to the transaction. The entire fairness standard would apply if MHR was the controlling stockholder of Loral, or if the majority of the Loral board was not disinterested and independent as to the transaction. In this case, the court found, both were true. A stockholder is controlling if, "'as a practical matter, [he] possesses a combination of stock voting power and managerial authority that enables him to control the corporation, if he so wishes.'" *Id.* at *72 (*quoting In re Cysive S'holders Litig.*, 836 A.2d 531, 553 (Del. Ch. 2003)). MHR had significant power over Loral and used that power to influence the financing process. Additionally, five out of the eight Loral directors were affiliated with MHR at the time the financing was agreed to. Thus, the deal was examined to determine whether it was entirely fair to Loral and its stockholders other than MHR.

The court next looked at the special committee, to determine whether it "functioned as an effective proxy for arms-length bargaining, such that a fair outcome equivalent to a market-tested deal resulted." The court found that neither the special committee formed by Loral's board, nor the committee's financial advisor, adequately protected the interests of Loral. Likewise, the court found, the price obtained by MHR in its negotiations with the committee was better than market.

For all these reasons, the defendants failed to show that the MHR deal was entirely fair. The remedy that the court then settled upon was "to take MHR and the Special Committee up on their desire to avoid a *Revlon* deal, and to reform the Securities Purchase Agreement to convert the Preferred Stock that MHR received into non-voting common stock on terms fair to Loral." *Id.* at *116. The court therefore divided the dollar amount MHR had invested by what the court determined to be a fair per-share price for Loral stock, and ordered that the quotient would represent the number of non-voting common shares to be issued to MHR. As the court explained, "MHR will hold 57% of the total equity of Loral, . . . but remain at its prior level of voting power (35.9%). . . . At the same time, the remedy rectifies the harm to Loral and its public stockholders from an unfair, non-market tested transaction that saddled the corporation with an unwieldy capital structure and a future in which MHR held unilateral veto power over virtually any major decision the Loral board made." *Id.* at *119-20.

The atypical form of relief ordered in *Loral* illustrates the Court of Chancery's willingness, when circumstances warrant, to use its equitable powers to devise remedies particularly suited to the circumstances at the time judgment is entered. By changing the terms of the MHR deal to make them fair, the court avoided a forfeiture while putting Loral and its other stockholders in the position they likely would have been in if an arm's-length transaction had been negotiated.

Cases To Watch: *In re SemCrude*

On June 19, 2009, the United States Bankruptcy Court for the District of Delaware issued three opinions in the *SemCrude* bankruptcy addressing questions of first impression. *In re SemCrude, L.P.*, 407 B.R. 82 (Bankr. D. Del. 2009); *In re SemCrude, L.P.*, 407 B.R. 112 (Bankr. D. Del. 2009); *In re SemCrude, L.P.*, 407 B.R. 140 (Bankr. D. Del. 2009). One opinion (407 B.R. 140) addressed whether an Oklahoma statute created an implied trust, thereby keeping certain assets outside of the Debtor's bankruptcy estate and preventing the creditors' security interests from attaching thereto. The other two opinions addressed the extent to which non-uniform amendments to the Uniform Commercial Code (UCC) adopted by certain states are applicable to perfect security interests.

These latter two opinions (the "UCC Opinions") are particularly noteworthy because of their broader applicability, though all three have been appealed directly to the Third Circuit Court of Appeals. In the UCC Opinions, certain creditors owning oil and gas wells located in Kansas and Texas claimed to hold automatically perfected purchase money security interests under non-uniform amendments to the Kansas and Texas UCC. Thus, the pivotal issue in each of the UCC Opinions was which state's law applied in determining whether a security interest was perfected. "Given the uniformity found in most states' versions of Article 9 of the UCC, choice of law issues regarding security interests are rarely litigated." 407 B.R. at 95. Because the dispute was brought before the bankruptcy court sitting in Delaware, Delaware choice of law provisions applied, though the court noted that each of the states relevant to the disputes in the UCC Opinions had adopted the standard UCC choice of law provision. *See* 407 B.R. at 104, 105 n.13; 407 B.R. at 133 & n.11; *see also* U.C.C. § 9-301. Section 9-301 of the UCC sets forth the general rule that, when a debtor is located in a particular jurisdiction, the local law of that jurisdiction governs perfection of a security interest in collateral. Because the debtors were Delaware and Oklahoma entities, Delaware and Oklahoma law applied. Since the court held that the non-uniform amendments did not fall outside the scope of the UCC, those statutes were not recognized under either Delaware or Oklahoma law to create a priority superior to that of creditors properly perfected under Delaware or Oklahoma law.

The court undertook a similar analysis with respect to other non-possessory security interests that, claimants asserted, were perfected under non-uniform UCC provisions enacted in states other than Delaware and Oklahoma. As a result, the claims of the creditors relying on inapplicable non-uniform amendments for perfection were subordinate to those of creditors who were properly perfected under the applicable state's laws. For the present, at least, the UCC, as adopted in Delaware, will generally govern perfection of security interests in collateral owned by Delaware entities, notwithstanding any non-uniform amendments to the UCC in a state where the collateral originated.

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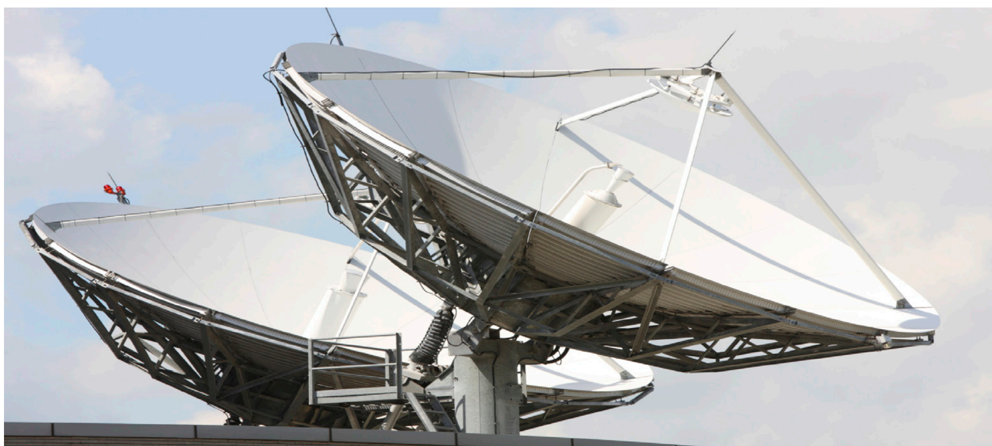
Case Law Developments: Terms of Equity Capital Raised in Unfair Transaction Reformed by Court

by Evangelos Kostoulas



In remedying a self-dealing transaction between a corporation and its controlling stockholder, the Delaware Court of Chancery reformed the terms of a securities-purchase agreement, converting the preferred stock issued under the agreement into non-voting common stock. *In re Loral Space & Communications, Inc. Consol. Litig.*, C.A. Nos. 2808-VCS, 3022-VCS, 2008 Del. Ch. LEXIS 136 (Del. Ch. Sept. 19, 2008), *aff'd sub nom. Loral Space & Communications, Inc. v. Highland Crusader Offshore Partners, L.P.*, 977 A.2d 867 (Del. 2009).

After Loral Space & Communications emerged from bankruptcy in 2005, its largest shareholder was MHR Fund Management LLC, owning 35.9% of Loral's common stock. Two of Loral's directors, Michael B. Targoff and John D. Harkey, Jr., were investment advisors to MHR. Targoff was also made Loral's CEO by MHR. Three other Loral directors were managing principals of MHR, including Mark H. Rachesky, MHR's founder, who served as Loral's chairman. Additionally, Rachesky had been a business school classmate of Harkey, and the two had stayed friends and acted as business references for each other.

Soon after Targoff became CEO, he sought, in consultation with Rachesky, to have Loral allow MHR to make a $300 million equity investment, "an investment equal to over half of Loral's existing stock market capitalization." *Id.* at *4. The Loral board appointed a two-person special committee to negotiate the proposed deal. Harkey was appointed chairman of the special committee and served on it with Arthur L. Simon, who had had no recent substantial involvement with the business world outside of his service on Loral's board.

Although Targoff had business plans for Loral that required capital, none of them required funding immediately. However, the special committee's "mandate" was to raise not less than $300 million in equity "quickly." *Id.* at *30. To assist it with this mandate, the special committee hired North Point Advisors LLC, a small investment bank headed by an individual with no graduate training in business or economics. North Point advised the special committee that Loral's best option was to sell convertible preferred stock to MHR, and that Loral "should pay a dividend between 5% and 7.5% and that the conversion premium should be 12% to 15%." *Id.* at *35. North Point did not conduct a market check before making this recommendation. Nevertheless, the special committee ultimately decided to give MHR the highest coupon and lowest conversion premium recommended by North Point and paid MHR a $6.75 million placement fee.

Additionally, in order not to give MHR a majority stake in Loral and thereby subject the Loral board of directors to "*Revlon* duties," the special committee fashioned the conversion terms of the preferred stock such that MHR's voting power would not exceed 39.999%. Nevertheless, "the class voting rights it acquired gave MHR a unilateral veto over any strategic initiative Loral undertook." *Id.* at *6.

Loral stockholders brought suit to challenge the MHR deal. In its post-trial opinion, the Court of Chancery first determined whether the entire fairness standard applied

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