SOUTHERN DISTRICT OF NEW YORK DISMISSES SECURITIES FRAUD CLASS ACTION ALLEGING FAILURE TO DISCLOSE CONTINGENT BANKRUPTCY PLANNING

On February 24, 2009, Judge Victor Marrero of the Southern District of New York granted summary judgment dismissing a securities fraud class action that had been brought against Bernard Schwartz -- the former Chairman and CEO of Loral Space & Communications Ltd. ("Loral") -- by shareholders who had purchased stock in the two-week class period prior to Loral's bankruptcy filing.[1] The decision supports the principle that when the market is aware of a company's "dire financial circumstances," there is no requirement to disclose contingent bankruptcy planning when otherwise speaking to the public.

Factual Background

As described by the court in its opinion, the factual background was as follows: prior to its July 15, 2003 bankruptcy filing, Loral -- a satellite company with substantial activities in both manufacturing and satellite-based communications -- had been experiencing severe difficulties due to the downturn in the market. In early 2003, Loral retained an investment bank to assist it in finding ways to alleviate its financial condition. Among other options, Loral considered a sale of certain of its satellites to Intelsat Ltd. ("Intelsat"). Intelsat commenced due diligence in March 2003. Yet after approximately two months of diligence, Intelsat began to demand that any sale of Loral's satellites take place in the context of a bankruptcy filing in order to assure safe passage of the assets.

On May 30, 2003, Loral and Intelsat agreed that the sale -- if it were to take place at all -- would be completed through a sale of property pursuant to Section 363(b) of the Bankruptcy Code. Loral retained bankruptcy counsel and a restructuring firm to assist it in the event that Loral filed for bankruptcy. But as of June 30, 2003, the first day of the class period, Intelsat had still not completed due diligence. And well into the class period, the parties were still $150 million apart on the purchase price. Finally, two days before the end of the class period, Loral and Intelsat agreed to a series of high-level face-to-face negotiations. At the close of the "intense" and "sometimes contentious" negotiations, Loral and Intelsat reached an agreement on a price of $1.06 billion. Loral's Board approved the transaction, and the following day -- before the market opened -- the bankruptcy was announced to the market.

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[1] Beleson v. Schwartz, No. 03 CV 6051, 2009 WL 508988 (S.D.N.Y. February 24, 2009). Defendant Schwartz was represented in this case by Willkie attorneys Francis J. Menton, Jr., Jeanne M. Luboja, Russell D. Morris and David A. Benner.

The Decision of the Court

During the two-week class period, Loral made several statements to the market, including the filing of three 8-K's to announce definitive agreements that it had just reached. The plaintiffs alleged that by failing to disclose that Loral was in the advanced stages of bankruptcy planning, those class-period statements were materially misleading. But Judge Marrero held that the failure to disclose its bankruptcy planning did not render any class-period statements misleading as to Loral's viability.

The court noted that the "information available to the market" was sufficient to "put investors on notice that a bankruptcy was a real possibility." The company had clearly warned the market that its "operations might not generate enough cash" to pay its obligations. Before the class period, an industry periodical predicted that the "heavily leveraged" company might be unable to avoid filing for bankruptcy court protection. Indeed, any "investor reading Loral's SEC filings could determine that . . . Loral's debt was approximately twenty times its equity value." As such, according to the court, that Loral "would end up filing a petition in bankruptcy was not a prospect outside the realm of possibilities that the securities markets would have anticipated, or that reasonable investors would have guarded against."

Judge Marrero further pointed out the good "public policy justifications for allowing a company operating near insolvency to make careful deliberations about its future, free from any obligation to disclose potential bankruptcy." According to the court:

> Any standard mandating disclosure of contingent bankruptcy planning would put an unacceptable burden on corporations and their officers. Such a standard might amount to a self-fulfilling prophecy, ensuring that all companies that begin contingent preparations for bankruptcy would inevitably go bankrupt because, upon disclosure of the plans, investors would immediately lose confidence in the company and close the capital markets.

Such a rule would "prematurely foreclose other options" being contemplated by a company that "could restore its financial viability and thus avert bankruptcy."

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If you have questions regarding the foregoing or would like additional information, please contact Francis J. Menton, Jr. (212-728-8246, fmenton@willkie.com), Jeanne M. Luboja (212-728-8241, jluboja@willkie.com), Russell D. Morris (212-728-8637, rmorris@willkie.com), or the Willkie attorney with whom you regularly work.

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