


# The “Buyer’s Option” Contract in Illinois

By John J. D’Attomo

Recent Illinois and seventh circuit opinions have recognized a buyer’s-option contract that obligates sellers to sell without also requiring buyers to buy. Sellers should review these rulings and take care not to create a buyer’s option when they intend to create a binding purchase obligation.



**M**anufacturers and other vendors often enter into supply agreements with buyers in which the seller agrees to sell products with given specifications to the buyer at a given price, often for a specified period. These agreements also sometimes include a statement of the buyer’s estimated purchases under the contract.

But do these terms create an obligation to purchase the estimated quantities? Do they require the buyer to purchase any goods at all?

In a pair of decisions, the U.S. Court of Appeals for the Seventh Circuit has ruled that such terms merely constitute a so-called “buyer’s option” contract and do not require the buyer to purchase, absent language giving rise to a “requirements” contract. The Illinois Appellate Court has similarly recognized the “buyer’s option” concept, without expressly adopting the term.

This article reviews seventh circuit and Illinois Appellate Court decisions on point, explores the differences between a “buyer’s option” and a “requirements” contract, finds precedent for the buyer’s-option concept in the UCC, and warns counsel for sellers not to inadvertently obligate themselves to buyers without a buyer being reciprocally obligated to purchase.

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## The seventh circuit recognizes the "buyer's option" contract

Few published decisions address the concept of a "buyer's option" contract. Indicative of its relative obscurity, the "buyer's option" contract theory was not raised by the litigants in either *Brooklyn Bagel Boys, Inc v Earthgrains Refrigerated Dough Products, Inc*<sup>1</sup> or in *In re Modern Dairy of Champaign, Inc.*<sup>2</sup> Rather, the court itself characterized the agreements as "buyer's option" contracts in both cases.

*Brooklyn Bagel* involved a contract under which Brooklyn Bagel agreed to manufacture and supply bagels to Earthgrains. The contract set forth price terms and a defined contract period. In addition, the contract required that Earthgrains provide Brooklyn Bagels with "a written forecast" of its expected bagel orders every three months.<sup>3</sup> The contract did not require that Earthgrains purchase a specific quantity of bagels from Brooklyn Bagel, but instead provided that Brooklyn Bagel would process and package the "ordered quantity" of bagels.<sup>4</sup>

After Earthgrains began manufacturing its own bagels, Brooklyn Bagel brought suit contending that the contract was a requirements contract and that Earthgrains was obligated to purchase its bagel requirements from Brooklyn Bagel. The seventh circuit affirmed summary judgment for Earthgrains, finding that the supply agreement did not obligate Earthgrains to purchase any specified quantity of bagels from Brooklyn Bagel, let alone all of its bagel requirements.

The court held that the district court had correctly characterized the agreement as a "buyer's option" contract. In so holding, the court observed that the contract reflected "an agreement by Brooklyn Bagel to manufacture bagels for Earthgrains at a specified price, within an agreed period, subject to Earthgrains' bagel needs."<sup>5</sup> Stated differently, the agreement merely set forth the terms that would govern the purchase of bagels if and when Earthgrains placed orders with Brooklyn Bagel.

The court recognized that the parties' relationship could also be viewed as a series of separate contracts with the contract terms relating back to the original contract. The court observed that such characterization "is consis-

tent with a buyer's option" because the original agreement was "akin to an offer by Brooklyn Bagel to manufacture bagels for Earthgrains at a specified price, within an agreed period."<sup>6</sup> The court noted that Earthgrains accepted Brooklyn Bagel's offer by placing orders for bagels on the terms set forth in the agreement.<sup>7</sup>

In reaching its decision, the *Brooklyn Bagel* court relied on an earlier opinion by Judge Posner in the case *In re Modern Dairy of Champaign, Inc.*<sup>8</sup> In *Modern Dairy*, the bankruptcy trustee brought suit on behalf of the debtor-milk dairy to recover amounts owed for milk sold to the defendant school districts. The defendants acknowledged nonpayment but sought to offset the amounts owed by claiming they suffered damages when the dairy ceased operations and they were forced to purchase milk from another source.

Like the plaintiff in *Brooklyn Bagel*, the school districts argued that their contracts with the dairy were "requirements" contracts such that the dairy was obligated to supply the school districts with all their milk requirements for the school year. The bankruptcy court and district court agreed, finding that the dairy breached the contracts by failing to supply the defendants with their milk for the full school year.

On appeal, the seventh circuit reversed. The court found that the question of whether the dairy breached a duty to supply the school districts with their requirements of milk depended on whether the school districts had committed to purchase their milk requirements from the dairy. While the bid specifications included a purchase estimate, the court concluded that nothing in the contract documents obligated the school districts to purchase all – or even any – of their milk from the dairy.

Rather, the court found that the contract terms merely reflected an agreement to supply milk at a specified price for a specified period of time. The court remarked, "So far as the contractual documents are concerned, all there is is the dairy's agreement to sell milk to the districts at a specified price that it cannot raise during the school year: in other words, a buyer's option."<sup>9</sup> Thus, in both *Brooklyn Bagel* and *Modern Dairy*, the court found that the contract at issue was a buyer's option contract.

## Buyer's option contract versus requirements contract

The seventh circuit implicitly recognized the notion of a "buyer's option" contract years earlier when addressing a requirements contract in *Empire Gas Corp v American Bakeries Co.*<sup>10</sup> There, Empire Gas Corporation was a distributor of propane gas and also sold converters which allowed gasoline-powered automobiles to operate on propane gas. American Bakeries owned a fleet of 3,000 vehicles that it sought to convert to propane gas. The parties entered into negotiations for the purchase of conversion units by American Bakeries and ultimately entered into an agreement "for approximately three thousand (3,000) [conversion] units, more or less depending upon requirements of Buyer..."<sup>11</sup>

Shortly after executing the agreement, American Bakeries decided not to convert its fleet of vehicles to propane. American Bakeries never ordered any converters from Empire, and never offered any justification for its decision. Empire sued for breach of contract seeking damages for lost profits on the converter units that American Bakeries did not order and the propane fuel the vehicles would have consumed during the contract period. The jury returned a verdict in favor of Empire.

The central issue on appeal was the jury instruction concerning American Bakeries' purchasing obligations under the contract. The parties agreed that the contract was a requirements contract governed by section 2-306(1) of the Uniform Commercial Code (UCC). Section 2-306(1) 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.

The trial court instructed the jury

1. 212 F3d 373 (7th Cir 2000).
2. 171 F3d 1106 (7th Cir 1999).
3. *Brooklyn Bagel*, 212 F3d at 378.
4. *Id* at 376.
5. *Id* at 380.
6. *Id* at 379 FN4.
7. *Id*.
8. *Modern Dairy* (cited in note 2).
9. *Id*, 171 F3d at 1108.
10. 840 F2d 1333 (7th Cir 1988).
11. *Id* at 1335.



concerning American Bakeries' purchasing obligations by simply reading section 2-306(1) to the jury without interpretation or clarification.

The seventh circuit concluded that the trial court erred in giving the instruction without interpretation or clarification because the "no quantity unreasonably disproportionate" provision is properly interpreted as precluding a buyer in a requirements contract from demanding quantities which greatly exceed the stated estimate, but not from decreasing its quantities far below the stated estimate.<sup>12</sup> Nonetheless, the court held that

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**A supply agreement that sets forth price terms, product specifications, and a defined period without requiring purchase of a fixed quantity of goods is probably a "buyer's option" contract.**

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the erroneous instruction was harmless error because American Bakeries offered no justification for its decreased purchases and, thus, no reasonable jury could find that American Bakeries acted in good faith.<sup>13</sup>

In so holding, the court noted that American Bakeries would be acting in bad faith if during the contract period it bought converters from anyone other than Empire.<sup>14</sup> However, the court continued as follows:

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.<sup>15</sup>

Thus, the court recognized that American Bakeries – the purchaser under a requirements contract – would not be acting in bad faith if it decreased its purchases to zero for business reasons unrelated to the contract terms.<sup>16</sup> The court then posed the question of whether a requirements contract was essentially a buyer's option contract, and answered the question in the negative.

The court first noted that option contracts are dealt with separately in sec-

tion 2-311 of the UCC. Further indicative of a distinction between a requirements contract and a buyer's option contract, the court noted that the official comments to section 2-306 provide 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."<sup>17</sup> Thus, the UCC comments suggest that a buyer under a requirements contract could not decrease its purchases simply to avoid unfavorable contract terms, but could decrease its purchases for business reasons unrelated to the terms of the contract.<sup>18</sup>

A reasonable inference to be drawn from this comment is that a purchaser under a buyer's option contract could decrease its purchases or make no purchases without necessarily articulating a legitimate business reason, subject only to the duty of good faith and fair dealing. Most compelling, the court noted that section 2-306 was a codification of prior Illinois case law recognizing

that the term "requirements" implies something more than subjective "needs" or "wants."<sup>19</sup> *Empire* thus counsels that the obligations imposed on a purchaser under a requirements contract are greater than those imposed on a purchaser under a buyer's option contract.

**The Illinois Appellate Court and "buyer's option" contracts**

Although only the seventh circuit has expressly adopted the term "buyer's option" contract, the Illinois Appellate Court has recognized the "buyer's option" concept in prior decisions.<sup>20</sup>

In *Streich v General Motors Corp.*,<sup>21</sup> the plaintiff brought suit for breach of contract alleging that a purchase order issued by the defendant evidenced an agreement to purchase certain valves from the plaintiff. Additionally, the plaintiff alleged that a letter accompanying the purchase order advised the plaintiff that the purchase order reflected the defendant's "requirements" for a one-year term.

Finally, the plaintiff alleged that it was orally advised that the defendant's requirements for the year would be approximately 1,600 units. The defendant subsequently cancelled the purchase

order and the plaintiff brought suit. The trial court dismissed the complaint, and the first district affirmed.

Consistent with the decisions in *Brooklyn Bagel* and *Modern Dairy*, the first district concluded that the purchase order and accompanying letter were properly construed as "an agreement on the part of the seller to sell a certain identified valve at a certain fixed price in such quantities as the buyer may designate, when and if it issues a purchase order for the same."<sup>22</sup> The court explained that the seller's promise to supply goods during the specified time period at the specified prices was merely "an invitation for orders," and not an enforceable contract.<sup>23</sup>

Even though such agreement may purport to be a bilateral contract, the court noted that an enforceable contract does not arise until the buyer submits an order for a specified amount of product.<sup>24</sup> Finding no enforceable contract, the first district affirmed the dismissal of plaintiff's complaint.

The first district similarly found that a purported "contract" was merely an invitation for orders in *Torres v City of Chicago*.<sup>25</sup>

12. See *Empire*, 840 F2d at 1339 ("The [no quantity unreasonably disproportionate] 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.")

13. *Id.* at 1341.

14. *Id.* at 1339.

15. *Id.*

16. The *Empire* court observed that its decision was consistent with the common law approach. *Empire*, 840 F2d at 1337-38 ("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.'") (citations omitted).

17. *Id.* at 1339, quoting UCC §2-306, comment 2 (emphasis added by *Empire* court).

18. *Empire*, 840 F2d at 1339.

19. *Id.* at 1339-40 (citations omitted).

20. See, for example, *Torres v City of Chicago*, 261 Ill App 3d 499, 632 NE2d 54 (1st D 1994); *Streich v General Motors Corp.*, 5 Ill App 2d 485, 126 NE2d 389 (1st D 1955). The fact that *Brooklyn Bagel*, *Modern Dairy*, and *Empire Gas* were each expressly decided under Illinois law further demonstrates that the "buyer's option" contract is a recognized principle of Illinois law.

21. *Streich* (cited in note 20).

22. *Streich* at 494, 126 NE2d at 394.

23. *Id.* (quoting *Corbin on Contracts*, Vol 1, Sec 157). The court further noted that this may be true even if the parties believe an enforceable contract exists and expressly label their agreement a "contract." *Id.*

24. *Streich* at 495, 126 NE2d at 394 ("The promise of the seller to furnish identified items at a stated price is merely an offer and cannot become a contract until the buyer issues a release or order for a designated number of items."). The court alluded to the notion of a "buyer's option" contract, but used the term "open end contract." *Id.* at 496, 126 NE2d at 395.

25. *Torres* (cited in note 20).



In *Torres*, the city of Chicago solicited quotes from vendors for the services of telephone switchboard operators. After receiving responses from several vendors, the city sent a form document to the plaintiff requesting operator services at specified hourly rates for a specified six-month period. The form requested that plaintiff make 20 operators available without specifying the number of operators that the city would actually hire.

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Further, the form provided that the number of operators and the dates on which they would work “DEPENDS ON REQUIREMENT.”<sup>26</sup> Finally, the city expressly reserved the right to terminate the agreement “if there is no further need.”<sup>27</sup> Plaintiff alleged that the reference to “requirement” made the agreement a requirements contract and the city was therefore required to hire all the operators it required from the plaintiff.<sup>28</sup>

The court rejected the requirements contract theory finding that the city reserved the right to obtain operators from other agencies. The court noted that “[w]ithout exclusivity, the buyer in a requirements contract has effectively promised nothing of value to the seller.”<sup>29</sup> The court stated as follows:

“In the absence of such a promise, or some other form of consideration flowing from the buyer to the seller, the requisite mutuality and consideration for a requirements contract is absent. The promise of the seller becomes merely an invitation for orders and a contract is not consummated until an order for a specific amount is made by the buyer.”<sup>30</sup>

Similar to the purported contracts in *Brooklyn Bagel*, *Modern Dairy*, and *Streich*, the court concluded that the form document was merely plaintiff’s invitation for orders that did not become a contract until the city ordered specific services.<sup>31</sup> The court accordingly affirmed summary judgment in favor of the city.

**Novel theory or new label for established principles?**

Assuming the seller in a “buyer’s option” contract has a duty to sell goods to the buyer at the buyer’s request, but the buyer is under no obligation to purchase goods from the seller, is the contract “illusory”? In other words, what consideration flows from the buyer to support the seller’s promise to supply goods?

While the “buyer’s option” theory has been expressly invoked only recently in reported decisions, the principle underlying the notion of a “buyer’s option” contract has been long recognized in the UCC. Section 2-205 of the UCC governs “firm offers” and dispenses with the requirement of consideration for purposes of a short term “buyer’s option” contract. In relevant part, section 2-205 provides as follows:

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....<sup>32</sup>

Thus, under section 2-205, an offer to sell goods may, for a period up to three months, give rise to an enforceable promise to sell goods even where the buyer provides no consideration to support the seller’s promise. Section 2-205 addresses only offers not supported by consideration.<sup>33</sup> Thus, assuming the seller’s offer is supported by consideration, the three-month limitation does not apply and the seller’s firm offer may remain open for the period specified by the parties.<sup>34</sup>

Relying on section 2-205, the court in both *Brooklyn Bagel* and *Modern Dairy* noted that a “buyer’s option” contract does not fail for lack of consideration even though the buyer makes no commitment to purchase goods.<sup>35</sup> However, it would appear that the relationship of the parties exceeded a period of three months in both cases. Thus, it could be argued that section 2-205 would not apply in those cases.

The *Brooklyn Bagel* court indirectly acknowledged this potential infirmity by alternatively suggesting that the “agree-

ment” merely constituted an invitation for bids rather than an “offer.”<sup>36</sup> Under this theory, the agreement merely set forth the terms that would govern in the event the buyer placed an order for goods. An enforceable contract would arise only if and when the purchaser issued a purchase order for a specific quantity and the seller accepted the purchase order.

**Conclusion**

Decisions from the seventh circuit and the Illinois Appellate Court recognize that, absent terms sufficient to create a requirements contract, a supply agreement that sets forth price terms, product specifications, and a defined time period without mandating the purchase of a fixed quantity of goods is properly characterized as a “buyer’s option” contract. These decisions further recognize that the use of purchase estimates in such agreements does not create an obligation to purchase.

A supplier seeking greater certainty with respect to a buyer’s purchasing obligations should ensure that the terms of a supply agreement cannot be construed as a buyer’s option contract. A contract that includes a fixed-quantity provision would provide a high level of certainty with respect to purchase volume.

Alternatively, a supplier might alternatively consider negotiating a requirements contract. However, even under a requirements contract, a buyer may reduce or terminate entirely its purchases under the contract for business reasons unrelated to the contract terms.

These principles dictate that counsel must fully appreciate the business objectives and risk tolerance of their clients when drafting supply agreements. Doing so will help minimize disputes over the parties’ obligations under the contract. ■

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26. *Id.* at 503, 632 NE2d at 57.

27. *Id.*

28. *Id.* at 503-04, 632 NE2d at 57.

29. *Id.* at 505, 632 NE2d at 58.

30. *Id.*, quoting *Propane Industrial, Inc v General Motors Corp.*, 429 F Supp 214, 219 (WD Mo 1977).

31. *Torres* at 500, 632 NE2d at 55 (“The document established the terms of the contract which became effective when the City actually ordered services from [plaintiff].”).

32. 810 ILCS 5/2-205.

33. 810 ILCS 5/2-205, Comment No 3.

34. *Id.*

35. *Brooklyn Bagel*, 212 F3d at 379; *Modern Dairy*, 171 F3d at 1110.

36. See *Brooklyn Bagel*, 212 F3d at 379 FN4.