



ENERGY CLIENT ALERT

COVID-19: Impact on Force Majeure in Energy Contracts

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[Last week](#), the World Health Organization officially declared the spread of the coronavirus (COVID-19) a pandemic. With the implementation of “social distancing” and quarantines as well as the [steep slide in oil and gas prices](#), the spread of COVID-19 presents unique challenges which should cause energy industry participants to evaluate their contractual rights and obligations.

Force Majeure Explained

A force majeure clause is a common contractual provision that temporarily or permanently relieves a party’s obligations under the contract when circumstances beyond the party’s control arise. The clauses typically cover unforeseen “acts of God.” If drafted appropriately, force majeure clauses act as a critical safety net to help parties deal with unforeseen events such as a natural disaster.

Force majeure clauses (often viewed as boilerplate) vary greatly. Such clauses can be drafted generally or specifically. General force majeure clauses cover events out of the parties’ control that (i) materially affect (e.g., “prevent” or “hinder”) performance and (ii) were unforeseeable at the time of contracting. Specific force majeure clauses, on the other hand, include a list of “triggering events” that excuse performance.

Force Majeure Clauses In Light of COVID-19. If a party plans to use the COVID-19 pandemic to justify non-performance of a contractual obligations, it should consider whether such justification is likely to be upheld in the face of a challenge by the counterparty. Upon a challenge to a force majeure claim, a court will begin its analysis by looking at the terms contained in the applicable contract. From there, courts in various jurisdictions treat the clauses differently, but most courts will likely consider a few key questions when determining whether a delay exercised under a force majeure clause is justified. These questions include the following:

- Does the contractual language provide an opening for pandemics to be considered a cause for delay (either as a specific triggering event or through catch-all language)?
- Was the outbreak and spread of COVID-19 unforeseeable at the time of contracting?
- Was there a causal link between the COVID-19 outbreak and the resulting delay or non-performance?
- Was the spread of COVID-19 so severe as to excuse non-performance?

Our research indicates pandemics are not normally included in a list of triggering events (though epidemics sometimes are included), but a “catch-all” clause in a force majeure provision may justify non-performance if the above questions can be answered in the affirmative.

Even if a party seeking to invoke force majeure determines the COVID-19 outbreak does not fall within the scope of enumerated force majeure triggering events or an applicable “catch-all” clause in its contract, the party should continue to evaluate the treatment of other events related to the impact of the virus.¹ Such events may include decreased demand for energy products, workforce shortages, supply chain disruptions or governmental restrictions and mandates (such as travel bans, construction bans, or quarantines). Case law suggests, for example, when a natural gas purchase and sale transaction indicates a preferred source of supply, transportation path, or market, the loss or unavailability of such source, path, or market may constitute a force majeure event.

Invoking Force Majeure. Before deciding to invoke a force majeure clause, the invoking party should consider the extent to which its performance obligations will be suspended under the applicable contract. Payment and indemnification obligations are commonly excluded from performance obligations which may be suspended due to a force majeure, for instance. In the drilling context, more specifically, the common form of the IADC Daywork Drilling Contract contains a force majeure clause that relieves the parties’ performance under certain, specified events, but requires the operator pay the specified day rate during the force majeure event. Under those circumstances, the operator should consider releasing the rig. The drilling contractor’s invocation of the force majeure clause may, in turn, relieve the operator of its obligations under the continuous drilling clause of its oil and gas leases. If a court considers such an event an “equitable consideration” justifying cessation of drilling or production, then the lease would remain in effect although the primary term has expired and no actual operations are being performed on the leasehold.

Force Majeure Notices. When a contracting party believes events constitute a force majeure, it should carefully craft a force majeure notice to send to its counterparty. The party invoking force majeure should be sure the notice describes all grounds on which the party seeks to invoke the force majeure clause. The invoking party should also not hesitate to update or supplement its notice as facts and circumstances continue to change. Finally, the invoking party should carefully review the applicable contract to confirm all timing and notice requirements will be satisfied by the force majeure notice. Further, upon transmission or receipt of a force majeure notice, the sending or receiving party should consider whether dispute resolution is probable. If so, preservation notices should be distributed.

Other Considerations

Allocation of Resources. As a result of COVID-19, parties may be *limited* in their ability to perform if not entirely *prevented* from performing. These parties may be inclined to allocate performance to higher-priority counterparties or contracts. Before allocating resources, however, parties should know performance under some contracts (but not all) could detrimentally affect any force majeure claims asserted under contracts where performance is suspended. After all, force majeure is predicated on the idea that an event prevented performance of the party’s obligations under its contract(s).

Nonetheless, an allocation of resources may be proper in certain circumstances. Natural gas supply contracts, for example, frequently include provisions requiring pro-rata allocation of supply when capacity at certain delivery points is reduced. In addition, Section 2-615 of the UCC provides a “fair and reasonable” standard for allocation of products by a seller whose full performance is impracticable due to a “failure of presupposed conditions.”

Adequate Assurance. When receipt of a force majeure notice is anticipated, a potential recipient should evaluate its right to seek adequate assurance from the party whose performance is in jeopardy. Before sending a request for adequate assurance, however, the recipient should determine its options for the

¹ In light of the recent decline in oil and gas prices, courts have previously held fluctuations in prices of commodities and increases in performance costs caused by market factors are generally considered “foreseeable” events that do not qualify as force majeure.

event that adequate assurance is not provided. In other words, the recipient may not want to send a request for assurance if doing so could accelerate the timeline for contract termination.

Common Law Rights. Even when a force majeure clause is included in a contract, a contracting party may want to consider the rights available to it under common law. For instance, depending on the jurisdiction, doctrines of commercial impracticability, frustration of purpose, or impossibility may afford opportunities for relief from contractual obligations.

What Should Companies Do?

As protective measures and restrictions continue to be introduced to manage the spread of COVID-19, energy companies may find that they or their counterparties struggle to meet contractual obligations.

Now is the time for energy companies to review the force majeure provisions in their contracts and to potentially seek contract modification. In addition, contracts currently being negotiated should expressly exclude the spread of COVID-19 as a force majeure event. Similarly, parties should consider in the future whether “pandemics” or “epidemics” should be listed as force majeure triggering events.

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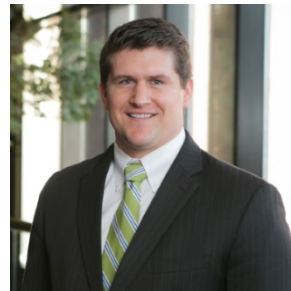
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