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**IN SEARCH OF BEST EFFORTS:  
REINTERPRETING *BLOOR V. FALSTAFF***

VICTOR P. GOLDBERG\*

When contracting parties cannot quite define their obligations, they often resort to placeholder language, like “best efforts.” They (and their counsel) likely have little idea of what they might mean, but, so long as they avoid litigation, it will not matter much. But “best efforts” clauses are on occasion litigated, and courts must read content into them. In *Bloor v. Falstaff*, a casebook favorite,<sup>1</sup> the court held that Falstaff’s lackluster promotional efforts for Ballantine beer violated its best efforts covenant. So far as I can tell, no commentators have questioned this outcome. Indeed, some commentators have found Falstaff’s breach so egregious as to provide not much of a test of the boundaries of “best efforts.” Farnsworth, for example, says: “Unfortunately, its decision did relatively little to add precision to the meaning of ‘best efforts,’ since Kalmanovitz [of Falstaff] fell so far short of the mark.”<sup>2</sup>

“Best efforts” can only be defined contextually. However, neither Judge Brieant at trial<sup>3</sup> nor Judge Friendly on appeal,<sup>4</sup> attempted to place the contract in its business context. Had they framed the problem properly, the outcome

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1. *Bloor v. Falstaff Brewing Corp.*, 601 F.2d 609 (2d Cir. 1979). Casebooks which reprint it as a main case include: STEVEN J. BURTON, *CONTRACT LAW: SELECTED SOURCES MATERIALS* 448 (1995); JOHN D. CALAMARI ET AL., *CASES AND PROBLEMS ON CONTRACTS* 459 (2d ed. 1989); E. ALLAN FARNSWORTH & WILLIAM F. YOUNG, *CASES AND MATERIALS ON CONTRACTS* 623 (5th ed. 1995); LON L. FULLER & MELVIN ARON EISENBERG, *BASIC CONTRACT LAW* 868 (6th ed. 1996); ROBERT W. HAMILTON ET AL., *CASES AND MATERIALS ON CONTRACTS* 254 (2d ed. 1992); ROBERT E. SCOTT & DOUGLAS L. LESLIE, *CONTRACT LAW AND THEORY* 280 (1988). The decision is briefly noted in the Knapp and Murray casebooks. CHARLES C. KNAPP & NATHAN M. CRYSTAL, *PROBLEMS IN CONTRACT LAW: CASES AND MATERIALS* 503 (3d ed. 1993); JOHN EDWARD MURRAY, JR., *CONTRACTS: CASES AND MATERIALS* 260 (4th ed. 1991). The case is cited in Murphy and Speidel, but there is no further discussion. EDWARD J. MURPHY & RICHARD E. SPEIDEL, *STUDIES IN CONTRACT LAW* 792 (5th ed. 1997).

2. E. A. Farnsworth, *On Trying to Keep One’s Promises: The Duty of Best Efforts in Contract Law*, 46 U. PITT. L. REV. 1, 11 (1984). “The opinion may seem somewhat disappointing in that the breach was sufficiently flagrant that the court did not define ‘best efforts’ with precision.” E. A. FARNSWORTH & W. F. YOUNG, *CONTRACTS: CASES AND MATERIALS—FIFTH EDITION, MANUAL FOR TEACHERS* 186-87.

3. *Bloor v. Falstaff Brewing Corp.*, 454 F. Supp. 258 (S.D.N.Y. 1978).

4. *Bloor v. Falstaff Brewing Corp.*, 601 F.2d 609 (2d Cir. 1979).

would have been different. Falstaff was not contracting to be a distributor for another beer producer, the remarks of numerous commentators notwithstanding.<sup>5</sup> The fact that some of Ballantine's compensation was contingent upon Falstaff's selling effort makes it appear similar to a distribution agreement. But the purpose of the contingent compensation is quite different and that should be taken into account when interpreting the contract. Thus, while I am sympathetic to the Goetz-Scott argument that the contract should be interpreted to maximize expected joint profits,<sup>6</sup> I disagree with their application of it to this case (which, in effect, treats the deal as if it were a distribution arrangement).

The essential feature of the contract is that Ballantine was exiting the beer business and was making a one-shot sale of some of its assets to Falstaff. That purpose is crucial for understanding the role of this "best efforts" clause. The buyer of an asset is naturally concerned about the asset's quality. There are numerous devices for assuring the buyer that he is not purchasing a "lemon."<sup>7</sup> The seller could, for example, provide extensive representations and warranties. Or, the buyer could incur significant due diligence expenses. Or, the seller could make a portion of its compensation contingent upon the quality of the asset. The royalty arrangement in this transaction, essentially an "earnout," served precisely this role. Profits or, in this case, gross sales, serve as a "meter," an imperfect measure of the quality of the asset. Because an earnout alters the buyer's incentive structure, the seller must limit the buyer's ability to take advantage of the meter's imperfections. The best efforts clause can best be understood as an attempt to cope with that problem. The question the court should have asked was: did Falstaff opportunistically redirect revenues away from the meter (Ballantine's sales)? And the facts make clear that Falstaff did not.

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5. See, e.g., J.C. Bruno, "Best Efforts" Defined, 71 MICH. B. J. 74, 76 (1992) ("Falstaff agreed to distribute Ballantine beer, in addition to its own label, in exchange for payments to Ballantine . . ."); Gillian K. Hadfield, *Bias in the Evolution of Legal Rules*, 80 GEO. L. J. 583, 608-9 ("The plaintiff signed a contract in which Falstaff, the defendant, agreed to use its 'best efforts' to promote the sale of Ballantine beer (which continued to be produced by Ballantine breweries.); Lawrence S. Long, *Best Efforts as Diligence Insurance: In Defense of "Profit Über Alles,"* 86 COLUM. L. REV. 1728, 1733 (1986) ("Falstaff would not have agreed to spend money up front marketing Ballantine if Ballantine could later have come back and demanded a higher royalty . . ."); ROBERT E. SCOTT & DOUGLAS LESLIE, *CONTRACT LAW AND THEORY* 291 ("What changes do you think would be made in a new agreement between these two companies? Is that relationship likely to be renewed after litigation? Was litigation necessarily the best solution here?").

6. See Charles J. Goetz & Robert E. Scott, *Principles of Relational Contracts*, 67 VA. L. REV. 1089 (1981).

7. See Ronald J. Gilson, *Value Creation by Business Lawyers: Legal Skills and Asset Pricing*, 94 YALE L. J. 239, 262-64 (1984).

In Part I, I summarize the facts and the two opinions. In Part II, I explore the role of the contingent compensation in the sale of an asset and apply that analysis to the facts of *Bloor*. In Part III, I speculate on how a court might properly frame the question absent help from counsel. Even if courts choose not to be so proactive, the implicit argument is that litigators can (and should) frame their arguments in a more transactionally-sensitive way.

## I. THE BACKGROUND

### A. *The Facts*

Ballantine, a regional brewery selling low-priced beer primarily in the New York area, was sold to Investors Funding Corporation (IFC), a real estate firm, in 1969.<sup>8</sup> IFC lost a considerable amount of money with Ballantine, and left the beer business in 1972. It kept the brewery (eventually selling it for non-beer making purposes),<sup>9</sup> selling off the remainder of the business to Falstaff, a larger regional brewery that had no presence in the New York market. The parties had explored the deal for a few months but the final negotiations

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8. *Bloor*, 454 F. Supp. at 263. The record of the case is available on microfiche from the author; citations to the record will be limited to material not available in the public record.

9. They attempted, unsuccessfully, to convert the brewery into an industrial park. On Oct. 21, 1974, IFC and its wholly-owned subsidiary IFC Collateral Corporation both filed for reorganization under Chapter X of the Bankruptcy Act. On Nov. 1, 1974, James Bloor was appointed Trustee, replacing the Dansker management. On Dec. 23, 1980, while other suits were still ongoing, Judge Bonsal approved a reorganization plan in which Helmsley Enterprises would inject new money. See *In re Investors Funding Corp.*, 8 B.R. 739 (S.D.N.Y. 1980). Other litigation stemming from the IFC bankruptcy dragged on for over a decade. The Trustee Bloor had taken the position that a massive fraud had been perpetrated on the Company, and he sued the Danskers, the banks, the accountants, IFC's outside legal counsel, various others and, of course, Falstaff. The Trustee's claims against the principal accountants were dismissed. See *Investors Funding Corp. v. Dansker*, 523 F. Supp. 533 (S.D.N.Y. 1980). Claims of the Trustee against the outside directors, IFC's outside legal counsel and various other individuals were also dismissed. See *Investors Funding Corp. v. Dansker*, 566 F. Supp. 193 (S.D.N.Y. 1983), *aff'd sub nom.* *Bloor v. Carro, Spanbock, Londin, Rodman & Fass*, 754 F.2d 527 (2d Cir. 1985). Other claims of the Trustee against IFC's outside legal counsel were finally dismissed in 1986. See *Investors Funding Corp. v. Dansker*, 635 F. Supp. 1262 (S.D.N.Y. 1986). In addition, holders of the stock and debentures of IFC filed five class actions against the Danskers, the accountants and the banks which were consolidated for trial. The securities holders settled with the banks and the accountants on March 17, 1981. See *Investors Funding Corp. v. Peat, Marwick, Mitchell & Co.*, 9 B.R. 962 (S.D.N.Y. 1981). In an unrelated matter, some of IFC's officers faced criminal charges, stemming from the development of the George Washington Plaza shopping center. They were charged with conspiracy to give a \$100,000 bribe to Burt Ross, the Mayor of Fort Lee, New Jersey. On March 28, 1975, former IFC officers Norman Dansker, Donald Orenstein and Stephen Haymes were convicted of bribery. See *United States v. Dansker*, 537 F.2d 40 (3d Cir. 1976), *cert. denied*, 429 U.S. 1038 (1977). They eventually served six months in jail. See Walter H. Waggoner, *Terms Cut for 4 in Ft. Lee Bribery*, N.Y. TIMES, February 4, 1978, at 1.

involved a marathon session of three days with no breaks for meals, characterized by one of the participants as “negotiation-by-endurance.”<sup>10</sup> Falstaff paid \$4,000,000 plus a royalty of fifty cents per barrel for six years. Ballantine’s sales in the IFC years were about 2.2 million barrels per year, well below the 1964 peak of 4.4 million barrels.<sup>11</sup> Had Falstaff maintained Ballantine’s sales volume the royalty payment would have been over \$1,000,000 per year. For acquisition purposes, the rule of thumb in the beer business at that time was to value the target at about \$4 per barrel, which would have put a value on Ballantine of about \$8.5-\$9 million.<sup>12</sup> Falstaff agreed to use “best efforts” to promote and maintain a high volume of sales and further agreed to pay a cash sum in the event of a substantial discontinuance of distribution under the Ballantine brand name. The terms will be discussed in more detail below.

Falstaff’s strategy was to enter the New York market, selling beer from its Cranston, Rhode Island brewery, under both the Ballantine and Falstaff labels. Falstaff was a premium beer, Ballantine a low price beer, although, in fact, the beer in the two containers was identical. Falstaff expected that buying the Ballantine assets would help it in three ways. First, Ballantine had a trademark that was potentially valuable, especially in the New York area. Second, it had an existing distribution network in the New York area (it was servicing some 25,000 accounts); Falstaff would not have to assemble one to sell Ballantine and could use that network to develop the market for Falstaff. Third, consolidating production in the Cranston facility and closing Ballantine’s Newark brewery, which had been operating at less than fifty percent capacity, would increase the capacity utilization rate, thereby decreasing average production costs.

The record is mixed as to the appropriate weighting of these components. In his letter to the Justice Department immediately following the acquisition, Falstaff’s outside counsel described the purpose:

You requested that I confirm Falstaff’s purpose in acquiring the Ballantine brands and the steps which will be taken to produce and market Ballantine beer and ale. The primary purpose of the acquisition is to utilize the excess productive capacity of Falstaff’s seven plants.

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10. Judge Brieant scolded the parties for their method, but acknowledged that “it was the manner chosen by the parties for their own purposes, and they must each accept the consequences . . . They should have conducted themselves in a more mature fashion. Had they done so, at least some of the later disputes and difficulties could have been anticipated and avoided.” *Bloor*, 454 F.Supp. at 276 n.11.

11. Pl.’s Ex. 9 at A1618.

12. Falstaff’s Ralph Weir’s Dep. at A1576.

A further purpose of the acquisition (though not a major one) is that opportunity is afforded to introduce Falstaff beer on a premium price level in the New York metropolitan market. Any such introduction would necessarily be low-keyed, since Falstaff does not have the resources to support any other kind of entry into this market.<sup>13</sup>

A Falstaff internal document written at the very beginning of the process put much more weight on using the acquisition to facilitate Falstaff's entrance into the New York market:

Let us further assume that, since Ballantine is a declining brand, that Falstaff will not support and promote the brand, but, rather, cut advertising and promotion expenses to the bone and expect a rapid decline in sales of approximately 20% per year. Let us assume further that Falstaff uses the direct distribution system set up by Ballantine in the 5 boroughs and Northern New Jersey to promote Falstaff at a premium price. Since this is a large market, the market entry costs will be high . . . . In other words, the Ballantine distribution system will increase its distribution of Falstaff to offset the loss of volume for Ballantine such that the plants continue to produce at the capacity level the same as when Ballantine production was initiated.

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Thus, under these assumptions, it does not seem worthwhile to purchase Ballantine except for the entry to the N.Y. markets.<sup>14</sup>

In any event, it did not work out. Falstaff continued to promote Ballantine at about the same level as IFC had, but sales kept falling and red ink spilling. Falstaff claimed losses in 1972-75 of \$22 million on its Ballantine operations. In 1975, Paul Kalmanovitz acquired effective control of Falstaff and dramatically changed its operations.<sup>15</sup> In particular, he cut the Ballantine advertising budget nearly 90%, cut sales personnel, and closed or phased out four of the six distribution centers. Ballantine's sales plummeted. Some of the decline was attributable to the general sales decrease of regional beers, but Ballantine's sales fell faster than the sales of similarly situated beers.

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13. Pl.'s Ex. 23 at A1677-79.

14. Falstaff internal document entitled "Opportunistic Approach to Ballantine," Pl.'s Ex. 9 at A1616, A1618-9, dated Sept. 1, 1971.

15. Paul Kalmanovitz arrived in America penniless in his mid-20's and built a fortune in beer and real estate estimated at \$250 million (enough to earn him a spot on the *Forbes* 400 list) at the time of his death in 1987. See Burt A. Folkart, *Paul Kalmanovitz, Beer Industry Magnate, Dies*, L. A. TIMES, Jan. 23, 1987, at 28. His treatment of Ballantine was consistent with his treatment of the other beer labels he acquired. "Kalmanovitz's reputation as a cost-cutter was so dreaded that employees at Falstaff Brewing's St. Louis headquarters flew the flag upside down and at half-mast when they learned that [he] had taken it over in 1975. 'He went through Falstaff like Grant went through Richmond—he took no hostages,' recalls [his successor]." Seth Lubove, *The Legacy of Mr. Paul*, FORBES, May 1995, at 46.

In the meantime, IFC went into bankruptcy. Bloor, the trustee in bankruptcy for IFC, filed suit against Falstaff claiming, among other things, that Kalmanovitz's change of direction in 1975 violated Falstaff's best efforts obligation or, alternatively, amounted to a substantial discontinuance. There were some side issues related to the fact that some of Ballantine's pre-transaction sales volume was generated by illegal marketing practices, most of which were widespread in the industry, but the core of the dispute remained the best efforts and substantial discontinuance questions.

*B. The Contract*

Falstaff purchased the "Ballantine Assets" which were defined in the contract.<sup>16</sup> These included: (a) the "Proprietary Rights," Ballantine's brand names, trademarks, trade names and copyrights; (b) Ballantine's distribution network, including contracts, orders agreements, commitments, supply and requirements contracts, and collective bargaining agreements relating to the sale and delivery of its malt alcoholic beverage directly to retail sellers; (c) most of Ballantine's accounts receivable; and (d) miscellaneous items including the existing inventory and supplies, vehicles, cooperage, returnable cases and bottles and similar items. Falstaff paid \$4 million cash in three installments, the last payment on the date of closing. In addition, Falstaff would pay a royalty of fifty cents per barrel:

on the 7th day of each month, commencing May 7, 1972, and terminating April 7, 1978 (the "Royalty Period"), a sum in cash computed at the rate of \$.50 per barrel for each barrel of 31 U.S. gallons sold by the Buyer during the preceding calendar month under any of the Proprietary Rights, as royalties in respect of the use of such Proprietary Rights.<sup>17</sup>

In addition, the clause included a liquidated damages clause that would have come into effect if Falstaff substantially discontinued distribution of Ballantine.

... provided, however, that if during the Royalty Period the Buyer substantially discontinues the distribution of beer under the brand name "Ballantine" . . . , it will pay to the Seller a cash sum equal to the years and fraction thereof remaining in the Royalty Period times \$1,100,000, payable in equal monthly installments on the first day of each month commencing with the first month following the month in which such discontinuation occurs . . . .<sup>18</sup>

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16. Clause 1 of the contract. The complete contract is available as Pl.'s Ex. 1 at A1584-A1616. In each instance Falstaff would acquire Ballantine's "right, title, and interest," with the specific items defined in separate exhibits.

17. Clause 2(a)(v).

18. Clause 2(a)(v).

The clause at the center of the litigation, which included a rather embarrassing typographical error, read as follows: “Certain Other Covenants of Buyer. (a) After the Closing Date the Seller [sic!] will use its best efforts to promote and maintain a high volume of sales under the Proprietary Rights.”<sup>19</sup>

This was not the only appearance of “best efforts” in the agreement. It appears six other times. Falstaff agrees to use its best efforts to keep confidential non-public information about the seller.<sup>20</sup> The seller agrees that if any of its contracts are not assignable, it will use its best efforts to obtain consent of third parties.<sup>21</sup> Falstaff agrees to use its best efforts to collect the seller’s receivables (a contractually defined subset of the receivables).<sup>22</sup> The buyer also promises to use best efforts to collect the *buyer’s* receivables.<sup>23</sup> This is not as odd as it first appears, since the seller has some financial stake in the buyer’s receivables. Falstaff also agrees to use best efforts to retain as its own employees Ballantine’s sales, marketing, clerical and administrative personnel.<sup>24</sup> The casual usage of the phrase in these varied contexts does suggest a certain lack of care about its content.

The contract provided virtually no assurance as to the quality of the assets. “Ballantine Assets will be sold by the seller hereunder ‘as is’ and . . . the Seller makes no representations or warranties of any kind with respect to the description, condition, merchantability or fitness for any particular purpose of any of the Ballantine Assets.”<sup>25</sup>

At the closing Falstaff was to pay cash for 75% of Ballantine’s receivables.<sup>26</sup> In addition, it would pay to IFC 75% of all receivables collected beyond that, subject to a ceiling of \$7,125,000.<sup>27</sup> There was some concern over the receivables since in Pennsylvania it was unlawful for beer to be sold on credit and at least one large receivable (Pflaumer) was from Pennsylvania.<sup>28</sup> The treatment of receivables, as we shall see, turned out to have some significance, since IFC claimed (and Judge Briant agreed) that Falstaff’s payment for the receivables was part of the horse-trading involving the critical terms in the contract.

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19. Clause 8(a).

20. Clause 4.

21. Clause 6(a).

22. Clause 6(b). The phrase is used twice in this context.

23. Clause 8(g).

24. Clause 8(d).

25. Clause 16. There was a limited exception for inventory, equipment, and bottles that they would be “useable or marketable by the Seller in accordance with its customary standards, and all finished malt alcoholic beverage products sold to the Buyer hereunder shall be produced under a high degree of quality control.” Clause 9(f).

26. Clause 2(a)(vi).

27. Clause 2(a)(vii) and clause 2(b).

28. *Bloor*, 454 F. Supp. at 274-75. At the time of closing Pflaumer owed over \$800,000. *Id.*



The contract included what amounts to an acceleration clause, requiring Falstaff to pay immediately all money due under the royalty clause in the event of its bankruptcy.<sup>29</sup> The language is unclear, but I believe the clause means that the \$1.1 million per year liquidated damages would be due, not the uncertain expected value of the sum of future royalty payments. Falstaff also agreed to pledge to IFC the proprietary rights (the trademarks) as security for the royalty payments. If, however, such a pledge would be in violation of any of Falstaff's pre-existing agreements, Falstaff will "in good faith attempt to obtain . . . any consents to such pledge which may be required; and if any required consent is unobtainable or obtainable only upon conditions detrimental to [Falstaff], such pledge will not be deliverable as aforesaid. In such event, [Falstaff] will furnish [IFC] with such evidence as it may reasonably request to ascertain the reasons therefor."<sup>30</sup> Falstaff agreed not to transfer the proprietary rights during the royalty period without IFC's written consent.<sup>31</sup>

### C. *The Decisions*

Trial was held without a jury.<sup>32</sup> Falstaff argued that best efforts "must include consideration of Falstaff's own allegedly precarious financial position. Plaintiff, on the contrary, cited substantial precedent holding that financial difficulty and economic hardship do not excuse performance of a contract, and argued for the application of an objective standard, that of the 'average, prudent comparable' brewer."<sup>33</sup> Judge Brieant cited with approval precedent which would not excuse performance even in the face of financial difficulty or economic hardship.<sup>34</sup> But he did not go this far. Falstaff did not have to spend itself into bankruptcy to meet its contractual obligation, but it did have to meet the prudent comparable brewer standard, "and this it failed to do."<sup>35</sup>

Judge Brieant presented a litany of things Falstaff did (or failed to do) in failing to meet its best efforts obligation. He cited Falstaff's closing of four of its retail distribution centers, including the North Bergen facility, which, he

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29. Clause 2(d). "If the Buyer shall . . . file a voluntary petition in bankruptcy . . . [or other bankruptcy and insolvency related conditions] then each of the payments or installments provided for in subparagraph (v) of paragraph (a) above shall immediately become forthwith due and payable without demand or other notice of any kind."

30. Clause 8(b). I suspect that nothing was intended by the use of "good faith" here as opposed to "best efforts" which is scattered through the remainder of the document (including three of the seven covenants of the buyer in clause 8).

31. Clause 8(e).

32. *Bloor*, 454 F. Supp. at 260.

33. *Id.* at 266.

34. Insolvency or bankruptcy does not excuse performance of a contract. While the point is correct, it would take a large leap of logic to apply it to interpretation of the best efforts language.

35. *Bloor*, 454 F. Supp. at 267.

said, had been losing about \$2.2 million annually distributing Falstaff and Ballantine products.<sup>36</sup> He criticized Falstaff's shifting from a distribution system which sold to a large number of retail accounts, to one selling to a small number of wholesale accounts, in particular the assignment of the New York market to a particular distributor (Fatato) and Falstaff's failure to accept a different one (Molyneux).<sup>37</sup> The judge also criticized Falstaff's severe "cutback of personnel in distribution, sales, marketing, administrative and warehousing areas. It virtually eliminated its promotion and advertising of Ballantine Beer and closed its advertising department."<sup>38</sup> He quoted, and implicitly criticized, Kalmanovitz's description of his marketing strategy:

We sell beer and you pay for it . . . . We sell beer, F. O. B. the brewery. You come and get it.

Our responsibility is to give good product and you got responsibility to pay for it. That's it. That's the substance of my arrangement. Its working.<sup>39</sup>

Falstaff had not, the court held, treated Ballantine equally. Even if they had, the court held, that would not have been enough.

Falstaff's relationship to Ballantine is essentially different from its relationship to its own products. In the latter case, it may promote, continue or discontinue its products as it wills, subject to its duty to shareholders; in the former case it is bound by a contractual duty to the promisee. As the court said in a case cited by the defendant here: "[B]est energies' meant such effort as in the exercise of sound judgment would be likely to produce the most profitable

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36. *Id.*

37. In any event, after May 1976, any inability to appoint such an exclusive distributor in the New York area was caused by the fault or negligence of Falstaff. To the extent such fault or negligence prevented it from using effective marketing methods in the area which Molyneux proposed to serve, it is answerable in damages to Ballantine.

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Mr. Kalmanovitz as a traditional businessman expressed at trial his contempt for 'studies' and 'projections.' Consequently, in making the decisions to close the North Bergen facility and to appoint Mr. Fatato distributor in the New York City area, no effort was made to ascertain in advance the effect on Ballantine sales . . . . Falstaff was willing to appoint a distributor for the area, Mr. Fatato, about whose abilities the President of Falstaff had serious reservations, and to continue him in a virtual monopoly of Falstaff products in the area despite Mr. Molyneux's proposals. These actions exceed any reasonable variance allowable in the exercise of sound business judgment. No effort was made by Falstaff to examine or find alternatives to the drastic step of closing the North Bergen facility, although it accounted for a very large percentage of Ballantine sales.  
*Id.* at 269.

38. *Id.* at 270. Note that if this violated the best efforts obligation to sell Ballantine it likely would have also violated the best efforts obligation to keep employed the Ballantine personnel.  
*Id.* at 269.

39. *Bloor*, 454 F.Supp at 270.

results to the promisee in view of the nature of the business and the extent of the territory over which it was to be conducted.”<sup>40</sup>

Moreover, he suggested, Falstaff’s incentives favored promoting Falstaff at the expense of Ballantine.

Some of this apparent callousness towards Ballantine sales is undoubtedly caused by the fact that even though the liquid in a can of Ballantine Beer and in a can of Falstaff Beer is identical, and accordingly costs exactly the same amount to produce, sale of Falstaff Beer produces a greater profit for Falstaff. In part this is the result of the fact that Falstaff is a “premium” beer and nets Falstaff about \$4.20 more a barrel than does Ballantine, even before the \$.50 Ballantine royalty is subtracted from the latter.<sup>41</sup>

Judge Brieant did side with Falstaff in rejecting Bloor’s claim that Falstaff’s behavior amounted to substantial discontinuance of Ballantine. Falstaff had continued to distribute beer under the Ballantine name and had introduced Ballantine in other markets. Ballantine’s sales had dropped dramatically. However:

[a] very significant part of this decline is attributable . . . to the general decline of the market share of the smaller brewers, and to other causes unconnected with Falstaff’s closing of the North Bergen facility. The remaining decline is regarded as “insubstantial” under the contract. It is clear from the royalty rate established in the contract itself that the liquidated damages clause was included to cover situations approaching the total cessation of Ballantine production, rather than situations involving gradual but significant declines in sales.<sup>42</sup>

Damages were calculated by subtracting Ballantine’s actual sales from the sales that would have been made had Falstaff used its best efforts (as determined by the court).<sup>43</sup> The court accepted the expert witness’s estimate, which was based on the assumption that Ballantine’s sales would have followed the same trend as two other small New York labels, Schaefer and Rheingold. After some modest deductions, primarily to exclude Ballantine sales that were the product of illegal activities, the judge concluded that the royalties lost by Ballantine were approximately \$630,000. Falstaff had withheld royalties during the litigation and these too were awarded, bringing the final judgment to about \$1.3 million.<sup>44</sup>

Falstaff appealed the best efforts ruling and Bloor appealed the rejection of the substantial discontinuance claim. Judge Friendly, speaking for a

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40. *Id.* at 270-71 (quoting *Randall v. Peerless Motor Car Co.*, 99 N.E. 221, 226 (Mass. 1912)).

41. *Id.* at 269-70.

42. *Id.* at 266.

43. *Id.* at 280.

44. *Bloor*, 454 F. Supp. at 281.

unanimous court, affirmed. He restated Judge Briant's conclusion, softening it a bit. Briant's decision might have been interpreted as requiring Falstaff to continue promoting Ballantine regardless of the financial consequences. Friendly made clear, however, that "best efforts" did not mean that Falstaff must go to these lengths. But it did have a special duty to promote Ballantine beer sales.

While [the best efforts] clause clearly required Falstaff to treat the Ballantine brands as well as its own, it does not follow that it required no more. With respect to its own brands, management was entirely free to exercise its business judgment as to how to maximize profit even if this meant serious loss in volume. Because of the obligation it had assumed under the sales contract, its situation with respect to the Ballantine brands was quite different. The royalty of \$.50 a barrel on sales was an essential part of the purchase price. Even without the best efforts clause Falstaff would have been bound to make a good faith effort to see that substantial sales of Ballantine products were made, unless it discontinued under clause 2(a)(v) with consequent liability for liquidated damages . . . . Clause 8 imposed an added obligation to use "best efforts to promote and maintain a high volume of sales . . . ." (emphasis supplied). Although we agree that even this did not require Falstaff to spend itself into bankruptcy to promote the sales of Ballantine products, it did prevent the application to them of Kalmanovitz' philosophy of emphasizing profit *über alles* without fair consideration of the effect on Ballantine volume. Plaintiff was not obliged to show just what steps Falstaff could reasonably have taken to maintain a high volume for Ballantine products. It was sufficient to show that Falstaff simply didn't care about Ballantine's volume and was content to allow this to plummet so long as that course was best for Falstaff's overall profit picture, an inference which the judge permissibly drew. The burden then shifted to Falstaff to prove there was nothing significant it could have done to promote Ballantine sales that would not have been financially disastrous.<sup>45</sup>

## II. THE DEAL

Judges Friendly and Briant take it as axiomatic that the contract required Falstaff to trade off its profits for Ballantine's sales. Conspicuous by its absence in their decisions is any analysis of why the contract included the royalty arrangement and the best efforts covenant. That is not entirely the fault of the judges, as the record was completely silent on this point. So, we are left with the somewhat peculiar spectacle of a court giving meaning to a context-sensitive phrase with no guidance as to the context. The context dictates how "best efforts" should have been interpreted. Had the court recognized that the royalty was, in effect, an "earnout," ancillary to the one-shot sale of some of

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45. *Bloor*, 601 F.2d at 614-15.

Ballantine's assets to Falstaff, the outcome would have (or, at least, should have) been different.

An earnout makes part of the payment for an asset contingent upon some measure of future performance. Often it is a function of profits; here, it is a function of sales. Most corporate acquisitions do not involve earnouts. In 1998, of the over 9,000 acquisitions, only 153 included an earnout.<sup>46</sup> They would make little sense in the sale of a public corporation with numerous shareholders and where the seller ceases to exist as an entity. Here, where the seller is a private entity, which survives the transaction, it is more likely that the parties would choose to use an earnout. Earnouts rarely show up in appellate litigation; a Lexis search found only forty-two cases.<sup>47</sup> That might not adequately indicate the frequency with which they generate disputes. I suspect, based in part on my consulting experience, that the disputes are far more common, but that they arise in arbitrations, not litigation.<sup>48</sup>

IFC was, essentially, selling two assets—Ballantine's brand name (the proprietary rights) and its distribution network. IFC's purpose was simple; it wanted to sell at the highest price. That should be obvious, but the court's failure to recognize this basic point is the core of the problem. Falstaff purchased the proprietary rights in order to exploit them efficiently. By maintaining the flexibility to respond to new information as it appears, Falstaff increases the amount it would be willing to pay Ballantine for the right to exploit the brand name. Other things equal, the fewer post-sale restrictions on Falstaff's exploitation of the assets, the more Falstaff would be willing to pay. Falstaff's pursuit of "profit über alles," *ex post*, redounds to IFC's benefit, *ex ante*. So, any restriction, like the best efforts clause, immediately raises a red flag: how might the particular restriction raise the value of the Ballantine assets, *ex ante*?

#### A. *The Earnout*

Falstaff could have purchased the Ballantine assets outright rather than spreading the compensation over six years and making the payment contingent upon Ballantine sales. Why did they choose the latter course? There are three plausible reasons for using an earnout: (1) the seller is also filling the role of financier; (2) the seller is providing a bond for a promise not to engage in post-sale activities that would adversely affect the value of the assets to the buyer;

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46. For the number of deals, see *1998 M&A Profile*, 33 MERGERS & ACQUISITIONS 42 (1999). For the number including earnouts, see *Deal Structuring: Earn-Outs Get Into More Deals*, 33 MERGERS & ACQUISITIONS 35 (1999).

47. Lexis search, January 10, 2000.

48. In the last year I was involved, briefly, as a potential expert witness in two arbitrations concerning the interpretation of an earnout clause. On earnouts, see generally Mark D. Gerstein, *Earnouts: An Outline of Key Issues*, 1059 PLI/CORP 763 (1998).

and (3) the parties are responding to the information asymmetry. In this instance, the third is most plausible.

Ballantine was, in effect, making a six-year loan to Falstaff. The security arrangements and acceleration clause discussed above<sup>49</sup> are manifestations of this. A loan would make sense only if Falstaff could get terms at least as favorable from IFC as from alternative sources.<sup>50</sup> If restrictions in its existing capital structure—debt covenants and the like—constrained Falstaff, spreading the payments over time might have been a simple way of financing the transaction without violating the constraints.<sup>51</sup> A Falstaff planning document entitled “Ballantine Observations” hinted at some of the financing considerations:

6. Falstaff’s financing of this purchase —What form would it take—would it take external financing, stock issue, additional long-term debt, what is the availability of any of the forms of financing and what would it cost and what restrictions would it place upon our operations.
5. The present debt agreements
  - a. Do they allow this type of acquisition and when must these insurance companies be notified that we are considering such action.
6. The stockholder approval—What would be the mechanics here—what is the timing of such notification and what are the consequences of our announcing such to the stockholders in light of our present earnings situation and that of the last few years.<sup>52</sup>

While spreading the payments over time might be a perfectly sensible way to finance the project, financing considerations cannot explain why the payments were contingent upon *Ballantine sales*. Something more is necessary to explain why IFC in its role as financier would choose to take neither a fixed return nor an equity position in Falstaff.

Earnouts are sometimes used to discourage the seller’s management from engaging in post-sale actions detrimental to the buyer. Ballantine’s managers would provide a bond to Falstaff to assure that they would not by their future actions reduce the value of the Ballantine trademark. Suppose that the top management of Ballantine had developed some good will with the beer market. The value of the brand name they were selling would be impaired if they could

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49. See *supra* notes 29-30 and accompanying text.

50. If the costs of litigation are high, spreading the payments over time would give Falstaff some leverage to bargain down its future obligations. Deferral changes the status quo for subsequent litigation.

51. It is always possible that the structure of a transaction reflects tax consequences; I do not know of any in this instance and the record gave no indication of any.

52. Pl.’s Ex. 14 at A1624-25, dated Jan. 8, 1972.

subsequently re-enter and compete against Ballantine. A promise not to compete would, if enforceable, make the Ballantine assets more valuable. Giving these managers an interest in Ballantine's future sales or profits could substitute for, or complement, the non-compete covenant. The problem with this explanation, of course, is that the outgoing Ballantine executives had no competence in the beer industry<sup>53</sup> or expectation of staying in the beer industry; and Falstaff knew it. A promise not to compete, or any variant thereon, would have been worthless.

The earnout was a response to the problem of asymmetric information. In sales of complex assets the seller typically has more information than the prospective buyer.<sup>54</sup> If buyers cannot distinguish good assets from bad, then they are likely to be suspicious of any particular asset and to reduce their offer price accordingly. If the seller believes his asset to be sound, then conveying that information to the buyer can result in a higher net price. The parties have an incentive to economize on the joint production of information. By accepting some of its compensation in a contingent form, the seller provides some assurance to the buyer of the quality of the asset. Instead of insisting upon elaborate representations and warranties or engaging in extensive due diligence, Falstaff bought the Ballantine assets "as is" with over half the expected cost contingent upon future sales.

The parties want an arrangement which maximizes the value to the buyer *ex ante*. But producing information and assurance is not costless. The process of maximizing the value of the asset can reduce the size of the joint pie. That would obviously be true if the parties had spent months negotiating elaborate representations and warranties and/or engaging in a due diligence investigation. In this instance the parties avoided these costs using the royalty payment instead. It, too, is not costless. Earnouts, generally, have a number of value-reducing features. They do not track value perfectly; they can distort

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53. Judge Brieant accurately characterized IFC's competence in the beer business:

Mr. Donald Orenstein was Executive Vice-President of Investors Funding Corporation and of P. Ballantine & Sons at the time the negotiations with Falstaff took place. He testified at trial to the IFC management's complete lack of experience in the brewing industry. His own career began with IFC as a clerk, and ultimately he became President of IFC Realty Service. He stated at trial his views on IFC's acquisition of Ballantine (Tr. p. 124): "Q. When did it become apparent to you that Investors Funding should sell P. Ballantine & Company? A. The second day that I arrived at P. Ballantine, in '69. He (Mr. Jerome Dansker, Chairman of the Board of IFC) bought it on a Thursday; I told him Friday to sell it."

*Bloor*, 454 F. Supp. at 263 n.6.

54. See Victor P. Goldberg, *The Gold Ring Problem*, 47 U. TORONTO L. J. 469 (1997). The article analyzes the case in which the buyer might have superior information. Ballantine had superior information about the quality of its assets, but Falstaff had superior information about its plans on how to use those assets. Contingent compensation allows the seller to capture some of the gains despite its relative ignorance about the buyer's plans. *Id.*

incentives; and they are not strategy-proof—that is, the buyer can operate the business in a way that exploits the mechanism. For example, if an earnout were based on profits in the first three years, the buyer could make investment decisions which shift profits from the third to the fourth year. Anticipation of these costs will reduce the final price of the asset. If the best efforts clause means anything,<sup>55</sup> its role would be to prevent the buyer from taking undue advantage of the earnout.

Falstaff bought the Ballantine trademarks in order to exploit them. As Falstaff's CEO at the time of the transaction, Robert Colson, testified:

The intention when we went into this deal was to use our best efforts, and that's exactly what it says there. We were going to go out and do our best efforts to promote the brand, or why would we have bought the brand? You don't buy something with the intention that you're going to abandon it. If you did, then you spend a lot of time wasting your time.<sup>56</sup>

Conceivably, Falstaff could have bought the Ballantine brand name with the intention of eliminating Ballantine as a competitor. Since Falstaff was not in the New York market and the two beers were targeted at different customers, this would not have been a concern of the parties. However, during the life of the earnout, Falstaff could have combined with another brewer with a significant presence in the New York market; the best efforts clause could be viewed as protecting against that contingency.

The royalty acts as a tax (roughly 2%)<sup>57</sup> on sales, which could induce Falstaff to market a somewhat smaller amount of Ballantine product than it would have, but for the royalty. So “best efforts” might possibly mean that Falstaff should push its sales effort a bit beyond the point that would otherwise be optimal. The distortion of incentives, which in this instance is quite minor, is a common problem in contingent compensation arrangements (franchise fees, percentage leases, oil and gas royalties, and so forth) and “best efforts” is just one of the devices for dealing with the problem.

The more likely function was to police diversion. Falstaff bought two sets of assets: the proprietary rights and the distribution network. But the earnout was related only to the value of the former. Ballantine's owners had some reason for concern on this score. Falstaff was, after all, attempting to break into the New York market to sell its own brand and Ballantine's owners were aware of this prospect.<sup>58</sup> Had Falstaff simply jettisoned the Ballantine brand

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55. The liberal use of the term in the contract suggests that it was little more than filler.

56. Colson's Test. at 1099.

57. Ballantine's 1970 price was \$26.60 per barrel and the royalty rate was fifty cents per barrel. Pl.'s Ex. 9 at 1618.

58. On Falstaff's interest in the distribution network, *see supra* note 14 and accompanying text. On Ballantine's awareness, see the testimony of Melvin Carro, of Falstaff: “There was an expression of concern stated by somebody on the Ballantine side that possibly Falstaff would use the Ballantine distribution system to come into the New York area, and then for reasons of its



entirely and used the distribution network to distribute Falstaff beer instead, Falstaff would not simply be *maximizing* the value of the asset (the distribution network)—it would be *diverting* payment for that asset. The royalty arrangement would fail completely in its purpose.<sup>59</sup> More generally, to the extent that Falstaff could use the distribution network to sell Falstaff rather than Ballantine, the royalty would not track the value of the asset.

A “best efforts” requirement is one contractual device for protecting against this sort of diversion. But the context suggests how the clause should be read. “Best efforts” in this context means that Falstaff agreed that in its pursuit of “profit *über alles*” it would not opportunistically divert sales from Ballantine (the sales of which were to track asset value) to Falstaff. Did Falstaff use the network to divert more sales than the parties should reasonably have expected? That might be a difficult question to answer for some fact patterns, but for the facts of this case the answer is easy and negative. When Kalmanovitz took charge he dismantled the distribution system. The evidence Judge Brieant relied on to document what he believed to be Falstaff’s lack of best efforts supports the conclusion that Falstaff did not exploit a loophole in the earnout. Falstaff did not divert resources to the more profitable brand; it simply terminated (or at least drastically pared) a project that did not work.

So, we are left with three plausible meanings of “best efforts” in the context of this transaction. First, it could be aimed at preventing Falstaff from abandoning the brand following a merger with a brewer with a significant presence in the New York market. Second, it might have been an attempt to correct Falstaff’s incentives, which were a bit distorted by the royalty “tax.” Third, and the most plausible, it could have been an attempt to limit diversion of revenue away from the device chosen to provide assurance of that value. None provides a basis for concluding that Falstaff’s pursuit of profit *über alles*, by revising its Ballantine marketing strategy and dismantling much of the Ballantine distribution network, violated its obligation to Ballantine.

This is a simple and, I believe, compelling story. There is only one problem with it. It is not the story told by the witnesses or counsel. That does not make it wrong; but it does raise the questions of how courts are supposed to figure it out and, if they do, what they should do about it. That problem is compounded by the “substantial discontinuance” proviso, which can be explained, but the explanation is neither so simple nor compelling. After

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own, it might be possible . . . that Falstaff would concentrate on the sales of Falstaff, and either abandon or let the Ballantine beer sales diminish.” Carro’s Test. at A1074-75.

59. For completeness, we can identify another diversion possibility. Instead of selling Ballantine beer under the proprietary rights, Falstaff might have sold Ballantine pretzels or clothing or some other non-beer trademarked articles. They did not, so I need not pursue the matter further here.

attempting to make some sense of the proviso, I will return to the problem of decision-making by an ill-informed court.

*B. Substantial Discontinuance*

It is common to couple royalty payment schemes with minimum payment obligations.

Such arrangements are common in publishing and movies (talent receive royalties or a percentage of the gross to be offset against a bargained for fixed fee),<sup>60</sup> licensing agreements, franchising, shopping center and other retail leases, and so forth. It is tempting to assume that such arrangements would make sense in the sale of an asset, as in the present case. Indeed, my initial presumption was that the “substantial discontinuance” clause was a poorly drafted attempt to create a minimum obligation. However, I was wrong. The minimum does not add anything useful for the sale of an asset where the seller, like Ballantine, has no interest in, or affect upon, the outcomes other than the receipt of its compensation.

Up to the minimum, the effective tax rate is zero. Incentives still are distorted at the margin, but a high minimum means that at least over a broad range, the buyer’s incentives are not distorted. But the higher the minimum, the weaker the quality assurance provided by the royalty. A high minimum undercuts the quality assurance function since the purchaser must pay regardless of quality. So, while a minimum annual payment might help correct the tax distortion of the per barrel royalty, it does so only by undercutting the purpose.

A minimum guarantee might conceivably be of a bit more use in policing diversion. If the parties were indeed concerned with the possibility that Falstaff would use the Ballantine distribution network to distribute Falstaff beer, a minimum obligation would have imposed a sharp limit on Falstaff’s ability to do so. But if the advantage of distributing Falstaff were substantial (recall Judge Brieant’s claim that in addition to the fifty cents per barrel royalty, the identical beer sold for \$4.50 more per barrel when labeled Falstaff),<sup>61</sup> then Falstaff would have had a strong incentive to treat the minimum as a target. The royalty would serve no particular function.

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60. On publishing contracts, see Yoram Barzel, *Measurement Cost and the Organization of Markets*, 25 J. L. & ECON. 27, 34-35 (1982); Henry Hansmann & Reinier Kraakman, *Hands-Tying Contracts: Book Publishing, Venture Capital Financing, and Secured Debt*, 8 J. L. ECON. & ORG. 628 (1992). On gross profits compensation in movies, see Victor Goldberg, *The Net Profits Puzzle*, 97 COLUM. L. REV. 524, 546-49.

61. A price differential of around 20% is not trivial. However, we should recognize that brewers engage in a form of (legal) price discrimination by targeting different groups with beers priced accordingly. There is no reason to believe that Falstaff could sell its brand to the “price beer” market reached by the Ballantine brand and maintain the price differential.

Ballantine asked for a minimum guarantee, but Falstaff refused. Ballantine's Orenstein testified:

Falstaff was never willing to give us a guarantee of a million one. They said they would use their best efforts . . . they didn't give us really, what we wanted. We wanted a million one guarantee, that if for any reason the sales dropped below fifty cents a barrel times two million two . . . we would be guaranteed at least, a million one, and that's not in the contract.

Q. It did not get in there?

A. No. We traded that off. It did not get in there.<sup>62</sup>

Although the contract did not include a minimum guarantee, it did include liquidated damages of \$1.1 million per year (the same amount Ballantine had been asking as the minimum) in the event of Falstaff's substantial discontinuance of Ballantine. If this proviso were included as part of the quality assurance mechanism, as I first thought, it makes no sense. In effect, it says: if the assets are really terrible so that they are unusable, then Falstaff pays Ballantine \$1.1 million per year for the duration; if on the other hand, they are only pretty bad, Falstaff pays less. That is a perverse result, which I thought, could only be explained by poor drafting.

However, the clause makes more sense if it is viewed as being independent of the quality of the proprietary rights and instead concerns diversion of revenues from the exploitation of Ballantine's distribution network. Falstaff says, in effect: we agree that we will not cheat you by diverting receipts from the metering device (Ballantine sales) and profiting by the use of the other valuable asset we have purchased, your distribution network; if we have done too much diversion, we agree to pay a penalty (although the law does not permit us to call it that).<sup>63</sup> The trigger for the penalty would not be the *quantity* of Ballantine sold nationally. Rather, it would be the *percentage* of Ballantine being sold through the old Ballantine network.

But this mechanism had one big hole. What if the network itself turned out to be of little or no value? Falstaff essentially abandoned the network, but continued to exploit the proprietary rights as best it could. If the proviso's purpose was to thwart massive diversion of revenues, there was no diversion.

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62. Orenstein's Dep. at A1465-66. Falstaff's attorney made the same point:

During the negotiations, P. Ballantine & Sons attempted to elicit from Falstaff a guarantee as to the minimum royalty that would be paid to Ballantine, and Falstaff staunchly resisted any effort to force a minimum payment of royalties, and so the contract read that there would be only best efforts required of Falstaff Brewing Corporation.

Falstaff Att'y at A60.

63. Falstaff's Reply Brief raised, somewhat half-heartedly, the possibility that the proviso might be a penalty clause: "[A] construction of the proviso that would give it effect in any circumstances other than the near total cessation of Ballantine production would make of it, not a liquidated damages provision, but an unenforceable penalty clause." Falstaff's Reply Br. at 37.

Falstaff bore the direct risk of the distribution network being a lemon; it seems unlikely that *ex ante* the parties would have wanted Falstaff to post an additional bond against that prospect. But, and this must be emphasized, it is most likely that neither party expected the distribution network to be worth so little, and the contract reflected their failure to anticipate this possibility.

### III. SO, WHAT'S A POOR COURT TO DO?

The parties did not give the court much assistance in framing the case. This is, I believe, less a matter of the peculiar way in which facts percolate up through the judicial system than of genuine confusion. Orenstein's testimony on the origins of the controversial terms is indicative:

In substance what happened is that we just couldn't get together on those three items. It was the accounts receivables, the best efforts, and . . . the words substantial discontinuance. What does that really mean? How does one determine that? Can't we put in a formula? No, we won't give you a formula; we don't want to attach ourselves to anything. That's Colson's exact words. We told him, How can we make a deal not knowing where we're going? He said, Well, you have to believe that we're experts in the beer business for so many years; you're not selling to us just to collect a million one, you're going to look to us to collect much more, and we'll be able to increase the sales.

I said, Well, if that's the way you feel, why don't you write it? He said, No, he's not prepared to do that. They have certain standards under which they do deals, and that's one of them. They didn't want to put it in writing, but that's how we came to the receivable. I said, If that's the feeling, give me something. Take my receivables. He said, Maybe we'll do that. That's how the next dialogue started. They then recessed. . . .

I told [my colleagues] that the substantial discontinuance thing bothers me. What does that mean? Should we put in a percentage? Do you think we should try for a percentage? Then we all collectively said, in our minds, 30 percent would be considered a substantial discontinuance. I went back and mentioned that figure and they laughed. There was no way they would do it.<sup>64</sup>

Ballantine's lawyers asked various witnesses what best efforts meant to them and whether it meant more than good faith, a sterile inquiry designed to wrench damning statements out of the mouths of unwary witnesses. But neither side ever framed the question in terms of the underlying purpose of the transaction: sale of an asset of uncertain value. Counsel never even hinted at the possibility that the dismantling of the Ballantine distribution network should count in favor of Falstaff, instead of counting against it. The courts accepted the parties' terms of debate.

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64. Orenstein's Test. at A1473-74.

This was not inevitable; a court with a confident understanding of what the deal was about could easily have framed the best efforts question properly and disposed of it cleanly. From the contractual context, the plausible meanings of best efforts were narrowly circumscribed and under both those meanings, Falstaff had satisfied its obligation. The substantial discontinuance proviso presents a more difficult problem. Still, the most plausible explanation concerns the diversion of the revenue from the Ballantine distribution network; given the purpose of the transaction, we might reasonably infer that shutting down that network completely would not constitute a substantial discontinuance.

I am not suggesting that courts should ignore contract language and attempt to determine the parties' true intent. Rather, I am suggesting that when contract language is context sensitive, the court should use that context in interpreting the contract. The emphasis should not be on what these parties meant, but on what reasonable people in this situation should have meant. So, even if Orenstein's testimony regarding the origins of the substantial discontinuance was accurate and the best efforts language was lifted from a form book with the parties giving it no mind, that should not matter in interpreting the agreement. We ought not, in Judge Easterbrook's colorful phrase, invite "a tour through Walters' cranium with Walters as the guide."<sup>65</sup>

The starting point should be this: a rational seller would not want the buyer to promise to use the asset sub-optimally. It makes little sense to have an interpretative strategy that presumed such an irrational policy. An interpretation of a contract that begins with the presumption that the seller intended to restrict the buyer's subsequent use of the asset, is bound to fail unless there is an understanding of the possible gains from tying the buyer's hands.

#### IV. CONCLUDING REMARKS

Generally speaking, giving content to an amorphous concept like "best efforts" is extremely difficult. Even in this contract, in which "best efforts" was invoked seven times and "good faith" once, it is hard to determine how a court should respond to claims that particular best efforts obligations had not been met. How, for example, should one deal with a complaint that Falstaff had failed to meet its best efforts obligation to maintain as its own employees Ballantine's sales, marketing, clerical and administrative personnel? Ironically, while the problem is generally difficult or intractable, in the one case that has filtered down to the casebook level, the problem turns out to be an easy one. The context—a one-shot sale of assets—delimits the feasible

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65. *Skycom Corp. v. Telstar Corp.*, 813 F.2d 810, 814 (7th Cir. 1987).

meanings of “best efforts” and both of the meanings lead to the same conclusion: the courts got it wrong.

Again, I must emphasize, I am not asking courts to ferret out the true intent of the parties. People do often enter into foolish deals and it would be disastrous for courts to continually second-guess their choices. But where the language is inherently ambiguous, the court should not impose an irrational agreement upon the parties. The peculiar feature of *Bloor* is that the way the controversy was framed made the irrational seem natural to the litigators, the courts and the commentators. When the irrational seems natural it is time to re-think how we got there and to seek a better alternative.

