GUIDANCE ON HURRICANE HARVEY AND FORCE MAJEURE

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There is no question that Hurricane Harvey, which first struck Texas on August 25, 2017, was a storm of catastrophic proportions. The port of Houston was hit with the strongest rainstorm in the recorded history of the continental United States, in excess of 50 inches. When Harvey made landfall a second time, on August 30, the Texas ports of Port Arthur and Beaumont were deluged with more than two feet of rain. The storm caused substantial business disruptions, reportedly leading to numerous declarations of force majeure, particularly up and down the oil and gas supply chains. An event like Hurricane Harvey and the associated force majeure declarations have the potential to impact the performance of transportation contracts such as charter parties and contracts of affreightment. The analysis of the impact, if any, will ultimately depend on the factual circumstances and contractual language. This guidance describes the principal factors to be considered when a transportation contract contains a force majeure provision and when no such provision exists in the contract.

CONTRACTUAL FORCE MAJEURE CLAUSES

Under American law, the basic purpose of a force majeure clause is to "relieve a party from its contractual duty when its performance has been prevented by a cause beyond its control or when the purpose of the contract has been frustrated."[1] A force majeure clause is not however automatically triggered whenever a catastrophic event, like Hurricane Harvey, occurs. Consequently, that Hurricane Harvey was undeniably a catastrophic storm does not mean that in every case a contractual force majeure clause will relieve parties from their legal obligations under the contract. Each force majeure clause (which may also be referred to as a "general exceptions clause") must be carefully reviewed to determine exactly what type of occurrences constitute force majeure events and under what circumstances.[2] The clause should also be examined in accordance with the law governing the contract as various jurisdictions may construe force majeure provisions and events differently.

Generally speaking, the below-listed factors and issues should be considered in evaluating whether a force majeure clause has been triggered and relieves a party from performance of a transportation contract. These factors and issues should be considered whether you are considering making your own force majeure declaration or whether you are faced with a force majeure declaration from your contractual counterparty.

- Under U.S. law force majeure clauses are construed narrowly and are usually limited to the contingencies enumerated in the clause or similar to those enumerated. A somewhat broader construction may be applied if the clause refers to "any other cause whatsoever" or contains like language.[3] You should examine exactly what is excused under the specific clause. Also, does

[1] *Phillips Puerto Rico Core., Inc. v. Tradax Petroleum Ltd.,* 782 F.2d 314 (2d Cir. 1985).

[2] *See, e.g., In Re Agrifos Fertilizer, Inc.,* SMA No. 4049 (2009) (whether a party is entitled to cancel a charter party under a force majeure clause "turn[s] on the parties' express contractual undertakings – or lack thereof – read against the surrounding facts and circumstances.")

[3] Force majeure clauses in transportation contracts typically list several types of occurrences (e.g., storm, fire) followed by language such as "or any other similar clause." Under U.S. law, unless such language is followed by

the clause give a party the right to cancel the contract or is the obligation to perform simply suspended for the duration of the force majeure event? Can the contract be canceled if the force majeure event continues for a specified period of time?

- Did Hurricane Harvey truly prevent a party from being able to perform under the contract? If, for example, the hurricane renders performance more burdensome and/or expensive, but not impossible, then the force majeure clause may not relieve or suspend the obligation to perform. You should consider whether Hurricane Harvey actively and contemporaneously impacted the contemplated activity under the charter party or contract of affreightment.

- Be aware of notice provisions contained in the force majeure clause which may set forth the time and manner in which a force majeure declaration is to be made. The fact that the general public is aware of Hurricane Harvey and its devastating impact is not enough to trigger a force majeure clause. A force majeure declaration should be made in a timely manner and in accordance with the contractual requirements including any applicable notice requirements.

- When does the force majeure end? Typically, a force majeure only continues for as long as the event remains in effect and prevents performance. The party claiming force majeure may have a duty to promptly notify the other party once the force majeure has ceased.

- Remember, the burden of demonstrating force majeure is on the party seeking to have its performance excused. In so doing, the party must demonstrate its efforts to perform despite the occurrence of the claimed force majeure event. Examine the clause to determine whether it specifies the level of diligence and effort a party must undertake to minimize the effect of the force majeure event on its ability to perform. Whether you are contemplating making your own force majeure declaration or are facing a declaration from your contractual counterparty, you should document any alternatives that were considered or might be available.

Every potential force majeure situation must be carefully analyzed based on the terms of the contractual force majeure clause, the applicable law and the facts and circumstances of the event as they impact the performance of the contract.

THE ABSENCE OF A FORCE MAJEURE CONTRACTUAL PROVISION

There are charter parties and contracts of affreightment which do not contain a force majeure or general exceptions clause in either the boilerplate language or in standard rider clauses. This can lead to a situation in which some of the contracts within the chain (e.g., sub-charters or supply contracts) contain force majeure clauses whereas other contracts (e.g., head charters, etc.) do not. Accordingly, other parties in the chain may declare force majeure under the terms of their contract while the same protections and mechanism may not exist in the transportation contracts.

"whatsoever" or the like, the language has been construed as not expanding the scope of the type of occurrences but rather as encompassing events of the same character as those already identified. *See, e.g., M/V Energy Ranger*, SMA No. 3817 (2003).

In the absence of contractual language otherwise, a declaration of force majeure by a party elsewhere in a chain of related contracts does not constitute a force majeure event in a transportation contract. Similarly, a declaration within the chain is not determinative of whether there is any basis for relief from the obligations of the transportation contract. As such, assuming there is no language providing otherwise, a party's obligation to pay hire or demurrage under a transportation contract is not necessarily relieved by a declaration of force majeure by another party in the chain of contracts. Thus, that a charterer's supplier may have declared force majeure in the wake of Hurricane Harvey does not necessarily mean that the charterer's obligations under a transportation contract are relieved.

The absence of a force majeure clause does not mean, however, that a party (like a charterer) cannot seek to be relieved of its contractual obligations when faced with the occurrence of a force majeure event, like Hurricane Harvey. Generally speaking, a party can still rely on the common law doctrines of frustration, commercial impracticability and impossibility of performance in an effort to be relieved of its contractual obligations. For those potential remedies to be waived, the transportation contract would have to contain explicit waiver language.

Similar to the analysis of the ability to rely on a force majeure contractual provision, the ability to take advantage of these common law doctrines will depend on the specific facts. This guidance summarizes the doctrines and their required elements. As you will see, the doctrines are similar in terms of their required elements although technically they are slightly different in what needs to be established.

Frustration

A party can seek the termination of a contract based on frustration if the fundamental purpose of the contract has been rendered worthless by changed conditions. Generally speaking, a frustrated contract is one that, without fault of either party, has become incapable of being performed due to an unforeseen event resulting in the obligations of the contract being radically different from those contemplated by the parties to the contract. Unlike impossibility and impracticability (discussed below), frustration specifically involves the reason for the contract. Frustration has been described as focusing on events "which materially affect the consideration received by one party for his performance. Both parties can perform but, as a result of unforeseeable events, performance by party X would no longer give party Y what induced him to make the bargain in the first place."[4]

The Restatement (Second) of Contracts sets forth three elements for a frustration defense:

1. The purpose that is frustrated must have been a principal purpose of the party seeking to take advantage of the doctrine. It is not enough to have had some specific object in mind without which he would not have made the contract. The object frustrated must be so completely the basis of the contract that, as both parties understand, without it the transaction would make little sense.
2. The frustration must be substantial. It is not enough that the changed circumstances merely reduce profitability or even result in a loss to the party. The frustration must be so severe that it cannot be said to be within the risks assumed under the contract.

[4] *U.S. v. Gen. Douglas MacArthur Senior Village, Inc,* 508 F.2d 377, 381 (2d Cir. 1974)

3. The non-occurrence of the frustrating event must have been a basic assumption on which the contract was based. In other words, it must have been unanticipated, unforeseeable or unexpected.[5]

Despite the potentially broad reach of these elements, the doctrine of frustration has generally been limited to instances where a virtually cataclysmic, wholly unforeseeable event renders the contract valueless to one party.[6] A classic example of frustration is the permanent loss of use or destruction of the vessel that was the subject of the charter.

Commercial Impracticability

The doctrine of commercial impracticability was developed to provide relief from contractual obligations in instances where compelling performance under radically changed conditions would work an extreme hardship on one party to the contract. The basic elements of commercial impracticability are a supervening event making performance impracticable, the non-occurrence of which was a basic assumption on which the contract was based, and the occurrence of which was not the fault of the party seeking relief or a risk assumed by him in the contract.

Although the standard for establishing impracticability is less stringent than that of impossibility, the party claiming impracticability still bears a heavy burden of proof. Mere inconvenience or added expense is not sufficient. As with frustration, the fact that the performance of a contract has become more onerous or less profitable does not mean that it is impracticable. Cases have held that a contract is commercially impracticable when, because of unforeseen events, "it can be performed only at an excessive and unreasonable cost" or when "all means of performance are commercially senseless."[7] It has also been stated that "impracticability" means more than "impracticality" and that a mere change in the degree of difficulty or expense of performance, unless well beyond the normal range, does not amount to impracticability.

Impossibility of Performance

The doctrine of impossibility of performance may be equated with an inability to perform as promised due to intervening events. In many jurisdictions in the U.S., the defense of impossibility of performance has been replaced or subsumed into the defense of impracticability of performance. To assert impossibility, a party must demonstrate that due to unforeseen events the performance was "objectively" impossible. A contract can be rendered impossible to perform by the destruction of the subject of the contract or by an act of state. However, impossibility defenses generally fail when the probability of the unanticipated event was known to the party seeking relief. It has been explained that impossibility only applies if "some unexpected event upsets all parties' expectations; it is not enough that the unexpected event puts one side in a bind." Impossibility can excuse performance only if the new event "could not have been foreseen or guarded against" in the contract.

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[5] Restat 2d of Contracts, § 265.

[6] *See* 508 F.2d at 381.

[7] *Int'l Elecs. Corp. v. U.S.*, 646 F.2d 496 (1981); *Jennie-O Foods v. U.S.*, 580 F.2d 400 (1978).

SUMMARY

When a contract contains a force majeure clause, whether a force majeure event has occurred that excuses or suspends performance will depend on the specific language of the contract and the applicable law, as applied to the facts and circumstances of each case. If a contract does not have a force majeure provision, a party may still seek relief from its obligation to perform under the doctrines of frustration, commercial impracticability or impossibility of performance, but the standards for establishing those common law defenses are quite high.