

Hearing Date: August 25, 2004  
Hearing Time: 10:30 a.m.  
Objection Deadline: August 20,2004; 5:00p.m. EDT  
**PORTLAND**

UNITED STATES BANKRUPTCY COURT  
DISTRICT OF MAINE

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

Pegasus Satellite Television, Inc. and certain of its subsidiaries and affiliates, each a debtor and debtor-in-possession herein (collectively, the “Debtors”),<sup>1</sup> hereby file this motion (the “Motion”) requesting entry of an order pursuant to 11 U.S.C. §§ 105(a), 363 and 1146(c) and Bankruptcy Rule 9019 authorizing and approving the comprehensive Settlement Agreement

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<sup>1</sup> 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.

(attached hereto as Exhibit A and referred to herein as the “Settlement Agreement”)<sup>2</sup> by and among the Debtors, Pegasus Communications Corporation (“PCC”) (on its own behalf and on behalf of its non-Debtor subsidiaries, the “Pegasus Non-Debtors”), DIRECTV, Inc. (on its own behalf and on behalf of its subsidiaries, collectively “DIRECTV”), The DIRECTV Group, Inc. (on its own behalf and on behalf of its subsidiaries other than DIRECTV), National Rural Telecommunications Cooperative (“NRTC”), and the Official Committee of Unsecured Creditors appointed in the Debtors’ chapter 11 cases (the “Committee”) and certain members of the Committee with respect to specified provisions. The Debtors also seek authority, as an integral component of the Settlement Agreement, to (i) sell, transfer and convey to DIRECTV substantially all of the assets that comprise the Debtors’ direct broadcast satellite (“DBS”) business as provided in the Asset Purchase Agreement, attached hereto as Exhibit B (the “Asset Purchase Agreement”), free and clear of all liens, claims, encumbrances and other interests, pursuant to sections 363(b) and 363(f) of the Bankruptcy Code, and (ii) assist in the transitioning of their DBS business to DIRECTV as provided in the Cooperation Agreement, a copy of which is attached hereto as Exhibit C (the “Cooperation Agreement”, collectively with the Settlement Agreement and the Asset Purchase Agreement, the “Settlement”).<sup>3</sup> In support of the Motion, the Debtors respectfully state as follows:

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<sup>2</sup> Capitalized terms used herein and not otherwise defined shall have the meanings given to such terms in the Asset Purchase Agreement.

<sup>3</sup> The Debtors will also file a Motion to Assume and Assign Executory Contracts and Unexpired Leases pursuant to 11 U.S.C. §365 pursuant to which the Debtors will request authority to assume and assign to DIRECTV various leases and executory contracts as contemplated by the Asset Purchase Agreement. In addition, the Debtors have separately filed their Motion for an Order Pursuant to 11 U.S.C. § 363 Approving the General Partnership Interest Purchase Agreement By and Between Pegasus Satellite Television, Inc. and LEC Development, Inc. and Authorizing the Transactions Contained Therein, pursuant to which the Debtors will acquire certain partnership interests from LEC to facilitate the sale of all of the Subscriber Information to DIRECTV.

## **STATUS OF THE CASE AND JURISDICTION**

1. On June 2, 2004 (the “Petition Date”), each of the Debtors filed a voluntary petition for relief under chapter 11 of title 11 of the United States Code (the “Bankruptcy Code”). On the Petition Date, the Debtors also jointly filed motions or applications seeking certain typical “first day” orders, including an order to have these cases jointly administered.

2. The Debtors continue in possession of their properties and are operating and maintaining their businesses as debtors-in-possession pursuant to sections 1107(a) and 1108 of the Bankruptcy Code.

3. On June 10, 2004, the United States Trustee for the District of Maine appointed the Committee pursuant to section 1102(a) of the Bankruptcy Code.

4. No request has been made for the appointment of a trustee or examiner in these cases.

5. The Court has jurisdiction over this matter pursuant to 28 U.S.C. §§ 157 and 1334. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2). Venue is proper in this Court pursuant to 28 U.S.C. §§ 1408 and 1409. The statutory predicates for the relief sought herein are sections 105(a), 363 and 1146(c) of the Bankruptcy Code and Rule 9019 of the Federal Rules of Bankruptcy Procedure (the “Bankruptcy Rules”).

## PRELIMINARY STATEMENT

6. These cases are at a hazardous crossroads. Absent (i) a prompt reversal by the District Court of this Court's order denying the Debtors' request for a preliminary injunction<sup>4</sup> (the "Injunction Order") against DIRECTV and NRTC and (ii) the issuance by the District Court or this Court of an injunction requiring DIRECTV to continue providing DBS services to the Debtors, the Debtors will lose their ability to distribute DIRECTV programming as of August 31, 2004. Were this to occur, the Debtors' DBS business would utterly collapse, and the Debtors' estates would consist principally<sup>5</sup> of litigation claims against DIRECTV and NRTC. Relatedly, DIRECTV's threatened August 31st cessation of service effectively precludes the Debtors from selling their DBS business to third parties because the Debtors are incapable of providing prospective buyers any assurance that the Debtors could retain their most saleable asset -- their proprietary information arising from their relationship with over 1 million DBS subscribers -- for the time that would be required to transition the subscriber relationships to a buyer.<sup>6</sup> Moreover, an affirmance by the District Court of this Court's Injunction Order could seriously undermine the Debtors' ability to gain any significant value from DIRECTV and NRTC in consideration for the Debtors' litigation claims. Against this backdrop, the Debtors and the Committee have negotiated a comprehensive Settlement among the Debtors, the Committee, the Pegasus Non-

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<sup>4</sup> In a bench decision rendered on June 21, 2004 and by order dated June 21, 2004, the Bankruptcy Court denied the Debtors' request for a temporary restraining order. The Court offered to convert its ruling on the request for a temporary restraining order into a ruling on a preliminary injunction so that the Debtors could pursue an immediate appeal. After the Debtors requested that the Court convert its ruling to a preliminary injunction ruling, by order dated June 24, 2004, the Bankruptcy Court denied the Debtors' alternative request for a preliminary injunction.

<sup>5</sup> In addition to the Debtors' satellite-related assets, Pegasus Broadcast Television, Inc. owns (together with its subsidiaries) assets related to the broadcast television business, but the value of those assets is significantly less than the value of the DBS assets.

<sup>6</sup> As more fully set forth below, DIRECTV and NRTC also contend that the Debtors do not have the right to sell or otherwise transfer their subscriber information to potential purchasers.

Debtors, DIRECTV and NRTC. As more fully set forth below, the Settlement, if approved by this Court, will (a) resolve virtually all litigation among the parties, (b) secure for the Debtors a purchase price of approximately \$938 million, subject to adjustments as provided in the Asset Purchase Agreement, in connection with the release of litigation claims and for the sale, transfer and conveyance of the Debtors' DBS business assets to DIRECTV, and (c) preserve the Debtors' contingent right to receive up to approximately \$89 million in future patronage from the NRTC under specified circumstances. The Debtors respectfully request the Court to approve, and permit the prompt implementation of, the proposed Settlement.

### **FACTUAL BACKGROUND**

7. Prior to June 1, 2004, the Debtors were the largest independent distributor of DIRECTV® DBS services with approximately 1.1 million subscribers and the exclusive right to distribute certain DIRECTV services to approximately 8.4 million rural households in specified territories within 41 states. The Debtors provide DIRECTV® DBS services through agreements with NRTC, a not-for-profit cooperative corporation, called the “NRTC/Member Agreements for Marketing and Distribution of DBS Services” (the “Member Agreements”). NRTC obtained DIRECTV® DBS services through a contract with DIRECTV called the “DBS Distribution Agreement,” dated as of April 10, 1992, as amended, between NRTC and DIRECTV as well as its predecessor, Hughes Communications Galaxy, Inc. (the “DBS Agreement”). In addition, the Debtors sell certain additional programming services provided by DIRECTV pursuant to a Revised Seamless Consumer Program, dated October 3, 2001, as amended, between DIRECTV and certain of the Debtors (the “Seamless Agreement”). To permit the use of DIRECTV’s tradenames and trademarks in connection with the provision of the DBS services to NRTC, DIRECTV and NRTC entered into a Trademark License Agreement, dated as of September 12, 1994 (the “Trademark License Agreement”).

8. On June 1, 2004, DIRECTV and NRTC announced that they had mutually agreed to terminate the DBS Agreement and the Trademark License Agreement. On June 2, 2004, NRTC delivered notice to the Debtors that it had terminated the Member Agreements -- and the provision of DIRECTV DBS services required thereunder -- effective August 31, 2004. Concurrently with these purported contract terminations, DIRECTV informed the Debtors that DIRECTV had terminated the Seamless Agreement, also effective August 31, 2004. The Debtors dispute the legality and efficacy of the foregoing terminations.

9. On June 14, 2004, the Debtors filed an adversary proceeding in the Bankruptcy Court (the "Adversary Proceeding") in which DIRECTV and NRTC, among others, were named as defendants and in which the Debtors sought, inter alia, preliminary and permanent injunctive relief and damages.<sup>7</sup> In particular, the Debtors requested, among other things, either specific performance of the Member Agreements (and reinstatement of the DBS Agreement, to the extent such reinstatement is necessary to permit NRTC to perform under the Member Agreements), or damages from NRTC and DIRECTV to compensate the Debtors for the full value of the terminated Member Agreements.<sup>8</sup>

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<sup>7</sup> Shortly after the Petition Date, prior to the commencement of the Adversary Proceeding, the Debtors sought a determination from this Court that DIRECTV had violated the automatic stay provided for in section 362(a)(3) of the Bankruptcy Code by (i) marketing to new subscribers and existing subscribers in the Debtors' territories, and (ii) allegedly soliciting those subscribers using the subscriber information. In a bench decision rendered on June 10, 2004, and by order of the same date, this Court held that "[c]ertain, limited, action of DIRECTV . . . violates the automatic stay imposed by 11 U.S.C. Section 362" with respect to DIRECTV's use of the subscriber information contained in the Debtors' files, but that DIRECTV's efforts to solicit customers in the Debtors' territories did not otherwise violate the automatic stay (the "June 10<sup>th</sup> Decision"). Although DIRECTV and the Debtors each dispute different portions of the June 10<sup>th</sup> Decision, neither of them appealed or otherwise sought reconsideration of the June 10<sup>th</sup> Decision.

<sup>8</sup> Specifically, the Debtors asserted claims sounding in, inter alia, breach of fiduciary duty, aiding and abetting breach of fiduciary duty, civil conspiracy, unjust enrichment, violations of the Sherman Act, breach of contract, breach of duty of good faith and fair dealing, common law franchise, intentional

10. Concurrent with their initiation of the Adversary Proceeding, the Debtors also sought a temporary restraining order requesting the Court to, among other things, restore the status quo as of the date of the termination of the DBS Agreement and the Trademark License Agreement and to prevent the scheduled termination of the Member Agreements and the Seamless Agreement from taking effect. In a bench decision rendered on June 21, 2004, and by order dated June 21, 2004, this Court denied the Debtors' request for a temporary restraining order finding that the Debtors had not demonstrated a probability of success on the merits of the underlying causes of action.<sup>9</sup> After the Debtors accepted this Court's offer to convert the temporary restraining order ruling into a ruling on a preliminary injunction, this Court entered the Injunction Order denying the Debtors' request for a preliminary injunction for the same reasons. The Debtors filed a notice of appeal from the Injunction Order (the "Appeal") with the United States District Court for the District of Maine (the "District Court"). Expedited briefing was ordered in connection with the Appeal and that briefing has now been completed. DIRECTV and NRTC have filed a motion with the District Court to dismiss the Debtors' Appeal on jurisdictional grounds. No trial has been scheduled in the Adversary Proceeding and, in light of this Court's scheduling order entered in the Adversary Proceeding, one will not take place until after August 31, 2004.

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interference with contractual relations, intentional interference with performance of contractual relations, intentional interference with prospective contractual relations, misappropriation of trade secrets, and fraudulent transfer.

<sup>9</sup> In its opinion rendered from the bench, the Court specifically held, "So I conclude there's been no likelihood of success on the merits under business tort theory, under an implied covenant of good faith and fair dealing, under a breach of fiduciary duty, and aiding and abetting theories. And as I've indicated already, the nature of the injunctive relief sought is, to my mind, broad and retroactive in character and functions in a way that's at odds with the accepted role of interlocutory injunction relief to maintain the status quo. For those reasons, Pegasus motion for temporary restraining order or preliminary injunction is denied." Tr. June 21, 2004, Bankr. Docket no. 238, at 13-14.

11. Apart from the claims asserted by the Debtors in the Adversary Proceeding (the “Adversary Claims”) -- each of which DIRECTV and NRTC dispute -- other disputes between the Debtors and DIRECTV may impact the Debtors’ ability to sell their assets to third parties. For example, DIRECTV contends that the Debtors cannot sell or transfer their proprietary subscriber relationships to a purchaser of the Debtors’ assets because the Debtors’ rights, if any, to crucial Subscriber Information are circumscribed.<sup>10</sup> Specifically, DIRECTV maintains that it exclusively owns certain historical and current account information with respect to the various categories of subscriber information under both the Member Agreements and the Seamless Agreement (the “Non-Core Services Information”), such as premium programming, local channel programming, foreign language programming, high definition programming, and certain sports programming<sup>11</sup>, and that, without DIRECTV’s consent, the Debtors are prohibited from selling or transferring any such subscriber information, or using the same for any purpose not permitted by the Seamless Agreement and the Member Agreements, during the term of the Seamless Agreement and the Member Agreements and following the termination thereof on August 31, 2004. DIRECTV also asserts that in accordance with the applicable agreements, it, individually or as NRTC’s assignee, owns the historical and current account information collected and maintained in the joint billing system with respect to all other DBS services provided under the Member Agreements (the “Core Services Information”) subject to a

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<sup>10</sup> The Debtors assert that have developed extensive information regarding their subscribers, including the subscribers’ names, addresses (including zip codes), purchasing history, unique and addressable subscriber identification number, and other proprietary information (“Subscriber Information”). The Debtors assert that they developed this Subscriber Information over a period of 10 years, devoting a significant amount of time, money and effort. This information is unavailable to the public or to others, and derives independent economic value from not being readily ascertainable by other multi-channel video providers or others.

<sup>11</sup> More specifically, Non-Core Services Information consists of subscriber information in respect of the provision of programming transmitted over frequencies other than the 27 HCG Frequencies at the 101° W.L. orbital location as well as Non-Select programming (e.g., NFL Sunday Ticket).



proprietary (but not exclusive) interest of the Debtors in such information. DIRECTV and NRTC further contend that the Debtors' interest in the Core Services Information would revert to DIRECTV (both individually and as NRTC's assignee) upon termination of the Member Agreements and the associated termination of the Debtors' access to the billing system maintained by DIRECTV and NRTC. It is DIRECTV's and NRTC's position that without the consent of DIRECTV (as NRTC's assignee and as the intended third-party beneficiary of the Member Agreements), the Debtors are contractually prohibited from (i) selling or transferring the Core Services Information to third parties for a period of five years following the termination of the Member Agreements, and (ii) using any such information for any purpose other than as permitted by the Member Agreements and by the NRTC board policies.<sup>12</sup> The Debtors vigorously dispute each of these contentions and maintain that they have the unfettered right to use and transfer an exclusive interest in their Subscriber Information, including the Core Services Information and Non-Core Services Information, and that DIRECTV cannot use the Debtors' Subscriber Information, including the Core Services Information and the Non-Core Services Information, regardless of any termination of the Member Agreements.

12. Recognizing (i) the threat to the Debtors' continued DBS operations posed by the August 31st termination of the Member Agreements and the Seamless Agreement, (ii) the risk and expense of unrestrained litigation in respect of the Adversary Claims, and (iii) the impediments to an effective sale process for the Debtors' DBS business imposed by both the impending termination of service -- which, if implemented, would render it exceedingly difficult,

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<sup>12</sup> DIRECTV contends that even if the Debtors had an ownership interest in the Subscriber Information, the Debtors would have, at best, a joint undivided interest in such information with DIRECTV so that if the Debtors were to sell both DIRECTV's and the Debtors' interest in such information pursuant to section 363(h) of the Bankruptcy Code (which DIRECTV does not concede the Debtors could), DIRECTV would be entitled, among other things, pursuant to sections 363(e) and (h) of the Bankruptcy

if not impossible, for the Debtors to transition subscribers to a buyer -- and DIRECTV's position that the Debtors are contractually prohibited from selling or otherwise transferring any Subscriber Information to a competing buyer, the Debtors, with the assistance of the Committee, engaged in extensive, and at times heated, settlement discussions with DIRECTV and NRTC throughout late June and July in an effort to both resolve the Adversary Proceeding and maximize the value that could be realized in respect of the Debtors' DBS business. Concurrently, the Committee negotiated with the Pegasus Non-Debtors regarding the terms on which the Pegasus Non-Debtors would join the Settlement as required by DIRECTV and NRTC. Those negotiations culminated in the Settlement.<sup>13</sup>

13. The centerpiece of the Settlement is DIRECTV's agreement to pay to the Debtors approximately \$938 million, subject to adjustments provided in the Asset Purchase Agreement, in consideration for (i) a sale, transfer and conveyance of the Satellite Assets (defined below) to DIRECTV, free and clear of all liens, claims, encumbrances and other interests pursuant to sections 363(b) and 363(f) of the Bankruptcy Code, (ii) the Debtors' cooperation in effecting an orderly transition of the Satellite Assets to DIRECTV, (iii) a general release by the Debtors of all claims against DIRECTV and NRTC, including the Adversary Claims, but excluding certain claims preserved under the Settlement, and (iv) a release by the Pegasus Non-Debtors of all claims against DIRECTV and NRTC related to the Debtors' DBS business. Each facet of the Settlement is both interrelated and interdependent. For example, while DIRECTV required that the Pegasus Non-Debtors, including PCC, release certain claims against DIRECTV and NRTC, the Pegasus Non-Debtors were unwilling to release claims

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Code, to receive not less than one-half of the gross proceeds of such sale.

<sup>13</sup> The Debtors' prepetition secured lenders were kept apprised of the settlement discussions and, the Debtors believe, fully support the Settlement.

against DIRECTV and NRTC unless the Debtors released claims that the Debtors may have against the Pegasus Non-Debtors. The Committee, in turn, was unwilling to consent to a release of potential estate claims against the Pegasus Non-Debtors unless the Pegasus Non-Debtors supported the Settlement, issued the releases required by DIRECTV and agreed to waive prepetition claims against the Debtors held by the Pegasus Non-Debtors. By the express terms of the underlying agreements, the Settlement must be evaluated and approved as an integrated whole.

### **RELIEF REQUESTED**

14. By this Motion, the Debtors respectfully request that this Court enter an order approving the Settlement.

#### **A. The Settlement.**

15. Although qualified in full by the terms of the Settlement Agreement, the Asset Purchase Agreement and the Cooperation Agreement, the following is a summary of the material benefits to which the parties are entitled. The parties have taken a variety of steps to ensure certainty of closing, and realization of the benefits described, following receipt of this Court's approval and satisfaction or waiver of other conditions, including the posting by DIRECTV of a letter of credit in the amount of \$875 million in favor of PST.

16. Debtors. Pursuant to the terms of the Settlement, the Debtors will receive a purchase price of approximately \$938 million,<sup>14</sup> subject to adjustments as provided in the Section 3.2 of the Asset Purchase Agreement, from DIRECTV in exchange for substantially all

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<sup>14</sup> Section 3.1 of the Asset Purchase Agreement provides for a total purchase price of \$937,719,121, subject to adjustments specified in Section 3.2.

of the Debtors' Satellite Assets (as defined below). Without limiting in any respect provisions of Section 3.2 of the Asset Purchase Agreement, the \$938 million will be (i) reduced by approximately \$63 million to reflect the amount owed by the Debtors to DIRECTV on account of the judgment entered in favor of DIRECTV and against Pegasus in the Seamless Marketing Litigation,<sup>15</sup> (ii) increased by (a) approximately \$16.8 million, consisting of \$10.8 million of cash patronage distributions due to Pegasus for 2003 and an agreed amount for 2004 and an additional \$6 million credited by DIRECTV, and (b) amounts owed to the Debtors at closing under the Cooperation Agreement, and (iii) increased or reduced, as the case may be, by certain other adjustments specified in Section 3.2, including agreed working capital adjustments. The Debtors will receive from DIRECTV effective upon closing of the Settlement a general release of all claims, including with respect to the Seamless Litigation Judgment and any other litigation pending between the Debtors and DIRECTV.

17. In addition, NRTC will waive any argument that the Debtors' patronage capital certificates (the "Patronage Certificates") in the aggregate amount of approximately \$89 million are subject to forfeiture as a consequence NRTC's asserted termination of the Debtors as Associate Members of NRTC.<sup>16</sup> Specifically, NRTC has agreed that the Debtors will retain their

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<sup>15</sup> In 2001, DIRECTV commenced an action (the "Seamless Marketing Litigation") against Pegasus in the Superior Court of California for Los Angeles for, among other things, breach of contract and an accounting for violations of the joint marketing agreement. Pegasus removed the case to the United States District Court for the Central District of California. On April 14, 2004, a jury returned a verdict in favor of DIRECTV in the Seamless Marketing Litigation in the amount of approximately \$51.5 million. This judgment was entered by the court on May 24, 2004 in the amount of \$62,586,479.43, which included prejudgment interest (the "Seamless Litigation Judgment"). Pegasus filed its notice of appeal of this ruling on June 22, 2004.

<sup>16</sup> NRTC contends that the Debtors could lose any rights in respect of Patronage Certificates as a consequence of the termination of their status as an Associate Member of NRTC. The Debtors dispute this contention.

right to receive patronage distributions in respect of the Patronage Certificates, but only upon the occurrence of a “Trigger Event”.<sup>17</sup> As provided in the Settlement Agreement, NRTC has also agreed that the Debtors' Patronage Certificates will not be subject to discriminatory treatment, subordination or distribution rights which are in any way inferior to other like patronage capital certificates held by other NRTC patrons, including by means of amendment to NRTC’s Articles of Incorporation or bylaws. NRTC has also agreed to return to the Debtors the \$59 million letters of credit issued for the account of the Debtors and delivered to NRTC (which is cash collateralized at 105% of its face amount) that secures payment of amounts due under the Member Agreements.<sup>18</sup> In addition, the Debtors will receive from NRTC a general release of all claims.

18. Finally, the Debtors will receive from the Pegasus Non-Debtors a general release of all claims, except for claims arising after the Petition Date including postpetition claims under the Support Services Agreement.<sup>19</sup> These releases will include PCC’s prepetition claims of approximately \$28.1 million in the aggregate due under a promissory note issued by PSC and other inter-company receivables due from the Debtors. The benefits provided by the Pegasus Non-Debtors participation in the Settlement are further described below.

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<sup>17</sup> A Trigger Event is defined as: “any distribution (i) that NRTC’s Board of Directors, in its sole discretion may authorize, pursuant to NRTC’s bylaws, in connection with the retirement, repayment or rotation generally of patronage capital certificates of the same class as the Patronage Certificates, or (ii) that results from the actual dissolution of NRTC.” Settlement Agreement, section 4(b)(1).

<sup>18</sup> As noted below, the Debtors have agreed to pay to DIRECTV and NRTC all accrued but unpaid amounts due under the Seamless Agreement and the Member Agreements, respectively, as adjustments to the purchase price in accordance with the Asset Purchase Agreement.

<sup>19</sup> On July 22, 2004, the Court entered a final order authorizing the Debtors to continue performing under the Support Services Agreement, effective as of May 1, 2004, between Pegasus Communications Management Company (“PCMC”) and each of the Debtors and their non-debtor affiliates (the “Support Services Agreement”).

19. DIRECTV and NRTC. Subject to the terms and conditions of the Asset Purchase Agreement, the assets to be acquired by DIRECTV (the “Satellite Assets”) include the following assets held by the Debtors on the closing date:

- (a) all Subscriber Information;
- (b) all DIRECTV equipment and any rights to bill and collect from Subscribers for non-return fees in connection with DIRECTV equipment;
- (c) all rights to bill and collect from Subscribers for early termination or disconnect fees;
- (d) documents as specified in the Asset Purchase Agreement;
- (e) the leases, if any, set forth on Schedule 2.1(e) of the Asset Purchase Agreement (the “Purchased Facility Leases”), together with all improvements, fixtures and other appurtenances to real property subject to such Purchased Facility Leases and rights in respect thereof;
- (f) the furniture and equipment;
- (g) the Member Agreements, the Seamless Agreement and the contracts set forth on Schedule 2.1(g) of the Asset Purchase Agreement (the “Purchased Contracts”) and all rights thereunder;
- (h) all rights to receive cash patronage from NRTC in an amount up to the Patronage Amount, with respect to the periods commencing January 1, 2003 and ending on the Closing Date, whenever such amounts may be distributed by NRTC, excluding rights to Patronage Certificates or future cash distributions, if any, under Patronage Certificates as provided for in Section 4 of the Settlement Agreement;
- (i) all accounts receivable and unearned revenue of the selling Debtors as of the Closing Date that relate to the DBS business;
- (j) all rights under certain confidentiality agreements or under non-disclosure or confidentiality, non-compete or non-solicitation agreements with any employees that may be hired by DIRECTV;
- (k) to the extent transferable, all “1-800” telephone numbers owned or used by the Debtors in connection with the operation of the DBS business; and
- (l) any other asset, property or right existing on the closing date of the transactions contemplated by the Asset Purchase Agreement to the extent and in

the amount such asset, property or right is included in calculating the Final Net Working Capital Amount.

Pursuant to section 363(f) of the Bankruptcy Code, the sale of the Satellite Assets shall be free and clear of all liens, claims and encumbrances and other interests (other than Permitted Exceptions), with such liens, claims, encumbrances and other interests to attach to the proceeds of such sale.

20. The Debtors and DIRECTV have also entered into the Cooperation Agreement, which prescribes, *inter alia*, (i) the manner in which the Debtors will cooperate and assist with the transition of subscribers to DIRECTV, (ii) the undertaking of DIRECTV to reimburse certain costs incurred by the Debtors in connection with the transition, and (iii) the terms under which DIRECTV will provide DBS services to the Debtors after August 31, 2004, if necessary, in the event that there is no closing of the Satellite Assets sale by that date. As more fully set forth in the Cooperation Agreement, working teams will be established to, among other things, develop a plan to migrate subscribers from the Debtors' systems to DIRECTV's systems and to develop a process to contact the Debtors' dealers and distributors regarding the transition. Prior to Court approval and closing of the Settlement, the working teams' activities will be limited to planning for the transition of subscribers and services to DIRECTV, with the actual transition of subscribers and services being implemented post-closing. The post-closing transition services provided by the Debtors, the scope of which will be agreed upon by the working teams, will be provided by the Debtors for a period not to exceed 60 days following closing, and DIRECTV will reimburse the Debtors for all costs attendant to the provision of such services.

21. In addition to the sale, transfer and conveyance of the Satellite Assets and the Debtors' undertakings in the Cooperation Agreement, the Debtors have agreed to dismiss all pending litigation involving DIRECTV and NRTC including, *inter alia*, the Adversary Proceeding, certain California litigation,<sup>20</sup> and the Seamless Marketing Litigation appeal. Furthermore, the Debtors will release DIRECTV and NRTC, and DIRECTV and NRTC will release the Debtors, from any and all claims arising at any time prior to the effective date of the Settlement, except for claims in respect of the Settlement and certain other retained claims. The Debtors have also agreed to pay the prepetition and postpetition amounts due DIRECTV and NRTC under the Seamless Agreement and the Member Agreements, respectively, at the closing of the Satellite Assets sale and as an adjustment to the purchase price pursuant to the Asset Purchase Agreement. The Debtors estimate that the amounts due to DIRECTV and NRTC under the Seamless Agreement and the Member Agreements as of August 31, 2004 will aggregate approximately \$17.5 million and \$146 million, respectively.

22. Pegasus Non-Debtors. The Debtors cannot realize the benefits of the Settlement without the participation and support of the Pegasus Non-Debtors. DIRECTV and NRTC have required, as a condition to the Settlement, a release of claims from all Pegasus

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<sup>20</sup> In 2000, Pegasus filed a lawsuit against DIRECTV seeking equitable, declaratory and monetary relief for, among other things, alleged violations of DIRECTV's obligations to provide certain DBS services under the DBS Agreement for exclusive distribution by Pegasus in the territories covered by the Member Agreements and alleged misuse by DIRECTV of DBS subscriber information (the "California Litigation"). On or about March 19, 2001, DIRECTV and Hughes Communications Galaxy, Inc. filed counterclaims against Pegasus in the California Litigation seeking certain declaratory rulings as to Pegasus' rights under its Member Agreements. Pegasus voluntarily dismissed certain of its claims, and in a series of rulings issued during the California Litigation, the last of which was entered on May 11, 2004, the California court adjudicated and/or dismissed all of Pegasus' remaining claims. The court entered a declaratory judgment on certain of DIRECTV's counterclaims and dismissed the remainder. In addition to the California Litigation, in 1999, NRTC filed two lawsuits against DIRECTV seeking damages and declaratory relief for claims similar to the California Litigation. NRTC and DIRECTV subsequently settled their disputes with respect to this action. Pegasus did not participate in that settlement.



entities including the Pegasus Non-Debtors. Moreover, without support services from the Pegasus Non-Debtors, including key management expertise provided by employees of PCMC, the Debtors cannot meet their obligations to DIRECTV to maintain the integrity of the DBS business prior to closing and provide the pre- and post-closing cooperation and support envisioned by the Cooperation Agreement.

23. Following extensive arm's length negotiations, PCC and the Committee agreed on the terms on which the Pegasus Non-Debtors would join the Settlement and, concurrently with the Settlement Agreement, entered into the letter agreement attached hereto as Exhibit D (the "Letter Agreement"). The Settlement Agreement and the Letter Agreement together embody a broad-based resolution of the Pegasus Non-Debtors' relationships with the Debtors, which has the following principal components:

- Mutual Releases. The Pegasus Non-Debtors will release the Debtors from all claims, including an aggregate of approximately \$28.1 million in the aggregate due on the Petition Date under an inter-company note and other inter-company receivables due from the Debtors, but excluding claims arising after the Petition Date, including under the Support Services Agreement. The Debtors will release the Pegasus Non-Debtors from all claims, including the Potential Claims described below, but excluding claims under the Support Services Agreement. Both releases extend to the released parties' respective officers, directors and employees. The release given by the Debtors will also extend to their own directors and officers, who overlap substantially with the directors and officers of the Pegasus Non-Debtors. Accordingly, 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. In addition, certain members of the Committee will release the Pegasus Non-Debtors from all claims related to the Debtors, DIRECTV, and NRTC. These releases are contained in Section 3 of the Settlement Agreement.
- Support Services. The Committee has agreed in Section 5.d of the Settlement Agreement not to object to (i) payment to PCMC for services provided or expenses incurred pre- and post-closing pursuant to the Cooperation Agreement or (ii) the allocation to the Debtors of liability for those payments in accordance with the Support Services Agreement. The Committee has also agreed to support

an employee retention plan on the terms outlined in the Letter Agreement, which includes PCMC employees who provide services to the Debtors' DBS business.

- Sale of the Broadcast Assets. The Committee and PCC have agreed in principal on a sale to PCC of the Debtors' broadcast television assets. The Letter Agreement provides for an all cash purchase price of \$75 million, subject to higher and better offers, with no break up fee (but reimbursement of out-of-pocket expenses, not to exceed \$1 million). The agreement includes certain auction procedures and a timeline that contemplates completion of the auction and sale in October of this year. This agreement provides the Debtors a clear path to completion of a plan of reorganization reasonably promptly following the sale of the DBS assets. Because PCC is intimately familiar with these assets and has little timing risk on receiving required FCC approvals, PCC is well situated to provide the negotiated floor bid, subject to higher and better offers, which it has agreed to do without a break-up fee.

24. DIRECTV and NRTC cannot achieve a global settlement of claims related to the Debtors' DBS business without a release from the Pegasus Non-Debtors, which are involved directly (PCC is a named party in one of the pending actions<sup>21</sup>) and indirectly in these disputes. Accordingly, DIRECTV and NRTC have required from the Pegasus Non-Debtors, as part of the Settlement, a release of all matters relating to the Debtors' DBS business and a commitment not to engage in any further litigation that would adversely affect the implementation of the Agreements and to support the Settlement. See Sections 1, 3.c and 5.b of the Settlement Agreement.

25. The Debtors cannot compel the Pegasus Non-Debtors' participation in the Settlement. By joining the Settlement Agreement, the Pegasus Non-Debtors satisfy a necessary condition to the Settlement, and in that way provide a critical benefit to the Debtors. The terms on which they have agreed to do so, which are the product of arm's-length negotiation with the Committee, provide additional benefits to the Debtors, including the release of approximately \$28.1 million in pre-petition claims. The Debtors and the Committee believe that the satisfaction

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<sup>21</sup> DIRECTV, Inc. v. Pegasus Satellite Television, Inc., et al., Case No. CV 04-3895 RGK (C.D. Cal.)

of a necessary condition to the Settlement, together with these additional benefits, outweigh the value given up by the Debtors in granting the release of the Pegasus Non-Debtors under the Settlement Agreement, taking into account the considerations discussed below as to uncertainty of outcome, risk of an adverse outcome and expense associated with prosecution of the Potential Claims.

**B. Evaluation of the Proposed Settlement.**

26. As discussed in greater detail below, the Court should approve the proposed Settlement because it is in the best interests of the Debtors' estates. To reach this determination, the Court should assess, among other considerations, the value of what the Debtors are relinquishing and the value of what they are receiving under the Settlement. In considering the value of what the Debtors are relinquishing, the Court should consider: (a) the probability of success in the pursuit of claims that are being released; (b) the difficulty in obtaining an adequate remedy, including the collection of damages; (c) the complexity of the litigation involved and the expense, inconvenience and delay attendant to its prosecution; and (d) the view of creditors and interest holders, since their interests are paramount. The Debtors submit that the proposed Settlement Agreement is in the best interests of their estates.

27. Claims Against DIRECTV and NRTC.<sup>22</sup> The most significant claims that the Debtors hold against DIRECTV and NRTC are those that have been asserted in the Adversary Proceeding. Through the Adversary Proceeding, the Debtors seek effectively to reinstate the Member Agreements and the DBS Agreement (to the extent necessary to enable NRTC to perform its obligations under the Member Agreements) or, alternatively, to recover

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<sup>22</sup> The discussion of these claims is for settlement purposes only and shall not prejudice any parties' rights with respect thereto if the Settlement is not approved.

damages from DIRECTV and NRTC for the full value of the Debtors' rights under the Member Agreements. If the Debtors were completely successful in the Adversary Proceeding, including with respect to the Debtors' contention that the term of the Member Agreements extends until 2016<sup>23</sup> and that, upon completion of such term, the Debtors would be able to sell their DBS assets (including subscribers and Subscriber Information) at a fair market valuation, the Debtors believe that the value of the DBS business -- and, accordingly, the damages to which the Debtors would be entitled if the Member Agreements are not reinstated -- based upon the Debtors' DBS business plan and including the cash value of all patronage certificates held by the Debtors would permit the full payment of all of the Debtors' creditors and preferred shareholders and a return of value to PCC, the Debtors' ultimate shareholder.

28. But the path to such recovery is far from clear. Among other issues, the Debtors would have to persuade this Court that (i) NRTC violated a contractual, fiduciary or other duty owed to the Debtors by terminating the DBS Agreement and the Member Agreements, (ii) DIRECTV induced, or aided and abetted, NRTC's breach of contract and/or duty, (iii) DIRECTV was not privileged to take the actions it did with respect to the DBS Agreement, (iv) Pegasus' claims against DIRECTV are not foreclosed by rulings in the California Litigation, (v) Pegasus' arguments concerning the term of the Member Agreements

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<sup>23</sup> The Debtors' contend that the term of the Debtors' exclusive rights under the Member Agreements to provide DIRECTV DBS Services is tied to the useful life of the satellites providing DIRECTV programming. The projection of the useful life for such satellites has been variously estimated to expire no earlier than 2014 or 2016. DIRECTV contends that the term is tied to the useful life of only the initial satellite launched in December 1993, which life may expire in 2007. The term of the Member Agreements and DBS Agreement, however, was a subject of dispute in the California Litigation, but was never decided. The settlement reached between NRTC and DIRECTV in the California Litigation provided that the term of the DBS Agreement would expire no later than 2008. The Debtors contest the applicability of that agreement to the term of their exclusive distribution rights under the Member Agreements.

are correct,<sup>24</sup> and (vi) Pegasus is entitled to receive distributions on account of the Patronage Certificates. And, while the Debtors remain convinced of the vitality of the liability theories they have asserted in the Adversary Proceeding, the fact that this Court has already concluded, in connection with the denial of the Debtors' request for a temporary restraining order, that the Debtors failed to demonstrate a likelihood of success on the merits of the underlying causes of action for breach of contract and breach of fiduciary duty weighs against projecting significant recoveries against DIRECTV and NRTC for purposes of evaluating the proposed Settlement.

29. Similarly, the Court must consider the potential harm to creditors if the Debtors are unsuccessful in prosecuting the Adversary Claims. If DIRECTV remains resolute in its position that no DBS services will be available to the Debtors as of September 1st, the Debtors will have no independent means of preserving their subscriber base, and their only DBS income generating asset will disintegrate. Moreover, because (i) it would likely take several months to transition over 1.0 million subscriber relationships to another service provider, (ii) it is far from certain that subscribers would agree to convert to a service other than DIRECTV, and (iii) DIRECTV continues -- and will continue -- to challenge the Debtors' right to transfer subscriber information to a potential purchaser other than DIRECTV, the prospect of selling the Debtors' DBS subscriber relationships and information to an entity other than DIRECTV for consideration that remotely approaches the approximately \$938 million, subject to adjustments as provided in the Asset Purchase Agreement, that DIRECTV has offered is, in the Debtors' judgment, largely illusory.<sup>25</sup> Thus, if the Debtors refuse to embrace this Settlement and their

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<sup>24</sup> Briefs filed by the Debtors, DIRECTV and NRTC, which describe in greater detail the Debtors' arguments and DIRECTV's and NRTC's responses thereto, are available upon request from the Debtors and, in addition, are a matter of public record.

<sup>25</sup> At best, the Debtors believe that Pegasus might obtain a "per converted subscriber" price, but only after

Adversary Claims fail, the Debtors could realize virtually no value in respect of the Satellite Assets. Were this to occur, the Debtors' prepetition senior secured lenders<sup>26</sup> would be impaired, and the Debtors' remaining creditors -- the prepetition junior secured lenders<sup>27</sup> and more than \$900 million of unsecured creditors -- would likely recover nothing. In contrast, the Settlement, if approved and consummated, will insure that the prepetition secured lenders will be paid in full, and that the Debtors' general unsecured creditors will receive a very meaningful recovery on their claims.

30. Potential Claims Against the Pegasus Non-Debtors.<sup>28</sup> As part of the negotiated bases on which the Pegasus Non-Debtors have agreed to release their claims against DIRECTV and NRTC — an essential condition of the Settlement Agreement — the Debtors have agreed to release the Pegasus Non-Debtors from all claims (other than claims under the Support Services Agreement), including potential preference and fraudulent transfer avoidance claims, held by the Debtors' estates as of the effective date of the Settlement (the "Potential Claims"). The Potential Claims arise out of, among other things, the transactions discussed below.

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the Court resolved issues raised by DIRECTV concerning the transferability of subscriber information. Given the difficulties attendant to transitioning subscribers and the August 31st programming cut-off, the Debtors believe that the aggregate consideration ultimately received by Pegasus in such a transaction would be materially less than the consideration offered by DIRECTV under the Settlement. Moreover, in light of the ongoing marketing efforts by both EchoStar (DIRECTV's and the Debtors' primary DBS competitor) and DIRECTV, the number of subscribers that ultimately could be transferred in such a transaction would be uncertain.

<sup>26</sup> The prepetition senior secured lenders were owed, as of the Petition Date, approximately \$410 million.

<sup>27</sup> The prepetition junior secured lenders were owed, as of the Petition Date, approximately \$106 million.

<sup>28</sup> The discussion of these claims are for settlement purposes only and shall not be prejudice any parties' rights with respect thereto if the Settlement is not approved.

31. Potential Fraudulent Transfer Claims. PSC made the following transfers

to PCC in connection with, and since, PCC's formation in February 2001:

- The 2001 Reorganization. In 2000, Pegasus Satellite Communications, Inc. ("PSC"), then named Pegasus Communications Corporation, determined that, as constituted, PSC would be unable to meet its future operational and financing needs and that a corporate reorganization would be necessary. In that regard, on February 22, 2001, all common and preferred equity of PSC was exchanged for identical preferred and common equity of PCC, then newly formed to act as a public holding company (the "2001 Reorganization"). As a result of the 2001 Reorganization, PCC replaced PSC as the ultimate public parent corporation of the Debtors and assumed ownership of PSC and certain of its assets and responsibility for PSC's preferred stock (which were exchanged for identical shares of preferred stock of PCC). PSC remained liable on the public debt securities that it had issued prior to the 2001 Reorganization. As part of the 2001 Reorganization, PSC transferred to PCC the stock of Pegasus Development Corporation.
- Other Transfers. (i) On July 24, 2001, PSC transferred to PCC, PSC's membership interest in Pegasus Guard Band, LLC (licensee with respect to certain broadcast frequencies); (ii) on April 11, 2002, PSC transferred to PCC approximately 7% of the equity of Pegasus Communications Holdings, Inc. in the form of non-voting common securities; (iii) on May 8, 2002, PSC transferred to PCC the stock of Pegasus Real Estate Company (which owns PCC's headquarters building); and (iv) on June 28, 2002 PSC paid to PCC cash dividends in the approximate amount of \$122 million<sup>29</sup> and, contemporaneously therewith, PCC loaned \$114 million to PSC.<sup>30</sup>

If it is determined that PSC was insolvent at the time of, or rendered insolvent by, any of the foregoing transfers and received less than fair value for the assets so transferred, the transfer in question could be avoided as a constructive fraudulent transfer.

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<sup>29</sup>This transaction may also be subject to attack as an illegal dividend in addition to a constructive fraudulent conveyance. PCC disputes this characterization and would vigorously defend any such litigation.

<sup>30</sup>In addition, on January 19, 2004, PCC purchased the stock of Pegasus Travel, Inc. from PSC for \$737,500 in cash, and purchased the stock of Pegasus Communications Management Company from PSC for \$1.00 in cash and assumption of approximately \$5.8 million of net liabilities. If the respective purchase prices for these assets constituted less than fair value and PSC was insolvent at the relevant times, these purchases could be avoided as constructive fraudulent transfers.

32. Potential Preference Claims.<sup>31</sup> The Debtors made approximately \$49.6 million in aggregate payments to Pegasus Non-Debtors during the year preceding the Petition Date in respect of the June 28, 2002 loan and services provided to, and reimbursement of expenses incurred on behalf of, the Debtors. If it is determined that the Debtors making these payments were insolvent at the time of payment (which is presumed during the 90 days prior to the Petition Date) and the payments were not made in the ordinary course of business or for the receipt by the applicable Debtor of new value in exchange therefore, these payments could be avoided as preferences.

33. Any Potential Claims brought against the Pegasus Non-Debtors would turn, in the first instance, on whether the Debtors were solvent on the date of the applicable transfer. Since the Debtors' DBS business accounted for the bulk of the Debtors' total assets at the time of each transfer, the value of that business as of each applicable transfer date would be a central factor in determining the Debtors' solvency (or insolvency) on the date thereof. As the Court recalls, in connection with the Adversary Proceeding, the Court made a preliminary analysis of the key factor impacting the Debtors' DBS business — the strength and extent of the Debtors' exclusive distribution rights under the DIRECTV Agreements. This determination may play a role in determining the Debtors' solvency as of the dates of the foregoing transfers. However, in order to adjudicate the Potential Claims, the Court would be required to conduct a solvency analysis “as of” the dates of each of the potentially avoidable transfers, based upon the circumstances then present and the information then available.<sup>32</sup> The decisions adverse to PSC

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<sup>31</sup> Each of these transactions may also be constructive fraudulent transfers to the extent the applicable Debtor was insolvent at the time of the respective payments and received less than fair value in return for such payments.

<sup>32</sup> *See, e.g. In re R.M.L., Inc.* 92 F.3d 139, 155 (3<sup>rd</sup> Cir. 1996) (citing and following authorities holding that hindsight should not be used in gauging the financial condition of a transferor).



in the California Litigation (the first of which did not occur until August 2003) and the receipt of termination notices from NRTC and DIRECTV all post-date the substantial majority of the transfers at issue. This sequence of events would have to be taken into account in the determinations of solvency at the relevant times. The factual analysis in connection with the determination of the solvency of a Debtor at the time of any transfer would face additional complexity as a result of, among other things, changes in the respective balance sheets of the Debtors during the relevant period resulting from internal reorganizations of the Debtors, including transfers and assumptions of liability in respect of indebtedness. These factual analyses, necessary to be undertaken in connection with the determination of the solvency of a Debtor at the time of any transfer, would be extremely complex and the subject of protracted costly litigation. The litigation and ultimate outcome of the Potential Claims would be further complicated by an absence of case law discussing proper methods for valuing intangible assets, or the role (if any) of litigation contingencies in such valuations. In all likelihood, the litigation of the Potential Claims would involve extensive expert testimony and sharp disputes over valuation methodologies, among other factors.

34. In light of the complex factual and legal issues that must be adjudicated in the absence of a clear legal standard for the Court to apply, the value placed upon the Debtors' Potential Claims must be weighed against the uncertainty of the eventual outcome, the risk of an adverse outcome, and the sheer cost of prosecuting such claims. The Debtors and the Committee believe that the certainty in value that the Debtors' estates are receiving in connection with the Settlement and in exchange for releasing the Potential Claims outweighs the value of litigating the Potential Claims in light of the risks attendant thereto.

## BASIS FOR RELIEF REQUESTED

### A. The Settlement Should be Approved Because It Is Fair and Equitable and in the Best Interests of the Debtors' Estates.

35. Bankruptcy Rule 9019(a) provides, in pertinent part, that “[o]n motion by the trustee and after notice and a hearing, the court may approve a compromise or settlement.” 11 U.S.C. § 9019(a). Compromises are favored by bankruptcy courts. In re Greenacre, 103 B.R. 1, 5 (Bankr. D. Me. 1989) (citations omitted); Fogg v. Sherman Homes, Inc. (In re Sherman Homes, Inc.), 28 B.R. 176, 177 (Bankr. D. Me. 1983); In re C.P. Del Caribe, 140 B.R. 320 (Bankr. D. P.R. 1992); In re Hydronic Enter., Inc., 58 B.R. 363, 365 (Bankr. D. R.I. 1986). Approval of a compromise “is within the sound discretion of the bankruptcy judge.” Jeffrey v. Desmond, 70 F.3d 183, 185 (1st Cir. 1995). Before approving a settlement under Bankruptcy Rule 9019, a court must determine that the proposed settlement is in the best interests of the debtor’s estate. Greenacre, 103 B.R. at 5 (citation omitted). To reach this determination, the court must assess the value of the claim that is being settled and balance it against the value to the estate of the approval of the settlement. Hicks, Muse & Co., Inc. v. Brandt (In re Healthco Int’l, Inc.), 136 F.3d 45, 50 (1st Cir. 1998); Jeffrey, 70 F.3d at 185.

36. The standard by which courts should evaluate the reasonableness of a proposed compromise and settlement is well established and includes consideration of the following four factors: “(i) the probability of success in the litigation being compromised; (ii) the difficulties, if any, to be encountered in the matter of collection; (iii) the complexity of the litigation involved, and the expense, inconvenience and delay attending it; and (iv) the paramount interest of the creditors and a proper deference to their reasonable views in the premise.” Jeffrey, 70 F.3d at 185 (citation omitted); Greenacre, 103 B.R. at 5 (citations omitted); Sherman Homes, 28 B.R. at 177 (citation omitted). Furthermore, the bankruptcy court should

not “decide the numerous questions of law and fact raised by appellants but rather. . . canvass the issues and see whether the settlement ‘falls below the lowest point in the range of reasonableness.’” Healthco, 136 F.3d at 51 (quoting Cosoff v. Rodman (In re W.T. Grant Co.), 699 F.2d 599, 608 (2d Cir. 1983)).

37. The standard set forth above is clearly met in this case. By entering into the Settlement, the parties have agreed to resolve numerous complex disputes. It is beyond question that a litigated resolution of the Adversary Proceeding would be both time consuming and exceedingly costly for the Debtors, and would considerably delay distributions to creditors. Likewise, prosecution of the Potential Claims against the Pegasus Non-Debtors would be exceedingly time consuming and costly. The Settlement permits the Debtors to both avoid the uncertainty, delay and strain on financial resources associated with litigation and insure a relatively near term, and meaningful, distribution to the Debtors’ general unsecured creditors.

38. Of course, it is entirely appropriate for the Court to consider the preferences of creditors and equity holders when evaluating the merits of the proposed settlement. Jeffrey v. Desmond, 70 F.3d 183, 185 (1st Cir. 1995). The Committee played a pivotal role in the settlement negotiations. The Committee fully understands both the potential upside of a victory in the Adversary Proceeding, the likely return to creditors if the Settlement is approved, the potentially devastating consequences of a loss in the Adversary Proceeding -- particularly when coupled with the Debtors' inability to effect a full value sale of the subscriber base to a third party -- and the potential value (or lack thereof) of claims against the Pegasus Non-Debtors. Informed by this knowledge, the Committee unequivocally supports approval of the Settlement.

39. Without question, the Settlement is the product of arm's length negotiations among the parties, and DIRECTV is a good faith purchaser of the Satellite Assets and is entitled to protections under section 363(m) of the Bankruptcy Code. The Debtors believe that the compromises embodied in the Settlement are fair and reasonable and constitute the best obtainable results.

40. For the foregoing reasons, the Debtors respectfully submit that approval of the Settlement is in the best interests of the Debtors, their estates and creditors.

**B. The Court May Authorize a Transfer of the Satellite Assets to DIRECTV Pursuant to Section 363 of the Bankruptcy Code.**

**1. The Debtors' Have Exercised Sound Business Judgment in Entering Into the Settlement.**

41. Section 363(b)(1) of the Bankruptcy Code provides that “the trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate.” The Debtors submit that ample authority exists for the approval of the proposed transfer of the substantially all of the Debtors’ assets<sup>33</sup> to DIRECTV, free and clear of liens, claims and encumbrances, pursuant to section 363 of the Bankruptcy Code.

42. Section 363 of the Bankruptcy Code does not set forth a standard for determining when it is appropriate for a court to authorize the sale or disposition of a debtor’s assets prior to a confirmation of a plan. However, courts have required that the decision to sell substantially all of the debtors' assets outside the ordinary course of business be based upon the sound business judgment of the debtors. See In re Abbotts Dairies of Pennsylvania, Inc., 788

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<sup>33</sup> The proposed transfer of assets does not include the transfer of the Debtors’ assets related to their broadcast television business.

F.2d 143 (3rd Cir. 1986); Committee of Equity Security Holders v. Lionel Corp. (In re Lionel Corp.), 722 F.2d 1063, 1071 (2d Cir. 1983); In re Aerovox, Inc. 269 B.R. 74, 80 (Bankr. D. Mass. 2001); In re Delaware & Hudson Ry. Co., 124 B.R. 169, 176 (D. Del. 1991).

43. In Lionel, one of the seminal cases on a debtor's use of 363(b), the Second Circuit noted that case law under section 363's predecessor "used terms like 'perishable,' 'deteriorating,' and 'emergency' as guides in deciding whether a debtor's property could be sold outside of the ordinary course of business." 722 F.2d at 1070-71. Although the Lionel court found that Congress had relaxed these standards under section 363, it held that a court considering a section 363(b) application must determine whether the debtor had a "good business reason" for the 363 application, including considering the policy behind chapter 11. Id. Among the factors enumerated by the Lionel that a court may consider, the most important factor, according to the court, was "whether the asset is increasing or decreasing in value." Id. at 1071.

44. The Debtors submit that more than ample business justification exists immediately to sell the Satellite Assets to DIRECTV pursuant to section 363 of the Bankruptcy Code. Unless DIRECTV reverses its position concerning the provision of DBS programming to the Debtors after August 31st<sup>34</sup> or this Court (or the District Court) promptly issues an injunction requiring the continued provision of such services,<sup>35</sup> the Debtors' ability to distribute DIRECTV® programming to their subscribers will end as of August 31, 2004 . Without the

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<sup>34</sup> Pursuant to Section 2.6 of the Cooperation Agreement, DIRECTV has agreed to continue providing programming service to the Debtors beyond August 31st to the extent necessary to permit hearings on the Settlement to be concluded.

<sup>35</sup> If the Settlement is not approved by this Court, pursuant to the Cooperation Agreement, DIRECTV has agreed to continue providing programming services to the Debtors for a specified period under certain circumstances as set forth in Section 5.4 of the Cooperation Agreement.

ability to provide programming services, the Debtors will rapidly lose their entire subscriber base. And, without an intact subscriber base, the Debtors will be unable either to effect an internal reorganization, or obtain any significant value from a buyer for their satellite business.<sup>36</sup> Under these circumstances, the Debtors submit that the business reasons supporting a transfer of substantially all of the Debtors' Satellite Assets in connection with the Settlement are not only ample, they are compelling -- a transfer of the satellite assets to DIRECTV is crucial to avoid a rapid and material deterioration of the value of the satellite assets. See In re White Motor Credit Corp., 14 B.R. 584, 590 (Bankr. N.D. Ohio 1981) (approving a sale of substantially all of the debtor's assets, considering the substantial likelihood of loss in value should the sale not occur). Case law in this Circuit is in accord. See Connell v. Coastal Cable T.V. Inc., (In re Coastal Cable T.V. Inc.) 24 B.R. 609, 611 (B.A.P. 1st Cir. 1982) ("A sale of all or most of a debtor's assets may occur prior to confirmation of a plan."). See also In re Thrifty Liquors, Inc., 26 B.R. 26, 28 (Bankr. D. Mass. 1982) ("The continuing erosion of the Debtor's assets and the severe diminution in the value of those assets which is likely to occur in the future constitutes an emergency situation justifying... a sale of all assets prior to confirmation of a plan or reorganization.").

45. Furthermore, the Settlement is not a sub rosa plan of reorganization as was the transaction criticized by the Fifth Circuit Court of Appeals in Pension Benefit Guar. Corp. v. Braniff Airways, Inc. (In re Braniff Airways, Inc.), 700 F.2d 935, 939-40 (5th Cir. 1983). The Settlement only proposes to transfer assets of, and release potential litigation claims belonging

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<sup>36</sup> As noted above, the Debtors believe that it would take months to transition their subscribers to another service provider. Without assurances that the Debtors' subscriber base would be preserved during a transition period -- an assurance the Debtors are incapable of providing -- no buyer would, in the Debtors' judgment, offer value remotely approaching the value of the Settlement in order to acquire the Debtors' subscribers.

to, the Debtors; it does not alter the rights of the Debtors' creditors. Thus, the Settlement does not specify the terms under which a reorganization plan is to be adopted, and does not bind any parties or creditor constituencies under any future plan of reorganization to be proposed by the Debtors. As the court in In re Naron & Wagner, Chartered, 88 B.R. 85, 88 (Bankr. D. Md. 1988) stated, "[t]he sale proposed here is not a sub rosa plan because it seeks only to liquidate assets, and the sale will not restructure rights of creditors, as in the Braniff case." See also Eastern Airlines, Inc. v. Shugrue (In re Ionosphere Clubs, Inc.), 184 B.R. 648, 654 n.6 (S.D.N.Y. 1995) (distinguishing Braniff).

46. The Settlement is the culmination of a lengthy, and often times contentious, negotiation process in which all parties were represented by sophisticated counsel and financial advisors. Accordingly, the Debtors submit that DIRECTV is entitled to, and should be afforded, the protections that section 363(m) of the Bankruptcy Code provides to a good faith purchaser.

## **2. The Satellite Assets Can be Sold Free and Clear of the Secured Lenders' Liens.**

47. The liens held by the senior secured lenders<sup>37</sup> will attach to the cash proceeds received by the Debtors in connection with the Settlement. Under section 363(f) of the Bankruptcy Code, a debtor in possession may sell all or any part of its property free and clear of any and all liens, claims or interests in such property if (i) such a sale is permitted under applicable non-bankruptcy law; (ii) the party asserting such a lien, claim or interest consents to such sale; (iii) the interest is a lien and the purchase price for the property is greater than the

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<sup>37</sup> While the junior secured lenders do not hold liens on the Satellite Assets, the Debtors anticipate that both the senior secured lenders and the junior secured lenders will be provisionally paid the undisputed amount of their claims upon closing of the Settlement.

aggregate amount of all liens on the property; (iv) the interest is the subject of a *bona fide* dispute; or (v) the party asserting the lien, claim or interest could be compelled, in a legal or equitable proceeding, to accept a money satisfaction for such interest. See 11 U.S.C. § 363(f); In re Elliot, 94 B.R. 343, 345 (E.D. Pa. 1988) (section 363(f) written in disjunctive; court may approve sale “free and clear” provided at least one of the subsections is met). Because the Debtors expect that they will satisfy the first, second, third and fifth of these requirements, approving the sale of the satellite assets free and clear of all adverse interests is warranted.<sup>38</sup>

**C. The Sale should be Free and Clear of all Transfer Taxes Pursuant to Section 1146(c) of the Bankruptcy Code.**

48. The Debtors also request that the transfer of Satellite Assets be exempt from any transfer taxes as provided by section 1146(c). Under section 1146(c) of the Bankruptcy Code, the “transfer . . . or the making or delivery of an instrument of transfer under a plan confirmed under section 1129 of this title, may not be taxed under any law imposing a stamp or similar tax.” See 11 U.S.C. § 1146(c). Courts have broadly construed this provision to include sales and transfers that occur outside of a chapter 11 plan of reorganization and before or after confirmation of that chapter 11 plan. See In re Linc Capital, Inc., 280 B.R. 640 (Bankr. N.D. Ill. 2002); Dir. of Revenue, State of Delaware v. CCA P’ship (In re CCA P’ship), 70 B.R. 696 (Bankr. D. Del. 1987), aff’d 72 B.R. 765 (D. Del. 1987), aff’d, 833 F.2d 304 (3rd Cir. 1987); In re Jacoby-Bender, Inc., 758 F.2d 840, 842 (2d Cir. 1985) (holding that section 1146(c) of the Bankruptcy Code applied when the “transfer is necessary to the continuation of a plan”); In re 995 Fifth Ave. Assocs., L.P., 116 B.R. 384 (Bankr. S.D.N.Y. 1990) aff’d 127 B.R. 533

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<sup>38</sup> Furthermore, courts have held that they have the equitable power to authorize sales free and clear of interests that are not specifically covered by section 363(f). See, e.g., In re Trans World Airlines, 322 F.3d 283 (3d Cir. 2003); Volvo White Truck Corp. v. Chabersburg (In re White Motor Credit Corp.), 75 B.R. 944, 948 (Bankr. N.D. Ohio 1987).



(S.D.N.Y. 1991), aff'd in part, rev'd in part (on other grounds) 963 F.2d 503 (2d Cir. 1992). In so holding, the courts have focused on whether the sale and transfer is “necessary to the consummation of the plan.” Jacoby-Bender, 758 F.2d at 842. But see In re Hechinger Investment Co. of Delaware, Inc., 335 F.3d 243 (3rd Cir. 2003) (holding that section 1146(c) of the Bankruptcy Code only exempts taxes related to sales authorized by the terms of a previously confirmed chapter 11 plan); NVR Homes, Inc. v. Clerks of the Circuit Courts (In re NVR, LP), 189 F.3d 442 (4th Cir. 1999).

49. In these cases, the Debtors’ sale of the Satellite Assets is the essential precursor of any plan, and, therefore, should be deemed to be “under a plan” for purposes of section 1146(c). As noted above, the Satellite Assets represent the most significant assets of the Debtors. Accordingly, the Debtors submit that a sale of the Satellite Assets in anticipation of an ensuing liquidating plan that provides for prompt distributions to secured and unsecured creditors falls within the scope of the exemption provided under section 1146(c) of the Bankruptcy Code. See In re Permar Provisions, Inc., 79 B.R. 530, 534 (Bankr. E.D.N.Y. 1987) (sale of property one year prior to plan confirmation was exempt under section 1146(c) where sale proceeds were distributed to secured and unsecured creditors). Accordingly, the sale should be approved free and clear of transfer taxes.

### **NOTICE**

50. Notice of this Motion has been given to (i) the Office of the United States Trustee for the District of Maine; (ii) counsel to the Committee and the members thereto; (iii) administrative agents to the Debtors' prepetition credit facilities; (iv) counsel to the indenture trustees; (v) the prepetition senior secured lenders and their respective counsel; (vi) the prepetition junior secured lenders and their respective counsel; (vii) counsel to DIRECTV; (viii)

counsel to PCC; (ix) counsel to NRTC; and (x) all entities who have filed a notice of appearance or request for service of papers pursuant to Bankruptcy Rule 2002. The Debtors submit that in light of this Court's Order Establishing Notice and Service Requirements in these Chapter 11 Cases dated June 7, 2004, and the nature of the relief requested, no further notice is required.

**NO PRIOR REQUEST**

51. No previous request for the relief sought herein has been made by the Debtors to this or any other court.

WHEREFORE, the Debtors respectfully request that the Court enter an order: (i) authorizing the Debtors to enter into and perform the Settlement Agreement, the Asset Purchase Agreement and the Cooperation Agreement; (ii) waiving the provisions of Bankruptcy Rule 6004(g) staying the effectiveness of such order so that such order will become effective immediately and the parties will be permitted to consummate the transactions contemplated by the Settlement immediately upon entry of such order, and (iii) granting such other and further relief as the Court may deem proper.

Dated: Portland, Maine  
August 3, 2004

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