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Dealing with Uncertainty in Operational Contracts

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From start-up to decommissioning, the typical ethanol plant may operate for a period of 25 years or more. While there is no way to predict what surprise events might occur over the life of a project, owners should not overlook the opportunity to manage the effects that unexpected events may have on operations when first negotiating the various supply, sales and other agreements that are critical to a plant's success.

The legal concept of "force majeure" appears in most commercial agreements and provides owners with a contractual outlet for addressing the consequences of unplanned events, if and when they arise.

"Force majeure" is a French term meaning "an overwhelming force." When used in a legal agreement, it is typically thought to apply to an unavoidable force that prevents one or both parties from performing any of a number of their respective obligations. By including a force majeure clause in their contract, the parties agree that if an unexpected and overwhelming event occurs, they will be excused from their affected obligations—without defaulting or incurring liability—for the duration of that event.

The typical force majeure clause contains a seemingly exhaustive list of potential "overwhelming forces," including severe weather events, natural disasters, explosions and labor strikes. However, these typical clauses tend to be general in scope, and because they are often found in the "boilerplate" provisions at the end of contracts, owners may pay only passing attention to whether the list is actually well-suited to their unique operations. In order to provide proper protection against contingencies, a force majeure clause must be specially tailored to the purpose of the contract, the relationship of the parties and the risks associated with the project. Owners should consider not only the effects of geography and weather patterns on their operations, but also the potential for unavailability of critical inputs and disruptions in transportation channels, to name only a few key areas.

Moreover, owners must consider that a force majeure event under one contract may impact other facility agreements that depend in some way on the performance of that contract. In the same way that the various components of a plant must be interconnected to form a seamlessly functioning whole, owners should view all key operational agreements as part of an integrated package of legal documents that must work in concert in order to avoid critical gaps in protection. This can be a difficult task as these agreements are often negotiated at different stages of the development cycle, by different project representatives and with different counterparties. However, in the context of force majeure, it is critical that the owner avoid inconsistencies among these several documents so that an occurrence of force majeure that would excuse, for example, the project's corn supplier from delivering corn for an extended period would likewise excuse the owner from its obligations to deliver ethanol and distillers grains for the same period under its marketing agreements.

Without implementing carefully tailored and integrated force majeure provisions across all key facility agreements, owners may find that disconnects between various agreements leave them vulnerable to costly defaults in circumstances where they might ordinarily be excused from performing without liability.

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