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# Force majeure issues in today's gas market

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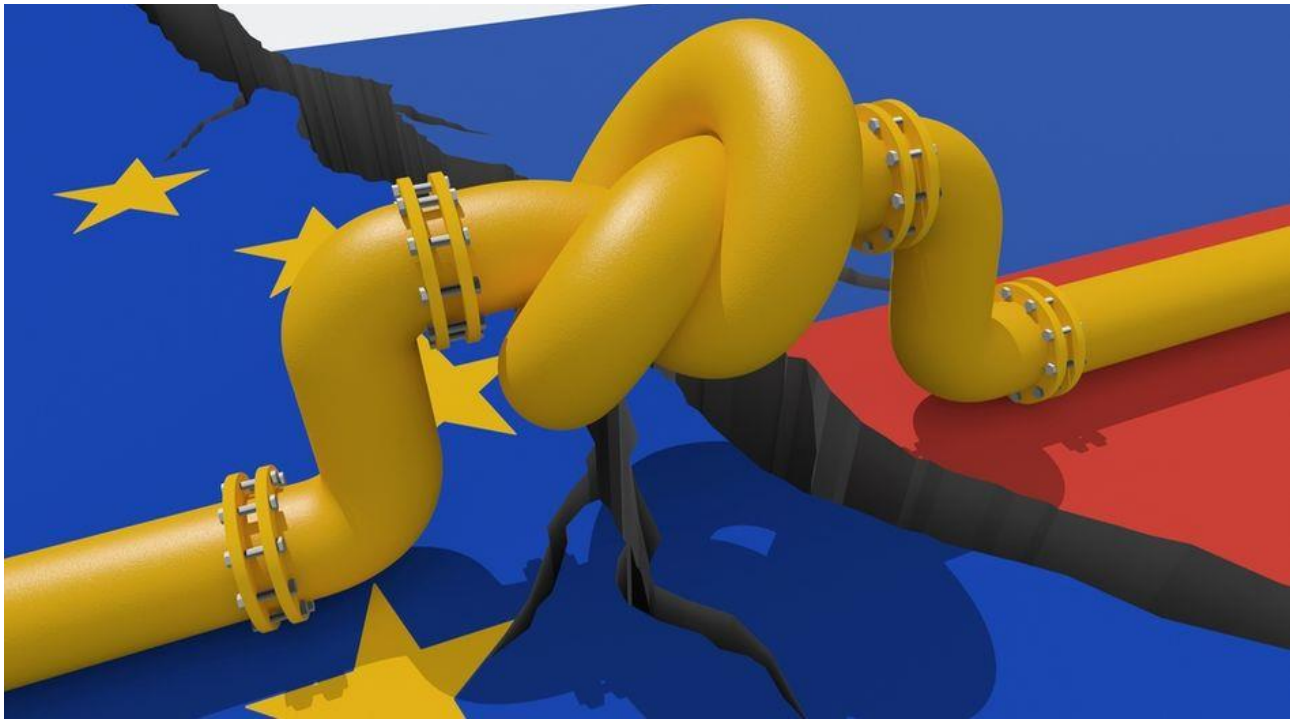

***Michelle Bock, Max Rockall, George von Mehren*** *and* ***Stephen Anway*** *of Squire Patton Boggs consider issues of force majeure in the context of Gazprom's sharp reduction in supplies of gas to Europe.*

Since the middle of June this year, Gazprom has reduced deliveries to Europe significantly, exacerbating the existing gas supply crunch. Gazprom's purported justification for this acute supply reduction: "extraordinary" circumstances. This article explores the issues of force majeure, contractual volume flexibility, and the increasing occurrence of missed cargo deliveries and reduced flows in the current market environment. While the applicability of force majeure, remedies, mitigation tools, and applicable law depends on the terms of the relevant contract, there are readily identifiable common issues in today's gas market.

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Supply variations over time are typically anticipated and accounted for in long-term gas supply and purchase agreements. Indeed, most long-term pipeline gas contracts contemplate a number of potential scenarios in which a seller may under-deliver gas, including:

- small delivery shortfalls that the seller compensates through penalty payments, which can vary depending on the time of year in which the shortfall occurs;
- small delivery shortfalls for which the seller pays replacement costs;
- delivery suspension or curtailment for a limited period, which is pre-agreed between seller and buyer, during which regular maintenance and repairs are performed on the transmission system and the parties' respective obligations, to deliver and to pay, are suspended in part or in whole; and
- Force majeure, where a party is unable to perform under specific events or circumstances, which excuse the affected party's performance.

Gazprom's sharp reductions in the supply of gas to Europe began in mid-June. This reduction occurred without any public statement that this period of time constituted pre-agreed repairs; or any declaration of force majeure. Depending on the language of a gas importer's contract, this reduction may mean that the importer may (subject to the particular contract) be entitled to penalty payments, replacement costs, or potentially both.

These reductions continue today and have become more acute as the Nord Stream 1 pipeline has entered a maintenance period. On 14 July 2022, Gazprom export declared force majeure under a variety of contracts for the delivery of gas to Europe, asserting that it did so retroactively to mid-June, when it sharply curtailed gas flows. Meanwhile, in Asia, Gazprom Marketing and Trading declared force majeure in relation to multiple cargoes that it was otherwise contractually required to deliver. These events have considerably raised the temperature in an already volatile market.

**Force majeure**

Most gas contracts contain a specific clause that defines force majeure and its consequences. Questions of force majeure are seldom straightforward, as the present supply crunch illustrates.

Under English law, force majeure has no inherent meaning but, rather, is a label given to a common type of contractual term allowing parties to suspend, delay or excuse performance of a contract where that performance is affected by a particular event beyond their control. Typically, force majeure under English law requires an extenuating event, an inability to perform the contract, and a causal link between the two.

Under German law, there is no defined term of force majeure in the statutory code. Rather, section 275 of the German Civil Code (BGB) addresses circumstances in which performance has become impossible. Similarly, under the Convention for the International Sale of Goods (CISG), there is no

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force majeure provision per se. Nevertheless, article 79 exempts a party from liability for failure to perform where the failure was due to an unforeseeable impediment beyond the party's control, the consequences of which could not have been avoided or overcome.
While force majeure and its application will depend on the specific contractual language and the applicable governing law, certain elements are typically required.

First, an event or circumstance must have occurred that causes one party to be unable to perform (or delayed in performing) its obligations. It is typically not enough that performance has become more difficult or more costly. Consequently, a party typically must be unable to perform its contractual obligations. Under German law, section 275 of the BGB excludes a claim for performance "to the extent that performance is impossible for the obligor or for any other person". Under English law, force majeure does not generally entitle a party to "fold their arms and do nothing", such that if the event or circumstance has merely made the contract more difficult or expensive to perform, a party may find that force majeure cannot come to its aid to excuse its failure to perform.

Second, the event or circumstance that has rendered a party unable to perform must typically be something unforeseen; beyond the reasonable control of the affected party; the consequences of which were unavoidable; and to which the affected party did not contribute. As such, in terms of the disruption, the party seeking to rely on the provision will often need to show that they have taken steps to mitigate or overcome the effects of the event or circumstance.

Contracts often define what is, and is not, an event or circumstance of force majeure. For example, a contract might specify that force majeure events include an act of God, such as a hurricane, earthquake or tornado. Equally, it may specify that it includes acts of conflict, such as war, insurrection, strikes, blockades or embargoes. In this regard, a contract's force majeure clause might also identify events specifically but say that force majeure "includes" such events, indicating that the list is non-exhaustive and that other events or circumstances might fall under the umbrella of the force majeure clause. As applied here, buyers of Russian gas and LNG in Europe and Asia should be actively scrutinising the force majeure provisions within their long-term contracts to gauge their potential applicability to the various sanctions introduced in recent weeks and months and the asserted circumstances that are alleged to contribute to the current supply disruptions.

By contrast, a contract's force majeure provision may expressly exclude certain events or circumstances, such as price increases, economic hardship, or delays by third-party contractors. Under many contracts, for example, price dislocation or a fall in demand are, in and of themselves, not valid triggers (and for good reason, given the careful allocation of price and volume risk that underpins long-term gas supply contracts). Importantly, in each case, the application of force majeure will depend on the specific wording of the contract.

**Why does it matter?**

Where there is a valid declaration of force majeure, an affected party's non-performance is excused. Therefore, if a party is normally obliged to pay penalty or compensation costs for its failure to perform, a valid declaration of force majeure will likely excuse it from having to do so.

To excuse a failure to perform, however, the key question is whether the force majeure declaration is valid. If, for example, a party alleges an inability to use a transmission route to deliver goods, the question is whether there are other routes by which it can deliver the goods to the relevant market. This issue is particularly relevant for long-term pipeline gas contracts, which often specify the ultimate delivery point or delivery market, but which rarely specify which parts of the interconnected European pipeline system must be used to transport the gas to the delivery point.

If a party is truly unable to perform, the question, then, is what events caused this inability. Was it something the seller really had no control over and to which it did not contribute? And does the force majeure clause provide any flexibility to the affected party in the impact on its performance? For example, does the language in the relevant clause contemplate performance being delayed, hindered or impeded as opposed to prevented, which imports a higher threshold question?

Many contractual force majeure clauses in long-term contracts require an affected party to immediately notify its counterparty of the occurrence of the force majeure event. Where a party waits weeks or months to notify its counterparty, this casts material doubt on whether a force majeure event has truly occurred. If it has occurred, what explains the long delay? Moreover, certain legal systems provide for stricter rules for the notice requirement. Under English law, for example, the requirement to provide notification within the contractually-stipulated time frame may amount to a condition precedent, the failure of which could be fatal to a party's declaration of force majeure.

Finally, many force majeure clauses (and many legal systems) require an affected party to take reasonable steps to mitigate the harm that its failure to perform has caused and bring its performance back into contractual compliance as soon as possible. This may be done, for example, by obliging a party to take steps to bring the force majeure to an end; and in certain instances, instructing the party to try to seek alternative supplies or other means of contractual performance.

**Options for buyers facing purported declarations of force majeure**

In the first instance, buyers must scrutinise both the terms of the force majeure notice and the language of the relevant contract. As explained above, while each case must be assessed individually and by reference to the relevant contract and applicable law, the party seeking to declare force majeure may be required to establish its compliance with the following (or similar) components of the relevant contractual provision:

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- evidencing the actual existence of the event or circumstance underpinning its declaration of force majeure;
- showing that it has actually been prevented, hindered, or delayed from performing its contractual obligations due to the particular event or circumstance on which it relies;
- establishing that there were no reasonable steps that it could have taken to mitigate or avoid the event or circumstances in question or their consequences;
- demonstrating that its failure to perform (or perform on time) was as a result of circumstances beyond its control;
- showing that it is taking all reasonable steps to bring the force majeure event to a conclusion as quickly as possible; and
- confirming that it complied with any relevant notice requirement.

In turn, the other party may start its own contractual enquiry, analysing these elements to ascertain whether it accepts or rejects the declaration of force majeure. In so doing, it should consider reserving all of its rights while it makes investigative enquiries. The non-declaring party also may have onward sale obligations and downstream supply responsibilities, prompting it to mitigate its own exposure by seeking to reschedule or reduce supply, or even possibly seeking supply from another source to avoid breaching its downstream contracts.

Importers facing a force majeure declaration may find value in taking steps to engage in immediate correspondence and dialogue with their counterparty. In particular, importers should inquire about the specific nature of the force majeure event and the steps being taken to overcome it, as well as requesting factual evidence and confirmations regarding alternative supplies or the mitigation efforts being deployed. If the purported force majeure declaration has led to a series of missed deliveries—for example, multiple LNG cargoes—the question is whether there is an obligation to reschedule, a shortfall clause, or a provision governing the delivery of force majeure restoration quantities? Equally, for pipeline gas contracts, can supply be diverted from another part of the transmission network to fulfil the delivery obligation? Is the seller's obligation subject to any legal qualification, such as using "best endeavours" or "reasonable endeavours"? These are all questions to consider from the outset of the enquiry.

To the extent that a buyer can objectively challenge the force majeure declaration, the buyer should consider its contractual options. If the seller has failed to perform, will it then seek to rely on a liquidated damages provision providing a penalty payment for the non-delivery based on a percentage of the value of the missed delivery? Is this described as a sole and exclusive remedy? Could the delivery failure be a tactical decision by the seller, or be motivated by commercial or financial incentives? If so, could that fall under some category of wilful default or misconduct? These, again, are all possible questions that may warrant examination in the current climate, where sellers are seeking to maximise the value of their sale commodities. With spot prices remaining high, paying a percentage penalty for non-delivery is a small price to pay compared to the windfall profits that can be made on the spot market.

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When, as now, importers of gas find themselves in a time of crisis, the starting point for any assessment is a mastery of the relevant contract and the factual circumstances at issue. Objectively assessing both the contract and the facts is crucial for importers of gas to confront and ultimately resolve the alleged force majeure issues arising in today's gas markets.

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