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"Reasonable Efforts" Clauses in Delaware: One Size Fits All, Unless…

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Editor's note: Peter Atkins and Edward Micheletti are partners at Skadden, Arps, Slate, Meagher & Flom LLP. This post is based on their Skadden memorandum and is part of the Delaware law series; links to other posts in the series are available here. Related research from the Program on Corporate Governance includes M&A Contracts: Purposes, Types, Regulation, and Patterns of Practice and Allocating Risk Through Contract: Evidence from M&A and Policy Implications (discussed on the Forum here), both by John C. Coates, IV.

Akorn Found

In Vice Chancellor J. Travis Laster's recent opinion in *Akorn, Inc. v. Fresenius Kabi AG*,[1] he discusses (on pages 212-216) the general subject of "efforts" clauses in contracts governed by Delaware law. The court's discussion appears to conclude that, for Delaware contract law purposes, at least among "efforts" clauses that expressly incorporate a "reasonableness" component, one size fits all. That is, the commitment in all cases is "to take all reasonable steps" to address the specified obligation—and word variations among a set of "efforts" clauses do not count.[2]

Below, we (a) review the general subject of "efforts" clauses (including the principal variations) and the approach taken in Delaware, (b) consider the meaning of Delaware's "all reasonable steps" standard (referred to in this memo as the "all reasonable efforts standard"), (c) consider whether that standard is satisfactory as the default standard (that is, if used without any contractual elaboration or modification of the "reasonable efforts" clause) and (d) discuss potential drafting approaches to improving alignment of the contracting parties' "reasonable efforts" commitments with their intent and risk concerns.

"Reasonable Efforts" Menu and the Delaware Solution

For many years, businesspersons and their lawyers have jousted with their contractual counterparties about the degree of commitment—short of absolute commitment—a contracting party should have to accomplish one or more specified obligations under the contract. In the M&A

[1] *Akorn, Inc. v. Fresenius Kabi AG*, C.A. No. 2018-0300-JTL (Del. Ch. Oct. 1, 2018).

[2] The *Akorn* decision is being appealed to the Delaware Supreme Court. Whether this leads to further guidance on the "efforts" issue remains to be seen. We also are aware of another high-profile case pending before Vice Chancellor Laster involving a dispute over whether a merger party used "reasonable best efforts" to obtain regulatory approval of a pending merger. *Tribune Media Company v. Sinclair Broadcast Group, Inc.*, C.A. No. 2018-0593-JTL. This may offer yet another opportunity for the Delaware Court of Chancery to opine about how Delaware construes such "efforts" provisions.

context, obligations that often are limited to some "efforts" commitment are a party's obligation (a) through closing, to preserve its current business organization, keep available the services of its current officers, employees and agents, and maintain its relationships and goodwill with suppliers, customers and others with business relationships with that party; (b) to consummate the transaction expeditiously, including obtaining all required consents and regulatory approvals; and (c) to obtain any required financing.

Variations on the "efforts" concept include commitments to make: "good faith efforts," "commercially reasonable efforts," "reasonable efforts," "reasonable best efforts" and "best efforts." Among lawyers, businesspersons and advisers in the transactional world, these variations often have been viewed as reflecting a hierarchy from lowest (good faith efforts) to highest (best efforts) level of commitment.[3]

From a business standpoint, it is understandable that different levels of contractual "reasonable efforts" may be appropriate or necessary. This could occur in cases where both contracting parties agree on the level of "reasonable efforts" commitment, *e.g.*, "commercially reasonable efforts," which they both believe is a lesser commitment than "all reasonable efforts." And it could occur in cases where they disagree, *e.g.*, where a cash-out seller is willing to accept the buyer's rejection of an unqualified "best efforts"—do what is within your power—commitment to close, but is unwilling to have the commitment slide to mere "reasonable efforts" and wants a tougher "reasonable best efforts"—do what is reasonably within your power—commitment.

That said, when applying Delaware law, the *Akorn* court, relying on the Delaware Supreme Court's decision in *Williams Companies, Inc. v. Energy Transfer Equity, L.P.*,[4] concludes that contracting parties may not impose refined levels of commitment simply by choosing from among the short menu of "efforts" variations that use the term "reasonable." The *Akorn* court stated:

> [In *Williams*,] the Delaware Supreme Court interpreted a transaction agreement that used both "commercially reasonable efforts" and "reasonable best efforts." Referring to both provisions, the high court stated that "covenants like the ones involved here impose obligations to take all reasonable steps to solve the problems and consummate the transaction." The high court did not distinguish between the two.[5]

This leaves at least three important questions: What does the "all reasonable efforts standard" mean? Is it satisfactory as a "one size fits all" default standard for the varying forms of reasonable efforts clauses? Would adding specificity to the "all reasonable efforts standard" improve the outcome?

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[3] ABA Mergers and Acquisitions Committee, Model Stock Purchase Agreement with Commentary Volume 1, 212 (2d ed. 2010) (referencing each of these "efforts" variations and ascribing a meaning to each).

[4] No. 330, 2016, Del., 159 A.3d 264 (Del. 2017).

[5] *Akorn*, at 215 (footnote omitted). The *Akorn* opinion does not reach a conclusion as to whether "good faith efforts" (at one end of the "efforts" spectrum) and/or "best efforts" (at the other end) are also within the "all reasonable efforts standard." As to "best efforts," the *Akorn* opinion acknowledges that Chief Justice Strine, in his 2017 dissenting opinion in *Williams*, identified a distinction between "best efforts" and "commercially reasonable efforts," describing the former as potentially leading to "the party making the promise having to take extreme measures to fulfill it," and the latter as "a strong, but slightly more limited, alternative." *Akorn*, at 215 n.797 (citing *Williams*, 159 A.3d at 276 & n.45) (referring to Lou R. Kling and Eileen T. Nugent, *Negotiated Acquisitions of Companies, Subsidiaries And Divisions*, § 13.06 (2018 ed.)). However, the *Akorn* opinion also notes an earlier judicial comment by Chief Justice Strine (from 2009, while serving on the Delaware Court of Chancery) that even a "best efforts" obligation is implicitly qualified by a reasonableness test because "it cannot mean everything possible under the sun." *Akorn*, at 215 (citing *Alliance Data Sys.*, 963 A.2d 746, 763 n. 60 (Del. Ch. 2009)).

Meaning of "All Reasonable Efforts Standard"

In the context of the Akorn/Fresenius transaction, the "all reasonable efforts standard" came up in two different circumstances, one relating to Akorn's conduct and one relating to Fresenius'.

As Applied to Akorn

As to Akorn, the court stated: "Under the Merger Agreement, Akorn was obligated to use *commercially reasonable efforts* to operate in the ordinary course of business in all material respects. As interpreted by the Delaware Supreme Court in *Williams*, this standard required that Akorn '*take all reasonable steps*' to maintain operations in the ordinary course of business."[6] A material breach of this obligation by Akorn gave Fresenius, under certain circumstances, a right to terminate the merger agreement between them. Fresenius claimed that Akorn materially breached this obligation.

Determining in this context whether Akorn had breached its "all reasonable efforts standard" obligation involved the court:

a. selecting a framework against which to measure the reasonableness of certain Akorn conduct, in this case by postulating a judicial construct—a "generic pharmaceutical company";[7]
b. determining whether such a pharmaceutical company operating in the ordinary course of business would be obligated to engage or would be acting improperly if it engaged in certain identified behavior; and
c. conducting its own facts and circumstances analysis to determine whether Akorn failed to engage in such obligated behavior or engaged in such improper behavior.

Based on that exercise, the court found multiple failures by Akorn to make "all reasonable efforts" to maintain operations in the ordinary course of business. The court also found those breaches material. Accordingly, after finding that Fresenius itself was not in material breach, the court concluded that Akorn's breaches provided Fresenius with a basis for terminating the merger agreement.

As Applied to Fresenius

As to Fresenius, under the merger agreement it was obligated (pursuant to a mutual "reasonable best efforts" covenant) to "use … [its] reasonable best efforts to promptly … take … all actions … necessary, proper and advisable to cause the conditions to the Closing to be satisfied as promptly as reasonably practicable and to consummate and make effective, in the most expeditious manner reasonably practicable, the [Merger]."[8] Again, the court applied the standard from the Delaware Supreme Court in *Williams*, stating that "the 'reasonable best efforts' standard in this provision imposed an obligation on Fresenius 'to take all reasonable steps to solve the problems and consummate the transaction.'"[9]

[6] *Id*. at 216 (emphasis added) (citation omitted).
[7] *Id*. at 11
[8] *Id*. at 224 (emphasis added).
[9] *Id*. (emphasis added).

Because Fresenius' right to terminate its merger agreement with Akorn, based on Akorn's breaches of the merger agreement, was conditioned on Fresenius not "then [being] in material breach of any of its … covenants or agreements [in the merger agreement],"[10] the court had to inquire whether Fresenius breached the foregoing covenant.

The court bounded Fresenius' covenant obligation by the terms of the merger agreement. In its words:

> Importantly from my perspective, the parties agreed in the Reasonable Best Efforts Covenant to seek to "consummate and make effective" the transaction that they had agreed to in the Merger Agreement on the terms set forth in the contract. They were not committing themselves to merge at all costs and on any terms. Instead, they were committing themselves to fulfill the contract they had signed, which contained representations that formed the basis for the transaction, established the conditions to the parties' performance and gave both sides rights to terminate under specified circumstances. As I see it, the Reasonable Best Efforts Covenant did not require either side of the deal to sacrifice its own contractual rights for the benefit of its counterparty. The concept of acting for the benefit of another is a fiduciary standard, not a contractual one.[11]

As with Akorn, the court identified a framework against which to measure the reasonableness of Fresenius' conduct. In this case, it was the relevant contractual obligations and rights applicable to Fresenius under the merger agreement. Because those obligations and rights contemplated the possibility of polar opposite outcomes—consummation and termination of the merger—the court developed, applied in a broad-based factual examination and articulated a very thoughtful and nuanced analysis. Particularly noteworthy were the following:

- In concluding that Fresenius genuinely was concerned with the issues it confronted post-signing, and not just suffering "buyer's remorse," the court pointed out that, unlike the buyers' conduct in some prior cases, (a) Fresenius had raised its concerns with Akorn promptly and invited explanation and cure and (b) Fresenius' buyer's remorse was justified (with the court noting that "Fresenius responded after Akorn suffered a General MAE and after a legitimate investigation uncovered pervasive regulatory compliance failures").[12]
- The court directly addressed whether Fresenius' investigation of problematic areas was genuine or essentially an effort to find an escape route from a deal it no longer wanted to do, and concluded that the nature and potential severity of the issues investigated warranted the investigation based on the right to terminate on the basis of a material breach.[13]

[10] *Id*. at 223.
[11] *Id*. at 224-225.
[12] *Id*. at 230.
[13] As a separate matter, the court concluded that, with one brief and immaterial exception, Fresenius did not breach the Hell-or-High-Water Covenant relating to its agreement to take "all actions necessary" to obtain antitrust approval, and therefore its conduct in this area would not bar Fresenius from exercising its termination right. This Hell-or-High-Water covenant was absolute and not constrained by any "efforts" clause limitation.

In sum, if the *Akorn* (via *Williams*) Delaware default standard for all "efforts" clauses with a "reasonableness" component were to apply to a contracting party's obligation:

- It would require that *all* reasonable steps be taken. While "all" seems like a demanding standard, it is no more than a commitment to do what is reasonable, without addressing the possibility of alternative reasonable steps.
- It would impose both *affirmative and negative conduct requirements*—requiring affirmative action if it reasonably would advance accomplishing the underlying objective and requiring not taking action that unreasonably would interfere with that goal.
- It would require the party subject to the obligation to make *judgments on a continuing basis* as to steps that might be taken or avoided in furtherance of the goal and as to their "reasonableness."
- If there is a subsequent challenge to what the party subject to the obligation did, it would call for a *judicial assessment of reasonableness*. This could involve a court adopting its own standard of reasonableness (*e.g.*, judicially declared conduct of a hypothetical "generic pharmaceutical company," rather than conduct tied to some real-world reference point) and, in any event, would involve the court making an independent assessment of reasonableness based on a factual review.

Is Delaware's Default "Efforts" Standard Satisfactory?

In some cases, contracting parties might expressly select the "all reasonable efforts standard" as the general "efforts" commitment. It is likely, however, that the parties would select "commercially reasonable efforts" or "reasonable best efforts" in many cases, if they believed that the meaning of the selected standard could reliably be discerned and applied and better reflected their intent and risk concerns.

The guidance from *Akorn*, however, is that under the "one size fits all" Delaware approach there is no basis to expect gradations in the level of "reasonable efforts" committed based on simple word variations in how they are expressed. This leaves contracting parties wishing to use Delaware law as the law governing their contracts with the need to consider whether the "all reasonable efforts standard" would be satisfactory and, if not, how and in what circumstances it should be modified.

Whether Delaware's default "all reasonable efforts standard" would be satisfactory is a situation-specific determination. Frequently it would involve assessing, among other considerations: the particular contractual obligation involved; the benefits/risks of applying the Delaware default "efforts" standard to the obligation; whether it is a mutual obligation (with a presumption of parallel treatment of the contracting parties); the importance of the underlying commercial transaction; and the potential for interfering with achieving it by disagreeing with use of the standard. (As to the last factor, even in circumstances where multiple variations of "reasonable efforts" commitments have been available, it often has been the case that, although the variation selected was not all that precise and had no common contractual meaning spelled out, it was largely acceptable to the contracting parties (perhaps with specificity in a few areas) because any attempt to achieve greater clarity of meaning was simply too difficult and counterproductive from the standpoint of signing a deal.)

Drafting to a "Better" Result

As suggested in the above parenthetical, one other important consideration that bears on whether Delaware's default "all reasonable efforts standard" could be satisfactory in a specific contract setting is the ability contractually to clarify or modify the default outcome.

The "one size fits all" approach in Delaware to "reasonable efforts" variations is a default position, applicable if no contractual directions are otherwise given. However, contracting parties have wide latitude substantively to specify agreed meaning to or agreed limitations on "all reasonable efforts" in particular circumstances, both in terms of what it encompasses and what it does not. Contracting parties also have the ability to impose helpful procedural clarity, by specifying rules and processes to apply in assessing compliance with the "all reasonable efforts standard."

Contractual Substantive Improvement

Dealing with Specific Types of Issues: Contractual substantive improvement is not new territory, as illustrated by the treatment of antitrust/competition law approvals in acquisition agreements. Sometimes, one of the most difficult issues presented in negotiating an acquisition agreement is the level of commitment to which one or both parties will be subject in connection with obtaining antitrust/competition law clearance. In some cases (such as in *Akorn*), the issue is so important to the seller, in terms of avoiding risk, that the buyer is willing to expressly agree to an absolute "hell or high water" obligation, which is not limited by any "efforts" standard.

In other cases, the buyer is only willing to undertake a commitment expressed in terms of a specified level of effort. Moreover, in some cases, the buyer is unprepared to accept the general "efforts" standard and insists on specifically limiting action it would be required to take. Those limitations have been expressed in various ways, including that in no event will the buyer be required to dispose of, agree to any structural or conduct remedy regarding, or change any portion of its business, or undertake any other burden, and they are often tied to exceeding dollar thresholds or buyer's good faith determination of materiality to buyer's business or expected benefits from the transaction or a material adverse effect on the combined company. Additionally, in some cases it is expressly provided that the buyer is not required to litigate with the government if it challenges the transaction.

Also in the M&A context, an "efforts" commitment to operate in the ordinary course and/or to preserve the company's business, relationships, etc., typically is accompanied by a listing of certain types of actions that are expressly prohibited or subject to specific limitations, unless the other party consents. This litany reflects recognition that contract drafting can take many potential "reasonableness" decisions regarding a broad range of identifiable circumstances relating to operating the company (*e.g.*, issuing stock, incurring debt, changing compensation, making capital expenditures, making acquisitions, amending governance documents, granting liens) out of the hands of a court.

As indicated, on "big issues" and other important issues contracting parties can detail their rights and obligations, and significantly mitigate or eliminate potential uncertainty or risk associated with the default "efforts" commitment, as interpreted by a court. Moreover, this ability can be used not only expressly to limit a party's "reasonable efforts" commitment, but also to clarify "reasonable efforts" that will be required.

Dealing With "Conflicting" Provisions: Apart from adding contractual clarity to an "efforts" commitment, *Akorn* points out another area where contract drafting could be quite helpful—where separate "efforts" commitments potentially conflict with one another. In *Akorn* (as would be the case in many other similar situations) material noncompliance by one party with its obligation to use "commercially reasonable efforts" to operate its business in the ordinary course until closing resulted in the other party having a right to terminate. However, that right was conditioned on the potential terminating party not having materially breached its "reasonable best efforts" commitment to complete the transaction. While in *Akorn* the court provided the framework for how to analyze the potentially conflicting rights (termination) and obligations (completion) of the party seeking termination,[14] it highlights an area where contractual clarification may be useful.

Perhaps most simply and directly, where this potential conflict is present, the contract could acknowledge that a party's obligation to seek to close the transaction shall not limit such party's contractual right to terminate the transaction, including taking reasonable steps in good faith incident to determining if a right to terminate exists (including by seeking information from the counterparty under contractual information access rights, seeking outside advice, etc.). Alternatively, the parties may wish contractually to exclude or limit the ability to take all or some of those steps in pursuit of a right to terminate.

Dealing with Standard of Reasonableness: The court in *Akorn* postulated a judicial construct—a "generic pharmaceutical company"—as the standard against which to measure the reasonableness of certain Akorn conduct against its obligation to use all reasonable efforts to operate its business in the ordinary course. This raises the question for contracting parties whether they would prefer a contractually identified standard for that particular assessment. It would not be surprising for a contracting party to assume that when the subject relates to operating its business in the ordinary course, the "standard" would be how, in fact, the company has operated its business. As *Akorn* illustrates, however, that standard may be wholly unsatisfactory when the challenged conduct involves illegality or impropriety, yet it is, in fact, how the party "operated its business in the ordinary course." That said, rather than abdicating entirely to a judicial construct, a basic reference to the company's manner of operating its business, with certain carve-outs, might be more appealing.

The potential need to select a standard of reasonableness also arises in dealing with significant unexpected, not previously experienced situations that may arise between signing and closing, such as a "#MeToo" event, an explosion at a major facility or a first-ever strike. By definition these are not ordinary course events and there would be no company frame of reference for dealing with them in the ordinary course of business. Perhaps they would be excluded from the "efforts" commitment and left to be dealt with under the contract's MAE provisions, and perhaps that should be explicitly stated. (Of course, arguments could be made that to the extent any of those events involved a failure of adoption or enforcement, or a violation, of a company policy, it involved a failure to operate in the ordinary course of business.) At minimum, the contracting parties should focus on whether and, if so, how to deal with these non-ordinary course possibilities.

[14] See footnote 11 and related text.

Contractual Procedural Clarification

Another, non-mutually exclusive, approach to clarifying the operation of Delaware's default "all reasonable efforts standard" would be to consider imposing contractual procedural requirements in connection with determining compliance. In particular, in connection with determinations regarding "reasonableness," provisions implementing one or more of the following could be included in the contract:

- **Multiple Reasonable Alternatives:** The agreement could provide that in dealing with a particular issue, if it would be reasonable for the party subject to the "all reasonable efforts" commitment to take any one of a number of possible actions in response to the issue, and such party takes one of them, then it will be deemed to have complied with its commitment.
- **Self-Determination:** The agreement could provide that a judgment by a contracting party as to reasonableness reached in good faith and on an informed basis by such party regarding its compliance will be given effect.
- **Use of Experts:** The agreement could specifically provide for a designated or to be selected expert or panel of experts to assess the reasonableness of decisions subjected to compliance challenges.
- **Assigning Burden and Standard of Proof:** The agreement could contractually assign the burden of proof to the party claiming non-compliance and provide for a contractually agreed-upon standard of proof (*e.g.*, the preponderance of the evidence).

* * *

In sum, Delaware's default "all reasonable efforts standard," applicable to "efforts" clauses incorporating a reasonableness component, may not, by itself, fully align with the contracting parties' intent and/or risk concerns in a particular situation. However, Delaware law permits the contracting parties to modify the standard substantively and procedurally through contract drafting approaches, which can significantly improve that alignment. It will be interesting to see whether *Akorn*'s spotlight on the "one size fits all" nature of Delaware's default "all reasonable efforts standard" results in rethinking (a) the use of Delaware law as the governing law of contracts or (b) the use by contracting parties of their ability to clarify (and de-mystify) by contract the application of that standard.