IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF DELAWARE

In re:	)	Chapter 11
DIRECTV LATIN AMERICA, LLC	)	Bankruptcy No. 03-10805 (PJW)
Debtor.	)	
RAVEN MEDIA INVESTMENTS LLC,	)	
Appellant,	)	
v.	)	Civ. No. 03-981-SLR
DIRECTV LATIN AMERICA, LLC,	)	
Appellee.	)	

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MEMORANDUM OPINION

Dated: February 4, 2004
Wilmington, Delaware

ROBINSON, Chief Judge

I. INTRODUCTION

On October 24, 2003, appellant Raven Media Investments LLC ("Raven") filed this appeal from the August 22, 2003 bankruptcy court order to subordinate any claims of Raven arising from a put agreement ("the Put Agreement") between debtor-appellee DirecTV Latin America LLC ("DTLVA"). (D.I. 1) The court has jurisdiction to hear this appeal pursuant to 28 U.S.C. § 158(a)(1). The facts on appeal are undisputed and the issue before the court is whether the bankruptcy court erred in granting DTLVA's motion to subordinate Raven's contract claim pursuant to 11 U.S.C. § 510(b). Because the court concludes that Raven's claim is outside the scope of § 510(b), the bankruptcy court's decision shall be reversed.

II. STATEMENT OF FACTS

A. Procedural History

DTVLA filed a voluntary petition for under Chapter 11 of the Bankruptcy Code on March 18, 2003. That same day, DTVLA filed a motion for an order authorizing rejection of the Put Agreement and subordinating any claims arising from the Put Agreement pursuant to 11 U.S.C. § 510(b). (D.I. 6 at 1-10) Raven filed its objection to DTVLA's motion to reject and subordinate on April 4, 2003. On July 11, 2003, DTVLA filed a motion for summary judgment subordinating the claims, which was opposed by Raven. (Id. at 51-88) On August 6, 2003, the bankruptcy court held a hearing on the summary judgment motion and ruled from the bench, granting DTVLA's motion to reject and subordinate Raven's claim. (Id., ex. G)

B. Factual Background

DTVLA provides direct-to-home satellite television entertainment in Latin America. DTLVA's services are distributed in Argentina through Galaxy, a local operating company. DTVLA is a privately held company primarily owned by Hughes Electronics Corp., Inc. ("Hughes"). Raven is a wholly owned subsidiary of Grupo Clarin, Inc. ("Grupo Clarin"), an Argentine communications company.

During the period of October 30, 1997 through November 10, 2000, DTVLA and DTVLA Holdings, Inc., owned a forty-nine percent (49%) interest in Galaxy. The remaining fifty-one percent (51%) of Galaxy was then owned by Plataforma Digital, S.A. ("Plataforma"), another wholly owned subsidiary of Grupo Clarin. Due to some restructuring among Grupo Clarin subsidiaries, Plataforma's interests related to DTVLA were transferred to Raven.

As a result of conflicts between Raven and DTVLA concerning the operation of Galaxy, the companies began exploring options to terminate their joint venture. In February 2000, DTVLA expressed its interest in acquiring Raven's interest in Galaxy. In September 2000, several meetings took place between the parties and Mogan Stanley, DTVLA's financial advisor, to discuss the potential transaction. The parties negotiated a purchase price for Raven's interest in Galaxy of $170 million; that price was subsequently reduced to $169 million.

On November 10, 2000, the parties executed a stock purchase agreement ("the Stock Purchase Agreement") and the Put Agreement. (D.I. 6, ex. A) On April 30, 2001, the parties executed a limited liability company admission agreement, subsequently amended by an amended and restated limited liability agreement ("LLC Agreement"). (Id.)

Pursuant to the Stock Purchase Agreement, DTVLA purchased Raven's interest in Galaxy in exchange for a four percent (4%) membership interest in DTVLA and the rights under the Put Agreement. The percentage interest conveyed to Raven resulted from an apparent unilateral determination by DTVLA, without discussion or an independent valuation.[1]

Under the LLC Agreement, DTVLA's interest was subject to certain restrictions including: (1) the requirement that DTVLA approve any sale of Raven's interest to a competitor; (2) a right of first refusal granted to other members on any third-party sale of Raven's interest; and (3) drag-along rights (e.g., DTVLA's

[1]If four percent (4%) reflected an accurate valuation, than Galaxy would have had a worth of approximately $4.25 billion, which at that time would have accounted for twenty-seven (27%) of Hughes's market capitalization. (D.I. 6 at 92)

right to require Raven to sell its interest at the same time and on the same terms as the majority interest holder, provided those terms are no less than the amount of the Put Agreement). (D.I. 6, ex. A, B) Pursuant to the parties' agreements, Raven was also required to sign an irrevocable proxy in favor of the other DTVLA members with respect to any matter requiring a supermajority vote. (Id.)

The parties' agreements also exempted Raven from the DTVLA's restriction on a member's ability to pledge its interest in DTVLA, and Raven held no obligation to make capital contributions to DTVLA, and would not suffer dilution as the result of other member's contributions. (Id.) Further, Raven did not receive notice of DTVLA meetings, decisions made at those meetings, or the exercise of Raven's proxy. Raven did not receive a position on DTVLA's governing executive committee, and was not consulted in any manner with respect to DTVLA affairs.

Under the Put Agreement, Raven could exercise its option during a ten-day period in November 2003, three years after the date the agreement was executed. The Put Agreement fixed the amount DTVLA was required to pay to a base purchase price of $169 million, plus interest at approximately five percent (5%) per annum, for a total price of $194.8 million. (Id., ex. A) DTVLA's obligation to pay could also be triggered by certain accelerating events, including whether DTVLA or any of its significant subsidiaries "shall generally not, or shall be unable to, or shall admit in writing its inability to, pay its debts as they become due." (Id., ex. A at 7) Other accelerating events including certain DTVLA mergers or consolidations unrelated to DTVLA's financial condition.

DTVLA has stipulated, for purposes of its summary judgment motion, that a put accelerating event occurred more than two months prior to the petition date. Under the Put Agreement, the option was automatically deemed to be exercised, and any requirements of presentment, demand, protest, or similar notices were expressly waived by DTVLA. (Id. at 8) Consequently, as of January 8, 2003, Raven held a contract claim under the Put Agreement in the amount of $169 million exclusive of interest.

III. STANDARD OF REVIEW

In undertaking a review of the issues on appeal, the court applies a clearly erroneous standard to the bankruptcy court's findings of fact and a plenary standard to that court's legal conclusions. See Am. Flint Glass Workers Union v. Anchor Resolution Corp., 197 F.3d 76, 80 (3d Cir. 1999). With mixed questions of law and fact, the court must accept the bankruptcy court's "finding of historical or narrative facts unless clearly erroneous, but exercises 'plenary review of the [bankruptcy] court's choice and interpretation of legal precepts and its application of those precepts to the historical facts.'" Mellon

Bank, N.A. v. Metro Communications, Inc., 945 F.2d 635, 642 (3d Cir. 1991) (citing Universal Minerals, Inc. v. C.A. Hughes & Co., 669 F.2d 98, 101-02 (3d Cir. 1981)). The district court's appellate responsibilities are further informed by the directive of the United States Court of Appeals for the Third Circuit, which effectively reviews on a de novo basis bankruptcy court opinions. In re Hechinger, 298 F.3d 219, 224 (3d Cir. 2002).

In the present case, Raven contends that the bankruptcy court committed legal error and, thus, the de novo standard of review applies.

IV. DISCUSSION

Section 510(b) of the Bankruptcy Code provides:

> For the purpose of distribution under this title, a claim arising from rescission of a purchase or sale of a security of the debtor or of an affiliate of the debtor, for damages arising from the purchase or sale of such a security, or for reimbursement or contribution allowed under section 502 on account of such a claim, shall be subordinated to all claims or interests that are senior to or equal the claim or interest represented by such security, except that if such security is common stock, such claim has the same priority as common stock.

In In re Telegroup, Inc., the United States Court of Appeals for the Third Circuit considered whether a post-issuance contractual breach of a stock purchase agreement is within the scope of § 510(b). 281 F.3d 133 (2002). In that case, the shareholders alleged that the company had breached its contractual obligation to use good faith efforts to register the stock. Had the company done so, the shareholders might have mitigated their losses when the company began to decline.

In construing § 510(b), the Third Circuit first concluded that the statute's plain language was ambiguous. Id. at 138. The legislative history suggested that the congressional intent was to prevent shareholders from using allegations of securities fraud to bootstrap their claims in an effort to avoid the effect of the absolute priority rule. Otherwise, such claims might permit shareholders to avoid the statutory design to treat shareholders as residual claimants. Id. at 142. As residual claimants, the Bankruptcy Code requires that shareholders bear the risk of unlawful conduct which results in a loss of share value. See id. at 143. Central to the Third Circuit analysis is that equity investors choose to participate in profits and, in exchange, assume the risk of business failure; this is the distinguishing factor between equity and creditors and justifies the subordination of certain claims in bankruptcy. See at 142.

Nonetheless, simply being a holder of equity interest would be too broad of a basis to justify subordination of claims, just as limiting subordination to only tort claims would prove too narrow. As a result, the Third Circuit applied a hypothetical securities fraud test to the shareholders' claims. See id. at 143. In Telegroup, the post-issuance breach alleged by the shareholders was the debtor's failure to use good faith efforts to register the stock. The court reasoned that the same essential claim could be brought as securities fraud if, at the time of purchase, the shareholder was told the company was using its best efforts to register the stock. In the latter case, the shareholder's claim would be subordinated. The court held that since the asserted contract claims were indistinguishable from a hypothetical securities fraud claim, they too were within the scope of § 510(b). Id. The court concluded that "[s]ince claimants in this case are equity investors seeking compensation for a decline in the value of Telegroup's stock, we believe that the policies underlying § 510(b) require resolving textual ambiguity in favor of subordinating claims." Id. at 142.

Applying the Third Circuit's hypothetical securities fraud claim test, this court concludes that the present case is distinguishable from Telegroup and from the scope of claims covered by § 501(b). As an initial matter, the transaction's structure clearly shows that Raven did not seek to hold an equity interest in DTVLA. The transaction was structured such that Raven did not participate in the entity's management. Raven's interest was apportioned not based upon a fair valuation of DTVLA, but apparently upon an arbitrary figure. Raven was excused from capital contributions required of other LLC participants, and its interest was subject to certain restrictions on transferability. Raven did not participate in

LLC management and was not informed of the business affairs of DTVLA or even the exercise of its proxy. These are not conditions consistent with a purchase of equity, and certainly not consistent with an equity investment in the amount of approximately $170 million. Raven's interest also received unique treatment in that it was exempt from certain member restrictions, enabling it to monetize the holdings and obtain immediate cash. Most importantly, it is indisputable that the transaction was so structured that Raven would not bear the risk of illiquidity or insolvency. In sum, while Raven held equity in name, it possessed few of the characteristics consistent with that status.

The essence of the asserted claim in the present case is distinguishable from Telegroup. In that case, the contract claim could have been brought as a misrepresentation claim and the damages would be predicated upon diminished share value. Telegroup, 281 F.3d at 143. In contradistinction, Raven asserts a claim neither predicated upon misleading statements nor measured by diminished share value. Raven's right to payment arose without respect to actionable conduct by DTVLA, and without relation to the present value of its interest in DTVLA.

DTVLA contends that, as the Put Agreement simply gave Raven the right but not an obligation to sell its interest back to DTVLA, it participated in the profits and, therefore, falls within the scope of Telegroup. (D.I. 12 at 12) While participation in profits is a critical aspect of an equity interest, participation in the risk of loss is similarly crucial. See Telegroup, 281 F.3d at 139-42. In the present case, DTVLA can not reasonably assert that the transaction, as structured, was intended to expose Raven to any risk of loss. Consequently, § 501(b) should not subordinate Raven's claim for payment under the Put Agreement.

To be clear, the court does not conclude that a shareholder's possession of a put option to the debtor alone relieves a holder of equity of the effect of the absolute priority rule. The application, however, of a simple bright-line test is not consistent with the Third Circuit's analysis in Telegroup. See Telegroup, 281 F.3d at 144 n.2. Instead, Telelgroup counsels the court to consider whether subordinating the claim furthers the anti-bootstrapping intent of § 510(b) so that those who have contractually accepted the risk of business failure, bear that burden in bankruptcy. In the present case, the court concludes that the purpose of § 510(b) is not served by imposing the risk of business failure upon a party that unequivocally did not contract for it.

IV. CONCLUSION

For the reasons state above, the court concludes that the bankruptcy court's decision was in error and should be reversed.

An order consistent with this opinion shall issue.

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RAVEN MEDIA INVESTMENTS LLC,	)	
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	)	
DIRECTV LATIN AMERICA, LLC,	)	
	)	
Appellee.	)	

O R D E R

At Wilmington, this 4th day of February, 2004, consistent with the memorandum opinion issued this same day;

IT IS ORDERED that the August 23, 2003 bankruptcy court order in the above captioned case is reversed and remanded for disposition consistent with this opinion.

Sue L. Robinson
United States District Judge