Memo To: All Lawyers
Folder: Alexsei Research Memo (Public)
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Jurisdiction: Ontario, Canada
Date: March 20, 2020
Regarding: COVID-19 Force Majeure?

Issue

Does the COVID-19 crisis constitute a force majeure, or, in the alternative, a material adverse change or material adverse effect?

Facts

No additional facts were supplied.

Conclusion

The applicability of a force majeure clause in a given situation will depend on its terms. Force majeure clauses vary from contract to contract and will specify the types of triggering events to which it applies, as well as the level of impact required to excuse performance (*Atcor Ltd. v. Continental Energy Marketing Ltd.*).

Force majeure clauses generally operate to discharge a contracting party when a supervening event beyond control of either party makes performance impossible. The common thread among all force majeure clauses is that of the unexpected; something beyond reasonable human foresight and skill. (*Atlantic Paper Stock Ltd. v. St. Anne-Nackawic Pulp and Paper Company Limited*)

No cases applying a force majeure clause to a pandemic or outbreak of a disease could be identified. While some force majeure clauses may specifically indicate that they are triggered by a "pandemic" or "outbreak", many will not. However, the COVID-19 crisis may fall under more open-ended categories such as "emergency", "any unexpected eventuality beyond the control of the impacted party", or, in the case of construction contracts, "any cause beyond the Contractor's control". Forced closures of non-essential businesses (whether it be the contracting party or a

necessary supplier of the contracting party) may also fall under "government action" or similar language, if such is provided for in the clause at issue.

Material adverse change (MAC) and material adverse effect (MAE) clauses are similar to force majeure clauses in that they are defined by their terms. They may, but often do not, list particular triggering events. No cases addressing a MAC or MAE clause in the context of a pandemic or outbreak of a disease could be identified. However, in the context of a dispute over a private placement agreement, the Ontario Superior Court of Justice has stated that the applicability of a MAC clause is restricted to changes that materially affected the party relying on the clause, rather than changes affecting businesses in a given industry generally. (*Stetson Oil & Gas Ltd. v. Stifel Nicolaus Canada Inc.*)

Law

Force Majeure

In Canada's common law jurisdictions, force majeure is a creature of contract. The applicability of a force majeure clause in a given situation will depend on its terms. Force majeure clauses vary from contract to contract and will specify the types of triggering events to which it applies, as well as the level of impact required to excuse performance (*Atcor Ltd. v. Continental Energy Marketing Ltd.*, 1996 ABCA 40 (CanLII), para. 12).

However, there is a common thread among all force majeure clauses, as explained by the Supreme Court of Canada in *Atlantic Paper Stock Ltd. v. St. Anne-Nackawic Pulp and Paper Company Limited, [1976] 1 SCR 580*, 1975 CanLII 170 (SCC) ("*Atlantic Paper*"):

> An act of God clause or force majeure clause … generally operates to discharge a contracting party when 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 *Atcor Ltd. v. Continental Energy Marketing Ltd.*, 1996 ABCA 40 (CanLII) ("*Atcor*"), the Alberta Court of Appeal appeared to relax this "impossibility standard" in favour of a commercial reasonableness standard:

> [13] This contract offered a very broad list of events. (It was quite clear about the third requirement: the contract was suspended, not terminated.) There is much to be

> said for that. The event need not be a catastrophe or "act of god", just something not present in sound business calculations. I assume in this age that amounts to a list of events for which insurance is not available at a reasonable cost. Otherwise, the parties would be wiser expressly to fix an obligation to insure a risk upon one party or the other.
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> [14] But a broad list of force majeure events offers the risk of turning the bargain on its head if it can be used as an escape clause. When the list is broad, one reasonably expects to see in the contract that the event is tied to meaningful consequences. A good contract would expressly deal with several possible results, and different levels of obligation to mitigate, as did some samples from the trade put before the trial judge. This unfortunately did not. We are told only that, as a prerequisite to invocation, the invoking party must show a causal tie and also show it did not "fail to remedy the condition". Those terms, unfortunately, are not very specific. It was a choice of words that assured litigation. The judicial assistance thereby rendered necessary should not, however, depart from the commercial context. On the one hand, the condition to be remedied includes the effect of the event, not just the event. On the other hand, the assessment of the effort at remedy must also keep in mind commercial reality. In my view, one is driven by the clause to inquire about a reasonable allocation of risk between the parties about the various events that might occur. That inquiry should be case and industry specific. The inquiry, as a result, would assess risk in terms of what, in commercial terms, were the mutual and reasonable expectations of the parties about risks that may arise. Cast in terms of the duty of the supplier here, the test is whether replacement purchases by Atcor were commercially reasonable and feasible.

However, *Atcor* has not been widely followed and, in fact, was distinguished in *Domtar Inc. v Univar Canada Ltd.*, 2011 BCSC 1776 (CanLII) as being a decision specific to the terms of the clause in issue.

In *Atlantic Paper*, the defendant was the owner and operator of a pulp and paper mill contracted to purchase all of the waste paper it used for secondary fibre from the plaintiff. The contract provided for a minimum purchase of 10,000 tonnes of secondary fibre per year for ten years, subject to the following force majeure clause:

> St. Anne warrants and represents that its requirements under this contract shall be approximately 15,000 tons a year, and further warrants that in any one year its requirements for Secondary Fibre shall not be less than 10,000 tons, unless as a result

> of an act of God, the Queen's or public enemies, war, the authority of the law, labour unrest or strikes, the destruction of or damage to production facilities, or the nonavailability of markets for pulp or corrugating medium.

After 14 months, the defendant advised the plaintiff that it would not accept anymore waste. The plaintiff sued for damages. The defendant pleaded non-availability of markets for pulp or corrugating medium in its defence, relying on the force majeure clause. The Supreme Court construed the clause strictly, holding that in order for "nonavailability of markets" to excuse performance, it must be limited to an event over which the defendant had no control:

> If markets were unavailable to St. Anne, did they become so because of something unexpected happening after April 10, 1970? Was the change so radical as to strike at the root of the contract? Could the company, through the exercise of reasonable skill, have found markets in which to trade? Clause 2(a) contemplates the following frustrating events: an act of God, the Queen's or public enemies, war, the authority of the law, labour unrest or strikes, the destruction of or damage to production facilities. Reading the clause ejusdem generis, it seems to me that "nonavailability of markets" as a discharging condition must be limited to an event over which the respondent exercises no control.
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> The primary cause of the failure of St. Anne's corrugating medium facility was lack of an effective marketing plan for corrugating medium. …
>
> The difference between the conclusion of the trial judge and that of the Appeal Division turned essentially on whether the words "non-availability of markets" meant non-availability of economic markets for St. Anne. Mr. Justice Barry applied what might be called an objective test, the Appeal Division a subjective test. The Appeal Division was of opinion that the words "available market" necessarily connoted a market advantageous or profitable to St. Anne. Mr. Justice Barry found no such connotation in the language of the clause. The effect of the Appeal Division opinion would be to relieve St. Anne of contractual obligation if St. Anne could not operate at a profit. I doubt that reasonable men would have made such a bargain. It would in my opinion be doing violence to the plain words "non-availability of markets for pulp or corrugating medium" in the context of the entire clause within which the words are found, to permit St. Anne to rely upon its soaring production costs to absolve it of contractual liability. …

…

> I do not think St. Anne can rely on a condition which it brought upon itself. A fair reading of the evidence leads one to conclude that the whole St. Anne project for the manufacture of corrugating medium was misconceived. The problems which plagued it proceeded, however, not from non-availability of markets for corrugating medium but from (i) lack of an effective marketing plan, as I have stated; St. Anne spent $16,000,000 to produce a product without any notion of where the product would be sold and (ii) inordinate operating costs, aggravated by two subsidiary factors (a) lack of captive outlets and (b) failure to produce linerboard; customers needed both corrugating medium and linerboard, and preferred manufacturers who could offer both. The project, conceived in ephemeral hopes and not the harsh realities of the market place, resulted in a failure for which St. Anne and not changes in the market for corrugating medium during the period April 10, 1970 to June 9, 1971 must be held accountable.

No cases applying a force majeure clause to a pandemic or outbreak of a disease could be identified. While some force majeure clauses may specifically indicate that they are triggered by a "pandemic" or "outbreak", many will not. However, the COVID-19 crisis may fall under more open-ended categories such as "emergency", "any unexpected eventuality beyond the control of the impacted party", or, in the case of construction contracts, "any cause beyond the Contractor's control". Forced closures of non-essential businesses (whether it be the contracting party or a necessary supplier of the contracting party) may also fall under "government action" or similar language, if such is provided for in the clause at issue.

Material Adverse Change or Material Adverse Effect

Material adverse change (MAC) and material adverse effect (MAE) clauses are similar to force majeure clauses in that they are creatures of contract defined by their terms. MAC and MAE are often used interchangeably, though it is arguable that MAE clauses are broader. They may, but often do not, list particular triggering events. No cases addressing a MAC or MAE clause in the context of a pandemic or outbreak of a disease could be identified.

A "standard" material change clause used in private placement agreements was discussed by the Ontario Superior Court of Justice in *Stetson Oil & Gas Ltd. v. Stifel Nicolaus Canada Inc.*, 2013 ONSC 1300 (CanLII). The standard clause read:

> If, after the date hereof and prior to the Time of Closing, there shall occur any material change or change in a material fact which, in the reasonable opinion of the Underwriters (or any of them), would be expected to have a significant adverse effect on the market price or value of the Securities, any Underwriter shall be entitled, at its option, to terminate its obligation under this agreement by written notice to that effect, given to the Company at or prior to the Time of Closing.

The Court noted that this clause does not define what is meant by "material change or change in a material fact", however, the Court deferred to the particular meaning that had been ascribed to this phrase within the securities industry:

> [101] The IIAC material change out clause does not define what is meant by material change or change in a material fact. These are not loose terms but have particular meaning in the securities industry.
>
> [102] Mr. Halperin's opinion is that MAC out clauses in the securities underwriting context (again subject to the specific language of the relevant provision) would typically be expected to be interpreted by reference to the legal definition of "material change" in the *Securities Act* (Ontario) and comparable provisions under other Canadian provincial securities legislation, which define a "material change", in pertinent part, as: "a change in the business, operations or capital of the issuer that would reasonably be expected to have a significant effect on the market price or value of any of the securities of the issuer ...". He went on to say:
>
> In my experience, "MAC out" provisions in underwriting agreements tend to be based upon the statutory definition of material change (adding the adjective "adverse"). Thus, in the underwriting context, Reasonable Market Actors would expect that a "MAC out" would be available to the underwriter in the event of a change in the business, operations or capital of the issuer of the securities that would rise to the level of a defined material change, with the change "trigger" being the price or value of the issuer's securities, without regard to whether the change is permanent or transformational.

Of note is the Court's conclusion that the applicability of a MAC clause would be restricted to changes that materially affected the party relying on the clause, rather than changes affecting businesses in the industry generally:

[103] Mr. Halperin went on to say that there is some debate and uncertainty as to whether a MAC out in this context only gives rise to an underwriter termination right if the MAC out is specific to the issuer as opposed to being of general application. Mr. Halperin said that the issue is sometimes addressed through specific drafting of the provision in the underwriting agreement. In this case Weisel never attempted to negotiate an underwriting agreement.

[104] Mr. Halperin's opinion is that in the absence of drafting specificity, the Reasonable Market Actor would derive some guidance on the issue from two sources, being National Policy 51-201 of the Canadian Securities Administration dealing with disclosure standards for reporting issuers and a decision of the Supreme Court of Canada in *Kerr v. Danier Leather Inc.*, [2007] 2 S.C.R. 331 (S.C.C.) which he said became well known in the business community.

[105] National Policy 51-201 states that it is only external developments that have a direct effect on a business not generally experienced by other business in the same industry that require disclose of changes, as follows:

Companies are not generally required to interpret the impact of external political, economic and social developments on their affairs. However, if an external development will have or has had a direct effect on the business and affairs of a company that is both material and uncharacteristic of the effect generally experienced by other companies engaged in the same business or industry, the company is urged to explain, where practical, the particular impact on them. For example, a change in government policy that affects most companies in a particular industry does not require an announcement, but if it affects only one or a few companies in a material way, such companies should make an announcement.

[106] In *Danier*, the trial judge held that a significant change in weather patterns was not a change in the business of *Danier* and thus not a material change within the definition of material change in the *Securities Act*. The Supreme Court agreed with that finding and pointed out that the distinction between a material fact and a material change was deliberate. Binnie J. stated:

The distinction between "material change" and "material fact" is deliberate and policy-based, as explained by a former chairman of the O.S.C.:

The term "material fact" is necessary when an issuer is publishing a disclosure document, such as a prospectus or a take-over bid circular, where all material information concerning the issuer at a point in time is published in one document which is convenient to the investor. The term "material change" is limited to a change in the business, operations or capital of the issuer. This is an attempt to relieve reporting issuers of the obligation to continually interpret external political, economic and social developments as they affect the affairs of the issuer, unless the external change will result in a change in the business, operations or capital of the issuer, in which case, timely disclosure of the change must be made.

[107] Thus the purport of Mr. Halperin's opinion is that absent a specific contractual provision to the contrary, a Reasonable Market Actor would consider that a standard material adverse change out clause would require a change to the business of Stetson and not a change in oil pricing generally in order for Weisel to attempt to rely on the clause.

…

[111] … I accept the opinion of Mr. Halperin that a Reasonable Market Actor would be guided by the provisions that he referred to in thinking that a material adverse change out clause would restrict changes to those that materially affected Stetson rather than just affecting businesses in the industry generally.

Authorities

Atcor Ltd. v. Continental Energy Marketing Ltd., 1996 ABCA 40 (CanLII)
Atlantic Paper Stock Ltd. v. St. Anne-Nackawic Pulp and Paper Company Limited, [1976] 1 SCR 580, 1975 CanLII 170 (SCC)
Domtar Inc. v Univar Canada Ltd., 2011 BCSC 1776 (CanLII)
Stetson Oil & Gas Ltd. v. Stifel Nicolaus Canada Inc., 2013 ONSC 1300 (CanLII)