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Chapman Client Alert

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More Than a Lack of Enthusiasm Required for a Party to Violate Its "Commercially Reasonable Efforts" Covenant

In merger and acquisition and other commercial agreements, the parties often agree to undertake "commercially reasonable efforts" in support of the transaction. In *The Williams Companies, Inc. v. Energy Equity, L.P.*, C.A. No. 12168-VCG (Del. Ch. June 24, 2016), the Delaware Chancery Court recently analyzed whether a prospective acquirer violated its agreement to use "commercially reasonable efforts" to satisfy a condition precedent to the consummation of a merger agreement. As more thoroughly discussed below, the Chancery Court found that the acquirer's lack of enthusiasm for the transaction following a decline in the energy market and the value of the assets to be acquired, without more, was not sufficient to show that the acquirer did not use "commercially reasonable efforts" in support of the transaction when its tax attorneys were unable to deliver a tax opinion that was a condition precedent to its obligation to complete the transaction. The court found significant the fact that the plaintiff could not point to any action or the absence of any action on the part of the prospective acquirer that caused or had a material effect on the failure of the closing condition to be satisfied.

Facts of the Case

Williams Companies, Inc. (*"Williams"*) and Energy Equity, L.P. (the *"Partnership"*) entered into a merger agreement on September 28, 2015, pursuant to which Williams would merge with and into Energy Transfer Corp. L.P., (*"ETC"*), a Delaware limited partnership created by the Partnership for purposes of the transaction. The merger agreement included a closing condition that the Partnership's tax attorneys issue an opinion that the transactions contemplated by the merger agreement "should be" treated as a tax-free exchange under Section 721(a) of the Internal Revenue Code (the *"721(a) Opinion"*). Following the execution of the merger agreement, conditions in the energy markets deteriorated and the value of the assets held by Williams and the Partnership declined. It was against this backdrop that the Partnership became concerned that its tax attorneys would not be able to issue the 721(a) Opinion. After performing substantial diligence at the Partnership's request following the Partnership's communication of its concern regarding the 721(a) Opinion, the Partnership's tax attorneys informed the parties that the firm would not be able to issue the 721(a) Opinion.

Williams brought suit to enjoin the Partnership from terminating the merger agreement. Williams alleged that the Partnership breached the merger agreement because it failed to use "commercially reasonable efforts" to secure the 721(a) Opinion and that it therefore should be estopped from terminating the merger agreement. The Partnership maintained that since the delivery of a 721(a) Opinion was a condition precedent that could not be satisfied, it had the right to terminate the merger agreement.

The court concluded that the Partnership's tax attorneys determined in good faith that they could not issue the 721(a) Opinion. Moreover, Williams was unable to demonstrate that the Partnership materially breached its contractual obligation by failing to use "commercially reasonable efforts" to obtain the requisite 721(a) Opinion. The court ordered that if the Partnership's tax attorneys could not issue a 721(a) Opinion, a condition precedent would not be satisfied and as a result the Partnership would be entitled to terminate the merger agreement.

Court's Analysis of "Commercially Reasonable Efforts"

In determining whether the Partnership violated its obligation to use "commercially reasonable efforts" to obtain the 721(a) Opinion, the court noted that the term is not addressed with particular coherence under Delaware case law. Because the parties did not define the term "commercially reasonable efforts" in the merger agreement, the court found that the Partnership "bound itself to do those things objectively reasonable to produce the 721(a) Opinion in the context of the agreement reached by the parties." The court found significant that Williams did not provide any evidence of specific actions the Partnership could have reasonably taken to have the

721(a) Opinion issued. Williams argued that turning down two proposals presented by its counsel to potentially resolve the tax issue was evidence of the failure of the Partnership to take “commercially reasonable efforts,” but the court concluded that the refusal did not impact the Partnership’s attorneys’ ability to issue the 721(a) Opinion and therefore was immaterial. The court also noted that even though the Partnership wanted to terminate the merger agreement for economic reasons, that motivation alone was not enough to demonstrate a breach of its “commercially reasonable efforts” obligation.

The court specifically highlighted the fact that there was no evidence that the Partnership manipulated the knowledge or ability of its attorneys to render the 721(a) Opinion. The court noted how there was no evidence that the Partnership failed to fully inform its tax attorneys or do anything to obstruct them from satisfying the condition precedent of issuing the 721(a) Opinion. The court also distinguished the facts in the present case from the facts in *Hexion Chemicals, Inc. v. Huntsman Corp*., 965 A.2d 715 (Del. Ch. 2008), in which an acquirer knowingly provided a financial advisor with misleading and inaccurate information in order to obtain an opinion that the combined company would be insolvent, thus making it impossible to obtain financing for the transaction. The court ruled in *Hexion* that the acquirer had not used “reasonable efforts” to obtain financing as it was contractually obligated, but instead actively and affirmatively destroyed its ability to obtain financing. In the present case, the Partnership did not affirmatively act in a way that frustrated its tax attorneys’ ability to issue the 721(a) Opinion and, as a result, the court found that it did not breach its “commercially reasonable efforts” obligation.

Practical Implications of the Court’s Decision

The court’s decision underscores the risk of using terms such as “commercially reasonable efforts,” “best efforts” or “reasonable best efforts” in commercial agreements without including a definition of what the parties intend such terms to mean. If extraordinary efforts are expected of a party in certain circumstances, the parties should consider specifically defining those efforts in the agreement in order to insure that a court will interpret the agreement consistent with the expectations of the parties.

For More Information

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