



Cineplex V Cineworld: An Analysis of Covid-19's Impact on Damages in a Complex M&A Dispute

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INTRODUCTION

In December 2019, Cineworld Group plc of UK ("Cineworld") entered into an Arrangement Agreement with Cineplex Inc. ("Cineplex") in Canada, agreeing to acquire Cineplex's shares for a transaction value, including the repayment of Cineplex's outstanding debt, of approximately C\$2.8 billion. The deal was scheduled to close no later than June 30, 2020, but, prior to closing, Cineworld sent a notice to Cineplex to terminate the Arrangement Agreement on June 12, 2020.

Subsequently, Cineplex brought a claim against Cineworld in Ontario's Superior Court of Justice (the "Court") alleging that the latter had no basis to terminate the Arrangement Agreement. Cineplex sought damages for breach of contract in the range of C\$1 billion.

In responding to the Cineplex claim, Cineworld submitted that it was entitled to terminate the Arrangement Agreement because Cineplex breached its covenants in the agreement – in particular, the covenant to operate in the ordinary course of business between the date of the agreement and closing, including the period impacted by the Covid-19 pandemic. Cineworld also brought a counterclaim to recover its transaction costs of £32 million from Cineplex. Like most matters, the Court was required to decide upon several complicated legal issues before quantifying the damages. In particular, the Court had to deliberate on:

KEY TAKEAWAYS IN CINEPLEX v CINEWORLD

- Ontario Court awarded damages of C\$1.2 billion to Cineplex in failed Cineworld deal
 - Cineplex, relying on its damages expert (Secretariat), advanced various damages measures for breach of contract to assist the Court
 - Secretariat analyzed multiple theories to calculate damages from four perspectives
 - Alternative calculations assisted the Court in assessing damages under different legal theories
 - The Court awarded two damages measures based on its findings, in agreement with the damages conclusion of Secretariat.
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- **Material Adverse Effects ("MAE")** clause, which provided that Cineworld could refuse to close the transaction if a MAE occurred, except if the MAE was caused by "any earthquake, flood or other natural disaster or outbreaks of illness or other acts of God"; and

- **Operating Covenants**, which required Cineplex to operate its business in the “Ordinary Course and in accordance with Laws” between signing the Arrangement Agreement and closing, and to “use commercially reasonable efforts to maintain and preserve its and its Subsidiaries business organization, assets, properties, employees, goodwill and business relationships with customers, suppliers, partners and other Persons with which the Company or any of its Subsidiaries has material business relations.”

As the perspective to calculate damages was unclear at the time of pleading the case, Cineplex, relying on its damages expert (Secretariat), advanced various damages measures for breach of contract to assist the Court in quantifying Cineplex’s damages based on its findings on liability.

The trial was heard from September through November 2021. The Court issued its decision on December 14, 2021. The Court found that Cineworld had no basis for terminating the Arrangement Agreement. Cineplex was awarded damages of C\$1.2 billion (exclusive of pre-judgment interest) and Cineworld’s counterclaim was dismissed.

CINEPLEX’S CLAIM FOR DAMAGES

Given the myriad of legal issues surrounding the peculiar nature of the Arrangement Agreement, multiple theories to calculate damages were analyzed from the following perspectives:

- **Securityholders of Cineplex:** At the close of the transaction, the shareholders would have received the pre-agreement amount, which they did not receive given the termination of the Arrangement.
- **Cineplex’s monetization of its assets:** From a financial and economic perspective, the Arrangement Agreement enabled Cineplex to monetize its assets at the agreed deal value. However, after the termination of the Arrangement, it was left with assets of diminished value.
- **Cineplex as a legal entity:** Cineplex entered into the arrangement with an expectation that some of its costs and liabilities will be funded by Cineworld and certain synergistic benefits would accrue to it. However, the termination of the Arrangement deprived Cineplex of the opportunity to realize the expected benefits.
- **Benefits obtained by Cineworld:** Terminating the Arrangement provided Cineworld with certain benefits which would not have otherwise accrued to it, representing a disgorgement claim.

Secretariat looked at various perspectives and presented the following measures of damages:

- **Measure #1:** Loss calculated as the consideration that Cineworld would have paid to the Securityholders less the value of the securities retained;
- **Measure #2:** Loss calculated based on diminution in value of Cineplex’s future cash flow;
- **Measure #3:** Loss of synergies suffered by Cineplex that would result from the combination with Cineworld;
- **Measure #4:** Liability for the redemption of the share units issued to employees and management;
- **Measure #5:** Credit facilities and their carrying costs;
- **Measure #6:** Cineplex’s transaction expenses; and
- **Measure #7:** Disgorgement of the benefits obtained by Cineworld

Secretariat explained to the Court that measures #1, #2, and #3 are independent of one another, so only one of these measures could be awarded to Cineplex. While measures #4, #5, and #6 could all be awarded in any combination with the measure #3, they could not be combined with measures #1 and #2. Lastly,

the disgorgement amount for the benefits obtained by Cineworld quantified under measure #7 reflected an alternate to all other measures of damages.

Based on its review of the case facts, the Court decided that “the only damages recoverable by Cineplex are the losses sustained by Cineplex, not its shareholders”. Consequently, the Court did not consider measure #1 to be appropriate measure of damages and found that:

- ...the only right that the shareholders had was to receive the consideration if the Transaction closed. They did not have any rights, as third-party beneficiaries, to enforce the agreement or to sue Cineworld for any breach.
- ...Cineplex was appointed as the agent for the shareholders only for the purpose of collecting the consideration if the Transaction closed. It was not appointed as agent for the purpose of enforcing their rights against Cineworld if it failed to close.

The Court also found that loss of synergies to Cineplex calculated by Secretariat under measure #3 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... 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 Arrangement

Agreement and had closed the Transaction”. Since measure #3 was accepted as an appropriate measure of damages, measure #2 and #7 were not considered.

Therefore, the Court awarded damages (exclusive of pre-judgment interest) to Cineplex of C\$1.2366 billion on account of the lost synergies. In addition, Cineplex was awarded its transaction costs of C\$5.5 million calculated under measure #4.

CONCLUSIONS

The Court found that Cineplex did not breach the covenants in the Arrangement Agreement and complied with the operating covenant (specifically during the period impacted by the Covid-19 pandemic). As a result, Cineworld had no basis for terminating the Arrangement Agreement. The Court also found that the shareholders of Cineplex did not have a right to sue Cineworld for any breach of the Arrangement Agreement. At the same time, the damages from Cineworld’s termination of the Arrangement Agreement are the losses sustained by Cineplex, and not its shareholders.

In summary, an expert witness can assist the court’s assessment of damages by providing alternative calculation of damages, when appropriate, to evaluate different theories of the case. These alternative calculations can assist the court in awarding the appropriate amount of damages based on its own legal findings.

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We would like to hear from you

Whether you are interested in speaking to one of our experts or learning more about our exciting careers, we look forward to hearing from you.

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