



Air Canada (TSX:AC) to Be Sued Over COVID-19 Refunds: Should You Sell the Stock?

Description

The **Air Canada** ([TSX:AC](#))(TSX:AC.B) saga took another dramatic turn this week, after a group of passengers proposed a lawsuit against the airline and its competitors. The lawsuit is seeking refunds on flights booked prior to March 11.

Until recently, Air Canada had been giving full refunds to customers whose flights had been cancelled due to COVID-19. On March 24, the company's CEO released a statement saying that customers would instead receive vouchers.

The move got the approval of the Canadian Transportation Agency, which said that vouchers are a valid form of compensation as long as they "do not expire in an unreasonably short period of time." The agency clarified that 24 months would be a reasonable period for vouchers to remain valid.

The lawsuit stems from customers believing that they are entitled to cash refunds. If the suit goes ahead and succeeds, it would represent a major cost to shareholders. However, as you're about to see, there's a much bigger danger beneath the surface.

The legal problem

The lawsuit against Air Canada and its competitors is being overseen by Simon Lin, a Vancouver lawyer with EvoLink Law Group. According to Lin, Air Canada passengers are entitled to monetary refunds. He has argued that the CTA's statement in support of vouchers is not legally binding, and that *Force Majeure* does not absolve the airlines of their responsibilities.

Force Majeure is a contract clause that exempts a party from their responsibilities due to unforeseen circumstances. According to an article by the law firm Blakes, Canadian courts generally uphold high standards for *Force Majeure* — in line with Lin's argument that it doesn't let airlines off the hook for refunds.

Business realities

If Lin is correct, and Air Canada owes all of its passengers full refunds, it's bad news for the company. The proposed class-action suit is seeking not only refunds but additional damages, which will result in staggering costs. In fact, the costs would be greater than if Air Canada had issued refunds immediately. This raises the question of why it and other airlines [went with vouchers](#) in the first place. Top management must have known that passengers would get upset and take legal action. Why, then, make this wildly unpopular move?

As it turns out, it may be because the airlines don't have the cash to pay up.

According to reports, many passengers are hearing that their refunds can't be processed, because their airline doesn't have the money. Looking at Air Canada's financial statements, it appears that could be the case. At the end of last year, AC had [about \\$6 billion in cash and equivalents](#). That same year, it had \$17 billion in operating expenses. This means that the company would not be able to cover operating expenses with cash on hand.

It's therefore quite possible that much of Air Canada's 2020 revenue had been sunk back into its business before the voucher program came into effect. If that were the case, then the company may not have the cash needed to give refunds. That would indicate a major liquidity problem — one that's ultimately a far bigger concern for investors than any potential lawsuit.

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