

Drafting Enforceable Commercially Reasonable Efforts Clauses in Business Agreements

Closing Obligations, Earn-Out Agreements, Licensing Agreements, Recent State Cases

TUESDAY, JUNE 29, 2021

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“Efforts” Clauses



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YMMV – small changes
in facts can be significant

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Why use “efforts” clauses?

- Might not know what’s wanted / needed
- Don’t want to take the time to figure it out
- So: Punt – defer the decision
(Setting up for disputes later?)

Examples?

- NDA: Recipient must use C.R.E./B. efforts to preserve confidentiality of Discloser's confidential information
- Pay-if-paid clause: Prime contractor must use C.R.E./B. efforts to collect payment from customer (so as to pay subcontractor)
- Reseller must use C.R.E./B. efforts to promote sales of manufacturer's goods and/or services
- Software supplier must use C.R.E./B. efforts to keep malware out of delivered software.
- Non-breaching party must use C.R.E./B. efforts to mitigate damages from breach

Choose one; *Best efforts* means...

- A. Whatever it takes, including bankruptcy?
- B. Whatever it takes, but *short of* bankruptcy?
- C. All reasonable efforts?
- D. “Just” reasonable efforts?

What business people believe it means:

“Bring your ‘A’ game!” ?

Or.....

- Is your “B” game good enough?
- What about your “C” game?

Hypothetical: Freeway driving



- Speed limit:
70 max, 40 min
- Good weather;
light traffic
- **Question:** To get to destination,
would driving 50 be "best efforts"?
60? 70? 90?

S.D.N.Y.: In N.Y., *reasonable* efforts *might* satisfy “best efforts” obligation

See *Holland Loader Co. v. FLSMIDTH A/S*, 313 F. Supp. 3d 447, 470 & n.5 (S.D.N.Y. 2018) (C.R.E.) (citations omitted)

“Everything under the sun”?

“Best efforts’ . . . cannot mean everything possible under the sun.”

– Coady Corp. v. Toyota Motor Distrib., 361 F.3d 50, 59 (1st Cir. 2004)

New York: concrete jungle without concrete rules

- *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)
- *Hexion Specialty Chemicals, Inc. v. Huntsman Corp.*, 965 A.2d 715 (Del. 2008)
- *Leigh Co. v. Bank of New York*, 617 F. Supp. 147 (S.D.N.Y. 1985)
- *Rex Med. L.P. v. Angiotech Pharm. (US)*, 754 F. Supp. 2d 616 (S.D.N.Y. 2010)
- *Bloor v. Falstaff Brewing Corp.*, 454 F. Supp. 258 (S.D.N.Y. 1978)
- *Town of Roxbury v. Rodrigues*, 277 A.D.2d 866, 867 (3d Dep't 2000)

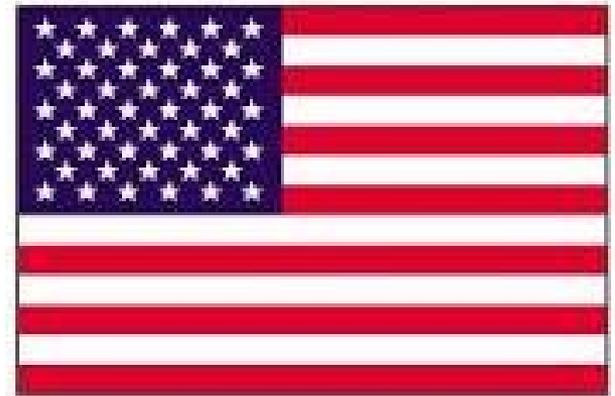
What happens if I'm in . . .

- **New Jersey**- commercial reasonableness is a "flexible concept based upon a consideration of all relevant factors presented in each individual case."*Puretz v. Brikman*, 2019 N.J. Super. Unpub. LEXIS 1936 (L. Div. Aug. 26, 2019)
- **Ohio**- [w]hile the phrase best efforts is used to describe the extent of an undertaking, this has properly been termed an extravagant phrase...a more accurate description of the obligation owed would be the exercise of "due diligence" or "reasonable efforts". *Permanence Corporation v. Kennametal, Inc.*, 908 Fed. 2d 98 (6th Cir. 1990),
- **California**--California courts interpret efforts clauses as something different than "a promise to act in good faith," and something less than fiduciary duty. *California Pines Prop. Owners Assn. v. Pedotti*, 206 Cal. App. 4th 384 (2012); an efforts clause "permits the performing party to consider its economic business interests" in evaluating how it is obligated to perform. *Citri-Lite Co. v. Cott Beverages, Inc.*, 721 F. Supp. 2d 912 (E.D. Cal. 2010)
- **Texas**--no distinction between best efforts and commercially reasonable efforts, but framework provided in *CKB & Associates, Inc. v. Moore McCormack Petroleum, Inc.*, 809 S.W.2d 577 (Tex. App.—Dallas 1991, writ denied
- **Massachusetts**- flexible. Massachusetts courts have held that "[b]est efforts does not require unreasonable, unwarranted or impractical efforts and expenditures of time and money out of all proportion to economic reality." *Macksey v. Egan*, 633 N.E.2d 408 (Mass. App. Ct. 1994). Parties are "allowed to give reasonable consideration to their own interest." *Id.*

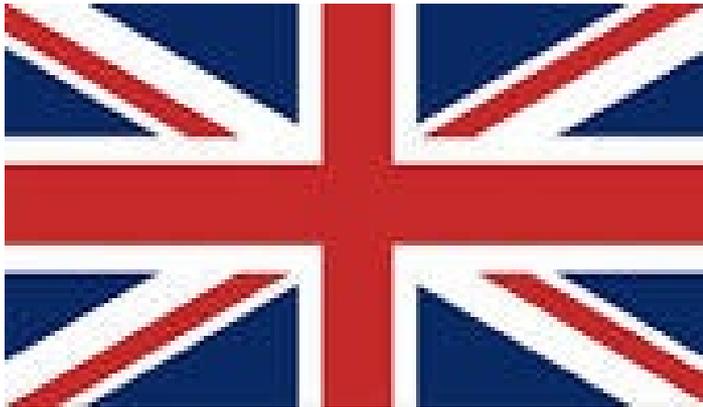
Best efforts: U.S. courts

Best efforts = diligent
making of “reasonable
efforts”

*So say some U.S. courts,
Restatement (Second) of Agency
§ 13, comment a (1957)*



“Best” efforts:
What (some) other courts think



“All reasonable
endeavours”



“Leaving no stone
unturned”

Litigation danger: 20-20 hindsight

- Opposing counsel (and expert witness): Monday-morning quarterbacks
- *Best efforts*: There's always *something* else that (supposedly) *could* have been done

Summary judgment or 12(b)(6)?

- Can be very fact-dependent
- *Best efforts* – will S/J even be possible?
- S/J for comm. rsnbl. efforts *might* be possible
 - MY Imagination, LLC v. M.Z. Berger & Co., No. 17-1218 (6th Cir. Feb. 16, 2018) (reversing grant of Δ's MSJ)
 - Netologic Inc. v. Goldman Sachs Gp. Inc., 2018 NY Slip Op 31409 (granting Δ's MSJ)
 - Organo Gold Int'l v. Aussie Rules Marine Services, 416 F. Supp. 3d 1369 (S.D. Fla. 2019) (denying Δ's MSJ)
 - PPD Enterpr., LLC v. Stryker Corp., No. 4:16-CV-0507 (S.D. Tex. Nov. 1, 2017) (C.R.E.; denying Δ's MSJ)

What might a court consider?

- No efforts by Δ

- Holland Loader Co. v. FLSMIDTH A/S, 313 F. Supp. 3d 447, 479 (S.D.N.Y. 2018) (C.R.E.; Δ jmt - bench trial; lots of cites)
- CKB & Assoc., Inc. v. Moore McCormack Petrol., Inc., 809 S.W.2d 577, 581-82 (Tex. App.—Dallas 1990) (best efforts; affirming π SJ)

- Δ 's performance in other, similar deals

- Olympia Hotels Corp. v. Johnson Wax Dev. Corp., 908 F. 2d 1363 (7th Cir. 1990) (Posner, J.; dictum (?) in granting new trial).

- Δ 's unexplained refusal to proceed

- Seaport Global Sec. LLC v. SB Grp. HoldCo, LLC, 2021 NY Slip Op 30704 (C.R.E.; granting π 's MSJ)

- Δ 's nonresponsiveness

- Wavedivision Holdings, LLC v. Millennium Digital Media Sys., L.L.C., 2010 Del. Ch. LEXIS 194 (Sept. 17, 2010) (jmt. for π - bench trial).

- Did π adduce evidence of *what* would be C.R.?

- Shane Campbell Gallery, Inc. v. Frieze Events, Inc., No. 20-1535-cv (2d Cir. Dec. 17, 2020) (C.R.E.; affirming grant of Δ 's 12(b)(6) motion) (non-precedential summary order)
- Terumo Americas Holding, Inc. v. Tureski, 251 F. Supp. 3d 317 (D. Mass. 2017) (C.R.E.; granting Δ 's MSJ)

So: *Define* “best efforts”? Example:

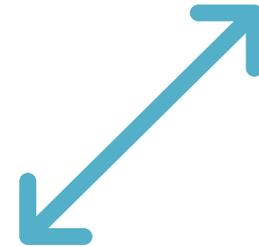
“A party obligated to use ‘best efforts’ to achieve an objective must diligently make reasonable efforts to achieve the objective, *but*:

1. need not take any *unreasonable* action;
2. need not take *every* conceivable reasonable action; and
3. need not materially harm its own lawful interests in pursuit of the objective.”

Map your contract out



What is your goal?



What acts/conditions are you seeking to control with your “reasonable efforts” clause?

Examples:

- Increased sales—how much? by what percentage?
- How was a task done—were new ways to increase sales tried? Are you looking for an innovative approach?
- Are there other benchmarks to work off of?

Can drafter(s) be more specific?

Partial checklist:

- Allocation/spending of money
- Incurring expenses / liabilities
- Time to be spent on various tasks
- Desire for new business strategy
(or maintain current business strategy)
- Disposing of assets
- Dealing with litigation

Be specific — and realistic

- Be as specific as possible.
 - The broader the clause, the more discretion exists to find the parties did or did not act with their best efforts.
- Use language that reflects the industry your client is in
 - Best practices vs. Reasonable industry practices
 - Fewer companies adhere to “best practices” as opposed to “reasonable industry practices”
 - A good starting point– will an industry expert be able to objectively define **what my client seeks** through the “best efforts” clause
 - Don’t bite off more than you plan to chew
 - “reasonable commercial judgment”

Use a *negative* definition?

Might be easier to specify what *needn't* be done

Punt? Set up cooperative process

Rule: If you can't now specify *outcome*, try specifying a (future) *process*:

- Periodic check-in calls
- Advance consultation about efforts
- Quick escalation of disputes
- Quick neutral eval of disputes (maybe w/ mini-trial to senior management?)
- Quick baseball arbitration of “what’s necessary to meet the efforts requirement”?

Thank you!



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