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Satisfying 'commercially reasonable efforts'/'best efforts' clauses in today's environment

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Over the past several weeks, the novel coronavirus (COVID-19) has upended the marketplace and imposed upon industries, companies, and their workforce new and often unanticipated challenges and delays.

Many deal and commercial contracts contain provisions requiring one party to provide performance consistent with its "best efforts," "commercially best efforts," "commercially reasonable efforts," or some other "efforts" qualification.

The COVID-19 crisis raises the question of what burden these clauses place on businesses — whether in a merger or other sale transaction, earn-out agreement, licensing agreement, or other commercial arrangement — in order to meet contractual obligations when those obligations are suddenly, and unexpectedly, made more difficult by that crisis.

The application of these flexible, and often uncertain, standards to the COVID-19 crisis has broad implications in sale and commercial agreements.

Key jurisdictions for sale and commercial agreements have described the obligations of these efforts clauses in different ways.

Understanding the scope of these obligations is critical to moving forward through this crisis.

Delaware courts, for example, have imposed upon the party subject to the efforts clause a duty to work with its counterparty to find solutions to emergent problems.

New York, Massachusetts, and California courts, on the other hand, have focused more closely on the "reasonableness" of a party's actions, and have explicitly acknowledged that a party may give some consideration to its own interests, including potentially countervailing economic or other interests, in complying with its efforts duties.

- **Delaware** – Delaware courts have described "commercially reasonable efforts" or "best efforts" as obligating the parties to cooperate in challenging circumstances. In *Williams Companies, Inc. v. Energy Transfer Equity, L.P.*, 159 A.3d 264 (Del. 2017), the Delaware Supreme Court stated that these standards required the parties "to take all reasonable steps to solve problems and consummate the transaction. Put another way, under Delaware law, "reasonable best efforts," requires a party to (i) have "reasonable grounds to take the action" it takes and (ii) seek "to address problems with its counterparty." *Akorn, Inc. v. Fresenius Kabi AG*, 2018 WL 4719347 (Del. Ch. Oct. 1, 2018), *aff'd*, 198 A.3d 724 (Del. 2018).

- **New York** – New York courts have held that "commercially reasonable efforts" is an objective standard, focused on objective reasonableness. *Holland Loader Co., LLC v. FLSmidth A/S*, 313 F. Supp. 3d 447 (S.D.N.Y. 2018), *aff'd*, 769 F. App'x 40 (2d Cir. 2019). But in acting reasonably, a party need not act against its own interests. Rather, the "efforts" standard, as New York courts have described, "requires at the very least some conscious exertion to accomplish the agreed goal, but something less than a degree of efforts that jeopardizes one's business interests." *Id.*

- **Massachusetts** – Massachusetts courts view efforts clauses flexibly, with an eye towards simply acting in "good faith. Similar to the way New York recognizes countervailing concerns, 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). Thus, the obligated parties are "allowed to give reasonable consideration to their own interest." *Id.*

- **California** – California courts describe 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). Like other jurisdictions, California recognizes that 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).

Critically, in each of these jurisdictions, the courts recognize that "best efforts" and "commercially reasonable efforts" are highly flexible standards and the interpretation thereof depends on the

specific challenges faced by the obligated party, its industry, and the market as a whole.

The application of these flexible, and often uncertain, standards to the COVID-19 crisis has broad implications in sale and commercial agreements.

Because of the flexible nature of agreements to perform in accordance with one's "best efforts" or "commercially reasonable efforts," there is enormous uncertainty in these provisions that will often turn on situation-specific factors.

The potential applications include:

- **M&A/sale transactions, closing obligations** – Both sides of an M&A transaction frequently must use "best efforts" or "commercially reasonable efforts" to close the deal. But that obligation is not all-consuming. In *Akorn*, the Delaware Chancery Court concluded that the buyer's rigorous investigation of the company and ultimate decision to terminate the agreement did not breach the buyer's "reasonable best efforts" duties because (i) the buyer repeatedly communicated with the seller in order to determine whether the deal would succeed, and (ii) the buyer's concerns about the seller's performance were legitimate and justified the buyer's decision to back out. Buyers approaching closing during the COVID-19 crisis subject to similar efforts clauses would be wise to likewise communicate actively with sellers about their ongoing operations as closing approaches and, if the crisis places closure of the deal in jeopardy, to thoroughly investigate and document the impacts of the crisis on the ability or obligation of buyers to close.

- **M&A/sale transactions, interim period operations** – Most sale transactions include some duties of the seller to operate the business pre-closing with "best efforts," frequently paired with language describing the duty as consistent with the "ordinary course of business. The emergent and uncertain nature of the unfolding COVID-19 crisis raises dramatic uncertainty in how any operation currently undertaken is in the "ordinary course," or whether unanticipated, but necessary, changes in operations in response to the crisis. While under contract, sellers should be mindful of any interim covenants (including covenants not to enter into certain transactions outside the ordinary course of business) and keep lines of communication open with buyers about any significant steps being taken within the business to address the crisis. Sellers should be prepared to explain and justify the reasons for those steps taken to address the crisis, as well as other options considered but rejected and their reasons for rejecting, in landing on the chosen path.

- **Earn-out agreements** – In earn-out transactions, an acquirer must operate the acquired company consistent with "best efforts" or "commercially reasonable efforts" to protect a seller's earn-out rights. An acquirer's response to a decline in business, including strategic decisions to alter the focus of the business in response to a crisis, could call into question whether the acquirer is meeting its "efforts" obligations while simultaneously reacting to emergent adversities. Acquirers should thoroughly explore and document the basis for any changes in strategic direction that could lead to a challenge under an efforts clause, including industry-wide or other market-based changes that support the shift in approach.

- **Licensing/collaboration agreements** – License agreements and other commercial agreements often place on the developing and/or commercializing party a requirement that they do so with "commercially reasonable" or other "efforts." In license agreements in particular, the licensee often must use "commercially reasonable efforts" to achieve certain diligence milestones by specified deadlines. In *Holland Loader*, the New York court concluded that the defendant had breached its duty to promote plaintiff's products with "commercially reasonable efforts," primarily through its failure to develop a marketing plan and strategy similar to other products it sold. Tracking how other similar products (whether commercialized by the applicable party or by third parties in the same industry) are performing and the steps that the commercializing parties take to continue their development and commercialization efforts throughout the crisis can reveal whether a party is using "reasonable efforts."

At bottom, the COVID-19 crisis presents new and emergent challenges for individuals and businesses attempting to interpret and understand their contractual obligations.

Because of the flexible nature of agreements to perform in accordance with one's "best efforts" or "commercially reasonable efforts," there is enormous uncertainty in these provisions that will often turn on situation-specific factors.

It is thus important to understand the position courts have taken when interpreting such standards under the governing law of the applicable contract, including whether the law allows a party to take into account its own economic considerations, requires careful coordination with its counterparties, or has some other requirements.

It is always important to bring a thoughtful, well-supported approach to whatever steps are taken to satisfy these efforts

clauses, to make clear that a party is working in good faith to understand its obligations, and to create a demonstrable record to support the reasonableness and necessity of the actions taken.

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