

Energy Alert

Force Majeure Issues Impacting the Power Sector

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The power sector has responded rapidly to the Coronavirus pandemic by following Emergency Operations Plans, some of which specifically include responses to epidemics. The reliability of the grids across the United States has been maintained and power providers are necessary to the continued functioning of the country. It is not yet known what the fallout will be for the industry with respect to demand degradation, interruptions to supply chains, and the ability to comply with regulatory requirements under the circumstances. This article discusses force majeure clauses in various agreements that will need to be reviewed to determine the potential risk associated with counterparties in the power industry.

The Anatomy of the Force Majeure Clause

An analysis of force majeure claims in any context, and whether or not due to the novel Coronavirus or COVID-19, will be dependent upon the specific contract language and the facts at hand. In the electric power sector, there are industry standards, trade usage and expectations that are particular to the electric power industry that will inform this analysis even though force majeure provisions are the product of contractual negotiations and vary among parties, products and types of contracts. In the context of electric power contracts, and in particular project-finance backed power purchase agreements (PPAs), other long and short-term PPAs and hedging agreements, tax equity financing and contracts for differences, the contract language will typically include as part of the definition of an event constituting force majeure the following or similar language: any act or event that could not be reasonably anticipated and resulted from a cause beyond a party's reasonable control that could not be avoided through the exercise of due diligence. The language will typically also specify certain events that are specifically identified. Such force majeure provisions are often termed "closed" force majeure clauses because they include a specific and "closed" list of events which trigger a force majeure event. Whether an event is enumerated in a contract and qualifies as a force majeure event is especially important because some courts interpret force majeure provisions narrowly and will primarily focus on the list of terms in the contract.¹ A common closed force majeure provision in a PPA would list some combination of the following terms that may be applicable to a particular COVID-19 event or situation:

- epidemic;
- plague;
- action or inaction by a governmental authority;
- curtailment due to emergency conditions;
- disconnection of service under an interconnection agreement;
- inability to attain regulatory approvals (despite diligent efforts);

¹ See *Sun Operating Ltd. P'ship v. Holt*, 984 S.W.2d 277, 282-83 (Tex.App.-Amarillo 1998, pet. denied) ("the scope and application of the [force majeure] doctrine is utterly dependent upon the terms of the contract in which it appears.").

- inability to attain necessary services or materials (despite diligent efforts); or
- a national, regional, or local emergency;
- the inability of the regional transmission organization or independent system operator to perform key functions.

For parties seeking to invoke force majeure provisions due to COVID-19, contracts with specific references to epidemics or plagues will be extremely useful and will provide parties with a strong argument that a force majeure event has occurred. For all future agreements, the parties should consider the impact of including, or excluding, such terms in the force majeure clause. With respect to force majeure clauses in retail agreements, depending on the size and type of customer to a retail electricity supply contract, the force majeure language may be mandated by the State utility commission or may be freely negotiated. Similarly, the ability to declare a force majeure by the supplier under a retail contract may also be limited by orders of the State utility commission, which has already occurred in multiple States. These include moratoriums on disconnections, delayed payment obligations or waiver of certain payment obligations. Prior to disconnecting a retail customer, a review of both the agreement with the customer and the relevant retail rules should be undertaken. Distribution utilities also are subject to these same types of requirements in many states such that disconnection or exercise of remedies under an agreement is prohibited by the relevant regulatory body, effectively freezing the obligations of the retail customer and requiring the utility to continue to provide service. This is effectively a force majeure for the retail customer with a continuing obligation to serve on the part of the utility.

Review of Force Majeure Considerations in Power Contracts

The effects of COVID-19 have not been as transparent in the power industry as in other industries such as the hospitality industry. However, given the potential impact to business operations in this critical sector, recognized in the exclusions of the industry from the current “shelter in place” orders issued by various governing bodies,² parties should be aware of risks that may originate with their own employees, their counterparties, vendors, contractors and suppliers. A careful review of exposure under these contracts based on the force majeure provisions should be undertaken with consideration of the following factors that may affect or contribute to a claim of force majeure by either party to the agreement.

- **Supply Chain Delays**

Supply chain delays may impact existing power contracts and new projects under development. Fuel source shortages have not yet been a problem for power suppliers in part due to the collapse of the natural gas demand and pricing, however this could change depending on the duration of the pandemic, the extent of restrictions imposed by governmental shelter-in-place orders, and whether widespread workforce shortages occur. Renewable projects may be especially hard hit as they face delays in solar panel, inverters and other component deliveries from China and other countries significantly impacted by COVID-19.

² See e.g., State of New York, Executive Order No. 202.6, *Continuing Temporary Suspension and Modification of Laws Relating to the Disaster Emergency*, Mar. 18, 2020, <https://www.governor.ny.gov/sites/governor.ny.gov/files/atoms/files/EO202.6.pdf>; City of Austin, Order 20200324-007, *Stay Home- Work Safe*, Mar. 24, 2020, <http://www.austintexas.gov/edims/document.cfm?id=337824>.

- **Workforce Shortages**

Workforce shortages pose a threat to all sectors of the economy and the power industry is no exception. As discussed above, the power sector has thus far been largely exempted from government-mandated shelter-in-place orders. The Federal Energy Regulatory Commission (FERC) and the National Association of Regulatory Utility Commissioners (NARUC) have jointly urged all states to designate utility workers as providers of essential services and the various shelter-in-place orders specifically exclude electricity service providers.³ As a result, electricity service providers, including power generators, retail service providers and utilities, should they experience workforce shortages, will not be able to point to government shelter-in-place orders as a cause of workforce shortages. Instead, staffing shortages will need to be proven up on a case by case basis as having been directly caused by COVID-19. It is critical that utility service providers document employee absenteeism. Documentation will also have to be provided of the actions taken to prevent the spread of COVID-19 among employees to support potential force majeure claims by demonstrating that the claiming party complied with the requirement to exercise due diligence to avoid and minimize the force majeure. Companies that are subject to shelter-in-place orders would be well advised to maintain similar records and to document all attempts to implement robust remote work arrangements and mitigate the negative effects of social distancing orders.

- **Increased Market Risk**

Electric power stakeholders face increased market uncertainty as demand patterns shift in response to shelter-in-place orders and in the areas hardest hit by COVID-19, to the degradation in demand due directly to spread of the virus. Power prices shift in response to demand changes and falling oil prices, while at the same time credit markets are tightening. However, parties should be aware that courts may view market price fluctuations as foreseeable market risks and be reluctant to construe price fluctuations as force majeure events. Courts have determined that force majeure provisions will not insulate a party from the “normal” risks of the contract, including risks associated with changes in market prices, when parties have entered into a fixed-price contract.⁴ It will be imperative to demonstrate that that market impacts posed extraordinary and unforeseeable risks. Further, renewable projects may be impacted as tax equity investors re-examine the financial benefits of investing in renewable developments. Renewable and traditional generation industry groups continue to lobby for tax relief provisions to be included in future federal COVID-19 related legislation. If such tax relief provisions come to fruition, it may buffer the financial impact of the epidemic on both renewable and traditional power developers and at the same time raise the bar for parties claiming force majeure.

- **Regulatory Delays**

Market participants should anticipate delays in administrative proceedings as regulatory authorities continue to operate under remote work policies. FERC,⁵ NERC,⁶ the Texas Public Utility Commission (PUCT),⁷ the Electric

³ See Federal Energy Regulatory Commission, *FERC, NARUC Join Efforts to Help Ensure Essential Services During Pandemic*, Mar. 26, 2020, <https://www.ferc.gov/media/news-releases/2020/2020-1/03-26-20.pdf>.

⁴ See *N. Indiana Pub. Serv. Co. v. Carbon Cty. Coal Co.*, 799 F.2d 265, 275 (7th Cir. 1986) (“The whole purpose of a fixed-price contract is to allocate risk in this way.”).

⁵ See Federal Energy Regulatory Commission, *FERC, NERC Provide Industry Guidance to Ensure Grid Reliability Amid Potential Coronavirus Impacts*, Mar. 18, 2020, <https://www.ferc.gov/media/news-releases/2020/2020-1/03-18-20.pdf>.

⁶ *Id.*

⁷ See Docket No. 50664, *Issues Related to the state of Disaster for Coronavirus Disease 2019*, Memorandum from Chairman Walker at 1 (Mar. 16, 2018); see also Docket No. 50664, *Order Suspending Rules* (Mar. 16, 2020) (Commission adopting order consistent with Chairman Walker’s memorandum).

Reliability Council of Texas (ERCOT),⁸ and other ISOs⁹ have signaled that the highest priority in managing the COVID-19 crisis is to maintain the reliability of the electric grid. Parties to contracts with pending regulatory approval deadlines should maintain communications with administrative staff and counterparties regarding approval timelines and should consider seeking to amend deadlines as soon as it appears delays are likely to occur. If parties are not able to agree on changes to the required deadlines, the force majeure provisions should be reviewed to determine whether the language in the agreement covers a situation where the governmental entity has not directly acted and has neither denied an application nor timely approved the application. However, when these situations are not explicitly listed in an agreement, courts have previously determined that the failure to obtain necessary regulatory approvals is foreseeable and is therefore not a force majeure event.¹⁰

- **Governmental Disaster Declarations**

COVID-19 presents an unprecedented period within which a force majeure event may occur. Unlike a “typical” natural disaster such as a hurricane or a tornado, COVID-19 is anticipated to directly impact operations across the globe for weeks or months to come and the location of the force majeure is not limited to any particular area. That is starkly different from a natural disaster occurring in a confined geographic area and measured in days or weeks.

A key issue related to timing is likely to be the role of various disaster declarations made by governmental entities. While it is unquestionable that a pandemic has occurred, whether the pandemic affected a particular business operation at a particular time is ripe for dispute in a crisis that lasts for many months. Emergency declarations with wide-ranging restrictions and enforcement provisions are being issued by federal, state, and local governmental entities. Some force majeure provisions require that the force majeure be identified “immediately” or “as soon as practicable”, when the actual force majeure event, such as the inability of a manufacturer to ship product timely, may not be known until the arrival is delayed, and then the reason for the delay, although related to COVID-19, may not be well-documented. Force majeure claims for non-performance that are wholly attributable to COVID-19 may be rejected or only partially excused, as courts will only excuse performance to the extent made necessary by the force majeure event.¹¹ Some agreements will contain audit provisions that allow for a review of pricing, but usually not a review of reasons for nonperformance with respect to force majeure. Such information will be necessary, for example, to support a claim that the original equipment manufacturer failed to supply due to a COVID-19 force majeure rather than a simple failure, which may provide a buyer/reseller with the ability to allege force majeure for the resale of the generating equipment to a project developer.

⁸ See ERCOT Pandemic Plan Preparations for Coronavirus (COVID-19), Mar. 31, 2020,

http://www.ercot.com/content/wcm/lists/200199/ERCOT_Pandemic_Planning_Actions_for_COVID19_FINAL.pdf.

⁹ See ISO New England, *ISO New England implements actions in response to the Coronavirus (COVID-19) outbreak*, Mar. 20, 2020, <http://isonewswire.com/updates/2020/3/20/iso-new-england-implements-actions-in-response-to-the-corona.html>, last visited on March 31, 2020; see also PJM, *PJM Info-Connection*, Mar. 12, 2020, <https://www.pjm.com/about-pjm/newsroom/info-connection.aspx>, last visited on March 31, 2020.

¹⁰ See *URI Cogeneration Partners, L.P. v. Bd. of Governors for Higher Educ.*, 915 F. Supp. 1267 (D.R.I. 1996) (holding that cogenerators' inability to secure zoning approval for project was a foreseeable event and not subject to the agreement's force majeure provision).

¹¹ See *Aquila, Inc. v. C.W. Mining*, 545 F.3d 1258 (10th Cir. 2008) (holding that coal mining company's deficient performance to supply coal to public electric utility was excused only to extent that partial force majeure caused deficiency).

- **Reasonable Mitigation Steps**

Many force majeure provisions in all manner of wholesale, project development and retail electric service and utility power contracts including interconnection agreements, impose a duty on the party claiming force majeure to exercise reasonable diligence or efforts to prevent, avoid, or mitigate the effects of a force majeure event. The electric power industry is built on redundancy and risk reduction. Generators and utilities are well-versed in emergency preparedness and stakeholders across the electric power industry are already taking exceptional steps to reduce their risk in response to COVID-19. Grid system operators such as ERCOT closed their facilities to stakeholder meetings and non-employees.¹² On the power generation side, temporary on-site housing is being set up at generation units to protect operators from exposure to COVID-19. These examples demonstrate that what is considered to be a reasonable mitigation practice in response to COVID-19 may be a higher standard than the traditional mitigation with respect to normal business operations.

- **Notice**

Complying with all contractual notice requirements is critical to asserting a successful force majeure claim. If the COVID-19 pandemic continues to impact markets for coming months, determining when notice must be given will likely be a fact question. Familiarity with contractual notice provisions is important for instances when a party becomes aware that they may not be able to perform in the future. From the time a party becomes aware of the potential of a force majeure event until the force majeure notice provision is triggered, is the window within which alternative performance obligations may be explored in order to meet obligations to mitigate discussed above, however contractual language may differ with respect to the triggering of the notice period itself. If the clause provides that a party will notify the counterparty as soon as practicable that such party will not be able to perform, the notice may need to be provided as soon as the party knows that at a point in time they will not be able to perform. Such triggering event may be weeks or months prior to the force majeure event actually affecting performance.

- **Change in Law**

In addition to evaluating the force majeure language in power contracts, parties should also be sure to review the change in law provisions. These provisions can be heavily negotiated in PPAs, and hedging arrangements because the power markets are so heavily regulated. A law or regulation for purposes of a change in law clause is broad. The applicable law will ordinarily encompass federal (FERC, North American Electric Reliability Corporation (NERC), state commission and RTO or ISO rules, protocols, order or standards. The provisions typically address circumstances where a change in law materially or adversely affected and changes the benefits and/or obligations of one or both parties. Change in law provisions typically address situations when an existing law has been amended, modified, supplemented, or repealed. These provisions may also refer to an enactment or making of a new law or a change in the application or interpretation of an existing law.

Change in law provisions often stipulate that if a change in law becomes effective related to an essential or material element of the contract, then the parties may, upon mutual agreement, renegotiate certain terms or provisions of the agreement that were adversely affected or materially changed because of the change in applicable law. In some instances, a party may terminate the agreement altogether either with a termination payment based on the

¹² See ERCOT Market Notice M-A030320-02, *ERCOT Precautionary Measures in Response to Coronavirus - Visitation Restrictions to all ERCOT Facilities*, Mar. 9, 2020, http://www.ercot.com/services/comm/mkt_notices/archives/4468, last visited on March 31, 2020.

gains and losses for the remaining term of the agreement, without penalty, or at some negotiated level in between. In any case, there is likely to be a winner or a loser in a termination due to change in law.

In the context of COVID-19, there may be several situations where a new order, rule or directive may make it impossible for a party to fulfill its obligations and duties under a contract. For example, many jurisdictions across the country are subject to shelter-in-place orders that require residents to remain home and often close non-essential businesses. If a party cannot fulfill its obligations under a contract because it was forced to close because of a shelter in-place order, then that party may be able to rely on the change in law provision to renegotiate the terms of the agreement to better address the current situation or it may seek to exit the agreement altogether. Some change in law provisions have materiality thresholds while others do not. Parties should carefully review any change in law provisions in their contracts to identify alternative avenues to exit a contract or create an opportunity for a party to open certain terms and/or provisions to renegotiation when a bargained-for element of a contract has been altered due to a change in law.

Going Forward

As parties negotiate new agreements, it will be important for parties to characterize and plan for events like the COVID-19 outbreak in negotiating contracts for power supply, retail sales, and with contractors and suppliers. Trade usage and relationships between the parties may also be relied on in the determination of what was intended when the parties executed the agreement with respect to an event like COVID-19.

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