

As a result, EchoStar began searching desperately for a way out of the contract. When VOOM HD (temporarily) refused to give away its programming for free to EchoStar for a six-month period in connection with a new-subscriber promotion, EchoStar's Vice Chairman ordered his team to look for any excuse to terminate the contract and to "determine now if they are in breach."

After the search that had been ordered from on high, EchoStar latched on to Section 10's spending requirement as its pretext for getting out of the deal. In June 2007, EchoStar sent a letter claiming VOOM HD had failed to spend \$100 million on the VOOM Service in 2006, and demanding "written certification on the amounts spent on the Service in 2006." In response, VOOM HD provided EchoStar with a financial statement reflecting \$102.959 million in domestic expenditures on the Service in 2006, including \$59.1 million in "Programming, Production, and Licensing" expenditures and the remainder on other clearly-identified categories of the Service's operating expenses, such as "salaries and benefits," general administrative expenses, and marketing. Instead of objecting that these categories of spending were unresponsive to the request for "amounts spent on the Service," EchoStar called for an audit of VOOM HD's spending to try to establish that VOOM HD had not actually spent \$102.959 million. The audit took place in October 2007, and EchoStar's own auditor reported that "[e]verything at Voom looks fine . . . these guys are clean."

It was only after this audit that EchoStar, still frantic to find any way out of the deal, asserted for the first time in writing that VOOM HD could not treat "general overhead costs" as part of its \$100 million investment in "the Service." EchoStar took this position despite the fact that it had conducted extensive due diligence into VOOM HD in 2005 and had, in fact, reviewed projections of total operating expenses in 2006 for the VOOM Service—projections that

included various overhead costs, both VOOM HD's own general administrative expenses and the management overhead expenses of Cablevision/Rainbow that would be allocated to VOOM HD. Making its true motive clear, EchoStar gave VOOM HD an ultimatum: either agree to retiering of the VOOM HD channels (*i.e.*, agree to place the channels in packages that only customers who pay extra will receive) and thereby accept radically lower subscriber fees from EchoStar, or face outright termination of the Affiliation Agreement. VOOM HD tried to resolve the matter to avoid this litigation, but when it refused to acquiesce to EchoStar's heavy-handed tactics, EchoStar formally terminated the Agreement on January 31, 2008.

EchoStar defends its termination of the Affiliation Agreement on the unsupported and cramped theory that expenditures "on the Service" are narrowly restricted to expenditures on the "content" or "programming" portions of the Service alone. Although the parties used the words "content" and "programming" throughout the Affiliation Agreement, Section 10 made no mention of "content" or "programming" as a limitation of expenditures "on the Service." And Section 10 did not exclude "overhead" or any other category of the operating expenses associated with the Service. The Affiliation Agreement defined the term "Service" broadly as the "television programming service known as 'VOOM,'" including "in the aggregate, all components and/or parts thereof." In fact, the distinction between "Service" and "content" was made throughout the Affiliation Agreement, making clear that "content" was only one "component" or "part" of the "Service." Most notably, Section 4 of the Affiliation Agreement, entitled "CONTENT OF THE SERVICE," set forth in detail VOOM HD's numerous obligations concerning the quality and quantity of "content" and "programming," and it stated that "*programming . . . shall comply with the provisions of this Section.*" (emphases added). EchoStar's termination right in Section 10 applied only in the event VOOM HD failed to spend

\$100 million per year “on the Service,” including *all* of its “components” and “parts,” up to the total investment of \$500 million.

The contemporaneous extrinsic evidence only confirms what the parties understood: The phrase “spend . . . on the Service” included all of the expenses of operating the VOOM Service. This broad definition of what constituted “spend[ing] . . . on the Service” was consistent with VOOM HD’s own LLC Agreement, which was executed at the same time as the Affiliation Agreement. The LLC Agreement provided that VOOM HD’s parent companies would make the first \$500 million in “cash capital contributions” to VOOM HD to be “used for an On-Going Business Purpose” in accordance with Annex A. In Annex A, the parties specifically set forth six categories of “expenditures of the LLC relating to the ongoing operations of the . . . VOOM 21 high definition business” that would count toward the \$500 million investment: “Salaries and Benefits,” “Marketing,” “Intercompany Allocations” (with 12 sub-categories), “Programming Expenses” (with four sub-categories), “Other General and Administrative,” and “Capital Expenditures.”

The LLC Agreement further addressed and controlled the “Intercompany Allocations” category of expenditures that counted toward the \$500 million investment in VOOM HD. Section 4.4 expressly permitted the “payment of all reasonable and necessary direct *and indirect* expenses . . . incurred by [VOOM HD] or [its affiliates] in furtherance of the businesses of the LLC” (emphasis added), which at all times included only the VOOM Service. And Annex B to the LLC Agreement, entitled “Allocation Policy for Management Overhead,” set forth the precise manner in which different costs for managerial support and department services (*e.g.*, accounting, human resources, information technology) would be allocated to the VOOM Service. Because Annex A and Annex B were drafted at the same time as the Affiliation Agreement, they

constitute powerful evidence of the types of permissible expenditures that VOOM HD could make on the VOOM Service.

For these reasons, EchoStar cannot seriously dispute that VOOM HD spent more than \$100 million “on the Service” in 2006. EchoStar therefore had no lawful basis for terminating the Affiliation Agreement, and this proof at trial will establish that it is in plain breach of contract.