

Hearing Date:
March 24, 2005 at 10:30 a.m.
Objection Deadline:
March 17, 2005 at 4:00 p.m.
PORTLAND

**UNITED STATES BANKRUPTCY COURT
DISTRICT OF MAINE**

In re:	:	Chapter 11
	:	
PEGASUS SATELLITE	:	Case No. 04-20878
TELEVISION, INC., et al.,	:	
	:	(Jointly Administered)
Debtors.	:	

**OBJECTION OF AD HOC COMMITTEE OF PSC NOTEHOLDERS
TO CONFIRMATION OF DEBTORS' FIRST AMENDED JOINT CHAPTER 11 PLAN**

The Ad Hoc Noteholders Committee of Pegasus Satellite Communications, Inc. (the "Ad Hoc Noteholders Committee") hereby submits the following objection to the confirmation of the Debtors' First Amended Joint Chapter 11 Plan of Pegasus Satellite Television, Inc. and its subsidiaries and certain of its affiliates (the "Plan"), each a debtor and debtor-in-possession herein (collectively, the "Debtors")¹ (the "Objection"), and respectfully states as follows:²

1 The Debtors are: Argos Support Services Company, Bride Communications, Inc., B.T. Satellite, Inc., Carr Rural TV, Inc., DBS Tele-Venture, Inc., Digital Television Services of Indiana, LLC, DTS Management, LLC, Golden Sky DBS, Inc., Golden Sky Holdings, Inc., Golden Sky Systems, Inc., Henry County MRTV, Inc., HMW, Inc., Pegasus Broadcast Associates, L.P., Pegasus Broadcast Television, Inc., Pegasus Broadcast Towers, Inc., Pegasus Media & Communications, Inc., Pegasus Satellite Communications, Inc., Pegasus Satellite Television of Illinois, Inc., Pegasus Satellite Television, Inc., Portland Broadcasting, Inc., Primewatch, Inc., PST Holdings, Inc., South Plains DBS, LP., Telecast of Florida, Inc., WDSI License Corp., WILF, Inc., WOLF License Corp., and WTLH License Corp.

2 As used herein, defined terms shall have the same meanings as set forth in the Debtors' First Amended Joint Chapter 11 Plan, dated January 31, 2005.

PRELIMINARY STATEMENT

1. This Objection to the Debtors' Plan is prompted by grave concerns regarding the dissipation of the Debtors' assets. The Ad Hoc Noteholders Committee, whose members are holders of claims that will be paid from the Debtors' Remaining Assets, seek to protect and preserve the ability of the Liquidating Trustee to be appointed under the Plan to maximize the value of the recovery for the holders of such claims by preserving the ability of the Liquidating Trustee to analyze the allocation of certain expenses between and among the Debtors and non-debtor affiliates, to audit the Debtors' monthly operating reports, to prosecute any potential claims revealed by such analysis or audit, and to pursue other claims on behalf of the Noteholders. To the extent that the Plan releases or otherwise impedes the ability of the Liquidating Trustee to pursue such claims, the Ad Hoc Noteholders Committee submits that the Plan is unconfirmable absent modification.

2. Additionally, the Plan impermissibly provides for releases of third-party claims against non-debtors. Therefore, the Plan is fatally flawed and should not be confirmed.

3. Finally, the Ad Hoc Noteholders Committee seeks to preserve the assets to be transferred to the Litigation Trust by requiring the Debtors to obtain the consent of the Creditors' Committee prior to any payment or transfer by any or all of the Debtors of an amount greater than \$250,000.00 in the aggregate to any party during the time period from the Confirmation Date to the Effective Date of the Plan.

BACKGROUND

4. On June 2, 2004 (the "Petition Date"), the Debtors filed petitions for relief under chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the District of Maine (the "Court"). On June 4, 2004, the Court entered an order directing joint administration of the Debtors' cases for procedural purposes only.

5. The Debtors have continued in possession of their respective properties and have continued to operate their businesses as debtors in possession pursuant to Sections 1107(a) and 1108 of the Bankruptcy Code.

6. No request has been made for the appointment of a trustee or examiner. On June 10, 2004, the United States Trustee for the District of Maine (the “U.S. Trustee”) appointed a six member committee to represent the interests of unsecured creditors of the Debtors pursuant to Section 1102(a)(1) of the Bankruptcy Code (the “Creditors’ Committee”). Since that date, certain members of the Creditors’ Committee have resigned and new members have been appointed.

7. Debtor Pegasus Satellite Communications, Inc. (“PSC”) is a holding company and the direct or indirect parent company of each of the other Debtors and a direct wholly-owned subsidiary of Pegasus Communications Corporation (“PCC”), a non-debtor Delaware corporation that is a publicly listed company (NASDAQ: PGTV). *See* Affidavit of Ted S. Lodge in Support of First Day Motions, dated June 2, 2004 (“Lodge Aff.”), ¶¶ 1 & 10. As of the Petition Date, PSC had issued and had six outstanding series of unsecured notes with varying interest rates and maturities and with principal balances in the aggregate amount of \$899,086,000 plus accrued interest in the amount of \$35,380,801. *See* First Amended Disclosure Statement for Debtors’ First Amended Joint Chapter 11 Plan, dated January 31, 2005 (hereinafter “Disc. Stat.”), at 14. The members of the Ad Hoc Noteholders Committee hold a large portion of these notes.

8. Debtor Pegasus Media & Communications, Inc., a Delaware corporation (“PMC”), is a direct wholly-owned subsidiary of PSC. PMC is a holding company that owns, directly or indirectly, the remaining Debtors. *See id.* Prior to the commencement of these chapter 11 cases, PMC conducted (a) direct broadcast satellite operations through Debtor Pegasus Satellite Television, Inc., a Delaware corporation (“PST”), and other subsidiaries

owned, directly or indirectly, by PST Holdings, Inc., a Delaware corporation (“PST Holdings” and collectively, the “PST Debtors”) and (b) television broadcasting operations through subsidiaries owned, directly or through its subsidiaries, by Debtor Pegasus Broadcast Television, Inc., a Pennsylvania corporation (“PBT” and collectively, the “PBT Debtors”). *See id.* at 10-11 & 14. As will be described in greater detail below, the Debtors’ direct broadcast satellite business was sold to DIRECTV, Inc. pursuant to an order of the Bankruptcy Court dated August 26, 2004 (the “Global Settlement Order”), for approximately \$938 million, subject to certain adjustments. *See id.* at 10-11. The PBT Debtors, however, still own and operate the television broadcast operations although efforts to sell these assets are on-going.

THE DEBTORS’ FIRST AMENDED PLAN OF REORGANIZATION

9. On January 31, 2005, the Debtors filed the Plan and the Disclosure Statement in connection with the solicitation of acceptances of this Plan. *See Disc. Stat.* at 1. Generally, the Plan provides for the transfer of the Debtors’ assets, including the cash proceeds of the sale of the Debtors’ satellite business, and, potentially, proceeds of a sale of the Debtors’ broadcast television business, into a Liquidating Trust charged with resolving claims and making distributions on account thereof. *See id.* On February 9, 2004, the Court entered an order approving the Disclosure Statement, as modified on the record, and set a hearing on the confirmation of the Plan for March 24, 2005.

10. Pursuant to the Plan, either prior to or upon confirmation, certain of the Debtors will be divided and substantively consolidated, leaving four separate entities: (1) PSC; (2) PMC; (3) the PBT Debtors; and (4) the PST Debtors. *See Plan* at § 5.1. On the Effective Date, all intercompany claims between and among the various Debtors and Debtor entities will be eliminated. *See id.* at § 5.1(c).

11. As discussed above, the Plan provides for the establishment of a Liquidating Trust on the Plan’s Effective Date to be administered by the Liquidating Trustee

appointed by the Creditors' Committee. *See Plan* at § 5.4(e). Under the Plan, Holders of Allowed Class 3A Claims, which consists of the claims held by the general unsecured creditors of PSC, including the Noteholders, will receive a pro rata share of the Liquidating Trust or such other treatment as may be agreed to by the Holder thereof. *See id.* at § 4.3(a). According to the Debtors' Disclosure Statement, it is anticipated that Holders of Allowed Class 3A Claims will only be paid 56-60% on account of their claims, *see Disc. Stat.* at 5-6, while claims of the general unsecured creditors of PMC, the PBT Debtors, and the PST Debtors (*i.e.*, Classes 3B, 3C, and 3D) will be paid in full in cash on the Effective Date or as soon as practicable thereafter. *See Plan* at § 4.3(b).

12. Upon the Effective Date, the Remaining Assets held by the Debtors will be transferred to the Liquidating Trust and/or the Reserves. *See Plan* at §§ 5.4(c). Holders of Allowed Class 3B, 3C, and 3D claims, to the extent that any such claims exist, will be paid in full, while Holders of Allowed Class 3A Claims will receive notification of the number of Liquidating Trust Interests to be allocated to the Holder. *See id.* at §§ 5.4(c) & 5.4(d). The Remaining Assets to be transferred to the Liquidating Trust are "all right, title and interest of the Debtors in and to all assets, properties, interests and rights of whatever kind and nature, whether real or personal, tangible or intangible, including, but not limited to, all of the shares of Class A Common Stock of PCC owned by the Debtors, not sold in a Broadcast Sale or a Satellite Sale, or not otherwise abandoned pursuant to section 554(a) of the Bankruptcy Code." *See Plan* at § 1.102. On the Initial Distribution Date and on each Distribution Date thereafter each Holder of an Allowed Class 3A Claim shall receive its pro rata share of Liquidating Trust Interests, all Liquidating Trust Assets that are or have been converted to Cash less all amounts held in the Reserves (the "Liquidating Trust Available Cash"), and/or such other Distributions as made by the Liquidating Trustee in respect of Allowed Class 3A Claims. *See id.* at § 4.3(a).

13. Based upon the proposed Plan structure, general unsecured creditors of PSC, such as the Noteholders, have a remainder interest in all assets of the other Debtor entities

and will be directly and substantially harmed by the dissipation of, or inability to recover, any assets in which the Debtors held an interest.

14. Among the Liquidating Trustee's responsibilities under the Plan are: (a) the winding-down of the Debtors' affairs; (b) the maximization of the value of the recovery for Holders of Allowed Claims in Class 3A that receive Liquidating Trust Interests pursuant to the Plan (i.e., PSC's unsecured creditors); and (c) the administering of the Plan. *See id.* at § 5.4(f).

15. The Liquidating Trustee is also charged with the investigation, enforcement, and prosecution of "all Avoidance Actions, and any other claims or causes of action held by the Debtors and not released pursuant to the Global Settlement Order or, to the extent applicable, pursuant to the Broadcast Order (defined as the "Litigation Claims" under the Plan). *See id.* at §§ 1.79 & 5.4(f). The term "Avoidance Actions" is defined by the Plan as "any actions or proceedings that may be instituted for the recovery of property pursuant to chapter 5 of the Bankruptcy Code (e.g., 11 U.S.C. §§ 542, 544, 547, 548, 549, 550 or 553) or applicable state law." *See id.* at § 1.12.

16. The Plan provides that on the Effective Date the Debtors shall transfer the Litigation Claims to the Liquidating Trust "[e]xcept as otherwise provided in this Plan, the Confirmation Order, a PCC Court Approved Bid or the Alternate Court Approved Bid, as and to the extent applicable, or in any document, instrument, release or other agreement entered into in connection with this Plan, in accordance with section 1123(b) of the Bankruptcy Code." *See id.* at § 5.7. Pursuant to the Plan, only the Liquidating Trustee, as the successor in interest to the Debtors, may enforce, sue on, settle or compromise (or decline to do any of the foregoing) any or all of the Litigation Claims. *See id.* Thus, the Liquidating Trustee will have the authority to pursue claims against third parties not otherwise released.

CONCERNS RELATING TO DEBTORS' FINANCIAL AFFAIRS

17. The Ad Hoc Noteholders Committee submits that there are numerous issues that require an investigation by the Liquidating Trustee in order appropriately wind-down the Debtors' affairs, maximize the value of the assets to be transferred to the Liquidating Trust and to maximize the recovery for PSC's unsecured creditors. Principal among these concerns is the rapid deterioration of the Debtors' available cash subsequent to the sale of the Debtors' direct broadcast satellite business in August 2004. In particular, according to a tortured analysis of the monthly operating reports filed with the U.S. Trustee, as of September 2004, the Debtors appear to be reporting cash totaling \$458 million amongst the four debtor groupings covered by the reports. An analysis of the monthly operating reports filed with the U.S. Trustee, the Debtors' aggregate cash as of January 31, 2005 was \$423 million. No satisfactory explanation has been provided for this drastic decline, especially in light of the fact that there has been no real change in the status of operations and the bankruptcy since the sale of the direct broadcast services operation in August.

18. A related issue of concern is the propriety of payments made by the Debtors to their non-debtor affiliates, particularly payments for certain support services provided by Pegasus Communications Management Company ("PCMC"). As part of its first day motions, the Debtors sought approval of a Support Services Agreement between the Debtors, their non-debtor affiliates, and PCMC pertaining to the provision of various support services by PCMC to the Debtors and the non-debtor affiliates (the "Operating Affiliates"). *See* Motion of the Debtors and Debtors in Possession Pursuant to 11 U.S.C. § 363 for Interim and Final Orders Authorizing the Debtors to Continue Performing Under the Support Services Agreement with Pegasus Communications Management Company, dated June 2, 2004 (the "Support Svcs. Ag. Motion").

19. The Support Services Motion provided that the compensation due to PCMC for such services was to be based upon the actual cost (including direct and indirect costs)

to PCMC for the provision of same. *See id.* at ¶ 13. According to the Motion, “the amount PCMC charges the Operating Affiliates for the Support Services is to be based upon an estimate of the level of effort devoted by PCMC to each of the Operating Affiliates, including: (i) the cost of compensation of each Operating Affiliate compared to total cost of compensation of all Operating Affiliates; (ii) the net assets employed by each Operating Affiliate compared to total net assets of all Operating Affiliates; (iii) the net revenue generated by each Operating Affiliate compared to total net revenue generated by all Operating Affiliates; or (iv) other similar allocation methods.” *See id.* (citing to Support Services Agreement, Attachment B). Attachment B to the Support Services Agreement merely states that the allocation among Operating Affiliates “may” be upon the same criteria detailed in the Motion.³

20. In the Support Services Agreement Motion, the Debtors attempted to further clarify the method for allocating the cost of support services and stated that:

More specifically, the methodology for allocating PCMC’s costs for the Support Services under the Agreement may be broken down into two tiers. The first [sic] tier is allocated based upon aggregate salaries for employees (excluding PCMC employees) as follows: (i) 7% to Pegasus Communications Corporation (“PCC”) based upon aggregate salaries for employees of Pegasus Development Corporation and its WiBand division, and (ii) 93% to PSC and its subsidiaries based upon aggregate salaries for the employees of PST and Pegasus Broadcast Television, Inc. Under the second tier, the Debtors further allocate the 93% allocated to PSC under the first tier to the Debtors based upon net revenue as follows: (i) 97% is allocated to the Debtors’ Satellite division, and (ii) 3% is allocated to the Debtors’ Broadcast division.

See Support Svcs. Ag. Motion, ¶ 14.

³ In the Motion, the Debtors also sought approval to compensate PCMC for certain support services charges which were to be based upon each Operating Affiliate’s (including the Debtors) share of actual costs (including direct and indirect costs) incurred by PCMC in the performance of such services. *See id.* at ¶ 17 (citing to Support Services Agreement, Attachment B).

21. The Support Services Agreement Motion fails to substantiate the propriety of the 93%/7% split in the “first tier” of the allocation. Moreover, the Order entered on July 22, 2004, granting the Motion (the “Support Services Order”) makes no reference to the method to be used to determine the allocation among Debtor and non-debtor entities. At a June 4, 2004 hearing on the Debtors’ first-day motions, including the Support Services Agreement Motion, the Debtors noted that there were three different methodologies that could be employed for allocating the costs incurred in providing support services and that between the non-debtors and the Debtors in this case, the employee compensation method had been employed. *See Transcript of June 4, 2004 Hearing*, p. 52. According to the Debtors, “[t]he application of that formula allocates the expenses on a 93 percent basis to the debtor entities and a 7 percent basis to the non-debtor entities.” *See id.* The Debtor further advised that “[w]e are happy and intend to sit down with our committees and lenders and walk through exactly how the company performs these allocations, the methodology and the rationale for that.” *See id.*

22. The Support Services Order recognized concerns with the Agreement and required PCMC to provide a cash flow statement listing all relevant receipts received and disbursements made by PCMC for the immediately preceding week to counsel for certain creditors and creditors’ representatives. *See Support Svcs. Order*, at 2-3. The Order also reserved the rights of the Creditors’ Committee to object to any receipts and disbursements reflected on a weekly cash flow statement of PCMC, which they believe are unreasonable or improper. *See id.* at 3. The Ad Hoc Noteholders Committee believes that no objections ever occurred and that the oversight of these payments and disbursements may have been inadequate. In light of such deficiencies, the Ad Hoc Noteholders Committee submits that the rights of the Creditors’ Committee under the Support Services Order must be assigned to the Liquidating Trustee so that a proper analysis of the payments and disbursements can be conducted.

**RELEASES RELATING TO THE SALE
OF THE DEBTORS' SATELLITE TV BUSINESS**

23. While the Plan grants the Liquidating Trustee the power to pursue the Litigation Claims on behalf of the Liquidating Trust, the ability to pursue such actions is circumscribed by releases of potential causes of action in the Plan and “pursuant to the Global Settlement Order or, to the extent applicable, pursuant to the Broadcast Order.” *See Plan* at §§ 1.79 (defining “Litigation Claims”). Additionally, the Plan explicitly provides that it shall not conflict with or derogate from the provisions of certain agreements relating to the Debtors’ sale of its direct broadcast satellite business, including “(a) the Global Settlement Order, (b) the Global Settlement Agreement, (c) the Asset Purchase Agreement, [and] (d) the Cooperation Agreement” *See Plan* at § 11.9.

24. The agreements listed in section 11.9 of the Plan were entered into by the Debtors, PCC (on its own behalf and on behalf of its direct and indirect subsidiaries, other than the Debtors, collectively, “Pegasus Non-Debtors”), the National Rural Telecommunications Cooperative (the “NRTC”), DIRECTV, Inc. (“DIRECTV”), the Creditors’ Committee, and certain members of the Creditors’ Committee. On or about August 3, 2004, the Debtors sought approval of these agreements and filed a Motion for Entry of an Order Pursuant to 11 U.S.C. §§ 105(a), 363 and 1146(c) and Bankruptcy Rule 9019 (I) Approving Global Settlement by and Among the Debtors and Debtors In Possession, Pegasus Communications Corporation and Other Non-Debtor Affiliates, DIRECTV, Inc., The DIRECTVGroup, Inc., National Rural Telecommunications Cooperative, and The Official Committee of Unsecured Creditors, and (II) Authorizing And Approving in Connection Therewith a Sale, Transfer and Conveyance of Certain Assets of the Debtors to DIRECTV, Inc. (“DIRECTV”), dated August 3, 2004 (the “Settlement Motion”). On August 26, 2004, the Court approved the Settlement Motion, including the Global Settlement Agreement, the Asset Purchase Agreement, and the Cooperation Agreement.

25. The Settlement Motion agreements provided for, among other things: (1) the sale of substantially all of the Debtors' satellite assets to DIRECTV, Inc., for a purchase price of approximately \$938 million, subject to certain adjustments (the "Asset Purchase Agreement")⁴; (2) a global settlement agreement under which pending litigation would be dismissed and the parties would provide certain mutual releases (the "Global Settlement Agreement"); (3) an agreement between the Debtors and DIRECTV to provide, among other things, for the continued operation of the Debtors' satellite assets until the consummation of the asset sale, and an undefined period following such sale (the "Cooperation Agreement"); and (4) an agreement between the Pegasus Non-Debtors and the Creditors' Committee providing, among other things, an outline for a potential sale of the Debtors' broadcast assets (the "Letter Agreement") (collectively, the "Agreements"). See Disc. Stat. at 21-22.

26. Under the Global Settlement Agreement, the Debtors released "the Pegasus Non-Debtors and their legal representatives, successors and assigns, the respective present and former directors and officers of the Pegasus Debtors and the Pegasus Non-Debtors, the respective present and former members, partners, trustees, shareholders, employees, agents, representatives and advisors of the Pegasus Non-Debtors and the respective heirs, executors, administrators, legal representatives, successors and assigns of each of the foregoing, solely in their capacities as such (collectively, the 'Pegasus Non-Debtor Released Parties')" from all claims "against the Pegasus Non-Debtor Released Parties or any of them, singly or in any combination, on account of, arising out of, or in connection with, any thing, cause, matter, transaction, act or omission of any nature whatsoever" occurring from "the beginning of the world" through the effective date of the Global Settlement Agreement. See Global Settlement Ag., § 3.e. The effective date of the Global Settlement Agreement was August 27, 2004, the

⁴ Subsequent to their receipt of the purchase price, the Debtors obtained approval of the Court to pay certain prepetition Secured Lenders \$519,539,668.80 for principal and non-default accrued interest due under the Debtors' prepetition term loan documents and \$11,326,068.99 to settle the settlement claims of certain Secured Lenders for prepayment premiums. See Disc. Stat. at 26-27.

proximate date that the sale of the Debtors' satellite business closed. *See id.* at § 5.a.; Disc. Stat. at 23.

27. In the Settlement Motion, the Debtors justified extending the releases by the Debtors and the Releasing Members to the Debtors' own directors and officers because the Debtors' officers and directors "overlap substantially with the directors and officers of the Pegasus Non-Debtors" and "the Pegasus Non-Debtors' directors and officers would not receive a meaningful release unless they are also released in their capacity as directors and officers of the Debtors." Settlement Motion, at 17.

28. The Global Settlement Agreement specifically did not release the Debtors' claims under the Support Services Agreement against the Pegasus Non-Debtor Released Parties. *See id.* at § 3.i.6. With respect to the Support Services Agreement, the Global Settlement Agreement further stated that "it is understood that the releases granted by the Pegasus Debtors in Section 3.e and the releases granted by the Releasing Members in Section 3.f shall not affect the rights of Creditors' Committee expressly provided in the order of the Bankruptcy Court dated July 22, 2004 approving the Support Services Agreement, as such rights have been modified by Section 5.d." *See id.* at § 3.i.6.

RELEASE PROVISIONS OF THE FIRST AMENDED PLAN OF REORGANIZATION

29. While the Settlement Motion did not release the Debtors' claims and causes of action relating to the Support Services Agreement and those accruing after the effective date of the Global Settlement Agreement, the broad releases contained in the Plan will have a material and adverse effect on the ability of the Liquidating Trustee to prosecute such claims and causes of action.

30. For example, section 11.6 of the Plan provides the following releases:

Except as may be provided in this Plan or the Global Settlement Order, as of the Confirmation Date, but subject to the occurrence of the Effective Date, none of: (I) the Liquidating Trustee, the Debtors, the Reorganized Debtors, their successors and assigns; (II) their present directors and officers; (III) their former directors and officers who held such position with the Debtors as of or since the Petition Date; (IV) agents, attorneys, advisors, financial advisors, investment bankers and employees of the Debtors; (V) the Indenture Trustees; and (VI) the Creditors' Committee, its current and former members, agents, attorneys, advisors, financial advisors and investment bankers, shall have or incur any liability to any person for any claim, obligation, right, cause of action or liability (including, but not limited to, any claims arising out of any alleged fiduciary or other duty and the avoidance of preferences or fraudulent conveyances or any guaranty issued by any of the debtors), whether known or unknown, foreseen or unforeseen, existing or hereafter arising, based in whole or in part on any act or omission, transaction or occurrence from the beginning of time through the Effective Date in any way relating to the Debtors; and all claims based upon or arising out of such actions or omissions shall be forever waived and released; provided, however, that this section shall have no effect on the liability of any person that otherwise would result from any action or omission to the extent that such action or omission is determined in a final order to have constituted willful misconduct.

The release described in clauses (I) solely to the extent PCC is deemed to be a successor or assign thereunder, (II) and (III) of the preceding paragraph of this section 11.6 shall not be enforceable against any holder of a claim or interest that is not receiving distributions under this plan. Claimants of the Debtors shall be enjoined from commencing or continuing any action, employment of process or act to collect, offset or recover any claim that is released as provided herein.⁵

⁵ The Plan was amended to provide the exception set forth in the second paragraph of section 11.6 as part of a resolution reached by the Debtors with Par Capital Management, Inc. and Par Investment Partners, L.P. (collectively, "Par Capital") and HSBC Bank USA, National Association, as Indenture Trustee ("HSBC") in response to an objection to the Disclosure Statement filed by Par Capital and HSBC. See Transcript of February 9, 2005 Hearing, p. 9, l. 21 - p. 10, l. 19. The Debtors have failed to elucidate any reason why the claims of a creditor not receiving a distribution under the Plan should not be released while the claims of a creditor receiving a distribution should be.

31. The Debtors also seek to limit the liability of certain parties with respect to Chapter 11 Activities as follows:

None of the Debtors, the Reorganized Debtors, the Liquidating Trustee, the Indenture Trustees, the Creditors' Committee, or their respective officers, directors, managers, employees, current or former members or agents (each acting in such capacity), or any professional persons employed by any of them will have or incur any liability to any person for any action taken or omitted to be taken in connection with or related to the formulation, preparation, dissemination, implementation, confirmation, or consummation of this Plan, the Disclosure Statement, any contract, release, or other agreement or document created or entered into, or any other action taken or omitted to be taken in connection with this plan or the chapter 11 cases, and all claims based upon or arising out of such actions or omissions will be forever waived and released; provided, however, that nothing herein shall affect the liability of any person that otherwise would result from any action or omission to the extent that such action or omission is determined in a final order to have constituted willful misconduct or gross negligence.

Plan at § 11.10.

32. In the Disclosure Statement, the Debtors justify the releasing of claims against the officers, directors and employees of the Debtors and the professionals retained by them (the "Releasees") because the Releasees "elected to continue to serve the Debtors and their creditors during these Chapter 11 Cases ...[and] made substantial contributions to the Chapter 11 Cases by steering the Debtors towards a reorganization supported by the Creditors' Committee. The Debtors also assert, without factual support, that the Releasees need "protection from specious lawsuits" and that "[f]ailing to grant the releases or exculpation described above would be inconsistent with the goals of maximizing value and equality of treatment for all similarly situated creditors." Disc. Stat. at 44.

RELIEF REQUESTED

33. The Ad Hoc Noteholders Committee seeks the entry of an order: (i) denying confirmation of the Plan absent modifications to the Plan preserving the ability of the

Liquidating Trustee to investigate and prosecute any and all claims (a) arising from the Support Services Agreement, including such rights to object to payments and disbursements held by the Creditors' Committee pursuant to the Support Services Order; (b) against non-debtor affiliates and the Debtors' present and former officers and directors that accrued subsequent to August 27, 2004; (c) against any parties relating to KB Prime Media transaction, including the purchase of the loan and entry and execution of the Option Agreement; and (d) relating to the underwriting of any or all of the Notes, and exempting all such claims from the release, indemnification, and exculpation provisions of the Plan; (ii) denying confirmation of the Plan unless the Plan is modified so as to remove the granting of any and all releases of third-party claims against non-debtors; and (iii) requiring, pursuant to Section 105(a) of the Bankruptcy Code, the Debtors to obtain the consent of the Creditors' Committee prior to any payment or transfer by any or all of the Debtors of an amount greater than \$250,000.00 in the aggregate to any party during the time period from the Confirmation Date to the Effective Date of the Plan.

ARGUMENT

I

THE LIQUIDATING TRUSTEE'S RIGHTS TO INVESTIGATE AND PROSECUTE CLAIMS MUST BE PRESERVED IN THE PLAN

34. Upon the sale of the Debtors' direct broadcast satellite business, the Debtors specifically retained the right to pursue claims based upon the Support Services Agreement and claims against non-debtor affiliates and directors and officers that accrued after the closing of the sale on August 27, 2004. The ability to preserve these claims must be preserved. The importance of preserving these claims has been magnified by the dissipation of the Debtors' cash subsequent to August 2004. During the time period from August 2004 to January 2005, the Debtors' aggregate cash has decreased by \$35 million despite the fact that the Debtors sold the majority of their operations in August 2004, and the remaining operating

business, i.e., the broadcast television stations, purportedly generate positive cash flow from operations.

35. The Debtors have failed to provide satisfactory explanations for the expenses recently incurred by the Debtors' estates or for the substantial decrease in the Debtors' available cash. Moreover, the ability to adequately review the Debtors' finances has been hampered by the fact that the Debtors' have been filing four consolidated operating reports for the twenty-eight Debtors. The lack of transparency, or ease of understanding, of financial information given by the Debtors publicly is particularly troubling when one considers that the Debtors' officers and directors substantially overlap with those of the non-debtor affiliates. *See Settlement Motion*, at 17.

36. Upon information and belief, Marshall W. Pagon is the sole director of the Debtors and a director of all non-debtor affiliates; further, upon information and belief, the officers for all of the Debtors and non-debtor affiliates are identical.

37. The Ad Hoc Noteholders Committee submits that a thorough investigation of, among other things, the Debtors' monthly operating reports and the transfers detailed therein as well as payments made pursuant to the Support Services Agreement must be conducted by an independent party such as the Liquidating Trustee. Moreover, the Liquidating Trustee must have the authority to pursue any and all claims that may be discovered against third parties, including the non-debtor affiliates and directors and officers.

38. With respect to the Support Services Agreement, a full investigation into the payments thereunder must also be performed to ensure that cash has not been unjustifiably withdrawn from the Debtors. Specifically, an inquiry into the method used to allocate charges between the Debtors and non-debtor affiliates is necessary to ensure that the Debtors were not disproportionately burdened or that an unfair or inappropriate allocation of expenses was used. While an allocation formula was discussed by the Debtors at the time of the Motion, the Support

Services Order did not require the Debtors and non-debtor affiliates to use the formula. Moreover, because the Support Service Motion was brought early in these cases, an in-depth analysis of the Debtors' methodology was difficult. Furthermore, because of the interrelated nature of the Debtors and non-debtor affiliates, an investigation should be conducted to determine whether, and to what extent, the services were actually provided to the Debtors.

39. The importance of preserving claims relating to the Support Services Agreement and the concerns inherent to the Agreement have been demonstrated throughout these chapter 11 cases. For example, the Support Services Order recognized concerns with the Agreement and required PCMC to provide cash flow statements and reserved the rights of certain creditors and creditor representatives to object to unreasonable or improper receipts and disbursements. *See* Support Svcs. Order, at 3. Additionally, the Global Settlement Agreement specifically excluded claims under the Support Services Agreement from the Debtors' release of their non-debtor affiliates and their directors and officers. *See* Global Settlement Ag., at § 3.i.6. There is no reason why these claims should not be preserved for the benefit of the Liquidating Trust on behalf of the unsecured creditors.

40. However, due to the proposed releases provided for in the Plan, these potential claims may be released before a complete vetting of the issues is conducted. In Section 11.6 of the Plan, the Debtors seek to release: (i) their successors and assigns; (ii) their present directors and officers; and (iii) their former directors and officers who held such position with the Debtors as of or since the Petition Date. To the extent that any of the non-debtor affiliates could be considered as successors or assigns to the Debtors, the provisions of section 11.6 would release the Debtors' claims against them. The Ad Hoc Noteholders Committee submits that this is a valid concern due to the potential sale of the Debtors' broadcast television business to PCC. Pursuant to such Sale, PCC could be deemed a successor of the Debtors. The Ad Hoc Noteholders Committee submits that the granting of a release under the Plan in such a manner would be improper and should be prohibited.

41. The Debtors have failed to provide an appropriate basis for releasing these claims. The standard for compromising claims in a plan is the same as the standard for approval of settlements under Bankruptcy Rule 9019. See *In re Cajun Elec. Power Coop., Inc.*, 230 B.R. 715, 751 n.101 (Bankr. M.D. La. 1999); *Connecticut Gen. Life Ins. Co. v. United Cos. Fin. Corp.* (*In re Foster Mortgage Corp.*), 68 F.3d 914, 917 (5th Cir. 1995). See, e.g., *In re Public Serv. Co.*, 114 B.R. 820, 826-27 (Bankr. D.N.H. 1990) (applying Rule 9019 factors to settlement included in plan of reorganization).

42. Pursuant to Rule 9019(a), the burden is on the proponent to demonstrate that the compromise or settlement is in the best interest of the estate and should therefore be approved. See *In re 110 Beaver St. P'ship*, 244 B.R. 185, 187 (Bankr. D. Mass. 2000); *In re C.P. del Caribe, Inc.*, 140 B.R. 320, 326 (Bankr. D.P.R.), *appeal withdrawn*, 143 B.R. 11 (Bankr. D.P.R. 1992); *In re Hydronic Enterprise, Inc.*, 58 B.R. 363, 365 (Bankr. D.R.I. 1986). Moreover, as debtors-in-possession, the Debtors have a duty to investigate the merits of these claims before compromising them. See *110 Beaver St. P'ship*, 244 B.R. at 192.

43. The Disclosure Statement and the Plan are devoid of any information about an investigation conducted into the loss of approximately \$35 million in cash subsequent to the closing of the sale of the Debtors' direct broadcast services business or the payments made pursuant to the Support Services Agreement. Furthermore, there is no indication that the parties being released have provided any consideration for the releases being granted. In light of the failure of the proponents of the Plan to investigate these issues and the overlap of the management of the Debtors and non-debtor affiliates, the Ad Hoc Noteholders Committee submits that these claims must be preserved so the Liquidating Trustee may investigate and prosecute any and all claims arising therefrom.

II

THE PLAN CANNOT BE CONFIRMED BECAUSE IT RELEASES THE CLAIMS OF THIRD PARTIES

44. The release of claims held by third parties as provided for under the Debtors' Plan make the Plan patently unconfirmable. Section 524(e) provides, in relevant part, that the "discharge of a debt of the debtor does not affect the liability of any other entity . . . for such debt." 11 U.S.C. § 524(e). While some courts have utilized Section 105(a) as a basis to grant third party releases, they have done so only in rare and extraordinary circumstances. Under the circumstances of this case, the proposed releases are impermissible under any standard.

45. The Ad Hoc Noteholders Committee submits that this Court should adopt the restrictive view of third party releases adopted by the Fifth, Ninth and Tenth Circuits. These courts have determined that Section 524(e) of the Bankruptcy Code discharges only the debtor and expressly precludes the discharge of liabilities of non-debtors. *See, e.g., Feld v. Zale Corp. (In re Zale Corp.)*, 62 F.3d 746, 761 (5th Cir. 1995); *Underhill v. Royal*, 769 F.2d 1426, 1432 (9th Cir. 1985); *Landsing Diversified Props.-II v. First Nat'l Bank & Trust Co. (In re Western Real Estate Fund, Inc.)*, 922 F.2d 592 (10th Cir. 1990), *modified sub nom. Abel v. West*, 932 F.2d 898 (10th Cir. 1991). These courts have viewed the release of non-debtor liabilities as "indistinguishable from a bankruptcy discharge." *See Gillman v. Continental Airlines (In re Continental Airlines)*, 203 F.3d 203, 212 (3d Cir. 2000) (citing *American Hardwoods, Inc. v. Deutsche Credit Corp. (In re American Hardwoods, Inc.)*, 885 F.2d 621, 626 (9th Cir. 1989)).

46. However, even if this court is inclined to adopt the more flexible approach utilized by other courts, the Debtors cannot demonstrate that this is one of those rare and extraordinary cases where third party releases should be granted.

47. The case of *In re Master Mortgage Inv. Fund, Inc.*, 168 B.R. 930 (Bankr. W.D. Mo. 1994) has been cited by several courts as setting forth the appropriate standard for

considering the propriety of third party releases.. The *Master Mortgage* cautioned that, because non-debtor releases and injunctions create “knotty problems,” they should only be allowed in specific and extraordinary contexts. *Id.* at 934 (citing *In re Specialty Equip. Co.*, 3 F.3d 1043, 1047 (7th Cir. 1993)).

48. The *Master Mortgage* court fashioned the following five (5) factor balancing test to be considered in determining whether a non-debtor release is permissible:

- (1) There is an identity of interest between the debtor and the third party, usually an indemnity relationship, such that a suit against the non-debtor is, in essence, a suit against the debtor or will deplete assets of the estate[;]
- (2) The non-debtor has contributed substantial assets to the reorganization[;]
- (3) The injunction is essential to reorganization. Without the it [sic], there is little likelihood of success[;]
- (4) A substantial majority of the creditors agree to such injunction, specifically, the impacted class, or classes, has “overwhelmingly” voted to accept the proposed plan treatment[; and]
- (5) The plan provides a mechanism for the payment of all, or substantially all, of the claims of the class or classes affected by the injunction.

Id. at 934-935 (the “*Master Mortgage* test”).

49. The bankruptcy court in *In re Mahoney Hawkes, LLP*, 289 B.R. 285, 302-303 (Bankr. D. Mass. 2002), applied the *Master Mortgage* test and denied confirmation of a liquidating chapter 11 plan at the disclosure statement phase. In that case, the plan provided for an infusion of cash to effectuate a liquidating plan, but the court found that because the creditors would not receive a substantial contribution from the third party seeking a release, the plan was facially unconfirmable. The court observed that Section 105(a) grants authority to issue any order that is appropriate or necessary to carry out the Plan, but that “[t]he First Circuit has cautioned, however, that using this section to enjoin a non-debtor third party involves an

extraordinary exercise of discretion.” *Id.* at 300 (citing *In re G.S.F. Corp.*, 938 F.2d 1467, 1474 (1st Cir. 1991)). The *Mahoney Hawkes* court found that because the plan proponents had failed to “resoundingly demonstrate[] that they [had] met the *Master Mortgage* test[], there is insufficient evidence to warrant such an exercise of discretion in this case.” *Id.* at 302-303.

50. The application of the *Master Mortgage* test to the facts of this case demonstrates that the third party releases are not appropriate. In particular, there has been no evidence that the third parties will contribute substantial assets to the Debtors’ estate. In fact, because there will be no on-going business once the Broadcast Sale occurs, this standard cannot met. See *In re Swallen’s, Inc.*, 210 B.R. 123, 127 (Bankr. S.D. Ohio 1997); *In re Optical Techs., Inc.*, 216 B.R. 989, 993-94 (Bankr. M.D. Fla. 1997). Second, the Debtors have not demonstrated that the third party releases are essential to the Debtors’ reorganization. Finally, and perhaps most importantly, the Plan does not provide for the payment of all or substantially all of the claims of creditors who will be impacted by the release. Instead, the Debtors’ Disclosure Statement estimates that unsecured creditors of PSC, which claims total in excess of \$900 million, will receive no more than 60% on account of their claims.

51. Accordingly, absent a modification striking the third party releases, the Debtors’ Plan should not be confirmed.

III

**THE COURT SHOULD REQUIRE THE DEBTORS TO
OBTAIN CONSENT OF THE CREDITORS’ COMMITTEE
FOR PAYMENTS OR TRANSFERS IN EXCESS OF
\$250,000.00 PRIOR TO THE EFFECTIVE DATE**

52. Taking into consideration the dissipation of the Debtors’ cash subsequent to August 2004 and the interrelated nature of the management of the Debtors and non-debtors, the Ad Hoc Noteholders Committee requests that the Court exercise its authority to safeguard the assets of the estate pursuant to Section 105(a) of the Bankruptcy Code and require the Debtors to

obtain the consent of the Creditors' Committee prior to any payment or transfer by any or all of the Debtors of an amount greater than \$250,000.00 in the aggregate to any party during the time period from the Confirmation Date to the Effective Date of the Plan.

53. Under Section 105 of the Bankruptcy Code, this Court “may issue any order, process or judgment that is necessary or appropriate to carry out the provisions of” the Bankruptcy Code. *See O’Donnell v. Royal Business Group, Inc. (In re Oxford Homes, Inc.)*, 180 B.R. 1, 13 (Bankr. D.Me. 1995) (Haines, J.); *In re Management Technology Corp.*, 56 B.R. 337 (Bankr. D.N.J. 1985). “The basic purpose of [Section] 105 is to enable the Court to do whatever is necessary to aid its jurisdiction, i.e., anything arising in or relating to a bankruptcy case.” 2 *Collier on Bankruptcy*, ¶105.02 at 105-03 (15th Ed. 2001).

54. Pursuant to Section 105, the Court is vested with great latitude to protect the assets of the debtor’s estate, including the use of equitable remedies to ensure maintenance of the *status quo*. *See Elliott v. Kiesewetter*, 98 F.3d 47, 58 (3d Cir. 1996); *Hoxworth v. Blinder, Robinson & Co., Inc.*, 903 F.2d 186, 205 (3d Cir. 1990). The Court’s power under Section 105 has been properly utilized to issue injunctions and other writs necessary to protect the estate from interference, and to ensure its orderly administration, *see Management Tech. Corp.*, 56 B.R. at 338, and also to facilitate the collection and equitable distribution of the debtor’s assets to its creditors. *See Dalton Dev. Project #1 v. Unsecured Creditors Committee (In re Unioil)*, 948 F.2d 678, 682 (10th Cir. 1991). Courts have also used Section 105 to ensure that assets were not disposed of pending the determination of whether the assets were truly assets of the bankruptcy estate, *see In re Global International Airways Corp.*, 76 B.R. 700, 706 (Bankr. W.D. Mo. 1987), and to enjoin debtors from taking certain conduct that would deplete the debtor’s bankruptcy estate or make it more difficult to ascertain the nature and extent of bankruptcy estate property. *See Block v. Moss (In re Moss)*, 258 B.R. 405, 427 (Bankr. W.D. Mo. 2001), *aff’d sub. nom., Block v. Citizens Bank of Tulsa (In re Moss)*, 267 B.R. 834 (B.A.P. 8th Cir. 2001).

55. Additionally, the Court has authority to regulate the Debtors' businesses to protect creditors from the dissipation of the estate's assets pursuant to Section 363 of the Bankruptcy Code which provides that a debtor-in-possession may enter into transactions in the ordinary course of business "unless the court orders otherwise." *In re Selgar Realty Corp.*, 85 B.R. 235, 240 (Bankr. E.D.N.Y. 1988) (citing H.R.Rep. No. 595, 95th Cong., 1st Sess. 181-82 (1977), 1978 U.S.Code Cong. & Admin.News, 5787, 6141-6143). *See, e.g., In re Crystal Apparel, Inc.*, 220 B.R. 816, 830 (Bankr. S.D.N.Y. 1998) ("The purpose of requiring notice and hearing if a transaction is other than in the ordinary course of business is so that creditors, who have a vital interest in maximizing realization from assets of the estate, have an opportunity to review the terms of the proposed transaction and to object if they deem the terms and conditions are not in their best interest") (citing *In re Caldor, Inc.*, 193 B.R. 182, 186 (Bankr. S.D.N.Y. 1996)).

56. The Ad Hoc Noteholders Committee is gravely concerned that a fair division of the Debtors' assets will not be accomplished if the dissipation of the Debtors' cash continues unabated until the appointment of the Liquidating Trustee on the Effective Date. As this Court has recognized, "cash and cash equivalents are highly susceptible to diversion and loss" and are "in liquid form, and therefore, deserving of special protection." *See O'Donnell v. Royal Business Group, Inc. (In re Oxford Homes, Inc.)*, 180 B.R. 1, 13 (Bankr. D. Maine. 1995) (Haines, J.). The Ad Hoc Noteholders Committee submits that the Creditors' Committee must be empowered to protect the Noteholders' interests in the Debtors' "liquid assets" until such time as the Liquidating Trustee can act in his fiduciary capacity. Such empowerment is necessary because the Debtors have failed to provide any satisfactory justification for the decrease in the Debtors' cash or the expenses being incurred by the Debtors. Absent the protection requested from the Court, the Noteholders' interests may be substantially harmed by the dissipation of, or inability to recover, the Debtors' assets. The Ad Hoc Noteholders Committee asks that the Court provide some modicum of protection to prevent this harm from occurring.

CONCLUSION

57. For the reasons outlined above, the Ad Hoc Noteholders Committee respectfully requests entry of an order:

(i) denying confirmation of the Plan absent modifications to the Plan preserving the ability of the Liquidating Trustee to investigate and prosecute any and all claims (a) arising from the Support Services Agreement, including such rights to object to payments and disbursements held by the Creditors' Committee pursuant to the Support Services Order; (b) against non-debtor affiliates and the Debtors' present and former officers and directors that accrued subsequent to August 27, 2004; (c) arising from the KB Prime Media transaction, including the purchase of the loan and entry and execution of the Option Agreement; and (d) relating to the underwriting of any or all of the Notes, and exempting all such claims from the release, indemnification, and exculpation provisions of the Plan;

(ii) denying confirmation of the Plan unless the Plan is modified so as to remove the granting of any and all releases of third-party claims against non-debtors therein;

(ii) requiring, pursuant to Section 105(a) of the Bankruptcy Code, the Debtors to obtain the consent of the Creditors' Committee prior to any payment or transfer by any or all of the Debtors of an amount greater than \$250,000.00 in the aggregate to any party during the time period from the Confirmation Date to the Effective Date of the Plan; and

(iii) granting such other and further relief as the Court deems just and proper.

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Dated: March 11, 2005

Certificate of Service

I hereby certify that service of the above Objection to Confirmation has been made through the Court's ECF system on those registered to receive service through the ECF system.

date: 3/11/05

/s/John P. McVeigh