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Drafting Enforceable Commercially Reasonable Efforts Clauses in Business Agreements

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Today's faculty features:

Rebekah R. Conroy, Founding Partner, **Stone Conroy**, Florham Park, NJ

D.C. Toedt, III, Attorney, **On Contracts**, Houston, TX

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Commercially Reasonable Efforts

A recent Delaware Supreme Court holding might motivate contract drafters to define the term for themselves.

BY D. C. TOEDT III

Contract drafters often use the term "commercially reasonable efforts" in lieu of stating more precise standards of performance. Many clients are drawn to such clauses, which can speed up contract negotiations, even though the vagueness of the term poses a risk of disagreement later. (Clients can sometimes be overconfident that *"we'll just work it out later if the issue ever comes up"*—forgetting that the congenial individuals who negotiated the contract might not be in the same jobs later.)

The Williams Companies, Inc.: "Commercially reasonable efforts" means "*all* reasonable efforts"

The Delaware Supreme Court's holding in *Williams Companies, Inc. v. Energy Transfer Equity, L.P.*[1] implies that contract drafters might want to specifically define "commercially reasonable efforts," possibly as stated in this article, to reduce the risk that their clients will be caught unawares by a far-stronger commitment than they might have actually intended.

The use of commercially reasonable efforts the court remarked "placed an affirmative obligation on the parties to take *all reasonable steps*"[2] to achieve the stated objective. (This, even though the contract elsewhere used the term "reasonable best efforts,"[3] which, under the principle of inclusio unius, exclusio alterius, might have suggested that the two terms were intended to have different meanings.)

In a dissent on other grounds, Chief Justice Leo Strine opined that commercially reasonable efforts is "a comparatively strong" commitment, one that is only "slightly more limited" than "best efforts."[4] Indeed, in the proceedings below, the Delaware Chancery Court had all but equated the term "commercially reasonable efforts" with "reasonable best efforts," holding that a party that had made such a commitment had "bound itself to do *those things objectively reasonable to produce* the desired [result]."[5]

But what do clients expect?

Clients might be taken aback by the notion that commercially reasonable efforts requires the making of *all* reasonable efforts; if pressed, many clients might rank efforts commitments in roughly the following order:

- **Reasonable efforts:** One or more reasonable actions reasonably calculated to achieve a stated objective, *but with no expectation that all possibilities are to be exhausted*. Colloquially, this could perhaps be phrased as, "I'll give it a shot."
- **Commercially reasonable efforts:** Those efforts that reasonable business people would expect to be made, but again not necessarily all such efforts. Or, again colloquially, "I'll do what professionals would normally do." In a major lawsuit between Indiana and IBM, the contract in question defined the term as "taking commercially reasonable steps and performing in such a manner as a well managed entity would undertake with respect to a matter in which it was acting in a *determined, prudent*, businesslike, and reasonable manner to achieve a particular result."[6]
- **Best efforts:** "All reasonable" efforts—as the British Columbia Supreme Court said, "leaving no stone unturned in seeking to achieve the stated objective."[7] Or it could be stated in sports terms: "I'll bring my 'A' game." (In the U.S., courts sometimes define "best efforts" in terms of diligence, although some caselaw seemingly equates "best efforts" with mere "reasonable efforts.")[8]

Consider a hypothetical example. On major U.S. highways, some of the speed-limit signs often include both maximum and minimum speeds of 70 mph and 45 mph. Let's assume that those two speeds establish the upper and lower bounds of reasonableness: Anything less than 45 mph is unreasonable and so too is anything more than 70 mph. On these hypothetical facts, suppose that a trucking company were to agree that its driver would use a certain level of effort to drive a shipment of goods from point A to point B on a highway where drivers must drive between 45 mph and 70 mph. In good weather, with a functioning trucking rig and light traffic, clients might expect the following to apply:

On these facts, would driving at the following speeds be considered:	35 mph	45 mph	60 mph	65 mph	70 mph
Reasonable efforts?	No	Yes	Yes	Yes	Yes
Commercially reasonable efforts?	No	No	Yes	Yes	Yes
Best efforts?	No	No	No	No	Yes

Under the Delaware Supreme Court's *Williams Companies* holding, it might be argued that the commercially reasonable efforts standard could be met only by driving 68 mph or higher.

Texas caselaw is unclear

The author is not aware of any Texas cases addressing the meaning of "commercially reasonable efforts." Some insight can be had, however, from cases in which best efforts was at issue. For example:

- In the 2011 *Kevin M. Ehringer* case, the 5th Circuit of the U.S. Court of Appeals, quoting a Texas appellate court, held that under state law, "to be enforceable, a best efforts contract must set some kind of goal or guideline against which best efforts may be measured."[9] In its earlier *Hermann Holdings* opinion (cited in *Kevin M. Ehringer*), the 5th Circuit held that "as promptly as practicable" and "in the most expeditious manner practicable" were sufficient to meet that requirement.[10]
- In a 1991 case, the 5th Court of Appeals in Dallas affirmed summary judgment that an oil refiner, which had done nothing to produce agreed volumes of refined petroleum products, had not used best efforts. The refiner had focused its efforts on high-priced products, while making no effort to produce the specific products that it was contractually obligated to produce. The court remarked that "[a]s a matter of law, no efforts cannot be best efforts."[11]

W.I.D.D.: When in doubt, *define*

Drafters who want a less strict standard than that defined in *Williams Companies* can consider the following from the author's *Common Draft* project (a work in progress, available at commondraft.org):

- **Commercially reasonable efforts: (a)** "Commercially reasonable efforts" refers to at least those efforts that people experienced in the relevant business would generally regard as sufficient to constitute reasonable efforts in the relevant circumstances. Other uses of the term "commercially reasonable" have corresponding meanings; and **(b)** A party does not fail to act in a commercially reasonable manner, or to take commercially reasonable action, solely because it gives preference to its own interests over those of another party.
- **Reasonable efforts: (a)** "Reasonable efforts" refers to one or more reasonable actions reasonably calculated to achieve the stated objective; **(b)** Any assessment of reasonable efforts is to give due regard to the information reasonably available to the relevant person at the relevant time, for example, the likelihood of success of specific action(s), the likely cost of other actions, the parties' other interests, the safety of individuals and property, and the public interest; **(c)** A requirement to make reasonable efforts: (1) does not necessarily require taking every conceivable reasonable action and (2) does not require the obligated party to put itself in a position of undue hardship; and **(d)** A party obligated to make reasonable efforts may consider potential cost and potential return when determining what actions it must take to satisfy that obligation.

"Commercially reasonable efforts" could be defined in terms of consistency with past practice—but *whose* past practice? In a merger or acquisition agreement, or M&A agreement, a seller will sometimes agree to an "earnout" arrangement in which part of the sale price is pegged to the success of the business under the buyer's management. In those cases, the seller will normally want the buyer to commit to using commercially reasonable efforts to operate the business. The M&A agreement might define "commercially reasonable efforts" as those consistent with the buyer's past practices (which presumably would favor the buyer), or as those efforts consistent with industry-standard practices (which might favor the seller if the buyer's practices were subpar).[12]

Alternative: Baseball arbitration?

What if it's not possible to agree on a definition of "commercially reasonable efforts"? In that case, contract drafters can think about provisions to encourage settlement and reduce the chances of getting bogged down in litigation over the term. Such provisions might include, for example, a baseball arbitration provision,[13] requesting the court in any litigation to select one of the parties' two competing proposals, without modification.

The key feature of baseball arbitration is that the decision-maker has no power except to choose between the competing proposals. That gives each party an incentive to be reasonable in making its proposal: "Because the panel has to choose between one of the two offers, the player and team are both forced to present reasonable offers as the panel will choose the offer that is closer to what they believe is the player's true arbitration value."[14] That, in turn, often gets the parties close enough to be able to bridge the remaining gap on their own; for example, after the Houston Astros won the 2017 World Series, the team and series MVP George Springer reached agreement on a two-year, $24 million contract, avoiding the salary arbitration to which Springer was entitled.[15]

One possible baseball arbitration clause is set forth in the author's *Common Draft* project; its relevant language is as follows:

… (b) The dispute is to be decided by "last-offer" arbitration, sometimes known as "baseball" or "pendulum" arbitration, in which: (i) each party submits no more than two proposed determinations of the particular issue; (ii) the tribunal is jointly requested (if a court) or directed (if an arbitral tribunal) to select, as its determination of the particular issue, exactly one of the parties' proposed determinations, in its entirety, without modification; ….

Conclusion

Defining "commercially reasonable efforts" can help clients avoid unpleasant surprises. If an agreed-in-advance definition isn't feasible, then provisions to help the clients reach agreement about specific proposals can advance their long-term business interests. **TBJ**

Notes

1. *Williams Companies, Inc. v. Energy Transfer Equity, L.P.*, No. 330 [2016], 2017 Del. LEXIS 128 (Del. March 23, 2017).
2. *Id.* at *19 (emphasis added).
3. *See id.* at *3.
4. *Id.* at *27 & n.45 (Strine, C.J., dissenting) (citation omitted).
5. *Williams Companies, Inc., v. Energy Transfer Equity, L.P.*, No. 12168, 2016 Del. Ch. LEXIS 92 (Del. Ch. June 24, 2016) (emphasis added).
6. *Indiana v. IBM Corp.*, 4 N.E.3d 696, 716 n.12 (Ind. App. 2014), aff'd, 51 N.E.3d 150 (Ind. 2016).
7. *Atmospheric Diving Systems Inc. v. International Hard Suits Inc.*, 89 B.C.L.R. (2d) 356 (1994). Australian and British courts take a similar view. *See, e.g.*, Shawn Helms, David Harding & John Phillips, *Best Efforts and Endeavours—Case Analysis and Practical Guidance Under U.S. and U.K. Law*, Jones Day, July 2007, http://www.jonesday.com/Best-Efforts-and-EndeavoursCase-Analysis-and-Practical-Guidance-Under-US-and-UK-Law-07-30-2007/; Janet T. Erskine, *Best Efforts versus Reasonable Efforts: Canada and Australia*, McCarthy Tetrault, Nov. 30, 2007, http://mccarthy.ca/article_detail.aspx?id=3779.
8. *See* Restatement (Second) of Agency § 13, comment a (1957), *quoted in Corporate Lodging Consultants, Inc., v. Bombardier Aerospace Corp.*, No. 63-1467-WEB, 2005 U.S. Dist. LEXIS 9259 at *13 (D. Kan. May 11, 2005), *quoting T.S.I. Holdings, Inc., v. Lawrence S. Jenkins & Roger W. Hood, M.D.*, 924 P.2d 1239, 1250 (Kan. 1996). *See generally* John Pavolotsky, *Best efforts clauses—what buyers expect versus how suppliers respond*, IACCM, May 29, 2015, http://www2.iaccm.com/resources/?id=8571.
9. *Kevin M. Ehringer Enterprises, Inc., v. McData Services Corp.*, 646 F.3d 321, 327 (5th Cir. 2011) (reversing judgment on jury verdict; best-efforts pro-vision was "too indefinite and vague to provide a basis for enforcement").
10. *See Herrmann Holdings Ltd. v. Lucent Technologies Inc.*, 302 F.3d 552, 559-61 (5th Cir. 2002) (reversing dismissal under Rule 12(b)(6); citing cases).
11. *CKB & Assoc., Inc. v. Moore McCormack Petroleum, Inc.*, 809 S.W.2d 577, 581-82 (Tex. App.—Dallas 1991); *see also, e.g.*, Will Taylor, Laurens Wilkes, Joshua Fuchs, Basheer Ghorayeb & Roy Powell, *Contracts Requiring "Best Efforts" and "Commercially Reasonable Efforts,"* 2015 A.B.A. Sec. Pub. Energy Lit. at https://apps.americanbar.org/litigation/committees/energy/articles/spring2015-0515-contracts-requiring-best-efforts-commercially-reasonable-efforts.html.
12. *See generally* Kristian Werling, Richard B. Smith & Daniel Goldstein, *"Commercially Reasonable Efforts" Diligence Obligations in Life Science M&A*, The M&A Lawyer, June 2014, at 16, https://www.mwe.com/~/media/files/thought-leadership/publications/2014/06/commercially-reasonable-efforts-diligence-obliga__/files/unnamed-item/fileattachment/m_a_lawyer_june2014.pdf.
13. Baseball arbitration is named for a procedure used in Major League Baseball to resolve salary disputes between teams and their eligible players. Importantly, the procedure "*is designed to produce a settlement*, not a verdict." Thomas Gorman, *The Arbitration Process: The Basics*, Baseball Prospectus, Jan. 31, 2005, http://www.baseballprospectus.com/article.php?articleid=3732 (emphasis added).
14. Justin Sievert, *Breaking down the MLB salary arbitration process*, SportingNews, Jan. 13, 2018, http://www.sportingnews.com/mlb/news/mlb-salary-arbitration-process-breakdown-spring-training-2016/4jkawqkczi8i17cb4rhqjxseh.
15. *See* Hunter Atkins, *George Springer bets on self, gets lucrative deal*, Houston Chronicle, (Feb. 5, 2018), https://www.houstonchronicle.com/sports/astros/article/George-Springer-bets-on-self-gets-lucrative-12553722.php.

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