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## Force Majeure to Apply Small Comfort to Some Crisis-Affected Contracts

A. Michael Sabino

If Charles Dickens lived in our times and not a century-and-a-half ago, no doubt he still would have penned the immortal words, “it was the best of times, it was the worst of times.” Unfortunately, these days it is difficult to figure the best of times for whom; most folks seem to be on the short end of the stick. Against the unfortunate backdrop of the current economic crisis, our editor asked this humble writer to address the ramifications of force majeure clauses if invoked by members of the energy industry who find themselves in such distress that they cannot fulfill their contractual obligations. However, as we shall see at the conclusion of this article, catastrophe brought on by financial events (i.e., unavailability of credit, the inability to fund operations, and so on) will most likely not qualify for excuse by reason of force majeure, unless the parties had the prescience to anticipate the economic meltdown of today and write it into their contracts.

Unavailability of credit, the inability to fund operations, and so on, will most likely not qualify for . . . force majeure, unless the parties had the prescience to anticipate the economic meltdown of today.

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### Other Features

Special Issue: Effect of Coming Recession on Natural Gas & Electric Industries

**Anticipated Recession Effects—Natural Gas**  
Recession Aside, Depending on NYMEX Forward Price Curve Is Mistake  
*Dale M. Nesbitt and Thomas Y. Choi* ..... 8

**Anticipated Recession Effects—Gas Prices**  
Natural Gas Prices in a Recession  
*Christopher Gulick*..... 13

**Anticipated Recession Effects—Storage**  
Can Gas Storage Development Survive the Recent Financial Market Collapse?  
*Kenneth L. Beckman* ..... 19

**Anticipated Recession Effects**  
FERC Winter Outlook Shows Changing Economic Conditions, Falling Prices  
*FERC Staff* ..... 22

### Columns

**Federal Regulation and Energy Issues**  
Is the Era of Big Government Back?  
*James J. Hoecker*..... 28

**Energy and the Environment**  
Measuring the Costs and the Benefits of Energy Development  
*Jonathan A. Lesser*..... 30

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## ORIGINS AND BROAD MEANING OF FORCE MAJEURE

The doctrine of force majeure finds its roots in the antiquity of commercial law, whereby merchants in particular could be excused from performing under an otherwise binding contract because circumstances beyond anyone's control made performance an impossibility. Originally French, in modern law it is defined as a "superior or irresistible force,"<sup>1</sup> and often equated with an "Act of God . . . An act occasioned exclusively by violence of nature . . . without the intervention of man."<sup>2</sup> Note well that we do not term these unfortunate events to be unforeseen; quite to the contrary, centuries of contract writing have led to rather detailed categorization of events that, while catastrophic, are at least somewhat foreseeable. They include natural disaster, war, political strife, labor stoppages, and, sadly these days, acts of terrorism. A modern force majeure clause represents the ultimate in "what-ifs" from the direst pessimist.

. . . merchants could be excused from performing under an otherwise binding contract because circumstances beyond anyone's control made performance an impossibility.

Despite its melancholy, this is all to good purpose. Events such as these, be they man-made or natural, are well capable of crushing a company out of existence if its lack of performance is not excused in some fashion. From its inception in the fundamental laws of contracts to the modern code of commercial transactions, the concept is ultimately pragmatic in its recognition that performance can be made impossible by events that are completely beyond the control of either party, even if such disasters can be anticipated. To be sure, it is one thing to be aware of the risks of a hurricane; it is quite something else to say mere awareness does not excuse performance when such a natural disaster has devastated a seller's refinery, despite every human precaution to ensure the continuity of business.

Thus, the doctrine of force majeure was born, first to excuse performance when disaster strikes, and additionally, to provide a platform upon which thoughtful parties can catalogue the

events they fear most, and fashion alternatives and courses of relief as they see fit. Force majeure clauses are thus long imbedded in the law of contracts generally and have risen to a fine art form in maritime contracts, particularly for the carriage of goods overseas, as that is where Mother Nature is her most unforgiving of man's puny endeavors.

## FORCE MAJEURE WITHIN THE UCC

For our purposes today, force majeure generally finds its rightful place within the friendly confines of the Uniform Commercial Code (UCC), and then within Article 2 thereof, dealing with contracts for the sale of goods between merchants. Specifically, Section 2-609 of the UCC addresses the rights of any party to a contract to seek adequate assurance of performance from the countervailing party. This device was implemented so that merchants, for whatever reason skeptical of the ability of the counterparty to perform, could insist that there be some demonstration of the wherewithal to get the deal done, and thereby be adequately assured.

Because force majeure is the invocation of the complete excusal of performance owing to the impossibility of circumstances, it is the diametric opposite of adequate assurance; it is more than adequate notification that the only sure thing is that performance will not be forthcoming. This feature frees the quite unassured party to take whatever steps it needs to secure replacement goods from a different, third-party vendor. Given that force majeure is, in effect, the opposite side of the coin from adequate assurance, the concept fits snugly into Section 2-609.

Before proceeding, an important distinction must be made. In the context of the energy industry, this discussion will generally confine itself to the supplying of feedstock and like commodities for the production of electricity and other forms of power. Thus, we concern ourselves mainly with the force majeure clauses of contracts between commodity sellers and their buyers, nominally power generators. It is important to note that the supplying of actual electricity or power to buyers is not covered by the UCC, for reason that that sale of electricity itself is widely recognized as the provision of a service, not the sale of goods, the former of which is not within the purview of the UCC.<sup>3</sup>

## SEVERAL CASES DEVELOP THE LAW

These cases include district and appellate cases in natural gas matters.

### *Sabine*

Pertinent to our readership here is a benchmark case decided some years ago in the oil patch of Oklahoma. *Sabine Corp. v. ONG Western, Inc.*,<sup>4</sup> concerned the alleged breach of a fairly customary take-or-pay natural gas contract for a period of five nonconsecutive years in the early and mid-1980s. The central allegation was that the defendant failed to take or pay for the gas because a general collapse of the markets rendered it unable to take the product and resell it at a profit. Among other things, the plaintiff Sabine asserted that ONG failed to give it proper notice of a purported force majeure event; the circumstance relied upon was not a proper force majeure event per the contract, nor could the defendant prove an event qualifying under the force majeure clause; and, finally, a mere price increase cannot constitute a force majeure event because the defendant, as buyer, assumed the risk of escalating prices [1162–63].<sup>5</sup> After extensive discovery, the parties moved for summary judgment (i.e., a disposition before trial by the judge acting without a jury), ostensibly because the material facts were not in genuine dispute, and all the court needed to do was apply the law to those plain facts.

On that very point, District Judge David L. Russell found there was a threshold issue as to whether or not ONG gave the contractually required notice to Sabine of the supposed calamity: “The failure to give proper notice is fatal to a defense based upon a force majeure clause requiring notice” [1168]. While that was the legal principle, the court took note of the extensive and conflicting facts as to the whos, whats, and wheres of the notice supposedly given. Because these so-called facts were far from being undisputed, the court properly noted such a factual question could only be answered by a jury. That matter, among others, being reserved for a fact finder at a full trial, the court forged ahead with what legal issues it could resolve that day [1168].

For its first legal argument, Sabine had asserted that the force majeure clause did not relieve ONG of its obligation to pay for gas not

taken. The court disagreed. Here, the contractual language was unambiguous in excusing the buyer’s obligations to take or pay “when gas cannot be taken for a reason *within the clause*.” [1169]. Implicitly, Judge Russell appropriately confined the operation of the force majeure clause to events set forth in the agreement’s actual language.

Sabine next argued that an event of force majeure must be unforeseeable to actually constitute a catastrophe that would lawfully excuse performance under the clause itself; the court likewise rejected this assertion: “Nowhere does the force majeure clause specify that an event or cause must be unforeseeable to be a force majeure event.” Rather, pointed out Judge Russell, “The focus of the clause is upon a party’s ability to control rather than its ability to foresee the alleged cause.” The *Sabine* court demonstrated consistency in applying the precise language the parties had themselves agreed to in their deal.

So far, the buyer was winning the battles. But would it win the war?

So far, the buyer was winning the battles. But would it win the war? Now the tables turned, for Sabine decried what it characterized as the insufficiency of the evidence that ONG had presented in its defense. This time, the court agreed with the plaintiff and found that ONG had failed to put into the record any evidence that circumstances had rendered it unable to take the gas within the meaning of the force majeure clause. Admittedly, said the court, the collapse of the market at the relevant time meant ONG would have had to take the gas from Sabine at a loss. But that is a function of market price and “does not render a party ‘unable’ to take gas,” at least how these parties had so defined “unable” under their agreement. While the *Sabine* court opined that the purpose of a force majeure clause “is to shift risks otherwise assigned and limit the parties’ obligations under a contract,” that general aim “cannot alter the plain and unambiguous meaning of the term ‘unable,’” as employed by the buyer and seller in this deal. Equally so, the court found it clear in this arrangement that ONG as a buyer had plainly assumed “the

risk of a decline in market demand and market price” [1171–72].

Judge Russell then concluded this portion of his holding with these incisive words: “[ONG] herein is not and could not rely on a nonexistent ‘failure of markets’ provision in the force majeure clause.” Far to the contrary, the events that compelled ONG to neither take nor pay for the gas were bona fide and naturally occurring market forces that did not in any way constitute an event of force majeure [1172]. And while the opinion went on to parse a variety of other legal issues not germane to this article [1172 and following pages], among its final conclusions was its ruling, consistent with the foregoing, that ONG’s force majeure defense was fatally flawed. The agreed-to language of that clause did not contemplate a market decline as an event constituting force majeure, at least in how these parties had written their contract [1191]. To the buyer’s remorse, it eventually had to pay for the gas anyway, but most likely learned a lesson for the future as to how to more carefully draft its force majeure clauses.

### PPG

The essential reasoning of *Sabine* was validated barely a year later in the similar case of *PPG Industries, Inc. v. Shell Oil Co.*<sup>6</sup> In short, the appellate court affirmed the district court’s ruling that the defendant oil company was excused from performing under a delivery contract for reason of an explosion at its refinery, that calamity giving the defendant seller the right to invoke the force majeure clause of the operative contract.

The Fifth Circuit ruled that the scope of the force majeure “was supplied by the *terms of the contracts* rather than the *dictates of the law*” [18 (emphasis in the original)]. Here, the pertinent language defined force majeure as including an event beyond the parties’ reasonable control, and the refinery explosion was found to be such an event. Contrary to the buyer’s allegations, a number of earlier cases examined by the tribunal were found “not [to] establish a rule of law regulating the content of a force majeure clause.” Force majeure represents another exercise by contracting parties in crafting language to their individual needs, and while doing so “parties retain the utmost freedom to anticipate business risks and allocate them ac-

ordingly,” said the panel. These “two sophisticated corporations” jointly agreed to write their contract a certain way, including the allocation of risk via the device of force majeure, and now the Fifth Circuit would hold them to their mutually agreed-to terms [19].

### Kaltim

We now come to a landmark and most illustrative case on this point, decided in 2001 and entitled *PT Kaltim Prima Coal v. AES Barbers Point, Inc.*<sup>7</sup> The plaintiff Kaltim Coal (KPC) owned coal mines in Indonesia, while the defendant (a subsidiary of the much larger AES power generation concern) operated an electricity production facility at Barbers Point, Hawaii. This coal-fired plant provided 20 percent of the electricity for the Hawaiian island of Oahu. Years before, the parties had entered into a 20-year requirements contract, whereby KPC would provide the coal AES required to fire the Barbers Point generation station. The contract called for monthly deliveries of coal to be shipped across the Pacific to the Hawaiian Islands, with extensively detailed provisions about how and when KPC would designate the transport vessel, its loading, and its departure from the Far East [476–77].

For an extended period in 2000, KPC experienced a great deal of labor unrest at its Indonesian facilities. This included work stoppages and the blockading of its conveyor system to bring the coal out of the mines. Around August of that year, with mounting uncertainty about its ability to fulfill its shipping commitments, KPC declared a preliminary force majeure to AES and its other customers. Significantly, the coal company advised all its customers that it was seeking alternative sources of coal, so that it might still fulfill its contractual commitments. Notably, KPC was 50 percent owned by mining giant Rio Tinto and was arranging for replacement coal from its parent’s facilities in Australia, as well as from third parties (ironically, one of those third parties was a prebankruptcy Enron) [478 n.3 and 477–78, respectively].

But AES was taking no chances. Almost immediately, it sought out new suppliers and executed fresh contracts to supply coal to the Barbers Point plant. The power generation company’s actions might have been a tad premature, for KPC was able to finally resolve its

labor problems, and the Indonesian mines came back on line in late August. KPC rescinded the force majeure and loaded up vessels on schedule for the September and October shipments to Oahu. However, AES was not interested: it refused to accept either delivery, citing the declaration of the force majeure as giving it the right to move on with new suppliers, at least for those months. Greatly displeased, KPC commenced this lawsuit, alleging the buyer was in breach for its unlawful refusal to accept delivery and the concomitant damages.

District Judge Allen Hellerstein posed the question before him as whether or not AES breached by refusing delivery subsequent to KPC's declaration of the force majeure. In a classic step borrowed from the world of boxing, this judge rendered a "split decision," insofar that AES was correct to refuse the September shipment but erred when it rejected delivery of the October shipment of coal [480]. To begin its analysis, the court made some valuable observations about the workings of force majeure in the world of modern contracts.

As to its overarching purpose, Judge Hellerstein noted that "[a] declaration of force majeure relieves both seller and buyer of their contractual obligations" [482, citing Farnsworth, E. Allan. (1998). *Farnsworth on Contracts* (2nd ed.), p. 650]. The court briefly mentioned that that typical force majeure clause catalogs a variety of calamities, such as war, political upheaval, labor strikes, and natural disasters, the intervention of which makes performance of the contract well nigh impossible. Thus, the clause affords relief to both sides from being obligated to do something that, practically speaking, cannot be accomplished.

But an absolute voiding of all duties to perform is merely the most elementary variation of a force majeure clause. Parties are free to distinguish in their individual contracts as to what constitutes a force majeure trigger, and what is to be done in such an event: "Parties may agree, however, that a force majeure event will have a different result, such as broadening or narrowing excuses of performance and attaching conditions to the exercise and effects of a force majeure clause" [482]. Judge Hellerstein made clear that the definition of what constitutes force majeure is left to the parties: they can widen the scope of the clause to include whatever catastrophes

they wish, great or small, and, conversely, they can delimit what they deem to be cataclysmic to fit their own world view. Far more importantly, the basic freedom to contract allows parties the latitude to establish whatever rights, remedies, and alternatives become available when a force majeure event is declared.

In the instant case, the *KPC* court found that the relevant contract was just such an instrument, because it authorized the seller to take clear-cut steps to remediate the impact of any declaration of force majeure. Among other things, the coal supplier had the right to provide coal from sources other than its Indonesian mines, and that is precisely one of the steps it had permission to and did in fact take [482–83].

To be sure, the court recognized that AES had rights too, most especially the absolute right to seek out alternative suppliers [483; see also UCC Section 2-609 (right of either party to demand adequate assurance of performance).] Relating this to the facts at hand, Judge Hellerstein ruled that "AES did not have to wait out until a missed shipment might jeopardize its ability to generate power. . . . AES did not have to assume the risk [of] a tightening market" [484]. More importantly, the court now posited this point of law with regard to the power generating company's refusal of the September shipment. Given the time frame required to extract and move coal, charter a vessel, load it, and then assure its transit across the Pacific Ocean, the August invocation of force majeure by KPC liberated AES from the contract, at least for that monthly shipment, and the buyer was well within its rights to go elsewhere for necessary feedstock. Implicitly, the burden of AES to supply nearly a quarter of the electricity needed on Oahu was not something to be put at risk; hence, AES was well within the law to refuse the September shipment that KPC's labor troubles had put in jeopardy.

That was September. October was a different matter altogether. The *KPC* court took the pragmatic view that most force majeure events are transitory, not permanent. With that common-sense notion in mind, Judge Hellerstein ruled that "AES was not entitled, however, to proceed as if the event of force majeure would never cease." This jurist deemed it significant that this long-term contract contemplated monthly shipments.

Moreover, as mentioned above, the operative agreement detailed a specific process by which KPC would nominate certain colliers (a cargo vessel specializing in carrying coal), when they would be loaded, when they would set sail for the Hawaiian Islands, and methods whereby the buyer could check on the progress of its shipments [484]. Put another way, the court ultimately determined that AES had the ability to monitor the situation with KPC, even with the force majeure in effect, and then to make decisions accordingly, but on a short-term, not permanent, basis.

Of crucial import, the *KPC* court declared that AES had no right to assume that future shipments beyond September were jeopardized: “AES’ cover for October was therefore hasty, unreasonable in the circumstances, and insufficient to excuse its contract obligations to KPC with respect to the October 2000 shipment.” Simply put, while AES was right to refuse delivery of the September load, its rejection of the following month’s shipment constituted a breach of contract, as the force majeure was no longer in effect. [484].

Finally, after assessing the measure of damages incurred by the seller, the court held that, of course, AES had no liability for the September shipment it correctly rejected, but owed nearly \$1.5 million in damages to KPC for its unlawful rejection of the October delivery [486]. All in all, this is a sterling example that the proper application of force majeure merely begins with the essential notion of excusing performance among the parties but is quite subject to the individual tailoring made by each and every contract.

## LESSONS TO BE DRAWN

The above is force majeure. Let us now review its essentials. First, force majeure is a long-established contractual device that permits parties to be excused from performance upon the occurrence of specific events. Second, parties have the freedom to tailor their force majeure clauses as they see fit, widening or delimiting the scope of the clauses. Likewise the parties may fashion broad or narrow options and remedies when the clause takes effect. Third (and probably most important), courts will enforce force majeure clauses as they are written, neither adding to nor deleting the language previously agreed to by the contracting parties. In sum, a distinct ju-

dicial doctrine of noninterference, coupled with a strict enforcement of contractual terms.

Courts will enforce force majeure clauses as they are written, neither adding to nor deleting the language previously agreed to.

For decades, experience has compelled the energy industry to carefully detail its force majeure clauses to anticipate the known horrors: war, political strife, labor unrest, and natural disasters, just to name a few. But have market conditions, lack of credit, recession, or any such machinations of the financial world found their way into these carefully thought-out accords? We think not. A force majeure clause is only as good as the calamities it anticipates. It can be said that few in the industry anticipated the hardships of the current environment. Therefore, and while unfortunate, it is highly unlikely that any current force majeure language will be sufficient to excuse a party from performance due to financial disaster of whatever kind, and the courts will undoubtedly not imply such downfalls into contracts already written.

It is highly unlikely that any current force majeure language will be sufficient.

Now knowing that economic disasters can be as ravaging as forces of nature, no doubt members of the energy industry, as well as others, will have pause and give long and hard thought as to when and how to anticipate such misfortunes into the language of future force majeure clauses. ○

## NOTES

1. (1979). *Black's Law Dictionary* (5th ed.), p. 581.
2. *Ibid.*, p. 31.
3. *Encogen Four Partners, L.P. v. Niagara Mohawk Power Corp.*, 914 F.Supp. 57 (S.D.N.Y. 1996) (Sprizzo, J.).
4. 725 F.Supp. 1157 (W.D. Oklahoma 1989).
5. In this case and the following cases, to avoid a long string of “*Ibid.*” cites and the reader continually referring to the end of the article, merely the page number in the case will be given, in brackets, in the text.— *Ed.*
6. 919 F.2d 17 (5th Cir. 1990).
7. 180 F.Supp 2d 475 (S.D.N.Y. 2001).