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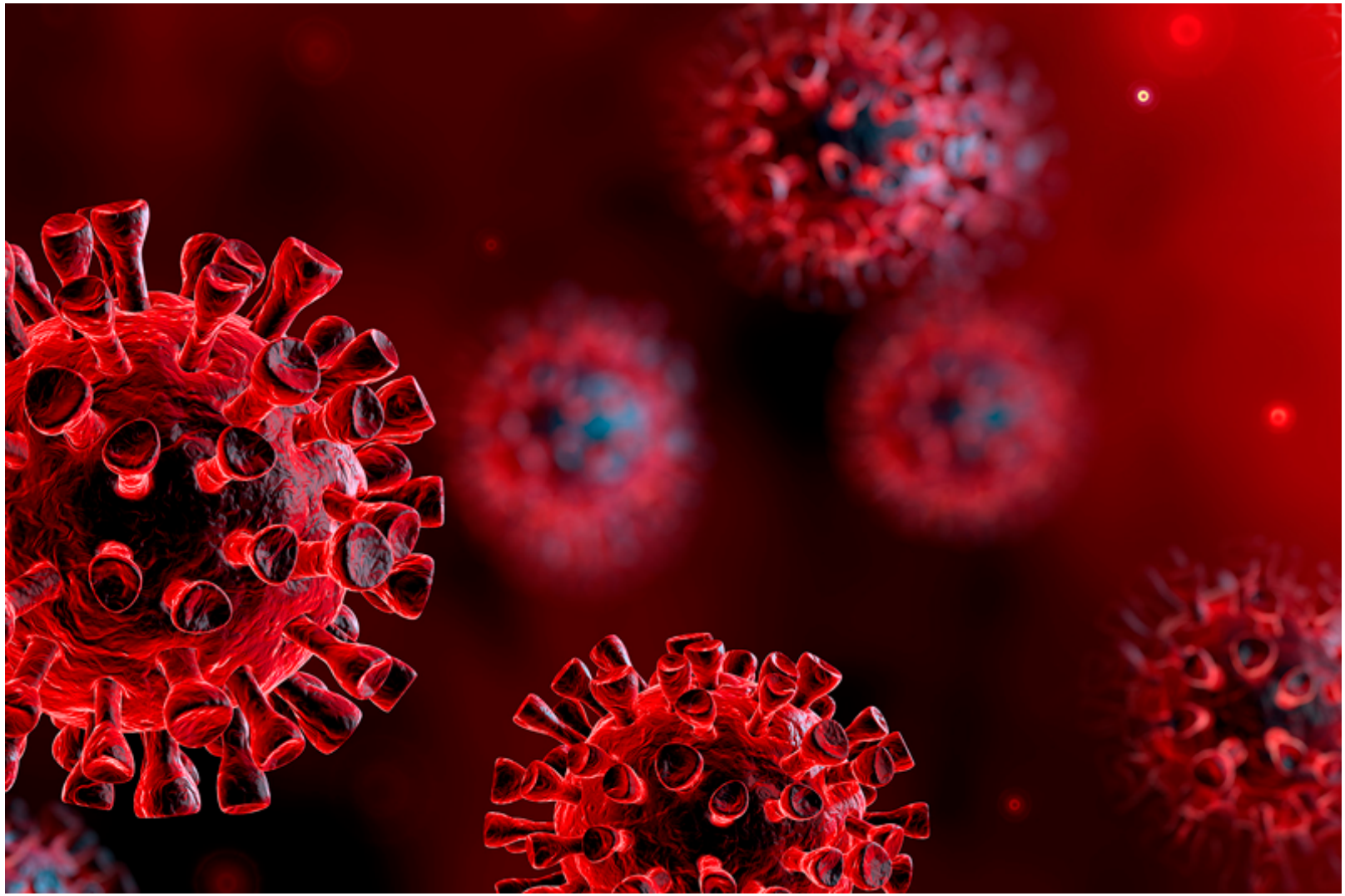

“Commercially Reasonable Efforts” in a COVID-19 and Low Oil Price World

by Kevin Jacobs and Cornelius Sweers May 8, 2020

The COVID-19 pandemic and dramatic oil price drop have parties looking closely at their contracts to determine their rights and obligations. While much attention has been focused on force majeure and whether the COVID-19 outbreak or oil price drop supports such claims, less attention has been paid to other contract provisions that may provide flexibility in these extraordinary times. One possible provision found in contracts is a qualifier that a party must use "commercially reasonable efforts" to perform a certain obligation or set of obligations. Sometimes undefined in the contract, what qualifies as "commercially reasonable efforts" is a frequent source of dispute in ordinary times. In the current extraordinary situation, we expect to see a new wave of these disputes as parties seek to limit or avoid suddenly burdensome long-term contractual obligations.

An Overview of How Courts Define "Commercially Reasonable Efforts" When the Contract is Silent

Rather than negotiate for a precise performance standard at the outset of the relationship, contract drafters often define performance in terms of a party's "commercially reasonable efforts" to perform or achieve a certain result. While resorting to a "commercially reasonable efforts" provision may speed up contract negotiations—which may seem like a good idea at the time to keep everyone's options open—when the market for the product or service changes, parties may find themselves in a dispute about what it means to use commercially reasonable efforts.

Unsurprisingly, there are no cases applying a “commercially reasonable efforts” standard in the context of a disease outbreak, epidemic or commodity price drop. And, in the event of a dispute over what qualifies as “commercially reasonable efforts,” there are few cases giving specific guidance on what it means to use “commercially reasonable efforts” when the contract is silent. But courts appear to follow the following broad principles when considering “commercially reasonable efforts” standards.

- What constitutes “commercially reasonable efforts” is an objective test determined by reference to the particular industry at issue.
- Expert testimony is particularly helpful and almost necessary to establish the industry standard for “commercially reasonable efforts,” as well as whether or not a party’s conduct met that standard.
- “Commercially reasonable efforts” can require a party to take “all reasonable steps” in pursuit of the goal—with the caveat that a party is typically not required to act against its own business interests or give up other contractual rights.
- It is supposed to be measured at the time—not by what was commercially reasonable in hindsight.
- “Commercially reasonable efforts” are a fact-intensive inquiry that usually cannot be resolved by summary judgment.

One observation from the caselaw is, without expert testimony, a claim based on failure to use “commercially reasonable efforts” is unlikely to succeed. In Musket Corp. v. Suncor Energy (U.S.A.) Marketing, Inc., Musket and Suncor entered an exclusive crude oil supply contract for Suncor to supply Musket’s Windsor Colorado terminal with 20,000 barrels of crude oil per day. The contract required Musket as buyer to “[u]se any and al reasonable commercial efforts to ensure that the Windsor Terminal has sufficient

capacity to receive Product delivered by Seller at all times throughout the Term" but did not further define "reasonable commercial efforts." Both parties struggled to meet the 20,000 barrel daily volume commitment and litigation ensued. Musket and Suncor both brought breach of contract claims against each other, and Suncor's claim was based in part on Musket's alleged failure to use reasonable commercial efforts to receive the 20,000 barrels/day amount. Suncor asserted that Musket failed to ensure it had sufficient capacity to meet the 20,000 barrels/ day obligation and that this was all the evidence needed on the issue of whether Musket used "reasonable commercial efforts." Musket countered that Suncor failed to provide any evidence or expert testimony on how Musket's actions compared to the industry. The federal trial court in Texas sided with Musket and granted summary judgment against Suncor's claim. The trial court reasoned "if the parties contemplated that it was patently unreasonable to not expand the terminal enough to accept the committed volumes, there would have been no need to add the reasonable commercial efforts provision." The court also observed that "the commercially required efforts required to expand a rail terminal . . . are also not something about which the ordinary finder of fact would be sufficiently familiar to draw conclusions from the evidence."

Another key limit on "commercially reasonable efforts" that courts have imposed is that "[a] contractual requirement to act in a commercially reasonable manner does not require a party to act against its own business interests, which it has a legal privilege to protect." In Patriarch Partners, the defendant, the manager of a special purpose investment vehicle agreed with plaintiff (the insurer of the investment vehicle's assets) to use commercially reasonable efforts to obtain an investment grade rating on the "B" class of promissory notes issued by the investment vehicle as soon as reasonably practicable. However, in order to achieve the investment-grade rating for the B notes,

the defendant believed that it was necessary for the investment vehicle to have assets above $650 million, since the investment grade rating issued for another of the investment vehicle's classes of notes (the "A" notes) was contingent upon the investment vehicle achieving an asset base of $650 million. But despite defendant's efforts, the investment vehicle was not able to accumulate $650 million of assets. As a result, the defendant believed that if it sought a rating for the "B" notes, it could risk a downgrade of the A notes, which would have hurt both defendant and plaintiff (as the insurer of the investment vehicle). In a bench trial, the court concluded that the defendant had used commercially reasonable efforts, and noted that a party is not required to act against its own business interests in order to act in a commercially reasonable manner. Id. at 617-18. The court noted that the plaintiff had presented no evidence to "define the parameters" of the commercially reasonable standard in the investment management industry, and that instead the evidence presented at trial established that defendant's conduct was "well within the bounds of any rational characterization of the 'commercially reasonable' standard."

Analysis: Considerations for Assessing "Commercially Reasonable Efforts" in A COVID-19 and Low Oil Price World

In light of the new and extraordinary conditions caused by the COVID-19 pandemic and the dramatic oil price drop, obligations to use "commercially reasonable efforts" to perform or accomplish a specific task may offer flexibility and limited relief from having to perform at prohibitive cost. But as a reasonableness-based standard that turns on parties' particular facts and circumstances, what qualifies as "commercially reasonable efforts" is often up for debate and can be fertile ground for disputes on those differing perspectives. As a result, parties should carefully assess whether to assert that

performance is no longer commercially reasonable under the circumstances and when it may become commercially reasonable to resume performance.

While courts have not (yet) interpreted “commercially reasonable efforts” standards in the context of a pandemic or a commodity price drop, courts have provided general guidance and principles for parties to consider when evaluating their or their counterparties “commercially reasonable efforts” obligations when the contract is silent.

- One touchstone of “commercially reasonable efforts” is whether or not a party’s efforts are “in the fairway” of the relevant industry. If your or your counterparty’s actions are outside the mainstream, it can strengthen a breach of contract claim.
- Another touchstone is that the “commercially reasonable efforts” standard generally does not require parties to forego their other contractual rights or ignore their business interests. As the Patriarch Partners case illustrates, parties are generally permitted to balance their own business interests with the obligation to use “commercially reasonable efforts” to achieve the contractual goal such as closing a transaction or distributing a product.
- In the event of a dispute, expert testimony is essential as courts tend to require evidence establishing the industry standard and on how a party’s conduct met that standard. Practically speaking, it is difficult to establish either without expert testimony, and it is likely not enough to say that a party’s conduct was not commercially reasonable because the party did not meet contract benchmarks, as the Musket v. Suncor case makes clear.
- What constitutes “commercially reasonable efforts” is a fact-intensive inquiry and is rarely resolved on summary judgment. As a result, parties should be prepared for

lengthy litigation or arbitration in these types of disputes and the need to support their positions with witnesses and contemporaneous documents.

- One issue that courts have not provided guidance on is a situation where it is initially commercially unreasonable to perform, but at what point do circumstances change such that a party must resume performance? For example, if a "stay-home" order has made it commercially unreasonable for a party to perform, but the order is lifted, at what point does it become commercially reasonable to perform? Parties need to remain vigilant about identifying when circumstances change making it reasonable to resume performance and act accordingly to resume performance.

In the economic aftermath of the COVID-19 pandemic and the oil price drop, we expect to see a number of disputes over the scope and application of "commercially reasonable efforts" performance standards. While in certain cases these standards may offer limited relief from suddenly burdensome obligations, parties should not treat "commercially reasonable efforts" clauses as silver bullets that can excuse failures to meet performance goals.

[1] *MBIA Ins. Corp. v. Patriarch Partners VIII, LLC*, 950 F. Supp. 2d 568, 618 (S.D.N.Y. 2013).

[2] *See, e.g., B.D.G.S., Inc. v. Balio*, 861 N.E.2d 813, 817 (N.Y. 2006) (relying on expert testimony concerning reasonable commercial standards in banking industry); *Musket Corp. v. Suncor Energy (U.S.A.) Marketing, Inc.*, 2017 WL 896510 (S.D. Tex. Mar. 7, 2017) ("While the commercially reasonable efforts required to expand a rail terminal in the instant case are perhaps not as complex as those required to obtain FDA approval of a drug in Sekisui, they are also not something about which the ordinary finder of fact

would be sufficiently familiar to draw conclusions from the evidence.") *aff'd* 759 Fed. Appx. 280 (5th Cir. Jan. 8, 2019).

[3] *See Williams Companies, Inc. v. Energy Transfer Equity, L.P.*, 159 A.3d 264 (Del. 2017) ("[C]ovenants like the ones involved here ["commercially reasonable efforts" and "reasonable best efforts"] impose obligations to take all reasonable steps to solve problems and consummate the transaction."); *Williams Field Services Group, LLC v. Caiman Energy II, LLC*, 2019 WL 4668350, at *34 (Del. Ch. Sep. 25, 2019) ("More generally, an obligation to take reasonable actions or use commercially reasonable efforts obligates a party "to take all reasonable steps to solve problems and consummate the transaction" on the terms set forth in the governing agreement. It does not require a party "to sacrifice its own contractual rights for the benefit of its counterparty." To the extent that Williams has rights under the Caiman LLC Agreement, such as a right to refuse to consent to amendments that are adverse to its interests, then Williams can stand on that right. EnCap cannot rely on the IPO Cooperation Clause to force Williams to waive or compromise its right.") (internal citations omitted); *Patriarch Partners*, 950 F. Supp. 2d at 618 ("A contractual requirement to act in a commercially reasonable manner does not require a party to act against its own business interests, which it has a legal privilege to protect") (internal quotations omitted); *Citri-Lite Co. v. Cott Beverages, Inc.*, 721 F. Supp.2d 912, 924 (E.D. Cal. 2010) ("[i]nterpreting the term "commercially reasonable efforts" in the manner Citri–Lite suggests would require Cott to engage in promotional and selling efforts without any regard to its economic business interests, which it has a legal privilege to protect."); *Vintage Rodeo Parent, LLC v. Rent-a-Center, Inc.*, 2019 WL 1223026, at *22 (Del. Ch. Mar. 14, 2019) ("A party's obligation to use commercially reasonable efforts must be cabined by its bargained-for contractual right If an agreement to use commercially reasonable efforts to comply with obligations in a

contract means that a party cannot exercise its bargained-for right to terminate that contract, that bargained-for right would be illusory.").

[4] *See Holland Loader Company, LLC v. FLSmidth A/S*, 313 F.Supp.3d 447, 472-73 (S.D.N.Y. 2018) ("A court's evaluation of a party's compliance with a "commercially reasonable efforts" requirement does not involve a hindsight comparison of the party's actual conduct to that which could have been undertaken to produce a better result; a court should evaluate only whether the party's actual conduct was sufficient.").

[5] *E.g. Patriarch Partners VIII, LLC*, 842 F. Supp. 2d at 706; *Citri-Lite*, 721 F. Supp.2d at 926.

[6] 2017 WL 896510 (S.D. Tex. Mar. 7, 2017), *aff'd* 759 Fed. Appx. 280 (5th Cir. Jan. 8, 2019).

[7] *Musket Corp. v. Suncor Energy (U.S.A.) Marketing, Inc.*, 759 Fed. Appx. 280, 283.

[8] *Musket Corp. v. Suncor Energy (U.S.A.) Marketing, Inc.* 2017 WL 201365, at *3 (S.D. Tex. Jan. 18, 2017).

[9] 2017 WL 896510, at *6-7.

[10] 2017 WL 896510, at *6.

[11] *Id*.

[12] *Patriarch Partners*, 950 F. Supp. 2d at 618.

[13] *Id.* at 571-81, 617.

[14] *Id.* at 590-91.

[15] *Id.* at 617-18.

[16] *Id.* at 617.

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