

# Force Majeure Primer and Flowchart for Oil and Gas Leases

Client Alert | April 14, 2020

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Within the oil and gas industry, *force majeure* clauses are often (but not always) included in oil and gas leases where they play an important role.<sup>[1]</sup> These clauses provide generally that, under certain circumstances, a lessee may be relieved from the consequences of a failure to comply with the terms of the lease due to the occurrence of an unforeseen event, even where the resulting liability might otherwise include damages or the forfeiture of the lease.

Assessing the applicability and enforceability of such clauses in oil and gas leases requires a highly fact-specific analysis. To assist clients in identifying issues they should evaluate in connection with their lease obligations in the face of the pandemic, we have prepared the following five-step analysis and flowchart to assist in the review and assessment of *force majeure* clauses in your oil and gas leases.

## STEP 1: Does COVID-19 trigger the *force majeure* clause?

As an initial matter, the application of a *force majeure* clause depends on the specific language of such clause in the lease, which can vary considerably from lease to lease. Therefore, the precise words of your *force majeure* clause should first be closely reviewed to determine whether one or more of the categories included within the enumerated causes could cover the current pandemic, its effects or responses to it.<sup>[2]</sup>

In some general commercial contracts, the *force majeure* clause will reference an “epidemic,” “pandemic,” “disease outbreak” or even “public health crisis” as a triggering event giving rise to a *force majeure*. However, in our experience, the inclusion of such terms in oil and gas leases are rare. More commonly, *force majeure* clauses in oil and gas leases specifically refer to triggering events like “acts of civil or military authority” or “government orders or regulations,” both of which may be relevant under the current climate. In an effort to “flatten the curve” and slow the spread of COVID-19, several states and jurisdictions have issued shelter-in-place or other stay-home orders to employees of nonessential businesses, which may in some cases include employees of oil and gas companies and associated contractors. Therefore, when analyzing whether the *force majeure* clause in an oil and gas lease has been triggered, clients should evaluate any newly enacted restrictions to understand what, if any, impact they may have on the ability to comply with lease terms. Another example of government orders which have been accepted as a *force majeure* event includes an interruption in operations caused by bankruptcy proceedings.<sup>[3]</sup> Therefore, to the extent the lessee’s bankruptcy proceedings are hindering its drilling or production operations, the lessee may be able to seek relief under a *force majeure* claim.<sup>[4]</sup>

## STEP 2: Did COVID-19 effectively prevent performance by the lessee?

Many *force majeure* clauses explicitly incorporate a performance standard that requires performance of contractual obligations be “prevented,” “delayed,” “interrupted” or made “impossible” as a result of the *force majeure* event before performance will be excused. In this context, courts are reluctant to accept claims of a *force majeure* event when such event merely made performance more expensive or inconvenient, especially where the

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clause expressly requires performance to be made impossible.<sup>[5]</sup> Under the same performance standard, a Texas court rejected a *force majeure* claim during an industry-wide scarcity of materials where the lessee nevertheless used its limited materials in its inventory to drill other leases but not the lease at issue in the dispute.<sup>[6]</sup> Therefore, while COVID-19 may have resulted in supply chain disruptions which make it more difficult for lessees to obtain replacement parts in their drilling or production operations, it is necessary to evaluate whether performance really is impossible unless the *force majeure* clause in question contains a lesser performance standard.

### **STEP 3: Does the *force majeure* clause contain any additional requirements (e.g., knowledge, control, due diligence)? If not, does your jurisdiction impose any additional requirements?**

Many *force majeure* clauses explicitly set forth additional requirements in order for lessees to be able to claim a *force majeure* event and obtain contractual relief from the consequences of the event. Three common additional requirements include that the *force majeure* event cannot have been foreseeable, must have been out of the lessee's reasonable control and the lessee shall have exercised due diligence to overcome the condition claimed to be a *force majeure* event. In some jurisdictions, courts will impose one or more of these requirements regardless of whether the lease expressly includes such a requirement.

First, the unforeseeability requirement is often framed as a requirement that the *force majeure* event not have been within the lessee's actual or presumed knowledge or reasonably expectable by the lessee. And in the absence of express contractual language addressing knowledge, some courts have adopted an implicit requirement of unforeseeability.<sup>[7]</sup> Thus, while it has been held that a government order *postdating* the execution of a lease may constitute a *force majeure* event,<sup>[8]</sup> a government order *predating* the lease execution is unlikely to constitute a *force majeure* event because it was knowable at the time of contracting.<sup>[9]</sup> Therefore, to the extent a lease has been entered into since the outbreak of the virus, in certain jurisdictions, you may find it more challenging to allege that the effects of COVID-19 (including the resulting government regulations) were not reasonably expected at the time of entry into the lease. Further, this unforeseeability requirement is often cited by courts in rejecting claims that mere changes in commodity prices or reduction in demand constitute a *force majeure* event.<sup>[10]</sup> As stated by a Texas appellate court, "fluctuations in the oil and gas markets are foreseeable as a matter of law."<sup>[11]</sup> Therefore, in order to obtain relief, the lessee must identify a permitted *force majeure* event (e.g., the pandemic) and prove that such permitted event and its consequences (which include a reduction in commodity prices and demand) resulted in the lessee's inability to perform.

Second, the requirement that the event have been beyond the reasonable control of the parties has led to a division in the case law in terms of whether courts will impose such requirement in the absence of express contractual language. Thus, some courts have adopted an implicit requirement that the condition alleged to constitute a *force majeure* event must be beyond the lessee's reasonable control (with the lessee's fault or negligence negatively affecting its claim to entitlement of relief).<sup>[12]</sup> However, at least one Texas appellate court has held that a reasonable control requirement should not be implied in oil and gas leases in the absence of express language to that effect.<sup>[13]</sup>

Third, the requirement that a party seeking to invoke *force majeure* exercise due diligence or explore all available options to overcome the condition prior to declaring an event a *force majeure* event is intended to be a "proximate cause" requirement.<sup>[14]</sup> However, in the absence of express contractual language imposing such a requirement, at least one Texas appellate court has held that due diligence requirement should not be imposed on oil and gas leases absent express contractual language.<sup>[15]</sup>

### **STEP 4: Is the obligation or performance in question covered by the *force majeure* clause?**

Upon establishing the occurrence of the *force majeure* event, the next step is examining the lease to determine the precise obligation or performance to be consequently excused. The *force majeure* clause may explicitly suspend or excuse all of the lessee's obligations,<sup>[16]</sup> or, more commonly, excuse only certain of the lessee's obligations (e.g., the lessee's obligation to drill or produce) while requiring the lessee to comply with certain other obligations (e.g., the lessee's obligation to make certain payments to the lessor).<sup>[17]</sup> Similarly, the lease may explicitly set forth which portion of the habendum clause that the *force majeure* event applies. In these cases, where the provisions are explicit, the analysis is often relatively straightforward. In other cases, the application of the *force majeure* clause is unclear, in which case legal analysis will need to be conducted to determine exactly what is being suspended or excused, and to what term of the habendum clause the *force majeure* event will apply. For example, one court has held that to the extent (i) the habendum clause in the lease does not incorporate the *force majeure* clause by reference or contain any language expressly subjecting it to the other lease terms and (ii) the *force majeure* clause does not refer to the habendum clause with specificity (i.e., "anything in this lease to the contrary notwithstanding" being insufficient), the *force majeure* clause would not apply to extend the primary term.<sup>[18]</sup>

Leases vary in either fixing the period of time for which the obligations are suspended or excused (e.g., one month, one year) or excuse performance for so long as the *force majeure* event inhibits performance (with or without a period of time within which the lessee must resume its obligations following the end of the event). If your lease contains the latter provision, you should be particularly diligent in determining whether the circumstances have changed whereby the *force majeure* savings provision would no longer apply.<sup>[19]</sup>

Finally, notwithstanding the foregoing, in an attempt to reconcile competing provisions of the lease and fulfill the intent of the contracting parties, courts will generally refuse to excuse performance under the *force majeure* clause if another clause is applicable, such as excusing production by the payment of shut-in royalties<sup>[20]</sup> or if the lease obligates the lessee to commence drilling or reworking operations within a certain amount of time following cessation of production and the *force majeure* event did not prevent the commencement of drilling or reworking operations.<sup>[21]</sup> Therefore, the lease should be read holistically to determine the interaction of the *force majeure* clause with the other provisions of the lease.

## **STEP 5: Are there contractual notice requirements?**

*Force majeure* clauses generally may require either (i) a minimum amount of notice ahead of an event contemplated by the lease or (ii) notice within a certain number of days of the triggering event. *Force majeure* clauses in oil and gas leases are no exception. Failure to provide timely notice may prohibit a lessee from obtaining the benefit of a *force majeure* clause in the agreement even when a triggering event is otherwise covered by the lease's *force majeure* clause.<sup>[22]</sup> Notice provisions may specify the form of the notice, to whom it must be sent, and the manner in which it must be sent. Additionally, many agreements will require that notices given thereunder must provide sufficient specificity to make clear why the relevant triggering event applies to a given provision.

Given the current work-from-home orders, it may be difficult to comply with all formal notice requirements in a contract, and clients may wish to propose alternative methods of providing notice with contract counterparties for so long as the current climate persists. Gibson Dunn may also be able to assist clients with mailings—either notices required to be given or responses to notices received—especially where the client does not have an operational mailroom.

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## **Step 1. Does COVID-19 trigger the *force majeure* clause?<sup>[23]</sup>**

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Does the *force majeure* clause specifically reference an “epidemic,” “pandemic,” “disease outbreak,” or “public health crisis”?

No ?

Yes ?



If yes, proceed to Step 2.

Does the *force majeure* clause refer specifically to “acts of civil or military authority” or “government order or regulation”?

No ?

Yes ?



If yes, proceed to Step 2.

Does the *force majeure* clause have a catchall provision that covers “any other cause whatsoever beyond the control of the respective party” (or similar) and contains an enumeration of specific events that otherwise do not cover the current situation?

No ?

Yes ?



If yes, the *force majeure* clause may not have been triggered because courts generally interpret *force majeure* clauses narrowly and will not construe a general catch-all provision to cover externalities that are unlike those specifically enumerated in the balance of the clause.

But depending on the jurisdiction, if the failure to perform is caused by forces beyond the lessee’s control, a court may take into account traditional equitable principles in construing the lease provision in question or in applying some exception to it.

## Step 2. Did COVID-19 effectively prevent performance by the lessee?

Does the *force majeure* clause require

No ?

Yes ?



If yes, the *force majeure* clause may have been

performance of obligations to be “prevented”, “delayed”, “interrupted” or made “impossible” before contractual obligations are excused?

triggered if the current government regulations specifically prohibit the fulfillment of contractual obligations. Merely making performance more expensive or inconvenient, especially where the clause expressly requires performance to be made impossible, is likely insufficient. Proceed to Step 3.

**Step 3. Does the *force majeure* clause contain any additional requirements (e.g., knowledge, control, due diligence)? If not, does your jurisdiction impose any additional requirements?**

If the lease or applicable jurisdiction requires the *force majeure* event to not be within the lessee’s actual or presumed knowledge or reasonably expectable by the lessee, is this requirement satisfied?

No ?

Yes ?



If yes, and the answers to the other questions in Step 3 are yes, proceed to Step 4.

If the lease or applicable jurisdiction requires the condition alleged to constitute a *force majeure* event be beyond the lessee’s reasonable control, is this requirement satisfied?

No ?

Yes ?



If yes, and the answers to the other questions in Step 3 are yes, proceed to Step 4.

If the lease or applicable jurisdiction requires the lessee to exercise

No ?

Yes ?



If yes, and the answers to the other questions in Step 3 are yes, proceed to Step

due diligence or explore all available options to overcome the condition prior to declaring an event a *force majeure* event, is this requirement satisfied?

4.

**Step 4. Is the obligation or performance in question covered by the *force majeure* clause?**

Is the obligation or performance in question covered by the *force majeure* clause?

No ?

Yes ?



If yes, and the answer to the other question in Step 4 is no, proceed to Step 5.

Is the obligation or performance in question covered another clause of the lease?

No ?

Yes ?



If yes, courts will generally refuse to excuse performance under the *force majeure* clause, and you will be expected to comply with the obligation or performance requirement set forth in the other clause of the lease.

If no, and the answer to the other question in Step 4 is yes, proceed to Step 5.

**Step 5. Are there contractual notice requirements?**




Does the lease require notice?

No ?

Yes ?



If yes, timely notice must be provided in accordance with the notice provision, or termination may not be available even though a triggering event has occurred. Some notice provisions required notice *in advance* of performance

|   |               |  |   |
|---|---------------|--|---|
| Does the contract contain specific provisions for the <i>method</i> of notice?              | No ?<br>Yes ? |   | due. Others required notice <i>within</i> a certain number of days of the triggering event.<br>If yes, notice provisions may specify the form of the notice, to whom it must be sent, and the manner in which it must be sent. Specific notice language may also be required. |
| Does the contract require specific <i>language</i> to give notice of a force majeure event? | No ?<br>Yes ? |   | If yes, determine whether required wording is present in any notice. Some leases may even have form of notices attached as exhibits to the contract.  |
| Does the contract specify a specific <i>method</i> for delivery of such notice?             | No ?<br>Yes ? |  | If yes, notice may be required by email, priority mail, or through use of a particular form addressed to specific people.   |

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[1] Whether or not the lease contains a *force majeure* clause, if the failure to perform is caused by forces beyond the lessee's control, a court may take into account traditional equitable principles in construing the lease provision in question or in applying some exception to it. See 4 Kuntz, Law of Oil and Gas § 53.5 (2019).

[2] See, e.g., *Sun Operating Ltd. Partnership v. Holt*, 984 S.W.2d 277, 283 (Tex. App. Amarillo 1988) (“[The] scope and application [of a *force majeure* clause], for the most part, is utterly dependent upon the terms of the contract in which it appears.”).

[3] See, e.g., *Gilbert v. Smedley*, 612 S.W.2d 270 (Tex. Civ. App. Fort Worth 1981).

[4] If the *force majeure* clause references “pricing fluctuation” or “market conditions”, then the lessee may be able to claim a *force majeure* event. See *In Kodiak 1981 Drilling Partnership v. Delhi Gas Pipeline Corp.*, 736 S.W.2d 715, 721 (Tex. App.—San Antonio 1987) (holding that a *force majeure* clause that included “partial or total loss of gas supply or market” excused performance due to “an unprecedented combination of factors—a general economic recession, a plummeting crude oil price, weather conditions ....”). However, in our experience, the inclusion of such terms in oil and gas leases are rare.

[5] See, e.g., *Logan v. Blaxton*, 71 So.2d 675 (La. Ct. App. 1954); *San Mateo Community College Dist. v. Half Moon Bay Ltd. Partnership*, 65 Cal. Rptr. 2d 287 (Cal. App. 1st Dist. 1998).

[6] See *Gilbert v. Smedley*, 612 S.W.2d 270 (Tex. Civ. App. Fort Worth 1981).

[7] See, e.g., *TEC Olmos, LLC v. ConocoPhillips Company*, 555 S.W.3d 176, 185 (Tx. Ct. App. 2018) (“a ‘catch-all’ provision [in the *force majeure* clause] generally requires a showing of unforeseeability”); *Gulf Oil Corp. v. Federal Energy Regulatory Comm.*, 706 F.2d 444, 454 (3d Cir. 1983) (“Even presuming that [the lessee’s] routine mechanical repairs were within the ambit of the *force majeure* clause, their frequent, almost predictable, occurrence takes them outside of a *force majeure* excuse to nonperformance.”); *Baldwin v. Kubetz*, 307 P.2d 1005 (Cal. Ct. Appeals 1957) (the lessee “acquired [the lease] with knowledge of the necessity of procuring a [drilling permit]” and “his failure to perform this obligation does not justify his falling back” on utilizing the *force majeure* clause).

[8] See, e.g., *Frost National Bank v. Matthews*, 713 S.W.2d 365 (Tex. App. Texarkana 1986); *Gordon v. Crown Cent. Petroleum Co.*, 679 S.W.2d 192 (Ark. 1984).

[9] See, e.g., *Goldstein v. Lindner*, 648 N.W.2d 892 (Wis. Ct. App. 2002) (holding that parties to an oil and gas lease are presumed to know what laws and regulations will affect the lessee’s ability to win permits); *Hughes v. Cantwell*, 540 S.W.2d 742 (Tex. Civ. App. El Paso 1976) (holding that the *force majeure* clause did not operate to extend the lease where the railroad commission’s spacing rules for gas wells were presumably known to the parties at the time they entered into the lease).

[10] See, e.g., *Valero Transmission Co. v. Mitchell Energy Co.*, 743 S.W.2d 658 (Tex. App. Houston 1987); *Langham Hill Petroleum, Inc. v. S Fuels Co.*, 813 F.2d 1327 (4th Cir. 1987).

[11] See *TEC Olmos, LLC v. ConocoPhillips Company*, 555 S.W.3d 176, 184 (Tx. App. Houston 2018).

[12] See, e.g., *Perlman v. Pioneer Ltd. Partnership*, 918 F.2d 1244 (5th Cir. 1990) (holding that, notwithstanding new regulations by the state, the lessee made no effort whatsoever to take actions necessary to comply with state’s requirements); *Atkinson Gas Co. v. Albrecht*, 878 S.W.2d 236 (Tex. App. Corpus Christi 1994) (holding that the lessee was not relieved of its duty to produce by virtue of the *force majeure* clause of the lease where the lessee’s own conduct in failing to timely file production reports with the railroad commission caused it to order the well sealed).

[13] See *Sun Operating Ltd. Partnership v. Holt*, 984 S.W.2d 277, 285 (Tex. App. Amarillo 1998) (holding that whether the occurrence of the listed *force majeure* event must be beyond the reasonable control of the lessee depends upon the language of the applicable *force majeure* clause).

[14] See, e.g., *Wilson v. Talbert*, 535 S.W.2d 807 (Ark. 1976); *Logan v. Blaxton*, 71 So.2d 675 (La. App. 2d Cir. 1954); *Woods v. Ratliff*, 407 So.2d 1375 (La. App. 3d Cir. 1981).

[15] See *Moore v. Jet Stream Investments, Ltd.*, 261 S.W.3d 412 (Tex. App. Texarkana 2008).

[16] See, e.g., *Baldwin v. Kubetz*, 307 P.2d 1005 (Cal. App. 2d. 1957).

[17] See, e.g., *Hunter v. Vaughn*, 46 So.2d. 735 (La. 1950); *Illinois Mid-Continent Co. v. Tennis*, 102 N.E.2d 390 (Ind. App. 1951); *Huhn v. Marshall Exploration, Inc.*, 337 So.2d. 561 (La. App. 2d Cir. 1976).

[18] See *Beardslee v. Inflection Energy, LLC*, 31 N.E.3d 80 (N.Y.3d 2015). See also *Illinois Mid-Continent Co. v. Tennis*, 102 NE(2d) 390 (1951) (holding that a *force majeure* clause which specifically related to “drilling obligations” did not serve to extend the primary term of the lease where drilling was frustrated in the last year of the lease).



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[19] See, e.g., *Wilson v Talbert*, 535 S.W.2d 807 (Ark. 1976) (holding that, notwithstanding the *force majeure* clause providing that the lease will not terminate as a result of a temporary cessation of production because a breakdown of equipment, the lease nevertheless terminated because the lessee failed to make the necessary repairs and restore production within a reasonable time).

[20] See *Welsch v. Trivestco Energy Co.*, 221 P.3d 609 (Kan. App. 2009) (the unavailability of purchasing and transportation services did not prevent the lessee from paying shut-in royalties and the *force majeure* clause was therefore not triggered).

[21] See *Trinidad Petroleum Corp. v. Pioneer Natural Gas Co.*, 416 So.2d 290 (La. Ct. App. 1982).

[22] See *Toyomenka Pac. Petroleum, Inc. v. Hess Oil Virgin Is. Corp.*, 771 F. Supp. 63, 67–68 (S.D.N.Y. 1991) (noting that a *force majeure* notification outside the limits of a notice period may waive the applicability of the *force majeure* clause if the parties intended the notice period as a condition precedent to the clause).

[23] As noted above, if the lease does not have a *force majeure* clause, an analysis using traditional equitable principles, depending on the jurisdiction, may be warranted.

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Gibson Dunn's lawyers are available to assist with questions you may have regarding developments related to the COVID-19 outbreak. We regularly counsel clients on issues raised by this pandemic in the commercial context, including in the oil and gas industry. For additional information, please contact any member of the firm's Coronavirus (COVID-19) Response Team, the Oil & Gas Team, the Gibson Dunn attorney with whom you work, or the following authors:

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