

Commercial Aftershocks of the Great Eastern Japan Earthquake: Force Majeure and Related Issues

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The Earthquake as a *Force Majeure* Event

The March 11, 2011 Tōhoku earthquake and tsunami, which the Japanese government formally named as the “Great Eastern Japan Earthquake” (*Higashi Nihon Daishinsai*) was undeniably a disaster of Biblical proportions. According to the U.S. Geological Survey, the 9.0 magnitude earthquake is the fourth largest in the world since 1900 and the largest in Japan since modern instrumental recordings began 130 years ago. Tens of thousands of people were killed, a comparable number are still missing or injured, and many more have been displaced from their homes. The earthquake and tsunami wrought tremendous devastation, including serious damage to the Fukushima Daiichi Nuclear Station. According to some reports, the damage to the Fukushima Daiichi Nuclear Station has released enormous amounts of radiation, more than 100,000 times as much as was released in the Three Mile Island nuclear incident in 1979. The Japanese government recently raised the severity rating of the nuclear accident to a 7 on the International Nuclear Event Scale, the highest severity level possible and the rating shared by the Chernobyl nuclear disaster in 1986.

The economic fallout from the Great Eastern Japan Earthquake is likely to continue for some time. Some have estimated that the total cost of recovery exceeds several hundred billion dollars, making it the most costly natural disaster ever. In addition to damage to factories, offices, and infrastructure caused by the earthquake and tsunami, the radiation risk has rendered some factories and offices unusable. Similarly, because of damage to Japan’s electrical power capability in the affected region, other factories have had to shut down. A number of companies temporarily halted production in Japan in March. Even when production resumed, many factories had to operate at limited capacity because of parts shortages. Operation of factories at limited capacity will have ripple effects, even on companies that did not directly suffer damage from the Great Eastern Japanese Earthquake. Companies whose factories are operating at limited capacity will need fewer materials, parts, and components than they had anticipated needing before the earthquake. In turn, suppliers of those materials, parts, and components will want to reduce their purchases from their own suppliers. Additionally, business down the supply line, which require manufactured equipment or components from factories in the affected region, are not receiving the products or supplies they need to use in their operations or to complete products or projects for customers. The impact ultimately will extend all the way up and down the supply chain.

One inevitable consequence of the Great Eastern Japanese Earthquake will be the nonperformance, or partial performance, of various contractual obligations. With supply agreements, purchase orders, joint venture agreements, and many other contractual relationships, parties who would otherwise honor their contractual obligations may simply not be able to do so. Some may only be able to partially perform or there may be a delay in performance. Perhaps in

the short term, most parties will focus on their recovery efforts rather than asserting claims. In the long term, however, the expectation is that disputes will arise between contracting parties as to who should bear the losses and damages resulting from non performance, partial performance, or delay in performance of contracts resulting from the Great Eastern Japanese Earthquake. *Force majeure*, and related concepts, will likely be central to resolution of such disputes.

General Force Majeure Principles

Force majeure is a legal principle, either provided for by contract or imposed on parties by law or courts, which excuses, or partially excuses, one or both parties to a contract from performing contractual obligations in certain specified circumstances. Usually, *force majeure* excuses a party from performance obligations or liability if some unforeseen or unanticipated event beyond the control of that party prevents it from performing its contractual obligations. Typically, *force majeure* covers "Acts of God" (such as fire, flood, earthquake, tsunami, storm, hurricane, or other natural disasters) or war, terrorism, or similar occurrences, and may also excuse performance based on the failure of third parties (such as suppliers and subcontractors) to perform their obligations to the contracting party (either generally or as a result of an Act of God or due to war, terrorism, or similar occurrences). *Force majeure* is not intended to excuse a party if the failure to perform could have been avoided by that party through commercially reasonable means.

When the parties to a contract "have themselves defined the contours of *Force Majeure* in their agreement, those contours dictate the application, effect, and scope of *Force Majeure*." *Sun Operating Limited Partnership, et al. v. Holt, et al.*, 984 S.W.2d 277, 283 (Texas App. 1998). Thus, when a contract contains a *Force Majeure* provision, the interpretation and application of the language of the contract provision governs whether some particular event will excuse a party from performing. An example of a *Force Majeure* provision follows:

Neither party shall be liable in damages or have the right to terminate this Agreement for any delay or default in performing hereunder if such delay or default is caused by conditions beyond its control including, but not limited to Acts of God, Government restrictions (including the denial or cancellation of any export or other necessary license), wars, insurrections and/or any other cause beyond the reasonable control of the party whose performance is affected.

<http://www.library.yale.edu/~license/forcecls.shtml>. *Force majeure* provisions, however, come in all shapes and sizes, and may be more or less elaborate than this example. Some clauses provide more examples of events that can trigger the *force majeure* defense. Many will specifically list earthquakes, tsunamis, and hurricanes as examples of *force majeure* events. Some clauses may require the party who is invoking *force majeure* to give prompt written notice of the *force majeure* event. It is not unusual for *force majeure* clauses to require the party asserting *force majeure* to take reasonable steps to minimize the delay or damages resulting from a default in performance and to perform all non-excused obligations under contract. More elaborate *force majeure* clauses may address whether or under what circumstances performance excused by a *force majeure* event must later be performed, whether or under what circumstances either or both of the parties may terminate the contract in the event of *force majeure*, or how – in the event partial performance is possible – allocation or prioritization of performance should be done.

Even when a contract does not contain an express *force majeure* clause, applicable law may excuse a party's contractual performance in much the same way that a *force majeure* clause would. The United Nations Convention on Contracts for the International Sale of Goods ("CISG") does not use the words "*force majeure*," but provides an equivalent relief as a matter of law:

A party is not liable for a failure to perform any of his obligations if he proves that the failure was due to an impediment beyond his control and that he could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the contract or to have avoided or overcome it, or its consequences.

CISG, Article 79(1) ([http://www.uncitral.org/pdf/english/texts/sales/cisg /CISG.pdf](http://www.uncitral.org/pdf/english/texts/sales/cisg/CISG.pdf)). The CISG is a treaty that applies to contracts of sale of goods between parties whose places of business are in different States when such States have both ratified the CISG or when the rules of private international law lead to the application of the law of a State that has ratified the CISG. Japan acceded to the CISG in 2008, and the CISG entered into force for Japan on August 1, 2009.

In addition to the CISG, various jurisdictions provide a *force majeure* defense even in the absence of an express contractual clause, provided that the parties do not expressly indicate that *force majeure* does not apply. For instance, the California Civil Code provides:

The want of performance of an obligation, or of an offer of performance, in whole or in part, or any delay therein, is excused by the following causes, to the extent to which they operate:

* * * *

2. When it is prevented or delayed by an irresistible, superhuman cause, or by the act of public enemies of this state or of the United States, unless the parties have expressly agreed to the contrary

.....

Cal. Civil Code § 1511. Similarly, the French Civil Code provides:

There is no occasion for any damages where a debtor was prevented from transferring or from doing that to which he was bound, or did what was forbidden to him, by reason of force majeure or of a fortuitous event.

French Civil Code, Article 1148. The Uniform Commercial Code also contains a *force majeure* provision:

Except so far as a seller may have assumed a greater obligation and subject to the preceding section on substituted performance:

(a) Delay in delivery or non-delivery in whole or in part by a seller who complies with paragraphs (b) and (c) is not a breach of his duty under a contract for sale if performance as agreed has been made impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made or by compliance in good faith with any applicable foreign or domestic governmental regulation or order whether or not it later proves to be invalid.

(b) Where the causes mentioned in paragraph (a) affect only a part of the seller's capacity to perform, he must allocate production and deliveries among his customers but may at his option include regular customers not then under contract as well as his own requirements for further manufacture. He may so allocate in any manner which is fair and reasonable.

(c) The seller must notify the buyer seasonably that there will be delay or non-delivery and, when allocation is required under paragraph (b), of the estimated quota thus made available for the buyer.

UCC § 2-615.

If contracts contain a *force majeure* clause, or applicable law provide for a *force majeure* defense even in the absence of an express clause, little doubt exists – absent unusual contract language – that the Great Eastern Japan Earthquake constitutes a *force majeure* event. But this is only the very beginning of the necessary analysis to determine whether, and to what extent, *force majeure* excuses a contracting party's performance under a contract. Depending on the contract language, the governing law, and the facts and circumstances of a particular situation, there are a number of other issues that may need to be considered.

Common Force Majeure Issues

1. Accuracy of Notice of the Event

Early on, one important issue that must be considered is whether the party invoking *force majeure* has given adequate notice. The contract or applicable law might dictate a specific type of notice (e.g., written), may specify when such notice must be given (e.g., promptly), and may require other information to be included in the notice (e.g., the expected delay associated with the *force majeure* event). For example, in *Aquila, Inc. v. C.W. Mining*, 545 F. 3d 1258 (10th Cir. 2008), a public utility and a coal mining company entered into a coal supply agreement which contained a *force majeure* clause. This clause required the party invoking it to give promptly written notice of the *force majeure* event. Within one week of signing the contract, a labor strike hit the mining company. The mining company nonetheless anticipated that it could meet its contractual obligations, but it soon began experiencing geological problems. Just before the mining company's coal delivery obligations were slated to begin, it gave written notice that it considered the labor strike to be a *force majeure* event, but the mining company never gave written notice that it considered the geological problems to be *force majeure* events. Eventually, the utility sued the mining company for breach of contract, and the mining company asserted that the labor strike and the geological problems were both *force majeure* events excusing performance. As a factual matter, however, the district court found – and the court of appeals affirmed – that the mining company's inability to perform primarily resulted from the geological problems, not the labor dispute. Because the mining company did not give written notice as required by the contract that it considered the geological problems to be a *force majeure* event, *force majeure* did not excuse the mining company's performance. Accordingly, the court awarded the utility approximately \$24 million in damages against the mining company. Had the mining company promptly notified the utility in writing that the geological problems were *force majeure* events in addition to the labor dispute, the outcome may have been entirely different.

The *Aquila* case illustrates another important issue in *force majeure* disputes: whether the *force majeure* event – such as the Great Eastern Japan Earthquake – actually caused the contracting party's delay or default in performing its contractual obligations. In *Aquila*, there was no doubt that the labor dispute qualified as a *force majeure* event, but it did not excuse performance because the labor dispute did not cause the mining company's inability to perform. Whether the *force majeure* event prevented a party from performing its contractual obligation is a factual question that must be determined in each case. When a contracting party invokes *force majeure* and asserts an inability to perform its contractual obligations, the other party should not necessarily simply take for granted that the *force majeure* event – whether it be an earthquake, labor dispute, or something else – has caused the delay or default in performing. Undoubtedly, in the vast majority of cases, contracting parties will only assert *force majeure* when they have a good faith basis for doing so. History, however, teaches that sometimes certain parties may try to exploit tragedies like the Great Eastern Japan Earthquake to avoid unwanted contractual obligations, even though the *force majeure* event did not prevent performance of the contract.

2. No Excuse If Performance Is Otherwise Possible

Perhaps more common is the situation in which a *force majeure* event makes performance more difficult or expensive but not impossible. As one U.S. court explained:

Hurricane Katrina was undoubtedly a force majeure. However, . . . this is only part of the contractual defense To relieve an obligor of liability, a [*force majeure*] event must make the performance of the obligation truly impossible. . . . Nonperformance of a contract is not excused by a [*force majeure*] event where it may be carried into effect, although not in the manner contemplated by the obligor at the time the contract was entered into. In other words, if the [*force majeure*] event prevents the obligor from performing his obligation in the manner contemplated at the time of contracting, he must pursue reasonable alternatives to render performance in a different manner before he can take advantage of the defense of impossibility. An obligor is not released from his duty to perform under a contract by the mere fact that such performance has been made more difficult or more burdensome by a [*force majeure*] event. The [*force majeure*] event must pose an insurmountable obstacle in order to excuse the obligor's nonperformance.

Ziegler v. Pansano, unpublished decision (La.App. 2009). In *Ziegler*, the purchaser of residential property failed to close the transaction within the deadline specified in the parties' agreement. The purchaser claimed that Hurricane Katrina was a *force majeure* event that made her performance impossible by the specified deadline, and sued the seller for breach of contract. As a factual matter, the trial court found that Hurricane Katrina did not prevent the purchaser from closing the transaction on time and dismissed the purchaser's claims. The court of appeals affirmed, noting that although Hurricane Katrina may have made performance of some obligations more difficult, it did not make them impossible.

Difficult issues arise when performance is not impossible and the question is whether performance in a different manner from that contemplated at the time of contracting is a "reasonable alternative." Analysis of these difficult issues will generally again be fact driven.

3. Duration of Excuse of Performance

Another issue that may be troubling is the length of time that *force majeure* will last. Many *force majeure* clauses may only suspend, not terminate, a party's obligations for the period of time the force majeure events render performance impossible or insurmountable. Uncertainty or disagreement may exist between the contracting parties as to how long this period should be. Even if no uncertainty or disagreement exists, one or both of the contracting parties may find the prospect of long-delayed performance unsatisfactory and prefer some alternative arrangement. This might particularly be the case when it appears that delay in performance resulting from the *force majeure* could be quite lengthy. Some contractual *force majeure* provisions may explicitly address this issue, providing that if the duration of a *force majeure* event lasts, or is expected to last, more than a specified period of time (such as six months), either party may terminate the contract.

4. Priority of Performance/Allocation of Capacity

Some of the most difficult issues arise when the force majeure event affects only a part of a party's capacity to perform and that party must allocate performance among its customers or other contractual counter-parties. Under Section 2-615 of the Uniform Commercial Code, for example, a seller is entitled to allocate performance "in any manner which is fair and reasonable." "Fair and reasonable" is not a precise standard, and reasonable and fair-minded people may have different ideas as to what is "fair and reasonable." Whether a particular allocation is fair and

reasonable is a factual question, and the determination may turn on the seller's reason for a particular allocation, industry custom and practice to the extent it exists, and expert testimony.

Tejas Power Corp. v. Amerada Hess Corp., 1999 Texas App. Lexis 6014 (1999) illustrates how a "fair and reasonable" allocation can be a flexible concept. In *Tejas Power Corp.*, the plaintiff brought a lawsuit against the defendant for breach of a natural gas purchase contract. When abnormally cold weather caused gas wells to begin freezing, the defendant was not able to meet its obligations to supply natural gas to all of its customers for three days in February 1996. The defendant allocated the available gas so that certain customers who distributed natural gas to residential users were only slightly affected but the plaintiff received only 77% of its promised supply on one day and no natural gas at all on two days. The plaintiff argued that the defendant should have apportioned its gas evenly among all of its customers. The defendant justified its allocation of gas "in light of the human needs" presented by its customers who distributed gas to residential users, and the court agreed that this was a "fair and reasonable" allocation. This case indicates that a "fair and reasonable" allocation does not necessarily require equal apportionment among all customers if some good reason exists for a different allocation.

Conclusion

A tremendous number of contractual relationships were impacted by the Great Eastern Japan Earthquake. The resulting inability of parties to perform their contractual obligations, or delay in performance, undoubtedly will cause substantial losses and damages to all contracting parties affected by the earthquake. In the near term, many companies may be focused on recovery and returning their operations to normal as quickly as possible. In the longer term, however, the issue of which of the contracting parties should bear responsibility for those losses and damages, and to what extent, will likely arise. When this occurs, affected parties will need to carefully analyze the applicable *force majeure* provisions, governing law, and the facts and circumstances of each situation, in determining how to assert or defend claims relating to those losses and damages.



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