

# MAY ACID RAIN LEGISLATION EXCUSE PERFORMANCE OBLIGATIONS UNDER COAL CONTRACTS?

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## I. INTRODUCTION

The Clean Air Act Amendments of 1990<sup>1</sup> (CAAA or Amendments) require 111 electric utility plants to reduce significantly their emissions of sulfur dioxide (SO<sub>2</sub>) and nitrogen oxides (NO<sub>x</sub>) by January 1, 1995. Further reductions of SO<sub>2</sub> and NO<sub>x</sub> emissions by all electric utilities will be required prior to January 1, 2000. As these compliance deadlines approach, many electric utilities may find themselves unable to utilize coal purchased under long-term contracts entered into before the enactment of the CAAA unless they make significant and costly modifications to their generating facilities and/or purchase SO<sub>2</sub> allowances. Furthermore, the very act of installing new equipment needed to meet the requirements of the CAAA, such as scrubbers, new or re-designed electrostatic precipitators and low NO<sub>x</sub> burners, may cause a utility to be unable to meet its annual purchase obligations because of the lengthy outage required to perform such work on the generating unit. The utilities' inability to utilize the coal for which they have contracted raises important issues relating to the nature of their contract obligations under the circumstances.

The purpose of this article is to review the extent to which the acid rain provisions of the CAAA may give rise to a claim of force majeure, commercial impracticability or frustration of purpose. As a result of recent natural resource and environmental litigation, including the take-or-pay disputes that arose between natural gas producers and their pipeline purchasers during the 1980s, an extensive body of case law exists concerning the applicability of the doctrines of force majeure, commercial impracticability and frustration of purpose to governmental actions affecting a buyer's ability to take a commodity purchased under a long-term contract. This case law should provide guidance to the analysis and resolution of claims asserted by electric utilities as a result of their inability, due to compliance with the CAAA, to take coal under long-term contracts.

## II. THE CLEAN AIR ACT AMENDMENTS

The CAAA extensively revised and strengthened the then-existing requirements of the Clean Air Act (Act) and in Title IV — the so-called acid rain provisions — imposed a new program to achieve greater reductions of

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1. 42 U.S.C. §§ 7410-7626 (Supp. II 1990).

SO<sub>2</sub> and NO<sub>x</sub> than required for the purpose of protecting local air quality through the use of state implementation plans (SIPs) and New Source Performance Standards (NSPS).<sup>2</sup> Title IV mandates a two-step program to reduce electric utility SO<sub>2</sub> and NO<sub>x</sub> emissions by the year 2000.<sup>3</sup>

Phase I begins on January 1, 1995, and is directed at existing utility generating units that are 100 megawatts (MW) or larger and had emission rates above 2.5 pounds of SO<sub>2</sub> per million British Thermal Units (lbs/MMBtu) in 1985.<sup>4</sup> Two hundred sixty-one individual units at 111 electric generating stations are subject to these Phase I SO<sub>2</sub> requirements.<sup>5</sup> In Phase I, these affected units will be given annual allowances by EPA that are based on a 2.5 lbs/MMBtu emission rate and the units' level of operation in a 1985-87 baseline period.<sup>6</sup> Phase I is designed to reduce SO<sub>2</sub> emissions nationally by 3.5 million tons per year from 1980 levels.

An allowance is a transferrable license to emit one ton of SO<sub>2</sub>.<sup>7</sup> In order to operate, each unit must hold allowances in at least the amount of its actual emissions. The utility can achieve this requirement by (1) reducing SO<sub>2</sub> emissions at that unit to the number of allowances allocated by EPA; (2) transferring allowances from early — or over-compliance at other affected units on its system; and/or (3) purchasing allowances from another utility or industrial source.<sup>8</sup>

Phase II begins on January 1, 2000, and is directed at all other utility units.<sup>9</sup> In Phase II, affected units will be issued allowances based on a 1.2 lbs/MMBtu SO<sub>2</sub> emission rate and the same 1985-87 baseline.<sup>10</sup> Phase II will require a 10 million ton per year reduction in SO<sub>2</sub> emissions nationwide from 1980 levels.

Section 407 of the Act establishes the NO<sub>x</sub> emission reduction program.<sup>11</sup> The statute establishes a maximum allowable emission rate for tangentially-fired boilers of 0.45 lbs/MMBtu and for dry bottom, wall-fired boilers of 0.50 lbs/MMBtu.<sup>12</sup> If EPA determines that more effective low NO<sub>x</sub> burner technology is available, it may revise these limits no later than January 1, 1997.<sup>13</sup> The Amendments seek to reduce NO<sub>x</sub> emissions from electric utilities nationwide by 2 million tons per year (from 1980 levels) by the year 2000.

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2. See R. Nordhaus, *Acid Rain Compliance: Coordination of State and Federal Regulation*, 13 ENERGY L.J. 341 (1992); Roger J. Marzulla and Douglas W. Smith, *Acid Rain Regulations*, published in THE CLEAN AIR ACT AMENDMENTS: BNA'S COMPREHENSIVE ANALYSIS OF THE NEW LAW, at 143-73 (1991).

3. 42 U.S.C.A. §§ 7651c and 7651d (West Supp. 1992).

4. *Id.* § 7651c.

5. *Id.* Table A.

6. *Id.* § 7651c.

7. *Id.* §§ 7651a(3) and 7651b(b).

8. *Id.* § 7651c.

9. *Id.* § 7651d.

10. *Id.*

11. *Id.* § 7651f.

12. *Id.* EPA must promulgate annual average NO<sub>x</sub> emission limitations for wet bottom, wall-fired boilers, cyclones, and other types of utility boilers by January 1, 1997.

13. *Id.*

Allowances and the allowance trading system apply only to SO<sub>2</sub> emissions, not to NO<sub>x</sub> emissions.

Section 412 of the Act requires the owner and operator of any source subject to Title IV to install and operate continuous emissions and rate monitoring equipment on each affected unit by November 15, 1993, for Phase I affected units and by January 1, 1995, for units regulated under Phase II.<sup>14</sup>

The penalties for exceeding the Phase I or Phase II emission allowances are severe. The CAAA provide for (1) a \$2,000 per ton "automatic emission fee," adjusted for inflation after 1995; (2) a ton-for-ton offset of excess emissions the following year; (3) \$25,000 per day in civil penalties; and (4) up to five-years imprisonment and a \$500,000 fine for a "knowing" violation.<sup>15</sup>

It has been estimated that the cost of compliance with the SO<sub>2</sub> and NO<sub>x</sub> requirements under Title IV will be \$4 billion to \$8 billion in Phase II.<sup>16</sup> Some utilities will be required to reduce total SO<sub>2</sub> emissions by as much as one-third from 1991 levels to meet the Phase I requirements, and by an additional one-third to meet the Phase II requirements.

In the face of these extensive and costly requirements, it is inevitable that disputes will arise between electric utilities and their coal suppliers concerning the continued acceptance of high or medium sulfur coal purchased under long-term contracts signed before enactment of the CAAA.<sup>17</sup>

### III. GOVERNMENTAL ACTION AS A BASIS FOR FORCE MAJEURE, COMMERCIAL IMPRACTICABILITY OR FRUSTRATION OF PURPOSE

Because of extensive changes in governmental regulations affecting natural resources and the environment during the 1980s, a substantial body of case law has developed concerning the effect of governmental actions on a party's contractual obligations. The legal theories most commonly relied upon by a party who is unable to perform contractual obligations that would exist but for the governmental action are force majeure, commercial impracticability and frustration of purpose. The doctrine of force majeure arises from the agreement of the parties; commercial impracticability arises under the common law and section 2-615 of the Uniform Commercial Code; and frustration of purpose arises under the common law. Each of these closely-related doctrines is merely a means of allocating risk to the party that has agreed, or is better able, to bear it. *Northern Indiana Public Service Co. v. Carbon County Coal Co.* (hereinafter *NIPSCO*).<sup>18</sup> This section examines each of these doctrines as applied to governmental actions.

#### A. Force Majeure

Although the resolution of a force majeure claim is a matter of contract

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14. *Id.* § 7651k.

15. *Id.* §§ 7413, 7651j.

16. Nordhaus, *supra* note 2, at 343 n.17.

17. See *Arbitration Ruling Favors PSI*, COAL OUTLOOK, Feb. 15, 1993, at 7; *Ark Land Co. v. Illinois Power Co.*, No. 93-L-4 (Cir. Ct., Perry Co., Ill. filed February 11, 1993).

18. 799 F.2d 265, 278 (7th Cir. 1986).

interpretation,<sup>19</sup> most force majeure clauses in coal, natural gas and other resource contracts contain similar requirements.<sup>20</sup> When the force majeure event is based upon governmental action, courts have generally held that performance may be excused if the buyer is able to establish (1) that the governmental action is of the type specifically contemplated by the parties as falling within the scope of the force majeure clause; (2) that a specific link exists between the governmental action and the buyer's inability to perform; (3) that the governmental action was beyond the control and without the fault of the buyer; (4) in some cases, that the governmental action was "unforeseeable"; (5) that the buyer used its best efforts to eliminate the effects of the force majeure; and (6) that the buyer gave prompt notice of the force majeure event. Each of these issues will now be reviewed.

### 1. The Governmental Action Must Be Defined as an Event of Force Majeure

The first issue raised by a claim of force majeure is whether the event relied upon to excuse performance falls within the contract definition of force majeure.<sup>21</sup> In considering that issue, effect must be given to the intention of the parties as expressed in the language of the contract.<sup>22</sup> "Ordinarily, only when a force majeure clause specifically includes the event alleged to have prevented performance, will a party be excused from performance."<sup>23</sup>

A comprehensive discussion of this issue is set forth in *Hamilton Bros.*<sup>24</sup> The contract in that case defined "force majeure" as including:

[a]ny act of omission (including failure to take gas) of a purchaser of gas from Buyer which is excused by any event or occurrence of the character herein defined as constituting force majeure, temporary or permanent failure of gas supply, and any laws, orders, rules, regulations, acts or restraints of any government or governmental body or authority, civil or military.<sup>25</sup>

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19. *Hamilton Bros. Oil Co. v. ANR Pipeline Co.*, No. CIV-88-132-A, 1989 U.S. Dist. LEXIS 17871, at \*4 (W.D. Okla. Feb. 20, 1989).

20. For typical force majeure provisions in coal contracts, see R. Nordstrom and R. Tannous, *Coal Supply Contracts and Proposed Clean Air Act Amendments*, 11 E. MINERAL LAW INST. § 12.02[2][b] at 12-9, 12-10 (1990); Carney, *The Nature and Extent of the Excuse Provided by a Force Majeure Event Under a Coal Supply Agreement*, 4 E. MINERAL LAW INST. § 11-1—11-7 (1983); Young, *Construction and Enforcement of Long-Term Supply Agreement — Coping With Conditions Arising from Foreseeable and Unforeseeable Events — Force Majeure and Gross Inequities Clauses*, 27A ROCKY MTN. MINERAL LAW INST. 127, 139 (1982).

For typical force majeure provisions in contracts between natural gas producers and pipeline purchasers, see J. Medina, *Take or Litigate: Enforcing the Plain Meaning of the Take-or-Pay Clause in Natural Gas Contracts*, 40 ARK. L. REV. 185, 222 n.117 (1986).

21. *Hamilton Bros.*, 1989 U.S. Dist. LEXIS 17871, at \*4.

22. See, e.g., *THQ Venture v. SW, Inc.*, 444 N.E.2d 335 (Ind. App. 1983); *Crutchfield v. Assocs. Invest. Co.*, 376 S.W.2d 957, 959 (Tex. Ct. App. 1964).

23. *United States v. Panhandle E. Corp.*, 693 F.Supp. 88, 96 (D. Del. 1988)(citing *Kel Kim Corp. v. Central Markets, Inc.*, 519 N.E.2d 295, 296 (1987)).

24. 1989 U.S. Dist. LEXIS 17871.

25. *Id.* at \*7 n.3. This force majeure clause is somewhat unusual in that it includes as a defined event the failure of a downstream purchaser to take the gas because of an event that would constitute force majeure under the contract.

In analyzing this force majeure language, the court held:

[I]nvariably, courts must address two questions in determining the applicability of force majeure clauses: (1) whether, under the particular contract, the event at issue is defined as a force majeure event; and (2) whether the event actually renders performance impracticable.<sup>26</sup>

The court held that FERC Order 380<sup>27</sup> was an event of force majeure within the meaning of the contract because, "[b]y excluding variable costs associated with the purchase of gas from minimum bills, FERC 380 relieved ANR's customers of their purchase obligation. . . . *FERC 380, therefore, falls squarely within the terms of the contract's force majeure clause.*"<sup>28</sup> The court properly distinguished the definitional issue, i.e., does the event relied upon to excuse performance fall within the force majeure clause of the contract, from the causation issue:

[A]n occurrence may constitute a force majeure event, squarely within the terms of the force majeure clause, and, yet, still fail to provide the basis for the suspension of a party's contractual obligations because it does not render performance impracticable.<sup>29</sup>

The court denied the producer's motion for partial summary judgment, holding that Order 380 was an event of force majeure as defined by the contract, but that its impact on ANR's performance raised a genuine issue of material fact for resolution at the trial.<sup>30</sup> At least five other cases involving ANR Pipeline Company, and interpreting the same or similar contract language, have followed this approach.<sup>31</sup>

26. *Id.* at \*4.

27. Order No. 380 essentially relieved pipeline customers of their contractual obligations to purchase gas under minimum bill provisions by declaring minimum bills inoperative to the extent they enabled pipelines to recover variable costs for gas not purchased by their customers. See 18 C.F.R. § 154.111(a)(2)(1988); *Wisconsin Gas Co. v. FERC*, 770 F.2d 1144, 1149-52 (D.C. Cir. 1985), *cert. denied sub nom.* Transwestern Pipeline Corp. v. FERC, 476 U.S. 1114 (1986).

28. *Hamilton Bros.*, U.S. Dist. LEXIS 17871 at \*8 (emphasis added).

29. *Id.* at \*10.

30. *Id.* at \*15.

31. Cases that have involved ANR Pipeline and have followed this approach are:

1. *ANR Pipeline Co. v. Devon Energy Corp.*, No. G86-1123 CA, 1989 U.S. Dist. LEXIS 17684, at \*8 (W.D. Mich. Feb. 1, 1989). The court stated "no ambiguity exists as to the definition of force majeure in the contract and . . . the failures of ANR's customers to take gas from ANR fall under the contracts' force majeure definition."

2. *Burkhart Petroleum Corp. v. ANR Pipeline Co.*, No. 86-C-257-C, 1988 U.S. Dist. LEXIS 9158, at \*11-12 (N.D. Okla. June 30, 1988). Here the court mentioned that "[t]he effect of the passage of Order 380 is an act of force majeure, as defined under the force majeure provision contained in the parties' Gas Purchase Contract."

3. *Atlantic Richfield v. ANR Pipeline Co.*, 768 SW.2d 777, 780-81 (Tex. Ct. App. 1989)(it was a question of fact for the jury whether FERC Order No. 380 rendered ANR unable "wholly or in part" to comply with the obligation of the contracts).

4. *Dyco Petroleum Corp. v. ANR Pipeline Co.*, No. 86-C-1097-C, 1988 U.S. Dist. LEXIS 18317 (N.D. Okla. Sept. 1, 1988). The court stated that:

[t]he effect of the passage of Order 380 and MGCRA [a Michigan law] are acts of force majeure, as defined under the force majeure provision contained in the parties' gas purchase contracts . . . [w]hether ANR has been rendered 'unable, wholly or in part, by force majeure' is a question of fact for the trier of fact rendering summary judgment inappropriate.

Similarly, in *Natural Gas Pipeline Co. of America v. The Anschutz Corp.*,<sup>32</sup> the court held that the FERC's restructuring of the natural gas industry satisfied the definitional requirement for an event of force majeure under the contract:

The present force majeure clause allows for the cessation of performance by a party when its performance is prevented or delayed by a "... restriction or restraint imposed by law or by regulation or order of duly constituted governmental authority . . . ." NGPL argues that Order 436 compels pipelines to open access to previously excluded spot sellers. [footnote omitted.] This, in turn, prevents NGPL from being a merchant and forces NGPL to be a mere conduit for the natural gas needs of these new competitors. The court agrees. The FERC has completely restructured the natural gas industry unlike in *NIPSCO* where the electric utility was merely prevented from passing on higher rates to customers because of a drop in the market price of electricity. The FERC regulations in and of themselves are the cause for the current lower natural gas market price. In *NIPSCO*, the governmental regulations dealt with the effects of a lowered electricity market price.<sup>33</sup>

The court held that issues of causation and foreseeability would be submitted to the jury.<sup>34</sup> Other courts have applied similar reasoning in allowing a force majeure defense to be tried.<sup>35</sup>

Courts have been hostile to the assertion of force majeure where the event relied upon is merely a change in market conditions, or where the seller is able to convince the court that the buyer's nonperformance is primarily due to market conditions rather than a change in governmental regulations. This hostility is a natural result of the reluctance of courts to permit a party to avoid the risk of a change in markets where the very purpose of a long-term contract is to establish that an agreed-upon quantity of a given commodity will be purchased at an agreed-upon price, thereby insulating the parties from inevitable price fluctuations in the market. Thus, courts have frequently rejected force majeure claims on the ground that the change in market condi-

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ANR Pipeline Co. v. Conoco, Inc., No. 86-6972-CK (Cir. Ct., Mecosta Co., Mich. 1987)(vacating order striking affirmative defenses).

32. No. 85-C-3446, 1987 U.S. Dist. LEXIS 16087 (N.D. Ill. Feb. 3, 1987).

33. *Id.* at \*4-6.

34. *Id.*

35. See *Mobil Rocky Mountain, Inc. v. Natural Gas Pipeline Co.*, No. C-85-5360 (D. Utah 1987)(vacating a prior grant of summary judgment on the force majeure defense and holding that "it cannot be said the decline in price of natural gas is the sole cause, nor may it even be the primary cause of the inability of the defendant to market its gas."); *Forest Oil Co. v. El Paso Natural Gas Co.*, No. CIV-86-1948-W (W.D. Okla. 1987)(force majeure defense based upon the regulatory effects of FERC Order 436 should be submitted to the jury); *SPG Exploration Corp. v. El Paso Natural Gas Co.*, No. 87-CV-4717 (Dist. Colo. 1988)(motion to strike affirmative defenses denied because of fact issues relating to effect of regulations by governmental authority); *Kodiak 1981 Drilling Partnership v. Delhi Gas Pipeline Corp.*, 736 S.W.2d 715, 716-17 (Tex. Ct. App. 1987)(upholding trial court determination that the defendants' inability to pay sums due under the contract was due to the failure of natural gas markets and was an event of force majeure where "force majeure" was defined to include "partial or entire failure to gas supply or market or any other cause, whether of the kind herein enumerated or otherwise, not reasonably within the control of the party claiming 'force majeure'."); *Exxon Corp. v. Columbia Gas Transmission Corp.*, 624 F.Supp. 610, 612 (W.D. La. 1985)("It is clear to this Court that there exists a very real question of fact as to whether Columbia has actually been rendered unable to perform, and whether the events cited by Columbia are encompassed by the force majeure clause of the contracts in question.").

tions does not fall within the definition of force majeure,<sup>36</sup> or on the ground that the change in market conditions did not cause the party to be unable to perform,<sup>37</sup> and courts have not always been careful to distinguish between the definitional and causation issues.<sup>38</sup>

Indeed, a few courts have disallowed force majeure claims as a matter of law through creative judicial draftsmanship or by simply disregarding express contract language defining an event of force majeure. In *Golsen v. ONG Western, Inc.*, for example, the Oklahoma Supreme Court held that the inability to sell gas at a profit is not in the contemplation of the law a force majeure event, even though the contract defined the term "force majeure"<sup>39</sup>

[T]o include, without limitation . . . any act or omission (*including failure to take gas*) of a purchaser of gas from Buyer which is excused by any event or occurrence of the character herein defined as constituting force majeure, *failure of gas supply or markets, and any laws, orders, rules, regulations, acts, or restraints of any governmental body or authority*, civil or military, or any other causes beyond the control of the parties hereto.<sup>40</sup>

In *Day v. Tenneco, Inc.*, the buyer relied upon a force majeure clause providing that an act of government excused performance "when any such Act of Government *directly or indirectly contributes in either party's inability to per-*

36. See, e.g., *Kennedy & Mitchell, Inc. v. Internorth, Inc.*, No. 86-C-404-C, 1988 U.S. Dist. LEXIS 17106, at \*22-23 (N.D. Okla. Sept. 20, 1989); *RJB Gas Pipeline Co. v. Colorado Interstate Gas Co.*, 813 P.2d 1, 10-11 (Okla. Ct. App. 1989); *Benson Mineral Group, Inc. v. Northern Natural Gas Co.*, No. 86-1903, 1988 U.S. Dist. LEXIS 17581, at \*18-19 (D. Kan. April 28, 1988); *Hanover Petroleum Corp. v. Tenneco, Inc.*, 521 So. 2d 1234, 1237 (La. Ct. App. 1988), *cert denied*, 526 So.2d 800 (La. 1988); See also *Conn Energy, Inc. v. Sea Robin Pipeline Co.*, No. 89-5436, 1990 U.S. Dist. LEXIS 5613 (E.D. La. May 9, 1990).

37. See, e.g., *Sabine Corp. v. ONG W., Inc.*, 725 F. Supp. 1157, 1168-71 (W.D. Okla. 1989). Here the court mentioned that:

[a]t best, ONG's evidence demonstrates that the effect of the various alleged events of force majeure was a decline in market demand and a disparity between ONG's contract price and the market price or value of gas . . . with the result that if ONG were to have taken the gas, it would have had to resell it at a loss. . . . Such a loss of market demand which, as opposed to absolute demand, is a function of price . . . and the inability to resell gas at a profit, does not render a party "unable" to take gas.

*Valero Transmission Co. v. Mitchell Energy Corp.*, 743 S.W.2d 658, 663 (Tex. Ct. App. 1987); *Hartman v. El Paso Natural Gas Co.*, 763 P.2d 1144, 1150-51 (N.M. 1988); *Dyco Petroleum Corp. v. El Paso Natural Gas Co.*, No. 86-C-897-C, 1988 U.S. Dist. LEXIS 17991, at \*10-11 (N.D. Okla. Nov. 1, 1988). The court stated that:

[t]o conclude that a decline in market demand coming as a result of regulatory changes, excuses El Paso's performance would fly in the face of the clear purposes of the contracts, and would be inconsistent with the contracts' other provisions. The risk of changing market conditions was to be borne by El Paso under these contracts.

38. See, e.g., *Langham-Hill Petroleum, Inc. v. Southern Fuels Co.*, 813 F.2d 1327, 1329-31 (4th Cir. 1987)(Rule 11 sanctions awarded against defendant for invoking force majeure defense); *Kaiser-Francis Oil Co. v. Producer's Gas Co.*, 870 F.2d 563, 566 (10th Cir. 1989). The court stated that:

[t]he change in the general or relative resale price of gas does not constitute a "partial failure of gas demand" which would relieve PGC of its obligation to take or pay. The force majeure provision cannot substitute for a price redetermination or market-out provision which would allow PGC to reduce the price paid to Kaiser-Francis for gas, thereby ameliorating PGC's take-or-pay obligation when the resale price of natural gas declined.

39. 756 P.2d 1209, 1212-13 (Okla. 1988).

40. *Id.* (emphasis added).

*form its obligations*" and upon a Mississippi force majeure statute that excuses nonperformance caused by "Acts of God, . . . or any cause beyond the control of such party. . . ." <sup>41</sup> The court held:

[T]he market collapse and changes in regulation described by Defendants, which occurred over a period of three years from 1982-1985, are not within the meaning of the force majeure provisions either of the contracts or the Mississippi statutes. The fact that events are unexpected . . . is insufficient by itself to show that an event is a force majeure. Here neither the market collapse nor the new government regulations constitute a force majeure under the terms of either the law of Mississippi or the terms of the contract. The very reason for entering the take-or-pay contracts was to insure payment to the producer in the event of substantial change in the marketplace. Defendants willingly accepted that risk. The fact that the unexpected happened does not excuse performance. Defendants accepted the risk and lost. <sup>42</sup>

The courts' understandable hostility to the assertion of force majeure based solely upon market conditions and the result-oriented approaches of *Golsen* and *Day v. Tenneco* should not confuse the analytical approach set forth in *Hamilton Bros.* While it is true that parties to a long-term contract often seek to insulate themselves from price fluctuations due to inevitable changes in the market, it is equally true that a force majeure clause is an essential term of the contract, the purpose of which is to allocate risk in accordance with the parties' intentions. <sup>43</sup> If the parties have allocated the risk in such a way that governmental action or a loss of markets may constitute force majeure, then it is the court's responsibility to enforce the contract as written, giving effect to the parties' intentions, not to re-write the contract, thereby re-allocating the risks in whatever manner the court deems appropriate. Accordingly, if the event claimed as force majeure falls within the contract definition — whether the event is governmental regulation, loss of markets, or a combination thereof — then the court's only inquiry should be as to causation, i.e. does an issue of fact exist as to whether the event actually caused an inability to perform? While the definitional issue will normally be a matter for the court to decide, causation should normally be decided by the trier of fact. <sup>44</sup>

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41. 696 F.Supp. 233, 235 (S.D. Miss. 1988) (emphasis added).

42. *Id.* at 235-36.

43. *United States v. Moore American Graphics, Inc.*, No. 84-C-6547, 1989 U.S. Dist. LEXIS 7751, at \*17 (N.D. Ill. July 6, 1989). See also *PPG Industries, Inc. v. Shell Oil Co.*, 919 F.2d 17, 19 (5th Cir. 1990) (describing a force majeure clause as within the parties' right to anticipate and allocate business risks between them); *Burkhart Petroleum Corp. v. ANR Pipeline Co.*, No. 87-C-257-C, 1988 U.S. Dist. LEXIS 9158, at \*11-12 (N.D. Okla. June 30, 1988); *Dyco Petroleum Corp. v. ANR Pipeline Co.*, No. 86-C-1097-C, 1988 U.S. Dist. LEXIS 18317 (N.D. Okla. Sept. 1, 1988) (refusing to dismiss ANR's force majeure claim where it was ANR's "legitimate concern" that a government order might alter its rights which "caused ANR to include the governmental acts event within the force majeure provision of its gas purchase contracts"); *Eastern Air Lines, Inc. v. McDonnell Douglas Corp.*, 532 F.2d 957, 991-92 (5th Cir. 1976) (when the promisor has anticipated a particular event by providing for it in a contract, he should be relieved of liability for the occurrence of such event).

44. See, e.g., *Burkhart Petroleum Corp. v. ANR Pipeline Co.*, No. 87-C-257-C, 1988 U.S. Dist. Lexis 17871, at \*13 (N.D. Okla. June 30, 1988); *Dyco Petroleum Corp. v. ANR Pipeline Co.*, No. 86-C-1097-C, U.S. Dist LEXIS 18317 (N.D. Okla. Sept. 1, 1988).



## 2. The Party's Inability to Perform Must Be Caused by the Force Majeure

The standard for determining whether a party is "unable" to perform its contract obligations within the meaning of a force majeure clause was considered at length by the Tenth Circuit in *International Minerals and Chemical Corp. v. Llano, Inc.*<sup>45</sup> In that case, a potash mine and processing facility operator, IMC, purchased natural gas under a take-or-pay contract with defendant Llano.<sup>46</sup> IMC became subject to new emissions restrictions under New Mexico's State Implementation Plan (SIP), mandated by the Clean Air Act.<sup>47</sup> IMC studied its alternatives for compliance, and, after consulting with New Mexico officials, determined that an operational change from an evaporative to a chemical process was required. After having its compliance plan sanctioned under New Mexico's SIP, IMC took the evaporators out of service for the final 18 months of the contract. As a result of taking the evaporators out of service, IMC's natural gas requirements were reduced by 60 percent. IMC argued that under an adjustment provision it was "unable" to receive its minimum purchase obligation due to the environmental requirements, and that it was therefore relieved of its contractual obligation to purchase natural gas.<sup>48</sup>

The court began its analysis by rejecting a literal interpretation of the word "unable":

A simplistic, literal interpretation of the word "unable" would, in our view, be inappropriate and lead to absurd results: IMC could never be "unable" to take Llano's gas; IMC could always take the gas and vent it into the air, even if its facilities were completely destroyed.<sup>49</sup>

Instead, the court noted that:

[t]he important question is whether an unanticipated circumstance has made performance of the promise vitally different from what should reasonably have been within the contemplation of both parties when they entered into the contract. If so, the risk should not fairly be thrown upon the promisor.<sup>50</sup>

Under this standard, the court excused IMC's performance:

Inasmuch as there was no technically suitable way for IMC to comply with the [regulation] without shutting down the [evaporators] and changing to the [alternative processing method], with the concomitant decrease in natural gas consumption, we hold that the adjustment provision of . . . the contract was triggered. IMC was unable, for reasons beyond its reasonable control, to receive its minimum purchase obligation of natural gas between January 1, 1981 and June 30, 1982; thus the minimum bill should have been adjusted appropriately. IMC should not be required to pay for any natural gas it did not take under the

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45. 770 F.2d 879 (10th Cir. 1985), *cert. denied*, 475 U.S. 1015 (1986).

46. *Id.* at 881-87.

47. *See* 42 U.S.C. § 7410 (1988).

48. *Llano*, 770 F.2d at 886-87. The relevant portions of the adjustment provision at issue in *Llano* provided that: "[i]n the event that . . . [b]uyer is unable to receive gas as provided in this Contract for any reason beyond the reasonable control of the parties . . . an appropriate adjustment in the minimum purchase requirements . . . shall be made." *Id.* at 882.

49. *Id.* at 886.

50. *Id.* (quoting 6 WILLISTON ON CONTRACTS, § 1931 (1938)).

contract.<sup>51</sup>

Other courts have likewise held that the need to comply with new government regulations may render a party "unable" to perform under the contract. For example, in *Kansas City Power & Light Co. v. The Pittsburgh and Midway Coal Co.*<sup>52</sup> a utility sought a declaratory judgment that continuous monitoring requirements with respect to SO<sub>2</sub> emissions constituted force majeure excusing its performance under a long-term coal supply agreement. The coal company moved to dismiss the claim, arguing that no force majeure event existed because the utility could comply with the emissions standards and use coal under the contract either by using new methods in its emissions process,<sup>53</sup> or by installing new pollution control equipment. Noting that there was evidence that installing such pollution control equipment, at a cost of \$140 million, might be "cost prohibitive" to the utility, and that alternative emissions methods might not enable the utility to comply with the SO<sub>2</sub> limitations, the court refused to dismiss the utility's force majeure claim.<sup>54</sup> Accordingly, governmental action may either prohibit performance directly or make performance so expensive that it is impracticable.<sup>55</sup>

In *NIPSCO*, on the other hand, the court rejected the defense of force majeure by a utility with respect to a coal purchase contract which permitted the utility to stop taking delivery of coal "for any cause beyond [its] reasonable control . . . including but not limited to . . . orders or acts of civil . . . authority . . . which wholly or partly prevent . . . the utilizing . . . of the

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51. *Id.* at 887. The court rejected IMC's claim that it was entitled to relief under the force majeure provision of the contract. First, the court held that IMC failed to give notice of its force majeure claim. *Id.* at 885. Second, the court held, that under the peculiarities of take-or-pay contracts, force majeure provisions only relieve parties of the duty to "take," while the duty to "pay" remains intact. *Id.* This reasoning has been criticized by other courts. *Sabine Corp. v. ONG W., Inc.*, 725 F.Supp 1157, 1169-70 (W.D. Okla. 1989).

52. No. 88-2224-S, 1989 U.S. Dist. LEXIS 15036 (D. Kan. Nov. 17, 1989).

53. *Id.* at \*8. The coal company suggested that the utility could meet the SO<sub>2</sub> emissions limit on a continuous basis "by using lime as a reagent in the power plant's emission removal process."

54. *Id.* at \*10-12.

55. See also *Atlantic Richfield Co. v. ANR Pipeline Co.*, 768 S.W.2d 777, 781-82 (Tex. Ct. App. 1989)(as a result of FERC order, pipeline was "unable" to comply with its contract obligations to purchase gas under the gas supply agreements); *Commonwealth Edison v. Allied-General Nuclear Serv.*, 731 F.Supp. 850, 860 (N.D. Ill. 1990)(Nuclear Regulatory Commission moratorium on reprocessing spent nuclear fuel was an event of force majeure that excused Allied-General's duty to perform); *City of Kansas City, Missouri v. City of Kansas City, Kansas*, 393 F.Supp. 1, 7 (W.D. Mo. 1975)(the added expense of complying with the Water Pollution Control Act of 1972, which required the treatment of sewage, would impose a very significant burden on the plaintiff and "when a party to a contract encounters extreme and unforeseen difficulties in performance due to some supervening [sic] legislative enactment, the duty of performance will be discharged"); *Eastern Air Lines, Inc. v. McDonnell Douglas Corp.*, 532 F.2d 957 (5th Cir. 1976)(finding defendant unable to perform its contract obligations and excusing the defendant from delays in scheduled deliveries of aircraft despite the fact that its inability to perform resulted from the manufacturer's voluntary choice to comply with the informal wishes of the government); *Natural Gas Pipeline Co. of America v. The Anschutz Corp.*, No. 85-C-3446, 1987 U.S. Dist. LEXIS 16087 (N.D. Ill. Feb. 3, 1987)("at issue here is not just a lowering of the market price of natural gas, but a restructuring of the industry by the FERC which would arguably compel NGPL to sell at a substantially lowered price. The court finds a question of fact exists as to whether the FERC regulations are of sufficient magnitude to prevent NGPL from performing under the contract").

coal.”<sup>56</sup> The utility argued that “the Indiana Public Service Commission’s ‘economy purchase orders’ prevented it, in whole or in part, from using the coal that it had agreed to buy. . . .”<sup>57</sup> In rejecting this contention, the court held:

All that those orders do is tell NIPSCO it will not be allowed to pass on fuel costs to its ratepayers in the form of higher rates if it can buy electricity cheaper than it can generate electricity internally using Carbon County’s coal. Such an order does not “prevent,” whether wholly or in part, NIPSCO from using the coal; it just prevents NIPSCO from shifting the burden of its improvidence or bad luck in having incorrectly forecasted its fuel needs to the backs of the hapless ratepayers. . . . By signing the kind of contract it did, NIPSCO gambled that fuel costs would rise rather than fall over the life of the contract; for if they rose, the contract price would give it an advantage over its (hypothetical) competitors who would have to buy fuel at the current market price. If such a gamble fails, the result is not force majeure.<sup>58</sup>

Thus, *NIPSCO* is an example of a case in which the alleged force majeure event (economy purchase orders issued by the state public utility commission) fell within the definition of force majeure in the contract (“orders or acts of civil . . . authority”) but the purchaser could not show that those orders caused it to be unable to perform its contractual obligations. *NIPSCO* may be contrasted with cases where the government order directly prevented or affected performance, such as in *Llano* and *Kansas City Power & Light*.

### 3. Beyond the Control and Without the Fault or Negligence of the Party Invoking Force Majeure

In *Nissho-Iwai Co. v. Occidental Crude Sales, Inc.*, the court described the element of control as follows:

The term “reasonable control” has come to include two related notions. First, a party may not affirmatively cause the event that prevents his performance. The rationale behind this requirement is obvious. If a contractor were able to escape his responsibilities merely by causing an excusing event to occur, he would have no effective “obligation to perform.” (citations omitted).

The second aspect of reasonable control is more subtle. Some courts will not allow a party to rely on an excusing event if he could have taken reasonable steps to prevent it. (citations omitted). The rationale behind this requirement is that the force majeure did not actually prevent performance if a party could reasonably have prevented the event from occurring. The party has prevented performance and, again, breached his good faith obligation to perform by failing to exercise reasonable diligence.<sup>59</sup>

The element of “control” and “fault,” however, have diminished applicability when the force majeure event is a federal statute.<sup>60</sup> A party is not required to oppose legislation,<sup>61</sup> and cooperation with the government is to be

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56. *NIPSCO*, 799 F.2d at 274.

57. *Id.*

58. *Id.* at 274-75.

59. 729 F.2d 1530, 1540 (5th Cir. 1984). See also *Chemetron Corp. v. McLouth Steel Corp.*, 381 F.Supp. 245, 257 (N.D. Ill. 1974) *aff’d*, 522 F.2d 469 (7th Cir. 1975).

60. See *Commonwealth Edison Co. v. Allied-General Nuclear Servs.*, 731 F.Supp. 850, 860 (N.D. Ill. 1990).

61. *Id.*

encouraged.<sup>62</sup> The actions of the government can hardly be deemed to be within the control or to be the fault of any private party.

#### 4. Foreseeability

The issue of foreseeability has been the subject of considerable controversy in force majeure cases. This controversy can be traced in part to the holding of the Supreme Court in *United States v. Brooks-Callaway Co.*<sup>63</sup> The contract at issue in that case, the Standard Form of Government Construction Contract, provided that:

[T]he right of the contractor to proceed shall not be terminated or the contractor charged with liquidated damages because of any delays in the completion of the work due to unforeseeable causes beyond the control and without the fault or negligence of the contractor, including, but not restricted to, acts of God, or of the public enemy, acts of the Government, fires, floods, epidemics, quarantine restrictions, strikes, freight embargoes, and unusually severe weather or delays of subcontractors due to such causes.<sup>64</sup>

The issue before the Court was whether a government contractor was liable for liquidated damages due to delays caused by "high water" which the contracting officer found to be customary and foreseeable in that area.<sup>65</sup> The Court of Claims held that liquidated damages should not be assessed because the "high water" was a "flood" and under the contract all floods were unforeseeable per se.<sup>66</sup> The Supreme Court reversed, holding that "the adjective 'unforeseeable' must modify each event set out in the 'including' phrase."<sup>67</sup> "Whether high water or flood, the sense of the proviso requires it to be unforeseeable before remission of liquidated damages for delay is warranted."<sup>68</sup>

This reasoning was then relied upon by the Third Circuit in *Gulf Oil Corp. v. FERC*,<sup>69</sup> in holding that a party claiming force majeure under a natural gas warranty contract must show that the event upon which it relies was "unforeseeable" even if that term is not used in the contract. The court held that "it is well settled that a *force majeure* clause in a non-warranty contract defines the area of unforeseeable events that might excuse nonperformance within the contract period."<sup>70</sup> The language in *Gulf Oil*, in turn, was relied upon by courts faced with the interpretation of non-warranty contracts to hold that, "[a] force majeure clause does not relieve a contracting party of the obligation to perform, unless the disabling event was unforeseeable at the time the parties made the contract."<sup>71</sup>

The requirement that a party claiming force majeure establish that the

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62. *Llano*, 770 F.2d at 887.

63. 318 U.S. 120 (1943).

64. *Id.* at 120-21 n.1.

65. *Id.* at 121.

66. *Id.* at 122.

67. *Id.* at 123.

68. *Id.* at 124.

69. 706 F.2d 444, 453 (3d Cir. 1983), *cert. denied*, 464 U.S. 1038 (1984).

70. *Id.* at 452 (emphasis added).

71. *Valero Transmission Co. v. Mitchell Energy Corp.*, 743 S.W.2d 658, 663 (Tex. Ct. App. 1987).  
See also *Sunflower Elec. Coop., Inc. v. Tomlinson Oil Co.*, 638 P.2d 963, 971-74 (Kan. App. 1981).

event was unforeseeable even if that requirement is not expressly set forth in the contract has now been widely repudiated. Courts recognize that "it is the contract, rather than a body of judicial doctrine, that I must interpret."<sup>72</sup> Accordingly, as the court held in *Sabine Corp. v. ONG Western, Inc.*:

Plaintiff's argument that an event of force majeure must be unforeseeable must be rejected. Nowhere does the force majeure clause specify that an event or cause must be unforeseeable to be a force majeure event. The focus of the clause is upon a party's ability to control rather than its ability to foresee the alleged cause.<sup>73</sup>

This rule has now been generally followed in cases in which the contract does not expressly state that the event must be "unforeseeable" to constitute force majeure.<sup>74</sup>

Even if the contract does impose a foreseeability requirement, however, it is now established that "foreseeability," in the context of governmental regulations, does not mean simply that the party could expect some governmental action to occur; rather it means that the party must have foreseen the exact timing, nature and impact of that action. As the court held in *ANR Pipeline Co. v. Devon Energy Corp.*:

Defendants argue that before the contracts were executed, ANR was aware that federal regulation of the natural gas industry was subject to change, and that such change could potentially affect the price of and demand for ANR's gas . . . . I am satisfied that although ANR might have theoretically been able to foresee . . . that some governmental action would affect its ability to compete in the market, the exact nature, timing, and effect of such action were unforeseeable and thus the specific enactment and consequences of [the administrative actions] were not predictable.<sup>75</sup>

Courts thus will not penalize parties for having the foresight to negotiate a broadly worded force majeure clause by holding that events intended to constitute force majeure were "foreseeable."

##### 5. Best Efforts to Eliminate the Force Majeure Event with a Minimum of Delay

The requirement of using one's "best efforts" is equivalent to the requirement that a party act in good faith.<sup>76</sup> A "best efforts" requirement does not strip the promisor of its "right to give reasonable consideration to its own

72. *Commonwealth Edison Co. v. Allied-General Nuclear Servs.*, 731 F.Supp. 850, 856 (N.D. Ill. 1990).

73. 725 F.Supp. 1157, 1170 (W.D. Okla. 1989).

74. See *PPG Industries, Inc. v. Shell Oil Co.*, 919 F.2d 17, 18-19 (5th Cir. 1990); *Kodiak 1981 Drilling Partnership v. Delhi Gas Pipeline Corp.*, 736 S.W.2d 715, 710-21 (Tex. Ct. App. 1987); *Eastern Air Lines, Inc. v. McDonnell Douglas Corp.*, 532 F.2d 957, 991-92 (5th Cir. 1976).

75. No. G86-1123 CA, 1989 U.S. Dist. LEXIS 17684 at \*9-10 (W.D. Mich. 1989). See also *Burkhart Petroleum Corp. v. ANR Pipeline Co.*, No. 87-C-257-C, 1988 U.S. Dist. LEXIS 9158, at \*11 (N.D. Okla. June 30, 1988) (Although action by a regulatory agency can be anticipated, the timing and resulting impact is unforeseeable); *Dyco Petroleum Corp. v. El Paso Natural Gas Co.*, No. 86-C-897-E, 1988 U.S. Dist. LEXIS 17991, at \*10-11 (N.D. Okla. Nov. 1, 1988).

76. *Triple-A Baseball Club v. Northeastern Baseball, Inc., Assocs.*, 832 F.2d 214, 225 (1st Cir. 1987), cert denied 485 U.S. 935 (1988); *Gulf Oil Corp. v. FERC*, 706 F.2d 444 (3rd Cir. 1983).

interests," nor does it require the promisor to engage in illegal activity.<sup>77</sup> Instead, the promisor is simply required to act in good faith to the extent of its own capability.<sup>78</sup>

#### 6. Notice of the Force Majeure Claim

Notice of the force majeure event is routinely required by the contract and failure to provide it will ordinarily defeat a force majeure claim. In *Superior Oil Co. v. Transco Energy Co.*, for example, the court held:

Without determining whether the events Pipe Line cites are encompassed by the force majeure clauses of the parties' contracts, this Court concludes that Pipe Line is barred from asserting a force majeure defense because it failed to properly invoke the force majeure clause. The clause provides that "nor shall such causes or contingencies relieve any party of liability unless such party give notice and full particulars of the same in writing or by telegraph to the other party as soon as possible after the occurrence relied on." Pipe Line has not complied with this requirement. Hence, there is no issue of material fact for this Court to try on the affirmative defense of force majeure. Under the very terms of the force majeure clause, Pipe Line is not relieved of its liability to take even if those events it cites did constitute force majeure.<sup>79</sup>

Similarly, in *Sabine Corp. v. ONG Western, Inc.*, the court held: "[t]he failure to give proper notice is fatal to a defense based upon a force majeure clause requiring notice."<sup>80</sup>

If the contract requires that an explanation of the force majeure event be provided, failure to do so may also be grounds for denying the claim. As the court stated in *Llano*:

IMC's notice to Llano was inadequate in that no reasons were given as to why gas consumption would be decreased. Adequate notice was required to trigger the protections of the provision.<sup>81</sup>

Accordingly, adequate and specific notice of the event of force majeure must be given as a prerequisite to invoking the defense.

#### B. Commercial Impracticability and Frustration of Purpose

If the parties to a contract do not explicitly assign a particular risk to one party or the other through the force majeure clause, then the doctrines of commercial impracticability and frustration of purpose may apply to excuse performance.<sup>82</sup> Like force majeure, commercial impracticability and frustration of purpose "are doctrines for shifting risk to the party better able to bear

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77. *Bloor v. Falstaff Brewing Corp.*, 601 F.2d 609, 614 (2nd Cir. 1979).

78. *Western Geophysical Co. v. Bolt Assocs. of Am.*, 584 F.2d 1164, 1171 (2nd Cir. 1978).

79. 616 F.Supp. 98, 108-09 (W.D. La. 1985).

80. 725 F.Supp. 1157, 1168 (W.D. Okla. 1989). See also *Resources Investment Corp. v. Enron Corp.*, 669 F.Supp. 1038, 1043-44 (D. Colo. 1987); *Union Oil Co. of California v. Enserch Corp.*, No. 87-1377-R, 1988 U.S. Dist. LEXIS 18097, at \*10 (W.D. Okla. July 13, 1988) (force majeure withdrawn or abandoned where no force majeure notice was served).

81. 770 F.2d at 885.

82. For a discussion of the relationship between force majeure on the one hand and commercial impracticability and frustration of purpose on the other, see *Commonwealth Edison v. Allied-General Nuclear Servs.*, 731 F. Supp. 850, 855-56 (N.D. Ill. 1990); *NIPSCO*, 799 F.2d at 278.

it, either because he is in a better position to prevent the risk from materializing or because he can better reduce the disutility of the risk (as by insuring) if the risk does occur.”<sup>83</sup>

### 1. Commercial Impracticability

The common law doctrine of commercial impracticability has been codified in Section 2-615 of the Uniform Commercial Code.<sup>84</sup> Section 2-615 provides:

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.

Although section 2-615 is drafted in terms of a seller, Official Comment 9 to the section states that “the reason of the present section may well apply and entitle the buyer to the exemption” and courts have been virtually unanimous in holding that the section may be invoked either by a buyer or a seller.<sup>85</sup> Thus, in order to prevail under section 2-615, a buyer must prove: (1) the occurrence of a contingency; (2) the non-occurrence of which was a basic assumption on which the contract was made; and (3) by which occurrence further performance has become commercially impracticable.<sup>86</sup>

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83. *Id.*

84. The common law originally refused to recognize a supervening event, such as an invasion, as an excuse for non-performance of a contractual undertaking on the theory that the parties could have expressly provided for that contingency in the contract. *Parradine v. Jane*, Aleyn 26, 82 ENG. REP. 897 (K.B. 1647). This theory was modified in the case of *Taylor v. Caldwell*, 122 ENG. REP. 309 (K.B. 1863), which held that performance would be excused if rendered absolutely impossible by a supervening event, such as a fire. By the time the Restatement of Contracts was drafted in 1932, the term “impossibility” meant “not only strict impossibility, but impracticability because of extreme and unreasonable difficulty, expense, injury, or loss involved.” THE RESTATEMENT OF CONTRACTS § 454 (1932). The Restatement (Second) of Contracts recognizes that performance is discharged “[w]here, after a contract is made, a party’s performance is made impracticable without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made.” THE RESTATEMENT (SECOND) OF CONTRACTS § 261 (1981). For a discussion of the evolution from the strict standards of impossibility to the modern standards of impracticability, see G. Gilmore, *THE DEATH OF CONTRACT* 35-90 (1974); FARNSWORTH ON CONTRACTS §§ 9.5-9.7 (1992).

85. See, e.g., *Kansas City Power & Light Co. v. Pittsburg & Midway Coal Mining Co.*, No. 88-2224-S, 1989 U.S. Dist. LEXIS 15036, at \*5 (D. Kan. Nov. 17, 1989); *Sabine Corp. v. ONG W., Inc.*, 725 F.Supp. 1157, 1174-75 (W.D. Okla. 1989); *Northern Ill. Gas Co. v. Energy Coop., Inc.*, 461 N.E.2d 1049, 1060 (Ill. App. 1984); *Nora Springs Coop. Co. v. Brandau*, 247 N.W.2d 744, 748 (Iowa 1976); *Hancock Paper Co. v. Champion Int’l Corp.*, 424 F.Supp. 285, 290 (E.D. Pa. 1976), *aff’d mem.*, 565 F.2d 151 (3d Cir. 1977); *Lawrence v. Elmore Bean Warehouse, Inc.*, 702 P.2d 930, 932 (Idaho Ct. App. 1985); *Llano*, 770 F.2d 879; See also Arthur Nakazato, *Uniform Commercial Code § 2-615: Commercial Impracticability from the Buyer’s Prospective*, 51 TEMP. L.Q. 518 (1978). In any event, because commercial impracticability is available to a buyer under common law as set forth in the Restatement (Second) of Contracts §§ 261 and 264, Section 2-615’s reference to a seller is “largely semantic.” *NIPSCO*, 499 F.Supp. at 276-7.

86. *Missouri Pub. Serv. Co. v. Peabody Coal Co.*, 583 S.W.2d 721, 726 (Mo. App. 1979), *cert. denied*,

Whether or not a party has "assumed a greater obligation" will depend upon the specific terms of the contract. In *Transatlantic Financing Corp. v. United States*,<sup>87</sup> a carrier had contracted to transport a cargo from the United States to Iran for a specified price. Although the contract did not specify the route, the parties knew that the most direct route was through the Suez Canal. When the Canal closed, the carrier had to divert its ships around Cape Horn at an additional expense of approximately \$44,000 on a \$306,000 contract. The court held that "circumstances surrounding the contract indicate that the risk of the Canal's closure may be deemed to have been allocated to Transatlantic." Because the "surrounding circumstances" indicated "a willingness by Transatlantic to assume abnormal risks," the court assessed "the impracticability of performance by an alternate route in stricter terms than we would were the contingency unforeseen."<sup>88</sup> In *Eastern Airlines, Inc. v. McDonnell Douglas Corp.*, on the other hand, the court held that the seller had not "assumed a greater obligation" because the contract did not limit the seller's "impossibility defense to delays caused by events similar to those specifically provided for in the excusable delay clause."<sup>89</sup> Thus, in order to determine whether or not a party has assumed a greater obligation than that imposed by section 2-615, the contract must be scrutinized to determine whether the parties allocated the risk of the contingency occurring.

Second, the party must show that a contingency has occurred and that the non-occurrence of this contingency was a basic assumption on which the contract was made. The Restatement (Second) of Contracts section 264 defines these requirements where the contingency is a governmental regulation or order. It provides:

If the performance of a duty is made impracticable by having to comply with a domestic or foreign governmental regulation or order, that regulation or order is an event the non-occurrence of which was a basic assumption on which the contract was made.

The comment states:

It is "a basic assumption on which the contract was made" that the law will not directly intervene to make performance impracticable when it is due. Therefore, if supervening governmental action prohibits a performance or imposes requirements that make it impracticable, the duty to render that performance is discharged, subject to the qualifications stated in § 261. The fact that it is still possible for a party to perform if he is willing to break the law and risk the consequences does not bar him from claiming discharge.

Therefore, if the contingency is a governmental order, it should be presumed that the non-occurrence of that governmental order was a basic assumption on

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444 U.S. 865 (1979); *Lawrence v. Elmore Bean Warehouse, Inc.*, 702 P.2d 930, 932 (Idaho App. 1985); *Heat Exchangers v. Map Constr. Corp.*, 368 A.2d 1088, 1091 (Md. App. 1977). J. WHITE AND R. SUMMERS, *HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE*, § 3-9, at 129 (2d Ed. 1980); S. York, *Re: the Impracticability Doctrine of the U.C.C.*, 29 DUQ. L. REV. 221 (1991); Fredric D. Tannenbaum, *Commercial Impracticability Under the Uniform Commercial Code: Natural Gas Distributors' Vehicle for Excusing Long-Term Requirement Contracts?*, 20 HOUS. L. REV. 771 (1983).

87. 363 F.2d 312 (D.C. Cir. 1966).

88. *Id.* at 318-19.

89. 532 F.2d 957, 988-89 (5th Cir. 1976).



which the contract was made, as long as the governmental order renders performance impracticable.<sup>90</sup>

Accordingly, the paramount issue is whether the governmental order or regulation renders performance impracticable. That standard is the same as the standard for determining whether a party is "unable" to perform within the meaning of a force majeure clause. As noted in *Llano*, a governmental order may render performance impracticable if "the added expense . . . would impose a significant, unreasonable burden . . . ."<sup>91</sup> Similarly, in *Kansas City, Missouri v. Kansas City, Kansas* the court held that the obligation of Kansas City, Missouri to accept and dispose of the sewage of Kansas City, Kansas under a 1917 agreement was excused as a result of the passage of the Federal Water Pollution Control Act and Amendments of 1972 because of the additional expense involved in treating the sewage.<sup>92</sup> Relying upon the Restatement of Contracts section 458,<sup>93</sup> the court rejected as "untenable" the argument of Kansas City, Kansas that "no increase in expense, regardless of its cause or its magnitude, will operate to excuse performance."<sup>94</sup> The court held:

[W]hen a party to a contract encounters extreme and unforeseen difficulties in performance due to some supervening legislative enactment, the duty of performance will be discharged. Kansas City Terminal clearly recognizes that performance may be discharged and excused if, on the facts, the difficulties arise from "an Act of God, the law or the other party." It is clear that the only way plaintiff could "accept" and "dispose" of defendant's sewage without violating federal law would be to treat the waste prior to discharge. The added expense of such treatment would impose a very significant burden on the plaintiff. And plaintiff's expense would be greatly increased by a cut-off of federal grants because of its failure to collect the necessary assessments from defendant or its residents as required by federal law. For these reasons we find and conclude that plaintiff's duty to accept defendant's waste under the 1917 contract has been discharged.<sup>95</sup>

Likewise, as the court held in *Kansas City Power & Light*:

[T]he court finds that plaintiffs have presented sufficient evidence to raise material questions of fact about whether their performance under the contract became objectively impracticable. Specifically, the 1987 Kansas regulation requiring continuous monitoring, the foreseeability of such a regulation, the December 1987

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90. Although the court in *NIPSCO* held that the governmental orders at issue there did not render performance impracticable, and the rule set forth in the Restatement (Second) of Contracts section 264 was therefore not at issue, the court espoused the following dicta:

It does not matter that it is an act of government that may have made the contract less advantageous to one party. (Citations omitted). Government these days is a pervasive factor in the economy and among the risks that a fixed-priced contract allocates between the parties is that of a price change induced by one of government's manifold interventions in the economy.

The court thereby failed to take into account the distinctive nature of governmental regulations or orders, as recognized in the Restatement (Second).

91. 770 F.2d at 886-7; See also *City of Vernon v. City of Los Angeles*, 45 Cal. 2d 710, 290 P.2d 841 (1955).

92. 393 F.Supp. 1 (W.D. Mo. 1975).

93. Section 458 of the Restatement of Contracts (1932) was the predecessor of section 264 of the Restatement (Second) of Contracts.

94. *Kansas City, Missouri v. Kansas City, Kansas*, 393 F. Supp. 1, 6 (W.D. 1975).

95. *Id.* at 6-7.

emissions tests indicating . . . that during certain test runs, LaCygne Unit No. 1 could not comply with the environmental regulations, and the costs of installing new equipment to achieve compliance while burning only P&M coal, create questions of fact about the commercial practicality of plaintiff's performance.<sup>96</sup>

Whether a particular governmental regulation renders performance impracticable will normally be a question of fact. However, it is clear from this authority that (1) absolute impossibility is not required; and (2) the cost of compliance is a critical component in determining whether the burden is unreasonable and therefore excused.

Several cases have added a further requirement to section 2-615 that the occurrence making performance impracticable be unforeseeable.<sup>97</sup> Other courts have held, however, that foreseeability is not a requirement of section 2-615.<sup>98</sup> Although there is nothing in section 2-615 indicating that the contingency must have been unforeseeable, even if such a requirement is imposed, it should not have any different meaning than it would have under a force majeure clause.

Accordingly, commercial impracticability may be available in circumstances in which the doctrine of force majeure is not available because the parties have not specifically allocated the risk of the contingency under the contract.

## 2. Frustration of Purpose

The seminal case dealing with the doctrine of frustration of purpose is *Krell v. Henry*.<sup>99</sup> Henry rented a room from Krell solely for the purpose of watching the coronation of King Edward VII, but two days before the date scheduled for the coronation, Edward became seriously ill and the coronation was postponed. When Henry refused to pay the balance of the rent, Krell filed suit and Henry counterclaimed for the return of his deposit. The court held that where the object or foundation of the contract fails to exist at the time of performance, the purpose of the contract is frustrated and the parties should be excused without penalty. Because the court determined that the sole purpose of renting the room was to view the coronation, when the coronation was canceled the purpose of the contract was frustrated and Henry was excused from paying the balance of the rent.

This doctrine was incorporated in the Restatement<sup>100</sup> and in the Restatement (Second) of Contracts, which provides in section 265:

Where, after a contract is made, a party's principal purpose is substantially frustrated without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made, his remaining duties to render performance are discharged, unless the language or the circumstances indicate the contrary.

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96. No. 88-2224-S, 1989 U.S. Dist. LEXIS 15036, at \*16-17 (W.D. Kan. Nov. 17, 1989).

97. *Golsen v. ONG W., Inc.*, 756 P.2d 1209, 1221 (Okla. 1988)(Kauger, J. and Opala, J. concurring); *Sabine Corp. v. ONG W., Inc.*, 725 F.Supp. 1157, 1174 (W.D. Okla. 1989).

98. *Aluminum Co. of America v. Essex Group, Inc.*, 499 F.Supp. 53, 75 (W.D. Pa. 1980); *Transatlantic Financing Corp. v. United States*, 363 F.2d 312, 318 (D.C. Cir. 1966).

99. 2 K.B. 740 (1903).

100. RESTATEMENT OF CONTRACTS § 288 (1932).

Comment A to Section 265 states that frustration is "distinct from the problem of impracticability . . . because there is no impediment to performance by either party." The comment further describes three requirements for establishing frustration of purpose:

First, the purpose that is frustrated must have been a principal purpose of that party in making the contract. . . . Second, the frustration must be substantial. It is not enough that the transaction has become less profitable for the affected party or even that he will sustain a loss. The frustration must be so severe that it is not fairly to be regarded as within the risks that he assumed under the contract. Third, the non-occurrence of the frustrating event must have been a basic assumption on which the contract was made. This involves essentially the same sorts of determinations that are involved under the general rule on impracticability. . . . The foreseeability of the event is here, as it is there, a factor in that determination, but the mere fact that the event was foreseeable does not compel the conclusion that its non-occurrence was not such a basic assumption.<sup>101</sup>

These requirements have been generally followed by American courts.<sup>102</sup> The Restatement (Second) of Contracts specifically recognizes government regulation as a basis for frustration of purpose.<sup>103</sup>

In *Aluminum Co. of Am. v. Essex Group, Inc.*, the court discussed the difference between commercial impracticability and frustration of purpose as follows:

The doctrine of impracticability and of frustration focus on different kinds of disappointment of a contracting party. Impracticability focuses on occurrences which greatly increase the costs, difficulty, or risk of the party's performance. Restatement (Second) of Contracts § 281 (1982).

The doctrine of frustration, on the other hand, focuses on a party's severe disappointment which is caused by circumstances which frustrate his principal purpose for entering the contract. Restatement (Second) of Contracts § 285. The doctrine of frustration often applies to relieve a party of a contract which could be performed without impediment; relief is allowed because the performance would be of little value to the frustrated party.<sup>104</sup>

Similarly, the court in *NIPSCO* addressed the difference between impracticability and frustration as follows:

Notice, however, that the only type of promisor referred to (in section 2-615) is a seller; there is no suggestion that buyer's performance might be excused by reason of impracticability. The reason is largely semantic. Ordinarily all the buyer has to do in order to perform his side of the bargain is pay, and while one can think of all sorts of reasons why, when the time came to pay, the buyer might not have the money, rarely would the seller have intended to assume the risk that the buyer might, whether through improvidence or bad luck, be unable to pay for the seller's goods or services. To deal with the rare case where the buyer or (more broadly) the paying party might have a good excuse based on some unforeseen change in circumstances, a new rubric was thought necessary, different from "impossibility" (the common law term) or "impracticability" (the Code term, picked up in Restatement (Second) of Contracts § 261 (1979)), and it received the name "frustration." Rarely is it impracticable or impossible for the payor to pay; but if something has happened to make the performance for which he would

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101. RESTATEMENT (SECOND) OF CONTRACTS § 265, cmt. a (1982).

102. See, e.g., *Northern Ill. Gas Co. v. Energy Coop, Inc.*, 461 N.E.2d 1049, 1059 (Ill. App. Ct. 1984).

103. RESTATEMENT (SECOND) OF CONTRACTS § 265, cmt. a, illus. 4 (1982).

104. 499 F. Supp. at 73.

be paying worthless to him, an excuse for not paying, analogous to impracticability or impossibility, may be proper.<sup>105</sup>

As noted by Judge Posner in *NIPSCO*, the doctrine of frustration, like force majeure and commercial impracticability, is concerned principally with the allocation of risk. In discussing *Krell v. Henry*, Judge Posner noted:

The question was, to which party did the contract (implicitly) allocate the risk? Surely Henry had not intended to insure Krell against the possibility of the coronation's being postponed, since Krell could always re-let the room, at the premium rental, for the coronation's new date. So Henry was excused.<sup>106</sup>

In *Kansas City Power & Light*, the court held that an issue of fact existed with respect to whether continuous monitoring requirements for SO<sub>2</sub> emissions frustrated the purpose of the contract thereby entitling the buyer to rescind the contract. The court held:

Plaintiffs also assert the doctrine of frustration of the contract's purpose as a basis for rescinding the coal supply agreement. The elements of this doctrine are quite similar to the elements of the doctrine of commercial impracticability. However, under the doctrine of frustration, performance remains possible, but is excused because a fortuitous event supervenes to cause a failure of the consideration or a total destruction of the expected value of the performance of the contract. (Citation omitted). The doctrine of commercial frustration excuses a breach of contract only if the purpose of the contract is frustrated or its enjoyment is prevented by law. (Citations omitted). P&M argues that summary judgment should be entered on this theory because the emission regulations limiting sulphur emissions were reasonably foreseeable by the plaintiffs when they entered into the contract.

The court, however, finds that questions remain whether the KDHE imposition of a continuous monitoring regulation was reasonably foreseeable. For the reasons discussed above regarding the force majeure clause and commercial impracticability, P&M's motion for summary judgment on the claim of rescission based on the frustration of the contract's purpose must be denied.<sup>107</sup>

Accordingly, the common law doctrine of frustration of purpose may also be available to a buyer under a long-term coal contract who is severely affected by requirements of the CAAA.

#### IV. FORCE MAJEURE, COMMERCIAL IMPRACTICABILITY AND FRUSTRATION OF PURPOSE ISSUES IN COAL CONTRACT LITIGATION UNDER THE CLEAN AIR ACT AMENDMENTS OF 1990

##### A. *Section 404(e)(3) of the Clean Air Act*

Section 404(e)(3) of the Clean Air Act provides:

In no event shall the provisions of this *paragraph* be interpreted as an event of force majeure [sic] or a commercial impracticability [sic] or in any other way as a basis for excused nonperformance by a utility system under a coal sales contract in effect before the date of enactment of the Clean Air Act Amendments of 1990.<sup>108</sup>

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105. 799 F.2d at 276-7.

106. *Id.* at 277.

107. No. 88-2224-S, 1989 U.S. Dist. LEXIS 15036, at \*17-18 (W.D. Kan. Nov. 17, 1989).

108. 42 U.S.C. § 7651c(e)(3)(emphasis added).

A threshold question naturally arises as to the scope of this provision and in what circumstances it precludes the use of force majeure, commercial impracticability or other claims of excused nonperformance based upon the provisions of the CAAA.

### 1. Section 404

Section 404 of the Clean Air Act establishes the requirements relating to SO<sub>2</sub> emissions during Phase I of the Acid Deposition Control program established by Title IV of the Act.<sup>109</sup> Section 404(a) establishes the emissions limitations for each "affected source" in accordance with the "tonnage limitations stated as a total number of allowances in table A" of Section 404. Sections 404(b), (c) and (d) provide for the possible reassignment of an affected unit's SO<sub>2</sub> limitations or a possible extension of the deadline for meeting the emissions limitation requirements under certain circumstances approved by the Administrator of EPA.

Section 404(e) provides in Paragraphs (1) and (2) for the allocation of additional allowances to a utility that makes early reductions in SO<sub>2</sub> emissions if that utility is part of a utility system that meets certain specific criteria.<sup>110</sup> Paragraph (3) of subsection (e) contains the limitation on the use of force majeure, commercial impracticability or other claims of excused nonperformance quoted above.

Table A of section 404 sets forth the "Affected Sources and Units in Phase I and Their Sulphur Dioxide Allowances (tons)." Sections 404(f) and (g) provide for the allocation of allowances to utilities that establish certain energy conservation measures. Section 404(h) provides for certain utilities to elect an optional emission baseline no later than March 1, 1991.

### 2. Legislative History of Section 404

The Clean Air Act Amendments of 1990<sup>111</sup> were the result of a Conference Committee reconciliation of two substantially different bills passed by the House and Senate. The Senate bill, S. 1630, originated in the Senate Committee on Environment and Public Works,<sup>112</sup> and was passed by the Senate on April 3, 1990 by a vote of 89 to 11.<sup>113</sup> The House bill originated as H.R. 3030 in the House Committee on Energy and Commerce,<sup>114</sup> and went to the floor of the House on May 23, 1990.<sup>115</sup> Pursuant to Resolution 399, the House then resolved itself into the Committee of the Whole for further consideration of H.R. 3030, and Congressman Dingell, Chairman of the House Energy and

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109. *Id.* § 7651c.

110. The utility must be part of a utility system in which the total coal fired generation decreased by more than 20 percent between January 1, 1980 and December 31, 1985, and the weighted capacity factor of all coal fired units within the utility system averaged less than 50 percent between January 1, 1985 and December 31, 1987.

111. 42 U.S.C. § 7410-7626 (Supp. II 1990).

112. See S. Rep. No. 228, 101st Cong., 1st Sess. (1989), *reprinted in* 1990 U.S.C.C.A.N. 3385.

113. 136 Cong. Rec. H3833 (daily ed. Apr. 3, 1990).

114. See H.R. Rep. No. 490, 101st Cong., 2nd Sess. (1990).

115. 136 Cong. Rec. H2756 (daily ed. May 23, 1990).

Commerce Committee, offered amendments en bloc to the bill.<sup>116</sup>

One of those amendments was the precursor of Section 404(e).<sup>117</sup> Significantly, the amendment consists of one paragraph (designated paragraph 3) divided into three subparagraphs.<sup>118</sup> Subparagraph (C) provides as follows:

In no event shall the provisions of this paragraph be interpreted as an event of force majeure [sic] or a commercial impracticability or in any other way as a basis for excused nonperformance by a utility system under a coal sales contract in effect before the date of enactment of the Clean Air Act Amendments of 1990.<sup>119</sup>

It is clear from the language of this amendment that the limitation on the use of force majeure, commercial impracticability or other excused nonperformance was intended to apply only to the provisions of "*this paragraph*," i.e. paragraph (3), which provided for additional allowances for early SO<sub>2</sub> reductions for a narrowly-defined class of utilities.<sup>120</sup>

The amendments offered en bloc by Congressman Dingell were agreed to by the House, which passed the bill by a vote of 401 to 21 (with ten Members not voting).<sup>121</sup> The House then struck out all of the provisions of the Senate Bill, S. 1630, after the enacting clause, substituted the provisions of H.R. 3030 in lieu thereof, and pursuant to Resolution 399 agreed to insist on the House Amendments to S. 1630 and request a conference with the Senate.<sup>122</sup>

The amendment discussed above that was the precursor to section 404(e) was paragraph (3) of section 503(m) of the House Amendments.<sup>123</sup> This paragraph was incorporated in large measure into the bill approved by the Conference Committee on October 26, 1990.<sup>124</sup> Indeed, the Conference Committee essentially inserted the entire text of paragraph (3) of section 503(m) as subsection (e) of section 404.<sup>125</sup>

However, when it incorporated section 503(m)(3) into section 404(e), the Conference Committee failed to align the use of the terms "paragraph" and "subsection." Thus, *subparagraph* (C) of section 503(m)(3) became *paragraph* (3) of section 404(e), but continued incorrectly to use the term "paragraph" instead of "subsection":

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116. *Id.* at H2756, H2769-71, H2832.

117. *Id.* at H2835.

118. *Id.*

119. *Id.*

120. The only utility known to meet these criteria is Union Electric Company of Missouri. The amendment was sponsored by Majority Leader Richard Gephardt of Missouri. See COAL OUTLOOK, December 24, 1990, at 4; ENERGY REPORT, December 24, 1990, at 784.

121. 136 Cong. Rec. H2859, H2943-44 (daily ed. May 23, 1990).

122. *Id.* at H2945.

123. See Side-by-side Comparison of S. 1630 and the House Amendments Thereto, The Clean Air Act Amendments of 1990, vol. II, at 803-807 (1990)[hereinafter "Side-by-Side Comparison"].

124. See H.R. Conf. Rep. No. 952, 101st Cong., 2d Sess. (1990), reprinted in 1990 U.S.C.C.A.N. 3867. The House of Representatives agreed to the Conference report on October 26, 1990. 136 CONG. REC. pt. 4, at H12,943 (daily ed. Oct. 26, 1990). The Senate agreed to the Conference report on October 27, 1990. 136 CONG. REC. pt. 2, at S17,434 (daily ed. Oct. 27, 1990). President Bush signed the bill into law on November 15, 1990.

125. The only changes the Conference Committee made in Section 503(m)(3)(C) was to adopt a different misspelling of the term "force majeure" than was contained in the House Amendments and to insert a misspelling of the term "commercial impracticability."

In no event shall the provisions of this *paragraph* be interpreted as an event of force majeure [sic] or a commercial impracticability [sic] or in any other way as a basis for excused nonperformance by a utility system under a coal sales contract in effect before the date of enactment of the Clean Air Act Amendments of 1990.<sup>126</sup>

### 3. Section 404(e)(3) Applies Only to Section 404(e), Not to Section 404 (Including Table A) as a Whole

Read literally, the Conference Committee's failure to change the word "paragraph" to "subsection" renders this provision meaningless, since it is only "the provisions of this paragraph," i.e., paragraph (3) of section 404(e), that may not "be interpreted as an event of force majeure [sic] or a commercial impracticability [sic] or in any other way as a basis for excused non-performance . . . ." The Supreme Court has recently re-affirmed, however, that a court should disregard a "simple scrivener's error" and give meaning and effect to Congressional intent based upon the language and structure of the statute. In *National Bank of Oregon v. Insurance Agents*, the Court noted:

Over and over we have stressed that "in expounding a statute, we must not be guided by a single sentence or member of a sentence, but look to the provisions of the whole law, and to its object and policy." *United States v. Heirs of Boisdore*, 8 How. 113, 122 (1849). . . . Statutory construction is a holistic endeavor," *United Savings Assn. of Texas v. Timbers of Inwood Forest Associates, Ltd.*, 484 U.S. 365, 371 (1988), and, at a minimum, must account for a statute's full text, language as well as punctuation, structure, and subject matter.<sup>127</sup>

Applying these rules, it is obvious from Section 404(e) itself that the phrase "the provisions of this paragraph" in Paragraph (3) should instead read "the provisions of this subsection."

If Congress had intended the force majeure provision of paragraph (3) to apply to all of section 404, it would have made that paragraph a separate subsection and assigned it a letter, such as (f). The context and structure of section 404(e) indicates instead that paragraph (3) applies only to subsection (e) and precludes a party from invoking force majeure, commercial impracticability or other claims of excused nonperformance only to the extent such claims are based upon early SO<sub>2</sub> reductions by a narrowly-defined class of utility systems.<sup>128</sup>

126. 104 Stat. 2597 (emphasis added).

127. 113 S.Ct. 2173, 2182 (1993). See also *Seban v. Block*, 626 F.Supp. 545, 550 (S.D. Ind. 1985) ("When a court attempts to determine the meaning of a phrase, it is necessary to look at the context in which the phrase appears.").

128. See *Gibbons v. New Castle Area School Dist.*, 543 A.2d 1087, 1089 (Pa. 1988). The court noted that "[t]here is, ordinarily, a purposeful distinction between a *sub* section and an independent section of a statute . . . [t]he former, by its nature, is placed within a context, and thereby limited to a degree that the latter is not." (emphasis added).

Table A is obviously a separate part of section 404 and not part of paragraph (3). First, the table applies to all of the Phase I SO<sub>2</sub> requirements set forth in sections 404(a)-(e) and is located at the end of subsection (e) only for convenience of reference. Table A is referred to throughout section 404(a), (b) and (c), which prescribe the emission limitations applicable to affected units. Second, the legislative history shows that both the Senate and House versions contained the identical table at the end of the Phase I compliance requirements. See *Side-by-Side Comparison*, vol. II, at 807-813. The Senate bill contained

The legislative history of the statute further confirms that paragraph (3) applies only to subsection (e). As discussed above, paragraph (3) originated as subparagraph (C) to section 503(m)(3) of the House Amendments to S. 1630.<sup>129</sup> The provision was introduced by Majority Leader Richard Gephardt for the benefit of Union Electric Company of Missouri.<sup>130</sup> In stating that the "provisions of this paragraph" could not be the basis for force majeure, commercial impracticability or other excused nonperformance, subparagraph (C) clearly applied only to the provisions of section 503(m)(3), which offered additional allowances for early compliance with the SO<sub>2</sub> requirements. That intent did not change when section 503(m)(3) of the House Amendments was incorporated nearly verbatim as section 404(e) of the Conference bill. The "scrivener's error" of the Conference Committee in failing to change the word "paragraph" to "subsection" does not alter the fact that the disallowance of claims of force majeure, commercial impracticability or other excused nonperformance applies only to specifically-defined utilities that comply early with the SO<sub>2</sub> requirements.<sup>131</sup>

The fact that Congress limited the circumstances in which a utility could not invoke force majeure, commercial impracticability or other excused nonperformance to the early compliance situation described specifically in section 404(e) shows that Congress did not intend to disturb the applicable contract law with respect to the effects of any other provisions of the CAAA. Had Congress intended to prohibit force majeure, commercial impracticability or other claims of excused nonperformance in any situation other than the very narrow circumstance described in section 404(e), it would have expressly so stated.

This is the well-settled rule, *expressio unius est exclusio alterius*. As the Supreme Court has held: "[W]here Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion."<sup>132</sup> Thus, "[a]s a matter of statutory construction, the authorities appear uniform in holding that an explicit exclusion appearing in and specifically limited to one provision of a statute and not

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sections 404(a) through (d) with Table A following those subsections; the House Amendments contained section 503(m)(1) through (4) with Table A following those paragraphs. *Id.* at 792-807. Thus, the House Amendments included an additional paragraph (4) (equivalent to a subsection in the final act) between paragraph (3) and Table A. *Id.* at 807. Significantly, the original amendment proposed by Mr. Gephardt to H.R. 3030 did not include Table A; it consisted only of the three paragraphs that became section 503(m)(3) and subsequently section 404(e). See 136 Cong. Rec. H2835 (daily ed. May 23, 1990).

129. See *Id.*; Side-by-Side Comparison, vol. II at 803-807.

130. See COAL OUTLOOK, December 24, 1990, at 4; ENERGY REPORT, December 24, 1990, at 784.

131. By prohibiting the use of force majeure, commercial impracticability or other excused nonperformance as a result of early compliance, Congress was ensuring that a utility could not invoke the rule established by the Tenth Circuit in *Llano* that a buyer of natural gas was excused from its contractual obligations as a result of its early compliance with environmental requirements imposed by the State of New Mexico. Although Congress was willing to permit a utility that met the requirements of Section 404(e)(1) and (2) to obtain additional allowances, it was not willing to permit such a utility to use those circumstances to excuse its performance under its coal contracts. That is a logical trade-off.

132. *Russello v. United States*, 464 U.S. 16, 23 (1983)(quoting *United States v. Wong Kim Bo*, 472 F.2d 720, 722 (5th Cir 1972)).



included in another provision of the same statute logically implies that the exclusion is inapplicable as to the latter provision.”<sup>133</sup> Accordingly, a party is entitled to invoke force majeure, commercial impracticability or other claims of excused nonperformance as a result of all provisions of the CAAA other than section 404(e).

*B. Application of Force Majeure, Commercial Impracticability and Frustration of Purpose to the Clean Air Act Amendments of 1990*

1. The Focus of the Inquiry

The CAAA impose drastic changes on many electric utilities, severely discouraging or prohibiting previously acceptable levels of SO<sub>2</sub> and NO<sub>x</sub> emissions. Nevertheless, because of the structure of the Act and the degree of flexibility a utility is given, at least with respect to SO<sub>2</sub> compliance, significant questions arise as to the circumstances under which a utility may properly invoke force majeure, commercial impracticability or frustration of purpose as a result of the requirements of the CAAA. Although a utility seeking to be excused from contract performance must of course establish each of the elements of force majeure, commercial impracticability or frustration of purpose, the focus in resolving such claims is likely to be on the utility’s “inability” to purchase the coal as a result of the Amendments.

Whether or not the Amendments (and EPA’s implementing regulations) fall within the scope of a force majeure clause should, in most cases, be a matter of straightforward contract interpretation, and if the force majeure clause does not specifically address such governmental action, the utility may still be able to rely upon its “compliance in good faith with any applicable . . . domestic governmental regulation or order” to invoke the doctrines of commercial impracticability or frustration of purpose. The adoption of the CAAA is certainly beyond the control and without the fault or negligence of an electric utility.<sup>134</sup> “As a matter of policy, individuals and corporations who cooperate with local regulatory agencies and comply with the letter and spirit of legally proper regulations, environmental or otherwise, are to be encouraged.”<sup>135</sup>

Similarly, although it could be argued that the Amendments were “foreseeable” since the mid-1980’s when acid rain legislation was first seriously discussed, it would have been virtually impossible for anyone to have predicted

133. *League to Save Lake Tahoe, Inc. v. Trounday*, 598 F.2d 1164, 1171 (9th Cir.), *cert. denied*, 444 U.S. 943 (1979) (interpreting an amendment to the Clean Air Act). *See also* *West Coast Truck Lines, Inc. v. Arcata Community Recycling Ctr., Inc.*, 846 F.2d 1239, 1244 (9th Cir. 1988), *cert. denied*, 488 U.S. 856 (1988); *United States v. Azeem*, 946 F.2d 13, 17 (2d Cir. 1991); *Arizona Elec. Power Coop. v. United States*, 816 F.2d 1366, 1375 (9th Cir. 1987).

134. *Hamilton Bros. Oil Co. v. ANR Pipeline Co.*, No. CIV-88-132-A, 1989 U.S. Dist. LEXIS 17871, at \*10-11 (W.D. Okla. Feb. 20, 1989) (FERC order held to be beyond the control of pipeline’s customers); *Dyco Petroleum Corp. v. El Paso Natural Gas Co.*, No. 86-C-897-E, 1988 U.S. Dist. LEXIS 17991, at \*10-11 (N.D. Okla. Nov. 1, 1988); *Burkhart Petroleum Corp. v. ANR Pipeline Co.*, No. 87-C-257-C, 1988 U.S. Dist. LEXIS 9158, at \*11-12 (N.D. Okla. June 30, 1988); *Atlantic Richfield v. ANR Pipeline Co.*, 768 SW.2d 777, 780-81 (Tex. Ct. App. 1989).

135. *Llano*, 770 F.2d at 887.

the form in which the Amendments were ultimately enacted — much less the timing, nature and impact of the statute on a particular utility. Nor could a utility be expected to avoid the legislation using its “best efforts.” As the court held in *Commonwealth Edison v. Allied-General Nuclear Services*:

The duty . . . to remove an obstacle to performance . . . is not a duty to exert heroic efforts to change laws, regulations, or policies of general applicability. To seek a variance from a zoning ordinance might well be regarded as encompassed by the duty to make a bona fide effort to avoid an excusing condition . . . . But to oppose the highest governmental authorities, no.<sup>136</sup>

Although a utility could reasonably be expected, and must be prepared, to show that it has also used its best efforts to eliminate the effects of the governmental action on its ability to perform under the contract, this issue is necessarily subsumed in the question of whether the utility is “unable” to take the coal as a result of the Amendments.

Finally, the requirement that the utility serve proper notice of its claim of force majeure, commercial impracticability or frustration of purpose should not be complex or particularly difficult to resolve.

Accordingly, the utility’s “inability” to take the coal is likely to be the central question presented by a claim of force majeure, commercial impracticability or frustration of purpose under the CAAA.

## 2. Can a Utility Ever Be “Unable” to Take Coal as a Result of the Act?

Coal producers will argue that the Act cannot cause a utility to be “unable” to purchase coal—no matter how high the sulfur content—because the utility is not actually *required* by the Act to reduce SO<sub>2</sub> emissions. All the Act does, according to this line of reasoning, is to require an affected unit to hold allowances in at least the amount of its actual SO<sub>2</sub> emissions. Although it is true that the unit will be given annual allowances during Phase I based only on a 2.5 lbs/MMBtu SO<sub>2</sub> emission rate (at the unit’s operating level during a 1985-87 baseline period), the Act does not *directly* require the unit to reduce its average annual SO<sub>2</sub> emissions to 2.5 lbs/MMBtu. All it says is that if the unit fails to reduce its emissions, then it must obtain one additional allowance (i.e., in addition to the number it received from EPA) for each ton of SO<sub>2</sub> it emits beyond that level. It may obtain additional allowances by purchasing them from another utility or by transferring them from another unit of the same utility system that has overcomplied. Furthermore, if the utility decides to reduce its SO<sub>2</sub> emissions to a level commensurate with the 2.5 lbs/MMBtu level on which EPA-awarded allowances is based, the Act leaves it up to the utility as to how to make those reductions. The utility may, for example, build flue gas desulfurization units, or “scrubbers,” or it may blend high sulfur coal with low sulfur coal. Given this structure and flexibility, then, can a utility ever be “unable” to take coal as a result of the Act?

As discussed above, the Tenth Circuit held in *Llano* that the operator of a potash mine and processing facility was “unable” to take natural gas after it

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136. 731 F.Supp. 850, 860 (N.D. Ill. 1990).

changed its operating method from an evaporative process to a chemical process in order to meet new environmental restrictions imposed by the State of New Mexico.<sup>137</sup> The court noted that a "literal interpretation of the word 'unable' would . . . be inappropriate and lead to absurd results. . . ." <sup>138</sup> Therefore, the court held, "the important question is whether an unanticipated circumstance has made performance of the promise vitally different from what should reasonably have been within the contemplation of the parties when they entered into the contract. If so, the risk should not fairly be thrown upon the promisor."<sup>139</sup> Similarly, in *Kansas City, Missouri v. Kansas City, Kansas*, the court held that the obligation of Kansas City, Missouri to take and dispose of the sewage of Kansas City, Kansas under a 1916 agreement had been discharged because the "added expense of . . . treatment" imposed by the Federal Water Pollution Control Act "would impose a very significant burden" on it.<sup>140</sup> In *Kansas City Power & Light* the court held that an issue of fact existed as to whether new requirements imposed by the State of Kansas with respect to the continuous monitoring of SO<sub>2</sub> emissions rendered the utility "unable" to take coal for which it had contracted.<sup>141</sup>

By contrast, in *NIPSCO*, the Seventh Circuit held that "economy purchase orders" of the Indiana Public Service Commission, which prevented NIPSCO from passing on fuel costs to its ratepayers if it could buy electricity at a lower cost than it could generate it using the coal subject to its existing contracts, did not "prevent" NIPSCO from using that coal; NIPSCO was only prevented "from shifting the burden of its improvidence or bad luck in having incorrectly forecasted its fuel needs to the back of the hapless ratepayers."<sup>142</sup>

Although unique in some respects, the requirements of the CAAA are more akin to the environmental restrictions at issue in *Llano*, *Kansas City, Missouri v. Kansas City, Kansas* and *Kansas City Power & Light* than the economy purchase orders at issue in *NIPSCO*. The Act clearly imposes enormous environmental requirements on utilities that own affected units. The NO<sub>x</sub> reduction provisions of the CAAA impose traditional mandatory limits, which if exceeded subject the utility to severe civil and criminal penalties. The NO<sub>x</sub> provisions are, therefore, very similar to the New Mexico emission limits at issue in *Llano* or the Kansas emission limits (coupled with continuous monitoring) at issue in *Kansas City Power & Light*. To the extent that a utility's inability to take coal is the result of the NO<sub>x</sub> reduction provisions of the CAAA, the utility should be able to establish the causation element of force majeure, commercial impracticability or frustration of purpose.

Inability to take coal due to SO<sub>2</sub> limits presents a thornier issue. Here a coal producer may argue plausibly that the Act does not actually "prevent" the utility from taking the coal because the Act allows the utility to continue to burn high sulfur coal as long as it obtains the required number of

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137. 770 F.2d at 886.

138. *Id.*

139. *Id.* (quoting 6 WILLISTON ON CONTRACTS § 1931 (1938)).

140. 393 F.Supp. at 7.

141. No. 88-2224-S, 1989 U.S. Dist. LEXIS 15036 (D. Kan. Nov. 17, 1989).

142. 799 F.2d at 275.

allowances. Thus, the producer may argue, the decision with which the utility is faced is purely an economic decision as to which method of compliance is cheaper—purchasing allowances or redesigning its facilities to permit the burning of high sulfur coal. The choice is the utility's.

Although this argument is not without some surface appeal, it is an oversimplification of the onerous requirements of the Act. The purpose of the Act, after all, is to reduce SO<sub>2</sub> emissions by 3.5 million tons per year from 1980 levels during Phase I alone. This reduction is mandatory. Although the Act does not prescribe the precise methods by which each affected unit will contribute to that reduction, the way each unit may operate after the Amendments is radically different from the way it could operate before the Amendments. Moreover, the Act imposes more than incentives to encourage SO<sub>2</sub> reductions; it imposes requirements which must be met for a unit to operate. The flexibility that the Act introduces in permitting an affected unit either to reduce its SO<sub>2</sub> emissions or purchase allowances, while more subtle than the more traditional governmental command and control regulation, is just as effective a means of economic compulsion and will achieve the same results. To the extent that a utility has a choice between SO<sub>2</sub> reductions and the purchase of allowances,<sup>143</sup> that choice may turn out to be the one "between the noose and the firing squad."<sup>144</sup> "When a condemned man is given [that choice], we do not ordinarily say that he has 'voluntarily' chosen to be hanged."<sup>145</sup>

The coal producers' argument thus ignores the fundamental fact that it is a property of the coal—its SO<sub>2</sub> content and the emissions created from burning that coal—that the Act addresses. The only reason a utility must take any action—whether it is purchasing allowances, modification of its generating equipment, purchasing lower sulfur coal to blend with existing supplies, or a combination of these measures—is because Congress has determined that SO<sub>2</sub> emissions resulting from the burning of coal must be reduced. The causal connection between the SO<sub>2</sub> content of the coal and the reduction of SO<sub>2</sub> emissions required by the CAAA can hardly be denied. The proper question, then, is not whether the utility is absolutely "prevented" from burning high sulfur coal, but whether further measures that it could conceivably take in order to

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143. The purchase of allowances may turn out not to be a viable alternative to SO<sub>2</sub> emissions reduction for many utilities. There is no established market for emissions allowances, and how that market is likely to function is not yet clear. The mechanics of the allowance market is complicated further by environmental organizations that have announced that they intend to purchase allowances for the purpose of "retiring" them, thereby at least theoretically increasing the cost of the allowances that remain for sale in the market. *See Auction of Rights to Pollute Fetches About \$21 Million*, WALL ST. J., March 31, 1993, at A6. Exclusive or even substantial reliance on allowances as a means of compliance may be too risky to constitute sound management. Public policy considerations may also mandate SO<sub>2</sub> reductions rather than reliance on the potential purchase of allowances. Utilities may, for example, face pressure from their shareholders or regulatory authorities to reduce SO<sub>2</sub> emissions as a matter of environmental policy. Some reduction in SO<sub>2</sub> emissions levels may therefore be effectively, even if not literally, required by the Act.

144. *Associated Gas Distrib. v. FERC*, 824 F.2d 981, 1024 (D.C. Cir. 1987).

145. *Id.*

burn additional quantities of high sulfur coal are "cost prohibitive."<sup>146</sup> This does not mean that the utility could not incur the additional cost under any circumstances, but only that it is not commercially reasonable to require it to do so.

Suppose, for example, that a utility could meet its Phase I reduction requirements by burning coal with a sulfur content no greater than 2.5 lbs/MMBtu, but the coal under its existing contracts averages 3.0 lbs/MMBtu. Can the utility properly refuse to accept coal that exceeds that level? Or suppose that a utility decides to construct a scrubber as part of its compliance efforts, and is thereby able to burn annually two million tons of coal with a sulfur content exceeding 2.5 lbs/MMBtu, but is required under its existing contracts to take annually three million tons of coal with a sulfur content exceeding 2.5 lbs/MMBtu. May it be excused from taking the additional one million tons on grounds of force majeure, commercial impracticability or frustration of purpose? Or must it build a second scrubber at a cost of approximately \$160 million in order to be able to burn the additional one million tons of "high" sulfur coal (i.e. greater than 2.5 lbs/MMBtu) it has contracted to buy?

Finally, suppose that instead of building a scrubber, the utility decides to blend the high sulfur coal with low sulfur coal purchased under a new contract or on the spot market; however, in order to meet its Phase I reduction requirements it must blend the low sulfur coal with the high sulfur coal at a ratio of 2:1. Now it can only burn one million tons of high sulfur coal each year. Can it invoke force majeure, commercial impracticability or frustration of purpose with respect to the additional two million tons of high sulfur coal that it can no longer use?

In each case, the determination of these issues will be highly fact specific, and will depend upon the individual circumstances of the utility and the way in which it has planned for compliance with the SO<sub>2</sub> reduction requirements. Utilities must prepare and file compliance plans showing how they will meet the SO<sub>2</sub> emissions limits.<sup>147</sup> These plans should be the benchmark for a consideration of whether a utility is "unable" to take high sulfur coal. Once approved by EPA, a presumption should arise that the measures in the compliance plan are commercially practicable. Whether any additional measures are also feasible — that is, not "cost prohibitive" — must be resolved on a case-by-case basis taking into account the expense already incurred by the utility in complying with the CAAA and the benefits to be derived from such measures.<sup>148</sup> Thus, whether the utility may refuse to accept coal with a sulfur content greater than 2.5 lbs/MMBtu will necessarily depend upon the extent of the financial burden that would be imposed upon it if required to take such coal. Construction of a single or second scrubber may be "cost prohibitive,"

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146. *Kansas City Power & Light*, No. 88-2224-S, 1989 U.S. Dist. Lexis 15036 at \*8 (D. Kan. Nov. 17, 1989).

147. Section 408(b), 42 U.S.C. § 7561g(b).

148. One consideration in making this assessment may be whether or not the additional measures would be deemed to be prudently incurred costs by the state public utility commission that regulates the utility's rates.

whereas in some cases blending may be feasible. Purchasing additional allowances may also be an option in some cases, depending upon the market for allowances and the quantity needed.

At some point, however, the utility will reach the limit of financial burden that can reasonably be imposed upon it. Therefore, the suggestion that a utility could "always" just buy more allowances is no more accurate than the contention that "no increase in expense, regardless of its cause or its magnitude, will operate to excuse performance."<sup>149</sup> The notion that a utility can simply keep purchasing allowances is akin to the "simplistic, literal interpretation of the word 'unable'" that the Tenth Circuit criticized in *Llano* as "inappropriate" and leading to "absurd results," since the buyer in that case "could always take the gas and vent it into the air."<sup>150</sup> Ultimately, the burden imposed upon the utility by the SO<sub>2</sub> reduction provisions of the CAAA must be the measure of whether the utility is "unable" to take coal it is otherwise obligated to accept.

### 3. Temporary Outages

Force majeure, commercial impracticability or frustration of purpose may also be available to a utility that is unable to take its full contractual commitment because of temporary outages of generating units required for the installation of pollution control equipment necessary to meet the SO<sub>2</sub> and NO<sub>x</sub> reduction provisions of the CAAA. This equipment includes flue gas desulfurization units or "scrubbers," flue gas conditioners, electrostatic precipitators and low NO<sub>x</sub> burners. Depending upon the construction schedule, such outages may last anywhere from six weeks to six months. During the outage the utility will obviously be unable to burn coal in the generating unit that is being modified.

Although the particular facts concerning the outage must be carefully examined in each case, a utility may be able to establish that force majeure, commercial impracticability or frustration of purpose excuse full performance during an equipment outage. The basic question in such a case is likely to be whether the outage is actually the result of the installation of equipment required for compliance with the CAAA, or whether such work is merely incidental to routine maintenance work that would be performed regardless of the CAAA. In order for performance to be excused, the utility must show that the outage was primarily caused by the need for CAAA compliance, even if maintenance work is performed during the outage, and not the other way around.<sup>151</sup>

## V. CONCLUSION

As the deadline for compliance with Phase I approaches, electric utilities should carefully review the allocation of risk to which their coal suppliers agreed in the force majeure clauses of their long-term coal contracts, and in

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149. *Kansas City, Missouri v. Kansas City, Kansas*, 393 F. Supp. 1, 6 (W.D. Mo. 1975).

150. 770 F.2d at 886.

151. See *Arbitration Ruling Favors PSI*, COAL OUTLOOK, February 15, 1993, at 7.

the event the contracts have not specifically assigned that risk, the availability of commercial impracticability and frustration of purpose with respect to their coal purchase obligations. Recent natural resource and environmental litigation offers an analytical approach to force majeure, commercial impracticability and frustration of purpose claims arising under the Clean Air Act Amendments of 1990. Depending upon the precise contract language at issue and the specific facts of each case, these doctrines may be available in cases in which a utility is unable, as a result of the Amendments, to utilize coal purchased under a long-term contract.