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The Impact of Force Majeure on the Oil and Gas Supply Chain

By Peter Hays*

The author of this article discusses the oil and gas supply chain interruption caused by Hurricane Harvey and the impact of force majeure on the supply chain.

Early indications are that shut down and curtailment of Gulf Coast oil and gas infrastructure caused by Hurricane Harvey, from Friday, August 25th (landfall), through Thursday, August 31, roughly included the following:[1]

- On Friday, August 25th, 377,000 b/d of oil production and 748 MMcf/d of natural gas production in the federal Gulf of Mexico is shut in, equivalent to 21 percent and 23 percent of pre-storm production for oil and gas, respectively; all major refineries in Corpus Christi with a combined 924,720 b/d in capacity have shut down, equivalent to 10 percent of total Gulf Coast refining capacity (PADD 3).
- By Monday, August 28th, shut in oil and gas production in the federal Gulf of Mexico begins to restart; major refineries in Corpus Christi and Houston with a combined 2.1 million b/d in capacity have shut down, equivalent to 22 percent of total Gulf Coast refining capacity.
- By Wednesday, August 30th, 15 major refineries in Corpus Christi, Houston, and Port Arthur with a combined 3.8 million b/d in capacity have shut down, equivalent to 40 percent of total Gulf Coast refining capacity or 21 percent of total U.S. refining capacity, and major refineries with a combined 1.5 million b/d in capacity are operating under curtailment.
- By Thursday, August 31, 10 major refineries remain shut down, while six have begun to restart—some restart operations may take weeks depending on damage.

Subject to final revisions, these estimates show that, at their respective high points during Hurricane Harvey, total shut in/shut down capacity was: 377,177 b/d of oil production and 748 MMcf/d of natural gas production in the federal Gulf of Mexico, equivalent to 21 percent and 23 percent of pre-storm

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[1] U.S. Department of Energy, Hurricane Harvey Situation Reports, https://energy.gov/oe/downloads/hurricane-harveysituation-reports-august-2017 (last visited Sept. 1, 2017).

production for oil and gas, respectively; 3.8 million b/d of total Gulf Coast refining capacity (PADD 3), equivalent to 40 percent of total Gulf Coast refining capacity or 21 percent of total U.S. refining capacity, plus major curtailments at other refineries.

The high points of shut in/shut down of capacity during Hurricanes Katrina and Rita were, roughly:

- 1.5 million b/d of oil production and 7 Bcf/d of natural gas production in the federal Gulf of Mexico, equivalent to 100 percent and 95 percent of pre-storm production for oil and gas, respectively; and 2.5/4 million b/d of total Gulf Coast refining capacity, equivalent to 40 percent of total Gulf Coast refining capacity, or
- 21 percent of total U.S. refining capacity.

The impact of Hurricanes Gustav and Ike in 2008 tracked Katrina/Rita shut down numbers by percentage, subject to overall reduction in pre-storm production capacity representing operations never restarted after Katrina and Rita.[2]

HURRICANE HARVEY ANALYSIS

It appears likely that in the final analysis of the impact of Hurricane Harvey, when measured against the prior major hurricanes of 2005 and 2008, taking into account the ratio of damage to production versus damage to refining as measured on an overall capacity reduction basis, will show that Harvey's major damage was to the refinery/downstream end of the Gulf Coast oil and gas supply chain, whereas on a relative basis the major damage done by Katrina, Rita, Gustav, and Ike was to upstream, Gulf of Mexico production. This is not a total surprise—Harvey made landfall near Corpus Christi and caused historical flooding around Houston, both major refining centers, whereas the 2005 and 2008 hurricanes took a more easterly path through the Gulf than Harvey, resulting in more severe and lasting damage to offshore production. It is also worth noting that onshore U.S. oil production levels feeding Gulf Coast refineries (largely protected from the storm, with the notable exception of Eagle Ford shut ins) has increased on a percentage basis in comparison to Gulf of Mexico oil production from 2005/2008 to 2017.

The significance of the above statistics to the present analysis is the effect that an overweight loss of downstream refining capacity compared to upstream production capacity will have / is having on the oil and gas supply chain during Harvey's aftermath, as the curtailment rolls upstream from the affected

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[2] U.S. Department of Energy, *Comparing the Impacts of the 2005 and 2008 Hurricanes on U.S. Energy Infrastructure* (Feb. 2009).

refineries to transporters, then to shippers and traders on affected pipelines, and eventually to producers at affected receipt points. Early indications are that this process has already started—as pipelines with primary delivery points into refineries start to back up, transporters are being forced to curtail upstream receipts points. In this case, failures of performance that will inevitably occur at points along the chain will need to be resolved pursuant to relevant contracts. Unless a party has the unilateral right to curtail performance (e.g., the counterparty is interruptible), it may be required to pay damages to cover the breach of its performance obligation, unless it has the right to declare force majeure and thereby excuse its performance.

ECONOMIC CONSEQUENCES OF FORCE MAJEURE OUT

In the event that a large-scale "force majeure"-type event shuts down one or more segments of an industry in an affected region, a party that does not have a legitimate force majeure out under its high-volume, firm contracts, risks absorbing a disproportionate share of the losses accruing to the affected side(s) of the supply chain.

In the oil and gas industry, even in circumstances where a participant takes reasonable precautions to control its cost, such as by buying the majority of its gas under long term contracts tied to a monthly index (e.g., forward month NYMEX, Henry Hub), any severe intra-month spike or trough in the price of natural gas resulting from a force majeure event has the potential to cause the buyer severe losses when a force majeure "out" cannot be established. Note for example, that when Hurricanes Katrina and Rita hit the Gulf Coast in quick succession during September and October of 2005, the price of gas for daily delivery at certain Transco delivery points in Louisiana spiked $5–$6 above the corresponding monthly index price and Henry Hub trading ceased altogether for a number of weeks.[3] Furthermore, the results are not necessarily symmetrical as between the participants on different sides of the market, either due to market practice or due to the nature of the applicable performance or services being provided and/or procured. One structural example is the relationship between natural gas processors and their customers, where it is not atypical for a processor to require that a customer pay processing fees in the event of failure to transact caused by the customer's force majeure, with no corresponding relief or benefit to customer in the event of processor's force majeure. As a commercial example, a review of case law indicates that when a force majeure

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[3] *Id.*; *Coral Energy Resources, L.P. v. Conectiv Energy Supply, Inc.*, No. 2006-40578, Pl.'s Mot. Sum. J., Ex. 10, "Expert Report of Benjamin Schlesinger"(334th Dist. Ct., Harris County, Tex., Feb. 6, 2008) (comparing index-based contract price against spot price at Transco 65 during period of August through October, 2005; at page 2 of Exhibit 4 to report).

event causes a price spike in the Gulf region, many sellers declare force majeure under their NYMEX priced contracts immediately, even if they have some gas supply. In at least one such case, the applicable seller then sold such gas that it did have available on the higher-price spot market.[4]

In the case of an upstream-focused force majeure event, one type of market participant most at risk is probably a hydrocarbon seller without a force majeure out. Assuming a chain of sellers starting with the upstream producer, it is likely that certain sellers on the chain will have the right under their delivery agreements to make force majeure declarations when their upstream sellers declare force majeure under their supply agreements, in which case the applicable loss is passed down the line to downstream sellers. But at some point along the chain a seller may not have a viable force majeure out under its contract. In this case, the seller may be forced to cover its performance to its buyer by obtaining gas under wildly fluctuating price conditions caused by market scarcity, potentially bearing significant losses. Since the contract is zero sum as between the counterparties, if the seller determines that it has even a slight chance of success in court, an economic risk/loss analysis (a large loss v. legal costs) may cause it to either declare force majeure to its buyer or challenge its upstream seller's force majeure declaration, or both.

As noted above, the portion of the oil and gas supply chain most affected by Harvey in terms of direct outages has been refineries along the Gulf Coast—i.e., the current force majeure "epicenter" is at the refineries. With no outlet, pipelines delivering to refineries are starting to back up; causing shippers, including buyers, sellers and upstream producers, to automatically lose capacity on the line. As this occurs, force majeure declarations will roll in the same direction, as each successive party in the chain tries to avoid being the one left holding the bag—in the present case, for buyers and sellers this may mean that the buyer is forced to sell excess hydrocarbons into a locally-depressed market at the delivery point (after buying at contract price from seller), while for shippers and transporters this may mean that the transporter fails to take at the delivery point. This type of force majeure "ripple effect" is common in the oil and gas industry due to the integration of capacity along the supply chain, typically occurring on a smaller scale, but on a massive scale during major hurricanes. It is interesting to note, however, that most jurisprudence on this subject involves analysis of the ripple effects moving in the opposite direction, starting with curtailment of upstream supply and rolling downstream, mainly

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[4] *Virginia Power Energy Marketing, Inc. v. Apache Corp.*, 297 S.W.3d 397, 407 (Tex. App.—Houston [14th Dist.] 2009) (seller declared force majeure for "failure of supply" under NAESB with buyer when hurricanes Katrina and Rita struck the Gulf Coast, but then was matched with original buyer by blind gas exchange for spot sale).

due to the influx of cases after Hurricanes Katrina and Rita, which, as discussed above, disproportionately impacted offshore production and transport.

FORCE MAJEURE ANALYSIS—CONTRACT CONTROLS

People living along the Gulf Coast have rituals built around hurricanes, personal and public. One commercial ritual tends to occur with participants along the oil and gas supply chain, including producers, shippers, processors, refiners, traders and lenders (now adding LNG liquefaction facilities, private equity investors and mineral interest owners), when managers and lawyers examine contracts to determine what impact a shut down will have on their business, including how to respond to a counterparty force majeure and whether, and how, when and in what form, to make their own declaration of force majeure. Sometimes they need to declare force majeure because their own facilities were directly impacted by the storm, but more frequently their curtailments are caused by capacity disruptions upstream or downstream of their delivery points. Typically their overriding concern is defensive—how to escape a situation where their counterparties' failure to perform makes their own performance impossible (or grossly sub-economic) under their other obligations up or down the supply chain.

Generally speaking, force majeure is a contractual right that excuses a party from its obligation to perform under a contract to the extent its performance is prevented by an allowable "force majeure" event, typically defined as an event that is outside of the reasonable control of the non-performing party. In Texas, courts treat a claim of force majeure as an affirmative defense, which means that the party claiming force majeure has the burden of proof.[5] The common law and the statutory law recognize limited forms of "force majeure" type relief—general speaking, the defense of impracticability and the failure of presupposed conditions, respectively.[6] However, courts have recognized that both the common law and the statutory law act only as "gap fillers" in this regard, and that, where the parties to a contract have agreed on an express force majeure provision, the language of that provision will control.[7] As a result, Texas courts interpreting an unambiguous force majeure provision will typically allow the contract language to control the result of its application. The court will not read common law concepts of force majeure into the contract, even if

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[5] *Hydrocarbon Management, Inc. v. Tracker Exploration, Inc.*, 861 S.W.2d 427, 436 (Tex. App.—Amarillo 1993).

[6] *Texas City Refining, Inc. v. Conoco, Inc.*, 767 S.W.2d 183, 186 (Tex. App.—Houston [14th Dist.] 1989); *Jon-T Chemicals, Inc. v. Freeport Chemical Co.*, 704 F.2d 1412, 1416–7 (5th Cir. 1983); Tex. Bus. & Com. Code § 2.614.

[7] *Sun Operating Ltd. Partnership v. Holt*, 984 S.W.2d 277, 283 (Tex. App.—Amarillo 1998).

the applicable provision contains items that would normally fall well outside of the common law concept of force majeure.[8]

So, the language of the contract is the correct place to start any force majeure analysis. To this end, note that many hydrocarbon agreements are actually amalgamations of contracts. One trade can involve a number of separate articles of paper, and potentially also oral or electronic agreements, including base agreements, general terms and conditions, volume nominations and trade confirmations, together sometimes with amendments, waivers and side letters to each of these. Each one may have a term relevant to force majeure and/or performance, and they should all be gathered up as part of a force majeure analysis.

FORCE MAJEURE AWAY FROM THE DELIVERY POINT

A significant portion of case law on force majeure focuses on whether the original mover impacting performance qualifies as an allowable "force majeure" event under the contract, with analysis focusing on whether the applicable event was outside of the reasonable control of the non-performing party or otherwise qualified under the wording of the contract. This article does not address those issues. One easy thing about a major hurricane is that you can typically sidestep this analysis—hurricanes, like plague, famine and war, are root-level force majeure events in most people's heads, and people seldom argue over whether the damage caused by the hurricane itself is a force majeure event. When a contract has a force majeure provision, it will typically cover a qualifying event that hits and is the direct cause of the shut down of the delivery point under the contract.[9]

Disputes as to scope arise more often, however, when the hurricane, or other qualifying event, impacts the oil and gas supply chain at a location away from the contractual delivery point. As discussed above, due to the integration of capacity along the supply chain, an event causing curtailment or nonperformance at a location away from the delivery point is likely to send curtailment / non-performance "ripples" upstream or downstream along the chain that are the actual cause of non-performance at the delivery point. In other words, the actual event causing the failure of performance may not technically be the

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[8] *See PPG Industries, Inc. v. Shell Oil Co.*, 919 F.2d 17 (5th Cir. 1990) (determining that use of the word "or" in a force majeure provision containing the phrase "reasonably beyond its control *or* by fire, explosion . . . ." meant that an explosion at seller's refinery could be a force majeure event even if it was within seller's reasonable control).

[9] *Virginia Power*, 297 S.W.3d at 405 (upholding lower court's grant of summary judgment in favor of seller claiming force majeure where performance was rendered impossible at the applicable delivery point).

initial qualifying event, but rather one or more of its secondary effects, such as lack of transportation capacity. For example, an event curtailing a party's source of supply or transportation capacity upstream of the delivery point may affect a party's ability to meet its sales obligations at the contract delivery point.

In many cases, a party is expressly permitted under its contract to declare force majeure when its performance is affected by a force majeure condition that occurs elsewhere on the supply chain; however, frequently this type of causal "force majeure chain" is broken, either intentionally by agreement of the parties, typically in conjunction with a firm commitment (when a shipper agrees to support the capital build-out of a system or facility, regardless of its ability to ship during certain conditions) or under commodity trading agreements (where as a financial matter the parties agree to assume the obligation to cover at the applicable delivery point), or due to an intentional or unintentional silence or ambiguity under the relevant contract.

The body of case law on this issue is not extensive, and is still developing, including in the key jurisdictions of Texas and New York, which tend to lead jurisprudence on law pertaining to hydrocarbons and trading, respectively, each of which are heavily implicated on the oil and gas supply chain. Where it has been addressed, courts have focused on whether the parties clearly incorporated the relevant affected upstream or downstream infrastructure, and the availability thereof, as a component of the performance obligation of the affected party; or, alternatively, whether the parties intended to make performance at the relevant delivery point mandatory, notwithstanding the unavailability of such upstream or downstream infrastructure.

Actual language in the contract pertaining to the scope of performance away from the delivery point, including in particular any language expressly qualifying or disqualifying curtailment to particular infrastructure as a force majeure event, is usually determinative, if it exists. When a contract is silent on this point, courts have leaned towards excluding failure of the secondary factor as an allowable force majeure event; however, courts have given leeway to non-performing parties in cases where the availability of the relevant upstream or downstream factor is obvious or well known to the parties, either due to past dealings or to the physical reality of the markets at and around the delivery point, and the economic result of forcing a party to perform at the delivery point would be unreasonable under the circumstances.[10] Along these lines

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[10] Some leading case law on this point includes: (a) *Tejas Power Corp. v. Amerada Hess Corp.* (Tex. Civ. App.—Houston [14th Dist.] 1999). (court determining that, where an upstream-producer seller's "source of supply" was a certain field that had failed due to "abnormally cold" temperatures, seller was entitled to force majeure and did not have to buy gas on the spot market

leeway is sometimes granted based on analysis of the intent of "reasonableness" language present in many force majeure provisions, which courts have read to indicate that where market conditions make it nearly impossible to perform (i.e., where the cost to cover is punitive, etc.), performance may be excused.[11] In each case, physical and economic factors affecting a force majeure event and the local market are highly relevant to any risk analysis. Subject of course to the nature of the specific supply chain in each instance, in most cases it is reasonable to assume that as the impacted infrastructure moves further and further away from the relevant delivery point, the overall number of on-ramps / off-ramps that a party can use to cover its performance will tend to increase, and the negative financial impact of being forced to cover will be reduced, as the available cover market grows; conversely, local limitations on supply, including related limitations on transport/capacity, affecting a delivery point tend to make the financial impact of cover more severe—these seem to be factors in the courts' analysis on this matter. Based on dicta in many of these cases, it is reasonable to suppose that offers to cover at other delivery points or other offers of alternative performance made by a non-performing party during non-performance may also be pertinent in a court's final analysis, to the extent that the offers would have created an economically similar result for the counterparty, and were turned down by the counterparty. Nonetheless, when the affected infrastructure *is* expressly described in the context of the transaction at

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at "five times the selling price" in order to meet its obligations to buyer under the contract); (b) *Virginia Power*, 297 S.W.3d at 405–406 (overturning lower court's grant of summary judgment in favor of an upstream-producer seller claiming force majeure for loss of "source of supply," where seller's fields in the Gulf of Mexico and on the Louisiana coast were impacted by Katrina and Rita, and where the seller failed to designate a source of supply in the transaction confirmation. Case was remanded for fact determination as to whether seller's actual gas supplies in the area were sufficient to perform under the contract, noting evidence that seller sold gas in the area at the spot price during force majeure event. Throughout the proceedings, all parties seemed to agree (and the courts at each level seemed to support) the contention that, if it was proved that seller did not have an available equity supply of gas, seller would not have been required to buy gas on the open market in order to meet its obligations to buyer before declaring force majeure); (c) *Ergon-W. Virginia, Inc. v. Dynegy Mktg. & Trade*, 706 F.3d 419, 423–25 (5th Cir. 2013) (court affirmed summary judgment in favor of trade-seller claiming force majeure for loss of "source of supply," where its upstream source of supply (i.e., its upstream sellers) had failed due to hurricanes, citing expert testimony that, in the natural gas trading industry, a seller was not expected to obtain replacement gas when its upstream supplier source had failed); (d) *Hess Corp. v. ENI Petroleum US, LLC*, 435 NJ. Super. 39, 51 (NJ. Super. Ct. App. Div. 4) (applying New York law, the court determined that the failure of the parties to specify the pipeline used for transport in a Transaction Confirmation invalidated seller's force majeure claim when that pipeline failed). Hobbyists may also want to review the relevant dockets of *Virginia Power* and *Coral Energy Resources, L.P. v. Conectiv Energy Supply*.

[11] *Ergon-West Virginia*, 706 F.3d at 425.

issue, the non-performing party has a reasonably strong argument that, by incorporating the availability of the infrastructure into its performance, it has supplanted any requirement under the contract, common law or relevant statutory schemes that it use its reasonable efforts to offer substitute performance or to otherwise overcome the impact of the force majeure event to the extent that such reasonable efforts would require not using the delineated infrastructure.[12]

INDUSTRY EXAMPLE—GAS SALES UNDER FORM NAESB

Due in part to the fungible nature of natural gas in the United States market, including in particular markets that exist at many pipeline delivery points, and due in part to the actual language of the force majeure provisions in the form itself, courts addressing force majeure claims for natural gas sales made under a form NAESB[13] tend to attempt to distinguish between a failure of an element that is, by its nature, fundamental to a gas transaction (e.g., price, volume, date or location), and a failure of an element that is, without modification, ancillary to a gas transaction. In the present discussion, these "ancillary" elements would be: (i) in the case of a seller, the supply that it will use as the source of the applicable gas and the firm transport route that it will use to transport the gas from that source to the agreed delivery point; and (ii) in the case of a buyer, its downstream use of the gas (a facility or a downstream sale) and the firm transport route that it will use to transport the gas from the agreed delivery point. Taken as a whole, the case law implies that the force majeure provisions of the NAESB do not treat this type of "ancillary" infrastructure as an essential element of a transaction to the extent that, if the infrastructure fails, force majeure automatically becomes available; but rather that the contract provides a framework that allows the parties to establish by agreement that such type of facility will be considered to be an essential element of a transaction for force majeure purposes. Put more directly, courts tend to treat the force majeure provisions of the NAESB as designed so that, if a party properly designates a source of supply, pipeline for transport, or gas usage in a transaction confirmation, that party will have a reasonably strong argument that it is entitled to force majeure relief if the applicable infrastructure fails due to an otherwise eligible force majeure event. Absent such designation, the party

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[12] *Jon-T Chemicals*, 704 F.2d at 1415–6 (where a contract specified delivery by rail unless otherwise agreed, and delivery by rail was prevented due to qualifying force majeure event, gap-filling provisions of UCC did not apply, and there was no requirement to tender substitute performance by different transportation methods).

[13] Reference here is to the North American Energy Standards Review Board, *Base Contract for Sale and Purchase of Natural Gas (NAESB Standard 6.3.1)*, September 5, 2006 [hereinafter, the "NAESB"].

attempting to defeat a force majeure claim has a strong argument that the omitted infrastructure was not an element of the transaction as agreed between the parties, and that, therefore, interruption or curtailment of such infrastructure has no effect on the parties'ability to perform under the transaction because the party can always buy (in the case of seller) or sell (in the case of buyer) the gas necessary to cover its performance under the transaction on the open market.

As an example, where a party to a NAESB paths its transportation route in a transaction confirmation (i.e., names a specific pipeline as the route it will use to, or away from, the contractual delivery point), and capacity on the applicable pipeline is curtailed by an eligible event, the applicable party has a strong argument that its performance is excused by force majeure; and further, by incorporating the availability of the pipeline into its performance obligation, the party also has a strong argument that it was not required to use its reasonable efforts to tender substitute performance pursuant to an alternate transportation route. Alternatively, if the transaction confirmation does not path the transportation route, the party's potential force majeure claim could be substantially weakened, as the court may find that the scope of performance was limited to the contractual delivery point.[14]

ALLOCATION OF CAPACITY AT CURTAILED DELIVERY POINT

When a force majeure event curtails, but does not entirely interrupt, a party's ability to perform at a particular delivery point, disputes may arise over how the party allocates its limited, remaining ability to perform during curtailment, including especially when the affected party has multiple firm customers at the delivery point. Generally speaking, the courts have provided some leeway in allocating capacity curtailed during force majeure, so long as the affected party uses reasonable efforts to allocate capacity between its firm gas suppliers/customers in a fair and reasonable manner.[15] An allocation that is based solely on price would probably not be deemed to be fair and reasonable (e.g., where a seller allocates a disproportionately high amount of its available hydrocarbons to buyers paying the highest prices; or where a processor allocates a disproportionately high amount of its available capacity to customers with the highest fees). Most parties seem to proceed with relative caution in an allocation scenario, allocating performance pro rata to firm customers in accordance with

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[14] *Hess Corp.*, 435 NJ. Super. at 45.

[15] *See* generally, Joseph Witherspoon, *The Force Majeure Clause and Partial Impossibility of Seller's Performance*, 27 Tex. L. Rev. 775 (1949); Fred Pletcher, et. al, *Force Majeure (and other Useful French Profanities) in Resource Agreements*, 59 RMMLF-INST 17-1 (2013). *Also see Tejas Power*.

nominated volumes, avoiding the temptation to award overweight allocation to existing contracts with better pricing. When in doubt, a pro rata allocation will usually hold up as reasonable, although a different allocation scheme may be acceptable if the party can demonstrate that it resulted in a reasonable and fair distribution under the applicable circumstances.

Notwithstanding the above, entirely different approaches can arise at delivery points where price has been destabilized by a major force majeure event, especially where the local spot price has departed wildly from the current monthly index price that was set prior to the occurrence of the force majeure event. By definition, during a partial curtailment at a delivery point, supply at the location has been artificially curtailed, typically without any reduction in demand, and frequently with significant *increase* in demand during a major force majeure event, where nearby delivery points may also be curtailed or entirely shut down. This will typically present the party that retains partial capacity at the delivery point with an opportunity to profit by trading at local spot prices; however, the party will typically need to escape his firm obligations first, which are more likely to be trading at a monthly index price. In this case, the party will need to examine its contract for an argument that will allow it to allocate all of its remaining performance capacity away from all of its firm customers, and trade it on the spot market. One of many potential issues that may arise in this case, of course, is that the likeliest takers will be his firm customers who have retained their firm take-away capacity at the delivery point and are seeking to fill it, and who will likely have objections if they meet their original term seller on the spot market.

From a technical standpoint, note that transporters, and certain other operators of delivery points serving multiple customers, may require a shipper to pre-set priority rankings between its counterparties at a delivery point so that the transporter can immediately resolve capacity allocation in the event of a sudden curtailment, with higher ranked counterparties curtailed after the lower-ranked counterparties, and with counterparties of the same rank being curtailed pro rata. If the rankings are not properly set in advance, a participant at the delivery point is at risk of misallocating capacity if it does not immediately adjust its rankings at the start of curtailment—a factor that becomes more likely during the emergencies that typically accompany a force majeure event, of course.[16] Also, note that preset levels may be indicative or predictive of a counterparty's advance posture in relation to force majeure, if they can be determined or otherwise agreed in advance, or may be helpful to

[16] *Virginia Power*, 297 S.W.3d at 408–9.

obtain from a forensic standpoint during accounting following a curtailment event.

ALLOCATION OF CAPACITY TO ELIMINATE BACKLOG AFTER FORCE MAJEURE

When a refinery or other plant that has curtailed customers pursuant to force majeure during a qualifying event restarts, it is not unusual for it to fall behind schedule as it works through the inventory backlog that accumulated during the curtailment, together with current customer inventory. The plant typically continues to receive the benefit of force majeure, excusing any failure of performance as it works through such inventory congestion even though the actual force majeure event has cleared, provided that it works through the congestion in a reasonable and non-discriminatory manner.[17] Following Harvey, this scenario will presumably play out in a number of different forms as refineries, processors and chemical plants that were shut down by the storm restart after clean-up and refurbishment. It is important for affected parties to note the contractual difference between curtailment of firm capacity pursuant to force majeure and curtailment of interruptible capacity. In the prior case, the customer may have a claim to reasonable allocation of capacity to clear backlog inventory, presumably on a pro rata basis in accordance with its firm capacity that was curtailed by force majeure. In the latter case, it is likely that the customer was curtailed without remedy as an interruptible customer, not pursuant to force majeure, and therefore may not have any right to allocation of backlog clearing capacity.

DECLARING FORCE MAJEURE—ISSUING NOTICE

A declaration of force majeure should be made in a timely manner, subject to any express timing requirements, and otherwise in accordance with contractual requirements, including any relevant notice requirements or required declarations. Note that certain force majeure provisions make notice a condition precedent to relief, so that the non-performing party cannot obtain the benefits of the force majeure provision until it provides adequate notice to the other party.[18] Subject to these concerns, it is important to proceed carefully and thoughtfully when issuing a declaration of force majeure, especially when

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[17] *Toyomenka Pacific Petroleum, Inc. v. Hess Oil Virgin Islands Corp.*, 771 F. Supp. 63, 67(S.D. NY 1991).

[18] *Rowan Companies, Inc. v. Transco Exploration Co., Inc.*, 679 S.W.2d 660, 666 (Tex. App.—Houston [1st Dist.] 1984, writ ref'd n.r.e.) (failure to provide notice of force majeure is not necessary to obtain force majeure relief, where the other party was aware of the event causing failure of performance and notice of force majeure was not made an express condition precedent in contract). *See also Kleberg County v. URI, Inc.*, (Tex. Civ. App.—Corpus Christi 2016). *Cf. Matador Drilling Co., Inc. v. Post*, 662 F.2d 1190, 1198 (5th Cir. 1981).

preparing the written notice or any written supplemental notice. Recognizing that, for many participants on the oil and gas supply chain, it is necessary for operational reasons to be able to provide some type of immediate notice of curtailment to a counterparty during a force majeure event, such affected participants may want to consider creating internal procedures for instituting force majeure, whereby operational notice may be made immediately by staff, but would otherwise be limited to oral notice, containing only necessary logistical details, and providing that any formal, written notice would follow later, and must be reviewed and approved by management/legal prior to sending.

It is recommended that a written notice of force majeure should include only the minimum amount of information deemed necessary to meet the applicable notice requirements under the contract, in order to prevent any future claims that the party failed to provide adequate notice, while at the same time limiting the amount of information available for use in a future dispute. It is prudent to exclude any non-required or otherwise unnecessary information, including: (i) extraneous details pertaining to events, including names and actions of particular individuals, (ii) unnecessary speculation as to causes or as to the motivation of other parties, and (iii) any potentially incorrect or misleading information, including aggressive estimates on recovery times, etc. The concern here is that if the force majeure event is litigated, the notice itself will be pertinent, and may become disproportionately significant if it contains a lengthy narrative or incorrect facts. To this end, each notice should be reviewed prior to delivery with the pessimistic assumption that the force majeure claim (and the notice itself) will be challenged in court. If a force majeure declaration is likely to cause disproportionate losses to a counterparty, either because it will be forced to cover its performance to other parties at a loss, or otherwise bear penalties or fixed costs, it is reasonable to assume that disputes are more likely to arise, and prudent to proceed with extra caution and further consideration of the possibility of substitute performance.

As discussed above, the causal connection between the force majeure event and the applicable failure to perform is of major significance to a claim of force majeure.[19] So, where the contract requires the notice to include a description of the force majeure event, and especially where the contract makes proper notice a condition precedent of receiving the benefit of force majeure, it is important to determine and include a description of the actual eligible force majeure event that is affecting performance at the delivery point. For instance,

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[19] *Gulf Oil Corp. v. FERC*, 706 F.2d 444, 455 (3rd. Cir. 1983) (party claiming force majeure must show that applicable force majeure event was the cause of its nonperformance).

if delivery into a downstream transporter is impossible because the pipeline is full, and the pipeline is full because Hurricane Harvey shut down a downstream refinery, the temptation will be to declare the hurricane as the force majeure event, when the actual cause is lack of capacity at the receipt point into a downstream transporter and should be noted as such. This may be a difficult concept to sell internally, especially when a hurricane or some other headline-grabbing event is the root cause of force majeure along the supply chain; in this case, consider also noting the root cause (e.g., Hurricane Harvey) in a more general manner, in the context of a broader explanation.

RESPONDING TO NOTICE OF FORCE MAJEURE

When a counterparty provides a declaration of force majeure, considerations as to how to respond should center mainly around avoiding making a mistake that would waive future rights or claims. Subject always to contractual requirements, the safest strategy is typically to provide no response at all, or if that is not appropriate, limiting response to a verbal acknowledgement of receipt. Avoid without careful prior consideration any response that could be interpreted as a waiver of future claims for non-performance or tolling of time periods pertaining to force majeure, including by signing any letter agreement or any other type of acknowledgement that is not required by the contract.

CURATIVE WORK

Sometimes the facts and circumstances do not align in a participant's favor when the music stops, like it just did for Harvey, and each affected participant will need to work with the contracts and relationships that it has on the table. Do not despair—remember that an integral part of any force majeure event is cleaning up messes. Some remedial measures to consider include: (i) clarifying/confirming treatment of force majeure under ongoing or completed transactions with a willing counterparty, before a claim/demand posture arises between you and them; (ii) offering alternative performance that will put the counterparty in a similar economic position, if available and without compromising contractual/legal positions if litigation results; and/or (iii) reviewing and preserving records relating to upstream and downstream counterparty performance (or curtailment thereof) that caused your own force majeure event, in the event it becomes necessary to seek contribution at a later date.