

***In Re Loral Space and
Communications Inc.
Consolidated Litigation***

Presentation by David S. Wolpa



In Re Loral

- Synopsis:
Plaintiff minority shareholders in Loral Space and Communications, Inc. filed suit alleging that the terms of a \$300 million equity investment by Loral's controlling shareholder into Loral was an unfair conflicted transaction
- Holding:
The financing deal was unfair to the corporation—the terms of the deal were completely rewritten
- Decided:
September 19, 2008

Discussion

- Parties
- Narrative of the Financing Deal
- Legal Analysis – Entire Fairness
 - Fair Dealing
 - Fair Price
- Remedy
- Implications for Transactional Lawyers

Key Parties

1. Loral Space and Communications Inc. (Loral)
2. MHR Fund Management LLC (MHR)
3. Special Committee
4. Morgan Stanley—Loral's financial advisor
5. Goldman Sachs—unsolicited bidder
6. North Point—Special Committee's financial advisor
7. Deutsche Bank—MHR's financial advisor

Loral

- Satellite company
- Emerged from 2006 bankruptcy
 - Had institutional shareholder base of former creditors, the largest of which was MHR
- Capital Shortage
 - Needed capital to grow
 - Needed capital to acquire Telesat, another satellite company

MHR

- New York-based investment firm
- Owned 35.9% of Loral's common stock
- Controlled Loral's Board
 - Three agents on Board, including MHR founder Mark Rachesky, the Board's chairman
 - Two other Board members were "Selected Investment Advisors" to MHR
 - ❖ One of them, Targoff, worked rent-free in MHR's offices in exchange for investment advice
 - ❖ Targoff later became CEO of Loral

Special Committee

- CEO Targoff and Board decided company needs \$300 million
- Special Committee charged with evaluating and negotiating proposed financing **FROM MHR**
 - Board did not consider other financing sources
 - Only two people appointed to Special Committee

Special Committee's Two Members

- John Harkey
 - Chairman Rachesky's long-time friend and classmate
 - Harkey and Rachesky serve as business resources and references to each other
 - Pursued other business opportunities with MHR during deal process
- Arthur Simon
 - Accountant, retired since 1994
 - Previous Loral Director and on Board of a Loral spin-off
 - Not energetic

Other Parties

- Morgan Stanley
 - Loral's long-time financial advisor
 - Proposed alternative to deal early in the process but is ignored
- Goldman Sachs
 - Expressed interest in making investment—unsolicited
 - Rebuffed by Special Committee

Narrow focus of Special Committee

- Deal only with MHR to get \$300 million
- Court:
“[M]ost dangerous path for anyone dealing with a controlling stockholder – that of believing that its only option was to deal with the controller.”
- Morgan Stanley proposed alternative
 - Special Committee rejected it
- MHR refused to backstop public offering or make less than 100% of any new equity investment in Loral

Special Committee's Flawed Process

May 23: North Point Advisors LLC chosen as financial advisor to counter MHR's Deutsche Bank

- No experience with satellite industry
- No experience with type of convertible preferred equity investments

May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb
2006								2007	

Special Committee's Flawed Process

June 4: North Point recommended MHR investment to Special Committee

- Did not conduct market check
- *Revlon* issue was skirted: the deal was structured so as to avoid giving clear affirmative majority control to MHR, but left MHR with negative control over Loral so market would see it as controlled and insulated from market for corporate control
- Thus, no need to shop the company, even though M&A market booming

May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb
2006								2007	

Special Committee's Flawed Process

June 7: Primary economic terms agreed to



Terms of SPA finalized and signed in **October**

- \$300 million in Convertible Preferred Stock to be issued to MHR
 - 7.5% dividends to be paid in kind with securities
 - 12% conversion premium
- Issued in two series: one convertible to voting stock, one to non-voting stock
- Change of control provision generous to MHR
- Broad class voting and consent rights gave MHR veto power over Loral
 - Loral outside counsel: “not sure [he could] ever give a legal opinion that any action is duly authorized”
- MHR given right to nominate director for new Board slot

May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb
2006								2007	

The Four-Month Delay

- Opportunity to reconsider singular focus on MHR as only source of funds
- “Time pressure” gone
- Special Committee
 - Never performed market check of financing alternatives – relied on Deutsche Bank and Morgan Stanley
 - Rebuffed Goldman Sachs
 - Did not explore idea that Loral’s other institutional investors could provide financing, or backstop an offering
 - Never pushed MHR to consider backstopping a public offering, either on own or with large investment banks

May	Jun	<i>Four-month delay</i>	Oct	Nov	Dec	Jan	Feb
2006						2007	

Closing Process and Final Changes to Deal

- Special Committee minimally involved
- CEO Targoff led negotiations for Loral
- Problems with Special Committee's involvement
 - Harkey
 - ❖ Undercut Loral's negotiating position
 - ❖ Disclosed internal communications to MHR containing "fall-back" negotiating positions
 - ❖ Personally sought MHR investments for own deals
 - Simon
 - ❖ Deferred to other interested parties
 - ❖ Perplexed, left out of the loop
 - ❖ Out of reach for long period of time
- Targoff also solicited an investment from Rachesky and Harkey for another unrelated matter

Shareholder Outrage

- Announcement of financing drew protests from other shareholders
- Special Committee suspended recommendation to consider alternatives
- MHR proposed changes to the deal, but then retracted proposal
- Telesat deal went through
- Special Committee then essentially stops considering alternatives or changes to deal
- **February 2007:** Loral completed MHR Financing
- Minority shareholders filed this suit



Legal Analysis: Entire Fairness Standard Applies

- Whether Board satisfied its fiduciary duties where a controlling shareholder stands on both sides of the transaction is tested by entire fairness standard
- MHR was a controlling shareholder
 - Had 35% of Loral's voting stock
 - Directly controlled three of Loral's eight directors
 - Two other directors had relationships with Rachesky and MHR
 - MHR publicly declared that it controlled Loral
- Burden on MHR to prove entire fairness
- Two factors to consider
 - Fair dealing
 - Fair price

Fair Dealing Analysis

- Did the Special Committee function as an effective proxy for arms-length bargaining, such that a fair outcome equivalent to a market-tested ideal resulted?
- Did it function in a way that indicated that the controlling shareholder did not dictate the terms of the transaction, but instead the committee exercised real bargaining power?

Court's Fair Dealing Conclusion

- Special Committee did not act as it should have for FOUR reasons
 1. Composition of the Committee Flawed
 2. Poor Choice of Financial Advisor
 3. Special Committee's Narrow Mandate
 4. Special Committee's Timid Approach

Reason #1: Composition of the Committee Flawed

- Harkey
 - Too close a friend with Rachesky and MHR to push back hard
 - Had other business relationships with MHR and Rachesky
 - Forwarded internal communications to MHR
- Simon
 - “[B]rought the scientific concept of inertia to the Special Committee by generally remaining at rest until set into motion by the Committee’s advisors”
 - Passive, confused and otherwise disinclined to get a better deal for Loral

Reason #2: Poor Choice of Financial Advisor

- North Point was “outgunned and outwitted”
 - Unfamiliar with convertible securities, promised to but did not work with expert on deal
 - Advised the Special Committee to agree to the basic economic terms of the MHR deal WITHOUT doing a market check and only 11 days after being hired
 - Largely inactive after this advice
- North Point more interested in making MHR deal appear fairer rather than being objective
 - Email from North Point principal:
“[W]e need to make this appear to be more fair”

Reason #2 continued: Poor Choice of Financial Advisor

- Ineffectiveness of North Point NOT overcome by presence of transactional lawyers with a large strategic view of their role as counsel
- Special Committee represented by technically effective counsel from well-respected firm BUT the lawyers did not help the committee overcome its lack of strategic thinking, nor North Point's
- Lawyers showed no initiative

Reason #3: Special Committee's Narrow Mandate

- To get \$300 million in equity quickly
- Never considered sale of whole company or creating bidding war
- Only managed the *Revlon* implications of such a sale so as to avoid shopping the company
- Believed it could not explore other options because of time pressure
- Even when it had four extra months, did not explore market
- Rigidly stuck to \$300 million figure
 - Did not consider obtaining \$300 million from multiple sources
 - Did not ask why \$300 million – the amount that MHR wanted to invest!

Reason #4: Special Committee's Timid Approach

- Did not take advantage of opportunities to get better terms
- Did not explore alternatives even when pace of MHR deal slowed considerably
- Did not question \$300 million figure
- Did not question mandate that precluded alternatives to MHR financing
- In the end, CEO Targoff became a more aggressive negotiator than the Special Committee
- Did not explore alternatives even after Loral's other shareholders objected

Fair Price

- 7.5% dividend > median 5% of identified comparable
- 12% conversion premium < median 19.8% of identified comparables
- Court rejected MHR contention that generous terms were appropriate because it alone was solely taking on the risk
 - MHR **INSISTED** that it alone invest \$300 and take on the whole risk
 - MHR knew Loral had positive growth prospects (Telesat acquisition)
- MHR obtained a placement fee of \$6.75 million but MHR “placed” with themselves
- Class voting rights that gave MHR “an iron grip on Loral and the ability to extract a control premium for itself in any future Change of Control” were atypical because of their broad and expansive nature
- Conclusion: MHR received unfairly advantageous terms from Loral

Remedy

- Key Problem: Loral should have sought out the best price and compensation for the additional control rights it was conferring on MHR
- Court reformed Securities Purchase Agreement
 - Convertible Preferred Stock changed to non-voting common stock
 - Court determined value by giving half-weight to MHR's per-share value of Loral, and half weight to Loral shares' trading price
- MHR will hold 57% of total equity of Loral, but remain at its former level of voting power (35.9%)
 - MHR has substantial value, but not unilateral veto power over any major decision of the Loral Board
 - Loral not left saddled with unwieldy capital structure
- Struck placement fee of \$6.75 million

Implications – Importance of Process

- Special Committee composition
 - Need independent, active individuals
- Competent financial advisor
 - Must perform market check
- Special Committee's mandate cannot be so narrow as to rule out other options
- Special Committee must be energetic in its negotiating
- Be aware of broad powers of Delaware Chancery Court to re-write deal

Thank you

This presentation has been prepared by Bell, Boyd & Lloyd for clients and friends of the firm and is for information only. It is not a substitute for legal advice or individual analysis of a particular legal matter. Readers should not act without seeking professional legal counsel. Transmission and receipt of this publication does not create an attorney-client relationship.

BELL BOYD
BELL, BOYD & LLOYD LLP

70 West Madison Street
Chicago, Illinois 60602
t. 312-372-1121

3580 Carmel Mountain Road
San Diego, California 92130
t. 858-509-7400

1615 L Street, N.W.
Washington, D.C. 20036
t. 202-466-6300