Hearing Date and Time: November 18, 2009 @ 10:00 a.m.
Objection Deadline: November 13, 2009 @ 4:00 p.m.

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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re	:	Chapter 11
FAIRPOINT COMMUNICATIONS, INC. *et al.*,	:	Case No. 09-16335 (BRL)
Debtors.	:	(Jointly Administered)

TO: THE HONORABLE BURTON R. LIFLAND,
UNITED STATES BANKRUPTCY JUDGE:

MOTION OF THE AD HOC COMMITTEE OF FAIRPOINT NOTEHOLDERS FOR APPOINTMENT OF EXAMINER PURSUANT TO SECTION 1104(c) OF THE BANKRUPTCY CODE

The *ad hoc* committee (the "Ad Hoc Committee") of certain holders of the 13-1/8% Senior Notes Due April 1, 2018 and 13-1/8% Senior Notes Due April 2, 2018 (collectively, the "Senior Notes") issued by FairPoint Communications, Inc. ("FairPoint" and together with the above-captioned debtors and debtors-in-possession, the "Debtors"), by and through its undersigned counsel, hereby move this Court (this "Motion") for the entry of an order, pursuant to section 1104(c) of title 11 of the United States Code, 11 U.S.C. §§ 101-1532 (the "Bankruptcy Code"), directing the appointment of an examiner to investigate certain matters related to the

Debtors' chapter 11 cases (the "Chapter 11 Cases"), as described in more detail below. In support hereof, the Ad Hoc Committee respectfully represents as follows:

PRELIMINARY STATEMENT

1. The Ad Hoc Committee has had to learn the hard way that the representations made by these Debtors and their management must be taken with a large grain of salt. As recently as late August of this year, based upon a business plan and projections given to the advisors to the Ad Hoc Committee, the Debtors and the Ad Hoc Committee were engaged in negotiations for an out-of-court equitization of the Senior Notes, leaving the entirety of the Debtors' prepetition credit facility in place, and granting control of the company to the Ad Hoc Committee. Today, just two months later, the Debtors have massively "revised" their projections in conjunction with the execution of a Plan Support Agreement with the lenders under their prepetition credit facility to serve as the basis for a plan of reorganization providing for the deleveraging of over $1 billion of indebtedness under their prepetition credit facility, in addition to over $550 million of Senior Notes, and leaving the Senior Notes with just 2% of the equity of the reorganized company and out-of-the money warrants, while handing over 10% of the company to management.

2. It appears that the Debtors' management has seen fit to maximize their personal gain by aligning with their prepetition credit agreement lenders to squeeze out the holders of the Senior Notes, having negotiated for themselves up to 10% of the equity of the reorganized company in the form of restricted stock and options grants under a long-term incentive program, in addition to a "key employee incentive program," the terms of which are as yet undisclosed.

3. While the Ad Hoc Committee believes that the Debtors' current projections are both flawed and self-serving, and is prepared to challenge the Debtors' valuation at the appropriate time, this allegedly precipitous decline in the Debtors' fortunes and the

circumstances leading the Debtors to this juncture warrant investigation by an independent examiner—particularly as the Debtors are a public provider of communications services to nearly two million customers.

4. Moreover, the Debtors' Chapter 11 Cases come against a backdrop of many months of public statements by the Debtors, both on earnings calls with investors and to state public utilities commissions ("PUCs"), where the Debtors repeatedly claimed that they were addressing their operational and customer service issues, aggressively pursuing cost-cutting measures and were seeing revenue growth. Indeed, based on the Debtors' outlook for the second and third quarter of this year, the Debtors persuaded the holders of over 80% of the total principal amount of Senior Notes in July to tender their notes in the Debtors' exchange offer converting the interest payments on their Senior Notes to payment-in-kind for one interest period, supposedly to allow the Debtors to comply with the financial covenants under their prepetition credit agreement, in order give the Debtors and the Ad Hoc Committee time to negotiate an out-of-court equitization of the Senior Notes.

5. The Debtors' public statements and their prior discussions with the Ad Hoc Committee are all apparently now belied by the Debtors' current outlook and business plan. Whether as a result of calculated obfuscation or simple incompetence, it is clear that the Debtors' public outlook and business plan have been unreliable from day one—beginning with their ill-fated leveraged buy-out of Verizon's Northern New England wire-line operations (the "NNE Operations") and ending with their filing of a cram-down plan of reorganization. At this point the Debtors have lost their credibility with investors, creditors, regulators and the public alike, and this Court should not buy into their "we've got it right this time" approach to these Chapter 11 Cases.

6. The Debtors' actions leading up to the commencement of the Chapter 11 Cases reveal a pattern of misrepresentation and questionable decision-making, which merit investigation by an independent third party, including, among other things, (i) the overleveraged buyout of the NNE Operations based on incomplete information and flawed assumptions, (ii) the massive technical and operational problems that continue to plague the Debtors resulting from their unreadiness to transition Verizon's systems to their own in January of this year, (iii) the decision of the Debtors' Board of Directors (the "Board") to declare a $23 million dividend to shareholders just nine months ago, (iv) the decision of the Board to appoint one of their own members with no prior telecommunications industry experience as CEO upon the retirement of the Debtors' former CEO, and (v) the Debtors' decision enter into a settlement with the outside consulting firm principally responsible for their systems integration problems, which included a $15 million payment just two weeks prior to filing for bankruptcy.

7. The appointment of an examiner in the Chapter 11 Cases is not only required as a matter of law under section 1104(c)(2) of the Bankruptcy Code, as discussed further below, it is manifestly in the interests of creditors (not to mention the public customers served by the Debtors). The requested investigation can be conducted at relatively modest cost and without undue delay. An examiner therefore should be appointed to investigate the matters described herein, as well as any issues that flow from them.

JURISDICTION AND VENUE

8. This Court has jurisdiction over this Motion pursuant to 28 U.S.C. §§ 1334 and 157(b). This is a core proceeding pursuant to 28 U.S.C. § 157(b). Venue is proper in this Court pursuant to 28 U.S.C. §§ 1408 and 1409.

BACKGROUND

9. On October 26, 2009 (the "Petition Date"), the Debtors each filed voluntary petitions for relief pursuant to chapter 11 of the Bankruptcy Code. No trustee or examiner has been appointed in the Chapter 11 Cases and the Debtors have remained in possession of their assets and continued management of their business as debtors in possession pursuant to sections 1107 and 1108 of the Bankruptcy Code.

10. No official committee has yet been appointed in the Chapter 11 Cases.

11. On the Petition Date, the Debtors filed a Plan Support Agreement (the "PSA") executed by a majority of the lenders under their prepetition credit facility (the "Credit Facility"), together with a term sheet (the "Term Sheet") negotiated with a steering committee of the Debtors' Credit Facility lenders (the "Bank Steering Committee").

12. The PSA obligates the Debtors to file a plan of reorganization (the "Plan") conforming to the Plan Term Sheet within 45 days after the Petition Date. The Term Sheet contemplates, among other things, that the Debtors' Plan will provide for (i) the Debtors' Credit Facility Lenders to receive a *pro rata* share of $1 billion in new term loans, 98% of the equity of the reorganized company, and cash payments from excess cash; (ii) a death-trap mechanism whereby holders of the Senior Notes would receive 2% of the common stock of the reorganized company as well as 7-year warrants to acquire 5% of the common stock of the reorganized company struck at an enterprise value of $2.25 billion if holders of the Senior Notes vote to accept the plan or no distribution if they do not; and (iii) the implementation of a long-term incentive program (consisting of up to 10% of the stock of the reorganized company)[1] and a key employee incentive program for the Debtors' management.

[1] The Plan Term Sheet contemplates an emergence grant under the long-term incentive plan of 1.625-1.75% in restricted stock and 3-3.5% in 10-year stock options struck at the higher of an enterprise value of $1.875 billion or

THE AD HOC COMMITTEE'S PREPETITION DISCUSSIONS WITH THE DEBTORS

13. The Ad Hoc Committee commenced discussions with the Debtors in June of this year regarding a deleveraging of their balance sheet. At an initial organizational meeting on June 12, 2009 between the Debtors and the advisors to the Ad Hoc Committee, the Debtors indicated that the holders of the Senior Notes had little choice but to participate in an exchange offer (the "Initial Exchange") pursuant to which the September interest payment on the Senior Notes would be paid in kind, rather than in cash. According to the Debtors, in the absence of agreement by holders of the Senior Notes to the exchange, their alternatives were to either file for bankruptcy or to engage in negotiations with their Credit Facility lenders as the Debtors would otherwise breach the financial covenants under their Credit Facility. During these discussions, the Debtors reiterated their belief that the low interest rate Credit Facility was an asset to the Company, and could be supported by the Company's cash flow.

14. In exchange for noteholder support of the Initial Exchange, the Debtors covenanted to negotiate in good faith with the Ad Hoc Committee regarding the terms of an out-of-court restructuring of the Senior Notes. The Debtors were adamant that they would not seek an amendment to their Credit Facility due to its favorable interest rate, and thus the Debtors were highly motivated to work towards an out-of-court restructuring due to the potential detriment to the company from a bankruptcy filing. Relying on the Debtors' statements and promises, the members of the Ad Hoc Committee agreed to participate in the Initial Exchange for a below-

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the average trading price of the stock for 30 days post-emergence. Based on the terms of the Debtors' long-term incentive plan, it is clear where management's priorities lie as they have provided that they will ultimately realize more equity, sooner under the Debtors' plan of reorganization than unsecured creditors, including the holders of the Senior Notes, over and above the payments proposed to be made under their so-called "key employee incentive plan," the terms of which are yet to be disclosed. It is incredible that the very same management team that has brought the Debtors to this point could now seek to so richly reward themselves while wiping out unsecured creditors. This begs the question as to the extent to which the Debtors' present outlook is driven by maximizing the personal gain of management through lavish "incentive" payments and cheap equity on the back-end.

market consent fee. The Initial Exchange launched June 24th, less than two weeks after the initial organizational meeting, resulting in over 82% of the outstanding Senior Notes tendering in a highly successful exchange offer.

15. Just days after the consummation of the Initial Exchange, the Debtors delivered projections and a business plan (the "Initial Third Quarter Projections") to the Ad Hoc Committee, which supported a deleveraging of the Debtors' balance sheet through an equitization of the bonds, while keeping the entirety of the Debtors' $2 billion Credit Facility in place. During negotiations with the Ad Hoc Committee both before and after consummation of the Initial Exchange, the Debtors and their Advisors repeatedly maintained that they would not consider restructuring the Senior Notes through a prepackaged or any other type of bankruptcy proceeding and would only participate in an out-of-court transaction that conferred significant value upon existing equity and management. At a meeting on July 27, 2009, the Debtors delivered a proposal (the "July 27 Proposal") to the Ad Hoc Committee contemplating a complex, multi-step transaction to equitize the Senior Notes, that was seemingly impossible to consummate and driven by the toxic reaction of the Debtors' management to a bankruptcy filing.

16. In an effort to foster compromise while addressing some of the risks presented by the Debtors' proposal, the Ad Hoc Committee responded to the July 27 Proposal in August 2009 with several alternative transaction structures, including the possibility of a new capital infusion of $300 to $500 million by members of the Ad Hoc Committee in the form of a new debt instrument, in addition to the exchange of the Senior Notes for equity of FairPoint. When it became clear that the Debtors would give no consideration to the Ad Hoc Committee's alternative transaction structures, on August 18, 2009, the Ad Hoc Committee ultimately agreed

in principle to the transaction structure under the Debtors' July 27 Proposal, with minor revisions designed to minimize potential holdouts in an out-of-court transaction.

17. In response, however, on August 20, 2009, the Debtors advisors informed the Ad Hoc Committee's advisors for the first time that the Debtors were now suddenly facing liquidity issues which would require the holders of the Senior Notes to invest an additional $25 million as part of a restructuring transaction on an unsecured basis.[2] These liquidity issues were alternatively described to the Ad Hoc Committee as a "one-time" issue associated with a settlement contemplated with Capgemini U.S. LLC ("Capgemini"),[3] the consulting firm hired by FairPoint who had mismanaged the cutover of Verizon's NNE Operations to new FairPoint systems, and subsequently, as a more fundamental liquidity issue resulting from purported trade contraction.[4]

18. As a result, on August 21, 2009, the Debtors delivered to the Ad Hoc Committee a subsequent proposal (the "August 21 Proposal") that essentially reiterated their June 27 proposal, but made any exchange contingent upon a $25 million capital infusion by holders of the Senior Notes as well as requiring binding commitments from holders of 90% of the Senior Notes prior to commencing a debt-for-equity exchange of the Senior Notes. The Debtors demanded that the Ad Hoc Committee respond to the August 21 Proposal by August 27 and raised the possibility that the Debtors faced a serious risk of breaching the financial covenants under their Credit Facility as soon as September 30, 2009 (contradicting the Debtors' earlier

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[2] This revelation was at odds with the Debtors' public disclosures that they were actually expecting a significant upturn in working capital in the near term. *See* FairPoint Communications, Inc., Q2 2009 Earnings Conference Call, p. 15 (Aug. 6, 2009) (attached hereto as Exhibit A) (David Hauser: We should expect a significant swing back in our collections.).

[3] The Debtors reported at the time that Capgemini would not agree to a settlement absent a deleveraging of the Debtors' capital structure.

[4] The Ad Hoc Committee notes that during this time, the Debtors felt that $25 million was sufficient to address their liquidity issues, rather than the $75 million of post-petition financing they now claim that they need.

position that as a result of the Initial Exchange, the Debtors would be in compliance with their covenants).

19. Given the myriad of new facts and circumstances raised by the Debtors and their demand for an immediate response, the Ad Hoc Committee was not in a position to meaningfully respond to the Debtors by their self-imposed deadline, but offered to consider addressing the Debtors' request for a new capital infusion in the form of a new $25 million second lien note, even though there seemed to be little basis for the $25 million figure. The Ad Hoc Committee's overtures were summarily rejected by the Debtors in an ultimatum delivered on August 28, 2009 demanding that the Ad Hoc Committee agree to the Debtors' terms by the close of business on that day.

20. Following the breakdown in discussions between the Ad Hoc Committee and the Debtors at the end of August, few discussions took place between the Debtors and the Ad Hoc Committee during the month of September (while the Debtors were presumably negotiating the Term Sheet with the Bank Steering Committee) until September 25, 2009 when the Debtors' advisors provided the Ad Hoc Committee's advisors with a revised business plan and projections (the "Revised Third Quarter Projections") that were materially worse than the Initial Third Quarter Projections. Despite the downward revisions, the Ad Hoc Committee believed that the Revised Third Quarter Projections still provided the basis for substantial recoveries through a resolution between the Debtors, the Ad Hoc Committee and the Debtors' Credit Facility lenders for a pre-arranged bankruptcy filing. The Debtors communicated to the Ad Hoc Committee advisors that they were prepared to host a meeting with a subset of Senior Note holders to provide the Senior Note holders an opportunity to diligence the business plan and work with the Senior Note holders to negotiate terms for a prearranged Chapter 11. To facilitate a meeting, in

mid-October a steering committee of the Ad Hoc Committee (the "Ad Hoc Steering Committee") entered into confidentiality agreements with the Debtors in order to review the Debtors' Revised Third Quarter Projections and engage in discussions with the Debtors and their Credit Facility lenders.

21. On October 21, 2009 the Ad Hoc Steering Committee met with the Debtors. This meeting, however, fell significantly short what the Debtors had originally proposed. Instead of a restructuring discussion among the Debtors, the Bank Steering Committee and the Ad Hoc Steering Committee, the Debtors merely conveyed to the Ad Hoc Committee the terms of the self-serving Term Sheet and PSA, negotiated between the Bank Steering Committee, who stood to crystallize a plan that minimizes distributions to other creditors, and the management team that was eager to reward itself with a significant stake in the reorganized Company. Subsequently, on the Petition Date, the Debtors commenced their Chapter 11 Cases.

ISSUES RAISED BY PREPETITION CONDUCT OF THE DEBTORS AND THEIR OFFICERS AND DIRECTORS

A. The Sudden and Purported Decline in FairPoint's Projections

22. As discussed above, the Ad Hoc Committee had been in negotiations with the Debtors regarding the terms of a deleveraging transaction since June of 2009. In connection with these discussions, the Debtors provided the advisors to the Ad Hoc Committee with a business plan and projections that supported a deleveraging of the Debtors' capital structure through an equitization of the Senior Notes and demonstrated the ability of the Debtors to continue to support and service their $2 billion Credit Facility. These projections continued to serve as the basis for the Ad Hoc Committee's negotiations with the Debtors until these discussions broke down in late August. Throughout the course of these discussions, the Debtors intimated that

should the Ad Hoc Committee accede to their demands, their projections would be substantially lower and the alternative would be significantly worse for the holders of the Senior Notes.

23. It appears that at least one of the Debtors' predictions has come true. Today, based on a "revised" business plan and outlook made public for the first time on the Petition Date, the Debtors' financial condition has purportedly worsened so much that the Debtors are required to deleverage by over $1 billion more than was contemplated just two months ago. While it is not uncommon for a company to revise its projections, the magnitude of these revisions in this case—an approximately $100 million projected drop in EBITDAR for 2010 from their Initial Third Quarter Projections—is astonishing, particularly given that there have been substantial improvements in the financial markets and the economy overall during this time, as well as the continued buildout of the Debtors' network infrastructure and reported improvements in operations and customer service issues. In just two months, the Debtors have gone from contemplating a restructuring in which existing equity would retain significant value to a plan that contemplates effectively wiping out the Senior Notes—implying a decline of more than $600 million of enterprise value in that short period.[5]

24. The sudden and purported decline in the Debtors' fortunes raises significant questions as to either the Debtors' veracity or the competence of management (or both) that, in either case, merit investigation by an examiner. Creditors, and the Court, are entitled to understand the factors that lie behind this sudden and dramatic shift in the Debtors' projections

[5] The enterprise value implied by the plan contemplated by the Term Sheet is effectively less than $2 billion as there is essentially no recovery going to the Senior Notes. By contrast, the enterprise value implied by the proposal discussed between the Ad Hoc Committee and the Debtors in August was greater than $2.65 billion as existing equity was retaining significant value. The Debtors would apparently have creditors and this Court believed that they have experienced a diminution in their enterprise value of more than $600 million in the period from late August to late October, a period in which comparable public companies have experienced at least stable, and in many cases, improved results and higher stock prices. The only constant between the Debtors' current plan and their prior discussions with the Ad Hoc Committee seems to be the substantial value sought by management for themselves.

and whether they are the product of operational and managerial deficiencies, particularly as they serve as the basis for the Debtors' current plan of reorganization, which inures principally to the benefit of the Debtors' prepetition Credit Facility lenders and the Debtors' management.

B. FairPoint's Public Reporting

25. The Debtors' present circumstances are particularly puzzling in light of many months of public statements by the Debtors and their management that they were aggressively working to reduce costs and address their extensive operational and customer service issues related to the transition of the NNE Operations, which have been widely reported in the press and at public hearings before state PUCs, and had realized marked improvement in these areas.

26. For example, on the Debtors' second quarter earnings conference call on August 6, 2009 (the "Q2 Earnings Call"), newly-appointed CEO David Hauser announced that "a great deal of effort has been expended in resolving the cutover issues and most of them are behind us."[6] On that call, Mr. Hauser also asserted that the Debtors were focused on revenue growth and cost cutting strategies and expected to see near-term improvements in these areas.[7] With respect to the achievability of an adjusted covenant EBITDA level of $713 million over the six quarters beginning on July 1, 2009 (approximately $475 million on an annualized basis), which is one of the performance criteria for Mr. Hauser's target bonus under the Debtors' annual incentive plan, Mr. Hauser stated on the Q2 Earnings Call, "obviously I think it's an attainable number."[8] With respect to the Debtors' working capital situation, in response to a question as to whether the Debtors expected a notable swing back in working capital over the third quarter of

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6 FairPoint Communications, Inc., Q2 2009 Earnings Conference Call, at pp. 2-3 (Aug. 6, 2009).

7 *Id.* at p. 11 (David Hauser: But I do think we will be phasing in our cost reduction as we find them and I think you'll see some of the benefit of that in the third quarter. You will also see revenue increases associated with DSL as our promotions work.)

8 *Id.* at p. 14.

2009, Mr. Hauser proclaimed "the answer to that is yes. We should expect a significant swing back in our collections."[9]

27. On July 8, 2009, the Debtors filed a status report on their stabilization plan with state PUCs (the "Stabilization Report"). In the Stabilization Report the Debtors announced, among other things, that they had seen marked and dramatic improvements in call center activity, order flow and billing, and concluded that the results of the Debtors' stabilization plan "clearly show significant improvement for all the operating areas of the business since March," and "has allowed the company to return to many of its normalized activities."[10] On September 9, 2009 the Debtors' CEO Mr. Hauser and his management team testified at a hearing before the New Hampshire State Public Utilities Commission, reiterating the rosy views previously expressed in the Stabilization Report and to public investors. Notably, Mr. Hauser testified with respect to their business plan, "[i]t's really the business plan we've been working on. And it shows that the company's earnings are getting better."[11]

28. The accuracy of these reports, however, has come into question[12] and, significantly, following the filing of the Stabilization Report, the Public Service Board of the State of Vermont filed an order directing the Debtors to show cause as to why its certificate of public good should not be revoked, citing, among other things, unprecedented levels of consumer

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[9] *Id.* at p. 15.

[10] FairPoint Communications, Inc., Stabilization Plan Status Report, at p. 7 (July 8, 2009) (attached hereto as Exhibit B).

[11] New Hampshire Public Utilities Commission, Transcript of Hearing September 9, 2009 at 188:2-5. (excerpt attached hereto as Exhibit J).

[12] *See, e.g.*, Liberty Consulting Group, Assessment of FairPoint's Stabilization Plan Status Report (July 13, 2009) (attached hereto as Exhibit C); The Vermont Department of Public Service, *Department Files "Show Cause" Petition Against FairPoint*, July 15, 2009, http://www.vermont.gov/portal/government/article.php?news=1167 (attached hereto as Exhibit D); The New Hampshire Office of Consumer Advocate, Petition to Establish a New Adjudicative Docket to Investigate FairPoint Communications, Inc., filed with the New Hampshire Public Utilities Commission (July 17, 2009) (attached hereto as Exhibit E); Letter from Audrey J. Prior, FairPoint Communications, Inc. VP Government Relations – Maine, to Andrew Hagler, Maine Public Utilities Commission (July 28, 2009) (on file with the Maine Public Utilities Commission) (attached hereto as Exhibit F).

complaints, questions as to the success reported by the Debtors in the Stabilization Report, and the inability of FairPoint to effectively operate.[13] It seems that the Debtors are now trying to sweep these operational shortcomings under the rug through this proceeding.

29. Creditors and the Court are entitled to understand the Debtors' true operational condition and what lies behind the pervasive operational and customer service issues that continue to plague the company. FairPoint claims that its current predicament is the result of financial distress due to being over-leveraged and its successful reorganization depends principally upon effectively wiping out over $1.7 billion of debt. However, the discrepancies regarding FairPoint's public reports bespeak of a management team that is attempting to mask their own managerial deficiencies.

C. The Capgemini Settlement

30. Following the acquisition of Verizon's NNE Operations, FairPoint engaged Capgemini to build a new back-office infrastructure for the company to allow the transitioning of Verizon's integrated systems to newly created FairPoint's systems (the "Cutover"). Prior to commencing the Cutover, the Debtors had been working under a Transition Services Agreement with Verizon, under which the Debtors were paying Verizon approximately $15 million per month. The Cutover process began in January 2009, after having been pushed back from the originally targeted date of the end of November 2008, resulting in the Debtors incurring significant additional costs under the Transition Services Agreement with Verizon.

31. However, it quickly became clear that the Debtors were woefully unprepared to go forward with the Cutover in January. Defective back-office systems provided by Capgemini,

[13] The State of Vermont Public Service Department, Petition of the Department of Public Service for an Investigation and for an Order Directing Telephone Operating Company of Vermont LLC, d/b/a FairPoint Communications to Show Cause Why its Certificate of Public Good Should Not be Revoked, filed with the Vermont Public Service Board (July 14, 2009) (attached hereto as Exhibit G).

which have been widely acknowledged by the Debtors and regulators alike as the source of the Debtors' system integration problems, have resulted in significant operational and customer service issues for the Debtors. As a result of Capgemini's numerous failures, the Debtors withheld payment of approximately $50 million of invoiced amounts under their agreements with Capgemini prior to the Petition Date.

32. On October 9, 2009, FairPoint entered into a Settlement Agreement and Release (the "Settlement Agreement") with Capgemini, pursuant to which the Debtors agreed to pay $30 million of the invoiced amounts, plus ongoing fees (and presumably a release of the Debtors' claims against Capgemini) in exchange for Capgemini's agreement to continue to provide services to the Debtors. Fifteen million dollars of the settlement amount was paid upon execution of the Settlement Agreement (just over two weeks prior to the Petition Date), with the remaining $15 million payable on December 31, 2009. The Settlement Agreement also allows Capgemini to, among other things, assert an allowed unsecured claim (to which the Debtors have agreed not to object) for the remaining unpaid balance of their prepetition invoiced amounts of approximately $20 million. Furthermore, under the Settlement Agreement and the Term Sheet negotiated with their prepetition Credit Facility lenders, the Debtors have agreed to assume their agreements with Capgemini as modified by the Settlement Agreement during the Chapter 11 Cases.

33. The Debtors' decision, just two weeks prior to filing for bankruptcy, to pay $15 million in settlement (and obligate themselves to pay an additional $15 million) to the consultant whose incompetence has led to disastrous operational and infrastructural problems for the company, is incredible. Not only this, but the Debtors propose to continue to engage Capgemini's services despite the fact that Capgemini has for nearly a year been unable to rectify

the Debtors' Cutover issues. Even prior to the Petition Date, regulatory authorities have cited the need for further investigation into the Debtors' relationship with Capgemini.[14] Such an investigation is even more warranted now that the Debtors propose to continue to engage their services at great expense to their estates. Creditors are entitled to understand the efficacy of the Capgemini settlement and the impact it has had on the Debtors' liquidity, particularly as the substantial outlay of cash immediately prior to the commencement of the Chapter 11 Cases smacks of a transfer subject to avoidance as a preferential or fraudulent transfer.

D. The Verizon Acquisition

34. Fairpoint consummated the leveraged buyout of Verizon's Northern New England wire-line operations (the "NNE Operations") in March 2008 in exchange for consideration of more than $2.7 billion. In connection with the merger, FairPoint entered into the $2 billion prepetition Credit Facility and assumed the obligations under the Senior Notes. As is often the case in a leveraged buyout situation, FairPoint's obligations under the Credit Facility were guaranteed by certain of its subsidiaries, who also pledged their equity interests in the company's operating subsidiaries.[15] As is also typically the case in a leveraged buyout situation, the subsidiary guarantors and pledgors received little, if any, benefit from FairPoint's incurrence of debt under the Credit Facility (the proceeds of which were principally used to fund the cash merger consideration paid to Verizon) or from the guarantees and equity pledges provided in connection therewith.

35. Only twenty months after the consummation of the merger, the Debtors claim that they are now grossly over-levered. It stands to reason, therefore, that they likely overpaid

[14] Letter from William C. Black, Deputy Public Advocate, to Karen Geraghty, Administrative Director of Maine's Public Utilities Commission (July 15, 2009) (on file with the Maine Public Utilities Commission) (attached hereto as Exhibit H).

[15] The Senior Notes do not have any subsidiary guarantees.

significantly for the NNE Operations, based on a seriously flawed set of assumptions, and may have been insolvent at the time or rendered insolvent thereby. As such, the subsidiary guarantees and equity pledges granted by FairPoint's subsidiaries to secure the obligations under the prepetition Credit Facility may be subject to avoidance as fraudulent transfers. Furthermore, the Debtors may have causes of action against Verizon itself which merit investigation.[16] The debtors in possession, due to their management's involvement in the transaction, are unlikely to adequately investigate the issues presented by FairPoint's acquisition of the NNE Operations and the incurrence of indebtedness in connection therewith. Indeed, in connection with their proposed post-petition financing, the Debtors propose to waive all claims they may have against the Credit Facility lenders. In light of the closeness of management to the underlying transactions, their present affiliation with their prepetition Credit Facility lenders, and the value they stand to gain under the plan (which exceeds the recovery to holders of the Senior Notes), these matters should properly be investigated by an independent examiner.

E. FairPoint's January Dividend

36. On December 5, 2008, FairPoint declared a dividend (the "January Dividend") of $0.2575 per share of common stock, which was paid on January 16, 2009 to holders of record as of December 31, 2008. The January Dividend represented a payment of approximately $23 million in the aggregate to FairPoint shareholders, including Verizon. Directors and officers of FairPoint, who are significant shareholders, benefited substantially from the January Dividend. At the same time that the Debtors were making the January Dividend, they reached an agreement with Verizon to accelerate payments from Verizon not otherwise due until March 2010 (resulting

[16] *See* David Brooks, *Outside Help Seen Needed for FairPoint*, Nashua Telegraph, July 18, 2009, http://www.nashuatelegraph.com/apps/pbcs.dll/article?AID=/20090718/NEWS02/307189978/-1/news0121 (attached hereto as Exhibit I); The New Hampshire Office of Consumer Advocate, Petition to Establish a New Adjudicative Docket to Investigate FairPoint Communications, Inc., filed with the New Hampshire Public Utilities Commission (July 17, 2009).

in a free cash flow improvement of $23 million—the same amount as the January Dividend—in the first quarter of 2009) and drew down an additional $50 million under their revolving credit facility, ostensibly due to "continued uncertainty in the financial markets."

37. It is difficult to understand how the directors of a company that is facing the apparently severe operational and financial difficulties that the Debtors are facing could have been so shortsighted as to approve a $23 million payment to shareholders just nine months prior to a bankruptcy filing in which the Debtors are now seeking $75 million of post-petition financing to address liquidity shortfalls, and through which the Debtors propose to wipe out over $1.7 billion in debt, with holders of over $550 million in Senior Notes receiving little to no recovery.

38. In light of the questionable circumstances surrounding the January Dividend and the fact that the Debtors may have been insolvent at the time, an examiner should investigate the propriety of the January Dividend and whether it is subject to avoidance as a fraudulent transfer.

F. The Departure of Former CEO Johnson and the Appointment of Mr. Hauser as his Successor

39. As noted above, the Ad Hoc Committee's advisors met with the Debtors on June 12, 2009, after signing confidentiality agreements, to discuss the exchange of the Senior Notes and a potential restructuring of the Debtors' outstanding obligations. Yet, the Ad Hoc Committee first learned of the departure of then CEO Eugene B. Johnson only on June 16, 2009 when FairPoint filed a Form 8-K with the SEC stating that Mr. Johnson would retire and be succeeded by David L. Hauser, a director of the company for the past four years.

40. As the Debtors had been aware of Mr. Johnson's impending retirement for some time, they had also presumably undertaken a search for a new CEO prior to Mr. Johnson's departure. It is curious that under these circumstances the Debtors would have ended up with

one of their former directors as a new CEO. The decision of the Board of Directors of a struggling company to appoint one of their own members—an individual with no prior CEO or telecommunications experience other than his tenure as a director of the company—as successor CEO is unusual to say the least, particularly as the transition to a new CEO was shortly followed by a precipitous decline in the company's projections and outlook. Investigation by an examiner is warranted into the circumstances and process behind the decision of FairPoint's Board to appoint one of their own as Mr. Johnson's successor.

RELIEF REQUESTED

41. The Ad Hoc Committee requests the appointment of an examiner to conduct an investigation of the Debtors and their respective directors and senior officers, in respect of the following issues:

- The purportedly marked decline in the Debtors' business plan and projections from August 2009 to October 2009 and the relationship between the Debtors' current projections and the PSA and Term Sheet negotiated with their prepetition Credit Agreement Lenders;
- Discrepancies in the Debtors' public reports and whether there has been an effort by the Debtors' management to cover up their own operational shortcomings;
- The Debtors' settlement with Capgemini and their decision to continue dealing with Capgemini to address their ongoing Cutover issues;
- Issues arising in connection with FairPoint's leveraged buyout of Verizon's NNE Operations, including whether the guarantees and security interests under the Credit Facility are subject to avoidance as fraudulent transfers and any causes of action the Debtors may have against Verizon;
- The propriety of the January Dividend and whether it is subject to avoidance as a fraudulent transfer; and
- The process by which David Hauser, one of FairPoint's directors, was selected to succeed retiring CEO Johnson.

ARGUMENT

A. The Appointment of an Examiner is Mandatory in These Cases

42. Section 1104(c) of the Bankruptcy Code provides:

> If the court does not order the appointment of a trustee under this section, then at any time before the confirmation of a plan, on request of a party in interest or the United States Trustee, and after notice and a hearing, the court shall order the appointment of an examiner to conduct such an investigation of the debtor as is appropriate, including an investigation of any allegations of fraud, dishonesty, incompetence, misconduct, mismanagement, or irregularity in the management of the affairs of the debtor of or by current or former management of the debtor, if—
>
> > (1) such appointment is in the interests of creditors, any equity security holders, and other interests of the estate; or
> >
> > (2) the debtor's fixed, liquidated, unsecured debts, other than debts for goods, services or taxes, or owing to an insider, exceed $5,000,000.

11 U.S.C. § 1104(c) (emphasis added).

43. Section 1104(c) thus mandates the appointment of an examiner upon the satisfaction of four factors: First, the debtor must still be in possession of the estate and a trustee must not have been appointed. Second, a plan must not have been confirmed. Third, a party in interest or the United States Trustee must request the appointment. Lastly, one of the conditions set forth in section 1104(c)(1) or (c)(2) must be satisfied—either the appointment of the examiner is in the best interests of the creditors or the specified unsecured debts exceed $5 million. *See, e.g.*, *In re UAL Corp.*, 307 B.R. 80, 84 (Bankr. N.D. Ill. 2004) ("[A]ppointment of an examiner is mandatory if the four conditions are met, but the court retains the discretion to determine the nature and scope of the examiner's investigation.").

44. There is no question that no trustee has been appointed,[17] no plan has been confirmed, and that the Ad Hoc Committee is a party in interest in these cases. Furthermore, as

[17] The statute provides that an examiner cannot be appointed if a trustee has been appointed; however, this limitation was not intended to require the denial of a motion to appoint a trustee as a precondition to the appointment of an examiner. *See Keene Corp. v. Coleman (In re Keene Corp.)*, 164 B.R. 844, 855 (Bankr. S.D.N.Y. 1994) (stating that "[a] motion to appoint an examiner stands on its own, and need not be part of an

described above, the fixed and liquidated value of the unsecured claims against the Debtors, other than debts for goods, services or taxes, or owing to an insider, far exceeds $5 million. Where the circumstances set forth in section 1104(c)(2) are present, the plain language of the statute requires the appointment of an examiner. *See In re Revco D.S., Inc.*, 898 F.2d 498, 500-01 (6th Cir. 1990); *In re Lyondell Chemical Co., et al.*, Case No. 09-10023 (REG) (Bankr. S.D.N.Y. Oct. 26, 2009); *In re TCI 2 Holdings, LLC, et al.*, Case No. 09-16354 (JHW) (Bankr. D.N.J. Sept. 15, 2009); *In re Vision Dev. Group of Broward County, LLC*, Case No. 07-17778, 2008 WL 2676827, at *3 (Bankr. S.D. Fla. June 30, 2008) (finding that appointment of an examiner was mandatory where mezzanine lenders had claims of over $5 million); *In re Loral Space & Comm., Ltd.*, No. 04 Civ. 8645RPP, 2004 WL 2979785, at *5 (S.D.N.Y. Dec. 23, 2004) (finding that section 1104(c)(2) mandates the appointment of an examiner where the debt threshold is met); *In re Big Rivers Elec. Corp.*, 213 B.R. 962, 965-66 (Bankr. W.D. Ky. 1997) (finding that appointment of an examiner was mandatory because debt met $5 million threshold). Accordingly, under the plain meaning of section 1104(c)(2), the appointment of an examiner is mandatory in these cases.

45. In addition, the legislative history of section 1104(c)(2) of the Bankruptcy Code indicates that Congress intended third party intervention to be provided upon request in large cases involving public companies. Congress intended that in larger reorganization cases, third party intervention should be provided upon request where a party is uncomfortable with the representation provided by the debtor, as part of the congressional goal to validate the reorganization process. *See* Barry L. Zaretsky, "Chapter 11 Issues: Trustees and Examiners in

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unsuccessful motion to appoint the trustee."); *see also Gilman Servs.*, 46 B.R. at 322 (granting motion to appoint examiner where no separate motion to appoint a trustee had been filed). In fact, several cases have concluded that a court may appoint an examiner *sua sponte*. *See In re Public Serv. Co. of N.H.*, 99 B.R. 177, 182 (Bankr. D.N.H. 1989); *In re UNR Indus., Inc.*, 789, 795 (Bankr. N.D. Ill. 1987).

Chapter 11," 44 S.C. L. Rev. 907, 940 (Summer 1993). Mandatory appointment of an examiner is thus wholly consistent with Congress's intent in drafting section 1104(c)(2) of the Bankruptcy Code.

46. While a few courts have concluded that the appointment of an examiner under section 1104(c)(2) is discretionary in certain extreme circumstances, the facts of those cases are readily distinguishable and such cases are inapplicable here. *See, e.g., In re Rutenberg*, 158 B.R. 230, 233 (Bankr. M.D. Fla. 1993) (court denied motion for appointment of examiner where an individual debtor was no longer engaged in business); *In re GHR Cos.*, 43 B.R. 165, 176 (Bankr. D. Mass. 1984) (court denied motion for appointment of examiner where court was considering appointing a trustee instead); *In re Shelter Res. Corp.*, 35 B.R. 304, 305 (Bankr. N.D. Ohio 1983) (denying motion to appoint a trustee to investigate fairness of settlement where such investigation was rendered moot by approval of settlement); *In re Bradlee Stores, Inc.*, 209 B.R. 36, 38 (Bankr. S.D.N.Y. 1997) (denying motion to appoint a trustee due to the fact that the movants were petitioning the court for appointment mere weeks before the statute of limitations on certain claims expired).

B. The Appointment of an Examiner Is Also Justified Under Section 1104(c)(1)

47. While the appointment of an examiner in this case is mandated by the provisions of section 1104(c)(2), grounds for such appointment also exist under section 1104(c)(1). To determine whether appointment of an examiner under section 1104(c)(1) is appropriate, courts must determine "whether the creditors and equity security holders would be served by the appointment of an examiner and whether the costs of an examiner are not disproportionately high." *See In re Gilman Servs., Inc.*, 46 B.R. 322, 327 (Bankr. D. Mass. 1985) (finding that benefit to the estate of appointment of an examiner outweighed the costs where: (1) there had been an unexplained loss of assets since the filing of the bankruptcy, (2) the debtor's financial

reporting was deficient, and (3) transfer of real estate assets to a partnership owned by shareholders of the debtors may have been a fraudulent conveyance).

48. Under the facts and circumstances of this case, the appointment of an examiner is justified under section 1104(c)(1) because investigation into the issues enumerated above would serve the interest of creditors. Furthermore, as the Debtors are a provider of communications services to nearly two million of public customers, there is a strong public interest in the investigation of these issues. Moreover, as these matters are the subject of existing or anticipated litigation, the appointment of, and investigation of these matters by, an examiner would come at little incremental expense to the Debtors' estates.

NOTICE

49. In accordance with this Court's Interim Order Pursuant to Bankruptcy Code Section 105(a) and Bankruptcy Rules 1015(c) and 9007 to Implement Certain Notice and Case Management Procedures (the "Interim Case Management Order") notice of this Motion has been given by electronic mail or first class mail, as applicable, to the parties listed on the Master Service List (as defined in the Interim Case Management Order). The Ad Hoc Committee respectfully submits that no other or further notice need be given.

WAIVER OF MEMORANDUM OF LAW

50. Because the relevant legal authorities have been cited herein, the Ad Hoc Committee respectfully requests that the Court waive the requirement under Local Bankruptcy Rule 9013-1(b) that a separate memorandum of law be submitted.

NO PRIOR REQUEST

51. No prior motion for the relief requested herein has been made to this or any other court.

WHEREFORE, the Ad Hoc Committee respectfully requests that this Court enter an order, substantially in the form of the proposed order attached hereto, appointing an examiner in these Chapter 11 Cases and granting the relief requested herein and granting the Ad Hoc Committee such other and further relief as is just and proper.

Dated: New York, New York
October 30, 2009

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