

Omnilab v DCN: anatomy of a “red-blooded fraud”

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On the second day of Omnilab’s appeal against a finding that it had knowingly assisted a director of Digital Cinema Network to breach his fiduciary duties, lawyers for DCN argued that the finding must stand, and that Omnilab Media had committed “red-blooded fraud.” Meanwhile, negotiations for Australian and New Zealand independent cinemas are stalled.

Digital Cinema Network case

The case that DCN presented is elegant in its simplicity.

1. DCN was negotiating with the six US studios to be the deployment entity for digital cinema conversion and virtual print fees for Australian independent cinemas.
2. It’s chairman, Michael Smith, was conducting those negotiations on behalf of DCN, and they were nearing completion, the studios were about to sign. That made the contracts a very valuable asset for DCN.
3. Omnilab wanted to get into the digital cinema integration business and knew as early as 2008 that DCN was negotiating with the studios.
4. Michael Smith had signed an agreement to represent Independent Cinema Association of Australia (ICAA) members in the studio negotiations.
5. Omnilab was looking at buying all or part of DCN in order to get into the digital integration business. DCN’s most valuable asset was the studio contracts.
6. ICAA decided that Omnilab, not DCN, should be the integrator, and instructed Michael Smith to hand the contracts to Omnilab. Michael Smith did so, without informing his two business partners James and Martin Gardiner, while he was still negotiating the sale of DCN to Omnilab. ICAA had no right to issue that instruction, and Michael Smith breached his fiduciary duties to DCN when he obeyed it, and most certainly when he failed to inform his business partners.
7. With the contracts, Omnilab had no reason to buy or take a share in DCN.
8. Omnilab, and in particular John Fleming, General Manager of Omnilab Media, knew that the contracts were DCN’s property, knew that Smith shouldn’t have handed them over, and knew that they were breaking the law.
9. Omnilab deprived DCN of its property and its commercial opportunity.

The DCN case is supported by the undisputed fact that all of the draft contracts with the studios have DCN’s name on them as the “deployment entity”, by Omnilab board minutes and internal emails referring to DCN, and by a Screen Hub article showing that John Fleming had knowledge of DCN’s negotiations in 2008.

Omnilab Case

Omnilab’s case is that it didn’t know, and that the original trial judge was wrong in finding that it did. Omnilab argues that

1. ICAA (not DCN) was in charge of the VPF negotiations with the studios, and Michael Smith was acting as an agent of ICAA, not DCN.
2. Therefore ICAA, not DCN, owned the contracts, and was free to give them to Omnilab.
3. DCN’s name was only on the contracts because Michael Smith *misrepresented himself* to the studios as negotiating on behalf of DCN as the integrator, in order

to boost the value of DCN, when in fact he was negotiating for ICAA.

4. Omnilab was “on the sidelines” and couldn’t possibly have known that ICAA might not be in control of the negotiations.

5. DCN was too small to become the integrator, it did not have that capacity.

Omnilab’s case is supported by the existence of an agreement between Michael Smith of *MGS*, not DCN, and ICAA in which he undertakes to represent ICAA members in the negotiations.

The problem of Michael Smith

Central to the case is the question of just who Michael Smith was representing when he negotiated with the studios.

The trial judge found that on the documentary evidence, he was representing DCN. He told the studios he was representing DCN, that’s who he was representing.

On the evidence presented, his own lawyer, Mr Crennan, agreed that he had misrepresented himself, and Justice Rares concluded that: “Mr Smith does not come out of this as a person that you would like to do all these deals with.”

The problem for ICAA

DCN argues that ICAA couldn’t possibly own the contracts, as the studios would only negotiate with a “deployment entity”. ICAA never intended to become a deployment entity. ICAA counters by arguing that the contracts required a guarantor – ICAA’s role.

In any event, having dealt itself into the negotiations in order to obtain a good deal on the VPF subsidies with a single integrator (Omnilab) providing services to independent members, ICAA now finds itself with stalled Omnilab negotiations and an approaching deadline after which the studios will no longer sign new VPF agreements.

Worse still from ICAA’s point of view, not only did their chosen negotiator prove a very frail vessel indeed, Edge Digital Cinema, is also talking with the studios with the aim of becoming an integrator. Edge is owned by Amalgamated Holdings Limited, which also owns Greater Union, a major competitor for independent cinemas. That deal is rumoured to be far less lucrative for the independents than the one being negotiated by DCN / Michael Smith.

Justices Jacobson, Rares and Besanko reserved their judgement.

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