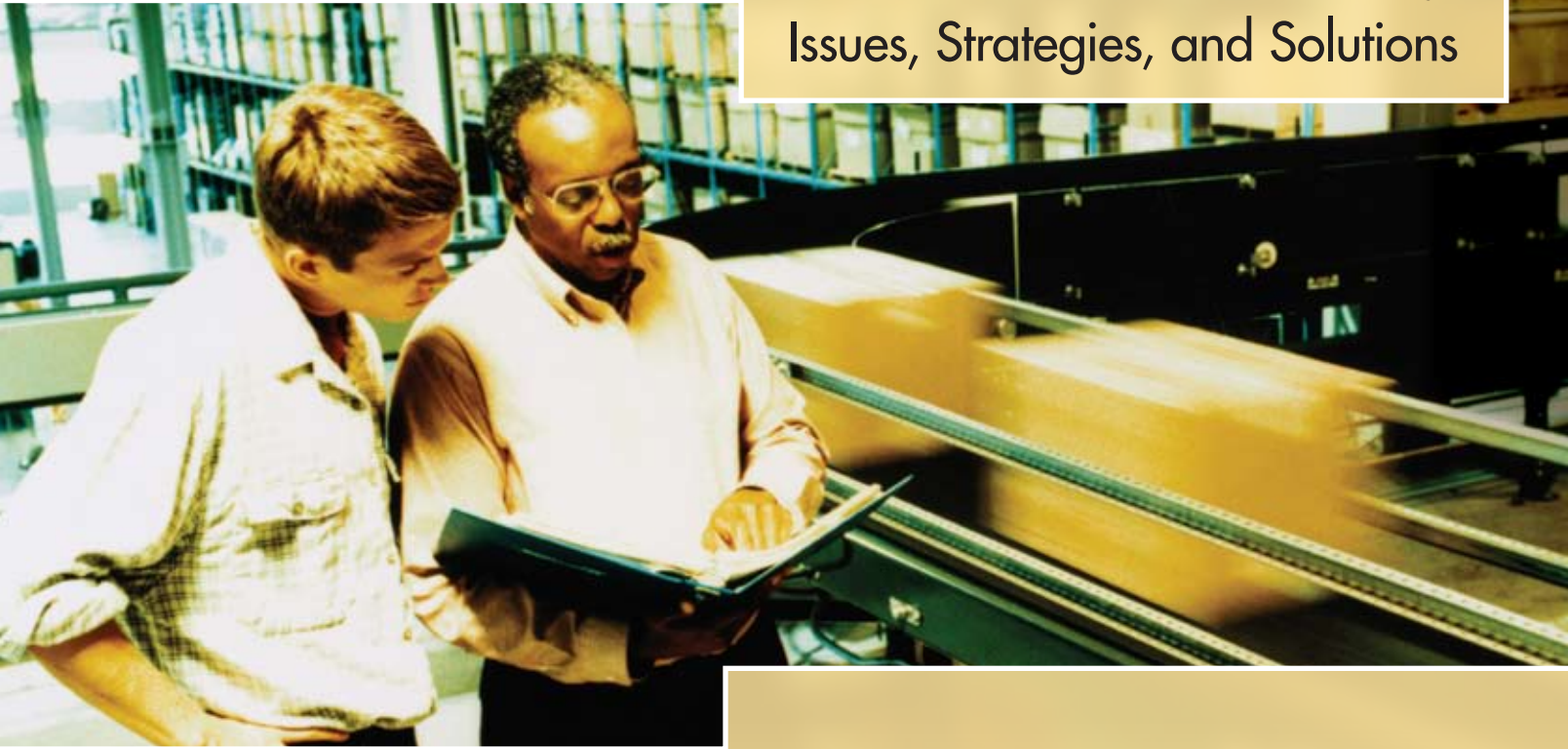


The Much-Maligned Purchase Order

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Issues, Strategies, and Solutions



Introduction

Few documents are used more commonly in day-to-day commercial transactions than the humble purchase order. Typically in the form of a single page incorporating extensive “standard terms and conditions,” purchase orders are the foundation of most commercial supply relationships, particularly in the automotive industry.¹ Despite this pervasiveness, the use of purchase orders has led to much litigation and a legal minefield.² This article identifies fundamental issues that should be considered by parties who use purchase orders and attorneys who counsel those parties. Additionally, this article proposes solutions to address those issues.

Issues

Issue #1: The Signed Writing Requirement

Most purchase orders are issued unilaterally by the buyer and are never signed by the seller. In the first instance, this raises a potential statute of frauds issue under the Michigan Uniform Commercial Code (UCC).³ The UCC’s statute of frauds requires that

contracts for the sale of goods over \$1,000 be “signed” by the party against whom enforcement is sought.⁴ Therefore, most purchase orders are unenforceable unless they satisfy an exception to the statute of frauds. There are three commonly used exceptions:

- (1) **The “Confirmatory Memorandum” Exception in UCC §2-201(2).**⁵ Although relatively innocuous on its face, this exception presents potential pitfalls in the purchase order context. If a purchase order does not accurately memorialize the terms actually accepted and agreed upon by the parties, then it may not qualify as an exception under UCC §2-201(2).⁶
- (2) **The “Specially Manufactured Goods” Exception in UCC §2-201(3).**⁷ Excepting commodity products, most manufacturing purchases involve “specially manufactured” goods, because the goods being purchased are custom-made, and designed to suit a particular use unique to the buyer. Notably, however, commentators and courts have restricted this exception to sellers, not buyers.⁸
- (3) **The “Part Performance” Exception.** Both the UCC and Michigan courts recognize that oral agreements may become enforceable through performance.⁹ Where parties have commenced performance, this exception generally is

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available, but only to the apportionable part of goods that the buyer has received and accepted, or for which the seller has received and accepted payment.¹⁰

One or more of these exceptions typically can be used to overcome a statute of frauds defense. This result is consistent with the UCC's fundamental tenet that "contracts for the sale of goods may be made in any manner sufficient to show agreement, including conduct by both parties which recognizes the existence of such a contract."¹¹

However, clearing the statute of frauds hurdle is not the end of the inquiry—the parties still must prove the actual terms of the agreement.¹²

Issue #2: The Quantity Requirement

Contracts for the sale of goods must contain a quantity term.¹³ The UCC specifically states that written agreements are not enforceable "beyond the quantity of goods shown in the writing."¹⁴ Michigan courts consistently have held that "the quantity term must be specifically stated" for a sales contract to be enforceable.¹⁵

There are two recognized exceptions to this general rule: requirements contracts and output contracts.¹⁶ In a requirements contract, the buyer is obligated to purchase some quantity or percentage of its requirements from the seller.¹⁷ In an output contract, the buyer is obligated to purchase some quantity or percentage of the seller's output.¹⁸ If purchase orders expressly purport to be requirements or output contracts, they are universally enforceable.¹⁹ Conversely, if there is neither a quantity term nor a reference to "requirements" or "output," they generally are unenforceable.²⁰ Courts cannot impose a quantity term if an agreement is silent on quantity.²¹

Many purchase orders do not state a specific quantity. Rather, they set a price and other terms, and contemplate that subse-

quent orders (often called "releases") will be issued by the buyer stating specific quantities. To overcome the UCC's strict quantity requirement, parties seeking to enforce purchase orders under these circumstances often strain to develop arguments that the quantity requirement has been met.

These strained arguments have created a murky legal landscape. Michigan courts have not articulated a clear standard concerning the specificity required to establish a quantity term:

- Some courts require that the word "requirements" be stated explicitly, and that the buyer expressly commit to purchase a specific volume of goods.²²
- Some courts analyze factors outside the purchase order (e.g., course of dealing, contemporaneous communications, or the UCC's good-faith duty) in determining the existence of a quantity term.²³
- One court has held the vague term "up to 10 million pounds" sufficient to state a quantity.²⁴
- One court has held the term "blanket" sufficient to state a quantity, "albeit an imprecise one."²⁵
- Other courts have held the term "blanket" to be insufficient, because it does not necessarily require any degree of exclusivity.²⁶

Although not entirely clear, Michigan courts are more likely to enforce purchase orders in which the buyer is expressly obligated to purchase some fixed minimum quantity of goods.²⁷ If the buyer possesses unbridled discretion as to whether to purchase goods from the seller, in unspecified quantities, the purchase order is not likely to be enforced.²⁸

Issue #3: Duration/Termination

Duration and termination issues arise frequently, especially when parties seek to extricate themselves from supply arrangements that have become commercially unfavorable. Under UCC §2-309, if contracts contemplate successive performance and are indefinite in duration, they are valid for a "reasonable time," but can be terminated by either party upon reasonable notification.²⁹ The length of notice required usually is tied to the time required for the buyer to reasonably obtain product from an alternative supplier.³⁰

Sellers seeking to invalidate purchase orders also seize on provisions that grant buyers the unfettered right to terminate at will, arguing that such purchase orders lack mutuality of obligation.³¹ This argument appears to be disfavored in recent case law. In one recent case, the Michigan Court of Appeals stated that, even if terminable at will, a requirements contract "imposes standards with regard to the duration of the contract" and restricts the ability of the buyer to terminate.³² Similarly, a Michigan federal court recently held that the UCC's good-faith requirements restricted the buyer's contractual, unilateral right to terminate.³³ Both courts

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merely imposed commercial fair dealing and reasonable notice standards on a buyer's termination of a purchase order.³⁴

Issue #4: Battle of the Forms

Another frequently litigated issue is whether the purchase order constitutes the “offer” or the “acceptance” for purposes of the UCC’s “battle of the forms” analysis. Resolution of this issue is significant because, under the UCC, when the parties’ writings differ, the “contract” consists of those terms in which the writings of the parties agree, together with any terms supplemented by the UCC. Additional terms in the acceptance become part of the contract, unless they are objected to by the accepting party, or “materially alter” the contract.³⁵

There has been much case law discussing this issue, generally requiring case-by-case analyses. Indeed, the number of cases holding that purchase orders are the “offer”³⁶ is virtually equal to the number of cases holding that purchase orders are the “acceptance.”³⁷

Strategies and Solutions

To overcome the inherent uncertainties that accompany the use of purchase orders, the following suggestions and solutions are offered.

1. Update purchase order terms and conditions. Many companies have not updated their purchase orders in recent years. There have been significant legal developments in the last five years, many previously discussed, that require a thorough review of the terms and conditions used in conjunction with a company’s purchase orders.

2. Post standard terms and conditions on the Internet. The days of mailing and faxing standard terms are nearly over. All standard terms should be posted on the company’s website.

3. Recognize the quantity issue. To have an enforceable contract, a quantity term must be stated. If all the buyer’s requirements are purchased from a sole supplier, the contract should be identified as a “requirements contract.” At a minimum, a quantity term, or at least a range, should be expressly stated.

4. Recognize the duration issue. If possible, it is good practice to set forth the term on the face of the purchase order. A set

term can be coupled with an identification of specific circumstances allowing for an “early out.”

5. Contract termination breeds litigation. Much litigation stems from the termination of contracts. Identify the specific circumstances justifying termination before the intended term, and specifically set forth those circumstances in the termination notice.

6. Avoid the battle of the forms. Buyers ignore the seller’s quotation (or equivalent documents) at their peril. If the seller’s document of sale contains provisions that are unacceptable to the buyer, it is better to confront those issues before the contract formation. A battle of the forms is rarely a satisfactory way to “form” a contract for the purchase of goods.

7. Consider entering into long-term agreements (LTAs). A buyer should identify its strategic suppliers and consider entering into LTAs. Key issues should be negotiated, not ignored, as often occurs when quotations and purchase orders are exchanged without thought or discussion.

Conclusion

Today’s pace of commerce leaves little time for the fine art of negotiating the terms and conditions of the commercial transaction. The challenge for the business attorney is to recognize the most critical commercial issues, review and perfect the contract documents, and deal with those issues in a way that does not hinder or frustrate the pace of the commercial transaction. ■



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FOOTNOTES

1. See Ben-Shahar & White, *Boilerplate and economic power in auto manufacturing contracts*, 104 Mich L R 953, 956–57 (2006).
2. See Trentacosta, *Drafting and litigation issues in contract formation*, 72 Mich B J 656 (1993).
3. MCL 440.1101, *et seq.*
4. MCL 440.2201(1). See White & Summers, *Uniform Commercial Code* §2–5 (5th ed 2006); Trentacosta, *Michigan Contract Law* §4.26.

5. MCL 440.2201(2); Trentacosta, Michigan Contract Law §4.28.
6. See *MacSteel, Inc v Eramet N America*, 2006 WL 3334019, *10 (ED Mich, November 16, 2006); *Dedoes Indus, Inc v Target Steel, Inc*, 2005 WL 1224700, *2 (Mich App, 2005).
7. MCL 440.2201(3)(a), Trentacosta, Michigan Contract Law §4.28.
8. See White & Summers, Uniform Commercial Code, *supra*, §2-5.
9. MCL 440.2201(3)(c); *MacSteel, supra*, *10. See also *Metal One America, Inc v Center Mfg, Inc*, 2005 WL 1657128 (WD Mich, 2005); *Benedict Mfg Co v Aeroquip Corp*, 2004 WL 1532280, *4 (Mich App, 2004); *Power Press Sales Co v MS1 Battle Creek Stamping*, 238 Mich App 173, 179; 604 NW2d 772 (1999).
10. MCL 440.2201(3)(c).
11. MCL 440.2204(1); Trentacosta, Michigan Contract Law §1.3.
12. *MacSteel, supra*; *Roth Steel Prods v Sharon Steel Corp*, 705 F2d 134, 143-44 (CA 6, 1983).
13. MCL 440.2201, cmt. 1. See Trentacosta, Michigan Contract Law §2.38. But see *Busch v Dyno Nobel, Inc*, 40 Fed Appx 947, 956 (CA 6, 2002) ("all contracts for the sale of goods, except for those that are 'specially manufactured,' must include a quantity term").
14. MCL 440.2201(1); Trentacosta, Michigan Contract Law §4.27.
15. See *Lorenz Supply Co v American Std, Inc*, 419 Mich 610, 614-15; 358 NW2d 845 (1984); *Great N Packaging, Inc v General Tire & Rubber Co*, 154 Mich App 777, 786; 399 NW2d 408, 412-13 (1986); *In re Estate of Frost*, 130 Mich App 556, 559; 344 NW2d 331, 333 (1984).
16. MCL 440.2306. See *Metal One, supra*, at *4-5.
17. *Metal One, supra*, at *4-5.
18. *Id.*
19. See, e.g., *Chainworks, Inc v Webco Indus, Inc*, 2006 WL 461251 (WD Mich, 2006). Under the UCC, however, requirements contracts need not be "exclusive" to be enforceable, so long as they obligate the buyer to purchase "all or some of" its requirements. See *General Motors Corp v Paramount Metal Prods*, 90 F Supp 2d 861, 874 (ED Mich, 2000).
20. But see *Great N Packaging, supra*.
21. *In re Frost Estate, supra*.
22. *Advanced Plastics Corp v White Consolidated Indus, Inc*, 47 F3d 1167 (CA 6, 1995) (unpublished); *Dedoes Industries, supra*.
23. *Plastech Engineered Prods v Grand Haven Plastics, Inc*, 2005 WL 736519 (Mich App, 2005) (party communications); *Metal One, supra* (course of performance); *TRW, Inc v Indus Sys Assocs, Inc*, Nos. 01-3134, 01-3196, 2002 WL 31205397 (CA 6, 2002) (defendant was "sole supplier" of parts).
24. *Busch, supra*, at 956.
25. *Great N Packaging, supra*, at 786.
26. *Acemco, Inc v Olympic Steel Lafayette, Inc*, 2005 WL 2810716, *4-5 (Mich App, 2005); *Advanced Plastics Corp, supra*.
27. See *Advanced Plastics Corp, supra*, *3.
28. *Id.* See also *Lorenz Supply Co, supra*, at 854, n 4 (Brickley, J., concurring) ("The Michigan court does not enforce contracts calling for the purchase or sale of such goods as may be 'desired,' 'ordered,' or 'wished.'").
29. MCL 440.2309.
30. MCL 440.2309, cmt. 8. See also *Aaron E Levine & Co, Inc v Calkraft Paper Co*, 429 F Supp 1039 (ED Mich, 1976).
31. See *Commercial Movie Rental v Larry Eagle, Inc*, 738 F Supp 227 (WD Mich, 1989); *Lorenz Supply Co, supra*.
32. *Plastech, supra*, at *7.
33. See *General Motors Corp, supra*, at 873.
34. See also *Metal One, supra*, at *6-7 (unilateral termination of purchase order constituted a bad-faith breach of contract where defendant ceased production merely "to curtail losses").
35. MCL 440.2207; *Plastech, supra*.
36. See *Chainworks, supra*; *Aaron E Levine & Co, supra*; *Mantaline Corp v PPG Indus, Inc*, 2000 US App LEXIS 14036, at *3 (CA 6, 2000).
37. See *Robert Bosch Corp v ASC Inc*, 2006 WL 2595301 (CA 6, 2006); *Sealed Power Technologies Ltd v The Torrington Co*, 1998 WL 1990486 (Mich App, 1998).