

Cineworld v Cineplex: What does it mean to operate movie theatres in the ordinary course during a pandemic?

January 6, 2022

By Macdonald Allen

On December 14, 2021, the Honourable Justice Barbara Conway of the Ontario Superior Court of Justice – Commercial List rendered her decision in [*Cineplex v Cineworld*, 2021 ONSC 8016](#). Justice Conway granted judgment for Cineplex Inc. (“Cineplex”) in the amount of approximately \$1.24 billion in damages.

The litigation stemmed from an acquisition of *Cineplex Inc.* by *Cineworld Group PLC* and *1232743 B.C. Ltd.* (“Cineworld”), and the subsequent termination of that acquisition by Cineworld. In December 2019, Cineworld agreed to acquire the shares of Cineplex at a 42% premium over their trading price at that time (the “Agreement”).

In March 2020, the pandemic was declared. On March 16, 2020 Cineplex closed its theatres across Canada, and Cineworld closed its theatres globally on March 17, 2020.

On June 12, 2020, Cineworld gave notice that it was terminating the Agreement.

Justice Conway was tasked with interpreting the Agreement and issues of risk allocation. The Agreement contained various covenants including an operating covenant during the closing period (December 2019 to June 2020, the “Interim Period”) which required Cineplex to operate in the “Ordinary Course” of day to day operations consistent with past practice (the “Operating Covenant”).

The Agreement also included various conditions of closing including that Cineplex’s bank debt not exceed \$725 million (the “Debt Condition”), and a material adverse effect clause (the “MAE”) which if breached would permit Cineworld to terminate the Agreement at or prior to closing. The MAE had specific exclusions that allocated the risk of systemic factors to Cineworld during the Interim Period. These systemic risks were specified in the Agreement and included, among other things, changes to the motion picture industry, changes in general economic or market conditions, changes in law, and, significantly, the outbreaks of illnesses.

Cineworld alleged that Cineplex breached the Operating Covenant because Cineplex deferred payments to suppliers, film studios and landlords and reduced capital expenditures during the Interim Period. Cineworld took the position that these steps were driven by Cineplex’s desire to stay under the Debt Condition and were not in the Ordinary Course. Justice Conway did not agree.

Cineworld took the position that Cineplex was required to operate during the pandemic exactly as it did during non-pandemic times, failing which Cineplex would be in breach of the Operating Covenant. Justice Conway disagreed with Cineworld’s interpretation holding that it ignored the other provisions of the Agreement and failed to read the contract as a whole. In particular, Justice Conway held that if Cineworld’s argument was accepted it would allow Cineworld to circumvent the very systemic risk (i.e. the pandemic) that it assumed in the exclusions to the MAE clause.

Justice Conway considered the steps that other companies in the movie industry had taken in response to the pandemic, and

accepted Cineplex's arguments that its actions were cash management strategies that the company had employed before in times of uncertainty or low liquidity.

Justice Conway held that Cineplex's conduct was not a breach of the Operating Covenant. Cineplex's actions were put into place when its theatres were closed by government mandate. The conduct did not render the nature of the business different than it was at the time the Agreement was entered into. Cineplex's conduct was pursued in good faith for the purpose of continuing the business and avoiding its deterioration.

Ultimately, Justice Conway did not find that there was any basis for Cineworld to terminate the Agreement, and because Cineworld had not negotiated a break fee, it was not allowed to walk away from the transaction and was ordered to pay damages to Cineplex for doing so.

Justice Conway distinguished the case before her from other cases. The concept of what is in the ordinary course of business for a particular business is a flexible and contextual one and is a question of mixed fact and law.

While an in-depth analysis of Justice Conway's reasons for awarding damages is outside the scope of this blog post, Cineplex presented multiple damages scenarios. Justice Conway awarded damages for lost synergies and transaction costs. Justice Conway declined to award damages equivalent to the value of the consideration that would have been payable to Cineplex's shareholders had the transaction been completed. While Justice Conway acknowledged that the ultimate benefit of the lost synergies had the transaction closed would have accrued to Cineworld as Cineplex's shareholder, it did not change her view that the lost synergies were a proper measure of damages. The value of the lost synergies were based on a pre-transaction report prepared by Cineworld's own advisors, and included the present value of cost synergies, revenue synergies and efficiency synergies.

Cineworld has publicly stated it will appeal the decision. The court's analysis of what is in the ordinary course of business tends to be fact specific, and it will be interesting to see what if any facts Cineworld attempts to magnify on appeal. Justice Conway's damages analysis may also become an issue on appeal.

Stay tuned...

The information and comments herein are for the general information of the reader and are not intended as advice or opinion to be relied upon in relation to any particular circumstances. For particular application of the law to specific situations, the reader should seek professional advice.

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