

NEW DEVELOPMENTS RE: *FORCE MAJEURE* CLAUSES

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Introduction

This paper concerns recent developments in the law respecting *force majeure* clauses, with emphasis on contracts in the energy sector.

The first point of this brief paper is that, while the notion of *force majeure* generally refers to the release of an obligation to perform upon the occurrence of events beyond either party's control, the ability to craft a clause that effectively allocates the risk of such events is a power held by the parties to the contract. The use of the clause has been expanded to address not only forces of nature or acts of God, but also events which are industry or transaction specific. Moreover, the courts have tended to hold the parties to an arguably narrow reading of their *force majeure* clauses, particularly where they are drafted using archaic boilerplate language. Thus, it is becoming increasingly important for contracting parties to specifically negotiate these clauses, with their particular circumstances and industry characteristics in mind.

The second point of this paper is that parties negotiating a *force majeure* clause should carefully consider implementing provisions which require mitigation, partial performance or the like in the instance of a *force majeure* event. That is to say, an event of *force majeure* need not automatically lead to a postponement or termination of a party's entire set of obligations under a contract. For instance, the clause could provide for suspension of all or part of the obligations, or, in the case of a supply contract, a requirement to prorate a deficient source of supply among many customers.² The ingenuity and creativity of the parties can have a dramatic impact in this area by fashioning alternative options and varying degrees of required mitigation efforts.

The Development and Philosophy of *Force Majeure* Clauses

Historically, *force majeure* clauses were intended to deal with the following:

An event or effect that can be neither anticipated nor controlled. The term includes both acts of nature (e.g., floods and hurricanes) and acts of people (e.g., riots, strikes and wars).³

Force majeure clauses arose in response to the strict and literal application of contractual terms by the common law courts. This approach was illustrated in the oft-cited seventeenth century decision of *Paradine v. Jane*.⁴ In that case, the court refused to excuse the unfortunate defendant from paying arrears of rent notwithstanding that he had been ejected from the land by "King Rupert's Horse"⁵. In the view of the court, there was no express or implied term in the contract which might afford the defendant any reprieve: the contract provided that rent was to be paid, so it had to be paid, no matter what the circumstances.

Force majeure clauses were developed to reduce the risk associated with events over which the parties had no control or which they could not foresee. The clause is designed to provide an escape hatch from liability under the contract in circumstances where the parties are unable or unwilling to be responsible for the consequences of certain events.

Boilerplate *force majeure* clauses are frequently inserted in contracts with little regard to the particular circumstances of the contracting parties. One often sees in modern commercial contracts *force majeure* clauses containing somewhat archaic language. For instance, common forms of the clause will include references to acts of the Queen's enemies, restraint of Princes, civil war, insurrections or epidemics.⁶

Again, there is no need to be a slave to ancient precedent, and there is good reason not to be. The scope and precision of a *force majeure* clause are limited only by the imagination of the draftsman. Accordingly, in drafting contracts pertaining to oil and gas matters, the draftsman should consider the particular escape hatches that may be desirable to the client. Inability to perform as a result of attack by the Queen's enemies may not be a significant risk.

The Current State of the Law in Canada and the Impact of *Atcor*

A leading decision of the Supreme Court of Canada is found in *Atlantic Paper Stock Ltd. et al. v. St. Anne-Nackawic Pulp & Paper Co. Ltd.*⁷ In that case, St. Anne had contracted with Atlantic Paper and others to purchase a minimum tonnage of waste paper over a 10 year period. One year into the contract, St. Anne sent notice that it would not be receiving any further deliveries of waste paper. Atlantic Paper sued for breach of contract. St. Anne defended on the basis of a *force majeure* clause which provided an escape hatch where the parties could not perform "as a result of an act of God, the Queen's or public enemies, war, the authority of the law, labour unrest or strikes, the destruction of or damages to production facilities, or the non-availability of markets for pulp or corrugating medium." The critical issue before the Court was the meaning of the phrase "the non-availability of markets."

The Court noted that a *force majeure* clause typically applies where there is a supervening event, beyond the control of either party, which renders performance impossible. However, the particular words of the clause must be considered and applied. Thus, the Court determined that the phrase "non-availability of markets" had to be interpreted in the context of the entire clause. In particular, the Court applied the *ejusdem generis*⁸ rule, the effect of which was that non-availability of markets must fall in the same class as the previously enumerated instances in the clause (acts of God, etc.); namely, events beyond the parties' control.

On the facts of the case, the Court found that, rather than resulting from events beyond St. Anne's control, the failure to perform was attributable to its poor marketing plan and its lack of research. A market for pulp and corrugating medium did exist; however, St. Anne could not compete economically. Therefore, the *force majeure* clause provided no defence to St. Anne.

This case illustrates the need for the practitioner to be very diligent in drafting a *force majeure* clause. Simply adding a few events to an archaic, boilerplate list of other events might leave one's client stuck in the seventeenth century.

A decision of particular significance to the energy sector is *Atcor Ltd. v. Continental Energy Marketing Ltd.*⁹ In that case, Atcor had contracted to supply natural gas to Continental. Atcor's gas supply was fed by the 'Nova line,' which suffered problems that ultimately affected Atcor's ability to deliver. As a result, there was a curtailment in the volume of gas that Atcor had available for distribution. Atcor defaulted on its obligation to supply Continental with gas, and claimed the protection of the *force majeure* clause in the supply contract. Continental sued for damages for breach of contract.

The *force majeure* clause in question read as follows:

9. Subject to the other provisions of this paragraph, if either party to this Agreement fails to observe or perform any of the covenants or obligations herein imposed upon it and such failure shall have been occasioned by, or in consequence of *force majeure*, as hereinafter defined, such failure shall be deemed not to be a breach of such covenants or obligations.

(a) For the purposes of this Agreement, the term "*force majeure*" shall mean any acts of God, including therein, but without restricting the generality thereof, lightning, earthquakes and storms and in addition shall mean any strikes, lockouts or other industrial disturbances, acts of the Queen's enemies, sabotage, wars, blockades, insurrections, riots, epidemics, landslides, floods, fires, washouts, arrests and restraints, civil disturbances, explosions, breakages of or accidents to plant, machinery or lines of pipe, hydrate obstructions of lines of pipe, freezings of wells or delivery facilities, well blowouts, craterings, pipeline tie-ins, pipeline connections, pipeline repairs and reconditioning, the orders of any court or governmental authority, the invoking of *force majeure* pursuant to any gas purchase contracts, any acts or omissions (including failure to take gas) of a transporter of gas to or for the Seller which is excused by any event or occurrence of the character herein defined as constituting *force majeure*, or any other causes, whether of the kind herein enumerated or otherwise, not within the control of the party claiming suspension and which, by the exercise of due diligence, such party is unable to overcome.

(b) Neither party shall be entitled to the benefit of the provisions of paragraph 9 hereof under any or all of the following circumstances: ...to the extent that the failure was caused by the party claiming suspension having failed to remedy the condition, and to resume the performance of such covenants or obligations with reasonable dispatch; ...if the failures were caused by lack of funds or with respect to the failure of payment of any amount or amounts then due hereunder. [Emphasis added.]

To digress, one should note the potential and unnecessary risk to which Atcor appears to have been exposed as a result of the clause referring to specific, contemplated events relative to gas

supply under the archaic notions of acts of God. Perhaps a stronger clause would enumerate those events under a separate class. Furthermore, one should also note the provision regarding due diligence – a provision that is intended to prevent a contracting party from relying upon fortuitous circumstances to avoid its obligations where it might otherwise be in a position to remedy the situation, all or in part.

At first instance, the judge held that Atcor was properly entitled to refuge under the *force majeure* clause. The judge reasoned that any event outside of a party's control would constitute *force majeure*. Thus, the focus was on the occurrence of a specified event and not the impact of that event. The use of the words "failure to perform" in the introduction to clause 9 were also significant in the judge's opinion: 'Failure' was distinguished from words such as 'unable' or 'impractical,' and was interpreted to mean that the party invoking the clause need not show that there was a significant hurdle to performing the contract if a specified *force majeure* event had been shown. Therefore, as Nova's pipeline difficulties were an event contemplated by the clause and outside of Atcor's control, Actor was properly protected by the *force majeure* clause.

Continental appealed, arguing that Atcor had breached an implied duty to prorate available supply among all customers, such that Atcor was not entitled to relief under the *force majeure* clause. Continental submitted that the implied duty arose from the duty to mitigate provided for in the contract. The Alberta Court of Appeal concluded that for Atcor to succeed, it must have established that the intervening event was within the scope of events contemplated by the *force majeure* clause. Further, Atcor must not have been caught by the two express limitations to the application of the clause. First, under clause 9(a), the party must have exercised due diligence in an attempt to overcome the consequences of the event. Second, in light of clause 9(b), the party could not invoke the *force majeure* clause if the failure to perform was the result of that party's "failure to remedy the condition and to resume the performance of such covenants or obligations with reasonable dispatch."

Thus, it was not sufficient that a *force majeure* event be established in and of itself. The Court stated:

In my view, the contractual relationship for a causal tie between event and non-performance evidences the intention of the parties that the relationship between the two must be substantial, not incidental. A supplier need not show that the event made it impossible to carry out the contract, but it must show that the event created, in commercial terms, a real and substantial problem, one that makes performance commercially unfeasible.

The Court further stated that the purpose of a *force majeure* clause is to protect the parties from events which fall outside of normal business risk.

Generally, then, counsel negotiating a *force majeure* clause should be alive to at least three separate areas of concern: (i) the triggering events (eg. flood); (ii) the effect of the events on the parties' ability to perform (ie. the extent to which remedial efforts must be employed); and (iii) the impact of satisfaction of (i) and (ii) on the parties' obligations (for instance, temporary suspension or termination of the contract). The Court in *Atcor* noted that "a good contract would expressly deal with several possible results, and different levels of obligation to mitigate..."

The Court stated:

... the test more likely intended by the parties would ask whether the event made performance commercially impracticable or unreasonable. I will not strive to force a contract into the one bag or the other when both are unsatisfactory. I repeat that, in my view, the test is this: A supplier need not show that the event made it impossible to carry out the contract, but it must show that the event created, in commercial terms, a real and substantial problem. [Emphasis added.]

Thus, an analysis of a party's ability and efforts to salvage the contractual relationship must account for the context of the prevailing industry practices and commercial practicality.

The Court of Appeal rejected the trial judge's distinction between the notions of a "failure to perform" and an *inability* to perform. The *force majeure* clause, read as a whole, created a duty to exercise due diligence in attempting to perform the contract; therefore, the phrase "failure to perform" held no magic.

Continental argued that Atcor had a duty to distribute its curtailed gas supply on a proportionate basis. The Court rejected the argument on the basis that the *force majeure* clause did not provide for such a duty. Nonetheless, the Court found that the contract did impose a duty to act in a commercially reasonable manner, which required a party to consider all possible alternatives before electing to default under protection of a *force majeure* clause. In the context of a natural gas supply contract, two alternative means of performance were identified. First, Atcor could have prorated volumes of gas available in order to avoid completely defaulting on any one contract. Second, there was the possibility of securing additional volumes from other sources. The critical question was whether either of these alternatives was a commercially reasonable solution. In this case, the Court agreed that Nova's pipeline problems fell within the contractual definition of *force majeure*, but concluded that there was insufficient evidence to determine whether or not it was commercially impracticable for Atcor to perform its supply obligations.

In the end, the Court of Appeal ordered a new trial, and the parties settled.

On one hand, the Court gave little guidance as to the meaning of 'commercially unreasonable.' At what point is an alternative to default considered commercially unreasonable? Is profitability a fair determination? While inability to profit is not in and of itself a basis to invoke *force majeure*,¹⁰ it can be argued that it would be unreasonable in a commercial sense to take any action that would not result in profit. Or, should the onus be elevated to that of a crushing burden, requiring the party to take any action short of economic destruction? Arguably, a burden of this magnitude would undermine the purpose of a *force majeure* clause. On the other hand, these cases must turn, in large part, on their facts. As such, an attempt to rigidly define 'commercially reasonable' might lead to more problems than it purports to solve.

A second problem arises with respect to the Court's guidance for drafting *force majeure* clauses. The Court espoused the desirability of a concise, narrowly constructed definition of *force majeure*. Given the fact that the underlying principle for the clause is to protect from risks including unforeseeable risks, this is a tall order.

Unfortunately, there has been little judicial consideration of *force majeure* clauses in Canada since *Atcor*. Of the few decisions available, most are fact specific and do not enunciate principles suitable for broad application.

Other notable cases arising in the energy sector are *NESI Energy Marketing Canada Ltd. (Trustee of) v. NGL Supply (Gas) Co.*¹¹ and *Tenneco Canada Inc. (c.o.b. Albright & Wilson Americas) v. British Columbia Hydro and Power Authority.*¹²

In *NESI*¹³, NGL Supply (Gas) Co. had entered into a natural gas brokerage agreement with NESI. There was a master agreement covering the general terms between the parties as well as individual purchase and sale contracts which governed specific transactions. As both parties were brokers, there had been numerous reciprocating buy and sell transactions. In 1996, NESI began to experience financial difficulties and was eventually petitioned into bankruptcy. NGL and others filed a proof of claim, claiming losses associated with the inability to purchase gas from NESI at a set price. The trustee argued that the claim should be reduced by any gains derived from the collapse of NGL's obligations to sell gas to NESI at a set price. In reply, NGL argued that the contracts were separate transactions and that the provisions in the master agreement dealing with bankruptcy did not address this situation.

While the *force majeure* clause in the master contract expressly excluded financial difficulties or economic inability to perform as a basis for invoking the clause, the Court looked to the clause for guidance in interpreting other provisions in the contract. Further, the *force majeure* clause specifically outlined an obligation on the part of the defaulting party to prorate available supply between contracts. The clause read as follows:

Where *Force majeure* occurs, the party claiming same shall be required to pro-rate the effect of such event of *Force majeure* equally (on a percentage basis) among all of its other firm gas purchase/sale contracts of a like and similar nature at the Delivery Point(s).

The Court held that this provision was instructive of the desired allocation of risk between the parties: as the parties had specifically provided for prorating distribution in the *force majeure* context, they would have made similar provisions in other areas of the contract if they had

intended such results. The Court concluded that because the clause addressing the impact of bankruptcy was silent with respect to set-off, the parties had not desired to allocate risk in that fashion.

*Tenneco Canada Inc. (c.o.b. Albright & Wilson Americas) v. British Columbia Hydro and Power Authority*¹⁴ concerned an agreement for the purchase of electricity which provided for two pricing components: a demand charge and an energy charge. The energy charge was associated with actual usage of electricity, while the demand charge was a monthly fee in connection with the capital equipment and service facilities required by B.C. Hydro to supply power to the customer.

Tenneco, a customer of B.C. Hydro, was a supplier of chemicals to the pulp and paper industry. When a major strike occurred in the pulp and paper industry, Tenneco was forced to halt production. As a result, Tenneco's power consumption during this period was negligible. Tenneco gave notice to B.C. Hydro under the *force majeure* clause in the contract. B.C. Hydro rejected the notice and continued to bill Tenneco for the monthly demand charge. After paying the invoices under protest, Tenneco brought proceedings to secure a refund.

The *force majeure* clause in the contract applied when either party was partly or wholly unable, "because of a *Force majeure*, to perform an obligation and claims that a *Force majeure* is occurring or has occurred and reasonably establishes that fact." In such a case, the performance of the obligation would be "deemed to be suspended". While strikes, legal lockouts or other labour disturbances are commonly specified and recognized as events qualifying as a *force majeure*, the Court ruled that Tenneco could not seek refuge under the *force majeure* provision. The Court reasoned that the contract between Tenneco and B.C. Hydro did not obligate Tenneco to consume a minimum amount of electricity on a monthly basis; therefore, the drop in consumption as a result of the strike did not create an inability to perform. Tenneco could, and did, pay the monthly demand charge notwithstanding the strike.

The Court went on to examine the applicability of a "Billing Adjustment" provision under the contract which was also drafted to apply in the event of strike or other labour disturbance, and granted some relief to Tenneco on that basis.

The Interpretation of *Force majeure* Clauses by the American Courts¹⁵

There is ample American case law discussing *force majeure* clauses or 'acts of God' clauses in a variety of contexts. There is a considerable number of cases dealing with oil and gas leases.¹⁶ In the more narrow context of energy supply contracts, the following sampling of cases illustrates the approach taken by certain American courts.

In *Aquila Southwest Pipeline, Inc. v. Harmony Exploration, Inc.*¹⁷, a natural gas purchase and processing agreement was in issue. Harmony, the producer, had contracted with Aquila to process and transport casinghead gas produced by Harmony's wells. Aquila would then process the casinghead gas into marketable products and pay Harmony accordingly. Aquila began to expand its business and accept volumes beyond the capacity of the processing plant. As a result, a portion of Harmony's gas was directly delivered to market and sold for a minimal value as unprocessed casinghead gas. Harmony sought damages for lost profits.

Under the contract, *force majeure* was defined as follows:

Force majeure means:

acts of God, strikes, lockouts or other industrial disturbances, acts of the public enemy, wars, blockades, insurrections, riots, epidemics, landslides, lightning, earthquakes, fires, storms, floods, washouts, arrests, and restraints of the Government, either federal or state, civil or military, civil disturbances, explosions, sabotage, malicious mischief, breakage or accident to machinery or lines of pipe, necessity of making repairs and maintenance to Buyer's facilities, freezing of wells or lines of pipe, refusal or inability of Buyer's resale purchaser(s) to take deliveries, partial or entire failure of gas supply or market, inability of any party hereto to obtain right-of-way, necessary materials, supplies or permits, any of the foregoing or any action due to existing or future rules, regulations, orders, laws or proclamations of governmental authorities (both federal and state), including both civil and military, and any other cause whether of the kind herein enumerated or otherwise, not reasonably within the control of the party claiming suspension.

Aquila attempted to rely on the *force majeure* clause, claiming that the capacity of the plant was finite and therefore certain volumes had to bypass the processing facilities. The weakness in this argument was that Aquila was soliciting new business during this same period. As a result, the inability to process all of the volumes was a circumstance Aquila had brought upon itself. Further, Aquila had not given notice under the *force majeure* clause which would have enabled Harmony to make alternative processing arrangements.

The Court also noted that a contract for the sale of oil or natural gas is a contract for the sale of goods under the Uniform Commercial Code. In a contract involving exclusive dealing, the Code imposed a duty on the parties to use "best efforts" with respect to the supply and sale of the goods in question. The application of the Code was determinative in this case as Aquila had not used its best efforts to fulfil its obligations to Harmony.

In *Northern Indiana Public Service Co. v. Carbon County Coal Co.*¹⁸ the central issue on appeal arose out of a long term supply agreement between Carbon and NIPSCO. The contract provided that Carbon would supply, and NIPSCO would purchase, a minimum of 1.5 million tonnes of coal for 20 years. NIPSCO used the coal to generate electricity. The contract contained a floor price of \$24/ tonne as well as an escalation clause which would inflate the cost per tonne in various circumstances. Seven years into the contract, the contractual price per tonne of coal had risen to \$44. Meanwhile, the price for coal on the open market had declined. Accordingly, NIPSCO's costs of generating electricity were higher than other producers in the market. NIPSCO sought approval from the requisite state board to increase the unit price of electricity and pass the inflated coal costs on to consumers. The board authority approved the increase in part, but directed that NIPSCO make a good faith effort to find and, whenever possible, buy electricity from other utilities who were able to sell it at a price that was lower than NIPSCO's cost of internal generation. Additionally, the board stated that "the adverse effects of entering into long-term coal supply contracts which do not allow for re-negotiation and are not requirement contracts, is a burden which must rest squarely on the shoulders of NIPSCO management." NIPSCO refused any further deliveries of coal and sought to be excused from the contract under the *force majeure* clause.

NIPSCO argued that the state board's orders prevented it from taking any additional coal from Carbon and that this fell within the ambit of the *force majeure* clause. The clause provided in part that NIPSCO would be excused from taking deliveries of coal "for any cause beyond [its] reasonable control...including but not limited to...orders or acts of civil...authority...which wholly or partly prevent...the utilizing...of the coal." The Court, however, categorically rejected this argument, pointing out that the orders did not prevent NIPSCO from accepting deliveries, but rather prevented NIPSCO from "shifting the burden of its improvidence or bad luck to the backs of helpless ratepayers." With respect to *force majeure* clauses generally, the Court stated:

A *force majeure* clause is not intended to buffer a party against the normal risks of a contract. The normal risk of a fixed price contract is that the market price will change. If it rises, the buyer gains at the expense of the seller (except insofar as the escalator provisions give the seller some protection); if it falls, as here, the seller gains at the expense of the buyer. The whole purpose of a fixed price contract is to allocate risk in this way. A *force majeure* clause interpreted to excuse the buyer from the consequences of the risk he expressly assumed would nullify a central term of the contract. [Emphasis added.]

Similarly, in *Kentucky Utilities Co. v. South East Coal Co.*¹⁹, Kentucky had agreed to purchase coal from South East under a long term supply contract. The agreement was heavily negotiated and contained numerous provisions for the alteration of the unit price. As South East's costs associated with recovering coal escalated, the price per tonne was also adjusted, eventually reaching \$57.00 per tonne. During this period, Kentucky refused deliveries of several hundred thousand tonnes of coal, claiming over 36 separate incidents of *force majeure*. These incidents were primarily related to plant maintenance and repairs.

The *force majeure* clause in the contract was unique in the sense that the definition was extremely broad, and expressly included equipment breakdown or outage, *including scheduled outages for maintenance*. The Court noted that this definition was much broader than those typically reviewed by the courts and concluded that the parties obviously agreed to include these more mundane occurrences as a basis for suspending contractual obligations. Notwithstanding the broad definition, the clause further required that a party was obligated to eliminate the disabling effects of such *force majeure* as soon as, and to the extent, possible.

The Court held that the analysis of the *force majeure* clause involved three separate steps. First, the event must fall within the definition of *force majeure*. Second, it must be determined whether the event was reasonably beyond the control of the party invoking the clause. Third, it must be shown that performance of the contract was not possible without unreasonable cost or expense. In articulating this three-part analysis, the Court also referred to the obligation to act in 'good faith' as required under the Kentucky state version of the Uniform Commercial Code.

The Court accepted that the broad definition allowed Kentucky to claim *force majeure* in a wider range of circumstances, including the performance of routine maintenance. However, the Court rejected that the mere occurrence of the event relieved Kentucky of any obligation to attempt to perform. The Court made specific reference to instances where South East had offered alternative delivery mechanisms at no additional cost to Kentucky. It was not reasonable for Kentucky to claim *force majeure* in those circumstances. *Force majeure* could only be claimed where the event in question created an unreasonable interference or expense.

While the American courts have not articulated the duty upon a party to avoid default under a *force majeure* clause to the same degree as the Court in *Atcor*, the application of the Uniform Commercial Code (the "U.C.C.") may serve to achieve the same result. The UCC applies to all commercial transactions involving the sale of "goods", a term which is very broadly defined. Section 2-103 requires that a party act in 'good faith' in fulfilling its obligations under a contract. Under s. 2-103(1)(c), 'Good Faith' is further defined as "honesty in fact and the observance of reasonable commercial standards of fair dealing in trade".²⁰ Thus, by application of the U.C.C., American law has also imparted the obligation to act in a commercially reasonable manner. At the end of the day, courts in either country will not allow a party to lightly excuse themselves from performing a contract under the guise of *force majeure*.

Emerging Trends: Cross-Border Energy Contracts and Standardization of Contracts

Given the growth in cross-border energy transactions in the last decade, coupled with the increasing demand for natural gas and other energy resources, the need to contractually allocate

risk is of increasing importance.²¹ This may entail consideration of relatively complex legal issues, such as the differences between Canadian and foreign law respecting *force majeure* clauses, choice of law clauses and related matters.

While standardized contracts for certain transactions have been adopted in the United States for several years (i.e.: short term natural gas contracts)²², Canada has been much slower to jump on the bandwagon. That said, standardization may become more common in the foreseeable future. The potential downsides to standardization, such as the loss of sufficient flexibility, may be countered by increased sophistication in the drafting of these contracts. Additionally, standardization may increase efficiency for the client. Common terminology and contractual obligations are also beneficial in an already complex business environment. Specifically with respect to *force majeure* clauses, a standard clause may place industry participants on equal footing.²³

For example, the creation of a master agreement for use in power purchase and sale transactions in the U.S. is said to have had a strong impact upon the development of similar contracts in Canada, and more specifically, Alberta. The definition of *force majeure* appearing under the American Master Power Purchase and Sale Agreement is as follows:

"Force majeure" means an event or circumstance which prevents one Party from performing its obligations under one or more Transactions, which event or circumstance was not anticipated as of the date the Transaction was agreed to, which is not within the reasonable control of, or the result of the negligence of, the Claiming Party, and which, by exercise of due diligence, the Claiming Party is unable to overcome or avoid or cause to be avoided. Force majeure shall not be based on (i) the loss of Buyer's markets; (ii) Buyer's inability economically to use or resell the Product purchased hereunder; (iii) the loss or failure of Seller's supply; or (iv) Seller's ability to sell the Product at a price greater than the Contract Price. Neither Party may raise a claim of Force majeure based in whole or in part on curtailment by a Transmission Provider unless (i) such Party has contracted for firm transmission with a Transmission Provider for the Product to be delivered to or received at the Delivery Point and (ii) such curtailment is due to "force majeure" or "uncontrollable force" or a similar term as defined under the Transmission Provider's tariff; provided, however, that existence of the foregoing factors shall not be sufficient to conclusively or presumptively prove the existence of a Force majeure absent a showing of other facts and circumstances which in the aggregate with such factors establish that a Force majeure as defined in the first sentence hereof has occurred. The applicability of Force majeure to the Transaction is governed by the terms of the Products and Related Definitions contained in Schedule P.²⁴

The above definition is unique in several ways. First, the focus is on what will not be considered to be a *force majeure* event, rather than defining an all encompassing definition. The archaic "act of God" language has been abandoned; the clause more succinctly reflects the risks that are expected to arise under the contract; and it establishes that these expected risks are not an excuse for non-performance. Second, the clause expressly outlines that curtailment by a 'Transmission Provider' is not *force majeure* unless there is a *force majeure* event under the transmission agreement. Third, the contract as a whole has numerous product classifications and schedules, which will each be impacted differently the Master Agreement, depending on the nature of the transaction. Again, however, the attempt to be very specific might leave a party exposed to performance obligations on the occurrence of more nebulous events - 'acts of God.'

Conclusions

While the notion of *force majeure* generally refers to an exculpation of liability on the occurrence of events beyond either party's control, the ability to craft a clause that effectively allocates the risk of such events is a power held by the parties to the contract. The use of the clause has been expanded to address not only forces of nature or acts of God, but also events which are industry or transaction specific. Moreover, the courts have tended to hold the parties to an arguably narrow reading of their *force majeure* clauses, particularly where they are drafted using archaic boilerplate language. Thus, it is becoming increasingly important for contracting parties to specifically negotiate these clauses, with their particular circumstances and industry characteristics in mind.

Parties negotiating a *force majeure* clause should carefully consider implementing provisions which require mitigation, partial performance or the like in the instance of a *force majeure* event. That is to say, an event of *force majeure* need not automatically lead to a suspension of all of a party's entire set of obligations under a contract. For instance, the clause could provide for suspension of all or part of the obligations, or, in the case of a supply contract, a requirement to prorate a deficient source of supply among many customers.²⁵ The ingenuity and creativity of the parties can have a dramatic impact in this area by fashioning alternative options and varying degrees of required mitigation efforts.

Addendum

The following is an *example* of the form of *force majeure* provisions that our office has used in certain long term supply agreements.

1. **FORCE MAJEURE**

1.1 **Events of Force Majeure**

"**Force Majeure**" will mean any cause which is beyond the reasonable control of the affected Party, provided such event is not due to the affected party's sole negligence and may include, but not be limited to:

- (a) causes such as flood, earthquake, storm, lightning, fire, epidemic, war, explosion, riot, act of public enemy, act of civil or military authority, civil disturbance or disobedience;
- (b) sabotage, ruptures, breakage of or accident to the Supplier's Facilities, Customer's Facilities or any pipeline, transmission line, plant, machinery or equipment;
- (c) accidents, sabotage and vandalism;
- (d) inability to obtain or curtailment of supplies of electric power, water, fuel or other utilities or services;
- (e) inability to obtain or curtailment of supplies of any materials or equipment;
- (f) restraint by court order, or the action or inaction of, or inability to obtain, maintain or renew Regulatory Approvals from any Governmental Authority unless such inability was caused by the violation of the terms thereof by the Party holding the Regulatory Approval; and
- (g) electrical disturbances originating in or transmitted through the affected Party's electrical system or any interconnected system

provided that strikes (or other labour disputes) and [**'s failure to deliver water to Supplier's Facilities shall be deemed to be events of Force Majeure**]; and provided further that lack of finances will not be considered an event or occurrence outside of a Party's control.

1.2 **Effect of Force Majeure and Notice**

If by reason of Force Majeure either Party to this Agreement is unable, wholly or partially, to perform or comply with its covenants and obligations hereunder, then the Party so affected by Force Majeure shall be relieved of its obligations or liability and shall suffer no prejudice for failing to perform or comply during the continuance and to the extent of the inability so caused from and after the happening of the event of Force Majeure, provided that the Party invoking Force Majeure gives to the other Party prompt notice, written or oral (but if oral, promptly confirmed in writing) of such inability and reasonably full particulars of the cause thereof. If notice is not promptly given, then the Party suffering the Force Majeure shall only be relieved

from such performance or compliance from and after the giving of such notice. The Party invoking Force Majeure shall use all reasonable efforts to remedy the situation and remove, so far as possible and with reasonable dispatch, the cause of its inability to perform or comply, provided that settlement of strikes and other labour disputes shall be wholly within the discretion of the Party involved and such Party shall not be required to accede to demands of its opponents in any such strike or labour dispute. The Party invoking Force Majeure shall give prompt notice of the cessation of the event of Force Majeure. Nothing in this Section shall relieve a Party of its obligations to make payments of any amounts accruing due, due or owing by the Party invoking Force Majeure prior to the time of the occurrence of the Force Majeure.

1.3 Extension of Supply Period

The Supply Period shall be extended for twice the duration of any periods of Force Majeure from which a Party claims relief and during which the supply or take of Energy Services hereunder is wholly or partially interrupted as a result of the event of Force Majeure; provided that, except in the case of total or partial destruction of the Supplier's Facilities, the maximum allowable extension will be two (2) years; and provided further that the length of the term of this Agreement shall not exceed the length of the lease term during which Supplier's Facilities may be operated pursuant to the leases between the Supplier and each of Dow and Bayer.

1.4 Duration

If any single event of Force Majeure from which a Party claims relief lasts longer than 2 years, or if any multiple events of Force Majeure from which a Party claims relief result in a continuous period of Force Majeure which is longer than two (2) years, either Party may, except in the case of total or partial destruction of the Supplier's Facilities, terminate this Agreement.

The following is an *example* of a *force majeure* clause which our office has used in certain natural gas contracts:

ARTICLE 16 FORCE MAJEURE

16.1 If a Force Majeure event occurs which directly causes a party to fail to perform all or part of any obligation under this Agreement, such obligation will, to the extent that its performance is prevented by such Force Majeure event, be suspended for so long as such Force Majeure event continues to prevent performance, and the non-performance of such obligation to such extent during such period of suspension will not constitute a breach or default hereunder. Despite the foregoing, the obligation of Buyer to pay for gas already delivered shall not be suspended and the party claiming Force Majeure (“the Claiming Party”) shall not be excused from its responsibility for Imbalance Charges.

16.2 A party may not rely on the provisions of Section 16.1:

- (a) unless it shall immediately upon being made aware of the occurrence, or the impending occurrence, of the event of Force Majeure, notify the other party of such event of Force Majeure and of the obligations expected to be

affected thereby. Initial notice may be given orally, provided that as soon as possible written notification is given with reasonably full particulars of the event;

- (b) unless it shall immediately commence, and diligently pursue, the taking of all such steps as may be commercially reasonable in the circumstances to cause the discontinuance of, and to minimize the effect of, the event of Force Majeure and resume performance of the obligation affected by the Force Majeure as soon as possible provided that neither party will be required by the provisions hereof to settle any strike, lockout or other labour dispute on terms which it would not otherwise be willing to agree to;
- (c) if, in the case of Seller, there were alternate supplies of gas available which could be delivered at the Delivery Point, and it was commercially reasonable for Seller to purchase, and resell to Buyer hereunder, such alternate supplies;
- (d) if, in the case of Buyer, there were alternate markets for gas available which could be supplied from gas delivered at the Delivery Point, and it was commercially reasonable for Buyer to sell gas to such alternate markets; or
- (e) notify the other party forthwith upon the occurrence of any significant development in the process of attempting to discontinue and minimize the effect of the event of Force Majeure.

16.3 The term “commercially reasonable” in this Article 16, shall mean, in the case of the purchase of alternate supplies of Gas by Seller that the purchase of such alternate supplies could be made at no greater cost, taking into account reasonable incremental transportation costs to the Delivery Point(s), than what will be fully recoverable by Seller upon the sale of such alternate supplies to Buyer at the Price under this Agreement, and in the case of Buyer obtaining alternate markets of Gas, the sale of such Gas could be made at a price, after taking into account reasonable incremental transportation costs from the Delivery Point(s), which will enable Buyer to fully recover the Price to be paid to Seller under this Agreement; and

16.4 For purposes of this Agreement, the term "Force Majeure" means any event not within the control of the Claiming Party, and includes, without limitation:

- (a) an inability to obtain, or a revocation or adverse amendment of, any licence, permit, approval or authorization of any governmental authority or regulatory body having jurisdiction;
- (b) the loss, interruption or curtailment of Firm transportation at the Delivery Point(s) as specified in the Confirmation Letter relating to a particular Transaction;

- (c) physical events such as acts of God, landslides, lightning, earthquakes, fires, storms (or storm warnings which result in evacuation of the affected area), floods, washouts, explosions, breakage or accident;
- (d) acts of others such as strikes, riots, sabotage, insurrections or wars; and
- (e) governmental actions including the requirement to comply with any court order or any law, statute, regulation, permit or authorization of a governmental authority having jurisdiction;

but does not include:

- (f) in the case of Seller, any increase in the price of its Gas supply, and in the case of Buyer, any decrease in the price of Gas in its resale markets;
- (g) in the case of a Firm Performance Obligation the loss, interruption or curtailment of interruptible transportation on any Transporter necessary to make or accept delivery of Gas hereunder, unless and only to the extent the same event also curtails all priorities of Firm transportation on such Transporter;
- (h) loss of markets or either party's inability to economically use or resell Gas purchased under this Agreement;
- (i) a lack of financial resources or available funds or similar financial predicament, or an event the occurrence or subsistence of which is due to the financial inability of the party seeking to claim such event as an event of Force Majeure to pay any amount which a prudent and financially sound entity in similar circumstances would reasonably be expected to pay to avoid or discontinue such event;
- (j) an event the occurrence or subsistence of which is due to a negligent act or omission, breach of Agreement, violation of law, violation of the terms of a regulatory approval or similar wrongful act or omission on the part of the party seeking to claim such event as an event of Force Majeure;
- (k) in the case of Seller, the depletion of Seller's reserves or loss of Seller's supplies and in the case of Buyer, the failure of any of its buyers of gas to take delivery of the gas.

16.5 If the Delivery Point is a "NOVA Inventory Transfer" ("NIT"), then this Section 16.5 applies. Notwithstanding Section 16.4, any event, which occurs upstream or downstream of the mainline facilities of NOVA (except for an event described in Section 16.4(a) and (e)), does not constitute an event of Force Majeure. Any claim of Force Majeure by a party relating to transportation service on NOVA will only constitute an event of Force Majeure if there is an interruption, curtailment or prorationing by NOVA of NIT service which affects all NOVA shippers who had nominated for deliveries or receipts to take place under a NIT

on that Day. On any Day or any portion of a Day where there is such a Force Majeure event, Seller will deliver to Buyer, and Buyer will receive from Seller, after taking into account Section 3.2, that percentage of the Contract Quantity which is equal to the percentage amount of Gas which according to NOVA had been nominated by all NOVA shippers for NIT and which NOVA is not interrupting, curtailing or prorationing on that Day or a portion of a Day.

16.6 The provisions of Article 16 will not:

- (a) apply so as to suspend the performance of any obligation to make payment of any amount payable under or in respect of this Agreement; or
- (b) give rise to any extension of the term of this Agreement.

ENDNOTES:

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- 1 Partner, Commercial Litigation. Very special thanks are owed to Cathleen Edwards, Student-at-Law. Thanks are also owed to Wayne Fedun (Partner, Oil & Gas) and Howard Gorman (Partner, Commercial Litigation) for their assistance.
- 2 Nicholas Gretener *et al*, *Consequences of and Remedies for Breach of Natural Gas Contracts*, Insight Inconference, November 22-23, 1999. Caution must be exercised in this area, however, as an obligation to prorate in one contract where there are other contracts without such an obligation could result in the party being obligated to breach a second contract.
- 3 Black's Law Dictionary, 7th ed. (1999: West Group, St. Paul, Minnesota).
- 4 (1647), 82 ER 8987.
- 5 While the author is by no means certain, it appears that "King Rupert's Horse" was some sort of military division.
- 6 See: Waddams, *The Law of Contracts*, 3rd ed., (1993: Canada Law Book Inc., Toronto, Ontario). That said, the modern energy practitioner must be alive to the possibility of events such as explosions, landslides, 'ecoterrorism' and the like.
- 7 (1975), 56 D.L.R. (3d) 409 (S.C.C.).
- 8 "A canon of construction that when a general word or phrase follows a list of specific persons or things, the general word or phrase will be interpreted to include only persons or things of the same type as those listed.", *supra*, note 3.
- 9 (1996) 38 Alta. L.R. 93d) 229 (C.A.).
- 10 *Supra*, note 7.
- 11 [2001] A.J. No. 822 (C.A.).
- 12 [1999] B.C.J. No. 1533 (C.A.).
- 13 *Supra*, note 11.
- 14 *Supra*, note 12.
- 15 The author is not an American lawyer. This paper does not purport to give a complete review of American law.
- 16 ALR 4th 46 976.
- 17 [2001] TX-XL 998 (Tex. App. Dist. 4).
- 18 799 F 2d 265 (7th Circuit. 1986).
- 19 836 S.W. 2d 392 (1992, S.C. Kentucky).
- 20 Jay Martin, *Cross-Border Issues that Arise in Conjunction with the Execution of U.S. - Canadian Natural Gas Contracts*, Insight Inconference, November 22-23, 1999.
- 21 *Supra*, note 20.
- 22 David Maffitt, *Recent Trends in Gas Contracting in North America*, Insight InConference, November 22-23, 1999.
- 23 Andrew S. Katz, *Using the EEI-NEM Master Contract to Manage Power Marketing Risks*, Energy Law Journal, Vol 21, 2000, p. 101-130.
- 24 Agreement as it appeared in Edison Electric Institute Conference materials for "*Managing Credit Risk and Trading Under the EEI Master Contract*", Atlanta, GA, March 22-23, 2001.

²⁵ Nicholas Gretener *et al*, *Consequences of and Remedies for Breach of Natural Gas Contracts*, Insight Inconference, November 22-23, 1999. Caution must be exercised in this area, however, as an obligation to prorate in one contract where there are other contracts without such an obligation could result in the party being obligated to breach a second contract.