

Energy Alert: Negative Oil Prices and Force Majeure

By Jeff Nichols and Gilbert Porter

The negative pricing for West Texas Intermediate oil (“WTI”) on Monday has raised alarm bells for many of our clients in the exploration and production and midstream industries. This article will clarify the issues for these companies and explain the forces at work that have created this situation.

The root cause of the current dilemma arises from the dramatic drop in demand starting with the onset of the COVID-19 virus on the United States. The drop in demand immediately started working its way upstream through refiners, transportation companies and ultimately to the producers. Producers cannot shut-in wells as quickly as the demand dropped, so there is an abundance of oil that must go into storage. But what happens if storage fills?

On April 20, for the first time in history, the WTI price closed at a negative price. This was widely attributed to traders having to sell contracts on that day at any price to avoid taking physical delivery.

But producers and their buyers have likely not sold oil at a negative price. This is because the pricing in physical oil agreements is usually the average of a month’s daily closing prices. The negative pricing seen on one day will hurt the average but is not likely to lead to producers seeing negative prices for their oil unless this phenomenon becomes routine. But even if the physical price remains positive, the fear remains that one day buyers will not be able to take the oil because storage is full. In that event, buyers may turn to the *force majeure* provisions of their contract.

As discussed in other articles, *force majeure* is a creation of contract around which a body of law has developed; except for certain statutory provisions affecting government contracts, the concept of force majeure does not exist as an independent concept of law applicable to commercial contracts that do not contain such a clause. Therefore, whether or not there is *force majeure* protection to a contract obligation depends entirely on the wording of the contract. Moreover, when force majeure provisions do exist in contracts, they are often highly-negotiated and fact-specific, so it is risky to draw generalities. Even the most thoughtful effort at anticipating future events is likely to not explicitly deal with the present situation, which is so unique.

Contractual Definition of Force Majeure

As much as each *force majeure* clause is tailored for the specific contract, there are common elements that are most always found in *force majeure* clauses:

- The event of circumstance must be unforeseen (and reasonably unforeseeable) and/or beyond the reasonable control of the asserting party;
- The event or circumstance must have the effect of rendering the asserting party unable to perform its contractual obligations;
- The asserting party must take reasonable actions to mitigate the impact of such event or circumstance;

- The asserting party must provide timely notice of such *force majeure* event or circumstance, the impact it has had on the asserting party and the steps being taken by the asserting party to mitigate (and timely notice must also be given as and when such *force majeure* event ceases to exist);
- The event or circumstance must NOT be on the list of events or circumstances expressly excluded from the scope of such relief; and
- The relief must be within the scope of relief permitted under the terms of the contract.

The Conoco 93 Form

Many of the contracts between producers and their buyers refer to the Conoco General Provisions Domestic Crude Oil Agreements, effective January 1993, often referred to as the “Conoco 93” form. This is a widely published form which negotiators will utilize as a starting point. But this form is normally modified, and the *force majeure* provision is often the object of these modifications.

The Conoco 93 *force majeure* provision is as follows:

E. Force Majeure: Except for payment due hereunder, either party hereto shall be relieved from liability for failure to perform hereunder for the duration and to the extent such failure is occasioned by war, riots, insurrections, fire, explosions, sabotage, strikes, and other labor or industrial disturbances, acts of God or the elements, governmental laws, regulations, or requests, acts in furtherance of the International Energy Program, disruption or breakdown of production or transportation facilities, delays of pipeline carrier in receiving and delivering crude oil tendered, or by any other cause, whether similar or not, reasonably beyond the control of such party. Any such failures to perform shall be remedied with all reasonable dispatch, but neither party shall be required to supply substitute quantities from other sources of supply. Failure to perform due to events of Force Majeure shall not extend the terms of this Agreement.

Notwithstanding the above, and in the event that the Agreement is an associated purchase/sale, or exchange of crude oil, the parties shall have the rights and obligations described below in the circumstances described below:

(1) If, because of Force Majeure, the party declaring Force Majeure (the “Declaring Party”) is unable to deliver part or all of the quantity of crude oil which the Declaring Party is obligated to deliver under the Agreement or associated contract, the other party (the “Exchange Partner”) shall have the right but not the obligation to reduce its deliveries of crude oil under the same Agreement or associated contract by an amount not

to exceed the number of barrels of crude oil that the Declaring Party fails to deliver.

(2) If, because of Force Majeure, the Declaring Party is unable to take delivery of part or all of the quantity of crude oil to be delivered by the Exchange Partner under the Agreement or associated contract, the Exchange Partner shall have the right but not the obligation to reduce its receipts of crude oil under the same Agreement or associated contract by an amount not to exceed the number of barrels of crude oil that the Declaring Party fails to take delivery of.

Reviewing the Conoco 93 Form

A brief comparison of the Conoco 93 form against our description of common elements brings the following points to note in the case of a buyer asserting *force majeure*:

- Circumstances causing the buyer to fail to perform need not be unforeseen or unforeseeable, but must be “reasonably beyond the control” of the buyer and must be “remedied with all dispatch.”
- Although the list of potential force majeure events is quite broad (notably including impact of “governmental laws” but not including pandemics), the list is non-exclusive and includes “any other cause, whether similar or not, reasonably beyond the control” of the asserting party
- While the Conoco 93 form is clearer in providing remedies for associated purchase/sale transactions (where each party has both a buy and sell obligation), the remedies are less clear in terms of a one-way purchase obligation:
 - The obligation to make payment is not excused, though the buyer is “relieved from liability for failure to perform ... for the duration and to the extent” caused by the *force majeure* event;
 - Neither party is “required to supply substitute quantities from other sources of supply.”
 - Failures to perform are to be “remedied with all reasonable dispatch,” but the terms of the Agreement are not extended.

Some or all of these uncertainties might be clarified in the specific modifications included in the relevant agreement. But whether or not modified, there are likely to be complex matters of fact to be interpreted, along with the plain meaning of the clause and a nuanced approach incorporating industry knowledge and precedent.

At Haynes and Boone, attorneys from our energy and litigation teams frequently advise clients on these types of agreements. For more information, please reach out to one of our contact attorneys listed below.

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