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COVID-19 *Force Majeure* Under Long-Term LNG Contracts

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In their March 3, 2020 Law 360 article, our colleagues, Rob Patterson and Shu-Shu Wong, commented on the trend of certain buyers evaluating the feasibility of invoking *force majeure* as an excuse for not performing their purchase obligations under their liquefied natural gas long-term sale and purchase agreements (**LNG SPAs**) due to the COVID-19 outbreak. That article looked at the situation from an English perspective; this article will focus more on contracts governed by New York or Texas law, based on our experience with many U.S.-based LNG projects that have come online in recent years.

Force Majeure

As in all discussions of *force majeure* concepts, our comments are subject to the specific facts, as applied to the stated *force majeure* terms of the contract. As oft-noted, *force majeure* is a contractual term around which a body of law has developed; it is not, in and of itself, a concept recognized under common law or statutory law that is applicable to private commercial contracts that do not contain such a clause.[1]

Therefore, the first step in analyzing whether an event or circumstance gives rise to *force majeure* relief is determining whether such event or circumstance reasonably fits within the contractual definition of covered events. The next step is evaluating whether such event or circumstance has affected performance by the party asserting such relief and whether such effect on performance meets the criteria for relief. And the last step is determining what relief is contractually provided for in the documents.

As a general principle, *force majeure* provisions are interpreted strictly by courts, the implicit notion being that it is a limited exception to the contractual agreement of the parties.

Contractual Definition

As much as each *force majeure* clause is tailored for the specific contract, there are common elements that are commonly found in long-term commercial contracts:

- The event or circumstance must be unforeseen (and reasonably unforeseeable) and beyond the reasonable control of the asserting party;

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[1] Some analogous concepts can be found in the Federal Acquisition Regulations relating to federal contracts. However, those do not apply to private commercial contracts or contracts between private parties and foreign government entities.

- The event or circumstance must have the effect of rendering the asserting party unable to perform its contractual obligations;
- The asserting party must take reasonable actions to mitigate the impact of such event or circumstance;
- The asserting party must provide timely notice of such *force majeure* event or circumstance, the impact it has had on the asserting party and the steps being taken by the asserting party to mitigate (and timely notice must also be given as and when such *force majeure* event ceases to exist);
- The event or circumstance must not be on the list of events or circumstances expressly excluded from the scope of such relief; and
- The sought relief must be within the scope of relief permitted under the terms of the contract.

Reviewing the Definitional Elements

A "pandemic" is a type of event that many would argue constitutes an "act of God" or an unforeseen circumstance beyond anyone's reasonable control. Indeed, many LNG SPAs expressly include pandemic and similar circumstances within the scope of listed *force majeure* examples. Likewise, government intervention (such as government orders to cease operations during a shelter-in-place period) could constitute a change of law that often fits within the scope of a *force majeure* event. Whether those events fit within the first element noted above is a matter of contract interpretation.

The next three elements require an analysis of the impact on the asserting party's ability to perform the contract and what steps may be taken to mitigate those impacts. An impact on the asserting party generally is not sufficient; that impact must directly impact performance and be analyzed against the specific contractual obligations of the asserting party under the contract. Moreover, the impact cannot merely make performance disadvantageous (as in lack of anticipated profitability due to increased costs or changes in markets, which are typically expressly excluded from *force majeure* provisions) – there must a clear linkage to an inability of the asserting party to perform. Therefore, the obligation to mitigate must typically include options that would reduce – even negate – the financial attractiveness of the contract to the asserting party. Providing notice of the event or circumstance, impact and efforts to mitigate are self-explanatory.

The penultimate element is very important for long-term contracts, which typically are expressly intended to survive any number of "anticipatable" events. Thus, financial and market issues are typically expressly excluded from *force majeure* relief, as are financial obligations (i.e., obligations to make payments that would be due irrespective of the other performance issues in question). There are often express limitations as to the types of governmental actions that might invite relief (i.e., foreign laws asserted as a defense to a New York law contract), limitations on whether State affiliates can be relieved by State actions, and limitations on discriminatory events (such as labor strikes against the asserting party that are not broader in scope).

The final element – relief – is very much tailored to each contract. In some cases, a limited period of *force majeure* may result in structured payments by the asserting party or an extension of the term of the contract to offset the period of non-performance; in other cases, there may be a termination event (and, perhaps, termination payments) if the period of *force majeure* continues for an extended period of time. There is substantial variance in the range of these terms.

Application to LNG SPAs

While LNG SPAs are generally written to allow either the buyer or the seller to claim *force majeure* relief, many (if not most) of the contracts for recent US LNG projects are primarily focused on events or circumstances which the seller is unable to operate its facilities to produce LNG or to deliver its LNG output. For example, if a seller is unable to deliver LNG due to a *force majeure* event there may be some relief to the buyer's obligations to purchase LNG, or those obligations may be deferred to another time.

A buyer's primary obligations under LNG SPAs are to take delivery of LNG from the seller and pay the seller. The typical LNG SPA for recent US LNG projects requires that the buyer arrange transport and accept delivery at prescribed times and in prescribed amounts, and also provides for certain payments-in-lieu when it is not able to do so; thus, absent terms to the contrary (which sometimes exist for limited near-term shipments) issues associated with the delivery by the buyer to its intended destination are often outside the scope of *force majeure* relief.

The impact of COVID-19 has been extensive and global in scale. Currently, the most likely adverse impact of the COVID-19 outbreak on a buyer in connection with an LNG SPA is that such buyer may be experiencing a significant reduction in market demand for natural gas and, concomitantly, LNG. Alternatively, the buyer's intended destination for the cargo may be unable to accept delivery, either due to oversupply or government shutdowns and quarantine restrictions. As noted above, reduction in market demand (sometimes referred to as "*economic force majeure*") is usually expressly excluded from the definition of *force majeure* under LNG SPAs. This means that even if a pandemic otherwise would qualify as a *force majeure,* a buyer probably will not be able to obtain relief solely on the basis of such economic and market-based impairments.

However, as noted above, the ability of a buyer to claim relief due to events that impair its ability to unload its cargo at its intended destination may exist as a by-product of market oversupply or by virtue of government shutdowns and quarantine restrictions. However, it is uncertain – perhaps unlikely – that such events would be viewed as an impairment on the buyer's ability to perform its obligation to accept delivery from the LNG terminal or make payments in lieu – unless, of course, the contract can be interpreted as expressly contemplating relief for such circumstances. Some contracts permit this relief for near-term shipments that have been clearly described with destinations, but those provisions are often limited in impact and often are provided separately from the *force majeure* provisions; moreover, if such a scenario is expressly anticipated by the contract and has specific remedies or disclaimers assigned thereto, then it is typically, by definition, not unforeseeable and not a *force majeure* event. Thus, the fact that some LNG SPAs expressly contemplate payment of tolling fees, or similar payments for failure to take cargo, may impair the ability of the buyer to assert *force majeure* for such failure.

Even where a buyer may be entitled to claim *force majeure*, its rights arising therefrom are typically limited to certain actions, such as reducing the amount of LNG it is obligated to take. The right to terminate—by either the buyer or the seller—is typically the most severe remedy available to be exercised under an LNG SPA and then only after a prolonged failure (e.g., 24 months) to perform as a result of the occurrence of a *force majeure*. In many LNG SPAs, there are no termination rights available to a buyer based on its having declared a *force majeure* for a prolonged period of time. In such LNG SPAs, if a buyer declares *force majeure* as an excuse to its performance for a prolonged period of time, then the seller has the right to terminate the LNG SPA. In other cases where the buyer may terminate an LNG SPA based on its being prevented from performing for a prolonged period of time due to a *force majeure* declared by the buyer, it may do so only for certain types of *force majeure*, such as failure to obtain any government approvals or the inoperability of LNG tankers.

It is important to note that this discussion relates to long-term take-or-pay contracts typically in place for the recent wave of U.S. LNG plants at the time of project financing; certain other types of LNG SPAs require a separate analysis, such as those used in secondary LNG contract markets (where the initial LNG purchaser resells its LNG to a third party) and LNG SPAs entered into by an LNG facility owner after it achieved financial closing and completed construction of its LNG facility. In those circumstances, the terms may differ significantly from the long-term LNG SPAs discussed in this article.