

# Cineplex awarded \$1.2 billion following failed pandemic courtship

Litigation | Litigation & Dispute Resolution

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In a remarkable trial decision resulting from a breach of contract claim commenced during the COVID-19 pandemic, Cineplex Inc. obtained a damages award in the amount of \$1.2 billion against the former suitor of its shares, Cineworld Group plc: *Cineplex v. Cineworld*, 2021 ONSC 8016 (CanLII).

In December 2019, prior to the pandemic, Cineworld had agreed to buy Cineplex's shares for approximately \$2.8 billion. The transaction was supposed to close no later than 30 June 2020. On 12 June 2020, however, Cineworld terminated the transaction. Cineplex then sued for damages. A trial was held on the Commercial List in Toronto, within approximately 18 months after the action was commenced.

A main issue at trial was the "material adverse effect" (MAE) clause in the share acquisition agreement, which is a contractual term that typically allows a buyer to back out of a deal upon the occurrence of certain events that occur between signing of the purchase agreement and closing.

The MAE clause at issue addressed the risk of a pandemic and allocated that systemic risk to Cineworld rather than Cineplex. Specifically, the definition of a material adverse effect *excluded* "outbreaks of illness," and while Cineworld could have refused to close if a material adverse effect to Cineplex occurred between signing and closing, if that event was a pandemic, the court determined that the exclusion applied. Therefore, Cineworld could *not* refuse to close on the basis of the MAE clause.

In addition to the MAE clause, the transaction involved an "ordinary course" covenant pursuant to which Cineplex was obliged to continue to operate the business in the ordinary course during the interim period before closing.

Buyers may be excused from closing a transaction "where the seller's own actions significantly change the nature of the business or have a long-lasting impact that would affect the buyer in operating the business after closing" (para. 111, citing *Fairstone Financial Holdings Inc v. Duo Bank of Canada*, 2020 ONSC 7397, paras. 163, 179). Cineworld made various arguments at trial to show that Cineplex had breached its covenant in that regard.

The covenant at issue required, firstly, that Cineplex conduct its business in the "ordinary course" and, secondly, that it use "commercially reasonable efforts" to maintain and preserve its business organization, assets, properties, employees, goodwill and business relationships with customers, suppliers, partners and other persons with which the company had material business relations.

In the decision, the court contrasted the circumstances with a recent case in the United States where the seller of a hotel chain had significantly altered its business in response to the COVID-19 pandemic and had operated in ways that it never had before, by choosing of its own accord to close two of its hotels, limiting the operations of several others and laying off or furloughing thousands of employees. The buyer would have been left with serious staffing shortages, amongst other issues, and would not have been left with the business operating in the manner that it had bargained for: *B Stable VIII LLC v MAPS Hotels and Resorts One LLC*, C.A. No. 2020-0310-JTL (Del. Ch. Crt).

Importantly, the court accepted Cineplex's evidence that it had done all that could reasonably be expected to continue to operate in the ordinary course during the pandemic, notwithstanding the government-mandated closure of movie theatres. In that regard, the court found that:

- Cineplex had implemented deferral and spending reductions to conserve its liquidity and preserve credit once the theatres were closed;

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- Cineplex adapted payment and spending practices once its theatres were closed that were not wholly different from Cineworld's own practices in closing cinemas, withholding payment, and negotiating deals with suppliers, landlords and film studios;
- Cineplex deferred payment of rent to landlords while it was working with a consortium (which included landlords) to seek rent relief from the government;
- When that effort proved unsuccessful, Cineplex started to negotiate directly with its landlords, ultimately securing significant rent savings;
- There was no evidence that Cineplex's relationships with third parties were damaged or impaired. The evidence from the witnesses at trial was to the contrary, namely that Cineplex's relationships continued throughout the pandemic and remain strong to this day.

Further, the court found that Cineplex's liabilities for June, 2020, when Cineworld terminated the purchase, were no greater than they were at the time the agreement was signed. Based on the applicable legal principles and the evidence, the court found that Cineplex did not breach the operating covenant, nor any other covenants that operated during the interim period.

Lastly, Cineworld argued that Cineplex breached a duty of honest performance by deliberately and knowingly misleading Cineworld with respect to material and relevant information related to Cineplex's compliance with the agreement. Pursuant to a term in the agreement, Cineworld had the right to request financial and operating data from Cineplex. At trial, Cineworld alleged that Cineplex provided misleading information on the type and status of rent relief it was seeking from the government and landlords.

The court disagreed, finding that Cineplex was clear that it had not been paying rent, had received default notices from landlords, was trying to obtain government relief through the consortium, and was in the process of negotiating with individual landlords when government rent relief was not forthcoming. Cineworld's position that it wanted "more" information was insufficient to ground a claim for breach of the duty of honest performance.

In the result, Cineplex's claim that Cineworld breached the agreement to complete the share purchase was allowed, and Cineworld's various complaints about Cineplex's own breaches were rejected.

As for damages, Cineplex argued firstly that it should be entitled to recover the value of the consideration that would have been payable to its shareholders had the transaction been completed, less the residual value of the shares on the termination date. This measure of damages was not accepted by the court, as the losses were those of the shareholders rather than Cineplex itself.

Cineplex was however entitled to the "loss of synergies" that it said would have resulted from the share acquisition, relating to, amongst other things, removal of the Cineplex board, headcount rationalizations, and spending reductions on the operational side. The increased revenues to Cineplex included additional fees from film studios to play trailers during pre-show time, additional online booking fees, and increased concession spending at theatres. Cineplex produced expert evidence that estimated \$163.5 million in annualized combination benefits to Cineplex, comprised of cost synergies (\$88 million), revenue synergies (\$72 million) and efficiency synergies (\$3.5 million) that would result from the combination with Cineworld.

The court accepted that the lost synergies was an appropriate measure of damages because, unlike the consideration payable to shareholders, the lost synergies are Cineplex's own losses as a result of Cineworld's termination. Based on the evidence, these were synergies that would have been realized by Cineplex had the Transaction been completed. An award of damages on this basis would therefore put Cineplex in the position that it would have been in if Cineworld had not terminated the purchase and had closed the transaction.

The amount awarded by the court on account of the lost synergies was a jaw-dropping \$1.2366 billion.

The decision reflects that a buyer may not back out of a binding transaction, even in the face of a monumental and industry-shaking pandemic like that of COVID-19, unless there is a term that has been bargained for as part of the transaction which allows the buyer an "out". Cineworld may well have had understandable concerns about the fate of the entertainment industry in June 2020 when it decided to back out of the Cineplex purchase. However, it could not establish that Cineplex had failed to operate pursuant to its contractual commitments and accordingly there was no legal basis to refuse to carry through with the transaction. A PDF version is available to download [here](#).

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