ 25 cmt. c, 87.

184. U.C.C. § 2-205. That section provides:

An offer by a merchant to buy or sell goods in a signed writing which by its terms gives assurance that it will be held open is not revocable, for lack of consideration, during the time stated or if no time is stated for a reasonable time, but in no event may such period of irrevocability exceed three months; but any such term of assurance on a form supplied by the offeree must be separately signed by the offeror.

Id.

185. *Id.*

186. *Id.* Official Comment 3 under section 2-205 provides:

A promise made for a longer period [than three months] will operate under this section to bind the offeror only for the first three months of the period but may of course be renewed.

option contract supported by consideration remains irrevocable for as long as the parties desire,¹⁸⁷ while a firm offer-option unsupported by consideration remains open for only three months (if the offeror has provided written assurance of its intent to keep the offer open).¹⁸⁸

Parties entering into a requirements-type contract likely do not intend to fulfill the requirements of the principles underlying option contracts, or firm offers for that matter. It is true that a promise of performance by the offeree in an option contract provides sufficient consideration to make the offer irrevocable.¹⁸⁹ It is also true that the buyer's promise to buy goods from the seller in a requirements-type contract provides consideration.¹⁹⁰ A requirements-type contract wherein a buyer/offeree purports to provide consideration beyond its promise to buy goods, however, is scarce¹⁹¹ at best.

A buyer's option, according to the reasoning of the Seventh Circuit, does not require the buyer to purchase any goods at all. Without such a promise to perform, the contract would require some form of additional consideration, especially if it is to remain irrevocable. Such a buyer's option would be an option unsupported by consideration, an idea that violates principles governing both option and requirements contracts. Courts interpreting requirements-type contracts as buyer's options may thus be implicating entirely new legal parameters. The *Modern Dairy* case discussed above again provides a representative example. That court's analysis only briefly recognized that a buyer's option may only be irrevocable for three months, and the court offered no analysis of the principles of option contracts.¹⁹² The court further gave no mention of the language of the instruments there and how they pertained to the making of firm offers.¹⁹³

Additionally, under the Code, a firm offer must include written *assurance* that an offer will remain open.¹⁹⁴ Although the *Modern Dairy* instruments purported to offer to provide goods for a school term period, the opinion is unclear as to the exact written nature of the instruments and the sufficiency of the

If supported by consideration it may continue for as long as the parties specify. This section deals only with the offer which is not supported by consideration.

187. See *Restatement (Second) of Contracts* §§ 25, 87; U.C.C. § 2-205 cmt. 3 (noting that the provisions regarding firm offers are not intended to apply to long term options, which would presumably be supported by separate consideration).

188. U.C.C. § 2-205 cmt. 3. In addition, the *Modern Dairy* court observed with respect to buyer's options:

A seller's firm offer to supply the buyer's needs for some good at a specified price and other terms is enforceable under the Uniform Commercial Code even though the buyer makes no reciprocal commitment to buy all its needs from this seller, but unless the offer is supported by consideration, it is revocable after three months.

171 F.3d at 1110 (citing UCC § 2-205).

189. *Restatement (Second) of Contracts* § 25 cmt. c.

190. In most courts, it is the promise to buy goods exclusively that provides the necessary consideration. See *supra* n. 16.

191. In fact, the author is yet to encounter such a contract in reviewing relevant case law.

192. See *Modern Dairy*, 171 F.3d at 1109-10.

193. *Id.*

194. U.C.C. § 2-205.

assurances provided therein.¹⁹⁵ It is possible that the instruments there may not have been sufficient to constitute firm offers under a Code-based strict firm offer analysis. If such an assertion were found to be true, the court would have succeeded in *creating* an invalid contract. For, if the contract was not a firm offer, consideration must have supported it.¹⁹⁶ As there was no indication as to any consideration provided, especially since the court alleged that exclusivity did not exist, the contract would necessarily fail under a normal analysis.¹⁹⁷

D. Final Thoughts Concerning the Buyer's Option

The danger involved in classifying a requirements-type contract as a buyer's option should now be clear. The fact that parties to such contracts often fail to recite specific consideration would seem to be an obvious indication of the parties' intent *not* to create a buyer's option. Any lack of contractual language emphasizing a seller/offeree's express assurance as to its intent to keep an offer open would provide an additional indication towards the same end.¹⁹⁸ Simply put, given the nature, purpose, and legal construction of option contracts, it would seem that parties would make clear their intent to enter into such agreements. Courts construing requirements-type contracts as buyer's options, absent obvious expressions to the contrary, then, would seem to be operating against the parties' intent.

A potential explanation for courts finding buyer's options in requirements-type situations might assert that such courts are likely attempting to protect sellers from non-exclusive requirements situations where the buyers are not bound to buy goods (although the sellers are bound to provide those goods should the buyers request). Ironically, in finding a buyer's option, courts accomplish exactly what they likely set out to prevent. Buyer's options place sellers in a position where only they (the sellers) must always be ready to perform. In addition, if a court finds a buyer's option in a requirements-type situation, it is unlikely that the buyer/offeree provided any additional consideration.¹⁹⁹ As a result, a court in such a situation could not only create an invalid contract, but could also effectively deprive the seller of consideration and any promise of performance the buyer may have implicitly made.

VI. CONCLUSION

When one considers the true scope of good faith in the specific context of section 2-306(1), it becomes apparent that it goes far beyond the scope of exclusivity. Good faith attaches to a buyer's determination and communication of its actual requirements. As such, and as suggested twenty years ago by Professor

195. 171 F.3d at 1108.

196. See *Restatement (Second) of Contracts* §§ 25 cmt. c, 87; U.C.C. § 2-205.

197. See *Modern Dairy*, 171 F.3d at 1108; *Restatement (Second) of Contracts* §§ 25 cmt. c, 87; U.C.C. § 2-205.

198. See U.C.C. § 2-205 cmt. 3.

199. See *supra* nn. 180-97 and accompanying text.

Bruckel, good faith must be seen as an affirmative obligation with which the buyer must comply. Because good faith serves as *the* overriding performance standard under section 2-306(1), it amounts to an obligation capable of validating a requirements contract.

The necessity of this conclusion is nowhere more evident than in the buyer's option contract. The buyer's option is a direct result of courts' hesitance to recognize non-exclusive requirements contracts—or at least requirements contracts lacking express exclusivity. Although the buyer's option may seem an attractive alternative to invalidation, buyer's options will almost certainly disadvantage one of the parties and fail to give life to the intentions of both parties. Because the parties in a requirements contract never fully express the full extent of their intentions within the contract, courts should seek to take advantage of the fact that the drafters of the UCC sought to impose the obligation of good faith as a matter of law. Its particular power in the context of section 2-306(1) could easily prevent the hasty and unnecessary judicial creation of contracts like the buyer's option—if only old habits didn't die so hard.

*Travis W. McCallon**

* J.D. Candidate, University of Tulsa College of Law (expected 2004); B.B.A., University of Oklahoma (2000).

