

# **“Best Efforts” Standards Under New York Law: Legal and Practical Issues**

By **David Shine**

It's sometimes said that no good deed goes unpunished. But good intentions need not suffer the same fate if drafted properly. Promises to perform in commercial agreements are typically modified by “best efforts,” “reasonable best efforts,” “commercially reasonable efforts” or similar language. These commitment standards are often heavily negotiated and can have meaningful consequences. But under New York law it is not clear that there is a meaningful difference between these standards, what level of financial exposure they entail, or how they are to be measured.

***“Best efforts” is at the top of the scale and is generally perceived to mean that a party must do all that can possibly be done to seek and obtain an end, even if the impact would be materially adverse to the seeking party and even if there is a material monetary cost to the action.***

This article will first explore the range of commitment standards and discuss the perceived rationale for them. Second, the article discusses cases under New York law that have sought to apply these standards. Finally, the article will suggest a framework for utilizing these standards in a meaningful way in light of the existing case law.

## **Customary Commitment Standards**

Agreements often include covenants of the parties to pursue ends that may not be fully under the control of the pursuing party. Acquirors, for example, may be required to seek approval for a transaction from antitrust authorities. Targets, on the other hand, may need to obtain consents from third parties who have contractual consent rights upon a change of control. In these instances the ability to obtain the approval or consent is dependent on a third party taking an action that it may only agree to take if certain demands are met.

The party charged with seeking these consents or approvals will therefore generally try to limit its exposure by qualifying the degree of effort it must exert. Agreements may also include payment obliga-

tions that are only triggered under certain circumstances. An acquisition agreement, for example, may include contingent payments based on future sales. In such circumstances the seller will be interested in specifying that the purchaser exert a high level of effort to encourage sales.

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The commitment standards most often used to address these contractual issues are “best efforts,” “reasonable best efforts” and “commercially reasonable efforts.” These standards generally are perceived by practitioners as constituting a sliding scale of effort levels. “Best efforts” is at the top of the scale and is generally perceived to mean that a party must do all that can possibly be done to seek and obtain an end, even if the impact would be materially adverse to the seeking party and even if there is a material monetary cost to the action.

“Reasonable best efforts” is a level down from the top end of the scale and is generally perceived as requiring substantial efforts be exerted in the process, but that a party would not ultimately be required to take any actions that would be commercially unreasonable under the circumstances. Finally, “commercially reasonable efforts” is toward the bottom of the scale and is generally perceived as limiting both the effort required to be exerted in the process as well as what a party may ultimately be obligated to do in order to obtain the desired end.

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## Applicable Case Law

There is not a coherent body of New York law on these commitment standards. In fact, Judge Friendly once noted that New York law in this area is “far from clear.” Therefore, rather than trying to draw broad conclusions from the cases, this section will use the available caselaw to address the principal questions raised by use of these standards.

### Is There a Meaningful Difference Between Best Efforts and Reasonable Efforts?

Notwithstanding what practitioners may perceive, there is little support under New York law for the view that best efforts is a different commitment standard than reasonable efforts. The only case that clearly supports this view is *LTV Aerospace and Defense Company v. Thomson-CSF S.A.*<sup>1</sup> However, *LTV* is a bankruptcy court decision and, although the court applies New York law, its precedential value is obviously limited. In *LTV*, the parties had entered into an asset purchase agreement pursuant to which Thomson would acquire the assets of LTV’s missiles division.

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The contract provided that LTV exert “reasonable efforts” in trying to close the transaction. As part of its analysis, the court noted that reasonable efforts was a lesser standard than best efforts. However, since, according to the court, even a best efforts clause allows parties “a choice of discretion” in selection of a course of action, the court never articulated its view as to the meaning of reasonable efforts, concluding instead that, based on the facts, LTV had met the even higher standard of best efforts.

However, contrary to *LTV*, several cases suggest that there is no meaningful difference between these two standards.

In *Kroboth v. Brent*, a land purchase was contingent on the buyer obtaining subdivision approval.<sup>2</sup> The contract provided that the buyer would use his “best efforts” to obtain the approval. The New York appellate division held that best efforts meant that the buyer must use “all reasonable methods for obtaining subdivision approval” thereby blurring any distinction between best efforts and reasonable efforts.

In *Timberline Development v. Kronman*, a seller of property had agreed to use “reasonable efforts” to obtain bankruptcy court approval for the sale.<sup>3</sup> The New York appellate division did not need to determine what reasonable efforts meant (the contract included a

liquidated damages clause which was applicable). However, the court apparently did not believe there to be any distinction between best efforts and reasonable efforts, noting that what was at issue in the case was the meaning of “reasonable efforts” or “best efforts as it is generally expressed.” Again, the court blurred any distinction between the standards.

### Does Best Efforts Mean Unlimited Financial Exposure?

A leading second circuit case suggests that best efforts does not mean that a party has to bankrupt itself and can give reasonable consideration to its own financial interests. In *Bloor v. Falstaff Brewing Corp.*, Bloor had sold its Ballantine beer business to Falstaff for a purchase price that included a percentage of the proceeds from future sales of Ballantine.<sup>4</sup> In the purchase agreement, Falstaff had agreed to use its “best efforts to promote and maintain a high volume of sales” of Ballantine. Thereafter, Falstaff experienced financial difficulties and, among other things, severely cut its advertising budget and closed four of six regional distribution centers. In *Bloor*, the court expressly noted that Falstaff had the right to give reasonable consideration to its own interests, and disagreed with any suggestion that the best efforts clause required it to take actions that would bankrupt it or result in sales of Ballantine at a substantial loss.

However, other cases have held that unprofitability or financial disadvantage does not excuse performance under either a best efforts or reasonable efforts standard.

In *Showtime Networks Inc. v. Comsat Video Enterprises, Inc.*,<sup>5</sup> the New York supreme court interpreted a contract for distribution of cable television programming in which the distributor agreed to use its “best efforts” in promoting certain programming and its “reasonable business efforts” to maintain the customer base for the programming. The court, in deciding a summary judgment motion, held unprofitability did not excuse performance under either standard.<sup>6</sup>

### What is the Standard Against Which Best Efforts is Measured?

Whether a party has used its best efforts in a particular situation is obviously a factual question. But what are a party’s efforts to be measured against? One possibility is that best efforts are to be measured against what the applicable party could do. The other possibility is that best efforts is to be measured against what a similarly situated party would do. Once again, New York law does not provide a clear answer.

In *Van Valkenburgh v. Hayden Publishing Company*, the New York court of appeals noted that even where a publisher had agreed to use its best efforts to promote an author's work, the publisher could still issue books on the same subject and promote them accordingly to the publisher's economic interest even if adversely affecting the contracting authors' sales.<sup>7</sup> The court noted that the publisher had the right to act in "its own interest" without regard to external comparisons. However, the court also noted that there may be a point where its acts are so harmful as to constitute a breach of a best efforts covenant.

***[A]greements should specify the standard against which efforts will be measured (i.e., whether efforts will be judged based only the contracting party and its circumstances, or whether industry standards should be taken into account).***

Contrary to *Van Valkenburgh*, in *McDarren v. Marvel Entertainment Group, Inc.* the district court applied an external test noting that, "if external standards or circumstances impart a reasonable degree of certainty to the meaning of the phrase 'best efforts,' the clause can be enforced."<sup>8</sup> A similar approach was taken in *U.S. Airways Group, Inc. v. British Airways PLC*.<sup>9</sup> There the district court noted "to the extent that the term 'best efforts' ... is ambiguous, and criteria by which to measure the parties' 'best efforts' are lacking, the extrinsic circumstances concerning the parties' understanding of that term may be considered by the finder of fact."

And in *Joyce Beverage of New York, Inc. v. Royal Crown Cola*, the district court looked to what was customary in the contracting party's industry as a way of measuring whether the contracting party had used its best efforts. There, even though a beverage distributor did not have an express obligation to distribute only Royal Crown cola, since industry practice was for distributors to distribute only one cola, the court found that the distributor breached its best efforts sales obligations to Royal Crown by distributing other colas.<sup>10</sup>

### **Advice to the Practitioner**

Faced with widely disparate interpretations of such commonly used language as "best efforts" and "reasonable efforts" what's a contracting party to do?

### **Be Specific**

To the extent possible, agreements should set out the specific expectations of the parties.

- Where contingent purchase price payments or royalty payments are to be based on post-closing performance, the parties should seek to agree on the parameters of the performing parties obligations. These could take the form of loss caps, minimum required out-of-pocket expenditures or exclusive marketing arrangements.
- Where third party consents to a transaction are to be sought, the parties should specify whether the seeking party will be required to make consent payments, any agreed upon maximum dollar amounts and whether there will be an economic adjustment to the transaction terms if one or more consents are not obtained.
- Where antitrust approval for a transaction is being sought, the parties should agree on whether the acquiror will be required to effect divestitures, agree to hold businesses separate or litigate with the government in order to obtain approval (and, if so, the extent of its obligations under each scenario).
- Parties should seek to utilize timetables for accomplishing specified tasks, such as making governmental filings.
- Finally, agreements should specify the standard against which efforts will be measured (*i.e.*, whether efforts will be judged based only the contracting party and its circumstances, or whether industry standards should be taken into account).

### **Anticipate Some Uncertainty**

Transactions often require parties to accomplish many tasks, not all of which are identifiable at the time the agreement is entered into. Therefore, even though specificity is better, there will continue to be a need for general best efforts language in agreements. As the cases above illustrate, courts have been inconsistent in their interpretation of these commitment standards under New York law. Therefore, when relying on a general commitment standard, each party should be aware that different courts could apply the standard in different ways.

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