1-1991

Commentary on Pitfalls of Force Majeure Clauses

Howard HUNTER
Singapore Management University, howardhunter@smu.edu.sg

Published in Journal of Contract Law, 1991, Vol. 3, Issue 3, pp. 214-217.

Commentary on 'Pitfalls of Force Majeure Clauses'*

H O Hunter

Professor Yates has covered in considerable detail the major problem areas in the use of force majeure clauses. His work is admirable in its technical details as well as in its use for the practitioner. I wish to add but a few brief comments about 2 chronic difficulties with the enforcement of force majeure clauses. To some extent these difficulties are common to all cases that involve excuse by way of frustration, impossibility, or commercial impracticability. The first has to do with foreseeability and the second has to do with post-excuse remedies.

It has become a truism that a force majeure clause provides relief from difficulties caused by a fortuitous event.[1] Some courts tend to limit the application of a force majeure clause to those events which are completely unexpected.

For example, in a 1987 decision the Texas Court of Appeals stated:

> A force majeure clause does not relieve a party of the obligation to perform, unless the disabling event was unforeseeable at the time the parties made the contract ... An economic downturn in the market for a product is not such an unforeseeable occurrence that would justify application of the force majeure provision, and a contractual obligation cannot be avoided simply because performance has become more economically burdensome than a party anticipated.[2]

This raises the question of whether the party seeking to be excused should be punished for having had the foresight to insist upon a force majeure clause as protection against an unlikely but not unforeseeable event.

The doctrines of impossibility, frustration, and commercial impracticability[3] all deal in one way or another with excuses for non-performance when there

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* Paper presented by Professor Yates at *JCL* Conference and published in (1991) 3 *JCL* 186 as 'Drafting Force Majeure and Related Clauses'.

1 Modern usage of the force majeure clause relates back to the definition in the *Code Napoleon*. 'There is no ground for damages and interest, when by consequences of a superior force or a fortuitous occurrence, the debtor has been prevented from giving or doing that to which he has bound himself, or has done that from which he was interdicted.' This quotation comes from 1148 *Code Napoleon*, Halsted and Voorhies, New York, 1841, p 40–1.

2 *Valero Transmission Co v Mitchell Energy Corporation*, 743 SW 2d 658, 663 (Tex App 1987), citing, *Gulf Oil Corp v Federal Energy Regulatory Commission*, 706 F 2d 444 (3rd Cir 1983), cert denied, 464 US 1038 (1984); *Mainline Inv Corp v Gaines*, 407 F Supp 423 (N D Tex. 1976). See also *Esplanade Oil & Gas Inc v Templeton Energy Income Corp* 889 F 2d 621 (5th Cir 1989) (doctrine of force majeure relieves a party of contractual obligation only when a fortuitous event makes performance impossible).

3 For a definition of commercial impracticability see s 2–615 of the Uniform Commercial Code which provides that a failure in performance is not a breach if 'performance as agreed has been made impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made'. By comparison article 79(1) of the Convention on the International Sale of Goods provides an excuse if the performing party proves that a failure to perform 'was due to an impediment beyond his control and that he could not reasonably be expected to have taken the impediment into account at the time of conclusion of the contract or to have avoided or overcome it or its consequences'.

is an unforeseen difficulty. A force majeure clause in a contract represents a bargained allocation of risk. There should be no impediment to the enforcement of that risk allocation simply because the parties have predicted the possibility that a certain event might come to pass and the event would make performance difficult, expensive, or of little utility.

Indeed, the Texas Court of Appeals appears to have reconsidered its own approach to the problem, and in a 1989 decision, the court stated that 'the parties were at liberty to define force majeure in whatever manner they desired'.[4] In that case a natural gas producer sued a pipeline company for $42m alleged to be due under the take or pay clauses of 4 contracts.[5] In defence, the pipeline company asserted the force majeure clause in each of the 4 contracts. The clause defined force majeure to include 'any laws, orders, rules, regulations, acts or restraints of any government or governmental body' which made it unable for either party to perform in whole or in part. The Federal Energy Regulatory Commission issued a new rule that the pipeline company considered to be force majeure. Whether it was or not became an issue for the trier of fact.

The production and distribution of natural gas within the United States is a regulated industry. The federal government and the various state governments have extensive regulatory authority over the industry, and these regulations change from time to time. It is not unusual for a new rule or regulation to make an existing contract more onerous for one party or the other. A change in regulations is not unforeseeable, and a party might have difficulty excusing performance simply because of a regulatory change unless the change were to make performance objectively impossible or illegal. However, the Texas court recognised that the parties could mutually agree upon an excuse from performance in the event of a foreseeable change in governmental regulations. This result is entirely consistent with the basic principles of freedom of contract and makes more sense than the imposition of an artificial limitation on the power of the parties to negotiate their own understanding of what constitutes an excusing contingency.

Indeed, neither party was concerned with the predictability of a regulatory change; the dispute was about the practical effect of the particular change and whether it was substantial enough to trigger the force majeure clause.[6]

The 'unforeseeability' requirement imposed by many courts does act as a check on what might be called intentional acts of force majeure. It prevents a performing party from acting to bring about or from failing to prevent circumstances that make performance impossible or unreasonably difficult.[7]

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4 *Atlantic Richfield Company v ANR Pipeline Co* 768 SW 2d 777, 781 (Tex App 1989).

5 'Take or pay' clauses are common in the petroleum industry. The buyer agrees to pay for a minimum quantity whether or not the buyer actually takes delivery. See eg *Universal Resources Corp v Panhandle East Pipe Line Co* 813 F 2d 77 (5th Cir 1987).

6 The Texas court did make reference to another case involving the same regulation and a virtually identical force majeure clause where the trial court found that the regulation did not constitute force majeure. *Hunt Oil Company v ANR Pipeline Company*, No 86-6314J, slip op (15th J Dist Ct, Paris of Lafayette, La 1987). But in *Burkhart Petroleum Corp v ANR Pipeline Co*, No 87-C-257-C (ND Okla 1988), another court found that the regulation did amount to force majeure under yet another contract with a virtually identical force majeure clause.

7 See eg *Suburban Newspapers of Greater St Louis, Inc v The Kroger Co* 886 F 2d 1060 (8th Cir 1989).

There are, however, better ways to police the parties' actions to prevent abuses of the force majeure excuse. The test suggested by a Pennsylvania court in 1988 is one example:

> In order to use a force majeure clause as an excuse for non-performance, the event alleged as an excuse must have been beyond the party's control and not due to any fault or negligence by the non-performing party. Furthermore, the non-performing party has the burden of proof as well as a duty to show what action was taken to perform the contract, regardless of the occurrence of the excuse.[8]

The party who seeks to be excused by reason of force majeure also may be subject to a good faith standard that requires reasonable effort to avoid the problem, to prevent its occurrence, or to continue performance notwithstanding the problem. The final determination as to excuse remains a question of fact for the jury or the court and is not determinable solely by the one who wants to be relieved of a performance obligation.

In sum, there is no good reason to limit the application of the force majeure excuse to circumstances involving an unforeseen, unpredictable, fortuitous event. It is more consistent with the goals of predictability, stability and individual freedom of contract to allow the parties to define excusing contingencies within their own agreements. The more common excusing contingencies are likely to be those that are foreseeable, such as changes in the regulatory structure of a regulated industry.[9] This approach gives more weight to the parties' own negotiated risk allocations and removes the uncertainty of a post hoc judicial determination of responsibility that is inconsistent with the bargain.[10]

Whether the excuse arises from a force majeure clause or from the application of the doctrine of frustration, impossibility or commercial impracticability, there remains the question of what to do with the parties after excuse. The intervening contingency may excuse future performance, but what of the performance that has occurred to date? In many contracts, one party may have expended a disproportionate share of resources at the moment of excuse. Should the parties be left where they are or should the court intervene to redistribute resources and thereby achieve some rough equality in the sharing of costs? How does a court go about balancing the out of pocket losses of one party against the dashed expectations of future gain of the other when neither is in breach?

This short essay is not the place to attempt to answer these questions, for they are too complex and they have bedevilled courts throughout the English speaking world for generations. They continue to be questions of difficulty and currency in the American system, and they are worth careful consideration

8 *Martin v Department of Environmental Resources*, 548 A 2d 675, 678 (Commonwealth Ct Pa 1988). The court did go on to say that acts of a third party which make performance impossible do not excuse failure to perform if the acts were foreseeable. Id, citing *Yoffe v Keller Industries Inc* 297 Pa Super 178, 443 A 2d 358 (1982). There is no particular reason why the parties could not agree in advance that certain acts of a third party would be excusing contingencies even if those acts might be foreseeable, although if the parties are silent it may be assumed that the risk of a foreseeable action is implicit in the agreement.

9 Admittedly this approach bears a close resemblance to the theory of conditions.

10 To avoid confusion and uncertainty the parties might characterise the excuse clause as a 'hardship' clause rather than a force majeure clause.

because the simple determination that one party or the other is excused from further performance by reason of force majeure is only part of the solution to what is often a dispute of considerable economic consequence.

The natural response of courts in the earlier frustration cases was to leave the parties where they were at the time of the excusing contingency.[11] This changed in England with the decision in *Fibrosa SA v Fairbarn Lawson Combe Barbour Ltd*[12] and the enactment of the Law Reform (Frustrated Contracts) Act 1943.[13] The English law provides for an award of what the court determines to be a 'just sum', 'having regard to all the circumstances of the case'.[14] Some American courts have gone even further and engaged in substantial rewriting of agreements and reallocation of resources to do 'justice' based on a post hoc determination of what is fair.[15] How to accomplish the task of doing justice after there has been an excusing event and whether this approach is efficient has been the subject of a good deal of academic commentary in the United States.[16] There is much to be said for the argument that the English approach is not the best one. Instead the parties should be left with the responsibility of living with the risk of a misallocation upon the occurrence of an excusing contingency or of negotiating a method for readjustment in the event of an excuse. In general the parties are in a better position to weigh the relative costs and benefits than is a court. For practical purposes the best approach is to include a remedial clause that provides an agreed formula for readjustment in the event of an excusing contingency.

For the purposes of this short comment it is enough to point out that the remedial problem does not end with a determination that there is an excuse by reason of force majeure, frustration, impossibility or impracticability. The greatest difficulty may lie ahead in trying to readjust the relative positions of the parties after performance has terminated midstream.

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11 See eg *Chandler v Webster* [1904] 1 KB 493 (CA).

12 [1943] AC 32 (1942).

13 6 & 7 Geo 6, Ch 40.

14 But within the limits prescribed in s 1(2).

15 See esp *Aluminum co of America v Essex Group, Inc*, 499 F Supp 5 (WD Pa 1980) and see generally Dawson, 'Judicial Revision of Frustrated Contracts: The United States', (1984) 64 *BUL Rev* 1; Trakman, 'Winner Take Some: Loss Sharing and Commercial Impracticability', (1985) 69 *Minn L Rev* 471.

16 See eg Ayres & Gartner, 'Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules', (1989) 99 *Yale LJ* 87; Craswell, 'Contract Law, Default Rules, and the Philosophy of Promising', (1989) 88 *Mich L Rev* 489; Gillette, 'Commercial Rationality and the Duty to Adjust Long Term Contracts', (1985) 69 *Minn L Rev* 521. Professor Andrew Kull of Emory University has prepared a comprehensive study of the subject which will be published in 1991. In the meantime the manuscript, entitled 'Mistake, Frustration and the Windfall Principle of Contract Remedies', is available from Professor Kull, c/o Emory University School of Law, Atlanta, Georgia 30322, USA.