



# Dollars and Sense

## GOVERNANCE IN THE AGE OF PRIVATE EQUITY

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In a two-article series last year, this column examined the potential positive and negative influences on the satellite industry of the emergent class of private equity shareholders in the operator sector. We did not go far in predicting which potential was more likely to be realized or to be dominant, and in part that was due to the high-altitude survey of an unprecedented development that we conducted; of necessity, we treated the private equity industry as a monolithic bloc, with one set of assumed characteristics and the strategic, or traditional, ownership of satellite operators as another undifferentiated mass with its own stereotypical characteristics. Of course, that is primitive treatment, useful for an initial survey of industry changes that this column's readers may be in the first stages of considering, but ultimately unworthy of the complexities of the subject matter. It is time to remedy that.

First of all, it is critical to keep in mind that, with the exception of Globalstar, 2004's operator acquisitions were all by consortia of private equity firms. Sales of minority and controlling stakes in Intelsat, Inmarsat, New Skies and Eutelsat have been to syndicates. Syndicated private equity ownership provides different dynamics and challenges from those of single firm private equity ownership, to say nothing of strategic shareholders. The previous trajectory of ownership for these operators, as inter-governmental organizations, as spun-off entities, as carriers' carriers, provided scant practical direct responsibility to beneficial owners, strong executives and boards of directors generally supportive of



those executives. In many cases, these companies' operations were sufficiently small in relation to those of their shareholders as to be invisible and probably unknown to the shareholders of those owners that were publicly owned themselves, and, in the case of strategic investments, often benignly and indulgently overlooked. In the post-private equity acquisition environment, the boards of these operators may be expected to be less deferential to management and to engage in a higher level of scrutiny than has been the case, particularly when strategic initiatives are under consideration, such as fleet replacement, new technology research and development, and new services launch.

That heightened scrutiny would tend both to put checks in the way of valid new strategies and to eliminate some of the technologically intriguing, but economically unfeasible, initiatives that have depleted so much capital in the industry throughout the last 10 years or so, thus with both potentially negative and positive effects, were each operator in question owned or controlled by only one private equity shareholder. In the case of syndicated private equity ownership, however, the probable effects of multiple board representation and non-aligned concerns will tend to make consensus on strategic and capital intensive initiatives more difficult to achieve, even when technologically and economically viable. If, in a given case, an individual private equity owner might consider an investment, return on which might not be fully realized prior to the owner's anticipated exit horizon, and thus not fully factored into the exit sale price, it is much less likely that a consortium of three or four such firms will be so inclined. It will be critical for operators owned by private equity consortia that want to stay ahead of the technology, new services and modern fleet curves to put in place shareholder agreements and other governance instruments that provide for capital reserves for such initiatives, voting

agreements for the adoption of strategic business plans developed by management within pre-set parameters, and restrictions on vetoes and super-majority rights that would have the effect of precluding investment necessary for the post-exit health of the operator. The only financial logic to doing so, of course, will be the adoption of a belief, then a policy, that such strategic provision and initiative will be reflected in the exit sale price.

In addition, operators' governance agreements will need to provide for coping with loss. The temporary loss late last year of the Loral-built Intelsat Americas 7, just six months after the operator decided to self-insure and shortly before the closing of its sale to a private equity consortium, casts a stark light on the need to provide for adversity. Although adjustment to purchase price when a loss occurs pre-closing is inevitable and is generally a factored-in part of the deal, the operators must provide in governance instruments and business plans for actions to be taken in the event of such losses, from replacement to insurance review to revision of business plan and investment needed in such cases, so that the shock to shareholders when a loss occurs will not be a paralyzing one.

The question of what investment and contingency to make provision for, and how to avoid paralysis in an age of active, watchful and return-oriented ownership is worth further consideration. In our next column, we will examine the role of insurance in the space business, whether it is a facilitator or impediment to satellite projects and whether it has become an independent basis of financing decisions. ♦

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