Empire Gas Corp. v. American Bakeries Co.
United States Court of Appeals
840 F.2d 1333 (7th Cir. 1988)

POSNER, Circuit Judge:

This appeal in a diversity contract case presents a fundamental question—surprisingly little discussed by either courts or commentators—in the law of requirements contracts. Is such a 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?

Empire Gas Corporation is a retail distributor of liquefied petroleum gas, better known as "propane." It also sells converters that enable gasoline-powered motor vehicles to operate on propane. The sharp rise in gasoline prices in 1979 and 1980 made American Bakeries Company, which operated a fleet of more than 3,000 motor vehicles to serve its processing plants and bakeries, interested in the possibility of converting its fleet to propane, which was now one-third to one-half less expensive than gasoline. Discussions between the companies resulted in an agreement in principle. Empire Gas sent American Bakeries a draft of its standard "Guaranteed Fuel Supply Contract," which would have required American Bakeries to install a minimum number of conversion units each month and to buy all the propane for the converted vehicles from Empire Gas for eight years. American Bakeries rejected the contract and Empire Gas prepared a new one, which was executed on April 17, 1980, and which was "for approximately three thousand (3,000) [conversion] units, more or less depending upon requirements of Buyer, consisting of Fuel Tank, Fuel Lock Off Switch, Converter & appropriate Carburetor & Small Parts Kit," at a price of $750 per unit. American Bakeries agreed "to purchase propane motor fuel solely from EMPIRE GAS CORPORATION at all locations where EMPIRE GAS has supplied carburetion and dispensing equipment as long as EMPIRE GAS CORPORATION remains in a reasonably competitive price posture with other major suppliers." The contract was to last for four years.

American Bakeries never ordered any equipment or propane from Empire Gas. Apparently within days after the signing of the contract American Bakeries decided not to convert its fleet to propane. No reason has been given for the decision.

Empire Gas brought suit against American Bakeries for breach of contract and won a jury verdict for $3,254,963, representing lost profits on 2,242 conversion units (the jury's estimate of American Bakeries' requirements) and on the propane fuel that the converted vehicles would have consumed during the contract period. The judge added $581,916 in prejudgment interest.

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The heart of this case is the instruction concerning American Bakeries' obligation under the contract. If there were no legal category of "requirements" contracts and no provision of the Uniform Commercial Code governing such contracts, a strong argument could be made that American Bakeries agreed to buy 3,000 conversion units or *slightly* more or *slightly* less, depending on its actual needs, and hence that it broke the contract by taking none. This is not only a semantically

permissible reading of the contract but one supported by the discussions that the parties had before the contract was signed (and these discussions are admissible to explain though not to change the parties' undertakings), in which American Bakeries assured Empire Gas that it was planning to convert its entire fleet. American Bakeries insisted on adding the phrase "more or less depending upon requirements of Buyer" just in case its estimate of 3,000 was off, and this is quite different from supposing that the phrase was added so that American Bakeries would have no obligation to buy any units at all.

The parties agree, however, that despite the negotiating history and the inclusion in the contract of a specific estimate of quantity, the quoted phrase sorted the contract into the legal bin labeled "requirements contract" and thereby brought it under the governance of section 2-306(1) of the Uniform Commercial Code, which provides:

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

Over American Bakeries' objection the judge decided to read the statute to the jury verbatim and without amplification, remarking to the lawyers,

> Now, I have nothing to do with the fact that there may be some ambiguity in 2-306. If there is ambiguity, well, that is too bad. This is the law that the legislature has adopted. With due respect to all these great judges that [American Bakeries' counsel] has cited and these great academic lawyers he has called to my attention, well, good, they have a lot of time to mull over these problems.
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> But I have the problem of telling this jury what the law is, and the law is right here, right here in this statute, and I have a good deal of faith in this jury's ability to apply this statute to the facts of this case.

It is not true that the law is what a jury might make out of statutory language. The law is the statute as interpreted. The duty of interpretation is the judge's. Having interpreted the statute he must then convey the statute's meaning, as interpreted, in words the jury can understand. If section 2-306 means something different from what it seems to say, the instruction was erroneous.

The interpretive question involves the proviso dealing with "quantity unreasonably disproportionate to any stated estimate." This limitation is fairly easy to understand when the disproportion takes the form of the buyer's demanding more than the amount estimated. If there were no ceiling, and if the price happened to be advantageous to the buyer, he might increase his "requirements" so that he could resell the good at a profit. See, e.g., Crane v. C. Crane & Co., 105 Fed. 869, 872 (7th Cir. 1901); Weistart, Requirements and Output Contracts: Quantity Variations Under the UCC, 1973 Duke L.J. 599, 640-41; cf. Utah International, Inc. v. Colorado-Ute Electric Ass'n, Inc., 425 F. Supp. 1093, 1100-01 (D. Colo. 1976). This would place him in competition with the seller—a result the parties would not have wanted when they signed the contract. So the "unreasonably disproportionate" proviso carries out the likely intent of the parties. The only problem is that the same result could easily be reached by interpretation of the words "good faith" in the preceding clause of section 2-306(1), thus making the proviso redundant. But

redundancies designed to clarify or emphasize are common in legal drafting; and anyway the Uniform Commercial Code has its share of ambiguities, see Wisconsin Knife Works v. National Metal Crafters, 781 F.2d 1280, 1288 (7th Cir. 1986).

The proviso does not distinguish between the buyer who demands more than the stated estimate and the buyer who demands less, and therefore if read literally it would forbid a buyer to take (much) less than the stated estimate. Since the judge did not attempt to interpret the statute, the jury may have read it literally, and if so the judge in effect directed a verdict for Empire Gas. The stated estimate was for 3,000 units; American Bakeries took none; if this was not unreasonably disproportionate to the stated estimate, what buyer shortfall could be?

So we must decide whether the proviso should be read literally when the buyer is demanding less rather than more than the stated estimate. There are no cases on the question in Illinois, and authority elsewhere is sparse, considering how often (one might think) the question must have arisen. But the clearly dominant approach is not to construe the proviso literally, but instead to treat the overdemanding and underdemanding cases differently. See, e.g., Angelica Uniform Group, Inc. v. Ponderosa Systems, Inc., 636 F.2d 232 (8th Cir. 1980) (per curiam) (Missouri law); R. A.Weaver & Associates, Inc. v. Asphalt Construction, Inc., 190 U.S. App. D.C. 418, 587 F.2d 1315, 1322 (D.C. Cir. 1978) (District of Columbia law); Lambert Corp. v. Evans, 575 F.2d 132, 138 (7th Cir. 1978) (Wisconsin law); HML Corp. v. General Foods Corp., 365 F.2d 77, 81 n. 5 (3d Cir. 1966) (dictum) (New York law); Northern Indiana Public Service Co. v. Colorado Westmoreland, Inc., 667 F. Supp. 613, 636 (N.D. Ind. 1987) (Indiana law); Note, Requirements Contracts, "More or Less," Under the Uniform Commercial Code, 33 Rutgers L. Rev. 105, 120-21 (1980); Note, Requirements Contracts: Problems of Drafting and Construction, 78 Harv. L. Rev. 1212, 1220 (1965). We think this is right. We also note that it was the common law approach: "the seller assumes the risk of all good faith variations in the buyer's requirements even to the extent of a determination to liquidate or discontinue the business." HML Corp. v. General Foods Corp., supra, 365 F.2d at 81; see also Fort Wayne Corrugated Paper Co. v. Anchor Hocking Glass Corp., 130 F.2d 471, 473 (3d Cir. 1942).

Granted, there is language in the Official Comments (not official in Illinois, be it noted) which points to symmetrical treatment of the overdemanding and underdemanding cases: "the agreed estimate is to be regarded as a center around which the parties intend the variation to occur." UCC §2-306, comment 3. But there is no elaboration; and the statement is in tension with the statement in comment 2 that "good faith variations from prior requirements are permitted even when the variation may be such as to result in discontinuance," for if that principle is sound in general, why should it cease to be sound just because the parties included an estimate of the buyer's requirements? A tiny verbal point against the symmetrical interpretation is the last word of the proviso—"demanded." The statement that "no quantity unreasonably disproportionate to any stated estimate . . . may be . . . demanded" is more naturally read as applying to the case where the buyer is demanding more than when he is reducing his demand below the usual or estimated level.

More important than this verbal skirmishing is the fact that the entire proviso is in a sense redundant given the words "good faith" in the main clause of the statute. The proviso thus seems to have been designed to explicate the term "good faith" rather than to establish an independent legal standard. And the aspect of good faith that required explication had only to do with disproportionately *large* demands. If the buyer saw an opportunity to increase his profits by reselling

the seller's goods because the market price had risen above the contract price, the exploitation of that opportunity might not *clearly* spell bad faith; the proviso was added to close off the opportunity. There is no indication that the draftsmen were equally, if at all, concerned about the case where the buyer takes less than his estimated requirements, provided, of course, that he does not buy from anyone else.We conclude that the Illinois courts would allow a buyer to reduce his requirements to zero if he was acting in good faith, even though the contract contained an estimate of those requirements.

This conclusion would be greatly strengthened—too much so, as we shall see—if the only purpose of a requirements contract were to give the seller a reasonably assured market for his product *by forbidding the buyer to satisfy any of his needs by buying from another supplier.* (An output contract, also dealt with in section 2-306(1), gives the buyer a reasonably assured source of supply by forbidding the seller to sell any of his output to any other buyer.) The buyer's undertaking to deal exclusively with a particular seller gives the seller some, although far from complete, assurance of having a market for his goods; and of course he must compensate the buyer for giving up the opportunity to shop around for a better deal from competing sellers.

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Both extreme interpretations—that the buyer need only refrain from dealing with a competitor of the seller, and that the buyer cannot go significantly beneath the estimated quantity except in dire circumstances—must be rejected, as we shall see. Nevertheless the judge should not have read the "unreasonably disproportionate" proviso in section 2-306(1) to the jury. The proviso does not apply, though the requirement of good faith does, where the buyer takes less rather than more of the stated estimate in a requirements contract.

This error in instructions requires reversal and a new trial on liability unless it is clear either that American Bakeries acted in good faith or that it acted in bad faith, since the statute requires the buyer to take his "good faith" requirements from the seller, irrespective of proportionality. The Uniform Commercial Code does not contain a definition of "good faith" that seems applicable to the buyer under a requirements contract. Compare section 2-104(1) with section 2-103(1)(b). Nor has the term a settled meaning in law generally; it is a chameleon. See, e.g., Bosco v. Serhant, 836 F.2d 271, slip op. at 11 (7th Cir. 1987); In re TCI Ltd., 769 F.2d 441, 445 (7th Cir. 1985). Clearly, American Bakeries was acting in bad faith if during the contract period it bought propane conversion units from anyone other than Empire Gas, or made its own units, or reduced its purchases because it wanted to hurt Empire Gas (for example because they were competitors in some other market). Equally clearly, it was not acting in bad faith if it had a business reason for deciding not to convert that was independent of the terms of the contract or any other aspect of its relationship with Empire Gas, such as a drop in the demand for its bakery
products that led it to reduce or abandon its fleet of delivery trucks. A harder question is whether it was acting in bad faith if it changed its mind about conversion for no (disclosed) reason. There is no evidence in the record on why it changed its mind beyond vague references to "budget problems" that, so far as appears, may have been nothing more than a euphemism for a decision by American Bakeries not to allocate funds for conversion to propane.

If no reason at all need be given for scaling back one's requirements even to zero, then a

requirements contract is from the buyer's standpoint just an option to purchase up to (or slightly beyond, i.e., within the limits of reasonable proportionality) the stated estimate on the terms specified in the contract, except that the buyer cannot refuse to exercise the option because someone offers him better terms. This is not an unreasonable position, but it is not the law. Among the less important reasons for this conclusion are that option contracts are dealt with elsewhere in the Code, see section 2-311, and that the Official Comments to section 306 state that "a shut-down by a requirements buyer for lack of orders might be permissible where a shut-down *merely to curtail losses* would not." UCC §2-306, comment 2 (emphasis added). More compelling is the Illinois Code Comment to section 2-306, which states that "this section . . . is but a codification of prior Illinois decisional law," which had made clear that a requirements contract was more than a buyer's option. "By the original agreement, appellant was entitled to order all the coal which was required or needed in its business for the season named; by the modified contract, appellant was restricted to the privilege of ordering twelve thousand tons. It was not the intention here to contract for the mere option or privilege of buying coal at a future time, but simply to limit the quantity to be bought. . . . It was not intended to be an option contract." Minnesota Lumber Co. v. Whitebreast Coal Co., 160 Ill. 85, 96-97, 43 N.E. 774 (1896). "Requirements" are more than purely subjective "needs," which would be the equivalent of "wants." See National Furnace Co. v. Keystone Mfg. Co., 110 Ill. 427, 433-34 (1884). Chalmers & Williams v. Bledsoe & Co., 218 Ill. App. 363 (1920), held that a buyer's decision to switch from coal to electricity did not excuse it from its obligation to purchase its "consumption requirements" of coal from the seller. That was a stronger case for the buyer than the present one, because the buyer did make a fundamental change in its operations—yet this did not excuse it, when it gave no reason for the change. See also Loudenback Fertilizer Co. v. Tennessee Phosphate Co., 121 Fed. 298, 303 (6th Cir. 1903).

These cases are old, but nothing has happened to sap their strength, and *National Furnace* has been cited and followed in a modern case. See Illinois Commerce Comm'n v. Central Illinois Public Service Co., 25 Ill. App. 3d 79, 82, 322 N.E.2d 520, 523 (1975). The statement of an estimate invites the seller to begin making preparations to satisfy the contract, and although no reliance expense was incurred by the seller in this case, a seller is entitled to expect that the buyer will buy something like the estimated requirements unless it has a valid business reason for buying less. More important than the estimate (which was not a factor in the Illinois cases just cited) is the fact that ordinarily a requirements contract is terminated after performance has begun, rather than before as in the present case. Whether or not the seller can prove reliance damages, the sudden termination of the contract midway through performance is bound to disrupt his operations somewhat. The Illinois courts interpret a requirements contract as a sharing of risk between seller and buyer. The seller assumes the risk of a change in the buyer's business that makes continuation of the contract unduly costly, but the buyer assumes the risk of a less urgent change in his circumstances, perhaps illustrated by the facts of this case where so far as one can tell the buyer's change of mind reflected no more than a reassessmentof the balance of advantages and disadvantages under the contract. American Bakeries did not agree to buy conversion units and propane for trucks that it got rid of, but neither did Empire Gas agree to forgo sales merely because new management at American Bakeries decided that its capital would be better employed in some other investment than conversion to propane.

The general distinction that we are trying to make is well illustrated by Southwest Natural Gas Co. v. Oklahoma Portland Cement Co., 102 F.2d 630 (10th Cir. 1939), which to the drafters of

the Uniform Commercial Code exemplified "reasonable variation of an extreme sort" (at least in the absence of an estimate, but that is irrelevant, for reasons we have explained). UCC §2-306, comment 2. A cement company agreed to buy all of its requirements of gas from the seller for 15 years. Seven years later, the cement company replaced its boiler, which had worn out, with more modern equipment; as a result its need for gas fell by 80 percent. The court deemed this a bona fide change in the cement company's requirements. It would have been unreasonable to make the company replace its worn-out plant with an obsolete facility.

It is a nice question how exigent the buyer's change of circumstances must be to allow him to scale down his requirements from either the estimated level or, in the absence of estimate, the "normal" level. Obviously it need not be so great as to give him a defense under the doctrines of impossibility, impracticability, or frustration, or under a force majeure clause. Yet, although more than whim is required, see Tennessee Valley Authority v. Imperial Professional Coatings, 599 F. Supp. 436, 439 (E.D. Tenn. 1984), how much more is unclear. There is remarkably little authority on the question. This is a good sign; it suggests that, while we might think it unsatisfactory for the law to be unclear on so fundamental a question, the people affected by the law are able to live with the lack of certainty. The reason may be that parties linked in an ongoing relationship—the usual situation under a requirements contract—have a strong incentive to work out disagreements amicably rather than see the relationship destroyed by litigation.

The essential ingredient of good faith in the case of the buyer's reducing his estimated requirements is that he not merely have had second thoughts about the terms of the contract and want to get out of it. See Wilsonville Concrete Products v. Todd Building Co., 281 Ore. 345, 352, 574 P.2d 1112, 1115 (1978); Royal Paper Box Co. v. E. R. Apt Shoe Co., 290 Mass. 207, 195 N.E. 96 (1935); Fort Wayne Corrugated Paper Co. v. Anchor Hocking Glass Corp., supra, 130 F.2d at 473-74; White & Summers, supra, at 126. Whether the buyer has any greater obligation is unclear, see id. at 126-27, but need not be decided here. Once it is decided (as we have) that a buyer cannot arbitrarily declare his requirements to be zero, this becomes an easy case, because American Bakeries has never given any reason for its change of heart. It might seem that once the district judge decided to instruct the jury in the language of the statute, American Bakeries was foreclosed from arguing that it had scaled down its requirements in good faith; a reduction to zero could never be proportionate if, as the instruction implied, the proviso on disproportion applies to reductions as well as increases in the buyer's takings. But the judge did not make this decision until the instructions conference. Until then American Bakeries had every opportunity and incentive to introduce evidence of why it decided not to convert its fleet to propane. t introduced none, and even at the argument in this court its counsel could give no reason for the change of heart beyond a hint that it was due to a change in management, which would not be enough by itself to justify a change in the buyer's requirements.

Even though Empire Gas had the burden of proving breach of contract and therefore (we may assume) of proving that American Bakeries acted in bad faith in reducing its requirements from 3,000 conversion units to zero (see HML Corp. v. General Foods Corp., supra, 365 F.2d at 83; but see Utah International, Inc. v. Colorado-Ute Electrical Ass'n, Inc., supra, 425 F. Supp. at 1100), no reasonable jury could have failed to find bad faith, and therefore the error in instructing the jury on proportionality was harmless. Empire Gas put in evidence, uncontested and incontestable, showing that American Bakeries had not got rid of its fleet of trucks and did have the financial wherewithal to

go through with the conversion process. After this evidence came in, American Bakeries could avoid a directed verdict only by introducing some evidence concerning its reasons for reducing its requirements. It not only introduced no evidence, but as is plain from counsel's remarks at argument it has no evidence that it would care to put before the jury—no reasons that it would care to share with either the district court or this court. It disagrees with the standard of good faith, believing that so long as it did not buy conversion units elsewhere or want to hurt Empire Gas it was free to reduce its requirements as much as it pleased. It does not suggest that it has a case under the standard we have adopted, which requires at a minimum that the reduction of requirements not have been motivated solely by a reassessment of the balance of advantages and disadvantages under the contract to the buyer.

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But we think the judge erred in awarding prejudgment interest. . . . At the time of breach, and indeed right up to the jury's verdict, it was entirely unclear what Empire Gas's loss had been, since that depended not only on the precise extent of American Bakeries' requirements but on Empire Gas's profit margins on converting units and propane. . . .

The judgment is affirmed except for the award of prejudgment interest.

MODIFIED AND AFFIRMED.

KANNE, Circuit Judge, dissenting:

I agree with the majority that the error in giving the instruction regarding the "unreasonably disproportionate" proviso in Illinois' Uniform Commercial Code §2-306(1) requires a reversal and new trial, "unless it is clear either that American Bakeries acted in good faith or that it acted in bad faith. . . ." The fundamental problem is that there was no evidence of either good or bad faith as those terms are normally defined.1 For different reasons neither Empire Gas nor American Bakeries produced evidence of American Bakeries' honesty or dishonesty or fair or unfair dealing in regard to its reduction of its requirements to zero. As in Massey-Ferguson, Inc. v. Helland, 105 Ill. App. 3d 648, 434 N.E.2d 295, 299 (1982), ". . . the material testimony in this case did not reveal any lies, deceit, overreaching or other examples of dishonesty in fact in the transaction . . . nor was any evidence adduced regarding reasonable commercial standards of fair dealing in the trade." In Massey-Ferguson, the Illinois Appellate Court found that a plaintiff's failure to introduce specific evidence as to bad faith constituted a failure to carry its burden of proof on the issue of bad faith.

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If, as the majority apparently holds—the seller has the burden of proof on the issue of the buyer's bad faith—I would reverse and remand for new trial because Empire Gas did not bear that burden and the trial record discloses no facts ordinarily found necessary by Illinois courts to prove bad faith.

If, on the other hand, the majority actually holds (again correctly I believe)—a buyer's assertion of an unreasonably disproportionate reduction in his requirements creates a bad faith presumption which may be rebutted by the buyer's proof of good faith—I would also reverse and

remand for a new trial because this new rebuttable presumption of bad faith was not the Illinois rule under which the trial was conducted.