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No exit: Force majeure and economic risk allocation during COVID-19

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Authors: Jacqueline Code, James R. Brown, Adam Margeson

When COVID-19 was declared a global pandemic and various government restrictions were imposed, corporate deal parties and contractual counterparties immediately turned their minds to whether the pandemic would provide an exit mechanism from deals that had not yet closed or from contractual arrangements that were in effect at the time.

As we wrote in 2020, contractual parties began reviewing the *force majeure* provisions of their agreements to determine whether relevant contractual obligations were required to be performed during the pandemic. Deal parties examined their "material adverse change" (MAC) clauses to determine whether the effects of the pandemic on a target's business could allow that party to walk away from a negotiated transaction. As we discussed last year, 2021 saw the first Canadian litigation regarding MAC clauses and interim operating covenants as they applied in three significant transactions. The referenced *Cineplex* decision came shortly after, reinforcing the challenges of walking away from a transaction. As we wrote in our Osler Update and in our M&A article, the decision's approach to damages was particularly notable in light of the reference to lost synergies.

Although we now have a body of case law regarding MAC clauses and other efforts to terminate transactions for contractual breaches, surprisingly few cases regarding COVID-19 and *force majeure* have been litigated to a decision on the merits. However, in 2022, the Ontario Superior Court of Justice released its decision in the litigation between Nieuport Aviation Infrastructure Partners GP (Nieuport), the operator of the terminal at Billy Bishop Airport in Toronto, and Porter Airlines Inc. (Porter), the primary airline operating out of Billy Bishop (*Nieuport Aviation)*. This decision confirms that even though the interpretation of a *force majeure* clause depends on its particular wording, the fact that a contract becomes significantly more economically onerous to perform is not a basis for invoking *force majeure* to refuse performance. This decision adds an important precedent to a relatively infrequently litigated area of contract law.

Narrow application of *force majeure* confirmed

The doctrine of *force majeure*

Force majeure clauses are extremely common contractual provisions. If applicable, they operate to excuse a party to an agreement from performing contractual obligations where certain specified circumstances outside the parties' control (e.g., acts of God, war, insurrection, labour strikes) have prevented a party from fulfilling its obligations under the contract.

While the precise wording of *force majeure* clauses differs from contract to contract and must be evaluated on a case-by-case basis, the Supreme Court of Canada held in *Atlantic Paper Stock Ltd. v. St. Anne-Nackawic Pulp and Paper Company Limited* that *force majeure* clauses typically apply where a "supervening, sometimes supernatural, event, beyond control of either party, makes performance impossible. The common thread is that of the unexpected, something beyond reasonable human foresight and skill."

In determining whether a *force majeure* clause is triggered, the court will generally first consider whether the triggering event is included within the scope of the *force majeure* clause, and second, whether the event prevented (or sometimes, hindered, restricted or delayed) the party seeking to make use of the clause from fulfilling its obligations under the agreement.

Force majeure and COVID-19

Unsurprisingly, COVID-19 has resulted in an uptick in *force majeure* litigation and in parties seeking advice regarding the applicability of the doctrine in circumstances where the pandemic or related government restrictions have rendered their contracts more difficult or onerous to perform.

Comparatively few cases have resulted in a judgment on the merits. However, several such decisions have been rendered in cases involving real property leases in which a tenant has invoked *force majeure* to avoid its obligations to pay rent as a result of the COVID-19 pandemic. With limited exceptions, the courts have consistently rejected such arguments as unsupported by the wording of the particular leases. Courts also invoke the general principle that tenants must pay for their continued possession of their leasehold interests even where they cannot operate their businesses from the leased premises. Most of these decisions do not contain extensive reasoning.

For example, in *Durham Sports Barn Inc. Bankruptcy Proposal*, a retail store that had been required to close as a result of governmental regulation sought a rent abatement. The court rejected this argument on the grounds that although the *force majeure* clause in question excused the landlord's obligation to provide quiet enjoyment of the premises because government COVID-19 regulations precluded the business from operating, it did not excuse the tenant's obligation to pay rent. While these obligations were clearly connected, this did not mean that the *force majeure* clause applied equally to both.

By contrast, *Windsor-Essex Catholic District School Board v. 231846 Ontario Limited* (*Windsor-Essex)* is an isolated example of a contrary decision. In that case, a specific clause provided for a rent abatement for the tenant where the landlord was unable to make the property available for use. In that case, the landlord's ability to invoke *force majeure* to relieve it of its obligations to provide the premises triggered the express abatement provision.

The *Nieuport Aviation* decision

In October of 2022, the Ontario Superior Court released its decision in *Nieuport Aviation*. In response to the pandemic, Porter ceased operating for a period of 18 months. During this time period, Porter stopped paying terminal fees to Nieuport. The decision contains relatively extensive reasons refusing to apply the doctrine of *force majeure* to excuse Porter from its contractual obligation. The Court's decision represents a potentially significant contribution to the law regarding *force majeure* and should provide welcome guidance to contractual parties in future.

Under the terms of its licence agreement with Nieuport, Porter was obliged to pay monthly

fees for privileges to use the airport terminal for its commercial aviation business. Its fees were based on the daily slots allocated – i.e., reserved – to it by PortsToronto, the airport operator. Its terminal privileges therefore corresponded to its allocated rights to fly to and from the airport. These rights continued to be reserved to Porter during the airline's shutdown. Porter alleged that COVID-19 and subsequent government regulations affecting the airline industry were events of *force majeure* that had prevented or restricted Porter from paying its terminal fees and from providing the required 12 months' notice under the contract of its intention to reduce its allocation of slots and related terminal privileges.

The Court's reasons focus primarily on Porter's argument that the *force majeure* clause in its licence agreement should relieve it of its terminal fee payment obligations during its 18-month period of inactivity. In wholly rejecting this argument, the Court accepted that the pandemic had resulted in an extraordinary and unprecedented drop in passenger levels and therefore a dramatic drop in revenues for Porter – events which equally affected Nieuport. The Court further concluded based on the evidence that Porter had made a commercial decision to cease operations; no government regulation precluded it from continuing to fly.

At the outset, the Court confirmed that Porter had the burden of bringing itself squarely within the *force majeure* clause to obtain its protection, affirming earlier case law to similar effect. The Court then considered whether Porter was "unable to fulfil or was delayed or restricted in fulfilling" its payment obligations by the pandemic or the government response to it.

The Court found that Porter had not, in fact, shown that it had been prevented or restricted from fulfilling its obligations due either to COVID-19 itself or to the government response to COVID-19. The Court cited *Atlantic Paper* and relied on a number of cases in which courts had previously concluded, under similarly worded clauses, that a party cannot invoke *force majeure* based solely on the fact that a contractual obligation has become more economically onerous to perform, even dramatically so.

Porter relied on the Alberta Court of Appeal decision in *Atcor Ltd. v. Continental Energy Marketing Ltd.* In that case, a *force majeure* clause was held to be engaged where performance of the obligations in question would be commercially impracticable or unreasonable. However, the Court in *Nieuport Aviation* stated that this case did not stand for the proposition that a *force majeure* clause may be invoked whenever an event outside the control of the parties renders the performance of a contractual obligation, even a payment obligation, commercially impracticable or unreasonable. The Ontario Court distinguished the *Atcor* case based on its particular facts – namely, a supply obligation that was physically impossible to fulfill – and disagreed with its reasoning. In any event, the Court noted that *Atcor* had generally not been followed in other cases or had been confined to its particular facts.

Porter then unsuccessfully argued that the terms of its licence agreement reflected an intention that Porter would only pay fees while it was able to operate and generate revenues from its commercial aviation business at the airport. The Court held that this interpretation was not supported by the wording of the licence agreement. Instead, the Court found that the contract imposed an unqualified obligation on Porter to pay terminal fees that was not conditional on Porter's ability to generate revenues from its business.

In any event, the Court held that Porter had not demonstrated that its failure to perform its payment obligation was *caused by* an act of *force majeure*. The Court distinguished the *Windsor-Essex* case on the basis that no government order required Billy Bishop to close or Porter to cease flying. While the government regulations may have decreased demand for air travel, this did not establish the direct causal link required to trigger the *force majeure* clause. The fact that Porter had decided to suspend commercial operations because

of the effect of the pandemic on the demand for air services did not allow it to invoke *force majeure*.

In conclusion, the Court held that Porter had not shown that there was any legal restriction on its ability to pay its fees. There was no physical reason precluding it from doing so. Nor had Porter asserted that its financial circumstances were such that it could not pay its fees. In fact, the evidence demonstrated that Porter had paid other creditors during its suspension and that its affiliates had undertaken significant capital expenditures during the COVID-19 period. In any event, the Court stated that, even if Porter had shown that it did not have the financial resources to pay its fees, this would not affect the Court's conclusion that the *force majeure* clause was not available to relieve it of those payment obligations.

The Court reached a similar conclusion with regard to Porter's contractual obligation to provide 12 months' notice of its intention to reduce its allocated slots and related terminal privileges. Porter argued that its ability to provide such notice was restricted by the pandemic because it could not accurately forecast demand as a result of COVID-19. Once again, the Court found that COVID-19 merely made this obligation more difficult, but that Porter had not shown that it was unable to perform this obligation, or that it was delayed or restricted in doing so.

Osler acted for Nieuport. Porter has indicated that it is appealing the decision.

COVID-19 not an automatic exit mechanism

We now have the benefit of several important cases arising from broken deal litigation, particularly focused on MAC clauses and assertions of interim period covenant breaches where targets had been affected by the COVID-19 pandemic. With the incremental benefit of guidance regarding the application of *force majeure* in *Nieuport Aviation*, we are now able to see a pattern developing. Despite the pandemic, courts will not be quick to allow a buyer to walk away from its acquisition commitments or a counterparty to walk away from its contractual obligations on the basis of frequently used clauses that have, until now, seen limited case law.

Buyers and counterparties will need to keep in mind the risk allocations afforded in their contracts as courts have clearly demonstrated their intention to hold parties to their bargains and to read potential escape clauses narrowly.