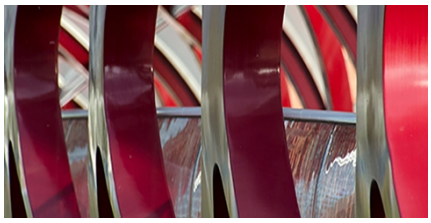
masuda funai



News & Types: Commercial, Competition & Trade Update

Buyer's Failed Claim of Breach of Requirements Contract Takes a Strange Turn – Enforceable as a Supply Contract for Fixed Quantity

10/2/2018

Practices: Commercial, Competition & Trade, Corporate, Finance & Acquisitions, Litigation

On December 7, 2015 we reported on a 7th Circuit opinion in which a buyer failed in its efforts to enforce a supply agreement as a requirements contract. (*BRC Rubber & Plastics, Incorporated v. Continental Carbon Company*, 7th Circuit Court of Appeals, Nos. 14-1416 & 14-1555, Nov. 5, 2015 reported at: link) Now, almost three years later, the case has taken a strange twist. The buyer did not give up and changed its claim against the seller from breach of a requirements contract to breach of a supply contract for a fixed quantity. Although it lost on summary judgment at the district court level, the 7th Circuit reversed and permitted the claim for breach of contract for a fixed quantity to continue. (*BRC Rubber & Plastics, Incorporated v. Continental Carbon Company*, 7th Circuit Court of Appeals, Nos. 17-2783, August 16, 2018)

BRC Rubber & Plastics, Incorporated (BRC) entered into an agreement on January 1, 2010 to purchase carbon black from Continental Carbon Company (Continental). But Continental had trouble filling all of its orders for carbon black and refused to ship some of BRC's orders. BRC sued, claiming it had a requirements contract and that Continental breached it by refusing to ship all of BRC's orders. The district court agreed and awarded damages to BRC for nearly $1 million. In the first *BRC* opinion issued on November 5, 2015, Judge Williams of the 7th Circuit Court of Appeals reversed the judgment, holding that there was no requirements contract.

Without amending its complaint, BRC then pursued its claim as a breach of a supply agreement for a fixed quantity. It cited the following terms in the agreement between BRC and Continental (the same provisions it cited in arguing for a requirements contract):

> "Quantity of Material
>
> It is the intent of this Agreement that Continental Carbon Company agrees to sell to BRC Rubber and Plastics approximately 1.8 million pounds of [carbon] black annually. These volumes are to be taken in approximately equal monthly quantities. BRC 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 BRC 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 BRC from any further obligation . . . ."

There was also a "Rebate/Penalty" provision under which BRC 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.

The judges on the 7th Circuit deciding the second *BRC* case were different from the three judges deciding the 2015 opinion, so the author of the second opinion (Judge Ripple) was also different.

In 2010, Continental shipped 2.6 million pounds of carbon black to BRC. By spring of 2011, Continental had provided more than one million pounds to BRC. In March 2011, demand began to exceed supply and Continental could not keep up. BRC placed an order for 360,000 pounds of N762 (a type of carbon black) in April 2011. Continental notified all its buyers that the N762 grade of carbon black would not be available in May 2011 due to plant outages and lack of inventory. In May 2011, BRC purchased N762 from another supplier at a higher price than the price in its Agreement with Continental.

The second *BRC* opinion cited evidence, not in the first opinion, that raised doubts about Continental's true situation and motives. Three different times, Continental tried to raise prices based on the shortage of carbon black.

- In mid-April 2011, a Continental sales representative e-mailed BRC's Vice President of Purchasing trying to increase the baseline price of carbon black by $.02 per pound. BRC declined, citing the prices in the Agreement. In late April, the same representative told BRC that Continental might withhold shipments from BRC. While not denying these communications, Continental claimed the representative delivered a false message and was terminated soon after.
- On May 20, 2011 (after BRC purchased N762 from the substitute supplier) Continental offered to ship BRC multiple railcars of carbon black at price increases up to $.06 per pound. Continental claimed that applying a price increase to the offer was an error. BRC again declined and a Continental director suggested that BRC "call another supplier." Continental claims this was a misunderstanding and on the same day Continental's attorney sent an email to BRC stating that Continental would continue to produce and timely ship at contract prices and would not cut off BRC.
- On May 23, 2011, BRC again asked about the status of its order. Continental said it would ship one railcar of carbon black the following day. At the same time, Continental emphasized that the Agreement required only 1.8 million pounds per year (150,000 pounds per month) and Continental had already shipped 1.2 million pounds (300,000 pounds per month). Continental, as promised shipped the railcar to BRC. Within a week, Continental e-mailed BRC to seek an increase in the baseline prices and to accelerate the payment terms in the Agreement.

BRC filed suit on June 2, 2011.

As noted, BRC lost on its claim that Continental had breached a requirements contract with BRC. (For a discussion of the first *BRC* opinion, see the Risk Management Update with the link above.) BRC then changed its strategy (without amending its complaint) to a claim for breach of an enforceable supply agreement. Perhaps guided by the earlier decision, the district court granted summary judgment to Continental because a) BRC did not amend its complaint to allege any alternative theory and b) the Agreement was an unenforceable "buyer's option" because it lacked mutuality of consideration. BRC appealed to the 7th Circuit Court of Appeals which overturned the summary judgment in Continental's favor.

Judge Ripple, the author of the opinion, found the Agreement to be supported by mutuality and consideration and was therefore enforceable. What were the mutual obligations?

Continental's obligation was to make available approximately 1.8 million pounds of carbon black annually in approximately equal monthly quantities at the baseline prices.

But BRC's obligations were more critical. Recall that the first *BRC* decision held the Agreement was not a requirements contract, since BRC did not commit to buying all of its carbon black requirements from Continental. Judge Ripple found other obligations.

Judge Ripple acknowledged that BRC was not obligated to purchase from Continental. BRC could purchase carbon black from another supplier at a higher price. BRC could produce its own carbon black. But BRC accepted a legal detriment in that if it sought to buy carbon black from another supplier at a lower price, it had to give Continental the chance to meet that price. To Judge Ripple, this was a sufficient legal detriment to provide consideration for the Agreement.

Judge Ripple then cited several cases in Indiana (the controlling law) holding that a right of first refusal to sell can support mutuality of obligation.

> ". . . Furthermore, the value of a right of first refusal is not undermined by its conditional nature. . . . Therefore, the right that Continental acquired through the "Meet or Release" provision is not legally diminished as a result of its limited application to only those offers that are "better" than the terms of the Agreement. It is not our place to question the value of this consideration.
>
> . . . It is clear under Indiana law that the "doctrine of mutuality of obligation does not require that every duty within an agreement be based upon a corresponding obligation." . . . Therefore, BRC's obligation under the Agreement need not mirror that of Continental; it is not the case that the seller be required to sell and the buyer be required to buy. . . . Because the Agreement imposes a definite obligation on both parties, there is mutuality and consideration."

Judge Ripple also rejected Continental's argument that the quantity term was too indefinite. The Agreement specifically referred to "approximately 1.8 million pounds" of carbon black. Citing Indiana cases, Judge Ripple determined that the approximation did not render the Agreement unenforceable.

Finally, Judge Ripple also reversed the district court's determination that dismissed BRC's complaint because it was not amended from the original failed claim of breach of requirements contract. Judge Ripple found that the facts in the unamended complaint "plausibly allege that Continental repudiated the Agreement by failing to provide adequate assurances of performance." Here, Continental's efforts to force a price increase worked

against it. These efforts showed BRC that Continental would not fulfill the Agreement at the prices agreed, resulting in the lengthy litigation. So the facts alleged by BRC were sufficient to allow the case to proceed.

BRC may still find its case difficult and worth less than it thought. The first *BRC* opinion reversed a verdict in favor of BRC of nearly $1 million based on the theory that the Agreement was a requirements contract. Now BRC must argue that Continental did not ship the agreed quantity to BRC. It is hard to see how the agreed quantity could be much different than the 1.8 million pounds stated in the Agreement.

In 2011, the year of Continental's alleged breach, Continental had already shipped 1.2 million pounds plus one rail car of unstated pounds to BRC. So, rather than measuring damages based on BRC's requirements, BRC must argue that Continental did not provide the quantity of carbon black agreed. If the quantity is around 1.8 million pounds, it would seem damages will be much reduced. Still, BRC's persistence may yet pay off.