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STATE OF NORTH CAROLINA — IN THE GENERAL COURT OF JUSTICE
MECKLENBURG COUNTY — MECKLENBURG CO., C.S.C. — SUPERIOR COURT DIVISION
11 CVS 19689

BY ______

THE FAIRPOINT COMMUNICATIONS, INC. *ET AL.* LITIGATION TRUST,

Plaintiff,

-against-

VERIZON COMMUNICATIONS, INC., NYNEX CORPORATION, VERIZON NEW ENGLAND, INC., CELLCO PARTNERSHIP d/b/a Verizon Wireless, AND VERIZON WIRELESS OF THE EAST LP,

Defendants.

COMPLAINT
(COMP)

The FairPoint Communications, Inc. *et al.* Litigation Trust (the "Trust" or "Plaintiff") for its Complaint against Verizon Communications, Inc. ("Verizon"), NYNEX Corporation ("NYNEX"), Verizon New England, Inc. ("Verizon New England"), Cellco Partnership d/b/a Verizon Wireless, and Verizon Wireless of the East LP (collectively with Verizon and NYNEX, Verizon New England, and Cellco Partnership, the "Defendants"), alleges:

I.

NATURE OF THE ACTION

1. This $2 billion dollar fraudulent transfer suit arises from a disastrous 2008 spin-off and merger (the "Transaction") between FairPoint Communications Inc. ("Old FairPoint"), a small, once well regarded, North Carolina-based telephone company and a short-lived

corporation that telecom behemoth Verizon created for the sole purpose of "spinning off" certain assets that Verizon considered undesirable — conventional landlines in northern New England.

2. Old FairPoint and the Verizon spin-off entity that was immediately merged into FairPoint, Northern New England Spinco Inc. ("Spinco"), took on an enormous debt load, approximately $2.5 billion, in order to effect this Transaction. Old FairPoint received sufficient loan proceeds to pay off its existing lenders and to pay some of the enormous bills incurred in putting the byzantine deal together. But the lion's share of the loan proceeds (principally $1.16 billion in cash) and new promissory notes ($551 million in principal) were transferred or conveyed to Verizon New England which, in turn, passed the money upstream to Verizon. Only 18 months after the Transaction closed, the merged entity (the "Combined Entity") filed for relief under chapter 11 of the United States Bankruptcy Code.

3. Some of Verizon's reasons for pursuing the Transaction were clear. First, Verizon would rid itself of aging DSL networks in three states that were expensive to maintain and increasingly disfavored by residential and business customers who preferred the speed and reliability of more modern technology like cable broadband internet and fiber optic cable. Second, the Transaction would pay Verizon richly, and Verizon could devote that money to its more profitable technology. Third, Verizon could use a complex "Reverse Morris Trust" structure for the Transaction that would result in the cash passing to Verizon tax-free. Fourth, Verizon could utilize Old FairPoint's appeal as a well-regarded small telecommunications company to assuage, or help to assuage, any regulatory concerns over the Transaction.

4. But a key part of Verizon's strategy in luring Old FairPoint into this transaction was not at all apparent until it was too late for Old FairPoint. Verizon structured the Transaction so that it could not only continue to compete with the Combined Entity in the relevant states after

the Transaction, but also so that it could crush the new competition created by the Transaction. Essentially, Verizon did not sell a stand-alone business to Old FairPoint. It sold a collection of low-margin assets in Maine, Vermont and New Hampshire (the "Spinco Assets") with two critical components missing.

5. One of those components was the growing part of the ILEC (defined below) business: internet protocol based business products targeted at business customers. That was a growing and profitable market segment that Verizon was able to exploit post-Transaction, while the Combined Entity was not. Instead, Verizon transferred to the Combined Entity only the shrinking part of the business: antiquated landlines and DSL technology that was already disfavored by customers and expensive to maintain. The other missing component consisted of the IT networks and back office functions that were essential to billing customers, servicing customers, and collecting payments. Instead, Verizon offered an expensive and inadequate transition services contract, so that the Combined Entity would have to pay dearly for essential services after the Transaction closed while creating its own operations at huge expense and with little relevant experience. Without those two components, Old FairPoint paid a princely sum for a collection of inferior assets that had no future.

6. Plaintiff, a litigation trust formed pursuant to the Bankruptcy Code for the benefit of the creditors of the Combined Entity, now seeks to recover for those creditors the payments and other benefits that Verizon took away from this debacle. The Trust seeks relief under the constructive fraud doctrine, as specifically authorized by both North Carolina and substantively identical federal fraudulent transfer law. When the North Carolina Legislature and the United States Congress enacted fraudulent transfer laws, each legislative body determined that in cases such as this, the public interest is best served by guaranteeing creditors some degree of protection

without being required to prove motive or assign fault. Only two questions need be answered: (1) Was the Combined Entity insolvent at the time of, or did it become insolvent or it was left with unreasonably small capital as a result of, the approximately $2 billion transferred to Verizon? and (2) Did the Combined Entity fail to receive fair value or fair consideration for the approximately $2 billion it gave to Verizon? Affirmative answers to both of these questions, without regard to intent, require Verizon to disgorge the value of such transfers.

7. Additionally, the facts of this case go beyond mere constructive fraud. When examined closely and in context, what Verizon did (and failed to do) is not only fraudulent as to creditors of the Combined Entity, but the Transaction is part of a consistent pattern of conduct by Verizon that can only be described as actual fraud. Verizon, for itself and its short lived subsidiary, Spinco, misrepresented facts, concealed facts, blocked due diligence efforts, and stood silent when candor required speech. And Verizon presided over two other failed dispositions of legacy Verizon assets that resulted in the bankruptcies of the acquiring companies under similar circumstances as FairPoint's. The Combined Entity's demise was the fastest of the three. Further, the actions of Old FairPoint before it made the transfers complained of herein rise to the level of an actual intent on its part to hinder, delay or defraud its creditors.

8. Verizon took advantage of delays in gaining regulatory approval for the deal to cannibalize business customers. It stopped performing even routine maintenance and upkeep on the assets that Old FairPoint was to acquire. Verizon also failed to disclose crucial changed facts. Going into the deal, Verizon and Old FairPoint both understood that landlines were losing a long-term battle with cell phones. Nonetheless, money can be made even in a declining market, and Old FairPoint had a successful record with rural landlines. But Verizon failed to disclose, whether because of Verizon's functional abandonment of the assets or otherwise, that

the landlines Old FairPoint had committed to buy via the Transaction were now losing customers at a much faster rate than the numbers on which Old FairPoint had based its projections. Verizon went to great efforts to keep these and other awkward facts under wraps. Even during the period after signing but before closing, Verizon prohibited any contact (save for a single welcoming speech) between Old FairPoint executives and their prospective new employees.

9. For its part, a blend of naïveté and optimism pushed Old FairPoint into the Transaction. By the time of the Closing (defined below), due to the crushing expense of trying to build complex operational support for the aging landline business it was going to acquire, Old FairPoint had become so strapped for cash that it could not even cover closing costs without help from Verizon. Old FairPoint executives, committed to taking on management responsibilities for a merger partner more than seven times its own size, while simultaneously shouldering a $2.5 billion debt, saw the writing on the wall, but believed Old FairPoint was trapped. The company had no chance given the hand it was dealt by Verizon. Old FairPoint was either insolvent or sliding over the edge into insolvency even before any money changed hands.

10. Further, as a result of the Transaction the Combined Entity was left with unreasonably small capital. Old FairPoint no longer had the wherewithal to deal with the sort of financial emergencies that arise from time-to-time even in a well-run company, and that could reasonably be expected in the immediate post-merger environment. To a behemoth like Verizon, such trifles could be handled with the equivalent of pocket change. Such was not the case for the Combined Entity.

11. This is an action to avoid and recover from Verizon the fraudulent conveyances made by Spinco, Old FairPoint and the Combined Entity to or for the benefit of Verizon pursuant to the North Carolina Uniform Fraudulent Transfer Act or other applicable fraudulent transfer or

conveyance law made applicable pursuant to Section 544(b) of Title 11, United States Code (the "Bankruptcy Code").

II.

JURISDICTION AND VENUE

12. This Court has personal jurisdiction over the Defendants pursuant to N.C.G.S. §1-75.4(1) as the Defendants engaged in substantial activity within North Carolina by way of the Transaction described herein.

13. Venue is proper in Mecklenburg County because the actions of the Defendants occurred in Mecklenburg County.

III.

THE PARTIES

14. Verizon is a Delaware corporation headquartered in New York, New York and is the largest telecommunications provider in the United States. It was, and continues to be, a highly sophisticated organization with knowledge of national and international telecommunications trends, capacities, and the industry.

15. Defendant NYNEX is a Delaware corporation headquartered in New York, New York.

16. Defendant Verizon New England is a New York corporation headquartered in Boston, Massachusetts.

17. Defendant Cellco Partnership is a Delaware partnership headquartered in Basking Ridge, New Jersey.

18. Defendant Verizon Wireless of the East LP is a Delaware partnership headquartered in Bedminster, New Jersey.

19. FairPoint Communications, Inc. was a Delaware corporation with its principal place of business in North Carolina.

20. On October 26, 2009 (the "Petition Date"), the Combined Entity and various of its subsidiaries[1] (collectively, the "Debtors") filed petitions for relief under Chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the Southern District of New York (the "Bankruptcy Court").

21. The Debtors could not pay creditors the billions they were owed in full, in cash, under any confirmable plan of reorganization.

22. The Debtors' creditors agreed to restructure a portion of the Combined Entity's debt and convert more than a billion dollars worth of debt into common stock of the reorganized FairPoint. Pursuant to the Plan, the Debtors' creditors also received the benefit of recoveries from the causes of action asserted in this lawsuit.

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[1] On or after the Petition Date, the following affiliates of the Combined Entity also filed bankruptcy petitions: C&E Communications, Ltd., Berkshire New York Access, Inc., Be Mobile Communications, Inc., Bentleyville Communications Corp., Berkshire Cable Corp., Berkshire Cellular, Inc., Berkshire Net, Inc., Berkshire Telephone Corp., Big Sandy Telecom, Inc., Columbine Telecom Co., Comerco, Inc., Commtel Communications Inc., Community Service Telephone Co., El Paso Long Distance Co., Enhanced Communications of Northern New England Inc., Exop of Missouri, Inc., FairPoint Broadband, Inc., FairPoint Carrier Services, Inc., FairPoint Communications Missouri, Inc., FairPoint Communications Solution Corp. - New York, FairPoint Communications Solution Corp. - Virginia, FairPoint Logistics, Inc., FairPoint Vermont, Inc., Fremont Broadband, LLC, Fremont Telcom Co., GTC Communications, Inc., YCom Networks, Inc., Unite Communications Systems, Inc., The El Paso Telephone Co., Odin Telephone Exchange, Inc., Northern New England Telephone Operations LLC, MJD Services Corp., GTC Finance Corp., GTC, Inc., Peoples Mutual Long Distance Co., Peoples Mutual Services Co., Peoples Mutual Telephone Co., Ravenswood Communications, Inc., Yates City Telephone Co., Chouteau Telephone Co., Chautauqua and Erie Telephone Corp., China Telephone Co., GITCO Sales, Inc., GIT-Cell, Inc., Germantown Long Distance Co., Fretel Communications, LLC, Elltel Long Distance Corp., Ellensburg Telephone Co., C-R Telephone Co., C-R Long Distance, Inc., C-R Communications, Inc., Maine Telephone Co., Sunflower Telephone Co., Inc., Marianna and Scenery Hill Telephone Co., Marianna Tel, Inc., Standish Telephone Co., ST Long Distance, Inc., ST Enterprises, Ltd., ST Computer Resources, Inc., Sidney Telephone Co., Utilities, Inc., Telephone Service Co., MJD Ventures, Inc., Northland Telephone Co. of Maine, Inc., The Orwell Telephone Co., Quality One Technologies, Inc., Taconic Technology Corp. Taconic Telcom Corp., Telephone Operating Co. of Vermont LLC, Orwell Communications, Inc., The Columbus Grove Telephone Co., The Germantown Independent Telephone Co., UI Communications, Inc., UI Long Distance, Inc., UI Telecom, Inc., ST. Joe Communications, Inc., and Chautauqua & Erie Communications, Inc. (the "Subsidiaries" and collectively with FairPoint, the "Debtors" or "FairPoint Entities").

23. The Debtors' *Third Amended Joint Plan of Reorganization Under Chapter 11 of the Bankruptcy Code* (the "Plan") was confirmed by the Bankruptcy Court on January 13, 2011.

24. The Plan and the confirmation order, dated January 13, 2011, provide for the creation of the Trust. On the Plan's "Effective Date," January 24, 2011, the reorganized FairPoint executed the FairPoint Litigation Trust Agreement (the "Trust Agreement"), creating the Trust and vesting it with the causes of action asserted herein.

25. Plaintiff, a trust created under the laws of the State of New York, is a successor of the Debtors and a representative of their estates under §§ 1123(a)(5), (a)(7), and (b)(3)(B) of the Bankruptcy Code.

IV.

FACTUAL BACKGROUND

Verizon's Origins - From A Baby Bell to A Behemoth

26. In 2000, Verizon provided domestic landline communications services in 32 states and the District of Columbia. These states included some with high population densities and very profitable landline businesses, and some in rural locales such as Vermont, Maine and New Hampshire with higher infrastructure cost. Along with its landline business, Verizon also owned a substantial part of the wireless market and an international segment of wireless and landline communications operations that extended to approximately forty countries. At the time of its formation, Verizon was often described as a behemoth, controlling and dominating the telecommunications industry.

27. Verizon was formed as a result of the break-up of the former American Telephone & Telegraph Co. system of local exchange companies in every major city in the United States

(the "Bell System"). As a result of an antitrust lawsuit, the Bell System was divested in 1984 into seven Regional Bell Operating Companies or "Baby Bells."

28. Bell Atlantic Corp. ("Bell Atlantic") was one of the regional operating companies formed as a result of the Bell System breakup. On June 30, 2000, GTE Corporation, formerly General Telephone & Electronic Corporation ("GTE"), the largest "independent" telephone company during the days of the Bell System, merged with Bell Atlantic. GTE and Bell Atlantic's merger formed a combined entity called Verizon Communications, Inc. This merger was valued at $52 billion at the time of its announcement. It was designed to create a combined company with the scale and scope to compete as one of the telecommunications industry's top-tier companies, providing long-distance and data services nationwide as part of a full package of other telecommunications services.

Old FairPoint

29. Old FairPoint's origins were more modest. It was founded as MJD Communications Inc. in 1991, a Delaware corporation headquartered in North Carolina. Old FairPoint was established for the purpose of acquiring and operating local telephone companies in rural markets. Historically, RLECs (rural local exchange carriers) like Old FairPoint faced a higher cost structure than telecommunications carriers in other regions because of the large fixed cost nature of the upfront investment and relatively low customer density. Rural areas typically have local access line density of less than 100 local access lines per square mile, while urban areas often have local access line density in excess of 300 local access lines per square mile. This leads to higher average operating and capital cost per line for RLECs in comparison to non-rural operators. In recognition of this higher cost, RLECs, including Old FairPoint, often benefited from government subsidized rural access rates.

30. Before the Transaction, Old FairPoint had grown by more than 25 acquisitions to having about 221,014 landline customers in 12 states. No single state represented over 25% of its customer case. Most of the communities Old FairPoint's telephone companies served had fewer than 2,500 lines. Its largest acquisition at that time involved approximately 60,000 lines.

31. During this period, Old FairPoint's acquisitions activities - - and later the entire company - - were led by Eugene Johnson ("Johnson"). A founder of Old FairPoint, he became Chief Executive Officer and Chairman on January 2, 2002. Johnson was described by his subordinates as the "eternal optimist" and a "deal junkie." Verizon later would take advantage of these personality traits.

32. On or about February 8, 2005 Old FairPoint did an initial public offering of its stock. Thereafter, Old FairPoint was a publicly held corporation whose stock traded on the New York Stock Exchange under the ticker symbol "FRP." Its stock price was considered a yield based stock whose trading value was tied to the regular dividend it paid.

33. In connection with its IPO, on February 8, 2005, Old FairPoint entered into a senior secured credit facility with a syndicate of financial institutions, including Deutsche Bank Trust Company Americas, as administrative agent (the "Old FairPoint Credit Facility"). At the time the Transaction closed, the total amount owing under the Old FairPoint Credit Facility was $694,062,421.40.

34. Following the IPO, Johnson and Old FairPoint's head of development, Walter Leach, remained on the lookout for acquisition opportunities.

Challenges Facing the Landline Industry

35. Challenges facing the landline (traditional, wire-carried telephone services) industry caused Verizon to rethink its business strategy. After the break up of the Bell System,

regional Bell operating companies and rural local exchange carriers ("RLECs") became the two types of incumbent local exchange carriers ("ILECs"). Due to technological changes and innovations in the industry, Congress passed the Telecommunications Act of 1996 (the "1996 Act"), deregulating the ILEC industry and opening up competition to CLECs (competitive local exchange carriers), which were typically newer telecommunications companies that did not possess the advantage of incumbency in a particular region. The 1996 Act was designed to expose the markets to competition by removing regulatory barriers to entry. Since ILECs like Old FairPoint were the incumbent carriers, they were regulated much more stringently than CLECs.

36. In the meantime, mobile phones and wireless communications were captivating the nation. Verizon realized that in addition to increased competition generally, customers were increasingly dissatisfied with traditional, slow speed Digital Subscriber Line ("DSL") internet service. DSL is a medium for transferring data over traditional copper phone lines. The new technologies included cable broadband, which was generally much faster than DSL and could handle more data. The landline industry was also facing pressure from new internet-enabled wireless, data, and Voice over Internet Protocol ("VoIP") telecommunications services.

37. Saddled with an increasingly outdated DSL capability, and unable to compete with the rapidly growing cable broadband, Verizon decided a massive deployment of fiber optic cable ("FIOS") was the answer. FIOS is an upgraded network architecture which is considered "future proof" in that it allows for rapid and relatively inexpensive upgrades to optical transport technology. For example, FIOS requires fewer active elements in the field when compared to the older and decaying copper networks. As such FIOS requires lower on-going maintenance costs. Verizon therefore formulated a business plan to divest most of its landline assets (keeping

just its most profitable ones in populated areas) and to raise capital to expand its fiber optic and other emerging telecommunications technology businesses.

38. To execute the divestiture part of the plan, Verizon's John Diercksen, Executive Vice President - Strategy, Development and Planning, established a divestiture team lead by Steve Smith and Goodwin Bennett. The team accomplished divesting 1.7 million landline access lines in five states within 2 years of Verizon's formation.

Project Nor'Easter

39. During the summer of 2005, the first events occurred that would propel Old FairPoint into the Transaction that would eventually lead to its bankruptcy. Old FairPoint asked the now bankrupt investment banking firm of Lehman Brothers to take a message to Verizon that Old FairPoint was interested in acquiring Verizon's rural access lines in Idaho. That led to an initial meeting on September 30, 2005 between Johnson and Leach of Old FairPoint and Diercksen and Smith of Verizon. During the meeting, Verizon declined to sell its Idaho business but encouraged Old FairPoint to consider what Old FairPoint would later describe in its public filings as "[Verizon's] wireline, long distance and Internet service provider businesses in Maine, New Hampshire and Vermont." Although it was Verizon that proposed the transaction to Old FairPoint, Old FairPoint would later lead the public to believe it was Old FairPoint's idea.

40. Indeed, even Old FairPoint's description of the business that it was acquiring - - "Verizon's wireline, long distance and Internet service provider businesses in Maine, New Hampshire and Vermont" - - was misleading. The Transaction was not a purchase of a complete and self-supporting business operation. Verizon intended to, and did, retain two critical pieces of the business, as described below. Those "holes" in the deal ensured that Old FairPoint would never receive the benefits for which the market thought it was bargaining.

41. First, the Spinco business would not include Verizon's more advanced business products that ran on the IP Network, and high end business products, and the business customers that used those products in the northern New England states. The IP Network is the newer, next-generation network Verizon was building in that region. Old FairPoint, thus, was forced to build a new advanced IP Network once the Transaction was consummated. In addition, Verizon never sold, and FairPoint never received, the products that ran on the IP Network, or the business customers that used such products (*e.g.*, ethernet services, Virtual Private Network services, Voice over IP services, IP-PBX or IP-Centrex services, SIP Trunking, and other MPLS based IP services).

42. Significantly, the IP Network and the business products Verizon retained were the segments of the ILEC industry that were growing, and helping to mitigate the impact of line losses in peer companies. In contrast, the Spinco Assets were a declining set of assets - - the rapid line loss of the Spinco Assets was a clear example of why it was referred to as the "shrinking part" of the ILEC industry.

43. The other critical component of the northern New England business which Verizon retained was the extensive operations necessary to run the network, including, most notably, IT systems for processing and collecting bills and responding to service requests. Over 30% of total annual expenses for Spinco Assets were for operations not transferred into the Combined Entity, including a sales force to sell to enterprise customers and the Network Operating Center which was the technical operations center that controlled and monitored the network and collection call centers, to name a few. The Combined Entity had to build these operations from the ground up and should have anticipated operating cost increases not

decreases. As a result of those two critical exclusions, the Combined Entity can be characterized as only half a business.

44. At Old FairPoint's December 14, 2005 board of directors meeting, Johnson requested and received approval to pursue further discussions with Verizon. Later that month Old FairPoint signed a non-disclosure agreement with Verizon.

45. On February 13, 2006, Verizon sent a letter (the "Discussion Letter") to Old FairPoint, dictating how a transaction had to be structured. Verizon required that the potential transaction be structured as a tax-free spin-off or split-off of Verizon's landline business in Maine, Vermont and New Hampshire, followed by a merger with Old FairPoint. Because Verizon wanted the transaction structured as a "Reverse Morris Trust," which would make the cash and stock transferred to Verizon at closing tax free, Verizon dictated that Verizon's shareholders must own more than 50% of the Combined Entity's stock. Verizon also specified that existing business debt would be included among the liabilities contributed to the Combined Entity, potentially up to the limit of Verizon's tax basis in the assets and additional leverage beyond the contributed debt would be added to the subsidiary via new debt. Thus, the very structure of the proposed deal contemplated saddling the new Combined Entity with enormous liabilities.

46. Johnson presented the proposed transaction with Verizon at a March 15, 2006 meeting of Old FairPoint's board of directors. Following the presentation, the board reconfirmed its direction to management to continue discussions with Verizon.

47. Five days later, March 20, 2006, Old FairPoint formally engaged Lehman Brothers and Morgan Stanley as its financial advisors in connection with a proposed transaction with Verizon. On May 19, 2006, Old FairPoint also engaged Morgan Stanley as a financial

advisor in connection with a proposed transaction with Verizon. The investment bankers Lehman and Morgan were to be paid only if a deal was consummated.

48. On March 16, 2006, Old FairPoint submitted to Verizon a proposal to acquire the Spinco Assets in a spin-off and subsequent merger as Verizon proposed. Old FairPoint proposed a Spinco valuation at what Old FairPoint thought was a multiple of Spinco's projected 2006 EBITDA (earnings before interest, taxes, depreciation and amortization). As Verizon suggested, the proposal contemplated Old FairPoint selling its 7.5% interest in the Orange County — Poughkeepsie Limited Partnership to a Verizon subsidiary, Cellco Partnership (a "Transfer" and part of the "Fraudulent Consideration"). Poughkeepsie generated current cash flow for Old FairPoint and was an attractive asset for Verizon. The proceeds of the sale were expected to fund (in part) Old FairPoint's significant fees and expenses for the Transaction.

49. Verizon viewed Old FairPoint's bid as surprisingly excellent and higher than Verizon's internal numbers supported. Nevertheless, Verizon pushed back in the negotiations to increase Old FairPoint's bid. On April 20, 2006, Old FairPoint submitted a revised proposal setting forth, among other things, a capital structure for Spinco which included $1.7 billion of debt the proceeds of which would go to Verizon.

50. By June of 2006, the investment bankers had given the transaction project the code name "Nor'easter," a term used in New England to describe a major storm along the East coast that can cause devastating damage. They also gave Verizon the code name "Viper," an offensive term for someone who is considered to be malicious or treacherous.

51. Negotiations continued. During the earlier part of 2006, Verizon continued its broadband build out in the state of New Hampshire so as to offer more to its customers there.

But, tellingly, by July of 2006, when a deal with Old FairPoint looked like a reality to Verizon, Verizon abruptly stopped its broadband build out in New Hampshire.

Limited Due Diligence

52. It was not until June 27, 2006, that Old FairPoint's working team conducted due diligence in Verizon's data room in Dallas, Texas. Walt Leach took a team of people to Dallas, Texas for two and a half days to review the contents of Verizon's data room which consisted primarily of contracts and regulatory orders. The data room did not contain historical financial data. All financial information provided by Verizon to Old FairPoint came through Steve Smith, head of Verizon's divestiture team, who was in complete control of the flow of information.

53. Historic financial data on Spinco was problematic for Verizon. The Spinco business had no historic financial information because the assets that comprised Spinco had never functioned as a stand alone company. Nevertheless, Verizon extracted information from Verizon's system and purported to create a set of financials for Spinco. Neither Old FairPoint nor its advisors were given the ability to test extensively the data underlying the numbers. In addition, upon information and belief, even though Verizon had created long-term financial projections for the Spinco Assets, Verizon did not share them with Old FairPoint.

54. Because of Old FairPoint's history as a small RLEC, Old FairPoint's management had little experience modeling or projecting cash flows or EBITDA based on landlines with no rural access rates supporting them, much less 1.3 million of them. They also had no experience in the wholesale market, which was part of the Spinco Assets. Furthermore, Verizon not only made no effort to assist Old FairPoint but stood silent knowing Old FairPoint's projections for the Spinco Assets were inconsistent with Verizon's projections.

55. Projections are not reasonable unless they include a sufficient working capital cushion to allow the company to withstand reasonably foreseeable risks. Mere survival is not enough. For revenue projections to be reasonable, Old FairPoint had to account for difficulties that were likely to arise, including interest rate fluctuations and general economic downturns, and otherwise incorporate some margin for error. Old FairPoint's projections did not. They were not only uninformed, they were wildly optimistic and did not have a cushion to cover even a minimal degree of difficulty caused by general economic conditions or specific events which might effect the Combined Entity.

56. Furthermore, although Lehman Brothers and Morgan Stanley were working with Old FairPoint preparing projections for the Combined Entity on which Old FairPoint's offer would be based, the bankers made clear that they did not assume responsibility for the verification of any information, whether publicly available or furnished to them, about Old FairPoint, Verizon, Spinco or comparable transactions. Neither Lehman Brothers nor Morgan Stanley rendered a fairness opinion with respect to the Transaction, and neither expressed an opinion about Old FairPoint's decision to engage in the Transaction.

57. Old FairPoint walked away from the potential transaction with Verizon three times, but Verizon, according to Walt Leach, was "relentless" in its pursuit of Old FairPoint. On September 29 and October 17, 2006, at John Diercksen's invitation, Johnson met with him as Diercksen tried to keep the deal alive. Diercksen was successful. On October 18, 2006, Johnson met with the Old FairPoint board of directors to seek approval to continue negotiations.

58. By the fall of 2006, Verizon felt they had a good read on Johnson who Verizon's Steve Smith believed "**[REDACTED]**."

[REDACTED]

59. But on the other hand, time was running out for Verizon to unload the decaying Spinco Assets, as EBITDA was eroding. Old FairPoint was concerned with the EBITDA performance of the Spinco Assets and monitored it as best it could with information relayed through Verizon. While Verizon was "**[REDACTED]**" Old FairPoint on value in late 2006, Diercksen asked Smith if there was "**[REDACTED]**." Later, when discussing Old FairPoint's bid, Verizon noted **[REDACTED]**.

60. Smith admitted that Verizon "**[REDACTED]**." Smith stated to his Verizon co-workers that if the Transaction were held up by the regulators, it would put pressure on EBITDA "**[REDACTED]**." At or around the same time, Smith also told Verizon's investment bankers that "**[REDACTED]**."

61. That is in stark contrast to what Verizon led Old FairPoint to believe. Ultimately a myriad of "add backs" to create what was called an "Adjusted EBITDA" for the Spinco Assets found their way into the Merger Agreement and ultimately the credit agreement. The Adjusted EBITDA number masked to the market the true state of the Spinco Assets.

62. Five days prior to the signing of the deal, Don Leonard, who worked in Verizon's finance department, characterized the valuation process of the Combined Entity as "**[REDACTED]**." **[REDACTED]**.

Signing Up the Deal

63. On December 8, 2006, initial drafts of a merger agreement, a distribution agreement and other transaction documents were submitted to Old FairPoint and its legal counsel, Paul, Hastings, Janofsky & Walker LLP ("Paul Hastings"), by Debevoise & Plimpton LLP, legal counsel to Verizon and Spinco. Verizon was also a client of Paul Hastings at the time

and remains so to this day. Paul Hastings would later serve as Debtors' counsel for the bankrupt Combined Entity.

64. On January 4, 2007, Old FairPoint selected Lehman Brothers, Morgan Stanley, and Bank of America (collectively, the "Underwriters") to lead the financing of the Transaction.

65. On January 14, 2007, Old FairPoint's board of directors met to consider and act upon the proposed Transaction. It was approved. Representatives of Deutsche Bank (the agent bank on the Old FairPoint Credit Facility which would be paid off with proceeds of a new loan if the Transaction closed) gave Old FairPoint's board of directors Deutsche Bank's financial analysis and an oral opinion as to the fairness of the Transaction. The fairness opinion was heavily qualified, noting that Deutsche Bank had not independently verified any information concerning Old FairPoint, Verizon, or Spinco. Similarly, the fairness opinion stated that it relied on Old FairPoint's financial projections and analyses of synergies expected from the Transaction.

66. Verizon's own financial advisors struggled with valuing the businesses. Their "comparable companies" for purposes of valuing the Combined Entity were not viewed internally by Verizon as comparable. Steve Smith confided in this team that he "**[REDACTED]**."

The Deal Structure

67. On December 20, 2006, Verizon incorporated Spinco and made Steve Smith its sole director. Verizon controlled Spinco. Therefore, Verizon's intent is imputed to Spinco.

68. On January 15, 2007, (the "Signing") Old FairPoint entered into an agreement with Verizon and Spinco pursuant to which Old FairPoint agreed, subject to approval of the Transaction by regulators, to participate in the upstreaming of almost $2 billion of value to

Verizon and assume the ownership and associated liabilities of Verizon's landline operations in Maine, New Hampshire, and Vermont.

69. On January 15, 2007, Verizon, Spinco and FairPoint executed a plan of merger (the "Plan of Merger" or the "Merger Agreement") and distribution agreement (the "Distribution Agreement"). The closing date of the Transaction was to be March 31, 2008 (the "Closing").

70. Pursuant to the Plan of Merger and Distribution Agreement, as later amended, Verizon was to cause the following transfers to occur simultaneously at the Closing:

> (i) Verizon's subsidiary, Verizon New England, Inc. ("Verizon New England"), was to form a wholly-owned direct subsidiary called Northern New England Telephone Operations LLC ("ILEC Spinco Subsidiary");
>
> (ii) Verizon New England was to transfer certain of its Maine, New Hampshire and Vermont local landline exchange businesses to ILEC Spinco Subsidiary;
>
> (iii) Verizon New England then was to transfer all of the membership interests in ILEC Spinco Subsidiary to Spinco, such that ILEC Spinco Subsidiary would become a direct wholly-owned subsidiary of Spinco;
>
> (iv) Spinco and Old FairPoint were to enter into a lending relationship with third parties which would fund payments to Verizon;
>
> (v) Spinco was to issue to Verizon New England Spinco common stock, senior notes, due 2018, in the principal amount of $551 million (the "Spinco Notes"), and borrow from lenders to make a cash payment of $1.16 billion (the "Special Payment" and together with the Spinco Notes and other amounts transferred to Verizon and certain of its subsidiaries (the "Verizon Group") and obligations incurred for the benefit of the Verizon Group, the "Fraudulent Consideration");
>
> (vi) Verizon New England was to transfer the Spinco Notes to the Verizon Group in exchange for what Verizon characterized as outstanding intercompany debt, but which, on information and belief, had originated as an equity contribution by Verizon and is properly recharacterized as such;
>
> (vii) Verizon then was to obtain the Spinco Notes from the transferees of Verizon New England in one or more transactions and exchange them for Verizon Group debt; and
>
> (viii) Verizon New England was to upstream the Special Payment to Verizon.

71. The Special Payment and the Spinco Notes were reported by Verizon as, and are properly characterized as, dividends. Spinco received no value in exchange. The dividends were improper and illegal because Spinco was rendered insolvent thereby.

72. Once the above steps (i) - (viii) occurred, the Plan of Merger provided that Spinco would merge with and into Old FairPoint, with FairPoint Communications, Inc. to be the surviving corporate entity.

73. As part of the planned Transaction, Old FairPoint also entered into (i) a Transition Services Agreement (the "Transition Services Agreement") with Northern New England Telephone Operations Inc. and Enhanced Communications of Northern New England Inc., as Buyers and Verizon Information Technologies LLC, as Supplier, (ii) a Master Services Agreement (the "Master Services Agreement") with Capgemini U.S. LLC ("Capgemini"), (iii) an Employee Matters Agreement with Verizon and Spinco (the "Employee Matters Agreement"), and (iv) a Tax Sharing Agreement with Verizon and Spinco (the "Tax Sharing Agreement").

74. Separately, on January 15, 2007, Taconic Telephone Corp., a subsidiary of Old FairPoint ("Taconic"), entered into a Partnership Interest Purchase Agreement (the "Interest Purchase Agreement") with Cellco Partnership d/b/a Verizon Wireless and Verizon Wireless of the East LP pursuant to which Taconic agreed to sell its 7.5% limited partnership interest in Orange County-Poughkeepsie Limited Partnership (the "NY Cellular Partnership Interest") to Cellco Partnership. On information and belief, Taconic received less than reasonably equivalent value for its interest and was rendered insolvent thereby.

Market Reaction to the Transaction

75. On January 16, 2007, Verizon and Old FairPoint announced that they had entered into agreements providing for the spin-off of Verizon's local exchange business in Maine, New Hampshire, and Vermont and the merger of this business with and into Old FairPoint.

76. Even without a complete understanding or appreciation of the facts, the stock market's verdict was that Old FairPoint was getting the short end of the stick. From the date the Transaction was announced to the day after the Closing, FairPoint's common stock price lost over 63% of its value. At the same time Verizon's stock rose.

Post-Signing Troubles

77. When completed, the Transaction would add 1,429,358 customers for Old FairPoint's services, increasing its customer base by about 746%. It was clearly crucial for the Combined Entity to be able to service those customers well and to keep them content with their new telecommunications provider's capabilities. Key to that effort were the former Verizon employees who knew the market and the customers, and would become employees of the Combined Entity.

78. After the Merger Agreement and the Distribution Agreement were signed, Johnson gave a speech to Verizon's employees who would become the Combined Entity's employees as a result of the Transaction. Beyond the welcome speech, however, Verizon precluded Old FairPoint from communicating with these critical employees.

79. These employees would have had knowledge of the problems with the Spinco Assets and systems; they were the people who worked day-in and day-out with the Spinco Assets and would be in the best position to help Old FairPoint with the transition. Old FairPoint's lack

of access to critical information would lead to a myriad of post-closing problems particularly with respect to the design of the IT system.

80. Verizon denied Old FairPoint access to its employees who would become part of the Combined Entity despite a Merger Agreement provision allowing Old FairPoint to have such access.

81. In the years leading up to the Merger Agreement, Verizon had neglected the Spinco business and starved it of capital expenditures. Because of Verizon's refusal to allow Old FairPoint to fully diligence the Spinco Assets, Old FairPoint did not realize the extent of Verizon's neglect until after the Signing.

Controversy and Public Protests Before the Regulators

82. The Public Utilities Commissions in Maine, New Hampshire, and Vermont (the "PUCs") had to approve the Transaction in order for it to be consummated.

83. Local consumers and residents, public advocacy groups and even competitive local exchange carriers in the three affected states vociferously objected to the Transaction before the PUCs.

84. The Communications Workers of America ("CWA") and the Internal Brotherhood of Electrical Workers ("IBEW", together with CWA, the "Unions"), to which roughly 60% of the Spinco workers belonged, organized protest rallies in a number of northern New England locations.

85. A common theme in the filings with the PUCs objecting to the Transaction was that the Combined Entity would not have the requisite experience and expertise to operate the Spinco Assets and would not be financially viable. Many of the filed objections requested that at a minimum, if the PUCs were to approve the Transaction, they should impose certain financial

conditions, commitment to service quality, and broadband expansion requirements on the Combined Entity. The Unions urged the regulators and Old FairPoint's shareholders to reject the Transaction because "Cash flow from these access lines will have to be plowed back into network upgrades in order to satisfy regulators and customers who are demanding improved service quality. Management's projected profit windfall from this deal is an illusion."

86. Verizon, however, had its own resources to marshal in the battle over regulatory approval. In 2007 and 2008, Verizon spent about $8.7 million and $13.52 million, respectively, on telephone utilities industry lobbying. Its affiliates spent another approximate $3.86 million and $4.5 million, respectively, on telecom services and equipment industry lobbying.

87. Vermont State Senator Vince Illuzzi, who in 2007 vigorously opposed the Transaction, later stated that the Vermont Public Service Board "should be called the Utility Service Board, rather than the Public Service Board," because it is too close to the industries it regulates.

88. Verizon's Diercksen believed he had to take the lead and "**[REDACTED]**" to Old FairPoint in order to get the PUCs to approve the Transaction, because, in Diercksen's words, Johnson acted "**[REDACTED]**." He agreed with Goodwin Bennett's view that Johnson was "**[REDACTED]**."

89. To manage the PUC process, Verizon's Diercksen had behind-the-door meetings with governors and other politicians.

90. Ultimately, each of the three states approved the Transaction with conditions. The PUCs required the Combined Entity to expand broadband, improve service, retain current employees, and accept rate freezes. The PUCs also imposed financial requirements that attempted to address the Combined Entity's financial viability. Those requirements, however,

were prospective and begged the question of whether the Combined Entity would be financially viable.

91. The PUCs' approval requirements overall increased the Combined Entity's cash flow requirements.

92. New Hampshire PUC Commissioner Graham Morrison still vigorously dissented from approving the Transaction, stating:

> I do not question FairPoint's good intentions. But no amount of courage and valour could prevent the vastly outnumbered Spartan-led Greek warriors from being overrun by the Persian invaders at Thermopylae in 480 B.C. So, too, with FairPoint, as they will increasingly face competition for their core customer from wireless voice, text and data carriers such as Verizon Wireless and AT&T, from VoIP vendors like Ooma, Lingo and Skype and from Wi-Fi competitors yet to come. The difference is that, while the defeated Greek warriors at Thermopylae could ultimately look to a newly inspired Athens to summon the naval resources necessary to save their civilization, FairPoint has no reserves, it has only its captive landline customers and reworked 3rd generation DSL over copper... with an eye to the future of technology options, Verizon is choosing now to exit the regulated environment. Clearly Verizon believes they are not exiting the retail telecommunications market; they are merely leaving behind the regulated space and an outdated copper infrastructure ... Verizon exits, and FairPoint overnight becomes the Incumbent Local Exchange Carrier (ILEC) in New Hampshire, and this vastly smaller and financially challenged entity will be faced with the same issues and problems that the greater Verizon felt were too challenging to undertake.

93. From signing until closing, the Unions' protests against the Transaction damaged Old FairPoint's name in Maine, Vermont, and New Hampshire.

Competition Intensifies

94. As the regulatory approval process dragged on, competition against the Spinco business intensified. Verizon itself was soliciting Spinco business customers to switch to a Verizon division. Verizon also was offering Spinco business customers the alternatives of wireless voice, data, and other services as well as long distance services, prepaid calling card services, and the resale of local exchange services.

95. The cable companies also were ramping up their phone service offerings. Comcast and Time Warner, having acquired Adelphia's New England cable subscribers from the Adelphia bankruptcy estate on July 31, 2006, (including those in northern New England) were updating quickly and offering phone service to Spinco's business customers, either as a separate service or as bundled with their cable or satellite television and high speed internet service.

96. Before the Signing, Verizon's internal communications make clear that **[REDACTED]**.

February 25, 2008 and the Costly Credit Agreement Amendment

97. Also, while the regulatory approval process dragged on, Old FairPoint moved perilously close to defaulting on its Old FairPoint Credit Facility and receiving a going concern qualification from its auditors. The agent for the facility described the situation as "**[REDACTED]**."

98. To avoid this situation, Old FairPoint had to negotiate an amendment of the Old FairPoint Credit Facility to ease the interest coverage ratio and the leverage ratio maintenance covenants. The agent Deutsche Bank predicted, the amendment "**[REDACTED]**." And it wasn't.

The Solvency Opinion

99. In January 2007 when the Underwriters committed to provide funding for the Transaction, they did not condition it on a solvency opinion. Yet, as the Closing drew near Verizon (upon information and belief unbeknownst to Old FairPoint) engaged Houlihan Lokey ("Houlihan") to provide a solvency opinion to Verizon's Board of Directors, a clear indication of Verizon's growing concern about the Transaction. In its February 22, 2008 purported solvency opinion to Verizon and Spinco's Board of Directors, Houlihan stated that it had concluded that

the Combined Entity would be solvent, have adequate capital and be able to pay its debts as they became due, based on its analysis of the Spinco Assets and the capabilities of the Combined Entity.

100. Houlihan stated, however, that its opinion was based on Old FairPoint's management's projections and that it did not independently test those projections. The opinion is replete with other disclaimers and assumptions.

101. **[REDACTED]**.

102. **[REDACTED]**. As the parties headed to Closing, the 2008 Financial Crisis began with the failure of Bear Stearns Companies, Inc. on March 13, 2008. As a result, within a three week period the interest rate of the Spinco Notes skyrocketed, which resulted in an automatic decrease in the Combined Entity's cash flow by over $27 million a year. **[REDACTED]**.

103. Houlihan acknowledges its solvency opinions are not valuations but, rather, are designed to assist in defending a transaction participant against a fraudulent transfer claim. They are based solely on management's projections.

104. Verizon knew Old FairPoint's management's projections were inflated. Because Verizon knew that this and many other key assumptions in Houlihan's opinion were wrong, Verizon knew that the solvency opinion was unreliable.

FairPoint's Huge Out of Pocket Costs To Consummate the Transaction

105. Old FairPoint did not have the ability to pay the pre-closing costs it had incurred to consummate the Transaction, which were estimated at $110 million. To provide Old FairPoint with funds to pay those costs, Verizon agreed to have a subsidiary purchase Old FairPoint's NY Cellular Partnership Interest for $55 million, and reimburse Old FairPoint an additional $40