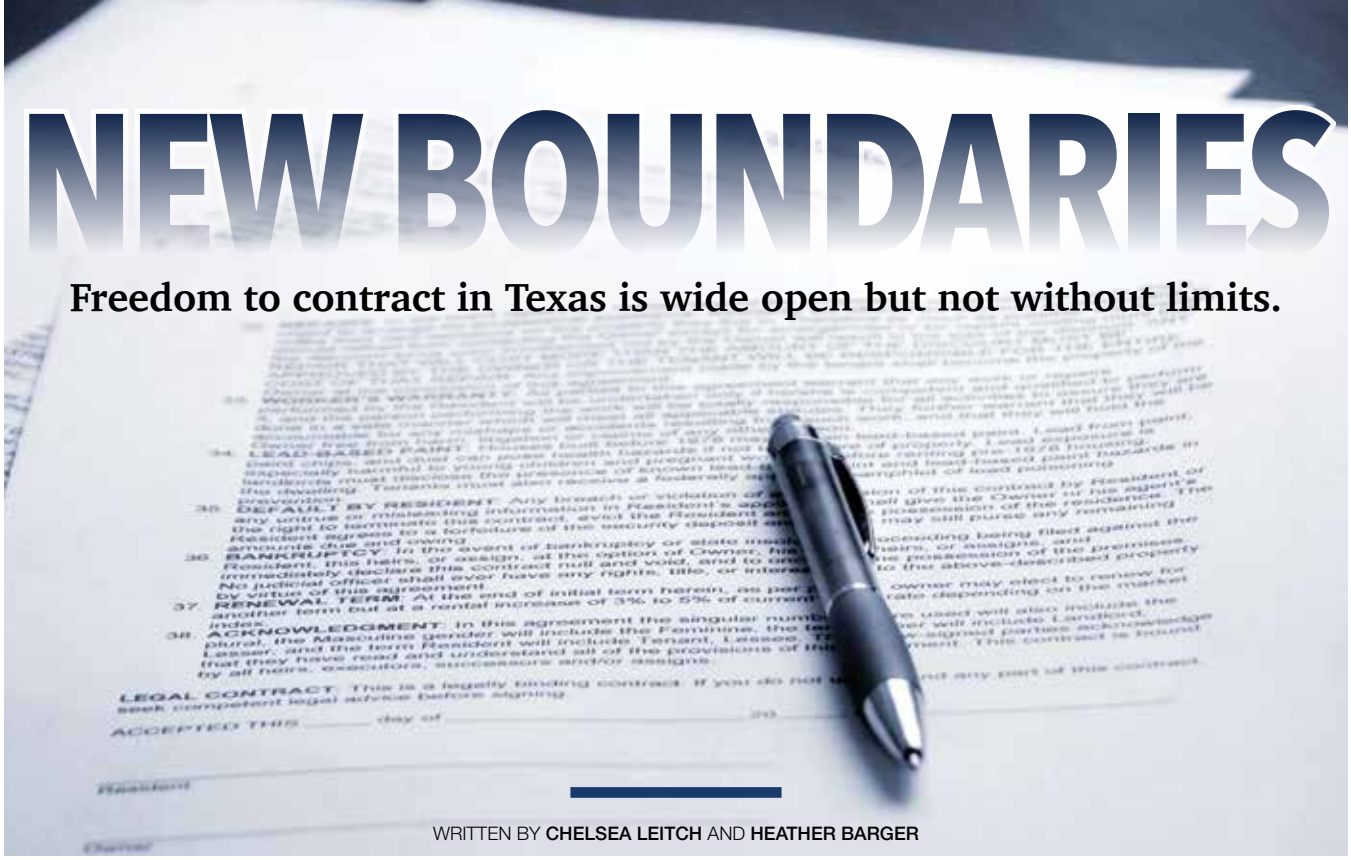
NEW BOUNDARIES

Freedom to contract in Texas is wide open but not without limits.



WRITTEN BY **CHELSEA LEITCH** AND **HEATHER BARGER**

Texans enjoy many freedoms—wide open spaces, education at unparalleled public universities, the ability to fry anything at the State Fair of Texas, and—importantly for lawyers—freedom of contract. "Texas law strongly favors parties' freedom of contract, under which parties may 'bargain for mutually agreeable terms and allocate risks as they see fit.'"[1] Although Texas courts are widely deferential to the freedom of contract doctrine, that freedom is not without limits. Two recent Texas cases inform new boundaries for the freedom of contract doctrine and provide additional insight into drafting two common provisions with an eye toward enforceability.

EFFORTS CLAUSES

In commercial contracts, covenants and other obligations are often softened by language stating that a party will use some level of effort—such as "best efforts," "reasonable best efforts," or "commercially reasonable efforts"—to perform. Instead of stating that a party is simply obligated to *fulfill* an obligation, the contract language will state that the party will *make efforts to fulfill* the obligation. A typical efforts clause may read as follows: "Supplier shall use its best efforts to manufacture the quantity of Products specified in each quarterly forecast delivered by Buyer."

While the Supreme Court of Texas has not explicitly acknowledged the enforceability of efforts clauses in contracts, it has acknowledged that such clauses can be inherently vague and subjective and present "a multitude of thorny issues" regarding interpretation and enforceability.[2] When a covenant is breached, it is almost impossible to make a confident after-the-fact determination as to whether the obligated party has *actually* exerted the required level of effort to perform, or if greater effort could have been taken. And yet, the Texas courts of appeals widely acknowledge that such clauses can be enforceable as long as they provide a clear standard to determine the required level of efforts.[3]

Attorneys generally view efforts clauses on a sliding scale, with "best efforts" as the most stringent, "reasonable efforts" as a middle-ground position, and "commercially reasonable efforts" as the least stringent. Often, negotiations will focus on what adjectives describe the level of effort that the obligated party needs to exert. However, if parties solely focus on the adjectives, they could miss the mark on a much more important goal: making sure the language is clear, objective, and enforceable.

Earlier this year, the 1st Court of Appeals in Houston addressed the inherent uncertainty in efforts clauses in *Spain v. Phoenix Electric*.[4] First, the court acknowledged that words such as "good faith effort" or "best effort" are "not talismanic, and the presence of these phrases in an agreement does not automatically mean that the provision which contains them is enforceable."[5] Next, the court discussed examples of clauses that were not specific enough to be enforceable, such as "[Party] will provide as much [financial support] toward the care and providing for the needs of [the other party] as possible"; and "all of [the party's] 'best effort' and 'everything else, such as [his] blood, sweat, tears and anything else [he] could come up with to get it done, avoiding any and all other opportunities.'"[6]

According to the court, what each of these clauses lacked was a specific, objective description of *how* these efforts could be accomplished. For example, how many contracts did the purchaser have to bid before showing best efforts? What specific measure of financial support showed that a party had exerted best efforts?

While Texas courts agree that efforts clauses may be enforceable, such clauses are not immediately enforceable unless they include specific, objective parameters by which those efforts can be measured.

Best Practices for Drafting

- Include a deadline or specific time frame for meeting the obligation—*e.g.,* "on or before X date," or "in any case, within X number of days" of the effective date of the contract.
- Specify actions that must be taken by the obligated party or a benchmark for the parties' performance—*e.g.,* obtaining regulatory approvals, developing a marketing plan, spending a certain amount, or producing a specific quantity of products.
- Include carveouts for actions the obligated party is *not* required to take, as long as such carveouts are accompanied by the flip side of the coin—*i.e.,* the specific deadlines or actions described above.[7]

NOTICE CLAUSES

Another often used but occasionally problematic principle in Texas contract law is the substantial compliance doctrine. Under the substantial compliance doctrine, if a party has made a good faith attempt to perform a contractual obligation but somehow fell short, the obligation may still be considered to be fulfilled. The Supreme Court of Texas recently tackled the intersection between freedom of contract and the substantial compliance doctrine, specifically as it relates to notice clauses.

Notice clauses set the standards for how parties will communicate with each other about the contract during the term. A notice clause is typically drafted with two goals in mind: to communicate *how* a party should give notice and *when* a notice is effectively delivered. Parties may send notices for various reasons—to "start the clock" on a cure period after a breach, to invoke a party's indemnification rights, or to assign the agreement to another party.

In *James Construction v. Westlake,*[8] the court held that "a party's minor deviations from a contractual notice condition that do not severely impair the purpose underlying that condition and cause no prejudice do not and should not deprive that party of the benefit of its bargain." Minor deviations may include things like mailing notice via regular mail and not registered mail where the contract required registered mail, but the party did receive the notice; or sending an insurer notice outside the 90-day window required by the contract where the insurer suffered no prejudice.[9] However, the doctrine does *not* allow oral notice when written notice is required by the contract, especially where the parties freely contracted for a written notice provision.

Best Practices for Drafting

- Carefully consider all language throughout the contract that requires notice to be given (in the notice clause and elsewhere). Consider including a defined term for "*Notice*" to clarify when notice must be delivered in accordance with the notice clause versus when a more lenient notice would be acceptable (*e.g.,* oral notice of an operational matter via telephone call). Require written notice, delivered in accordance with the notice clause, for consequential matters.
- Provide clear and specific instructions on the actions a party must take to give official notice under the contract. At a minimum, the notice clause should include the addresses to which notices should be sent (with procedures for updating those addresses) and the acceptable forms of delivery (*e.g.,* hand-delivery, certified mail, overnight courier).
- Review the notice clause from a practical perspective and think through each step. Could any issues arise in sending or receiving the notice? For example, if email notice is allowed, what if the notice ends up in the recipient's spam folder? Consider how to ensure confirmation of receipt and allowing for two forms of delivery.

CONCLUSION

At its core, Texas law seeks to allow parties the freedom to contract in whatever way they wish, while also ensuring that the parties are able to depend on a clearly drafted written agreement. If parties wish to include clauses that allow for some leniency, such as an efforts clause, then the contract should specify the outer bounds of that leniency by noting *how* compliance can be achieved. Similarly, courts will allow for some leniency in complying with the contract, but only within reason and in a manner that gives purpose to the terms included by the parties. **TBJ**

NOTES

1. *Waste Mgmt. of Tex., Inc. v. Stevenson,* 622 S.W.3d 273, 286 (Tex. 2021).
2. *Dallas/Fort Worth Int'l Airport Bd. v. Vizant Techs., LLC,* 576 S.W.3d 362, 369 n.12 (Tex. 2019).
3. Federal courts interpreting Texas law have reached the same conclusion that a best-efforts clause may be enforceable. *See, e.g.*, *Herrmann Holdings Ltd. v. Lucent Techs. Inc.,* 302 F.3d 552, 560 (5th Cir. 2002) (making *Erie* guess absent controlling Texas Supreme Court precedent).
4. *Spain as Trustees of Linda & Barry Spain Tr. v. Phoenix Elec., Inc.,* No. 01-22-00656-CV, 2024 WL 971661 (Tex. App.—Houston [1st Dist.] Mar. 7, 2024, no pet.).
5. *Id.* at 2024 WL 971661, *7 (Tex. App.—Houston [1st Dist.] Mar. 7, 2024, no pet.) (omitting internal citations).
6. *Id.* at 2024 WL 971661, *8-9 (Tex. App.—Houston [1st Dist.] Mar. 7, 2024, no pet.). Another example includes: "Purchaser shall use its best efforts in the operation of the Company's business from and after the Closing in a manner that maximizes the Earn-Out Payments to the Selling Shareholder, provided that Purchaser shall not be required to enter into any agreement that does not meet its historical profitability requirements."
7. Such carveouts may note that the obligated party's costs will not exceed a certain dollar amount, or that the obligated party does not need to take actions that would have a material adverse impact on its business.
8. *James Constr. Group, LLC v. Westlake Chem. Corp.,* 650 S.W.3d 392, 406 (Tex. 2022), reh'g denied (Sept. 2, 2022).
9. *Id.*

CHELSEA LEITCH
is a counsel in Haynes and Boone's Corporate Practice Group. Her practice focuses on structuring, drafting, and negotiating complex commercial agreements and related arrangements, bringing strategic legal insight and practical solutions into clients' business relationships. Leitch is an adviser for clients in a variety of industries and regularly assists them with a range of contracts, from business-critical, high-profile, complex commercial agreements to routine contracts that facilitate their day-to-day business activities.

HEATHER BARGER
is a counsel in Haynes and Boone's Commercial Litigation Practice Group. She is a pragmatic and proactive trial attorney with experience helping clients navigate pre-suit settlements, aggressive discovery fights, emergency hearings, mediations, and trials. Barger's practice spans industries, focusing instead on bringing a practical, business minded approach to all cases, from the smallest vendor disputes to company critical battles.