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# Output Contracts and the Unreasonably Disproportionate Clause of § 2-306\*

*Atlantic Track and Turnout v. Perini*<sup>1</sup>

## I. INTRODUCTION

Open quantity contracts evolved due to the commercial advantages inherent in such contracts. However, the level of permissible quantity variation within an open quantity contract has been frequently litigated. In *Atlantic Track and Turnout v. Perini*,<sup>2</sup> the First Circuit resolved a dispute concerning variation within such a contract. This Note examines the traditional analysis used by the court in resolving this dispute and suggests an alternative method of analysis.

## II. FACTS AND HOLDING

Atlantic Track and Turnout ("Atlantic") brought a breach of contract action against Perini Corporation under the Uniform Commercial Code ("UCC"), alleging Perini's failure to perform under a contract for the purchase and sale of railroad materials.<sup>3</sup> The Massachusetts Bay Transportation Authority ("MBTA") had awarded Perini the contract to rehabilitate a thirteen mile section of railroad track in October of 1987.<sup>4</sup> As part of the rehabilitation, Perini was to undercut the track and replace the stone foundation.<sup>5</sup>

In early June, Perini entered into a contract to sell salvage from the project to Atlantic.<sup>6</sup> Between June 28 and June 30, Atlantic issued purchase orders "for all available materials."<sup>7</sup> Each order estimated the amount of salvage that would be available.<sup>8</sup> Perini did not contest the reasonableness of these estimates at the time they were issued.

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1. 989 F.2d 541 (1st Cir. 1993).

2. *Id.*

3. *Id.* at 542.

4. *Id.*

5. *Id.*

6. *Id.* The case implies Perini contracted with Atlantic in June 1988, as Atlantic began issuing purchase orders for salvage materials in June 1988. *Id.*

7. *Id.*

8. *Id.* at 543.

The MBTA suspended undercutting on August 8, 1988 due to a funding shortage, and eventually Perini and the MBTA terminated the contract.<sup>9</sup> By October 26, Perini had no physical presence on the job site.<sup>10</sup> Atlantic knew by August 22, 1988 that all undercutting had been suspended and asked Perini when additional material would be available.<sup>11</sup> Perini informed Atlantic that the MBTA might terminate the project and that Perini had shipped "all available" salvage as required in the purchase orders, even though Perini had shipped only 15% of the materials previously estimated.<sup>12</sup> Atlantic sued Perini, claiming "that the amount of materials shipped was well below the stated estimates."<sup>13</sup>

Following cross motions for summary judgment, the trial proceeded on two issues: "(1) whether the contract was ambiguous; and (2) whether trade usage would supplement the contract terms to enable Atlantic to maintain its action."<sup>14</sup> After Atlantic's presentation of evidence, the court entered judgment in favor of Perini based on its partial findings.<sup>15</sup>

On appeal, the First Circuit Court of Appeals considered whether Perini's tender of only 15% of the quantity estimated was "unreasonably disproportionate" as defined by UCC section 2-306, which governs output contracts.<sup>16</sup> The First Circuit affirmed the trial court's decision in favor of Perini, holding that an output contract allocates "the risk of a change in the seller's business that makes continuation costly" to the buyer, while the "seller assumes the risk of a less urgent change in circumstances."<sup>17</sup>

### III. LEGAL BACKGROUND

Open quantity contracts allow one of the contracting parties to determine the quantity that will be taken or delivered under the contract.<sup>18</sup> The term open quantity contracts includes both requirements contracts and output

9. *Id.*

10. *Id.*

11. *Id.*

12. *Id.* at 543 and n.2.

13. *Id.* at 543.

14. *Id.* at 542.

15. *Id.* The court entered judgment pursuant to FED. R. CIV. P. 52(c) in favor of Perini. *Id.*

16. *Id.* at 544. The First Circuit also considered the issue of contract ambiguity and trade usage as discussed by the trial court.

17. *Id.* at 545.

18. Stacy A. Silkworth, *Quantity Variation in Open Quantity Contracts*, 51 U. PITT. L. REV. 235, 238 (1990).

contracts.<sup>19</sup> Under a requirements contract, a seller has an obligation "to supply the designated commodity to the buyer to the extent of the latter's needs during a specified period of time."<sup>20</sup> In contrast, an output contract involves an agreement "to sell all the goods or services a party may produce or perform to another party. . ."<sup>21</sup> Thus, the agreement between Perini and Atlantic was an output contract.<sup>22</sup>

Output contracts evolved due to the commercial advantages inherent in quantity contracts. Output contracts provide elements of security, efficiency and flexibility not found in fixed quantity contracts.<sup>23</sup> There is security because the seller is confident of a constant demand for her product, while the buyer is assured of a supply.<sup>24</sup>

Since the seller is assured of constant demand, the seller can maintain a steady production level, thus increasing efficiency.<sup>25</sup> This steady production level leads to stability in supply needs, allowing the producer to bargain for lower supply prices.<sup>26</sup>

Output contracts promote efficiency in various other ways.<sup>27</sup> First, parties do not have to continually renegotiate contracts; an output contract allows both the seller and buyer to contract for an extended period.<sup>28</sup> Therefore, the cost of locating new buyers is eliminated for the term of the contract.<sup>29</sup> Furthermore, the output seller can stabilize the rate of production, leading to efficient use of labor and capital.<sup>30</sup>

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19. *Id.*

20. *R.A. Weaver and Assocs., Inc. v. Asphalt Constr., Inc.*, 587 F.2d 1315, 1319 (D.C. Cir. 1978).

21. *Feld v. Henry S. Levy & Sons, Inc.*, 335 N.E.2d 320, 320 (N.Y. 1975).

22. *Atlantic Tract and Turnout*, 989 F.2d at 544.

23. *Silkworth*, *supra* note 18, at 238-39. *See also* John C. Weistart, *Requirements and Output Contracts: Quantity Variations Under the U.C.C.*, 1973 DUKE L.J. 599, 615.

24. *Silkworth*, *supra* note 18, at 238-39. The non-quantity determining party in open quantity contracts assumes some risk that the production levels of the other party will change. *Silkworth*, *supra* note 18, at 238-39.

25. *Weistart*, *supra* note 23, at 615.

26. *Weistart*, *supra* note 23, at 615.

27. *Silkworth*, *supra* note 18, at 238-39. In fact, the cost reduction offered to the output seller attracts sellers to enter into output contracts. Given a steady demand for production, the output seller "need not incur costs which are usually necessary to stimulate and respond to demand." *Weistart*, *supra* note 23, at 616.

28. *Silkworth*, *supra* note 18, at 238.

29. *Silkworth*, *supra* note 18, at 239.

30. *Weistart*, *supra* note 23, at 615.

Finally, output contracts present an element of flexibility to sellers that is not present in fixed quantity contracts.<sup>31</sup> When business reversals occur, the seller may reduce production to minimize losses.<sup>32</sup> In contrast, the seller may increase production under an output contract to maximize profits.<sup>33</sup> To achieve this level of flexibility, the buyer must accept the risk of quantity variations under the contract, usually in exchange for a lower price.<sup>34</sup>

Although flexibility is an important feature of output contracts, clearly there must be a limit to the level of variation permitted. "[T]he nature of permissible and impermissible quantity variation permissible in open quantity contracts has been the subject of lawsuits for over 100 years."<sup>35</sup> In determining the permissible level of variation, requirement contracts are often equated with output contracts.<sup>36</sup> In both types of contracts, "one party, either the requirements buyer or the output seller, determines the quantity that will be taken or delivered under the contract."<sup>37</sup> Furthermore, "[t]he output seller in a rising market . . . is in much the same position as the requirement buyer in a falling market."<sup>38</sup> In a falling market, the requirement buyer, obligated to pay the contract price for goods, has an incentive to purchase fewer goods.<sup>39</sup> Similarly, in a rising market an output seller, who receives the contract price for goods, operates at a higher cost; therefore, the output seller has an incentive to decrease output.<sup>40</sup>

### A. Pre-Code Decisions

Prior to the UCC, courts applying the common law refused to enforce open quantity contracts due to concerns related to lack of mutuality and indefiniteness.<sup>41</sup> However, courts eventually began to enforce these contracts as their commercial advantages became apparent.<sup>42</sup>

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31. Silkworth, *supra* note 18, at 239.

32. Weistart, *supra* note 23, at 613.

33. Weistart, *supra* note 23, at 613.

34. Weistart, *supra* note 23, at 613.

35. Silkworth, *supra* note 18, at 235.

36. Weistart, *supra* note 23, at 638.

37. Silkworth, *supra* note 18, 238.

38. Harold C. Havighurst & Sidney M. Berman, *Requirement and Output Contracts*, 27 ILL. L. REV. 1, 18 (1932).

39. *Id.* at 2.

40. *Id.*

41. Silkworth, *supra* note 18, at 246-47 (citing *Bailey v. Austrian*, 19 Minn. 535 (Gil 465, 468)(1873), *overruled by House of Gurney, Inc. v. Ronan*, 245 N.W. 30 (Minn. 1932)).

42. Silkworth, *supra* note 18, at 246-47 (citing *e.g.*, *T.B. Walker Mfg. Co. v.* <https://scholarship.law.missouri.edu/mlr/vol59/iss4/9>

As open quantity contracts became enforceable, various courts held that the party determining the quantity in an open quantity contract could vary the production level or demand.<sup>43</sup> In considering the issue of quantity decreases within an output contract, Professor Corbin asked if the "seller promise[s] by implication that he will have any 'output,' that he will run his factory or work his mine, with diligence, according to past custom, or at all?"<sup>44</sup> Corbin concluded that courts had generally allowed sellers in an output contract to decrease their production levels.<sup>45</sup>

Additionally, courts held that increases and decreases in quantity resulting from the behavior of the quantity determining party were permissible.<sup>46</sup> For example, in *Eustis Mining Co. v. Beer, Sondheimer & Co.*,<sup>47</sup> the buyer agreed to purchase the seller's entire output of cinder.<sup>48</sup> The seller's main business was sulphur refining, of which cinder was a by-product.<sup>49</sup> Due to the start of the First World War, the demand for sulphur increased.<sup>50</sup> Therefore, the seller increased production of sulphur, thus increasing its supply of cinder substantially.<sup>51</sup> The court held that the buyer had to accept the increased quantity of cinder, while acknowledging that the defendant might

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Swift & Co., 200 F. 529, 531 (5th Cir. 1912); *National Furnace Co. v. Keystone Mfg. Co.*, 110 Ill. 427, 433 (1884).

43. Weistart, *supra* note 23, at 619 (citing *e.g.* *Marx v. American Malting Co.*, 169 F. 582 (6th Cir. 1909); *Eustis Mining Co. v. Beer, Sonheimer & Co.*, 239 F. 976 (S.D.N.Y. 1917); *E.G. Dailey Co. v. Clark Can Co.*, 87 N.W. 761 (Mich. 1901)). In the two cited cases which follow *Eustis Mining*, Weistart notes that the "court emphasized that the increased needs of the buyer/plaintiff were foreseeable by the parties on the basis of facts known at the time the requirements contracts were entered into." *Id.* at 640, n.100. This reasoning closely resembles the interrelated doctrines of frustration of purpose and impossibility of performance discussed in this Note, which modern courts have often failed to use in determining the level of permissible variation within an open quantity contract.

44. 3 ARTHUR L. CORBIN, CORBIN ON CONTRACTS § 569 (1963), *quoted in* Weistart, *supra* note 23, at 619.

45. CORBIN, *supra* note 44, §569. For further support, see cases cited in CORBIN, *supra* note 44, §569 n.93.

46. *Silkworth*, *supra* note 18, at 249-56 (citing *e.g.* *Standard Magnesium Corp. v. United States*, 241 F.2d 677 (10th Cir. 1957); *Fort Wayne Corrugated Paper Co. v. Anchor Hocking Glass Corp.*, 130 F.2d 471 (3d Cir. 1942); *American & British Mfg. Corp. v. New India Quicksilver Mining Co.*, 293 F. 509, 530 (1st Cir. 1923); and *Welded Tube Co. of America v. Phoenix Steel Corp.*, 377 F.Supp. 74 (E.D. Pa. 1974).

47. 239 F. 976 (S.D.N.Y. 1917)

48. *Id.* at 986, *cited in* Weistart, *supra* note 23, at 639-40.

49. *Eustis Mining*, 239 F. at 986. *See also* Weistart, *supra* note 23 at 640.

50. *Eustis Mining*, 239 F. at 986. *See also* Weistart, *supra* note 23, at 640.

51. *Eustis Mining*, 239 F. at 986. *See also* Weistart, *supra* note 23, at 640.

not have entered the agreement if the increase in production had been contemplated.<sup>52</sup> The court stated that parties must "use more certain words" if they wish to limit quantity variations in output contracts.<sup>53</sup>

However, prior to the UCC, courts did not allow the seller in an output contract unbridled discretion to decrease or increase the quantity tendered. In *Mantell v. International Plastic Harmonica Corp.*,<sup>54</sup> a harmonica producer entered into an agreement to sell its total output of harmonicas to the buyer up to a stated maximum.<sup>55</sup> When the producer realized the contract was not favorable, it began delivering harmonicas to other purchasers without meeting its obligation to the output purchaser.<sup>56</sup> The court found that the producer was obligated to supply the buyer up to the maximum output required by the contract before selling harmonicas to other purchasers.<sup>57</sup>

Commentators generally agree that prior to the UCC, courts searched for good faith when reviewing open quantity contract cases involving quantity variations.<sup>58</sup> Courts found good faith when a valid business reason for the variation existed, as opposed to evidence of contract manipulation.<sup>59</sup> Therefore, if courts found a seller to have a valid business reason and to have no intent to manipulate the contract, the court would uphold the seller's quantity variation in an output contract.<sup>60</sup>

### B. UCC interpretations

Opinions differ as to whether the UCC establishes a quantitative limitation upon output and requirements variations.<sup>61</sup> Section 2-306(1) applies to both output and requirements contracts and reads:

52. *Eustis Mining*, 239 F. at 986. See also Weistart, *supra* note 23, at 640.

53. *Eustis Mining*, 239 F. at 986 cited in Weistart, *supra* note 23, at 610.

54. 49 A.2d 290 (N.J. Ch. 1946) modified, 55 A.2d 250 (N.J. 1947).

55. *Id.* at 293, cited in Silkworth, *supra* note 18, at 255. In reality, the seller agreed to sell all of its output up to a stated maximum. *Mantell*, 49 A.2d at 293.

56. *Mantell*, 49 A.2d at 293-94.

57. *Id.*

58. See Silkworth, *supra* note 18, at 236-37; Weistart, *supra* note 23, at 621.

59. Silkworth, *supra* note 18, at 256. Valid "business reasons justifying increases in quantity include modifications, technical advances, growth of business, and expansions of factories." Silkworth, *supra* note 18, at 256. Lack of demand, insolvency and the sale of one's business are justifications for decreases in quantity. Silkworth, *supra* note 18, at 256.

60. Weistart, *supra* note 23, at 620-21 (citing *e.g.*, *HML Corp. v. General Foods Corp.*, 365 F.2d 77 (3d Cir. 1966); *Oregon Plywood Sales Corp. v. Sutherlin Plywood Corp.*, 246 F.2d 466 (9th Cir. 1957); *Keener Oil & Gas Co. v. Consolidated Gas Util. Corp.*, 190 F.2d 985 (10th Cir. (1951)).

61. Weistart, *supra* note 23, at 600.

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.<sup>62</sup>

## 1. The Two-Step Analysis Approach

Some commentators have stated the explicit language of section 2-306(1) requires a two-step test in analyzing any variation of quantity within an open quantity contract.<sup>63</sup> Under this interpretation, courts must determine whether the quantity determining party is varying the quantity term in good faith.<sup>64</sup> Second, courts must determine whether the quantity variation is reasonably proportionate to a stated estimate or any prior output.<sup>65</sup> Under this analysis, the Code imposes a limitation beyond good faith on both increases and decreases in output levels.<sup>66</sup> The language of the UCC, which states that good faith variations are permitted except for disproportionate variations, explicitly limits variations not in good faith.<sup>67</sup>

The comments to the UCC offer little help in determining whether the drafters intended to engraft a quantitative limitation onto the common law test.<sup>68</sup> Comment 2 endorses the elasticity provided by open quantity

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62. U.C.C. § 2-306(1) (1990).

63. Silkworth, *supra* note 18, at 240; Weistart, *supra* note 23, at 603-04 and n.9. Professor Weistart notes that the Committee on Continuing Legal Education of the Oregon State Bar has accepted a quantitative limitation on certain requirements reductions.

Whereas the requirements under all output or requirements constraints are restricted by the limits of good faith, further limitation of reasonableness in the extent of variation from anticipation of quantities is improved where there is either a prior course of dealing between the parties on the basis of which output or requirements could be estimated or an estimate of output or requirements stated in the agreement.

Weistart, *supra* note 23, at 603-04 n.9 (quoting OREGON STATE BAR, UNIFORM COMMERCIAL CODE HANDBOOK 30 (1963)).

64. Silkworth, *supra* note 18, at 240.

65. Silkworth, *supra* note 18, at 240.

66. Weistart, *supra* note 23, at 603.

67. Weistart, *supra* note 23, at 603 (citing Professor Honnald in N.Y. REVISION COMMISSION, STUDY OF THE UNIFORM COMMERCIAL CODE (1955)).

68. Silkworth, *supra* note 18, at 239-46. The common law test considered only the good faith of the quantity determining party. *Id.* See *supra* notes 58-60 and accompanying text.

contracts and permits good faith variations.<sup>69</sup> Despite inherent ambiguities within comment 2, the comment appears to endorse the pre-UCC good faith requirements.<sup>70</sup>

However, comment 3 appears to be in direct conflict with the comment 2 endorsement of elasticity.<sup>71</sup> Comment 3 states:

If an estimate of output or requirements is included in the agreement, no quantity unreasonably disproportionate to it may be tendered or demanded. Any minimum or maximum set by the agreement shows a clear limit on the intended elasticity. In similar fashion, the agreed estimate is to be regarded as a center around which the parties intend variation to occur.<sup>72</sup>

Comment 3 appears "to require that a circle of reasonableness be drawn around an estimate or prior quantity that presumably would preclude extreme variations."<sup>73</sup>

One must recognize that while comments to the UCC are to be given some weight, the comments were not drafted at the request of the adopting legislature, nor are they subject to its review.<sup>74</sup> In addition, the comments were often drafted a considerable time after the drafting of the related UCC provision.<sup>75</sup> Therefore, the language of the UCC is to be given greater weight than the comments.<sup>76</sup>

By applying the two-step test to quantity variations in open quantity contracts, the flexible nature of such contracts would be limited.<sup>77</sup> This effect may be undesirable, as it may limit the commercial advantages of such contracts.<sup>78</sup>

69. Silkworth, *supra* note 18, at 241. Comment 2 reads in part:

Reasonable elasticity in the requirements is expressly envisaged by this section and good faith variations from prior requirements are permitted even when the variation may be such as to result in discontinuance . . . . Reasonable variation of an extreme sort is exemplified in *Southwest Natural Gas v. Oklahoma Portland Cement*.

U.C.C. § 2-306(1) cmt. 2 (1990).

70. Silkworth, *supra* note 18, at 241.

71. Silkworth, *supra* note 18, at 241.

72. U.C.C. § 2-306(1) cmt. 3 (1990).

73. Silkworth, *supra* note 18, at 242.

74. Weistart, *supra* note 23, at 606 n.17.

75. Weistart, *supra* note 23, at 606 n.17.

76. *See* Weistart, *supra* note 23, at 606 n.17.

77. Weistart, *supra* note 23, at 623.

78. Weistart, *supra* note 23, at 623.

## 2. The Separate Standards Interpretation

The more widely accepted interpretation of section 2-306 is the unreasonably disproportionate standard applies only to increases in quantity, and decreases in quantity are subject only to the good faith standard.<sup>79</sup> This interpretation finds support in both the language of the comments and the policy implications. Professor Weistart finds that comment 2 suggests decreases in quantity are subject only to the good faith standard, in part because the comment approves of the decision in *Southwest Natural Gas Co. v. Oklahoma Portland Cement Co.*<sup>80</sup> In that case, the court allowed a purchaser under a requirements contract to reduce its requirements drastically.<sup>81</sup>

Professor Havighurst details the output seller's economic position in situations involving a decrease.<sup>82</sup> In a scenario where the market price falls below the contract price and the seller wants to deliver less, both parties to an output contract lose.<sup>83</sup> The output seller loses profits.<sup>84</sup> The output buyer loses profits upon the loss of supply.<sup>85</sup> Thus, in allowing the quantity decrease, the market risk is generally spread between two parties, lessening the total economic impact.<sup>86</sup>

One commentator notes that disallowing disproportionate decreases in quantity under an output contract interferes with business judgment.<sup>87</sup> The parties entered into an open quantity contract, with flexibility in production and business judgment as a major concern.<sup>88</sup> Furthermore, a party entering into an open quantity contract has probably not given up the right to decrease output.<sup>89</sup> Therefore, the majority of commentators accept the good faith standard for decreases in quantity.

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79. Silkworth, *supra* note 18, at 242-43.

80. Weistart, *supra* note 23, at 633-34. Professor Weistart gives more credence to comment 2 than comment 3 due to the history of the comments. Weistart, *supra* note 23, at 635-36.

81. *Southwest Natural Gas Co. v. Oklahoma Portland Cement Co.*, 102 F.2d 630 (10th Cir. 1939).

82. Havighurst, *supra* note 38, at 15, *cited in* Silkworth, *supra* note 18, at 244-45.

83. Silkworth, *supra* note 18, at 244-45.

84. Silkworth, *supra* note 18, at 245.

85. Weistart, *supra* note 23, at 644.

86. Weistart, *supra* note 23, at 644.

87. Weistart, *supra* note 23, at 645-46.

88. Weistart, *supra* note 23, at 646.

89. Weistart, *supra* note 23, at 646. *See also* Note, *Business Practices and the Flexibility of Long Term Contract*, 36 VA. L. REV. 627 (1950).

However, in instances where the market price has fallen relative to the contract price, the output seller may take advantage of the output buyer by delivering more goods. Due to the increased incentive of an output seller to take advantage of market forces in a quantity increase, some commentators feel that quantity increases should have some limitation beyond good faith.<sup>90</sup> This limitation is justified as the seller will suffer no harm, presumably because he can sell the excess quantity on the market.<sup>91</sup> Therefore, the limitation is both necessary and justified because

a legitimate purpose of the law of commercial transactions is to temper one party's attempt to secure his greatest advantage with concern for the potential impact upon the party from whom performance can be exacted. If unbridled expectations are likely to produce considerable economic hardship for one party, the stability of commercial transactions is promoted by a limitation upon the effect of a potentially oppressive contractual term.<sup>92</sup>

Many courts have concluded that the UCC supports differing treatment of quantity decreases and increases. In *Angelica Uniform Group, Inc. v. Ponderosa Systems, Inc.*,<sup>93</sup> the Eighth Circuit stated that section 2-306(1) of the UCC "has been interpreted as allowing a buyer under a requirements contract to order reductions which are highly disproportionate to a stated estimate, if such reductions are done in good faith."<sup>94</sup> Furthermore, in *Empire Gas Corp. v. American Bakeries Co.*,<sup>95</sup> the court stated the unreasonably disproportionate provision "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."<sup>96</sup>

### 3. The Persistence of Pre-Code Standards

Although most commentators and courts agree the UCC changes the pre-UCC approach of analyzing permissible quantity variations, one commentator's survey finds that courts have not substantively altered their

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90. Weistart, *supra* note 23, at 646.

91. Weistart, *supra* note 23, at 646. Although this section discusses buyers in a requirements contract, an output seller in a falling market is in virtually the same position as a requirements buyer in a rising market. See *supra* note 38 and accompanying text.

92. Weistart, *supra* note 23, at 642-46.

93. 636 F.2d 232 (8th Cir. 1980).

94. *Id.* at 232.

95. 840 F.2d 1333 (7th Cir. 1988).

96. *Id.* at 1338.

analysis. "In the post-Code era . . . some courts attempt to use the reasonable proportionality test espoused in section 2-306. But this test does not seem to alter their analysis from that used by pre-Code courts and may, in fact, obscure it."<sup>97</sup>

For example, in *Orange and Rockland Utilities Inc. v. Amerada Hess Corp.*,<sup>98</sup> the court used the UCC language, but applied the common law test.<sup>99</sup> In *Orange and Rockland Utilities*, Amerada Hess agreed to supply the utility's fuel requirements at a fixed price for a period of about four years.<sup>100</sup> Estimates of the utility's requirements were included in a contractual clause.<sup>101</sup> As the price of fuel oil began to increase rapidly, the utility company increased its requirements for the year of 1970 by about 63 percent.<sup>102</sup>

Using UCC language, the court reasoned that unreasonably disproportionate is not the equivalent of lack of good faith.<sup>103</sup> The court found that the term unreasonably disproportionate is "keyed to stated estimates . . . which represents a departure from prior case law, wherein estimates were generally treated as having been made simply for the convenience of the parties and of no operative significance."<sup>104</sup>

The court found the utility's demand of more than double the stated estimate was disproportionate, but refused to use that measure as an inflexible standard of "unreasonably disproportionate."<sup>105</sup> Instead, the court listed factors leading it to conclude the quantity variation was disproportionate.

First, the court noted that the buyer's requirements had more than doubled.<sup>106</sup> The seller had no way to forecast such an increase.<sup>107</sup> The market price of fuel oil had more than doubled.<sup>108</sup> Finally, the increase in requirements was caused by the utility's increased sales to other utilities.<sup>109</sup> Effectively finding contract exploitation, the court disallowed the increase in quantity.<sup>110</sup>

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97. Silkworth, *supra* note 18, at 264.

98. 397 N.Y.S.2d 814 (N.Y. App. Div. 1977).

99. *Id.* at 821-22; Silkworth, *supra* note 18, at 259-60.

100. *Orange and Rockland Utilities*, 397 N.Y.S.2d at 816.

101. *Id.*

102. *Id.* at 817.

103. *Id.* at 818.

104. *Id.* at 818-19.

105. *Id.* at 821-22.

106. *Id.* at 822.

107. *Id.*

108. *Id.*

109. *Id.* at 822.

110. *Id.* See also Silkworth, *supra* note 18, at 260.

#### 4. A Possible Alternative: Frustration of Purpose

The interrelated doctrines of impossibility of performance and frustration of purpose protect both sellers and buyers where performance in a contract became impossible or impracticable.<sup>111</sup> The Uniform Commercial Code recognizes both doctrines in section 2-615.<sup>112</sup> However, the doctrine has rarely been applied to open quantity contracts.<sup>113</sup>

Although section 2-615 refers solely to sellers, comment 9 reflects the view many courts have adopted, stating that in certain instances "the present section may well apply and entitle the buyer to the exemption."<sup>114</sup> The term impracticability is used to refer to sellers, while frustration is applied to buyers.<sup>115</sup>

In order to be granted protection under section 2-615, three elements must be proven. First, a party "must not have assumed the risk of some unknown contingency."<sup>116</sup> Second, the "nonoccurrence of the contingency must have been a basic assumption underlying the contract."<sup>117</sup> Finally, the actual

111. JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE § 3.9 at 165 (3d ed. 1988).

112. Except so far as a seller may have assumed a greater obligation and subject to the preceding section on substituted performance:

(a) Delay in delivery or non-delivery in whole or in part by a seller who complies with paragraphs (b) and (c) is not a breach of his duty under a contract for sale if performance as agreed has been made impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made or by compliance in good faith with any applicable foreign or domestic governmental regulation or order whether or not it later proves to be invalid.

U.C.C. § 2-615 (1990).

113. For a rare case applying the impossibility doctrine to an open quantity contract, see *Mishara Constr. Co. v. Transit-Mixed Concrete Corp.*, 310 N.E.2d 363 (Mass. 1974). In this case, the plaintiff contracted with the concrete company for the supply of concrete to be used in a construction project. *Id.* at 364. The concrete company failed to make delivery due to a labor dispute. *Id.* Upon the plaintiff's suit for breach of contract, the defendant offered the defense of impossibility of performance. *Id.* at 366. The appellate court found the doctrine of impossibility applicable to the requirements contract involved in the case. *Id.* at 367-68.

114. U.C.C. § 2-615 cmt. 9 (1990).

115. *Northern Indiana Pub. Serv. Co. v. Carbon County Coal Co.*, 799 F.2d 265, 277 (7th Cir. 1986).

116. WHITE & SUMMERS, *supra* note 111, § 3.9, at 172 (quoting *Iowa Elec. Light and Power Co. v. Atlas Corp.*, 467 F.Supp. 129, 134 (N.D. Iowa 1978), *rev'd on other grounds*, 603 F.2d 1301 (8th Cir. 1979), *cert. denied* 445 U.S. 911 (1980)).

117. WHITE & SUMMERS, *supra* note 111, § 3.9, at 172.  
<https://scholarship.law.missouri.edu/mlr/vol59/iss4/9>

occurrence of the contingency "must have made performance commercially impracticable."<sup>118</sup>

However, courts have been reluctant to rely on mere variations in price to excuse performance in a fixed-price contract. Judge Posner noted that impossibility is a doctrine that shifts risk "in accordance with parties' presumed intentions . . ."<sup>119</sup> Therefore, the doctrine has no place in a fixed-price contract, which is "an explicit assignment of the risk of market price increases to the seller and the risk of market price decreases to the buyer . . ."<sup>120</sup> Therefore, courts rarely apply the doctrines of impracticability or frustration of purpose due to a price variation.

Although courts are reluctant to use the doctrines of impossibility and frustration of purpose in a fixed price contract, in the application of this doctrine a court must examine the parties' unstated expectations in order to determine which nonoccurrences were basic assumptions of the contract and which were not.<sup>121</sup> In order to do this, a court must often examine factors revealed in the parties' negotiation process.<sup>122</sup>

A court must often "direct a just and reasonable result" when contingencies occur about which the parties had no expectations.<sup>123</sup> In these cases, a court must determine the agreement reasonable people would have reached if the contingency had been considered, given the terms on which the parties did agree.<sup>124</sup>

Finally, it is clear that the drafters were at least thinking of quantity variations in open quantity contracts when writing the comments to section 2-615. In comment 9, the drafters wrote:

Exemption of the buyer in the case of a "requirements" contract is covered by the "Output and Requirements" section as to assumption and allocation of the relevant risks.<sup>125</sup>

The doctrines of impossibility and frustration of purpose offer an alternative form of analysis which courts may use to limit harsh consequences of quantity variations, made in good faith, within an output contract. When certain events occur within an open quantity contract about which the parties

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118. WHITE & SUMMERS, *supra* note 111, § 3.9, at 172.

119. *Northern Ind. Pub. Serv. Co.*, 799 F.2d at 278.

120. *Id.*

121. WHITE & SUMMERS, *supra* note 111, § 3.9, at 174.

122. WHITE & SUMMERS, *supra* note 111, § 3.9, at 174.

123. WHITE & SUMMERS, *supra* note 111, § 3.9, at 174.

124. WHITE & SUMMERS, *supra* note 111, § 3.9, at 174.

125. U.C.C. § 2-615 cmt. 9 (1990).

had no expectations, these doctrines offer courts a justification for excusing performance.

#### IV. INSTANT DECISION

In *Atlantic Track and Turnout*, the court noted output contracts are governed by UCC section 2-306.<sup>126</sup> The court stated little had been written regarding application of the UCC to quantity variations in output contracts.<sup>127</sup> Relying on previous cases analyzing the applicability of section 2-306 to requirement contracts, the court found that most authorities treated quantity increases differently than quantity decreases.<sup>128</sup> Thus, the court applied this differing treatment to the output contract between Atlantic and Perini.<sup>129</sup> The court noted that if an output seller chose to increase profits by increasing output provided to a buyer, good faith alone might not limit the risk to the buyer.<sup>130</sup> Therefore, the unreasonably disproportionate clause would be needed.<sup>131</sup>

However, the court refused to apply an additional limitation beyond good faith to the quantity reduction which Perini, as the output seller, had forced on Atlantic.<sup>132</sup> The court reasoned that forcing Perini and other output sellers to meet contract estimates would lead to inefficient business decisions.<sup>133</sup> Therefore, the court held that output contracts amount to a risk allocation, with the seller maintaining good faith discretion to limit output.<sup>134</sup> However, the seller is limited to quantity increases that are in good faith and not unreasonably disproportionate.<sup>135</sup>

#### V. COMMENT

The adoption of section 2-306 has led to confusion over the permissible level of quantity variation within an open quantity contract. Indeed, legal commentators have not established whether the drafters of the UCC intended to change the common law limitations on quantity increases. However, the language of section 2-306 demonstrates the drafters intended to create a two-

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126. *Atlantic Track & Turnout*, 989 F.2d at 544.

127. *Id.*

128. *Id.*

129. *Id.* at 545.

130. *Id.* at 544.

131. *Id.*

132. *Id.* at 545.

133. *Id.* at 544.

134. *Id.* at 545.

135. *Id.*

fold requirement for both quantity increases and decreases in open quantity contracts.

By adopting a different test in quantity increase cases, courts have assumed that the good faith standard fails to appropriately limit the seller from overreaching. For example, in *Atlantic Track and Turnout*, the court stated: "If a seller saw an opportunity to increase his profits by buying additional goods to resell as output to the buyer, this exploitation might not conclusively establish bad faith."<sup>136</sup>

However, the court failed to recognize that the factors developed under the good faith standard in pre-UCC decisions included both lack of contract exploitation and the presence of a valid business reason.<sup>137</sup> If a seller were to increase output merely because the market price had declined relative to the contract price, a court would not find good faith to be present. Therefore, the good faith standard would disallow quantity increase in *Atlantic Track and Turnout*.

In direct contrast to their lack of confidence in the good faith standard in quantity increase cases, commentators who advocate differing tests for quantity increases and decreases are comfortable in relying on the good faith limitation in quantity decrease cases. One commentator, in acknowledging that quantity decreases may result in inequitable distribution of contractual risks, states that the "overriding requirement of good faith should serve as an adequate basis for control."<sup>138</sup>

In justifying the requirement of only a good faith limitation on quantity decreases within open quantity contracts, some commentators rely on the disincentive a producer has in limiting production. As discussed above, some commentators have reasoned that a seller decreasing production will be decreasing profits, which the seller has a disincentive to do.<sup>139</sup> However, a decrease in production does not necessarily lead to a decrease in profits. In fact, decreasing production may lead to increased profits when the producer's production level is not at a point where its marginal costs equal marginal revenues.<sup>140</sup>

In addition, the widely accepted interpretation of section 2-306 limits the flexibility of the open quantity contract provision, which is an element of the parties' bargain. Recognizing that the buyer in an output contract probably

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136. *Atlantic Track and Turnout*, 989 F.2d at 545.

137. *See supra* note 59.

138. Weistart, *supra* note 23, at 644.

139. *See supra* notes 83-86 and accompanying text.

140. *See* Silkworth, *supra* note 18, at 268 n.248, who notes that lack of demand for the quantity determining party's product provides a valid business reason for a decrease in production.

received some price reduction for allowing the seller to maintain flexibility, it is unfair to limit the flexibility beyond good faith.

The UCC provides nothing more than default rules.<sup>141</sup> Nothing in the UCC suggests that the parties cannot control the harshness of their agreement.<sup>142</sup> Therefore, courts interpreting the UCC should limit the requirement for permissible quantity variations in an output contract to the standard of good faith.<sup>143</sup>

Even if the disproportionate limitation of section 2-306 is eliminated, courts will have access to the doctrines of frustration of purpose and impossibility to limit harsh results that the parties did not contemplate when contracting. For example, in *Eustis Mining*, the occurrence of World War I led to great increases in the output seller's production of cinder. Referring to section 2-615, a court could very easily find that the occurrence of the First World War was a contingency, the nonoccurrence of which was a basic assumption of the contract. If neither party assumed the risk of the occurrence and the occurrence made performance commercially impracticable, a court could excuse the buyer from purchasing the increased output of sulphur by invoking the frustration of purpose doctrine.

In *Atlantic Track and Turnout*, the court did not need to adopt the differing treatment of quantity increases and decreases to effectively limit overreaching in future increase cases. First, the court could have determined whether the quantity variation was made in good faith. Having discovered that Perini did not deliver the stated estimates of material due cancellation of the contract with MBTA, the trial court in fact determined that Perini did not act in bad faith.<sup>144</sup>

To effectively limit overreaching the court could have utilized the impossibility of performance doctrine. The court could have easily found that MBTA's funding shortage, and the resulting cancellation of MBTA's contract with Perini, was a contingency, the non-occurrence of which was a basis of the contract. Obviously, both parties contracted with the assumption that MBTA would fund Perini's undercutting. Therefore, Perini would be excused from performance.

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141. Weistart, *supra* note 23, at 619.

142. Weistart, *supra* note 23, at 619. See also U.C.C. § 1-102(3) (1990).

143. See Silkworth, *supra* note 18, at 272-75, who argues that courts largely follow the pre-UCC test for good faith in determining the level of quantity variation permitted. Because the pre-UCC good faith standard did not permit contract exploitation in quantity variation, the Code and courts should limit the standard in § 2-306 to good faith.

144. *Atlantic Track & Turnout*, 989 F.2d at 545-46.

## VI. CONCLUSION

The First Circuit Court of Appeals adopted a differing treatment for quantity increases and decreases within open quantity contracts. However, such a rule is unnecessary to limit overreaching in quantity increase cases. The good faith limitation and frustration of purpose doctrine effectively protects parties to an open quantity contract.

RANDAL OWINGS

