Declaring Force Majeure: Veracity or Sham?

Leon E Trakman
DECLARING FORCE MAJEURE:
VERACITY OR SHAM?

by

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ABSTRACT

The widespread practice by large scale producers, like Exxon Mobil and BP of declaring force majeure has created enormous legal and contractual problems. The practice is used, not only to respond the devastating disasters like Hurricane Katrina, but also to defects in pipelines amounting to little more than wear and tear The result is that customers are left waiting for goods or forced to pay higher prices until their suppliers decide to lift their declarations and resume performance.

This article challenges such declarations, arguing that they often fail to comply with both the law set out in article 2-615 of the Uniform Commercial Code and the applicable contract of supply. Presenting alternatives to declarations of force majeure, the article argues that these alternatives are not only fairer, but also more commercially sustainable.
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Total SA (TOT) has lifted force majeure on oil exports from its Dalia offshore installation in Angola, the company said. The force majeure was lifted on Friday, according to a Total spokeswoman. The force majeure was called early Wednesday after a technical problem hit the platform Tuesday. Dalia is expected to reach normal output of 240,000 barrels a day in about 12 hours, after running at reduced levels of around 127,000 barrels a day Thursday, said the spokeswoman. [Force Majeure Lifted on Oil Export from Dalia, 07-21-2007, at http://www.africanoiljournal.com]

**INTRODUCTION**

Suppliers who engage in complex oil infrastructure and supply markets function within a volatile market. They are subject, not only to political instability, but also to significant market swings in meeting their supply duties. The result, if they err, is significant cost, price and profit erosion when a radical swing in their costs can erase an entire profit margin, and then some.

Coupled with these problems is the tendency often to engage in fixed price supply contracting in which suppliers estimate costs and prices over a sustained period of time and in advance of the occurrence of a risk of loss. For suppliers to “get it right”, however careful their planning, is often difficult for them to achieve in a world inundated by disruption. This is especially so the longer the period of the contract and the wider the range of intrusive events that occur during the life of a long-term supply contract.

Against this background is the growing practice of contractors in construction contracts and suppliers in long term supply contracts to “declare force majeure”. For example, Exxon Mobil and ConocoPhillips’ claimed that their failure to supply customers was beyond their control after the partial shutdown of the Prudhoe Bay oil field in Alaska on grounds that, despite their reasonable diligence, they could not have averted the shutdowns. To similar effect, in August 2006 the largest oil field in the United States operated by BP was shut down because of pipeline corrosion that

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had gone undetected for years. The question in each case was whether the declaration was justified. Was the event beyond the supplier’s reasonable control? Was the supplier under a duty to exercise due diligence in ensuring a continuing supply? To what extent ought the supplier to have been bound to perform in law or by contract? And when was relief from performance justified on the facts of each case.2

Setting aside whether relief is provided for by contract, a first blush response to these questions is that a declaration of force majeure provides a supplier with an immediate legal basis upon which to modify performance, such as to delay delivery of materials or to increase the price. The ground is that that the declaration was made in response to unforeseen circumstances beyond the supplier’s control, the SARS epidemic, a war, terrorist attack, tsunami, strike, or explosion in the plant. Coupled with these events are many other circumstances in which suppliers can seek relief from performance: a breakdown of plant equipment, a delay in the shipment of supplies, wear and tear on an oil pipeline, etc.3

In reality, many declarations of force majeure are more about posturing than legal entitlement. Most often, the circumstances alluded to in the declaration fall short of force majeure as a legal excuse from performance.4 Equally often, the party invoking force majeure relies on a long term relationship, its market position, the goodwill of its customers, and its market muscle to be able to stand on its declaration, or failing that, to negotiate for modified performance.5 Sometimes, but not always, the supplier’s declaration is reinforced by a contract clause setting out an extensive list of circumstances leading to relief from performance, coupled with a residuary clauses encompassing “all other circumstances beyond its control” to legitimate its declaration by contract.6

What is pertinent today is a rethinking of the concept of force majeure itself, particularly in large scale supply contracts.7 In decades past, force majeure encompassed a determinate set of unforeseen risks beyond the control of the party

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2 See e.g.<http://www.iht.com/articles/2006/08/16/business/oil.php>
3 See further infra Section 5.
4 Ibid, Section 2.
5 Ibid.
6 See infra Section 5.
under a duty to perform that gave rise to a total excuse from performance. After recent debacles like 9/11, there are fewer risks that are unforeseeable and many that are now also foreseen. Parties to contracts today are increasingly concerned, not only with whether the supplier is prevented from performing due to an event beyond its control, than about the practical implications of ways in which to share risks between them.

The winner take all philosophy of the past is also more difficult to sustain in a business environment in which the parties need to either live with, or share losses arising from events that interfere with their business dealings. A growing perception is that responsibility for non-performance in which one side assumes all losses ought to subsume to a business strategy directed at sharing risks and apportioning losses.

A related view is that business planning in long-term contracts ought to be reached, not simply at the start of the contractual relationship, but recurrently during the course of performance.

The ultimate recourse often is for parties to seek middle ground in which the supplier gets some relief from performance, but the customer does not have to field the full burden of the performance disruption.

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10 See infra Section 5.


14 For an early study of the force majeure practices of international oil companies, see Leon E. Trakman, Nonperformance in International Sales Contract, 29 OIL & GAS TAX Q. 716-750 (1980); LEON E. TRAKMAN, THE LAW MERCHANT: OUR COMMERCIAL HERITAGE, Ch.6 (FRED B. ROTHMAN LITTLETON, COL., 1983)
Certainly, the parties to long-term supply contracts may argue about the legitimacy, extent and duration of the declaration of force majeure. Suppliers may well insist that they cannot continue in a long-term relationship without the extensive relief being declared. Customers may insist that suppliers ought to sustain risks of loss which those suppliers are better able to anticipate, avert and mitigate than their customers. All this may lead to altercations as each is preoccupied with redressing an intrusive economic hardship. At the end of the day, the parties may face a painful choice: to reconcile and preserve their relationship, or to part in response to a fractured relationship.

This article explores the issues arising out of a “declaration of force majeure”. Section 1 critically examines the circumstances in which force majeure declarations are reached. Section 2 explores the law governing force majeure, specifically the dual requirements of reasonable foresight and reasonable control over the risks giving rise to force majeure. Section 3 compares “genuine” with “suspect” declarations of force majeure. Section 4 evaluates responses to force majeure claims. Section 5 examines relief from performance clauses. Section 6 considers strategies involved in negotiating for unexpected risk contingencies.

For convenience, the illustrations used in this article deal with long term supply and construction contracts. The analysis can readily be applied to a host of other types of commercial contracts.

I. THE PROBLEM STATED

There is a tendency among some long-term suppliers, notably but not limited to the oil industry, to declare force majeure in the “ordinary” course of their business operations. In effect, the supplier claims that an unforeseen circumstances beyond its reasonable control has intervened that justifies securing relief from performance, usually in the form of a delay in delivery or an escalation in the price. In some cases, suppliers rely on wide performance relief clauses in their supply contracts to legitimate their declarations which are often drafted with their particular interests in mind. If pressed for a legal justification beyond the contract, they likely refer to the law of “impossibility”, arguing that performance has become “commercially

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15 The test here, as proposed here is the supplier is better able to sustain the risk because it has a lower cost in evaluating the risk and is better able to assume transactions costs, including that of insurance, in respect of that risk. See Richard A. Posner and Andrew M. Rosenfield, Impossibility and Related Doctrines in Contract Law: An Economic Analysis, 6 J. LEGAL. STUD. 83, 91 (1977).
16 As will be articulated below, such hardships may not be actionable as a matter of law. See further supra note 7 and infra notes 25 and 42.
17 See supra Section 4.
18 “Ordinary” is highlighted because the remedy, relief from performance, is often “extra-ordinary” in fact. See infra note 28.
19 See further infra Section 5.
20 Ibid.
impracticable” under Article 2-615 of the American Uniform Commercial Code, or in their international dealings, that the “purpose of the contract” has been “frustrated” in English Law, that the contract has been rendered impossible under French or German Law; or that an excuse is justified by another legal system, or by international law. Their alternative explanation is that, regardless of the law, the contract provides relief from performance which legitimates the declaration. Both legal and contractual arguments often are doubtful, however much suppliers may rely on them.

i. The Legal case


Suppliers of long-term contracts and owners of plants may well overstate the argument that their declarations of *force majeure* comply with the legal requirements of economic impracticability or the law impossibility.²⁶ Most declarations, if unsupported by a wide relief from performance clause in the applicable contract, actually fall short of *force majeure* as conceived in law. Those few that are legally challenged also tend to be struck down for failing the legal test of economic impracticability, frustration, or impossibility.²⁷ The result is that a supplier that “declares *force majeure*” often presents a factual and not a legal basis for relief from performance.²⁸ Far from rendering performance impracticable, the intervening event has temporarily slowed down production, causing a delay in the delivery of materials, or increasing the cost of performance. The supplier is still able to deliver the goods or service, albeit at a greater cost or with added effort. In effect, the supplier declaring *force majeure* without contractual authorizations remains legally bound to perform because it can still do so albeit with greater difficulty.²⁹

In addition, suppliers of long term supply contracts that declare *force majeure* often seek a different kind of performance relief than the excuse from performance that arises under the law of commercial impracticability. Their declaration of relief is to

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²⁶ See supra Sections 2 and 3.
²⁷ Instances in which declarations have been struck down include: declarations of force majeure in relation to increases in market prices, shutdown of plants for maintenance or repairs, disruptions in shipment, and currency fluctuations. The reasons given for failing to uphold such declarations include, variously: that the declaring party could reasonably have foreseen the risk of loss, was able to perform in fact and/or failed to exercise due diligence in redressing the risk of non-performance. See Northern Indiana Public Service Co. v. Carbon County Coal Co., 799 F.2d 265, 275 (7th Cir. 1986) where the United States Court of Appeals for the Seventh Circuit rejected a supplier’s declaration of force majeure based on inflation. The court held that a change in market price was a normal risk in a fixed-price contract and could not be avoided through the declaration of force majeure In Stand Energy Corp. v. Cinergy Services, Inc., 760 N.E.2d 453 (Ohio Ct. App. 2001), the Ohio Court of Appeals denied a declaration of force majeure to provide a party with relief from performance arising from a mistaken assumption about changing economic conditions, while recognizing that such clauses do provide flexibility in volatile economic conditions.
²⁸ For examples of such declarations, see the declaration by Anzon Australia on Basker crude loading in July- August 2007 due to problems with the oil field's mooring system, see <http://au.biz.yahoo.com/070709/19/1b2gv.html>. On a 10 day declaration in March 2005 by Nynas Naphthenics for transformer oils owing to operational problems at its naphthenics base oil plant in Nynashamn, Sweden, see <http://www.imakenews.com/ing/e_article000369792.cfm?x=b110_w> Nor are such declarations of force majeure limited to the oil industry. For example, Falconbridge declared force majeure in March-April 2006 on deliveries of copper from the Collahuasi copper operation in Chile after a breakdown of a concentrator mill. See <http://findarticles.com/p/articles/mi_m3MKT/is_13-1_114/ai_n16124636>. On Dow Chemical’s declaration of force majeure on caustic soda in February 2007 after a Canadian rail strike slowed shipments, see <http://www.purchasing.com/article/CA6423959.html>.
²⁹ On the point at which mere difficulty failing short of commercial impracticability progresses into grave difficulty sufficient to ground a claim under 2-615 of the UCC, see American Trading & Production v. Shell International 453 F. 2d 939, 942 (2 Cir. 1972); Transatlantic Financing Corp. v. United States, 363 F2d 312, 317(DC Cir. 1966); United States v Winstar 518 US 839, 906, 116 S.Ct.2432, 2470 (1996).
secure a delay in performance or an increase in the contract price. The relief available in law ordinarily is the grant of a complete excuse from performance, not a convenient price increase or delay in delivery.\textsuperscript{30}

Absent a relief from performance clause to the contrary, an intervening event constitutes \textit{force majeure} in law only when an intervening disruption of performance is not reasonably foreseen and not reasonable within the promisor’s control. For relief to be granted in law, it must be physically, legally and economically impracticable for the supplier to perform on account of changed circumstances that are unforeseen and beyond its control.\textsuperscript{31}

Instances do arise in which suppliers “declare \textit{force majeure}” when an intervening war, tide wave, or tsunami renders performance virtually impossible or commercially impracticable.\textsuperscript{32} Such was the case when Hurricanes Katrina and Rita shut down almost a third of the oil refining capacity of the United States.\textsuperscript{33} A natural disaster of such magnitude, moving pipelines miles from their constructed locations, is of such magnitude as to render the impact on performance beyond the reasonable foresight and control of suppliers. Such natural disasters, however foreseeable in general, are excusable in law because the magnitude of damage they cause may not be reasonably anticipated. Oil refineries that foresee the ongoing risk of such natural disasters, seldom foresee their timing and severity.\textsuperscript{34}

\textsuperscript{30} The “winner take all” conception of excuse from performance is still pervasive in long term contracts, and court adjustments based on loss sharing is the exception, not the rule. Illustrating this is the application of Article 2-615 of the UCC. See generally, Trakman, \textit{Winner Take Some}, supra note 11; Hillman, \textit{Court Adjustment of Long-Term Contracts}, supra note 12; Scott, \textit{Conflict and Cooperation in Long-Term Contracts}, Goldberg, \textit{Price Adjustment in Long-Term Contracts}, supra note 12; Speidel, \textit{Court-Imposed Price Adjustments Under Long-Term Supply Contracts}, supra note 12.

\textsuperscript{31} See e.g. Hans Van Houtte, \textit{Changed Circumstances and Pacta Sunt Servanda}, in, \textit{TRANSNATIONAL RULES IN INTERNATIONAL COMMERCIAL ARBITRATION}, EMMANUEL GAILLARD, ED.,105 (ICC PUBL./ILA, 1993).

\textsuperscript{32} The Restatement (Second) of Contracts provides for an excuse from performance for impracticability in section 261: “Where, after a contract is made, a party's performance is made impracticable without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made, his duty to render that performance is discharged, unless the language or the circumstances indicate the contrary.” \textit{RESTATEMENT (SECOND), CONTRACTS},§ 261 (1981).

\textsuperscript{33} On Dow Chemical’s declaration on September 2 2005 of \textit{force majeure} on TEGITOL, TRITON, Nonylphenol Ethoxylates (NPE), Octylphenol Ethoxylates (OPE), CARBOWAX SENTRY and Industrial Polyethylene Glycol (PEG) as a result of Hurricane Katrina, see <http://news.dow.com/prodbus/2005/20050902a.htm> On the impact of Hurricane Katrina generally on the declaration of \textit{force majeure}, see Charles Dominick, \textit{Is Your Force Majeure Clause Too Weak?} \textsc{NEXT LEVEL PURCHASING} (NOV. 1, 2005), also at http://www.nextlevelpurchasing.com/articles/force-majeure-clause.html

\textsuperscript{34} It is difficult to provide an exact threshold at which the impact of an intervening event is so monumental as to justify an excuse from performance. Courts also tend to diverge on such an issue, with the claim that the threshold is more readily passed under an “economic impracticability” test under 2:615 of the UCC, compared to the traditional law of impossibility. See Farnsworth, infra note 46. However, even under the doctrine of
Instances do arise in which suppliers are able to demonstrate that, while they can perform, doing so is rendered so much more difficult and so extraordinarily costly that an excuse from performance ought to be permitted on grounds of economic impracticability under 2-615 of the UCC, but such eventualities are the exception not the rule.  

In issue, then, is the need to determine the threshold between performance difficulties that are so severe as to justify a legal excuse from performance and less onerous performance difficulties. Suppliers are likely to be concerned when intervening difficulties, such as bottlenecks in production, cause them economic hardship, but these events usually fall short of a legal excuse. The alternative is for suppliers to have recourse to performance relief under their contracts of supply in which they extend the grounds for their relief beyond those provided under law.

ii. The contractual case

Suppliers in long term contracts sometimes insist that their declarations of force majeure accord, not with the law of economic impracticability set out in 2-615 of the UCC, but with clauses in their contracts that grant relief from performance. Given the sanctity of contract, such provisions may well vary from the law of economic impracticability, while not conflicting with it. They may also demonstrate the importance of the contract as the primary “law” chosen by the parties to regulate their long-term supply transactions.

Accepting that negotiating and drafting relief clauses is an expression of contractual autonomy, the concern is how effectively and fairly the parties can devise and

“economic impracticability”, courts repeatedly have held that even significant increases in cost of performance do not lead to a relief from performance. For a list of such cases and their denial of relief from performance, see supra note 27.

35 For extensive debate in the “Westinghouse cases”, involving long-term contracts, on whether the intervening circumstances were sufficiently grave to justify relief from performance, see Trakman, Winner Take Some, supra note 11: Speidel, Conflict and Cooperation in Long-Term Contract, supra note 12.


agree upon hardship clauses that grant relief from performance that do not ordinarily constitute a legal excuse. National legal systems seldom counsel parties on how to negotiate and draft relief from performance clauses that, in effect supersede the law governing excuse. Trade and law associations, in contrast, often provide parties with model rules and clauses directed at negotiating and drafting performance relief in response to intervening hardship.

iii. In summary

Declarations of *force majeure* purports to grant relief from performance on grounds of added performance difficulty as distinct from commercial impracticability. Such declarations are often tenuous as a matter of law. If parties incorporate hardship

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clauses into their contract, the law of that contract ordinarily prevails. If they declare force majeure without a legal or contractual basis, their relief for performance stems from the persuasiveness of their declaration rather than its legal or contractual authority. Whether their declaration is sustained or not depends on the extent to which their customers resort to business sanctions, or to arbitration or litigation. More often than not, the customer acquiesces in the declaration; there is no legal challenge, but that may be changing.43

2. THE LEGAL REQUIREMENTS

Leaving aside the availability of relief from performance clauses in contract, before a supplier under a duty to perform can “declare force majeure”, the supplier must ordinarily satisfy two legal tests under the law of economic impracticability. The first test relates to the supplier’s lack of reasonable foresight of performance risks.44 The second test encompasses the reasonable inability of the supplier to control the impact of the risk of loss upon its performance.45 Failing to satisfy both tests as a legal matter can lead to the denial of relief from performance notwithstanding the supplier’s declaration. These two legal requirements, foresight and control, are expressed differently in common and civil law systems where the supply contract chooses foreign law.46 Nevertheless, both common and civil law rely on the dual requirements of foresight and control in determining whether, when and to what extent to grant supplier’s with relief from performance.47 Both reasonable foresight and control tests are also imbedded in a growing body of international commercial law governing force

43 What makes declarations of force majeure more palatable to customers is the fact that the declarations tend to be short-lived and not permanent disruptions in performance. See further infra note 28
44 See infra Section 2, i.
45 See infra Section 2, ii.
46 The late Professor Allan Farnsworth argued that: “[C]ourts have been much more reluctant to hold that a party has been excused on the ground of frustration than on the ground of impracticability” See E. ALLAN FARNSWORTH, CONTRACTS § 9.7 at 561 (1990). Nevertheless, there are a number of US courts that restrict circumstances in which relief from performance is available, not unlike under the last of impossibility and frustration elsewhere. See e.g. Transatlantic Financing Corp v. United States, 363 F.2d 312, 319-20 (D.C. Cir. 1966) (court dismissed the claim that an increase of approximately $44,000 above the contract price of $305 gave rise to relief from performance on grounds of impracticality [footnote omitted]; American Trading and Production Corp. v. Shell International Marine Ltd., 453 F.2d 939 (2d Cir. 1972) (court held that an increase in the cost of performance of less than a third above the contract price did not constitute commercial impracticability); Public leve Indus., Inc. v. Union Carbide Corp., 17 U.C.C. Rep. Serv. (Callaghan) 989, 992 (E.D. Pa. 1975) (courts stated: “We are not aware of any cases where something less than a 100% cost increase has been held to make a seller's performance ‘impracticable’.“); Westinghouse 2, 597 F. Supp. 1456 (E.D. Va. 1984); Westinghouse I, 517 F. Supp. 440, 453 (E.D. Va. 1981) (court held that, although Westinghouse had established a significant loss in regard to one term of the contract, it had not established a loss of the entire contract).
Notable in domestic and international law alike is the view that the promisor should ordinarily be bound by its duty to perform and an excuse from performance should not readily be permitted by law.49

i. Foreseeability

One ground in favor of granting an excuse from performance is if the intervening event was unforeseen.50 In practice most intrusive events are foreseeable. The moment at which they intervene and the gravity of each intervention may be difficult for suppliers to determine; but few hazards associated with natural disasters and human intervention are totally unanticipated. From storms, cyclones and hurricanes to strikes and walkouts, wars, civil insurrection and terrorism, parties to long term supply contracts anticipate most of these eventualities.51 Such foresight of risk still does not lead to the conclusion that the promisor should be excused from performance. The applicable foresight test is not to determine whether a party under a duty to perform is incapable of anticipating an ever expanding spectrum of intruding events that might disrupt performance than with whether that party could reasonably


50 See e.g. Eastern Air Lines Inc. v. McDonnell Douglas Corp., 532 F.2d 957, 988 (5th Cir. 1976) (court stated: “[Section 2-615 excuses delay or non-delivery when the agreed upon performance has been rendered ‘commercially impracticable’ by an unforeseen supervening event not within the contemplation of the parties at the time the contract was entered into.”); accord, Eastern Air Lines Inc. v. Gulf Oil Corp., 415 F. Supp. 429, 438 (S.D. Fla. 1975).

have anticipated the occurrence, gravity and duration of the intervening event. The supplier’s excuse from performance goes to the unexpected nature and extent of the loss arising from the intervening event, not the general postulation that there are few risks in general that should surprise suppliers of long term supply contracts.

ii. Beyond control

The absence of reasonable foresight of an intervening event does not alone justify the right to an excuse from performance. The force majeure event must also be beyond the control of the party, here the supplier, under a duty to perform.

It is insufficient for a supplier to declare force majeure on the basis of an intervening occurrence, such as a storm, strike, or war, which that supplier was unable to prevent. Such a declaration misconceives of the requirement of reasonable control. A supplier under a duty to perform must be able to establish, not that the occurrence of the intruding event was beyond its control, but that the ensuing impact upon performance was beyond its control. It may well be that the second part of the inquiry will be answered in the affirmative: the supplier could not reasonably avoid or mitigate the effect of the strike, power outage, or production bottleneck upon its performance. However, reaching that conclusion requires scrutiny of the facts to determine the nature of the intervention, the action by which the supplier might reasonably have averted or reduced the impact upon performance, the action the supplier actually took, and the consequences of that action. In short, the fact that a war or strike occurred beyond the supplier’s control merely satisfies the first of a two

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52 See Frenchman & Sweet, Inc. v. Philco Discount Corp., 21 A.D.2d 180, 181, 249 N.Y.S.2d 611, 613 (4th Dep’t 1964) (court denied relief when third party withdrew from a merchandising arrangement, holding that "[f]rustration of performance is no defense where no unusual or unforeseeable event prevented performance and where provision could have readily been made for what actually occurred."); Maple Farms Inc. v. City School District, 76 Misc. 2d 1080, 352 N.Y.S.2d 784 (Sup. Ct. Chemung Co. 1974); VJK Productions Inc. v. Friedman/Meyer Productions Inc., 565 F. Supp. 916, 920 (S.D.N.Y. 1983);

53 For a model analysis on the nature and significance of foresight in regard to relief from performance, see Luca Anderline, Leonadro Felli and Andrew Postlewaite, Courts of Law and Unforeseen Contingencies, at <http://econ.lse.ac.uk/staff/lfelli/papers/A-F-P.pdf> On the historical and comparative background to foresight in law, see Académie de droit international, RECUEIL DES COURS: COLLECTED COURSES OF THE HAGUE ACADEMY OF INTERNATIONAL LAW, at 109 (MARTINUS NIJHOFF, PUBL., 1990).

54 See West Los Angeles Institute for Cancer Research v. Mayer, 366 F.2d 220, 225 (9th Cir. 1966) (court referred to "the now more widely accepted view that foreseeability of the frustrating event is not alone enough to bar rescission if it appears that the parties did not intend the promisor to assume the risk of its occurrence"), cert. denied, 385 U.S. 1010 (1967); Transatlantic Financing Corp. v. United States, 363 F.2d 312, 318 (D.C. Cir. 1966).

55 The occurrence of an event may be beyond the control of the party, but that party may still be able to avoid the event having an impact upon performance. The performance in issue itself must be rendered impossible or commercially impracticable in consequence of the intervening event. See further supra notes 8 and 12.

56 What is a force “beyond control” is often controversial. For an illustration, see Kenny Bruno, Indigenous Struggle in Ecuador Becomes a Cause Beyond Control: Transnational Oil Companies Free to Leave Amazon, EARTHRIGHTS INTERNATIONAL, MARCH 13TH, 2003, also at http://www.corpwatch.org/article.php?id=5911
part inquiry. The supplier must also be able to establish its inability reasonably to avert or mitigate the consequences of that war or strike in order to be excused from performance.  

A supplier is ordinarily under a continuing duty to perform for the duration of the contract. The supplier’s continuing duties may include, among others, the duty reasonably to inform itself about prospective performance risks and losses, to take preventative measures and to give the customer reasonable notice of its intention to seek relief from performance on account of an unforeseen intrusion beyond its reasonable control. Whether the supplier discharges its continuing duty to perform is ultimately a question of fact.

By converse reasoning, a supplier who is able to establish the continuing impact of an intervening event beyond its control upon its performance may argue for an excuse from performance for the duration of that intervention. That excuse may continue until the intervening circumstances have abated. Alternatively, it may lead to discharging the supplier from all duties when the intervening events go to the foundation of the contractual relationship and render performance is commercially impracticable.

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58 On the denial of excuses from performance claimed on grounds of an inability to avoid the harmful impact of such intervening events upon performance, such as being unable to deliver goods by ship after the closing of the Suez Canal, see Transatlantic Financing Corp. v. United States, 363 F. 2d 312, 315 (CADC 1966); American Trading & Production v. Shell International Marine (American Trading & Production 452 F 2d 933 (2nd Cir. 1972). See too Richard A. Posner and Andrew M. Rosenfield, *Impossibility and Related Doctrines in Contract Law: An Economic Analysis*, supra note 15.


60 As a matter of law, an “agreement to agree” is insufficiently certain to constitute a binding legal agreement. Its value often lies in the incentive such a clause has in encouraging parties to negotiate in good faith in order to avoid subsequently being held to be in breach of contract on other grounds. See further infra note 59 and 72.

61 See supra notes 21 and 31.

62 This statement presupposes two stages of commercial impracticability. Under the first, the supplier is unable to perform one or more of a series of sub-contracts with a particular customer. Under the second, the supplier is unable to perform in general because the intervening events have rendered its performance in general economically impracticable. This first event may occur when the supplier initially is unable to deliver a single product.
3. “GENUINE” VERSUS SUSPECT FORCE MAJEURE

A supplier that declares *force majeure* in the absence of both a legal excuse and an applicable relief clause in a supply contract must ordinarily rely on the acquiescence of the other party in order to obtain relief.\(^{63}\) That acquiescence often occurs in practice. Most customers under long term supply contracts are unwilling to arbitrate or litigate, given their dependence on their long-term suppliers. Imposing business sanctions on their suppliers may be ineffective. Suing their suppliers may be costly, time consuming and disruptive, destroying any semblance of an ongoing relationship. Nor is litigation a stellar attribute of effective business planning.\(^{64}\)

Then there are inter-party remedies that fall short of legal action. The seller’s declaration of *force majeure* may lead to a customer responding that supplier still can perform albeit at a higher cost. The customer may add that, if one party must bear that risk of loss, it assuredly should be the supplier. After all, the supplier is often better placed than the more remote customer to foresee and exercise due diligence in averting and mitigating the risk of loss, such as by instituting a disaster recovery plan and securing alternative supplies.\(^{65}\)

There are counter-arguments. The supplier may argue that the customer is just as able to anticipate risks of loss as the supplier in a volatile market and conceivably better able to secure alternative goods from other suppliers. The customer must also contend

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\(^{63}\) As a matter of law, such acquiescence may be conceived of as an estoppel or waiver by the acquiescing parting. See W. DAVID SLAWSON, ch.3, supra note 59; Richard Craswell, *Contract Law, Default Rules, and the Philosophy of Promising*, 88, MICH.L.REV.489-529(1989); SEAN WILKEN, THE LAW OF WAIVER, VARIATION AND ESTOPPEL (2nd Ed., OXFORD UNIVERSITY PRESS, 2002); ELIZABETH COOKE, THE MODERN LAW OF ESTOPPEL (OXFORD UNIVERSITY PRESS, 2000). For a comparison of common and civil law approaches towards estoppel, see C Larroumet, *Detrimental Reliance and Promissory Estoppel as the Cause of Contracts in Louisiana and Comparative Law*, 60 TULL.L.REV.1209 (1986).

\(^{64}\) This is not to suggest that parties to long-term supply contracts cannot agree to submit a dispute for resolution to a court or arbitrator while still continuing with their relationship. What is suggested is that intractable differences over the limits of relief from performance, not limited to situations in which that relationship is no longer efficient, often signal the crippling of future dealings between the affected parties. See further Posner and Rosenfeld supra note 15 and Trimarchi, supra note 21.

\(^{65}\) This assumption may not be justified when customers are better placed to anticipate disruptive events due to their proximity, experience with, or background in risk management, including being able to redress that risk, such as through upstream and downstream relationships with alternative suppliers. For a view in support of the rationale that, as a general rule, the promisor should be held strictly to have assumed the risk of non-performance and not likely granted an excuse, see Berman, supra note 49.
with the fact that most declarations of *force majeure* are temporary; suppliers usually resume supply, making it uneconomic for customers to litigate.\(^{66}\)

The key issue is that most of these arguments remain that, arguments: they are not resolved in courts of law. More often than not, the customer is captive to a particular source of supply and supplier; alternative products and services are not readily available or they come at a premium; and expediency requires that the customer accept the supplier’s modified performance as the best of several less than ideal options.\(^{67}\)

Customer in general may resent declarations of non-supply. Those who are more aggressive may insist on contract modifications in the future to accommodate their particular interests. If the supplier is amenable, these modifications may include negotiating that the supplier provide notice of impending non-performance, that the circumstances in which it can declare *force majeure* be limited, and that supplier remediate risks that give rise to relief from performance.

In summary, the danger in customers not challenging declarations of *force majeure* is that suppliers will grow bolder. Their declarations will become more frequent and more pervasive. Suppliers will also devise expansive relief from performance clauses and construe them even more expansively in their own interests, knowing that few customers will object in court. Redressing customer lethargy is an important consideration in contingency planning about risks.\(^ {68}\)

### 4. RESPONDING TO DECLARATIONS OF *FORCE MAJEURE*

How, then, can customers develop viable contingency plans to deal with risks of nonperformance in the face of recurrent declarations of *force majeure* by suppliers in long term supply relationships? At first glance, customers can develop contingency plans that include resort to other suppliers in the event of a supplier’s declaration of *force majeure*. The risk is that other suppliers may adopt comparable declarations, leaving customers no better off.


\(^{67}\) This is a proposition that imposing the risk of loss on the promisor is more likely to produce an economically efficient result. This rationale is based on these dual assumptions: that the supplier is ordinarily in a better position to ascertain and avert the risk of loss, and the customer is at least one step removed from such information and capacity. See e.g. Posner and Rosenfield, supra note 15 and Trimarchi, supra note 21.

\(^{68}\) These risks are borne out by the sheer number of declarations of force majeure made by long-term suppliers compared to the significantly smaller number of declarations that are challenged before courts of law. For illustrations of declarations, see supra notes 1 and 27. For illustrations of challenges directed at such declarations, see further supra note 28.
Assuming a continuing relationship, customers may try to negotiate that their suppliers received tempered relief from performance such as through modified price escalation clauses. The result may still be that their suppliers declare *force majeure* and purport to pass the costs of relief from performance onto their customers. The difference is that customers that engage their suppliers effectively in contingency planning may discourage those suppliers from flying in the face of a negotiated resolution of future risks.

Managing the relief from performance that is granted to a supplier may help to establish a reasonable balance between supplier needs and the protection of customers. For example, the extent of a supplier’s relief from performance may be subject to pre-determined limits. The supplier may be required to implement a disaster recovery plan; and the customer may be entitled to source alternative suppliers for the duration of the *force majeure* declaration. A legal benefit may be that suppliers will be seen to engage in good faith performance. A practical benefit may be that, so long as suppliers comply with these continuing duties of good faith, their relief from performance will not be challenged. Customers, in turn, may benefit by being able to plan more effectively for contingent risks and losses. Both parties may gain more by negotiating over such risk contingencies than the cost to them of doing so.

Negotiations may still fail to produce accord over performance, or they may falter at the time of a loss. The parties may argue over whether the supplier’s disaster recovery plan is adequate, whether its declaration of *force majeure* is consistent with the negotiated agreement, and whether continued relief is reasonable. Despite these risks, negotiations over performance can help the parties to arrive at practical

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70 On the negotiating, drafting and resolving international commercial disputes, including in regard to alleged force majeure, see William F Fox, Jr., INTERNATIONAL COMMERCIAL AGREEMENTS: A PRIMER ON DRAFTING, NEGOTIATING AND RESOLVING DISPUTES, 3rd Ed. (The HAGUE: KLUWEER LAW INTERNATIONAL, 1998).

71 For an illustrative force majeure clause, see Bruce Leshine, OUTSOURCING JOURNAL, February 2003, also at <http://www.lb3law.com/docs/ForceMajeureOJFeb03.cfm>.

solutions in anticipation of future contingencies for which that cannot accurately plan in advance.\textsuperscript{73}

5. RELIEF FOR PERFORMANCE CLAUSES

Given the prospect of suppliers declaring \textit{force majeure}, the likelihood of disruptions in supply and the difficulty of predicting the precise source and impact of such disruptions, parties to supply contracts are often better placed to plan for categories of risks rather than precise risks. Typical advance planning might include: agreeing on relief from performance due to delays in delivery, supply disruptions, production bottlenecks and labor unrest, and agreeing on price escalators to offset production and supply spikes as well as inflation.\textsuperscript{74} Such planning for relief is discussed immediately below.

i. The options

There are three broad categories of performance relief for which the parties to supply contracts can negotiate in advance. Firstly, they can provide no relief from performance at all. The assumption here is that the party, here the supplier, will be under a continuing duty to perform and that its duty will be strictly enforced. Such a clause is unlikely in most long-term supply contracts given the prospects of intervening risks, the bargaining power of most suppliers and their prospective costs in not providing for relief from performance. Secondly, the supplier can be excused from all its performance duties. This is also an unlikely remedy because a complete excuse from performance will usually suit neither party, except in the event of extraordinary performance disruptions. Thirdly, the parties can provide for different types and degrees of relief from performance, such as for differences in the price, time, mode and extent of delivery. In this last and most likely scenario, the precise nature of relief negotiated will depend on such background factors as trade practice and such party factors as the relationship between the parties, their bargaining power and profit margins.

\textsuperscript{73} On the case of devising contractual provisions in anticipation of force majeure assertions by one party in development agreements, see e.g. Georges Delaume, \textit{Excuse for Non-Performance and Force Majeure in Economic Development Agreements}, 10 COLUM J.TRANSNAT’L.L. 242 (1971).

ii. List or general relief from performance clauses

There are strategic benefits to adopting different types of relief from performance clauses. Two different types of clauses are: to provide a list of contingencies that give rise to relief from performance, the so-called enumerated method; and to adopt a general relief from performance clause.

The list or enumerated method has the advantage of allowing parties to list all conceivable contingencies that may lead to relief from performance. The also enables them to bargain over the list including over the exclusion of particular circumstances, such as ordinary wear and tear on plant or equipment. In contrast, a supplier may purport to extend that list to encompass a host of other circumstances beyond control giving rise to relief from performance, concluding with a residuary clause encompassing “all other circumstances, whether or not of the same kind” as those specifically enumerated.75 Strategically, if the parties agree to such a residuary clause, the supplier has a great deal of leeway in securing relief from performance. If the contract provides for “other circumstances beyond control” without specifying whether or not they are of the same kind as those enumerated, the eiusdem generis rule applies and such “other circumstances” will be limited to those that are “of the same kind” as those specifically enumerated.76

A general force majeure clause sets out criteria that must be satisfied in order to secure performance relief. There is no supplementary list. The supplier is granted relief due to the intervention of risks that were not reasonably foreseen and whose effect the supplier was not reasonably able to avoid or mitigate. The parties to a long term supply contract may adapt these criteria of reasonable foresight and reasonable control to suit their particular needs, as well to reflect industry standards and trade practice. For example, a general relief clause may link the requirement that the supplier was not reasonably able to avert the effect of a supply disruption with an industry standard of due diligence that governs its performance.77

76 See Georges Delaume, Change of Circumstances and Force Majeure Clauses in Transnational Loans, 7(3) DROIT ET PRATIQUE DU COMMERCE INTERNATIONAL 333-359 (September 1981).
A general relief from performance clause is less precise in nature than a list clause. As a result, it is more difficult to determine whether a particular disruption falls within the criteria for relief in a general compared to a list clause.78

Cultural issues, such as the legal background of the parties, may influence the adoption of general or list clauses. In international supply contracts, lawyers with civil law backgrounds who are trained in deductive reasoning may well opt for general force majeure clauses from which specific instances of relief can be deduced. Common lawyers trained in inductive reasoning are more likely to opt for enumerated clauses that specify more precisely the full spectrum of circumstances in which relief from performance will be granted.79

As a matter of practice, parties may decide to use a combination of list and general force majeure clauses. The list may be extensive. As an illustration, it may include a detailed enumeration of specific events under categories like “war” including among others, “riots, rebellions, insurrections, civil war, civil commotion”, supplemented by “acts of terrorism.” Lists of disruptive events are seldom exhaustive and will often be followed by general clauses purporting to complete the list. For example, a supply contract may enumerate a list of “insecure” sources of supply, followed by a general clause extending relief from performance to threats from “other” sources of supply that are not listed.80 The extent of those “other” circumstances will depend on the method by which each relief clause is formulated in the context of the particular relationship between the parties, the industry in which they operate, the risks in issue and the severity of any ensuing loss. The interpretation of that clause, in turn, may depend, inter alia, on whether the risks that materialized were not specifically enumerated in the contract and whether there were of the same kind as, or different from, those enumerated.81

iii. The extent of relief from performance


78 On such residuary force majeure clauses, see generally supra note 12, and Trakman, THE ALLOCATION OF THE RISKS OF UNUSUAL CONTINGENCIES IN INTERNATIONAL OIL SALES, supra note 13.

79 On the influence of legal traditions on dispute resolution in international commercial transactions, see Leon E. Trakman, Legal Traditions and International Commercial Arbitration, 17 American Review of International Arbitration 1-43 (Spring 2007), also at http://ssrn.com/author=508790. On the view that some courts are more likely to uphold list than general relief from performance clauses, see esp. Bund, supra note 74 at p.408.


Whether or not the parties use lists or general clauses, providing for relief from
performance by contract allows them to negotiate over the type and degrees of relief
to grant, rather than rely on the narrower parameters of the law of economic
impracticability. In limited cases, one or both parties to a supply contract may opt
for an all-or-nothing remedy based on the pervasive impact of an intervening
performance disruption. The supplier may be completed excuses from performance,
or failing that, it may be expected to perform. Suppliers who “declare force majeure”
usually prefer a lesser remedy upon which they can reasonably rely in advance of its
occurrence and which does not cause the contract to terminate. They want to be able
to perform at a later date than as specified in the contract, to be able to supply a
reduced quantity or quality of goods, or to pass additional supply and production
costs onto their customers. In essence, resort to the negotiated allocation of
performance risks and losses allow the parties to find middle ground that legal
remedies often fail to provide.

In developing a sustained business plan, the parties to a long term supply contract
may want to consider the following, among other options. What kinds and degrees of
relief should their contract permit? Should the relief clause provide for a spectrum of
relief, varying from a minor adjustment to total relief from performance? Should the
clause provide for staggered relief, such as a graduated reduction in the quantity of
goods delivered, or a graduated increase in the contract price? And should such
graduation be formulaic, such as based on a market price index, or determined
piecemeal such as by a facilitator appointed under the contract?

Take price increases as an example. The parties may opt for a market, consumer,
labor or industry price index to determine price increases; or they may appoint a
qualified industry analyst to decide. They may specify criteria to guide such
determinations, such as by incorporating industry indices that measure inflation, as
well as upward and downward spikes in costs and prices. They may also set out
criteria that suppliers must satisfy in order to receive continuing, tapering or
expanding relief. These criteria may take account, inter alia, of performance
conditions in the industry, such as volatility in energy prices. The parties may also
ground performance relief in prevailing industry standards while also taking account
of their distinctive relationship and business needs.

82 This is not to dispute the value of boiler plated relief from performance clauses, only that
they should be adapted to the specific context. See Tina L. Start, “NEGOTIATING AND
DRAFTING CONTRACT BIOLERPLATE, Force Majeure, Ch.11, 11(3) (ALM PUBL.,
2003).
83 On relief in the provision of telecommunications services for selected categories of
“interruption” of services due to “circumstances beyond control”, see NetStar
Telecommunications, Inc. Service Level Agreement (SLA) for SDSL, I DSL, NetStar T1, and
Aggregation Services, VI. Events Beyond Control of NetStar Telecommunications, Inc., p.5,
at <http://www.4houstonT1.com/images/NETSTAR%20T1%20BUSINESS%20DSL%20SLA%20MASTER%202004.pdf>
84 See further infra Section 5, iv.
What is most important is that relief from performance should be fitting to the context; it should be workable; and the parties should be willing and able to live with its consequences.

iv. Performance Modification Clauses

Parties to long-term supply contracts can adopt distinct performance modification clauses that are related to, but not necessarily part of more general performance relief clauses. Typical clauses are price escalation clauses providing for price increases and clauses providing for delays in performance arising from supply disruptions.\(^{85}\)

Before adopting a price escalator clause, it is important to understand the background surrounding each contract, the relationship between the parties, the market conditions affecting long-term supply contracts, and the strategic implications of adopting a particular modification clause.

It is equally important for the parties to understand industry conditions, the market risks associated with long-term relationships and comparable dealings across the sector.\(^{86}\)

v. Price escalation clauses

A price escalation clause ordinarily permits the supplier to adjust the contract price in response to unforeseen increases in costs arising from circumstances beyond its reasonable control. Typically, such a clause is also included in a long term construction contract in a rising price market.\(^{87}\) The clause substitutes for the law of economic impracticability, since the price increase is usually insufficient to justify setting the contract aside.\(^{88}\) The price escalator serves a balancing function. It

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\(^{85}\) For an example of a tender form providing for “suspension of performance” for an unspecified period during the course of intervening circumstances “beyond control”, see Clause 31, in Tender Form against the Ministry of Textiles of India for RUNNING MAINTENANCE, MANAGEMENT AND PROMOTION/ UPGRADEON OF HANDICRAFTS PORTAL, at <http://handicrafts.nic.in/tender070605.htm>


\(^{87}\) The extent to which construction costs are rising is evident in the observation, in Engineering News-Record, that the Construction Cost Index (CCI) posted a gain of 4.6 percent last year. The Building Cost Index (BCI) showed an increase of 5 percent for the year, mostly due to higher steel prices. The Materials Cost Index (MCI) ended the year with a 6.4 percent increase, as material price escalation provided the most fuel for inflation. See further Scott A. Bannett, How to Manage Rising Construction Costs”. The biggest cost driver is the price of materials, American Institute of Architects (Winter 2007), also at <http://www.aia.org/nwsltr_db.cfm?pagename=db_a_20060705_costs> For the most recent construction cost indices in Engineering News-Record, see http://enr.construction.com/features/coneco/recentindexes.asp

\(^{88}\) For practical ways in which to deal, inter alia, with cost/price overruns in PPP (public-private partnership) contracts, see Jacques Cook, US PPP Market on the Upswing: Some Thoughts from Abroad, 3, at
balances the supplier’s interest in passing rising costs onto customer and customer interests in managing the nature and extent of price increases. A related goal is to normalize a business relationship that both parties prefer to preserve, not terminate.

Parties may also agree on price escalators that limit opportunistic behavior. For example, they may apply price escalator clauses only to those materials that are most prone to market volatility; they may identify price indices that measure that volatility; and they may set ceilings above which the contract price may not rise.⁸⁹

Adopting price escalation clauses presupposes that the parties can agree upon a price escalation formula. Much depends on industry practices, what other suppliers are doing, profit margins and each party’s ability to relay costs upstream and downstream. In petroleum supply contracts, consideration may be given to measuring gyrations in energy costs, how those costs are embodied in price relief clauses, and how they can be relayed upstream and downstream.⁹⁰

The attitudes of groups of customer can also influence the formulation of price escalator clauses. Some customers may be reluctant to sign off on price escalations they believe are being priced into an already price inflated market. Some suppliers may compromise on price so as not to be seen to pass excessive price increases onto customers.

Assuming that the parties can agree to price increases, they need to agree on the form of a price escalation clause. One approach is for them to concentrate only on those risks that are most likely to lead to shifts in prices, such as on price sensitive materials.⁹¹ Another is for them to adopt an agreed formula, ratio or percentage by


⁸⁹ Of note, The US Government recognizes three types of price escalation clauses for the purpose of government contracting: (1) escalation clauses based on established prices; (2) escalation clauses based on actual costs of labor or materials; and (3) escalation clauses based on cost indexes of labor or materials, Federal Acquisition Regulations § 16.203-1. The American Institute of Steel Construction has recommended that members adopt one of the following types of escalator clauses: (1) Payment or credit is based on the substantiated “actual” costs incurred by the party supplying the goods or services. The final cost of supplied goods should be verified from actual invoices and compared to the original estimate or published industry prices at the time of contract. This type of clause is the most accurate indicator of price increases. However, it can only be implemented when the supplier is will to disclose and provide detailed purchase documents. (2) Price escalation is tied to a published material index. That index can be chosen either from commonly accepted industry publications or it can be developed by a governmental agency. This type of clause is easier to implement, but it lacks the accuracy of actual price determinants under (1) above. See further American Institute of Steel Construction, Inc., ISC Endorses Use of Escalation Clauses on Steel Contracts, February 25, 2004, at http://www.a-ztechsteelbuildings.com/steel_prices.htm See further Holland + Knight, 11(1) Construction and Design, (September 2005), at http://www.hklaw.com/Publications/Newsletters.asp?IssueID=607&Article=3226

⁹⁰ On the “run on” effect of increased prices of energy supplies, see As methanol prices rise, biodiesel industry takes notice, in BIODIESAL MAGAZINE, Nov. 2006, at <http://www.biodieselmagazine.com/article.jsp?article_id=1231>

⁹¹ For an obiter in which the court recognized that relief from performance may be justified in volatile markets, while denying relief in the instance case, see Stand Energy Corp. v. Cinergy Services, Inc., 760 N.E.2d 453 (Ohio Ct. App. 2001).
which to measure those price increases. Yet another is for them to set a specific limit above which the price may not increase.

Finally, the price escalation clause may be subject to due process requirements. The supplier may be required to provide reasonable notice of a price escalation as well as comply with procedures which circumscribe the nature, extent and duration of an escalation. The contract may also establish a reasonable method by which customers can pay for price increases, such as by delaying payment of increases for a reasonable period of time or by permitting installment payments.

Ideally, customers should be confident that only unavoidable price increases are included in a price escalator clause, that the increase in price is justified, and that customers have sufficient notice of that escalation to engage in contingency planning such as in securing funds to finance the price increase.

Price escalators are not risk free. Customers that are subject to significant price escalations may default on their contracts. Litigation may ensure, conceivably followed by customer bankruptcy. The issue for parties negotiating price escalators is to be realistic in setting price limits that are affordable, while also fairly accommodating the interests of suppliers faced with increased costs.

6. NEGOTIATING PERFORMANCE RELIEF CLAUSES

This section deals with strategies associated with contingency planning. The analysis is presented, firstly from the customer’s perspective and then from the supplier’s

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perspective. The guiding strategy is for the parties to try to lever off a non-fault based platform to arrive at workable responses to future performance impediments.  

i. Assumptions about risk allocation

One assumption about risk allocation is that the parties can negotiate a comprehensive agreement that takes account of the full spectrum of risks which might intervene during the life of the contract. Supporting assumptions are that: the parties are sophisticated; they have sound knowledge and experience in assessment and pricing risks into the contract; and they are skilled in managing risks.

A further assumption is that the parties are able to plan for at least some intervening risks, including the timing, depth and duration of their effect upon performance. Included in that planning is that the parties can agree upon intervening contingencies that give rise to relief from performance and the manner in which performance may be modified in response to those contingencies.

Yet another assumption is that the contract price is the key determinant in the allocation of performance risks in long term supply contracts. All other factors being constant, the party who receives a higher contract price for a good or service may be more willing to assume a greater risk in relation to that good or service. A party who receives a lower price, in contrast, may be less willing to assume that risk.

It is difficult to accept or reject these assumptions on their face. The offer of a higher contract price may, but need not, induce a party to assume a higher risk. A supplier may resist taking a greater risk for a higher price because it is risk adverse in a volatile market. A customer may oppose assuming a higher risk for a lower price because of the disproportionate impact of that risk upon its operations. In effect, the attitudes of both parties to long term supply contracts towards risks like delay, defective and non-performance may diverge for reasons that go beyond the contract price.

97 On buyer’s working towards arriving at workable solutions in regard to “take or pay” contracts for power stations, see Guy Hardaker, Force Majeure and Take or Pay Contracts for Power Stations: The Buyer’s Perspective. INT’L ENERGY & TAX REV. (July 2000), also at <http://www.hfw.com/l3/new/new13c002.html>.

98 That the parties have such negotiating and drafting skill does not refute the fact that the customer in most long-term supply contracts is in an inferior bargaining position compared to the supplier. See further infra Section 6.ii.

99 On the observation that fewer risks today are unforeseen, see e.g. supra text at note 9.


101 This is based on the economic efficiency rationale that parties self-insure to the extent that they are paid to assume extra risks. In effect a supplier agrees to assume the risk of non-performance in return for a higher price, or the purchase agrees to excuse the supplier in return for paying a lower price. On such efficiency arguments, see Posner and Rosenfield, supra note 15; Trimarchi, supra note 21.
One particular factor that may influence them in assuming such risks relates to their respective bargaining powers.

ii. Bargaining disparities

Legally speaking, neither party to a long-term supply contract can claim legal redress on grounds that the other party has abused its bargaining power. However disadvantaged customers may be at the hands of their long term suppliers, they are still different from consumers who must either “adhere” to take-it-or-leave-it contracts or refrain from contracting. However unequal their bargaining power is compared to their suppliers, customers engaged in long term supply contracts are different from the proverbial consumer. They usually have at their disposal engineers to measure the risk of loss, cost accountants to price those risks and lawyers to negotiate over them. So armed, long term supply customers cannot reasonably claim that their suppliers are abusing their bargaining power sufficient to justify the imposition of legal sanctions.

What customers can do to redress their de facto bargaining deficiencies is reduce their market dependence upon a single supplier. They can identify alternative sources of supply. They can conceivably establish relationships with other customers who share their interests. What they usually cannot do is rest back and expect their suppliers to perform no matter what.

iii. Some realism about realism

Leaving aside the issue of inferior bargaining, human nature is such that even the most sophisticated customers may enter into supply contracts in the hopeful expectation that intervening risks of loss will not occur, or that they can deal with them on a needs be basis if and when they arise. The rationale for such thinking is that parties to long term supply contracts usually avoid canvassing relief from performance in initiating their relationship because doing so may undermine their optimistic expectations about profit making. They tolerate uncertainty in regard to the

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102 The concept of “adhesion” contracts traces back to the now classic work of Frederick Kessler. See Friedrich Kessler, Contracts of Adhesion - Some Thoughts About Freedom of Contract, 43 COLUM L. REV. 629 (1943).

103 Such a proposition raises issues about strategy, not law, except insofar as legal remedies are part and parcel of those strategies. See infra, Section 6, iii.

risk of loss because they hope to benefit more from their relationship than lose because an uncertain risk might impinge upon it.  

Assumptions aside, no matter how expeditious parties to long term supply contracts are, they still need to arrive at strategies for dealing with uncertain future risks of loss. In particular, customers need to develop strategies that avert unexpected and invasive declarations of force majeure by their suppliers.

iv. Customer’s Strategies

Customers have a number of negotiation options they might consider to avoid or to redress declarations of force majeure by their suppliers. These options are presented in two categories: negotiating for loss sharing remedies; and reducing risks through negotiations with third parties such as insurers.

a. Negotiating with the Supplier

Customers that negotiate loss sharing remedies with their suppliers do more than engage in the a priori allocation of risks of loss. They help to manage the risk of uncertainty. For example, they manage the risk of uncertainty if they can reach agreement with their suppliers on the criteria to govern the initiation, continuation and termination of relief from performance. They manage uncertainty in negotiating for different categories of relief, such as between ordinary wear and tear for which relief may be limited and egregious plant shutdowns for which relief may be extensive. They manage uncertainty in negotiating over due process, such as over requiring that suppliers provide due notice of their intention to declare force majeure and over the duration of that declaration. They manage uncertainty in negotiating for loss sharing formula, for example that they absorb cost increases along a sliding scale from 25% to 75%. Customers manage uncertainty in negotiating for the “most favored customer” treatment compared to that accorded to other customers. Finally, customers manage both risks and losses when they bargain for the return to them of money and documentation provided to a supplier in advance of supply, for servicing by alternative suppliers during the course of the disruption.

107 On the adoption of loss sharing formulae, see supra note 106.
108 This, again, resides in the relationship between the parties, their respective bargaining power, their relationships with third parties, and industry practice and usage. See further supra note 77.
109 For example, the customer of supplies for construction might negotiate for the return of architectural drawings or engineering plans for use by a third party during the course of an intervening force majeure event.
b. Negotiating with third parties

Customers may offset the risk of suppliers declaring force majeure by engaging in risk sharing and loss reducing strategies with third parties. They may typically negotiate to reduce their commitments to banks and other suppliers, as well as to their downstream customers in the face of their suppliers’ declaration of force majeure.\(^{110}\)

Customers may also negotiate for insurance against the risk of loss arising from such declarations. They may buy “business interruption” insurance to cover disruptions to their business caused by supply shortfalls, lost income and lost profit. They may acquire “extra expense” insurance to cover the cost of having to move their business to an alternative location during the course of the disruption.\(^{111}\)

v. Suppliers’ strategies in allocating risks

Four assumptions guide the strategies of long term suppliers. Firstly, they ordinarily intend to continue with their contracts notwithstanding the greater cost or difficulty to them in doing so. Secondly, they intend to pass the risk of loss on to their customers for the duration of the intervening disruption of performance. Thirdly, they are constrained in passing on that risk of loss by their need to preserve their customer relationships as well as their reputation for reliability. Fourthly, their interest in being seen to be reliable may not deter suppliers that feel justified to reduce their performance.\(^{112}\)

The purpose, here, is not to present strategies to support the second strategy by which suppliers can pass risks of performance loss onto their customers. Nor is it to suggest how suppliers can devise force majeure declarations that are bullet-proof. The purpose is to arrive at strategies by which suppliers can limit the risk of intervening performance interruptions, reduce losses arising from their impact and promote timely, reliable and effective performance in the face of such losses.\(^{113}\)

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\(^{111}\) On business risk insurance, see generally C.A WILLIAMS AND R.M.HEINS, RISK MANAGEMENT AND INSURANCE (MCGRAW-HILL, NEW YORK, 1989); R.V. ERICSON AND A DOYLE, UNCERTAIN BUSINESS: RISK, INSURANCE AND THE LIMITS OF KNOWLEDGE (U. TORONTO PRESS, 2004).


\(^{112}\) Risks of nonperformance that are encompassed within a long-supply contract represent ways in which the parties “normalize” risks. In effect, they reduce risks that are extraneous to their contract part of it to the extent to that it impacts upon their relationship. On such “normalization” in long-term supply contracts, see infra, MACNEIL AND CAMPBELL, infra note 105.

\(^{113}\) For industry related strategies in dealing with declarations of force majeure see e.g. Steve Quinn, In Prudhoe Bay case, test of force majeure, INTERNATIONAL HERALD TRIBUNE, AUGUST 16, 2006, also at <http://www.iht.com/articles/2006/08/16/business/oil.php>; Sean Barry, *Collahuasi mill*
The first strategy involves developing an awareness of risks associated with supply, particularly those in regard to which suppliers are perceived to be most vulnerable. The virtue here is for suppliers to anticipate when those risks might materialize, the form they make take and the potential gravity of their impact. Developing such awareness is ordinarily in the interests of both parties, although primary responsibility to be informed about prospective performance risks ordinarily rests on the party that has assumed the applicable risk.  

The second strategy is to develop market intelligence about those performance risks, including methods of identifying, assessing and redressing those risks. This strategy encompasses developing “situation sense” about the trade or industry, as well as about the parties. It also includes determining the reliability of that intelligence and ways of harnessing it effectively.  

The third strategy is to engage in risk aversion. If the supplier is bound to deliver all or part of contracted for supplies in the face of an intervening risk, it may develop a contingency plan to purchase those materials in respect of which it is most at risk of not being able to supply. Risk averting practices directed at avoiding supply shortages arising from production disruptions may be addressed by building stockpiles and staggering delivery dates. Risks associated with the duration of long-term supply contracts may be redressed by shortening contract periods including in anticipation of intervening risks.


Parties implicitly negotiate about market intelligence in assuming risks of nonperformance and in allocating risks and ensuing losses between them. A supplier that is confident that it can identify a supply risk may resist assuming the risks of non-supply, but agree to provide the customer with advance “reasonable notice” of that risk. See further infra Section. 4, iv.

Risk averting strategies are implicitly part of any viable business plan. The issue relates to both the types of risks for and extent to which parties ought to plan for particular risks. A customer’s business plan may well call for purchasing business interruption insurance, but the customer cannot be expected to insure against every contingency that might occur that goes to the very basis of the customer’s operation. Firstly, such insurance may not be available. Secondly, it may be exorbitant. Thirdly, insurance against business interruptions that grows into insuring a business as a “going concern” may exceed the risks that insurers are willing to assume. On the practice of insuring catastrophic risks partly through capital markets due to risks to the capital of insurance companies, see Kenneth A. Froot, The Evolving Market for Catastrophic Event Risk, NBER Working Paper No. 7287, at <http://www.nber.org/papers/W7287.pdf>.
A fourth strategy, resembling the first, is for suppliers to be prepared for the unexpected. This involves developing early warning signals, such as about risks of loss and setting up contingency plans in light of them.

A fifth strategy, as much for customers as their suppliers, is to learn from past experience. Industries have a history of risks and losses, as well as methods of preventing and redressing them. Understanding how an industry has functioned in the past, how its functioning has changed in an evolving business cycle, and what strategies suppliers within it have developed in response to those changes may help to regulate current and prospective risks. 117

Finally, suppliers need to develop strategies to redress concerns of customers about the manner and likely impact of performance risks upon them. Customers may need to be assured that their suppliers fully comprehend market risks and that suppliers have effective risk detection and prevention systems. Customers may also seek confirmation of such assurances, such as by negotiating for their suppliers to use “best efforts” to perform in the face of impending risks of loss and assuming liability for failing to use such “efforts”. Suppliers may succumb to these demands in order to appease their customers, because they believe that the risks in issue are manageable, and in subscribing to a business ethic that supports such “best efforts.” 118

vi. Making strategic choices

There are no assured strategies that work in all cases. Take the relationship between an owner of a plant who declares force majeure in the event of an earthquake and its customers. Assume that the plant is located within a recognized earthquake zone. In the first case, the plant owner may accept an earthquake risk if it believes that the construction of its plant is earthquake-resistant. In the second case, the impact of the earthquake is so great that quake-resistant techniques used in that plant’s construction are ineffective. The owner is unlikely here to accept the risk of loss where the cost to it of taking additional precautions are exorbitant, or the severity of and damage caused by the quake is largely unavoidable. In the third case, the plant is located in a region in which earthquakes are less readily anticipated, less severe, or less able to be rendered earthquake “proof.” Here too, the owner is unlikely to assume the risk of a devastating earthquake.

In each case, the supplier makes a choice based on its perception of the nature, likelihood and severity of the earthquake, its physical and economic capacity to avert

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117 The advent of strategies to deal with new risks, such as the outbreak of the SARS epidemic, see Mario Nigro and Marianne Smith, Does SARS Trigger A Force Majeure Clause?, at http://www.blakes.com/english/publications/bdr/may2003/SARSmay03.asp#forcemajeure

118 Use of a “best efforts” test in a contract is a question of fact. On the negative side, it invites disagreement as to whether the use of “best efforts” entails a higher standard a “reasonable effort” to perform, and whether the party under such a duty has complied with it in fact however that duty is defined. The primary value of a “best efforts” clause is to encourage parties to exercise good behavior such as due diligence in performing in whole or part. See generally, E Allan Farnsworth, On Trying to Keep One’s Promises: The Duty of Best Efforts in Contract Law, 46 U PITT.L.REV 4 (1984).
or mitigate the impact of its impact and the market competitive in which it makes that strategic choice.\footnote{119}

7. **MAKING COMPROMISES**

In raising performance issues in advance, parties to long-term supply contracts make them germane before those risks materialize into losses. In so dealing with them, they can arrive at practical business solutions to what might otherwise regress into festering conflict.\footnote{120}

Parties to long-term supply contracts are unlikely to negotiate over every conceivably risk contingency.\footnote{121} At one extreme, suppliers may assume a take-it-or-leave-it attitude towards the risk of loss. At the other extreme, suppliers may negotiate over the full range of performance risks and losses. Most suppliers will reside somewhere between these extremes. Some will agree to restrict performance relief to specific disruptive events, while agreeing to accept other risks. Some assume additional risks in return for countervailing benefits such as an increase in the price. Most will expect their customers to serve as insurers for at least some supply risks, with the price serving as the insurance “premium.”

In issue is not that suppliers are unreasonable in adopting such a take-it-or-leave-it position. These are, after all, business decisions. However, supplier may be willing to entertain \textit{ex post} compromise to appease their customers and possibly in return for corresponding benefits. Such compromises are part of contingency planning. They may also help to get a business relationship off to a good start, to keep lines of communication open between the parties and to avoid needless conflict as the relationship progresses.\footnote{122}

Even strategies directed as parties reaching “agreements to agree”, however unenforceable they are in law, may serve as incentives for parties to reach compromises over performance risks. Such “agreements” may also serve as inducements for suppliers to demonstrate they negotiated in good faith in the face of subsequent legal challenges.\footnote{123}

\footnote{119} On the significance of foresight in the assumption of risks, see supra Section 2, I, and Luca Anderline, Leonardo Felli and Andrew Postlewaite, supra note 53.
\footnote{120} For Cordis FP6, \textit{Step by Step approach towards force majeure in managing a construction project}, see \url{http://cordis.europa.eu/fp6/stepbystep/problems.htm}
\footnote{121} It is useful for parties to establish a checklist of issues to consider in negotiating and drafting relief from performance clauses, including in regard to the validity of the assumptions above. See e.g., John G. McFarland, \textit{Checklist for Negotiating an Oil and Gas Lease}, Annual Meeting, Texas Land & Mineral Customers Association, October 5, 2006, at \url{http://www.tlma.org/oilgasleasechecklist.pdf}
\footnote{122} An exception to this generalization occurs when relief from performance is sought for reasons beyond the intervening force majeure claim. For example, the party so claiming no longer finds the long term contractual relationship profitable or sufficiently profitable compared to alternatives and hopes that the other party will terminate the contract.
\footnote{123} For an example of parties contracting to negotiate a modified aerospace supply agreement in the event of force majeure circumstances beyond control, see Condition 8 (Case of Unforeseeability and Force Majeure), at \url{http://www.lisi-aerospace.com/telechargement/tc_2007.pdf}. 

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Even when *a priori* agreement on the sharing of losses fails to eventuate, the parties still gain the benefit of certainty in business planning. Knowing that a supplier will decline to perform in the face of a particular disruption may enable a customer to plan for it, such as by arranging for substitute lines of supply and securing business interruption and extra-expense insurance. Reaching a contingent agreement with an alternative supplier or buying business risk insurance may well add a surcharge to the customer’s purchase price; but the benefit of doing so may be significant should the supplier subsequently declare *force majeure*. However flawed each form of contingency planning may be, it still presents part of an interlocking solution to impending business threats.  

Ultimately, the parties need to realize that no two situations are identical; and appropriate solutions will diverge from party to party, industry to industry and time to time. As a result, a “one size fits all” relief from performance solution will often be ill-fitting from one long-term supply contract to the next: so too will be contingency planning in consequence of it.  

**CONCLUSION**

The greatest strength behind long term supply relationship is the interest of both parties to continue it. The greatest risk arises when that relationship is no longer profitable for one party. If the potential loss of profitability is short-term, the parties may well be able to overcome it by agreement. If the potential loss is long-term, one or both parties have good reason to terminate their relationship.

In managing risks of non-or partial performance, both parties need to consider to what extent it is worth their while to preserve their relationship and how they should go about doing so. That decision is best informed by their ability to find a balance between their assessment of intervening risks of loss and their allocation of those risks between them in an efficient and fair manner. What is efficient and fair is not an abstraction; it is a business decision which the parties make. That decision also serves as the primary “law” governing long term supply relationships between those parties.

This essay has explored the management of long term supply relationship in the face of the growing practice by which suppliers declare *force majeure*. In issue is the risk of these declarations transforming amiable supply relationships into the economic privation of customers, sometimes leading to intractable differences. The essay has suggested strategies by which to redress such differences in the interests of both parties and ultimately, for the public good.

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