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'Best Efforts', 'Commercially Reasonable' And Other Terms No One Understands

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Contracting parties routinely use terms like “commercially reasonable” and “best efforts” to describe future performance, sometimes for strategic reasons, but usually because the demands of the deal do not permit the time needed to negotiate what steps will actually occur, or because the parties cannot agree and prefer to table the issue for another day, hoping it will not become a problem. As clients come to learn, however, adopting such undefined terms often leads to costly, time-consuming disputes.

In this article, we explore why these vague contractual terms are routinely used, explain how they have been inconsistently interpreted by the courts, and offer some practical tips to minimize the havoc ambiguous terms can wreak.

Using Deliberately Vague Terms to Get Things Done.

Flexible terms that can mean different things to each contracting party are what a sociologist would call “boundary objects”—those “which are both plastic enough to adapt to local needs and the constraints of the several parties employing them, yet robust enough to maintain a common identity across sites.”¹ In contract formation, boundary objects are the deliberate use of vague terms to facilitate cooperation. Contracts are fundamentally a mechanism



for getting things done. But parties come to the negotiation with different concerns, motivations, and perspectives. The two sides can be reluctant to focus on what could go wrong later, and there are often extreme time pressures to finalize a transaction. Terms like “commercially reasonable” and “best efforts” permit the parties to talk to each other and, at least on the surface, reach common understandings. Without them, some fear, negotiations could grind to a halt while the parties try to concretely define and address every potential contingency.

But What's the Risk?

In most contexts, the meaning of a boundary object is settled by the party with the most power. For example, imagine you are the parent of a teenager (our sympathies!), weary of a 15 minute argument about her curfew every time she walks out the door. As she leaves for the night, you tell her not to come home late, which to you means after 10:00 p.m. “Late” to her may mean midnight, especially if her friends have midnight curfews. You could have clarified the specific time for her return and saved yourself the

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argument you hoped to avoid earlier. But ultimately you get to decide whether she is grounded.

In business disputes, by contrast, we delegate the role of defining a broken boundary object to a third party—a court, a jury, or an arbitrator. Experienced practitioners know that terms like “commercially reasonable” and “best efforts” are inconsistently interpreted by courts, and applied in ways that may surprise both the party that thinks it will benefit from inclusion of the term (“I am *only* obligated to do what is good for my business”) and the party that gives something up by permitting it (“I wish the promisor were forced to invest more resources making sure the obligation is met.”).

One Extreme: “Save It for the Bankruptcy Court.”

There is no settled definition of commercial reasonableness applied by courts interpreting contracts under New York law. Instead, most judges will treat that term as a question of fact and place the burden on the party seeking to enforce the requirement. See, e.g., *Leigh Co. v. Bank of New York*, 617 F. Supp. 147, 153 (S.D.N.Y. 1985) (“the burden is on [plaintiff] to present evidence demonstrating what constitutes a commercially reasonable standard ... and how the [defendant] failed to meet this standard”).

There is a recognition that “[a] contractual requirement to act in a commercially reasonable manner does not require a party to act against its own business interests.” *MBIA Ins. v. Patriarch Partners VIII*, 950 F. Supp. 2d 568, 618 (S.D.N.Y. 2013). That would seem a low bar. Most would agree that losing money, or even investing resources in an activity or product that is not making very *much* money, is not in the “business interests” of the party obligated to make the effort. But a court’s view of “against business interests” can diverge sharply from the views of the parties. For example, the decision in *Rex Med. L.P. v. Angiotech Pharm. (US)*, 754 F. Supp. 2d 616 (S.D.N.Y. 2010), involved a distribution agreement for a medical device. The defendant distributor, Angiotech, argued that it should have been able to stop marketing and distributing the product and could terminate the agreement when the distribution of the devices led to financial losses of approximately \$1 million per month. *Id.* at 625. Combined with the company’s otherwise deteriorating

financial condition, the projected losses were so grave that continued performance of the agreement could ultimately lead it to file for bankruptcy. *Id.* The plaintiff manufacturer, Rex, moved to enjoin Angiotech from terminating the agreement, which required Angiotech to “use Commercially Reasonable Efforts to carry out the marketing and commercialization of [the device] in the Field throughout the Territory.” *Id.* at 624.

In granting Rex’s motion to enjoin, the court unequivocally dismissed Angiotech’s argument that continued distribution had become commercially unreasonable, calling it “utter and complete nonsense.” *Id.* In the court’s view, Angiotech’s argument frustrated the purpose of the contract and would cause irreparable harm to Rex. *Id.* As for the financial hardship Angiotech claimed from continued performance, the court said simply that “[t]his is an argument Angiotech should save for a bankruptcy court[.]” *Id.* at 625.

“Save it for the bankruptcy court” may not be what a party had in mind when agreeing to “commercially reasonable efforts.”

Another View: No Financial Pain Required.

Other decisions hold that any “rational characterization” of the “commercially reasonable” standard excludes actions that would hurt the breaching party financially. *MBIA Ins. v. Patriarch Partners VIII*, 950 F. Supp. 2d 568 (S.D.N.Y. 2013).

In *Patriarch Partners*, the parties entered into agreements involving the amelioration of certain troubled CDOs, which MBIA agreed to insure. *Id.* at 571. Their agreement required the parties “to cooperate and use all commercially reasonable efforts to procure as soon as reasonably practicable the satisfaction of the conditions” necessary for certain notes to be rated. *Id.* at 576. Patriarch never sought a rating for the notes at issue because it believed doing so would risk a downgrade of a related set of notes.

Following a bench trial, the court found that the plaintiff had failed to demonstrate that Patriarch’s conduct was not commercially reasonable. See *MBIA Ins.*, 950 F. Supp. 2d, 617. According to the court, “the evidence presented at trial established that Patriarch’s efforts were well within the bounds of any rational characterization of the ‘commercially reasonable’ standard” because “[a] contractual requirement to act in a commercially

reasonable manner does not require a party to act against its own business interests, which it has a legal privilege to protect.” See *id.* at 618 (internal citations and quotation marks omitted). Because “[a] downgrade of the A Notes would have hurt Patriarch ... [i]t was ... commercially reasonable for Patriarch to wait until [the collateral manager] had accumulated additional collateral before seeking a rating on the [notes].” See *MBIA Ins.*, 950 F. Supp. 2d, 618.

As these contrasting opinions illustrate, the line between what is “rational” and what is “complete and utter nonsense” when defining commercially reasonable efforts can be very thin indeed. While it is neither feasible nor practical to spend time and money trying to anticipate every uncertainty and market condition that may affect their future performance, negotiating parties should carefully evaluate whether the work that is avoided with the boundary term “commercial reasonableness” is worth the wildly unpredictable risk of entrusting that task to a third-party fact-finder after a dispute arises. Because “questions of commercial reasonableness are necessarily fact-intensive,” *Highland CDO Opportunity Master Fund, L.P. v. Citibank*, 2013 U.S. Dist. LEXIS 40415 (S.D.N.Y. March 21, 2013), they can almost never be resolved before trial, resulting in protracted and costly litigation.

Best Efforts: Better Than What?

Another commonly used boundary object in contract formation is “best efforts”—which sometimes modifies an obligation a party cannot or doesn’t *really* want to perform.

The case law in New York nominally requires “a clear set of guidelines against which to measure a party’s best efforts” to enforce such a provision. See *TPTCC NY v. Radiation Therapy Servs.*, 784 F. Supp. 2d 485, 506-07 (S.D.N.Y.), quoting *Mocca Lounge v. Misak*, 94 A.D.2d 761, 763, 462 N.Y.S. 2d 704 (2d Dep’t 1983). But the phrase appears so often and in so many contracts that courts are loathe to invalidate it even in the absence of guidelines on the face of the contract. *Maestro W. Chelsea SPE v. Pradera Realty*, 954 N.Y.S. 2d 819, 825 (Sup. Ct. 2012) (internal quotations omitted) (“[T]he law does not require that best efforts criteria be defined by the contract[.] ... If external standards or circumstances

impart a reasonable degree of certainty to the meaning of the phrase best efforts, the clause can be enforced”).

So, what exactly does “best efforts” require? Not much more than good faith, it appears—and in some cases, maybe less. In *TPTCC NY v. Radiation Therapy Servs.*, 784 F. Supp. 2d 485 (S.D.N.Y.), aff’d in part, rev’d in part, 453 F. App’x 105 (2d Cir. 2011), the plaintiff, a company offering a cancer treatment, brought a breach of contract claim against a consultant, which it had retained to obtain funding for the project; the consultant agreed to use its “best efforts.” *Id.* at 494. The only lending agreement presented by the consultant was with a private equity firm, which it later conceded was an “objectively unqualified lender.” *Id.* Plaintiff further alleged the whole transaction was a sham. *Id.*

While it may be reasonable to assume that the consultant would have done better than negotiating a sham lending agreement with an admittedly unqualified lender, the court reached the opposite conclusion. The best efforts clause at issue stated, “It is understood that [consultant’s] involvement in the Funding is strictly on a best efforts basis, and that the consummation of the Funding will be subject to, among other things, market conditions.” See *id.* at 507. The court held that this did not create an obligation to actually secure funding, and that the qualifiers in the clause, including “strictly” and the reference to “market conditions” were intended to ensure that the consultant could not be held liable for breach if it failed to do so. *Id.*

If “commercial reasonableness” at least hints at some effort to incorporate an objective standard—the impact on business—into an obligation, “best efforts,” without any definition, can be so vague as to add nothing but confusion. See *Maestro W.*, 954 N.Y.S.2d, 825 (internal quotations omitted) (“A best efforts clause imposes an obligation to act with good faith in light of one’s own capabilities. Best efforts requires that [a party] pursue all reasonable methods.”).

Can the Parties Define the Indefinite?

The first task in interpreting a vague term like “commercial reasonableness” or “best efforts” is to determine what steps needed to be followed. The second is to apply the facts and conclude whether they were. Drafters

can reduce the risk of uncertainty concerning that first inquiry by defining the term, putting guideposts around the boundary object. In practice, though, if the definition is not carefully crafted to incorporate objective standards, such as by requiring specific regulatory approvals or setting a floor for minimum financial returns, the definition merely creates more questions for a fact-finder that must be deferred until trial. This also begs the question: If with more forethought, it is possible to develop objective standards for commercial reasonableness at the outset of the deal, is the term necessary at all? Why not, where possible, require the parties to perform their obligations according to those objective standards that, while still questions of fact, may cause fewer disputes and reduce the cost of resolution?

Tips for Minimizing the Risk of Costly Disputes.

Flexible terms cannot always be avoided where unknowable externalities like a shifting regulatory environment or volatile market conditions loom. In some instances, the parties to a major transaction could be unwilling to spell out in writing the steps they are willing to take to secure regulatory approval, lest that undermine their negotiating leverage with a regulator. But clients are well advised to invest the time and energy up front in thinking through and describing exactly what they are agreeing to do and how they plan to do it. That investment usually pays big dividends because the amount of time spent interpreting a contractual clause? is usually inversely proportional to the time spent negotiating it. Some steps corporate counsel can take early on include:

- Clarify terms like “commercially reasonable” or “best efforts,” or eliminate the need for them, by using more objective standards like requirements for minimum spend, timelines, and performance metrics;
- Make sure you have identified and consulted the stakeholders to whom you are committing future obligations to be sure they are ready, willing, and able to hold up your end of the bargain;
- Implement a means to track not only your performance during the term of the agreement, but also to monitor the other side’s compliance;

- Build into the contract specific milestones to accomplish specific interim goals to have more objective means of measuring adherence to the contractual promises;
- Consider a mechanism for business leaders to meet and confer at the first sign of a dispute to see if the issue can be resolved. Such requirements impose a practical and powerful incentive for the parties to work through the dispute collaboratively (which one of you wants to be the one to tell the boss she has to rearrange her schedule to hammer out an issue you were not able to predict?). It also focuses attention on solving the problem early before potential damages start to accumulate.

Flexible contractual terms—as with any boundary object—can be useful mechanisms for getting parties to agree and move forward. But those benefits have to be balanced against the unpredictable risks of resorting to vague terms that can lead to significant and unanticipated costs. While it is hard with fast-moving deals to find the time to clarify what future performance is expected, striving to actually speak the same language at the negotiation phase is often worthwhile. If you and your teen can agree that “late” means “after 10:00 p.m.,” consider investing the time to find that out before she leaves the house. Following that advice on your next deal and avoiding costly litigation can similarly spare you headaches after midnight.



1. Star, S., & Griesemer, J. (1989). “Institutional Ecology, ‘Translations’ and Boundary Objects: Amateurs and Professionals in Berkeley’s Museum of Vertebrate Zoology, 1907-39.” *Social Studies of Science*, 19 (3): 387-420. doi: 10.1177/030631289019003001.