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Understanding Force Majeure In The Aftermath Of Harvey

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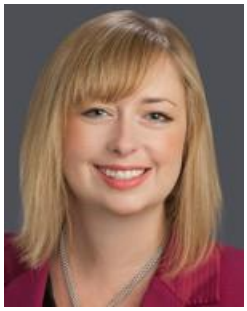

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At this point, it is impossible to assess the full impact of the devastation caused by Hurricane Harvey. However, we can predict that it will have wide-ranging effects on the ability of some members of the energy industry to fully perform contracts — from production, to transport, to the provision of oil- and gas-related goods and services.

It is common knowledge that some of the largest oil and gas production operations and refining facilities in the United States were forced to shut in or shut down as a result of the hurricane. What is less obvious — so far — is how many ongoing contracts are likely to be unfulfilled as a result of the shutdowns, and what the domino effect will be.

It is also unclear how many other companies — including providers of goods and services — will be unable to perform their contracts because of physical destruction and ongoing infrastructure issues caused by the hurricane and its aftermath. It is predictable, for instance, that manufacturing facilities that have suffered flood damage will suffer both loss of product and loss of or damage to the equipment necessary to manufacture more product quickly.

In short, the energy industry is likely to experience a rise in contract disputes across a range of Hurricane Harvey-related situations that will trigger force majeure or similar concerns, as occurred in the aftermath of Hurricane Katrina and Hurricane Ike.

Force majeure concerns are likely to arise from, among other situations, production shutdowns as a result of the hurricane and subsequent flooding; flooding or other damage to the premises of goods and services providers, resulting in delayed or non-delivery of goods; and potential government actions. Of course, every instance of delayed, partial or non-performance by one party is likely to have a detrimental effect on others in the energy value chain.

Force majeure, and the related doctrines of impossibility and/or commercial impracticability, may be viable defenses to failure to perform a contract where the

failure to perform is caused by a natural disaster. It is typical for a commercial contract to contain a force majeure clause.

Where a contract contains a force majeure clause, under Texas law, the terms of the contractual force majeure clause, as opposed to any common-law definition, generally control the breadth of the defense. See, e.g., Virginia Power En. Mktg. Inc. v. Apache Corp., 297 S.W.3d 397, 402 (Tex. App.—Houston [14th Dist.] 2009, pet. denied) ("The scope and effect of a 'force majeure' clause depends on the specific contract language, and not on any traditional definition of the term.").

Most contractual force majeure clauses cover "acts of God," such as hurricane, flood, other severe weather events, war, terrorist attacks or similar occurrences. Every force majeure clause is different, and the precise language of the clause should be the first consideration when assessing what to do if a company finds itself potentially unable to perform a contract in the wake of a weather event like Hurricane Harvey.

Some force majeure clauses will add a specific requirement that the event be "unforseeable," while others are drawn more broadly (although a court interpreting the provision may still read an unforseeability requirement into the contract). See, e.g., Valero Transmission Co. v. Mitchell Energy Corp., 743 S.W.2d 658, 663 (Tex. App.—Houston [1st Dist.] 1987, no writ); Hydrocarbon Mgmt. Inc. v. Tracker Expl. Inc., 861 S.W.2d 427 (Tex. App.—Amarillo 1993, no writ).

Force majeure clauses frequently require the non-performing party to take reasonable steps to minimize delay or damages caused by the force majeure event. The force majeure clause may also require the party claiming force majeure to provide notice to the other contracting party, often by a certain method (for instance, in writing), and possibly within a certain period of time. Close attention should be paid to any such requirements.

Even if there is no force majeure clause in the contract, depending on the jurisdiction, common-law doctrines that are the functional equivalent of a force majeure clause may provide a defense to performance. For example, in Texas, impossibility is recognized as a defense to contract performance. Pertinent to the post-Harvey situation, this defense may be applied where the thing necessary for performance has been destroyed or deteriorated and where the action is prevented by government regulation. See, e.g., Key Energy Servs. Inc. v. Eustace, 290 S.W.3d 332, 340 (Tex. App.—Eastland 2009, no pet.).

The impossibility defense may also be referred to as a force majeure defense or a "commercial impracticability" defense. Regardless of the nomenclature used by the parties and the court, at common law, a situation approaching true impossibility — as opposed to mere impracticability or inconvenience (such as financial inconvenience) — will typically be required for this defense to be successful.

Similar defenses are recognized across much of the world, which (depending on choice of law issues) may be pertinent when inability to perform is implicated in a transnational contractual relationship. For example, the United Nations Convention on Contracts for the International Sale of Goods (CISG), which applies to certain commercial transactions between parties who are citizens of signatory states, provides that a "party is not liable for a failure to perform any of his obligations if he proves that the failure was due to an impediment beyond his control and that he could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the contract or to have avoided or overcome it or its consequences." CISG Art. 79(1). Like a typical force majeure provision, the CISG also includes requirements for proper remedial actions and notice to the other party.

Ultimately, whether a force majeure or a similar doctrine will excuse performance is likely to turn on whether the party claiming force majeure could reasonably have avoided either the causal situation or non-performance. Whether the event was foreseeable is one element of this inquiry, but it is not necessarily determinative.

For instance, if an unforeseeable event were to cause a contract to become more expensive to perform (but not impossible), a force majeure defense is likely to be challenging to prove. See, e.g., Valero Transmission Co. v. Mitchell Energy Corp., 743 S.W.2d 658, 663 (Tex. App.—Houston [1st Dist.] 1987, no writ) ("[A] contractual obligation cannot be avoided simply because performance has become more economically burdensome than a party anticipated.").

It is best practice for a party considering asserting force majeure to analyze and evaluate whether there are alternatives that would make partial performance possible. Good faith and honest communications with the other party(ies) to the contract are key. It is generally advisable for the nonperforming party to retain any written communications detailing the efforts taken to perform; this evidence may become important in defending any resulting breach of contract action.

A nonperforming party should also be careful about industry perception: performing one's most lucrative contracts, while not performing the less lucrative ones on the basis of a force majeure event, may result in negative visibility if such "most favored nation" status is not part of the underlying contractual relationship(s). While none of these issues alone may be dispositive, they may have a practical effect on the outcome of any resulting disputes.

In sum, if Hurricane Harvey and its aftermath appear to have made performance of a contract impossible, consulting the relevant contract(s) for any governing force majeure language should be the first step. Alternative means of performance, even if difficult, should also be thoroughly considered.

Communication with the other contracting party(ies) is key and should be done in as timely a manner as possible. And finally, if the ultimate determination is that performance is not possible due to a force majeure event, notice should be provided to the other party(ies) in the time and manner required by the contract and/or governing law.

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