

Background

Contracting parties frequently use terms such as “commercially reasonable efforts,” “reasonable efforts,” “best efforts” or similar standards when describing their expectations regarding the performance of a party’s obligations. However, these terms are inconsistently interpreted by courts and are often subjectively applied. A requirement that a party undertake its “best efforts” in performing its obligations is universally understood to be the highest standard, requiring everything to be done by a party, except bankruptcy, in order to accomplish the stated objective. On the other end of the spectrum, “reasonable efforts” is a less stringent standard, requiring only that the party do what it can within reason in order to accomplish the stated objective. “Commercially reasonable efforts” is at a level below “best efforts” and is generally interpreted as requiring the party to exert substantial effort without requiring that the party take any action that would be commercially unreasonable under the circumstances. Finally, “commercially reasonable efforts” is a standard that has received limited interpretation by courts. In this article, we discuss how “commercially reasonable efforts,” “reasonable efforts,” and “best efforts” have been interpreted in recent court decisions and considerations with respect to the use of such terms by contracting parties.

“Commercially Reasonable Efforts”

In *Williams Cos. v. Energy Transfer Equity, LP*, a recent Delaware Court of Chancery case, the court offered guidelines for interpreting the conduct of a party to a merger agreement using the “commercially reasonable efforts” standard.¹ *Williams* involved a merger agreement between The Williams Companies, Inc. (“Williams”) and Energy Transfer Equity, L.P. for the creation of Energy Transfer Corp LP (“ETC”), into which Williams would merge. However, following entry into the merger agreement, the energy markets sharply fell and the merger became significantly less attractive to ETC. The merger agreement included a condition precedent requiring ETC to use commercially reasonable efforts to obtain a tax opinion from its outside counsel stating that the merger should be treated by the Internal Revenue Service as a tax-free exchange. However, ETC’s outside tax counsel concluded that it would be unable to provide the required opinion. As a result, ETC had reason to terminate the merger agreement. Williams sued ETC, alleging, among other things, that ETC had materially breached its obligations under the merger agreement to use “commercially reasonable efforts” to obtain the tax opinion at closing.

The court held that ETC was not in material breach of its contractual obligation to use its “commercially reasonable efforts” to obtain the tax opinion because ETC’s outside counsel acted in good faith in making the determination that it could not deliver the tax opinion and there was no indication that ETC had manipulated the ability of its outside counsel to render the tax opinion in any material manner. To that end, the court held that there was no basis for finding that ETC was in material breach of the “commercially reasonable efforts” requirement.

Williams relied heavily on the court’s prior decision in *Hexion Specialty Chemicals, Inc. v. Huntsman Corp.*, which found that the buyer did in fact materially breach its obligations to use “commercially reasonable efforts.”² In *Hexion*, which also involved a buyer who was motivated to avoid a merger, the buyer’s insolvency advisor issued an opinion that the combined entity would be insolvent, but the opinion was based on materially misleading information that the buyer had knowingly provided. The buyer in *Hexion* then argued that it had suffered a “material adverse change” and that it was not in knowing or intentional breach of the merger agreement. The court concluded that the buyer in *Hexion* “actively and affirmatively torpedoed its ability to finance.”

In practice, the courts have equated “reasonable best efforts” with “good faith” in the context of the contract at issue. As a result, by agreeing to use “commercially reasonable efforts” to achieve a desired outcome, the contracting party necessarily submits itself to an objective standard; it binds itself to do those things objectively reasonable to produce the desired outcome, in the context of the agreement reached by the parties.

“Reasonable Efforts”

Courts have been inconsistent in defining the types of conduct that constitute “reasonable effort” without using an objective commercial standard. In most cases, judges tend to assess whether a party has exercised “reasonable effort” as a question of fact and place the burden of proof on the party seeking to enforce the requirement. In determining whether “reasonable effort” was

¹ See *Williams Companies, Inc. v. Energy Transfer Equity, L.P.*, 2016 WL 3576682 (Del. Ch. June 24, 2016), *aff’d*, 2017 WL 1090912 (Del. Mar. 23, 2017).

² See *Hexion Specialty Chemicals, Inc. v. Huntsman Corp.*, 965 A.2d 715 (Del. 2008).

undertaken, courts have considered such factors as whether the promising party used the level of effort that a reasonable entity would have used, the economic feasibility and profitability of an action and a party's financial resources and business acumen.³

For example, in *Leigh Co. v. Bank of New York*, the court placed the burden on the plaintiff "to present evidence demonstrating what constitutes a commercially reasonable standard . . . and how the defendant failed to meet this standard."⁴ Of course, courts have recognized that acting in a commercially reasonable manner does not require a party to enter into agreements that are against its own business interests. However, a court's interpretation of conduct that is against a party's own interests can differ from case to case. For example, in *Rex Med. L.P. v. Angiotech Pharm. (US)*, despite the defendant's claim that continued performance of the agreement would lead to financial losses of approximately \$1 million per month, the court granted the plaintiff's motion to enjoin the defendant from terminating the merger agreement, concluding that the buyer's purported grounds for termination were "utter and complete nonsense."⁵

"Best Efforts"

In *Bloor v. Falstaff Brewing Corp.*, the court held that the "best efforts" standard does not prevent a party from giving reasonable consideration to its own interests.⁶ In practice "best efforts" is open to judicial interpretation and may depend on the relevant facts and context of the negotiations creating a contractual obligation. Though "commercially reasonable efforts" requires some level of an industry standard to compare against, "best efforts" also requires good faith efforts on behalf of contracting parties.

In *Maestro W. Chelsea SPE v. Pradera Realty*, a dispute arose over Pradera Realty's failure to submit an application to obtain a waiver required for the closing of an air rights sale.⁷ The contract, which was upheld by the court, required Pradera Realty to use its best efforts to obtain the waiver. The court dismissed the respondent's argument that a "best efforts" clause was invalid because it contained no objective criteria against which it could be measured. The court held that a "best efforts" clause simply imposed "an obligation to act with good faith in light of one's own capabilities." The court also clarified that the law does not require specific best efforts criteria to be defined in a contract, as external standards establish sufficient context for the objective meaning of "best efforts."

New York courts have historically required contracting parties to include a clear set of guidelines in the contract against which the court may measure a party's "best efforts."⁸ However, more recently, this requirement has become unworkable as the phrase appears so frequently in contractual disputes that New York courts have become hesitant to invalidate them even in the absence of a clear set of expressed guidelines. New York law does not require that "best efforts" criteria be defined in the contract if objective external standards provide the court with a reasonable degree of certainty as to the meaning of the phrase. Without express guidelines set forth in the contract or an objective external standard, New York courts have generally interpreted "best efforts" to simply impose a good faith standard on the contracting parties. As a result, "best efforts," without any contractual definition or objective external standard, may not be helpful to the contracting parties. Similarly, where contracts have not expressly provided a definition of "best efforts," courts have applied a broad standard requiring parties to use "reasonable efforts" to satisfy the requirements of a contract. In *Town of Roxbury v. Rodriguez*, where a real estate purchase agreement required parties to use "best efforts" to comply with stated requirements, the New York court held that use of the term requires that plaintiffs pursue "all reasonable methods for satisfying the necessary contingencies."⁹

Considerations When Using "Commercially Reasonable Efforts," "Reasonable Efforts," "Best Efforts" and Similar Standards

Contracting parties and counsel should take note of the following best practices when negotiating and drafting agreements to avoid conflict and the risk of an undesired result following judicial review:

³ See *Eastwood Ins. Serv., Inc. v. Titan Auto Ins.*, 469 Fed. Appx. 596 (9th Cir. Feb. 27, 2012) and *Citri-Lite Co.*, 2011 WL 4751110.

⁴ See *Leigh Co. v. Bank of New York*, 617 F. Supp. 147 (S.D.N.Y. 1985).

⁵ See *Rex Med. L.P. v. Angiotech Pharm. (US)*, 754 F. Supp. 2d 616 (S.D.N.Y. 2010).

⁶ See *Bloor v. Falstaff Brewing Corp.*, 454 F. Supp. 258 (S.D.N.Y. 1978).

⁷ See *Maestro W. Chelsea SPE v. Pradera Realty*, 954 N.Y.S. 2d 819, 825 (Sup. Ct. 2012).

⁸ See *TPTCC NY v. Radiation Therapy Servs.*, 784 F. Supp. 2d 485, 506-07 (S.D.N.Y.).

⁹ See *Town of Roxbury v. Rodriguez*, 277 A.D.2d 866, 867 (3d Dep't 2000), citing *Kroboth v. Brent*, 215 A.D.2d 813, 814, 625 N.Y.S.2d 748). In *Kroboth*, a dispute arose from a land sale contract requiring the parties to use their "best efforts" to obtain subdivision approval from the town of New Lebanon. The plaintiffs presented a perimeter survey of the premises to the Town Planning Board, but after the Planning Board declined to grant approval due to failure to meet certain requirements, plaintiffs took no further action gain additional approvals needed to satisfy the Planning Board. The court held that the "best efforts" provision required the plaintiffs to take further action to pursue all reasonable methods for obtaining the subdivision approval; a requirement that goes beyond mere good faith which is implied in all contracts.

- When drafting an agreement, contracting parties should use a consistent standard throughout that is agreeable to all parties. However, if a different standard of effort is intended, the parties should be informed of the differing, and at times inconsistent, judicial interpretations given to each standard by applicable courts.
- The parties should pay close attention to which parties are bound by a particular standard in the agreement; courts will dissect the language and intent of the agreement to interpret which party is held to a given standard.
- The parties should keep a record of their discussions regarding the accepted standard at the time the agreement is negotiated as it may prove to be a helpful source for a court’s future review of the standard.
- To the extent possible, the parties should provide specificity in the text of the agreement itself; this may include examples or metrics of how the requirements of a particular standard can be met.
- Ideally, if contracting parties intend to use an industry or other objective standard or carve-out specific known possible contingencies from the chosen standard, the parties should be advised to incorporate such criteria directly into the contract itself instead of relying upon a later judicial interpretation of the standard.

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