

News & Types: Commercial, Competition & Trade Update

Requirements Contract or Not? Courts Disagree

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A contract for the sale of goods should state a quantity to be enforceable. (Uniform Commercial Code Article 2-201). Article 2 of the UCC permits a quantity to be measured by the "requirements of the buyer." (UC Article 2-306) Of course, "requirements of the buyer" is not a fixed quantity, but it is sufficient to be enforceable.

As interpreted by the 7th Circuit Court of Appeals, a requirements contract has the following elements: 1) it must obligate the buyer to buy goods, 2) it must obligate the buyer to buy goods exclusively from the seller, and 3) it must obligate the buyer to buy all of its requirements from the seller. Note the emphasis on the buyer's obligations.

BRG Rubber & Plastics, Incorporated (BRG) entered into an agreement on January 1, 2010 to purchase carbon black from Continental Carbon Company. But Continental had trouble filling all of its orders for carbon black and refused to ship some of BRG's orders. BRG sued, claiming it had a requirements contract and that Continental breached it by refusing to ship BRG's orders. The district court agreed and awarded damages to BRG for nearly \$1 million. But Judge Williams of the 7th Circuit Court of Appeals had a much different view of the contract. (*BRG Rubber & Plastics, Incorporated v. Continental Carbon Company*, 7th Circuit Court of Appeals, Nos. 14-1416 & 14-1555, Nov. 5, 2015)

The terms of the agreement between BRG and Continental included the following:

"Quantity of Material

It is the intent of this Agreement that Continental Carbon Company agrees to sell to BRG Rubber and Plastics approximately 1.8 million pounds of [carbon] black annually. These volumes are to be taken in approximately equal monthly quantities. BRG Rubber and Plastics, to the best of their ability, will provide accurate forecasts of the future usage at their manufacturing sites which will assist Continental Carbon Company in meeting these and additional requirements."

"Meet or Release

If during the term of this agreement BRG receives an offer that they believe is better than the terms offered in this agreement, Continental Carbon will have the right to meet this agreement or release BRG from any further obligation"

There was also a "Rebate/Penalty" provision under which BRG would pay a little less per pound if it bought much more than 1.8 million pounds annually, and a little more per pound if it bought much less.

In 2010, Continental shipped 2.6 million pounds to BRC. However, in 2011, Continental could not keep up with demand. BRC placed an order on April 26, 2011 which Continental neither confirmed nor shipped. The parties continued communicating and it soon became apparent that there was a fundamental difference in their view of the agreement. In Continental's view, as long as it shipped approximately 1.8 million pounds annually, it did not have to accept and fill every BRC order. In BRC's view, its agreement with Continental was a requirements contract and Continental had to fill all of BRC's orders. As noted, BRC filed suit, persuaded the district court that the agreement was, indeed, a requirements contract, and was awarded nearly \$1 million.

Judge Williams, writing for the 7th Circuit, vacated the judgment and sent the case back. To analyze the reasons, we go back to the elements of a requirements contract as defined by 7th Circuit cases. Basically, BRC was not obligated to purchase.

First was the provision regarding the quantity of material that BRC was "required" to purchase. To Judge Williams, this provision was an estimate and did not contain the critical element of actually requiring BRC to purchase anything.

Second, Judge Williams viewed the "Meet or Release" provision as a right of first refusal. If BRC wanted to buy carbon black from another seller at a lower price, Continental would be given the chance to meet the price. Added Judge Williams, "But nothing in the "Meet or Release" provision prevented BRC from manufacturing its own carbon black or abandoning its use of carbon black altogether. In other words, the provision did not obligate BRC to buy carbon black from Continental."

Third, the agreement lacked the critical element of exclusivity. BRC again cited the "Meet or Release" provision to demonstrate that BRC had to buy exclusively from Continental. But, to Judge Williams, that was a misreading of the provision. As noted, Judge Williams saw it as a right of first refusal. Judge Williams further noted that price is not the only factor when a buyer decides from whom to buy and BRC conceded as much. So, again, the provision lacked the exclusivity element required by the 7th Circuit.

Interestingly, the court never indicated whether BRC actually purchased exclusively from Continental. Presumably, it did (at least until Continental refused to ship). But the court did emphasize a point that was more important than whether BRC purchased exclusively from Continental, that is whether BRC had to purchase exclusively from Continental. One way to analyze the case is to view it from the opposite perspective. Suppose it had been BRC that purchased carbon black from someone other than Continental? What remedies would Continental have had? Based on the decision by Judge Williams, the answer is probably none. No provision in the agreement quoted by the court would have provided Continental with specific remedies or clear damages if Continental had been the aggrieved party.

So the conclusion goes back to the elements of a requirements contract. No doubt BRC intended to buy carbon black from Continental. BRC could have made explicit its intention to buy exclusively from Continental all of its requirements of carbon black. But BRC may have intended to "hedge its bets" by leaving these critical elements open and ambiguous. In doing so, it also gave an "out" for Continental. The lesson is that any buyer that expects to have an assured supply of products by purchasing its requirements from a specific seller should make clear in the agreement that the buyer is also committing to purchase its requirements from the seller exclusively, exposing the buyer to damages if the buyer goes elsewhere for its products.

