



# Force majeure provisions and the ISDA Power Annex

## Energy Alert

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In the midst of the most severe weather crisis in Texas since 1895, many are taking a fresh look at the force majeure provisions under the International Swaps and Derivatives Association (ISDA) to determine whether performance under existing contracts may be excused. In this alert, we analyze the force majeure clauses in financially settled power transactions which are governed by an ISDA North American Power Annex (the Power Annex) as incorporated into either the 1992 Master Agreement (Multicurrency – Cross Border) or the 2002 ISDA Master Agreement (any such ISDA Master Agreement, as modified by the incorporation of the Power Annex, and ISDA Master Agreement).

## The Power Annex

The Power Annex was published jointly by ISDA and Edison Electric Institute in 2003 to allow market participants to transact in the wholesale physical energy markets under the ISDA Master Agreement. The Power Annex allows market participants to document physical power purchases and sales, as well as financially settled power transactions under a single ISDA Master Agreement.

## Force majeure and the Power Annex

The Power Annex has its own force majeure provision that applies to "transactions between the parties for the purchase or sale of a Product ...on a spot or forward basis or as an option to purchase, sell or transfer a Product ...<sup>[4]</sup> (Power Transactions). In general, the Power Annex force majeure provision replaces the provision found in the ISDA Master Agreement with regards to Power Transactions.<sup>[2]</sup>

In relevant part of the Power Annex, the force majeure provision (the FM Provision) reads as follows:

**Force Majeure.** To the extent either party is prevented by Force Majeure from carrying out, in whole or in part, its obligations under any Power Transaction and such party (the "Claiming Party") gives notice and details of the Force Majeure to the other party (the "non-Claiming Party") as soon as practicable, then, unless the terms of the Product specify otherwise, the Claiming Party shall be excused from the performance of its obligations with respect to such Power Transaction (other than the obligation to make payments then due or becoming due with respect to performance prior to the Force Majeure).<sup>[3]</sup>

To determine whether the force majeure provision can be used, all of the following conditions must be met:

- an event or circumstance constituting a force majeure has occurred
- the force majeure prevented the claiming party from performing in whole or in part
- the claiming party provided notice and details as soon as practicable and
- the terms of the product do not exclude force majeure as a defense to performance.

In the sections below, we discuss each of these elements in greater detail.

## When a force majeure event occurs

The first step of the analysis is to determine whether a force majeure event has occurred. Clause (i)(iv) of the Power Annex defines force majeure as follows:

"Force Majeure" means an event or circumstance which prevents the Claiming Party from performing its obligations under one or more Power Transactions, which event or circumstance was not anticipated as of the date the Power Transaction was agreed to, which is not within the reasonable control of, or the result of the negligence of, the Claiming Party, and which, by the exercise of due diligence, the Claiming Party is unable to overcome or avoid or cause to be avoided. Force Majeure shall not be based on (i) the loss of Buyer's markets; (ii) Buyer's inability economically to use or resell the Product purchased hereunder; (iii) the loss or failure of Seller's supply; or (iv) Seller's ability to sell the Product at a price greater than the Contract Price. Neither party may raise a claim of Force Majeure based in whole or in part on curtailment by the Transmission Provider unless (i) such party has contracted for firm transmission with a Transmission Provider for the Product to be delivered to or received at the Delivery Point and (ii) such curtailment is due to "force majeure" or "uncontrollable force" or a similar term as defined under the Transmission Provider's tariff; provided, however, that existence of the foregoing factors shall not be sufficient to conclusively or presumptively prove the existence of a Force Majeure absent a showing of other facts and circumstances which in the aggregate with such factors establish that a Force Majeure as defined in the first sentence hereof has occurred. The applicability of Force Majeure to the Power Transaction is governed by the terms of the Products and the Related Definitions contained in Schedule P.

Under clause (i)(iv), a force majeure will not occur unless each of the following conditions are met:

- the event or circumstance was not anticipated<sup>[4]</sup> as of the date of the Power Transaction
- the event or circumstance is not within the reasonable control of,<sup>[5]</sup> or the result of negligence of, the claiming party
- the claiming party is unable to overcome or avoid or cause to be avoided such event or circumstance by the exercise of due diligence<sup>[6]</sup>
- the event or circumstance does not fall within one of the categories of events expressly excluded from the definition of force majeure<sup>[7]</sup>
- the event or circumstance prevented the claiming party from performing its obligations<sup>[8]</sup> and
- Force majeure applies to the Power Transaction as governed by the terms of the products and the related definitions.

## The event or circumstance has prevented the claiming party from performing its obligations

The second step is to determine if the force majeure event has prevented performance by the claiming party. The FM Provision requires that the claiming party has been prevented from performing a contractual obligation. This requires proving a causal effect between the event which gave rise to the force majeure and the ability to perform by the party seeking force majeure relief. The effect needs to be a complete inability to perform – a mere delay or hinderance of performance is not enough to satisfy this provision.

## Schedule P – products and related definitions

The Power Annex force majeure definition refers to the definitions set forth in Schedule P, Products and Related Definitions to the Master Power Purchase and Sale.<sup>[9]</sup> In most instances, the product specified under physical offtake arrangements is Firm (LD). Schedule P defines Firm (LD) as follows:

"Firm (LD)" means, with respect to a Transaction, that either Party shall be relieved of its obligations to sell and deliver or purchase and receive without liability only to the extent that, and for the period during which, such performance is prevented by Force Majeure. In the absence of Force Majeure, the Party to which performance is owed shall be entitled to receive from the Party which failed to deliver/receive an amount determined pursuant to Article Four.

If a claiming party argues that force majeure applies to a Firm (LD) Power Transaction because it is unable to deliver power as a result of a supply-chain issue, then the non-claiming party could arguably assert that the claiming party is still able to deliver the power to the delivery point by purchasing it in the open market, since Firm (LD) does not require the power to have been sourced from a specified project. If, however, the entire power grid was disrupted, due something like the severe weather in Texas, it would be difficult to assert that this is not a force majeure.

## Claiming party to provide notice and details of force majeure as soon as practicable

The claiming party is required to provide notice and details of the FORCE MAJEURE as soon as practicable. The meaning of "as soon as practicable" is a fact-specific analysis. The notice should also be detailed enough to provide the non-claiming party with an understanding of the events and circumstances giving rise to the force majeure claim. If sufficient details are not available at the time of notification, the claiming party has an obligation to update the notice to provide additional details.

## Force majeure allows for performance to be stayed and then resumed when performance is no longer prevented

The Power Annex does not call for a termination of the affected transaction upon the occurrence of a force majeure. Instead, the party's performance is stayed until performance is no longer prevented by the force majeure.<sup>[10]</sup> Clause (b)(iii) describes this as follows:

The Claiming Party shall remedy the Force Majeure with all reasonable dispatch.<sup>[11]</sup> The non-Claiming Party shall not be required to perform or resume performance of its obligations to the Claiming Party corresponding to the obligations of the Claiming Party excused by Force Majeure.

The claiming party has an affirmative obligation to remedy the force majeure in a manner that would minimize the lasting effects that such event has on the parties' reasonable expectations.<sup>[12]</sup>

## Conclusion

As climate change generates ever more severe weather events, market participants will likely need to assess the applicability of their force majeure claims under the Power Annex. The above provides a brief outline of the steps to be taken in the assessment of such Force Majeure situations.

To learn more about carrying out such an assessment, please contact any of the authors or your usual DLA Piper lawyer.

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[1] The 2005 ISDA Commodity Definitions define Power Transactions as “transactions between the parties for the purchase or sale of a Product...on a spot or forward basis or as an option to purchase, sell or transfer a Product...”

[2] In the standard-form 1992 ISDA Master Agreement (Multicurrency – Cross Border) there is not a force majeure provision; however, market participants usually incorporate the force majeure provision from the 2002 ISDA Master Agreement by adhering to the ISDA Illegality/Force Majeure Protocol, expanding these provisions to include clause (b)(iii) of the Power Annex to cover Power Transactions.

[3] 2002 ISDA Master Agreement, clause (b)(iii) of the Power Annex.

[4] The claimant bears the burden of proving an event or circumstance was not “anticipated” or an unforeseen event. For example, the claimant would have to prove the parties to the Power Transaction did not anticipate supply chain issues due to severe weather.

[5] To determine if an event or circumstance is within “reasonable control of” a party is a facts and circumstance analysis. Events or circumstances outside of “reasonable control” most likely includes severe weather, floods, acts of God, public health related events (such as epidemics, plagues, diseases, and emergencies).

[6] The measure of due diligence is also determined by the facts and circumstances of the situation. However, the exercise of due diligence would not require the claiming party to take all actions, regardless of cost, to resolve the issue.

[7] The definition of force majeure expressly excludes (a) loss of the buyer’s market, (b) buyer’s inability economically to use or resell the product purchased hereunder, (c) the loss or failure of seller’s supply, or (d) seller’s ability to sell the product at a price greater than the contract price. Neither party may raise a claim of force majeure based in whole or in part on curtailment by the transmission provider unless (i) such party has contracted for firm transmission with a transmission provider for the product to be delivered to or received at the delivery point and (ii) such curtailment is due to “force majeure” or “uncontrollable force” or a similar term as defined under the transmission provider’s tariff. Again, however, these events and circumstances are not conclusive of the existence of a force majeure, or not, given an analysis of showing other facts and circumstances which, taken together, establish a force majeure.

[8] The inability to perform a contractual obligation is a fact and circumstance analysis.

[9] As published and modified from time to time by the Edison Electric Institute.

[10] Clause (i)(ii) of the Power Annex expressly amends the ISDA Master Agreement so that a “failure to deliver” under a Power Transaction will not, in and of itself, result in an event of default under Section 5(a)(i) of the ISDA Master Agreement; however, depending on the facts and circumstances, other events of default and termination events (including additional termination events) may still be actionable by the relevant party.

[11] The term “reasonable dispatch” is determined by the courts on a case-by-case basis.

[12] Note, however, that the stayed performance could, theoretically, be indefinite.

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