

Hearing Date: 10/23/04
10:30 a.m.
Portland

UNITED STATES BANKRUPTCY COURT
DISTRICT OF MAINE

IN RE:)
) Chapter 11
Pegasus Satellite Television, Inc.,)
) Case No.: 04-20878
Debtors) (Jointly Administered Cases)

**OBJECTION OF DELAWARE STREET CAPITAL MASTER FUND LP
AND CLAM PARTNERS, LLC. TO DEBTORS' SUPPLEMENTAL
MOTION FOR ORDER PURSUANT TO 11 U.S.C. §§ 363(b)
AND 105(a) AUTHORIZING AND APPROVING IMPLEMENTATION
OF A SUPPLEMENTAL MANAGEMENT RETENTION PLAN**

NOW COME Delaware Street Capital (“DSC”) and CLAM Partners, Ltd. (“CLAM”), and for their Objection to Pegasus Satellite Television, Inc. and certain of its subsidiaries and affiliates, each a debtor and debtor-in-possession herein (collectively, the “Debtors”), Motion (the “Motion”) for an Order Authorizing and Approving Implementation of a Supplemental Management Retention Plan (the “Supplemental Retention Plan”), state as follows:

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 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 are continuing 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 an official committee of unsecured creditors pursuant to section 1102(a) of the Bankruptcy Code (the “Committee”).

4. 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 alleged statutory predicates for the relief sought in the Motion are 11 U.S.C. §§ 363(b) and 105(a).

5. In the Motion, the Debtors address the remaining components of the initial KERP that were not addressed in the First or Second KERP Orders relating to Ted S. Lodge, President and Chief Operating Officer of PCC and each of its subsidiaries, including each of the Debtors (“Mr. Lodge”).¹

6. There are three components to the Lodge Supplemental Retention Plan. The first component is a \$1 million bonus payable upon the closing of the sale of the Debtors’ satellite assets, the “Closing Payment”. The second component is payment of \$400,000 upon consummation of a Chapter 11 Plan for the Debtors (the “Plan Payment”). The third component is Family Healthcare Coverage Benefits in accordance with ERISA and Section 4980B of the Internal Revenue Code (COBRA Benefits).

¹ KERP matters related to Marshall W. Pagon, Chairman and CEO of PCC and each of its subsidiaries, including the Debtors, will apparently be dealt with in the future.

7. As part of the “Global Settlement”, the Official Committee of Unsecured Creditors has agreed to support the Supplemental Retention Plan with respect to Mr. Lodge.

BACKGROUND AND DISCUSSION

8. Mr. Lodge has been with many of the Debtors since 1996, serving in a variety of functions. Additionally, Mr. Lodge has an “Executive Employment Agreement” dated July 21, 2002 with Pegasus Communications Corporation (“PCC”), the Debtors’ solvent parent company.

9. Mr. Lodge testified before this Court on August 25, 2004 that his base salary at the Debtors is approximately \$350,000 per year, and that as a matter of routine he makes bonuses of \$400,000 per year. Further information on Mr. Lodge’s past employment terms and compensation with the Debtors was not elicited in testimony, but it is likely that Mr. Lodge also holds and has held substantial stock and stock options in the Debtors and PCC, and that he has made a significant amount of money with the Debtors and PCC in the last eight years or so.

10. Significantly, Mr. Lodge also testified on August 25, 2004 that the \$1,000,000 Closing Payment bonus and \$400,000 Plan Payment bonus are, essentially, guaranteed by PCC. In fact, the Debtors seem to reiterate this arrangement in the Motion; for example, Paragraph 26 of the Motion states: “Such payment would be fully allocated to the Debtors. The Closing Payment and the Plan Payment would constitute offsets against any payments that Mr. Lodge may be allowed under the Employment Agreement.”² Mr. Lodge testified that he is indifferent to the \$1.4 million payment because he will be getting paid whether the Court approves this Motion or not. On cross-examination Mr. Lodge deflected the argument that the Global Settlement was simply about self-interest of the upper echelon of Debtors’ Management by stating that he was

² This language is repeated in the Debtors proposed Order for the Motion. It is no comfort to creditors of the Debtors to know that by the Estates diminishing their assets in paying Mr. Lodge a solvent third party (PCC) will gain the advantage of an offset to its liabilities.

going to get paid \$1.4 million by PCC if the Global Settlement or KERP were not approved. The Debtors and Mr. Lodge cannot have the argument work both ways. One cannot use the PCC guaranty on one day to get the Global Settlement Motion approved and then switch and argue on the next day that the Debtors have to pay the \$1.4 million.

11. Likewise, the Debtor argued in the context of the Global Settlement Motion that the Supplemental Retention Plan with regard to Mr. Lodge was wide open for argument before the Court in the future. To deflect the argument of management self-interest, the Debtors argue that there was nothing binding or influential in the Global Settlement Motion as regards the Supplemental Retention Plan. Again, this is a legitimate argument to make on August 25 and 26, 2004, but one cannot then in the present Motion argue or insinuate that in going forward with the Global Settlement Motion the Debtors and parties-in-interest were committing themselves to support Mr. Lodge's Supplemental Retention Plan.

12. Further, it is the obligation of these bankrupt Debtors, and the Committee, to make sure that as few assets of the Debtors flow to third parties (like Mr. Lodge) as possible, but instead, are retained for the benefit of the Estates. This is especially true here where Mr. Lodge has the option to be paid in full by PCC; PCC should be forced to live up to its contractual obligation.

13. Under these facts, Mr. Lodge's payments are not part of a KERP but simply funds flowing from the Estates, not to the executive being retained, but to a parent holding company to reimburse it for a previously existing obligation to pay the executive.

14. One also has to examine the value that Mr. Lodge and the Management team have brought to the Debtors prior to and since the filing. One has to put values on the services provided. No one person is worth what the Debtors seek to pay Mr. Lodge upon the approval of

the Motion. The Debtors' case began on June 2, 2004. The \$1 million for the Closing Payment, is, therefore, to be paid for services rendered for the months of June, July and August, 2004, given that the sale closing occurred on or about August 27, 2004. Mr. Lodge is likely a hard-working, highly skilled member of the Debtors' management team and carries with him a great deal of knowledge which helped the Global Settlement come to fruition, regardless of one's opinion on the virtue of Global Settlement. But for those three months of work, Mr. Lodge is essentially being paid \$1 million, or \$333,000 per month. In addition to this payment, Mr. Lodge testified that his regular income and bonus plan amount to at least \$750,000 per year from the Debtors, not to mention any additional compensation Mr. Lodge may receive from PCC or other non-Debtor subsidiaries of PCC. To pro rate the approximate \$750,000 regular salary and bonus over the three month period, would mean that Mr. Lodge would be making approximately one-fourth of \$750,000 for the three month period, or another \$187,500. Essentially, therefore, Mr. Lodge would be making for the three month period \$1,187,500.00 or \$395, 833.33 per month. On a yearly basis, this is income of a little over \$4 million dollars per year. This is simply too much. For purposes of the Motion one can assume that Mr. Lodge should be paid as a highly skilled, highly productive and hard-working individual, but he already is being paid these amounts by the Debtors, without any bonuses.

15. Second, one cannot forget that this is the same management team that let hundreds of millions of dollars worth of equity flow out of the Debtor in the years leading up to the bankruptcy that now seeks to be **rewarded** for doing the job it did. This is the same management team that after 5 years of litigation and \$40 million in attorneys' fees ended up with an emergency requiring the Global Settlement to go forward on an expedient basis, while at the same time garnishing releases for themselves and PCC.

16. Debtors will argue that they need to bonus Mr. Lodge to get him to stay at the Debtors. But if Mr. Lodge did not and does not have enough income from his job to pay for his talents, then he would have left the position long ago. Further, unlike many key executives who stay with Debtors through risky bankruptcies, and therefore should be rewarded for their risk, Mr. Lodge took no risk here because of the PCC guaranty.

17. Further, it is also unclear that Mr. Lodge is necessary going forward to ensure the Debtors' successful "reorganization," which reorganization may end up looking more like a liquidation. The issues have been greatly simplified, and it would seem that they could be carried out by the other managers.

18. Finally, the Debtors rely on the Business Judgment Rule to support the Motion. The Motion presents the classic case where the Business Judgment Rule should be questioned: where the very parties who seek to benefit from the Business Judgment Rule are the parties who gain from the deferral under the Business Judgment Rule. The key question in this case under the Business Judgment Rule is very simple: Are the Estates better off paying \$1.4 million or not paying \$1.4 million? The answer is clear.³

WHEREFORE, DSC and CLAM request that the Debtors' Motion be dismissed and denied and they be granted such other and further relief as is just and proper.

³ The Debtors cite case under the Business Judgment Rule for payments to executives, but few of these cases were substantially completed 3 months, few of these cases involve bonuses for three months of work, few of these cases led quickly to liquidation type scenarios, and none of these case involved guaranteed payments by third-party non-debtors.

DATED: September 17, 2004

/s/Daniel R. Felkel
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CERTIFICATE OF SERVICE

I hereby certify that I served a true and correct copy of the foregoing Objection of Delaware Street Capital Master Fund, LP and CLAM Partners, LP to Debtors' Supplemental Motion for Order Authorizing Retention Plan was served electronically on all parties on the Court's Electronic Filing List and served on each of the parties set forth on the Service List below via U.S. mail, postage prepaid, on the 17th day of September, 2004.

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