



## Contractual Standards: Distinctions without a Difference?

Commercial agreements typically specify specific standards in describing the degree of effort that a party is expected to undertake in order to carry out certain contractual obligations. For example, in many contracts, reference is made to one or the other party to the contract undertaking its “best efforts,” “reasonable efforts” or “commercially reasonable efforts.” Often, much time and attention is devoted to negotiating which of these standards will apply. Nevertheless, ambiguities remain as to the precise meaning of each of such standards. As we discuss below, these standards are inconsistently interpreted by courts and are often subjectively applied. That said, practitioners generally understand that “best efforts” is considered the highest of these standards requiring a party to undertake every action, short of bankruptcy, to accomplish the stated objective. On the other hand, “reasonable efforts” is perceived to be a less stringent standard, allowing a party to use its discretion “within its good faith business judgment” to fulfill a particular contractual obligation. “Commercially reasonable efforts” is generally interpreted as requiring a party to undertake some conscious effort to accomplish the agreed-upon goal; however, the standard is understood to limit the amount of effort a party is required to expend. This note discusses the ways in which each of these standards has been interpreted by courts and outlines certain considerations to take into account when using such terms in commercial agreements.

### “Best Efforts” Standard

Case law interpreting the “best efforts” standard is somewhat inconsistent, with some courts using “best efforts” and “reasonable efforts” interchangeably, thereby blurring the distinction between these two standards.<sup>1</sup> In practice, the question of whether a party used its “best efforts” is a factual one. Generally, “best efforts” requires, at the very least, a good faith effort to be undertaken by a party in light of its capabilities, including its sophistication, expertise and financial position.<sup>2</sup> However, like “reasonable efforts” and “commercially reasonable efforts,” a party may consider its own interests when selecting a course of action to achieve a contractual obligation.<sup>3</sup> Further, similar to “commercially reasonable efforts,” courts have used external benchmarks, such as promises made by the party during negotiations, industry practice and other criteria, in order to assess whether a party has complied with a “best efforts” standard.

Some courts have held that the “best efforts” standard imposes a duty on a party to act in good faith in light of its own capabilities.<sup>4</sup> In *Harbinger F&G, LLC v. FISmith A/S*, the court in the Southern District of New York held that the defendant did not breach a contract requiring the use of the party’s “reasonable best efforts” in trying to obtain as promptly as practicable the necessary approvals to consummate a transaction.<sup>5</sup> The defendant cooperated with the plaintiff’s suggestions in drafting revised forms, responded to questions, concerns and information requests, and otherwise “took all reasonable actions requested...as promptly as was practicable.” Due to the efforts actually expended by the defendant, the court found that it acted in good faith and used its reasonable best efforts.

As an alternative to the good faith standard, other courts have used a “reasonable efforts” standard to measure whether a party has used its “best efforts,” thereby equating the standards. In *Town of Roxbury v. Rodriguez*, wherein 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 required that plaintiffs pursue “all reasonable methods for satisfying the necessary contingencies.”<sup>6</sup>

In contrast, some courts have used objective criteria to measure whether a party has used its best efforts where the meaning of the term “best efforts” was ambiguous and the contract did not specify a set of criteria by reference to which the parties’ efforts would be measured. Previously, courts required parties to include a clear set of guidelines in the contract that the court could use to determine whether a party had used “best efforts.”<sup>7</sup> This requirement became unworkable as the phrase appeared so frequently in contractual disputes that courts were hesitant to invalidate them even in the absence of a clear set of expressed guidelines.

<sup>1</sup> See *Soroof Trading Dev. Co., Ltd. v. GE Fuel Cell Sys., LLC*, 842 F. Supp. 2d 502, 511 (S.D.N.Y. 2012) (stating that when interpreting a “reasonable efforts” clause, “New York courts use the term ‘reasonable efforts’ interchangeably with ‘best efforts’”).

<sup>2</sup> See *Bloor v. Falstaff Brewing Corp.*, 601 F.2d 609, 613 n.7 (2d Cir. 1979); see also *Cruz v. Fxdirectdealer, LLC*, 720 F.3d 115, 124 (2d Cir. 2013).

<sup>3</sup> See *Bloor*, 601 F.2d at 613.

<sup>4</sup> See *Holland Loader Co., LLC v. FISmith A/S*, 2018 WL 2078034 (S.D.N.Y. May 2, 2018).

<sup>5</sup> See *Harbinger F&G, LLC v. OM Group (UK) Ltd.*, 2015 WL 1334039, 39 (S.D.N.Y. Mar. 18, 2015).

<sup>6</sup> 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.

<sup>7</sup> See, e.g., *Strauss Paper Co. v. RSA Exec. Search, Inc.*, 260 A.D.2d 570, 688 (2d Dep’t 1999).

As a result, 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 regarding the meaning of the phrase under the circumstances.<sup>8</sup>

For example, 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.<sup>9</sup> The contract required Pradera Realty to use its best efforts to obtain the waiver. The court dismissed the respondent’s argument that the “best efforts” clause was invalid because it did not include objective criteria against which to measure efforts. 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. Rather, external standards provide sufficient context to create an objective meaning of “best efforts.”

### “Reasonable Efforts” Standard

While practitioners have understood “reasonable efforts” to be an “indisputably less stringent” standard than “best efforts,” courts have been inconsistent in defining the types of conduct that constitute “reasonable efforts” without using an objective commercial standard.<sup>10</sup> For a plaintiff to show that the defendant failed to use reasonable efforts, the plaintiff “must demonstrate that [the defendant’s] actions were inconsistent with good faith business judgments.”<sup>11</sup> 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 assessing whether a party undertook “reasonable efforts,” 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 a particular course of action and a party’s financial resources and business acumen.<sup>12</sup>

In the case of *In re Chateaugay Corp.*, the district court found that the plaintiff failed to prove that the defendant breached a provision of the contract requiring the defendant to “use all reasonable efforts...to consummate the transactions contemplated by the agreement.”<sup>13</sup> One requirement to consummate the agreement was Congressional approval. The court held that for the plaintiff to prove that the defendant did not use “reasonable efforts,” it had to show that the defendant’s failure to lobby members of Congress to change their opinions about the acquisition was inconsistent with good faith business judgment. The district court held that because the defendant made substantial efforts to do so, including engaging in numerous contacts with members of Congress, it was within its good faith business judgment to expend resources lobbying members of Congress who opposed the acquisition. Accordingly, the court affirmed that the plaintiff failed to show the defendant breached its duties to use all “reasonable efforts.”

While New York courts tend to draw a distinction between “commercially reasonable efforts” and “reasonable efforts,” Delaware courts tend to use the standards more interchangeably. For instance, in the recent *In re Oxbow* case, the defendant agreed to a reasonable efforts clause in an agreement with the plaintiff requiring the parties to act in good faith to achieve an exit sale.<sup>14</sup> Rather than applying a “reasonable efforts” standard, the Delaware Chancery Court applied the standard articulated in *Williams Cos. v. Energy Transfer Equity, L.P.*, stating that “‘commercially reasonable efforts’ imposes an ‘affirmative obligation on the parties to take all reasonable steps’ to complete a transaction.”<sup>15</sup> Because the defendants purposefully obstructed the exit sale by delaying to choose an investment bank, using litigation to slow the process and otherwise spending most of their energy and resources trying to thwart the sale, the court found that the defendants failed to comply with their duty to take reasonable steps to complete the transaction.

### “Commercially Reasonable Efforts” Standard

While the “commercially reasonable efforts” standard has received limited interpretation, courts have suggested that the standard at the very least requires “some conscious exertion to accomplish the agreed goal, but something less than a degree of efforts that jeopardize one’s business interests.”<sup>16</sup> While parties are not required to “jeopardize” their business interests, some courts have refused to excuse parties’ performance even when completing the obligation would put the business at risk of significant financial

<sup>8</sup> See *Maestro W. Chelsea SPE v. Pradera Realty*, 954 N.Y.S.2d 819, 825 (Sup. Ct. 2012).

<sup>9</sup> See *id.*

<sup>10</sup> See *In re Chateaugay Corp.*, 198 B.R. 848 (S.D.N.Y. 1996), *aff’d*, 108 F.3d 1369 (2d Cir. 1997).

<sup>11</sup> *In re Chateaugay Corp.*, 198 B.R. 848 (S.D.N.Y. 1996) (citing *Travelers Int’l, A.G. v. Trans World Airlines, Inc.*, 41 F.3d 1570, 1575-76 (2d Cir. 1994)).

<sup>12</sup> See *Eastwood Ins. Serv., Inc. v. Titan Auto Ins.*, 469 F. App’x 596 (9th Cir. Feb. 27, 2012) and *Citri-Lite Co.*, 2011 WL 4751110.

<sup>13</sup> See *In re Chateaugay Corp.*, 198 B.R. 848, 855.

<sup>14</sup> *In re Oxbow Carbon LLC*, 2018 Del. Ch. LEXIS 47, 179-80 (Del. Ch. Feb. 12, 2018).

<sup>15</sup> *In re Oxbow Carbon LLC*, 2018 Del. Ch. LEXIS 47, 180 (Del. Ch. Feb. 12, 2018) (quoting *Williams Cos., Inc. v. Energy Transfer Equity, L.P.*, 159 A.3d 264, 273 (Del. 2017)).

<sup>16</sup> *Holland Loader Co., LLC v. FISmith A/S*, 2018 WL 2078034 (S.D.N.Y. May 2, 2018).



harm.<sup>17</sup> Additionally, by agreeing to use “commercially reasonable efforts” as the standard, the contracting party “binds itself to do those things objectively reasonable” to achieve the desired outcome.<sup>18</sup> Finally, when “commercially reasonable efforts” is not defined in the contract, the party seeking to enforce the efforts clause must establish the standard that the breaching party’s efforts are to be measured against, in the context of the particular industry.<sup>19</sup>

In *Williams Cos. v. Energy Transfer Equity, L.P.*, the Delaware Court of Chancery found that the defendant did not breach a “commercially reasonable efforts” clause because it acted in good faith.<sup>20</sup> In this case, the plaintiff, Williams, and the defendant, Energy Transfer Equity, LP (“ETE”) entered into a merger agreement. The agreement required ETE to undertake “commercially reasonable efforts” to obtain a tax opinion stating that the merger should be treated as a tax-free exchange by the Internal Revenue Service. ETE’s tax counsel concluded that it could not provide the opinion, thereby providing ETE with grounds to terminate the agreement. Concurrently, the energy market plummeted and the plaintiff argued that the defendant breached its obligation to use “commercially reasonable efforts” to obtain the tax opinion at closing, instead choosing to terminate the transaction in light of market conditions.

The court held that the “commercially reasonable efforts” clause obligated ETE to “do those things objectively reasonable” to obtain the tax opinion. The court found that ETE did not breach the agreement because its outside tax counsel acted in good faith and genuinely believed it could not issue the opinion. There was also no indication that ETE manipulated or interfered with outside counsel’s decision. Therefore, the court held that there was no basis to find that ETE breached the “commercially reasonable efforts” standard under the merger agreement.

Recently in *Holland Loader Co., LLC v. FISmidth A/S*, a New York district court further clarified the “commercially reasonable efforts” standard by stating that it “requires at the very least some conscious exertion to accomplish the agreed goal, but something less than a degree of efforts that jeopardize one’s business interests.”<sup>21</sup> In *Holland*, the plaintiff sued the defendant for breaching an intellectual property agreement requiring the defendant to use “commercially reasonable efforts” to “actively promote the sale of products” in the mining and construction industries. Since the IP agreement did not define “commercially reasonable efforts,” the plaintiff had to establish the meaning of the term using objective standards. Based on testimony from the plaintiff’s expert witness, the standard of “commercially reasonable efforts” to promote a product in the mining and construction industry is proper planning. As the defendant failed to show evidence of a clear marketing plan or an effort to implement a later proposed marketing plan, the court found that the defendant failed to undertake “commercially reasonable efforts” to satisfy its obligations under the agreement.

## Considerations

Given the inconsistent interpretation by courts of these contractual standards, contracting parties should consider the following:

- Make sure that the parties’ expectations are reflected in the contract itself as the courts will first look to the language of the contract in order to determine the parties’ intent and expectations regarding the meaning of any standard.
- To the extent possible, the parties should specify the level of efforts that they expect by specifying examples of actions parties are obligated to take in order to achieve desired outcomes and outline timetables for such actions in the agreement or in development plans.
- Contracting parties should avoid using inconsistent standards in an agreement; if more than one standard is needed, then the differences between the standards should be clearly articulated in the agreement and the parties should understand the differing, and at times inconsistent, interpretations by courts of such clauses.
- It is often helpful to keep a record of any promises or assumptions made in connection with the negotiation of such clauses as a court may consider such promises and assumptions as evidence of objective criteria when asked to determine the meaning of an otherwise ambiguous standard included in an agreement.

<sup>17</sup> See *MBIA Ins. Corp. v. Patriarch Partners VIII, LLC*, 950 F. Supp. 2d 568, 618 (S.D.N.Y. 2013) (holding that a rational reading of “commercially reasonable” must exclude actions that will hurt the party financially); *Rex Med. L.P. v. Angiotech Pharm. (US)*, 754 F. Supp. 2d 616 (S.D.N.Y. 2010) (granting the plaintiff’s motion to enjoin the defendant from terminating the merger agreement despite the defendant’s claim that performing the agreement would lead to an approximate \$1 million financial loss per month).

<sup>18</sup> See *Williams Cos., Inc. v. Energy Transfer Equity, L.P.*, 2016 WL 3576682, at \*19 (Del. Ch. June 24, 2016), *aff’d*, 2017 WL 1090912 (Del. Mar. 23, 2017); *Sekisui Am. Corp. v. Hart*, 15 F. Supp. 3d 359, 381 (S.D.N.Y. 2014) (describing that the standard for evaluating “commercially reasonable efforts” is objective).

<sup>19</sup> See *Sekisui Am. Corp. v. Hart*, 15 F. Supp. 3d 359, 382 (S.D.N.Y. 2014).

<sup>20</sup> See *Williams*, 2016 WL 3576682, at \*17.

<sup>21</sup> *Holland Loader Co., LLC v. FISmidth A/S*, 2018 WL 2078034 (S.D.N.Y. May 2, 2018).



- To the extent that the contracting parties intend to use an industry or other objective benchmark to measure performance under an agreement, the benchmark should be set forth or referenced in the agreement.

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## Contacts

### Brian D. Hirshberg

New York

T: (212) 506-2176

E: [bhirshberg@mayerbrown.com](mailto:bhirshberg@mayerbrown.com)

### Alex J. Speyer

New York

T: (212) 506-2553

E: [aspeyer@mayerbrown.com](mailto:aspeyer@mayerbrown.com)



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