

UNITED STATES BANKRUPTCY COURT  
FOR THE EASTERN DISTRICT OF VIRGINIA  
Alexandria Division

In re: )  
 ) Chapter 11  
PATHNET TELECOMMUNICATIONS )  
INC., et al., ) Case No. 01-12264-SSM  
 ) Jointly Administered  
 )  
Debtors. )

**NOTICE OF HEARING ON MOTION OF THE DEBTORS FOR INTERIM ORDER  
PURSUANT TO 11 U.S.C. § 365(d)(4) EXTENDING THE TIME TO ASSUME  
OR REJECT UNEXPIRED LEASES OF NONRESIDENTIAL REAL PROPERTY**

Pathnet Telecommunications, Inc. ("PTI"), and its affiliated Debtors and Debtors-in-possession in the above-captioned case, Pathnet, Inc. ("PNI"), Pathnet Operating, Inc. ("POI"), Pathnet Operating of Virginia, Inc. ("POV"), Pathnet Real Estate LLC ("PRE") and Pathnet Fiber Equipment LLC ("PFE" and collectively with PTI, PNI, POI, POV and PRE, the "Debtors") have filed their Motion Of The Debtors For Interim Order Pursuant To 11 U.S.C. § 365(D)(4) Extending The Time To Assume Or Reject Unexpired Leases Of Nonresidential Real Property ("Motion")

The Motion was previously served on you. Please be advised that on June 1, 2001 the Court entered an *ex parte* Interim Order Extending Time To Assume Or Reject Unexpired Leases Of Nonresidential Real Property Under § 365(D)(4) Of The Bankruptcy Code ("365(d)(4) Interim Order"). A copy of the 365(d)(4) Interim Order is attached hereto as Exhibit "A."

A hearing on the Motion and on the *ex parte* entry of the 365(d)(4) Interim Order will be held at

Place of Hearing:	Date and Time of Hearing
Courtroom I, 2d Floor United States Bankruptcy Court 200 South Washington Street Alexandria, VA 22314	June 22, 2001 at 9:30 a.m.

Michael St. Patrick Baxter  
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Dennis B. Auerbach  
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1201 Pennsylvania Avenue, N.W.  
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*Counsel for Debtors and Debtors in Possession*

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Alexander M. Laughlin, Va. Bar No. 25237  
GOLD MORRISON & LAUGHLIN PC  
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McLean, Virginia 22102-4848  
(703) 836-7004  
*Proposed Local Counsel for the Debtors and Debtors in Possession*

DOCUMENT NUMBER-DATE

07079 JUN-6 2001

FPD-RECEIVED/REPORTING

Your rights may be affected. You should read these papers carefully and discuss them with your attorney, if you have one in this bankruptcy case. (If you do not have an attorney, you may wish to consult one.)

If you do not want the Court to approve the Debtor's Motion and the *ex parte* entry of the 365(d)(4) Interim Order, either in whole or in part, or if you want the Court to consider your views on the Motion or the *ex parte* entry of the 365(d)(4) Interim Order, then on or before June 15, 2001, you or your attorney must:

1. File with the Court, at the address shown below, a written response with supporting memorandum as required by Local Bankruptcy Rule 9013-1(H). **UNLESS A WRITTEN RESPONSE AND SUPPORTING MEMORANDUM ARE FILED AND SERVED BY THE DATE SPECIFIED, THE COURT MAY DEEM ANY OPPOSITION WAIVED, TREAT THE MATTER AS CONCEDED, AND ISSUE AN ORDER GRANTING THE REQUESTED RELIEF WITHOUT FURTHER NOTICE OR HEARING.** If you mail your response to the Court for filing, you must mail it early enough so the Court will receive it on or before the date stated above. The address of the Clerk's Office is:

Clerk of Court  
United States Bankruptcy Court  
200 South Washington Street  
P O Box 19247  
Alexandria, Virginia 22320

You must also mail a copy of your response with supporting memorandum to the persons listed below:

Michael St. Patrick Baxter  
Dennis B. Auerbach  
Anna P. Engh  
COVINGTON & BURLING  
1201 Pennsylvania Avenue, N.W.  
Washington, DC 20004-2401  
(202) 662-6000  
(202) 662-6291 (Facsimile)

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Charles H Jeanfreau  
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1330 Avenue of the Americas  
New York, NY 10019-5400  
(212) 841-1000  
(212) 841-1010 (Facsimile)

- and -

H Jason Gold  
Alexander M. Laughlin  
GOLD MORRISON & LAUGHLIN PC  
1660 International Drive, Suite 450  
McLean, Virginia 22102-4848  
(703) 836-7004

and to

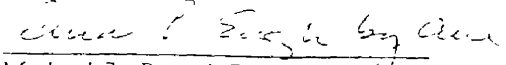
United States Trustee, Region 4  
115 South Union Street, Suite 210  
Alexandria, Virginia 22314

2. You (or your attorney if you have one) must also attend the hearing at the place and on the date shown above.

If no timely response is filed opposing the approval of the Motion or the *ex parte* entry of the 365(d)(4) Interim Order the Court may approve the Motion without holding a hearing and may enter a final order approving the 365(d)(4) Interim Order. If you or your attorneys do not take these steps, the Court may decide that you do not oppose approval of the Debtor's Motion or the *ex parte* entry of the 365(d)(4) Interim Order and may enter a final order approving the Motion and the 365(d)(4) Interim Order.

Dated June 1, 2001.

Respectfully submitted.

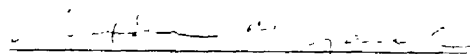
  
\_\_\_\_\_  
Michael St. Patrick Baxter

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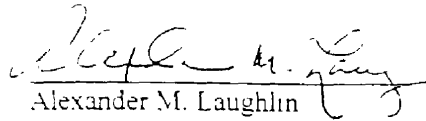
**Counsel for the Debtors and Debtors in Possession**

  
\_\_\_\_\_  
H. Jason Gold, Va. Bar No. 19117  
Alexander M. Laughlin, Va. Bar No. 25237  
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1660 International Drive, Suite 450  
McLean, Virginia 22102-4848  
(703) 836-7004  
(703) 548-9430 (Facsimile)

**Proposed Local Counsel for the Debtors and Debtors in Possession**

CERTIFICATE OF SERVICE

I hereby certify that on this 1<sup>st</sup> day of June, 2001, the foregoing Notice Of Hearing On Motion Of The Debtors For Interim Order Pursuant To 11 U.S.C. § 365(D)(4) Extending The Time To Assume Or Reject Unexpired Leases Of Nonresidential Real Property was sent via first class mail postage prepaid to all creditors and parties in interest as set forth on the attached service lists \*

  
Alexander M. Laughlin

\* Pursuant to Local Rule 5005-1(C)(8), the attached service lists are not being served on each of the parties, but is attached to the original Certificate of Service filed with the Court

UNITED STATES BANKRUPTCY COURT  
FOR THE EASTERN DISTRICT OF VIRGINIA  
Alexandria Division

In re: )  
 ) Chapter 11  
PATHNET TELECOMMUNICATIONS )  
INC., et al. ) Case No. 01-12264-SSM  
 ) Jointly Administered  
Debtors. )

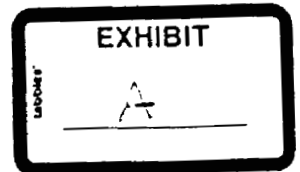
**INTERIM ORDER EXTENDING TIME TO ASSUME OR REJECT  
UNEXPIRED LEASES OF NONRESIDENTIAL REAL PROPERTY  
UNDER § 365(d)(4) OF THE BANKRUPTCY CODE**

Upon the motion of Pathnet Telecommunications, Inc. ("PTI"), and its affiliated Debtors and Debtors-in-possession in the above-captioned cases, Pathnet, Inc. ("PNI"), Pathnet Operating, Inc. ("POI"), Pathnet Operating of Virginia, Inc. ("POV"), Pathnet Real Estate LLC ("PRE") and Pathnet Fiber Equipment LLC ("PFE" and collectively with PTI, PNI, POI, POV, and PRE, the "Debtors") (the "Motion to Extend"),<sup>1</sup> for the entry of an order extending the time to assume or reject their unexpired leases of nonresidential real property under § 365(d)(4) of the Bankruptcy Code; and a hearing on the Motion to Extend being scheduled for June 22,

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Dennis B. Auerbach  
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Counsel for the Debtors and Debtors in Possession

H. Jason Gold, Va. Bar No. 19117  
Alexander N. Laughlin, Va. Bar No. 25237  
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160 International Drive, Suite 450  
McLean, Virginia 22102-4848  
(703) 436-7904  
Proposed Local Counsel for the Debtors and Debtors in Possession

<sup>1</sup> Capitalized terms not defined in this Order shall have the meanings given to them in the Motion.



2001, and the current deadline by which the Debtors must assume or reject the unexpired leases being set to expire on or about June 1, 2001; and the Debtors having requested before the expiration of the current deadline an interim extension of the period as it relates to the unexpired leases of nonresidential real property, pending consideration of the Motion to Extend by the Court; and after due deliberation and sufficient cause appearing therefor; it is hereby

ORDERED, that the period during which the Debtors may assume or reject their unexpired leases of nonresidential real property pursuant to § 365 of the Bankruptcy Code is hereby extended to and including such date and time as the Court enters an order with respect to the Motion to Extend; and it is further

ORDERED, that the relief granted herein shall include all unexpired leases of nonresidential real property pursuant to which the Debtors are or are determined to be lessees or sublessees, regardless of whether such lease or sublease is listed on Exhibit A to the Motion to Extend.

10

IT IS FURTHER ORDERED that the debtor shall promptly \*

Dated: June 1, 2001



HON STEPHEN S. MITCHELL  
United States Bankruptcy Judge

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\* give notice of the entry of this order by mailing a copy to the United States Trustee, counsel for the Official Committee of unsecured creditors, and each landlord affected by this order, and shall file with the clerk of this court a certificate reflecting such notice

PREPARED BY:

Anna P. Engh (H)

~~Michael St. Patrick Baxter~~  
Anna P. Engh Virginia Bar No. 30071  
~~Dennis B. Ascherbach~~  
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(202) 662-6000

**Counsel for the Debtors and Debtors-in-Possession**

H. James Gold

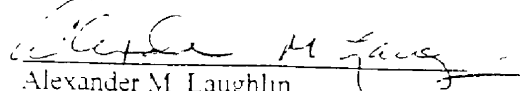
~~H. James Gold~~  
H. James Gold, Va. Bar No. 19117  
~~Alexander M. Laughlin~~  
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McLean, Virginia 22102-4848  
(703) 836-7004

**Proposed Local Counsel for the Debtors and Debtors-in-Possession**



CERTIFICATION PURSUANT TO LOCAL RULE 9022-1

I HEREBY CERTIFY that on this 1<sup>st</sup> day of June, 2001, a copy of the foregoing Interim Order Extending Time To Assume Or Reject Unexpired Leases Of Nonresidential Real Property Under § 365(D)(4) Of The Bankruptcy Code was sent by via first class mail postage pre-paid to all creditors and parties in interest on the attached service lists \*

  
Alexander M Laughlin

\* Pursuant to Local Rule 5005-1(C)(8), the attached service lists are not being served on each of the parties, but is attached to the original Certificate of Service filed with the Court

**UNITED STATES BANKRUPTCY COURT  
FOR THE EASTERN DISTRICT OF VIRGINIA  
Alexandria Division**

<b>In re:</b>	)	
	)	<b>Chapter 11</b>
<b>PATHNET TELECOMMUNICATIONS</b>	)	
<b>INC., et al.,</b>	)	<b>Case No. 01-12264-SSM</b>
	)	<b>Jointly Administered</b>
<b>Debtors.</b>	)	

**NOTICE OF HEARING ON MOTION OF THE DEBTORS FOR ORDER APPROVING:  
(1) SALES OF ASSETS FREE AND CLEAR OF LIENS AND INTERESTS,  
(2) AUCTION PROCEDURES FOR SALES OF ASSETS,  
(3) CERTAIN BID PROTECTION, AND  
(4) FORM OF NOTICE OF AUCTION AND SALE HEARING**

Pathnet Telecommunications, Inc. (“PTI”), and its affiliated Debtors and Debtors-in-possession in the above-captioned case, Pathnet, Inc. (“PNI”), Pathnet Operating, Inc. (“POI”), Pathnet Operating of Virginia, Inc. (“POV”), Pathnet Real Estate LLC (“PRE”) and Pathnet Fiber Equipment LLC (“PFE” and collectively with PTI, PNI, POI, POV and PRE, the “Debtors”) have filed their Motion Of The Debtors For Order Approving: (1) Sales Of Assets Free And Clear Of Liens And Interests. (2) Auction Procedures For Sales Of Assets, (3) Certain Bid Protection, and (4) Form Of Notice Of Auction and Sale Hearing (“**Motion**”). The Motion was previously served on you.

A hearing to the Motion will be held at:

Place of Hearing: Courtroom I, 2d Floor United States Bankruptcy Court 200 South Washington Street Alexandria, VA 22314	Date and Time of Hearing:  June 22, 2001 at 9:30 a.m.
-------------------------------------------------------------------------------------------------------------------------------------	----------------------------------------------------------------

Your rights may be affected. You should read these papers carefully and discuss them with

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 Anna P. Engh, Va. Bar No. 30071  
 Dennis B. Auerbach  
 COVINGTON & BURLING  
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your attorney, if you have one in this bankruptcy case. (If you do not have an attorney, you may wish to consult one.)

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1. File with the Court, at the address shown below, a written response with supporting memorandum as required by Local Bankruptcy Rule 9013-1(H). **UNLESS A WRITTEN RESPONSE AND SUPPORTING MEMORANDUM ARE FILED AND SERVED BY THE DATE SPECIFIED, THE COURT MAY DEEM ANY OPPOSITION WAIVED, TREAT THE MATTER AS CONCEDED, AND ISSUE AN ORDER GRANTING THE REQUESTED RELIEF WITHOUT FURTHER NOTICE OR HEARING.** If you mail your response to the Court for filing, you must mail it early enough so the Court will receive it on or before the date stated above. The address of the Clerk's Office is:

Clerk of Court  
United States Bankruptcy Court  
200 South Washington Street  
P.O. Box 19247  
Alexandria, Virginia 22320

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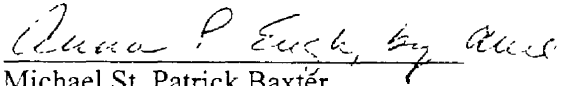
United States Trustee, Region 4  
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2. You (or your attorney if you have one) must also attend the hearing at the place and on the date shown above.

If no timely response is filed opposing the approval of the Motion, the Court may approve the Motion without holding a hearing. If you or your attorneys do not take these steps, the Court may decide that you do not oppose approval of the Debtor's Motion and may enter an order approving it.

Dated: June 1, 2001.

Respectfully submitted,

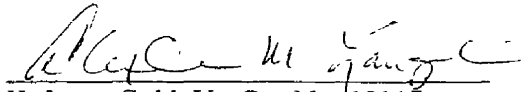


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**Counsel for the Debtors and Debtors in Possession**

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**Counsel for the Debtors and Debtors in Possession**

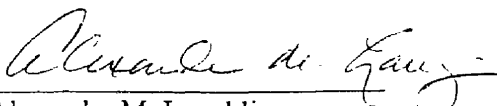


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(703) 836-7004  
(703) 548-9430 (Facsimile)

**Proposed Local Counsel for the Debtors and  
Debtors in Possession**

**CERTIFICATE OF SERVICE**

I HEREBY CERTIFY that on this 1st day of June, 2001, the foregoing Notice Of Hearing On Motion Of The Debtors For Order Approving:(1) Sale Of Assets Free And Clear Of Liens And Interests, (2) Auction Procedures For Sales Of Assets, (3) Certain Bid Protection, (4) Form Of Notice Of Auction And Sale Hearing was sent via first class mail postage prepaid to all creditors and parties in interest as set forth on the attached service lists.\*

  
Alexander M. Laughlin

\* Pursuant to Local Rule 5005-1(C) (8), the attached service lists are not being served on each of the parties, but is attached to the original Certificate of Service filed with the Court

UNITED STATES BANKRUPTCY COURT  
FOR THE EASTERN DISTRICT OF VIRGINIA

Alexandria Division

In re: )  
 ) Chapter 11  
PATHNET TELECOMMUNICATIONS )  
INC., *et al.* ) Case Nos. 01-12264 - SSM  
 ) Jointly Administered  
Debtors. )  
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**MOTION OF THE DEBTORS FOR ORDER APPROVING:**  
**(1) SALES OF ASSETS FREE AND CLEAR OF LIENS AND INTERESTS,**  
**(2) AUCTION PROCEDURES FOR SALES OF ASSETS,**  
**(3) CERTAIN BID PROTECTION, AND**  
**(4) FORM OF NOTICE OF AUCTION AND SALE HEARING**

Pathnet Telecommunications, Inc. (“PTI”), and its affiliated Debtors and Debtors-in-possession in the above-captioned cases. Pathnet, Inc. (“PNI”), Pathnet Operating, Inc. (“POI”), Pathnet Operating of Virginia, Inc. (“POV”), Pathnet Real Estate LLC (“PRE”) and Pathnet Fiber Equipment LLC (“PFE” and collectively with PTI, PNI, POI, POV and PRE, the “Pathnet Group” or the “Debtors”), hereby move this court for

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Dennis B. Auerbach  
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1660 International Drive, Suite 450  
McLean, Virginia 22102-4848  
(703) 836-7004  
*Proposed Local Counsel for the Debtors and Debtors in Possession*

the entry of an order, pursuant to sections 105(a), 363 and 365 of the Bankruptcy Code and Rules 2002, 6004 and 9006 of the Federal Rules of Bankruptcy Procedure (the “**Bankruptcy Rules**”), for entry of an order approving: (1) the sale of the Debtors’ rights, title and interests in assets free and clear of liens and interests pursuant to the Auction Procedures, (2) the auction procedures, substantially in the form annexed hereto as **Exhibit A** (the “**Auction Procedures**”) for the disposition by sale, lease, license, or other commercially reasonable manner (to “**Sell**” or a “**Sale**”) of the assets of the Debtors, in whole, in part or parts (collectively or in part, the “**Assets**”) by one or more Sales, to one or more bidders; (3) certain bid protection as described herein; and (4) the notice of auction and sale hearing, substantially in the form attached hereto as **Exhibit B** (the “**Notice of Auction and Sale Hearing**”) establishing a date, time and place for the Sale by public auction of the Assets and the approval of the Sale.

#### **BACKGROUND**

1. On April 2, 2001 (the “**Petition Date**”), each of the Debtors filed a voluntary petition in the United States Bankruptcy Court for the District of Delaware under Chapter 11 of the Bankruptcy Code. The Debtors continue to operate their respective businesses and manage their respective properties as Debtors-in-possession pursuant to sections 1107(a) and 1108 of the Bankruptcy Code.

2. On May 18, 2001, the United States Bankruptcy Court for the District of Delaware, on the joint motion of creditors Cisco Systems Capital Corporation (“**Cisco**”) and Nortel Networks Inc. (“**Nortel**”), transferred the venue of these cases to the United States Bankruptcy Court for the Eastern District of Virginia (Alexandria Division).



3. PNI was formed on August 25, 1995, under the laws of the State of Delaware. It is a wholesale telecommunications provider and has built a network designed to provide other wholesale and retail telecommunications service providers with access to underserved and second- and third-tier markets throughout the United States.

4. PTI was formed on November 1, 1999, under the laws of the State of Delaware, by the former shareholders of PNI to facilitate a corporate reorganization transaction, which became effective on March 30, 2000, and to continue the activities of PNI. Upon finalization of the corporate reorganization transaction, PNI became a wholly-owned subsidiary of PTI.

5. POI was formed on April 6, 2000, under the laws of the State of Delaware, to facilitate the development of the Pathnet Group's fiber optic business. POI is a wholly owned subsidiary of PTI.

6. POV was formed on June 26, 2000, under the laws of the Commonwealth of Virginia, to hold certain licenses used in the development of the Debtors' fiber optic business. POV is a wholly-owned subsidiary of POI.

7. PFE was formed on June 23, 2000, under the laws of the State of Delaware, to hold certain fiber assets used in the development of the Debtors' fiber optic business. PFE is a wholly owned subsidiary of POI.

8. PRE was formed on June 23, 2000, under the laws of the State of Delaware, to hold certain real estate assets used in the development of the Debtors' fiber optic business. PRE is a wholly owned subsidiary of POI.

9. The Pathnet Group's telecommunications network is intended to enable its customers, including existing local telephone companies, long-distance

companies, internet service providers, competitive telecommunications companies, cellular operators and other telecommunications providers, to offer additional services to new and existing customers in the markets the Pathnet Group serves without having to expend their own resources to build, expand or upgrade their own networks.

10. As of February 28, 2001, the Pathnet Group employed approximately 255 employees. Immediately prior to the Petition Date, the Pathnet Group, in a cost-saving measure, terminated the employment of approximately 17% of its employees. As of the Petition Date, the Debtors employed approximately 207 employees.

11. As of December 31, 2000, the Pathnet Group reported approximately \$298 million in assets and approximately \$472 million in liabilities on a consolidated basis.

12. As of December 31, 2000, the Pathnet Group's network consisted of over 6,300 wireless route miles providing wholesale transport services and 1,400 miles of installed fiber, with collocations in 73 cities.

13. PNI has outstanding \$350 million in aggregate principal amount of units consisting of 12-1/4% Senior Notes due 2008 (the "**Senior Notes**"), which have been registered under the Securities Act of 1933, as amended, and warrants to purchase Common Stock issued by PNI on April 8, 1998.

14. On or about April 19, 2001, the United States Trustee appointed an official committee of unsecured creditors in the above-captioned cases (the "**Creditors' Committee**"). No trustee or examiner has been appointed in these Chapter 11 cases.

15. Pursuant to 28 U.S.C. § 1334, the Court has jurisdiction over this Motion, which is a core proceeding within the meaning of 28 U.S.C. § 157(b)(2). Venue

of the Debtors' Chapter 11 cases and this Motion is proper in this district under 28 U.S.C. §§ 1408 and 1409. The statutory predicates for the relief sought herein are sections 105(a), 363 and 365 of the Bankruptcy Code, and Bankruptcy Rules 2002, 6004 and 9006.

### **RELIEF REQUESTED**

16. The Debtors respectfully request the entry of an order approving: (a) the Auction Procedures for the Sale of the Assets by one or more Sales, to one or more bidders; (b) certain bid protection as described herein; and (c) the Notice of Auction and Sale Hearing establishing a date, time and place for the Sale by public auction of the Assets and approval of the Sale.

### **BASIS FOR RELIEF**

17. The original Pathnet company, Pathnet Inc., was formed in 1995 for the purpose of building a network using wireless microwave technology.

18. As a result of the rapid advancement of fiber optic technology, it became apparent that the future of a wireless microwave network was limited. The use of fiber optic cables allowed an exponential increase in communications traffic compared to wireless technology. Consequently, in 1999, the business strategy was expanded to integrate fiber optic technology with the microwave network. This enabled the Pathnet Group to deliver higher bandwidth services as well as dark fibers (i.e., strands of fiber contained within a fiber optic cable that does not yet have its transmission electronics installed) to its customers.

19. The costs of building the Pathnet network proved substantial. The Pathnet Group incurred losses from operations every year since inception.

20. In May, 2000, the Pathnet Group engaged Goldman Sachs & Co. to advise on potential equity investors to help fund the Pathnet Group's business plan.

Unfortunately, the capital markets did not look favorably on telecommunications companies, and Pathnet was no exception. Despite diligent efforts, equity investment was not available. The Goldman Sachs engagement was terminated prior to the Petition Date.

21. The Pathnet Group subsequently retained FTI/Policano & Manzo as financial advisors to assist in financial forecasting, financial management and the conservation of cash in an effort to preserve the value of the Debtors' businesses and to maximize the value of the Debtors' assets.

22. The Pathnet Group also retained Houlihan Lokey Howard & Zukin ("**Houlihan Lokey**") as investment bankers to assist in effecting an orderly sale, merger, or other disposition of all, part or parts of the Debtors' assets, so as to maximize the value of the assets for the benefit of creditors.

#### **Reasons for Seeking Chapter 11 Protection**

23. The Debtors filed for Chapter 11 protection for several reasons. First, despite its diligent efforts, it was unable to obtain additional equity to fund operating shortfalls while its telecommunications network was being developed. Second, the Debtors needed a respite to complete an orderly sale or other disposition of all, part or parts of its assets in an effort to maximize value for the benefit of creditors. Third, seeking protection under Chapter 11 was the only way that the Debtors could conserve cash and ensure that all creditors would be treated fairly and equally.

24. The Debtors intend to pursue a sale or other disposition of all of the Debtors' businesses or assets.

25. The Debtors have determined that it is in the best interests of their respective estates and creditors to promptly sell the assets prior to confirmation of a plan of reorganization.

**Reasons for the Proposed Sale**

26. An expedited Sale of the Assets is necessary for the following reasons. First, the value of the Assets is diminishing as a result of continued operating losses. Despite its best efforts, the management of the Debtors does not believe that these losses can be avoided in the near future even with the internal cost reduction implemented both before and after the Petition Date. The Debtors believe that, if they do not Sell the Assets promptly, they will have insufficient cash to sustain their operations by the end of the summer. Second, the Debtors' pre-bankruptcy financial condition, exacerbated by the Chapter 11 filings, has strained and continues to strain relationships with the Debtors' suppliers, customers, and employees. Third, a prompt Sale will aid in minimizing the administrative expenses of these cases. Fourth, the proceeds of a Sale of Assets, to the extent sold as a going concern, likely will be greater than if the same assets are sold in a piecemeal liquidation. Finally, a Sale of the Assets, to the extent sold as a going concern, will likely preserve some of the jobs of the Debtors' employees.

27. The Debtors have explored numerous options for obtaining sufficient funds to continue the construction of the Debtors' telecommunications network. However, despite diligent efforts, the Debtors have been unable to obtain the necessary capital or financing.

28. Following consultation with their financial advisers and investment bankers, the Debtors, in the exercise of their business judgment, have concluded that a sale

by auction of the Assets, in whole or part, is the best and most feasible option to maximize the value of the Assets. An auction, as described below, is the best means available to maximize the realizable value of the Assets.

29. The Debtors seek to implement the Auction Procedures in order to obtain the highest or best offers for the Assets and to attract buyers who will sign definitive purchase agreement(s) regarding all, part or parts of the Assets.

30. The Debtors intend to commence and conclude an auction for the Assets within approximately eight weeks. While a longer period would normally be desirable, the Debtors are concerned that they take every step to minimize the operating losses while preserving the value of the Assets.

31. To that end, the Debtors intend to implement an intensive auction process designed to yield the best and highest value for the Assets. Houlihan Lokey, the Debtors' investment banker, has already commenced its marketing efforts. Prospective buyers have already been contacted. Due diligence materials have been prepared. An on-line data room has been created to facilitate the due diligence of prospective buyers. Proposed sale documentation has been prepared and provided to prospective buyers.

32. Prospective bidders have been informed that they should submit to Houlihan Lokey, by June 5, 2001, nonbinding expressions of interest together with the form of purchase agreement. The Debtors, after consultation with the Creditors' Committee and the Secured Creditors, will evaluate the expressions of interest and notify all parties of the Auction and the sale hearing.

33. Through the Auction Procedures, the Debtors intend to maximize the recovery to all creditors, both secured and unsecured, and to minimize the risk and costs of the bankruptcy process.

34. The Auction Procedures are prompted by the exigencies facing the Debtors. This is not an attempt to implement a *sub rosa* plan of reorganization. Rather, the Debtors seek only to realize the maximum value for their assets for the benefit of creditors. The proposed sale would not restructure the rights of creditors. A plan of reorganization in large and complex cases like this cannot be negotiated and confirmed within the limited time available to the Debtors to maximize the value of the Assets for the benefit of creditors. During and following the sale of the Debtors' assets, the Debtors anticipate the negotiation of a plan of reorganization with its creditors.

35. To encourage prospective bidders to enter into binding agreements to purchase the Assets, the Debtors seek authority to grant certain bid protections as described below, subject to the approval of Cisco and Nortel (collectively, the "**Secured Creditors**") and the Creditors' Committee. Bid protection is often necessary to encourage stalking horse bids, which can then be used to generate higher or better bids. Through the use of bid protection, the Debtors seek to facilitate a competitive auction atmosphere for the Assets. The Debtors reserve the right to seek such other bid protection as they believe is appropriate in their business judgment on not less than five business days' notice or such lesser notice as may be approved by the Bankruptcy Court. Any hearing on such other bid protection shall be held on June 22, 2001, at 9:30 a.m., or such other date and time as the Debtors may request, subject to approval of the Bankruptcy Court.

### Summary of the Auction Procedures

36. The following is a summary of the Auction Procedures pursuant to which the Debtors will solicit bids and sell the Assets.

(a) Within not more than three business days following the entry by the Bankruptcy Court of an order approving the Auction Procedures (the “**Sale Procedure Order**”), the Debtors will transmit the Notice of Auction and Sale Hearing by postage-prepaid, first-class U.S. mail, hand-delivery, telecopy, or overnight courier, to: (i) the Office of the United States Trustee; (ii) counsel to the Creditors’ Committee; (iii) the indenture trustee in respect of the Senior Notes; (iv) all known creditors in the cases; (v) those entities who have requested notice pursuant to Bankruptcy Rule 2002; (vi) those governmental agencies required to receive notice of proceedings under the Bankruptcy Rules and the Local Bankruptcy Rules; and (vii) potential qualified bidders known to the Debtors.

(b) The Assets may be sold in whole or in part or parts. Bidders will be allowed to perform reasonable due diligence on the Assets. The Debtors, in their discretion, after consultation with the Creditors’ Committee and the Secured Creditors, will qualify potential bidders according to their financial qualifications to consummate any purchase of the Debtors’ Assets.

(c) The Debtors, in their discretion, after consultation with the Creditors’ Committee and the Secured Creditors, may enter into an asset purchase agreement(s) with any entity or entities (collectively, the “**Stalking Horse Bidder**”) for the purposes of establishing a minimum bid and a foundation for further bidding on the Assets (a “**Stalking Horse Agreement**”), which may contain customary terms and



conditions. The Stalking Horse Agreement shall be subject to Bankruptcy Court approval and to higher or better offers.

(d) If the Debtors execute a Stalking Horse Agreement(s) with an earnest money deposit satisfactory to the Creditors' Committee and the Secured Creditors, the Debtors, with the approval of the Creditors' Committee and the Secured Creditors, may grant each such Stalking Horse Bidder the following bid protection (collectively, the "**Bid Protection**"):

(i) a break-up fee of up to the greater of (A) 3% of the total proposed purchase price (based upon the total cash and non-cash consideration) to be paid pursuant to the Stalking Horse Agreement subject to a maximum break-up fee of \$2 million; or (B) 3% of the total cash consideration of the proposed purchase price (the "**Break-Up Fee**");

(ii) reimbursement of the expenses of the Stalking Horse Bidder incurred in connection with its bid up to a maximum amount of \$250,000.00 (the "**Expense Reimbursement**"); and

(iii) a requirement that any bid submitted at the Auction must exceed the consideration to be paid pursuant to the Stalking Horse Agreement by no less than the sum of (A) the Stalking Horse Bid, (B) the Break-Up Fee, (C) the Expense Reimbursement, and (D) an amount designated by the Debtors up a maximum amount of \$250,000.00.

(e) Notwithstanding the provisions of paragraph (d) above, the Debtors may seek such other bid protection as they believe is appropriate in their business judgment on five business days' notice or such lesser notice as may be approved by the

Bankruptcy Court. Any hearing on such other bid protection shall be held on June 22, 2001, at 9:30 a.m., or such other date and time as the Debtors may request, subject to approval of the Bankruptcy Court.

(f) The Break-Up Fee and the Expense Reimbursement shall be paid only upon the execution and consummation by the Debtors of an agreement embodying a higher or better bid than the Stalking Horse Agreement prior to the termination of the Stalking Horse Agreement. Payment of the Break-Up Fee and the Expense Reimbursement is conditioned upon the Debtors' closing the agreement embodying the successful bid, and is not payable if the Stalking Horse Agreement is terminated due to the Stalking Horse Bidder's breach thereof.

(g) If the Debtors enter into a Stalking Horse Agreement(s), the Debtors shall provide notice of such agreement(s) to: (i) the Office of the United States Trustee; (ii) counsel to the Creditors' Committee; (iii) those entities who have requested notice pursuant to Bankruptcy Rule 2002; (iv) those governmental agencies required to receive notice of proceedings under the Bankruptcy Rules and the Local Bankruptcy Rules; (v) potential qualified bidders known to the Debtors; and (vi) counterparties to those executory contracts and unexpired leases that the Debtors may seek to assume or reject in conjunction with the Stalking Horse Agreement.

(h) The Debtors, in their discretion, after consultation with the Creditors' Committee and the Secured Creditors, may require that bids meet certain terms and conditions set forth in a form of definitive agreement (or a Stalking Horse Agreement, if applicable) which may be provided by the Debtors. If a bid is conditioned on the assumption and assignment of certain executory contract(s) or unexpired lease(s), the bid

must include sufficient information to permit the Debtors to determine the proposed assignee's ability to comply with section 365 of the Bankruptcy Code (to the extent applicable), including providing adequate assurance of such assignee's ability to perform in the future.

(i) The Sale of the Assets will be conducted by an auction to be held at the offices of Covington & Burling, 1201 Pennsylvania Avenue, N.W., Washington, D.C., at 10:00 a.m. Eastern Time on July 11, 2001, or such other date, time and place as the Debtors may determine (the "**Auction**"). The Debtors, after consultation with the Creditors' Committee and the Secured Creditors, will select the winning bids at the conclusion of the Auction, subject to Bankruptcy Court approval. The winning bidder must deliver within 24 hours after the conclusion of the Auction an earnest money deposit (the "**Earnest Down Payment**") equal to 10% of the total proposed purchase price (based upon the total of cash and non-cash consideration) in the form of a certified check or wire transfer payable to an escrow agent to be determined by the Debtors. In lieu of the Earnest Down Payment, the winning bidder may make such other arrangements as may be acceptable to the Debtors. The existence of an Earnest Down Payment or the nature of the alternative arrangements in lieu thereof shall be considered by the Debtors in the determination of the winning bid. Unless and to the extent otherwise agreed by the Debtors, the winning bidders will enter into definitive agreements before the Auction is concluded.

(j) The sale hearing will be held on July 24, 2001, at 1:30 p.m., or at other date and time as the Debtors may request, subject to approval by the Bankruptcy Court (the "**Sale Hearing**"). At least six business days before the Sale Hearing (or such

lesser time as may be approved by the Bankruptcy Court), the Debtors will file notice of the winning bidder(s) and a summary of the essential terms of the winning bid(s), including the assets to be purchased and any executory contracts or unexpired leases to be included therein (the “**Winning Bidder Notice**”). Any objections (an “**Objection**”), shall be in writing and filed and served not less than two business days before the Sale Hearing, in the manner set forth in the Auction Procedures. The Debtors will transmit the Winning Bidder Notice by hand-delivery, telecopy, or overnight courier, to: (i) the Office of the United States Trustee; (ii) Stroock & Stroock & Lavan LLP, 180 Maiden Lane, New York, New York 10038, Attention: Lawrence Handelsman, Esq.; (iii) the Secured Creditors; (iv) the entities who have requested notice pursuant to Bankruptcy Rule 2002; (v) those government agencies required to receive notice of proceedings under the Bankruptcy Rules and the Local Bankruptcy Rules; (vi) entities that are known by the Debtors to have filed proofs of claim asserting that their claims are secured and entities who hold secured claims according to the Debtors’ schedules of assets and liabilities; and (vii) counterparties to those executory contracts and unexpired leases that the Debtors may seek to assume or reject in conjunction with a Sale.

(k) The Debtors reserve their rights, after consultation with the Creditors’ Committee and the Secured Creditors: (i) to impose, at or prior to the Auction, additional terms and conditions on a Sale of Assets; (ii) to extend the deadlines set forth in the Auction Procedures, adjourn the Auction at the Auction, and/or adjourn the Sale Hearing in open court without further notice; (iii) to withdraw from Sale any Assets at any time prior to or during the Auction and to make subsequent attempts to market the same:

and (iv) to reject all bids if, in the Debtors' reasonable judgment, no bid is for a fair and adequate price.

## LEGAL AUTHORITY

### Sale of Assets Outside the Ordinary Course of Business

37. Section 363(b)(1) of the Bankruptcy Code provides that “[t]he trustee, after notice and hearing, may use, sell or lease, other than in the ordinary course of business, property of the estate.” 11 U.S.C. § 363(b)(1). In addition, section 105(a) of the Bankruptcy Code allows this Court to “issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Code].” 11 U.S.C. § 105(a).

38. In In re Lionel Corp., 722 F. 2d 1063 (2d Cir. 1983), the Second Circuit adopted the so-called “sound business purpose” or “business judgment” standard in approving sale of substantially all of a debtor’s assets before the proposal of a plan of reorganization. Under this standard, the use, sale or lease of property of the estate, other than in the ordinary course of business will be approved when a “sound business purpose” justifies such action. The Lionel approach has been widely adopted. See, e.g., In re Delaware & Hudson Ry., 124 B.R. 169, 176 (D. Del. 1991); Stephen Industries, Inc. v. McClung, 789 F. 2d 386, 390 (6th Cir. 1986); In re Continental Air Lines, Inc., 780 F.2d 1223, 1226 (5th Cir. 1986); and Titusville Country Club v. Pennbank, 128 B.R. 396, 399 (Bankr. W.D. Pa. 1991).

39. The Debtors’ proposed sale of Assets pursuant to the Auction Procedures satisfies the “sound business purpose” test. First, the value of the Assets is diminishing as a result of continued operating losses. Despite its best efforts, the management of the Debtors does not believe that these losses can be avoided in the near future even with the internal cost reduction implemented both before and after the Petition

Date. The Debtors believe that, if they do not Sell the Assets promptly, they will have insufficient cash to sustain their operations by the end of the summer. Second, the Debtors' pre-bankruptcy financial condition, exacerbated by the Chapter 11 filings, has strained and continues to strain relationships with the Debtors' suppliers, customers, and employees. Third, a prompt Sale will aid in minimizing the administrative expenses of these cases. Fourth, the proceeds of a Sale of Assets, to the extent sold as a going concern, likely will be greater than if the same assets are sold in a piecemeal liquidation. Finally, a Sale of the Assets, to the extent sold as a going concern, will likely preserve some of the jobs of the Debtors' employees.

40. The Auction Procedures are necessary to the Debtors efforts to maximize the value of their assets for the benefit of creditors. The Debtors believe that the Auction Procedures will be critical to the Debtors' efforts to preserve the value of their assets and to sell their assets at the best prices available. The Auction Procedures are designed to ensure that all bidders are placed on a level playing field and have the opportunity to compete for the assets that they seek.

#### **Bid Protection**

41. The Bid Protection is necessary to encourage prospective bidders to enter into binding agreements to purchase the Assets. Bid protection is often necessary to encourage stalking horse bids, which can then be used to generate higher or better bids for the Assets. Without such bid protection, a prospective bidder may be unwilling to enter a binding agreement with the Debtors because of the legitimate concern that the prospective bidder may lose out to higher or better offers in the auction process. The Bid Protection is designed to encourage a potential purchaser to make a "stalking horse" offer, which may

be shopped by the Debtors to attract higher offers. See In re Integrated Resources, Inc., 135 B.R. 746, 750 (Bankr. S.D.N.Y.), aff'd, 147 B.R. 650 (S.D.N.Y. 1992).

42. Outside of bankruptcy, break-up fees are presumptively valid under the business judgment rule. Integrated Resources, Inc., 135 B.R. at 750. In bankruptcy, however, courts will review break-up fees to ensure that they benefit the estate. Id.

43. In reviewing break-up fees, the following factors are considered by courts: (a) whether the fee is directly related to the maximization of value of the debtor's estate; (b) whether the underlying agreement is an arm's-length transaction between the debtor and the potential bidder; (c) whether the principal secured creditors and the creditors' committee support the payment; (d) whether the break-up fee constitutes a fair and reasonable percentage of the proposed purchase price; (e) whether the break-up fee is so large that it might have a chilling effect on other potential bidders; (f) whether there are safeguards built into the process to protect the debtor's estate from diminution if the bidding process is not successful in generating other higher bidders; and (g) whether there exists the potential for a substantial adverse impact on unsecured creditors who oppose the break-up fee. In re Hupp Indus. Inc., 140 B.R. 191, 194 (Bankr. N.D. Ohio 1992).

44. The Break-Up Fee proposed in the Auction Procedures satisfies all of the factors enumerated above. First, the Break-Up Fee is directly related to the Debtors' efforts to maximize the value of the Assets. The Break-Up Fee represents an incentive payment to the Stalking Horse Bidder whose bid will be used to attract other bidders. Second, the underlying transaction between the Debtors and the Stalking Horse Bidder will be negotiated at arm's length. Third, the Break-Up Fee can only be granted if the principal secured creditors and the Creditors' Committee consent. In the absence of such consent,

no break-up fee can be granted without further order of this Court. Fourth, the Break-Up Fee is a fair and reasonable percentage of the proposed purchase price. Fifth, the Break-Up Fee is not so large as to have a chilling effect on other potential bidders. Sixth, there are safeguards to protect the Debtors' estates from diminution if the bidding process is not successful in generating other higher bidders. Under the Auction Procedures, the Break-Up Fee is only payable in the event that the Debtors accept and consummate a transaction with a higher or better bidder at a purchase price in excess of the Break-Up Fee. Finally, there is little potential for a substantial adverse impact on unsecured creditors because the Break-Up Fee can only be granted if the Creditors' Committee, which represents the interests of the unsecured creditors, consent.

45. The Bid Protection includes the Debtors' reimbursement of the expenses of each Stalking Horse Bidder up to a maximum amount of \$250,000.00 each. This is necessary because substantial legal, appraisal and accounting expenses may be incurred by the Stalking Horse Bidder in making its bid. The Stalking Horse Bidder may make a lower bid, if one at all, if it cannot recover these expenses. Moreover, other potential bidders may capitalize on the Stalking Horse Bidder's due diligence in preparing their bid without having to incur the same substantial costs. Accordingly, it is both necessary and in the best interests of the estates to enable the Debtors to offer expense reimbursement. The Expense Reimbursement is subject to the same conditions as the Break-Up Fee, including the requirement for the consent of the Creditors' Committee and the Debtors' principal secured creditors. It, too, satisfies all of the factors enumerated in paragraph 43 above.



### **Auction Sale is Not a Sub Rosa Plan**

46. The Auction Procedures are not an attempt to implement a *sub rosa* plan of reorganization. To the contrary, the Debtors seek only to realize the maximum values for their assets for the benefit of creditors, not to restructure the rights of creditors. See In re Naron & Wagner, Chartered, 88 B.R. 85, 88 (Bankr. D. Md. 1988) (“The sale proposed here is not a sub rosa plan because it seeks only to liquidate assets, and the sale will not restructure rights of creditors”). In the limited time available to the Debtors, a plan of reorganization simply cannot be negotiated and confirmed in these large and complex cases, while at the same time also realizing the maximum value of the Debtors’ assets for creditors. See Delaware & Hudson Ry. Co., 124 B.R. 169, 178-79 (D. Del. 1991). The Debtors anticipate the negotiation of a plan of reorganization during and following the sale process.

47. The Debtors believe that the Auction Procedures are reasonable and appropriate and will enhance the Debtors’ ability to maximize the value of their assets for the benefit of creditors.

### **Sale Free and Clear of Liens and Interests**

48. Under Section 363(f) of the Bankruptcy Code, a debtor may sell property free and clear of liens and interests of an entity other than the estate. To satisfy the requirements of Section 363(f), at least one of the following must be satisfied: (a) applicable nonbankruptcy law permits the sale of the property free and clear of interests; (b) the entity consents; (c) if the interest is a lien, the price at which the property is to be sold is greater than the aggregate value of all liens on such property; (d) the interest is in bona fide dispute; or (e) the entity could be compelled to accept a money satisfaction

of the interest. 11 U.S.C. § 363(f). See, e.g., In re General Bearing Corp., 136 B.R. 361, 366 (Bankr. S.D.N.Y. 1992).

49. To the extent that there are holders of liens or interests in the Assets, the Debtors believes that one or more of the Section 363(f) requirements will be satisfied. Moreover, the Debtors submit that any liens or interests will be adequately protected by having it attach to the net proceeds of the Sale, subject to any claims and defenses the Debtors may have with respect thereto. Accordingly, the Sale pursuant to the Auction Procedures should be approved under Section 363(f).

#### NOTICE

50. Under Bankruptcy Rule 2002(a)(2) and (c), the Debtors are required to notify, *inter alia*, the Debtors' creditors of a proposed sale of the Debtors' assets outside of the ordinary course of business, including a disclosure of the time and place of a public sale, the terms and conditions of a private sale, and the deadline for filing any objections.

51. The Debtors have served this Motion on all creditors and other parties in interest identified in the cases. This Motion is sufficient to inform all interested parties of the anticipated impact of the Sale on the Debtors' businesses and/or anticipated plan. The Notice of Auction and Sale Hearing will provide further notice of the Sale and the Auction Procedures. The Winning Bidder Notice will provide notice of the actual proposed sale(s) and will supplement the notice already provide by this Motion.

52. Notice of this Motion has been given to (i) the Office of the United States Trustee; (ii) counsel to the Creditors' Committee; (iii) the indenture trustee in respect of the Senior Notes; (iv) all known creditors in the cases; (v) those entities who have requested notice pursuant to Bankruptcy Rule 2002; and (vi) those governmental

agencies required to receive notice of proceedings under the Bankruptcy Rules and the Local Bankruptcy Rules. The Debtors submit that no other or further notice is required.

**NO PRIOR REQUEST**

53. No previous application for the relief requested herein has been made to this or any other court.

54. The Debtors reserve the right to file a separate or supplemental memorandum of points and authorities in support of the Motion.

WHEREFORE, the Debtors respectfully request that the Court enter an order, substantially in the form attached hereto, and grant such other relief as may be just.

Respectfully submitted,

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**Proposed Local Counsel for the Debtors  
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June 1, 2001

## AUCTION PROCEDURES

These Auction Procedures<sup>1</sup> set forth the process by which Pathnet Telecommunications, Inc. and its affiliated Debtors and Debtors-in-possession, Pathnet, Inc., Pathnet Operating, Inc., Pathnet Operating of Virginia, Inc., Pathnet Fiber Equipment LLC, and Pathnet Real Estate LLC (collectively, the “**Debtors**”) may effectuate a Sale by Auction of their Assets. The Auction Procedures were approved upon the Debtors’ Motion (the “**Sale Procedure Motion**”) by order (the “**Sale Procedure Order**”) of the United States Bankruptcy Court for the Eastern District of Virginia (Alexandria Division) (the “**Bankruptcy Court**”) in which the Debtors’ jointly administered Chapter 11 bankruptcy cases are pending.

### 1. Assets to be Sold

The Debtors propose, by Auction (as defined below), to sell, lease, license, or otherwise dispose of (to “**Sell**” or a “**Sale**”) any and all of the Debtors’ assets in whole, in part or parts, or in any combination (collectively or in part, as appropriate, the “**Assets**”), by one or more Sales, to one or more bidders. The Assets may be sold free and clear of all liens, claims, encumbrances and interests.

### 2. Notice of Auction and Sale Hearing

Within not more than three business days following the entry of the Sale Procedure Order, the Debtors will transmit a notice, substantially in the form annexed to

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<sup>1</sup> Capitalized terms not defined herein, but defined in the Motion, shall have their respective meanings set forth in the Motion.

the Sale Procedure Motion. of the proposed sale of the Assets by Auction and the Sale Hearing (the “**Notice of Auction and Sale Hearing**”) by postage prepaid, first-class U.S. mail, hand-delivery, telecopy, or overnight courier, to: (i) the Office of the United States Trustee; (ii) counsel to the Creditors’ Committee; (iii) the indenture trustee in respect of the Senior Notes; (iv) all known creditors in the cases; (v) those entities who have requested notice pursuant to Bankruptcy Rule 2002; (vi) those governmental agencies required to receive notice of proceedings under the Bankruptcy Rules and the Local Bankruptcy Rules; and (vii) potential qualified bidders known to the Debtors.

**3. Confidentiality Agreement and Selection of Qualified Bidders**

Potential bidders for the Assets will be required to complete and execute a confidentiality agreement and to provide the Debtors with information about their financial qualifications and any other information the Debtors may reasonably request. The Debtors, after consultation with the Creditors’ Committee and the Secured Creditors, shall qualify potential bidders for continuing in the sales process by notifying potential bidders who have returned the confidentiality agreement and presented satisfactory financial qualifications that they have been selected as a qualified bidder (the “**Qualified Bidders**”).

**4. Notification of Stalking Horse Agreement**

Debtors reserve their rights, after consultation with Cisco Systems Capital Corporation (“**Cisco**”) and Nortel Networks, Inc. (“**Nortel**”) (collectively, the “**Secured Creditors**”), and the Creditors’ Committee, to enter into a purchase agreement (a “**Stalking Horse Agreement**”) with any entity or entities (collectively, the “**Stalking Horse Bidder**”), which may contain customary terms and conditions. The Stalking Horse Agreement shall be subject to Bankruptcy Court approval and to higher or better offers.

If the Debtors enter into a Stalking Horse Agreement(s), the Debtors shall provide notice of such agreement(s) to: (i) the Office of the United States Trustee; (ii) counsel to the Creditors' Committee; (iii) those entities who have requested notice pursuant to Bankruptcy Rule 2002; (iv) those governmental agencies required to receive notice of proceedings under the Bankruptcy Rules and the Local Bankruptcy Rules; (v) potential qualified bidders known to the Debtors; and (vi) counterparties to those executory contracts and unexpired leases that the Debtors may seek to assume or reject in conjunction with the Stalking Horse Agreement.

#### 5. Bid Protection

If the Debtors execute a Stalking Horse Agreement(s) with an earnest money deposit satisfactory to the Creditors' Committee and the Secured Creditors, the Debtors, with the approval of the Creditors' Committee and the Secured Creditors, may grant each such Stalking Horse Bidder the following bid protection (collectively, the "**Bid Protection**"):

(a) a break-up fee of up to the greater of (i) 3% of the total proposed purchase price (based upon the total cash and non-cash consideration) to be paid pursuant to the Stalking Horse Agreement(s) subject to a maximum break-up fee of \$2 million; or (ii) 3% of the total cash consideration of the proposed purchase price (the "**Break-Up Fee**");

(b) reimbursement of the expenses of the Stalking Horse Bidder incurred in connection with its bid up to a maximum amount of \$250,000.00 (the "**Expense Reimbursement**"); and

(c) a requirement that any bid submitted at the Auction must exceed the consideration to be paid pursuant to the Stalking Horse Agreement by no less than the sum of (i) the Stalking Horse Bid, (ii) the Break-Up Fee, (iii) the Expense Reimbursement, and (iv) an amount designated by the Debtors up a maximum amount of \$250,000.00.

Notwithstanding the foregoing, the Debtors may seek such other bid protection as they believe is appropriate in their business judgment on five business days' notice or such lesser notice as may be approved by the Bankruptcy Court. Any hearing on such other bid protection shall be held on June 22, 2001, at 9:30 a.m. or such other date and time as the Debtors may request, subject to approval of the Bankruptcy Court.

The Break-Up Fee and the Expense Reimbursement shall be paid only upon execution and consummation by the Debtors of an agreement embodying a higher or better bid than the Stalking Horse Agreement prior to the termination of the Stalking Horse Agreement. Payment of the Break-Up Fee and the Expense Reimbursement is conditioned upon the Debtors' closing the agreement embodying the successful bid, and is not payable if the Stalking Horse Agreement is terminated due to the Stalking Horse Bidder's breach thereof.

#### **6. Asset Purchase Agreement and Due Diligence**

The Debtors, in their discretion, may send, for negotiation, bidding or other purposes, to each Qualified Bidder or to any entity interested in participating in the Auction, a form agreement for the Sale of the Assets (the "**Asset Purchase Agreement**"). The Debtors will provide reasonable access to Debtors' books, records and executives to Qualified Bidders for the purpose of conducting due diligence.



7. **Auction and Selection of Winning Bid or Bids**

The Sale of the Assets will be by auction to be held at the offices of Covington & Burling, 1201 Pennsylvania Avenue, N.W., Washington, D.C. on July 11, 2001, at 10:00 a.m. Eastern Time or such other date, time and place as the Debtors may determine (the “**Auction**”). Only Qualified Bidders with a qualifying bid may attend the auction. For its bid to be considered, a Qualified Bidder must appear in person at the Auction or through a duly authorized representative.

To be considered, a bid must comply with the following:

(a) consist of an executed version of the Asset Purchase Agreement or Stalking Horse Agreement (if any) with marked alterations, if desired; or if no Asset Purchase Agreement or Stalking Horse Agreement exists, then a proposed form of asset purchase agreement;

(b) include an earnest money deposit (the “**Earnest Down Payment**”) equal to 10% of the total proposed purchase price (based upon the total of cash and non-cash consideration) in the form of a certified check or wire transfer payable to an escrow agent to be determined by the Debtors. In lieu of the Earnest Down Payment, the bidder may make such other arrangements as may be acceptable to the Debtors. The existence of an Earnest Down Payment or the nature of the alternative arrangements in lieu thereof shall be considered by the Debtors in the determination of the winning bid;

(c) clearly state the portion of consideration to be paid in cash and the portion to be paid in any other form of value;

(d) if any consideration is to be provided in a form other than cash, provide such information as to permit the Debtors to accurately assess the value of such consideration;

(e) must give sufficient indicia that the Qualified Bidder or its representative is legally empowered by power of attorney or otherwise, and financially capable, to bid on behalf of the Qualified Bidder and to complete and sign, on behalf of the Qualified Bidder, a binding and enforceable asset purchase agreement;

(f) must not contain any contingencies to the validity, effectiveness, and/or binding nature of the bid, including without limitation, contingencies for financing, due diligence or inspection;

(g) must identify with particularity each and every executory contract or unexpired lease the assumption and assignment of which is a condition to closing; and

(h) if a bid is conditioned on the assumption and assignment of any executory contract or unexpired lease, the bid must include sufficient information to permit the Debtors to determine the proposed assignee's ability to comply with section 365 of the Bankruptcy Code (to the extent applicable), including providing adequate assurance of such assignee's ability to perform in the future.

Bidders and all other entities shall keep bids confidential, with access restricted to the Debtors, the Creditors' Committee, and the Secured Creditors. However bids may be revealed to any other entity at the option of the Debtors. The Debtors may request additional information from a bidder (whether previously qualified or not) in order to evaluate the bidder's ability to consummate a transaction and to fulfill its obligations in

connection therewith, and such bidder shall be obligated to provide such information as a precondition to participating further in the Auction.

If multiple bids satisfying all requirements the Debtors may impose are received, each such bidder shall have the right to continue to improve its bid at the Auction. At the conclusion of the Auction, and subject to Bankruptcy Court approval following the Auction, the winning bid(s) will be selected by the Debtors, after consultation with the Creditors' Committee and the Secured Creditors, from the bids (singular or plural, as appropriate, the "**Winning Bid**"); provided, however, the Debtors shall have the right, in their discretion, after consultation with the Creditors' Committee and the Secured Creditors, to reject any and all bids. The Winning Bid shall be subject to approval by the Bankruptcy Court.

Prior to the conclusion of the Auction, unless and to the extent otherwise agreed by the Debtors, each entity that makes a Winning Bid (the "**Winning Bidder**") shall complete and sign all agreements, contracts, instruments or other documents evidencing and containing the terms and conditions upon which its respective Winning Bid was made. Within 24 hours after the conclusion of the Auction, the Winning Bidder(s) shall pay an earnest money deposit (the "**Earnest Down Payment**") equal to (when added to any Earnest Down Payment previously paid by the Winning Bidder(s) and still held for the benefit of the Debtors) 10% of the total proposed purchase price (based upon the total of cash and non-cash consideration) in the form of a certified check or wire transfer payable to an escrow agent to be determined by the Debtors. In lieu of the Earnest Down Payment, the Winning Bidder may make such other arrangements as may be acceptable to the Debtors. The existence of an Earnest Down Payment or the nature of the alternative

arrangements in lieu thereof shall be considered by the Debtors in the determination of the Winning Bid.

**8. Sale Hearing.**

The sale hearing will be held at the United States Bankruptcy Court for the Eastern District of Virginia (Alexandria Division), 200 South Washington Street, Alexandria, Virginia, on July 24, 2001, at 1:30 p.m., or at other date and time as the Debtors may request, subject to approval by the Bankruptcy Court (the “**Sale Hearing**”).

At least six business days before the Sale Hearing (or such lesser time as may be approved by the Bankruptcy Court), the Debtors will file notice of the winning bidder(s) and a summary of the essential terms of the winning bid(s), including the assets to be purchased and any executory contracts or unexpired leases to be included therein (the “**Winning Bidder Notice**”). Objections (an “**Objection**”), shall be in writing and filed and served not less than two business days before the Sale Hearing, in the manner set forth in the Auction Procedures.

The Debtors will transmit the Winning Bidder Notice by hand-delivery, telecopy, or overnight courier, to: (i) the Office of the United States Trustee; (ii) Stroock & Stroock & Lavan LLP, 180 Maiden Lane, New York, New York 10038, Attention: Lawrence Handelsman, Esq.; (iii) the Secured Creditors; (iv) the entities who have requested notice pursuant to Bankruptcy Rule 2002; (v) those government agencies required to receive notice of proceedings under the Bankruptcy Rules and the Local Bankruptcy Rules; (vi) entities that are known by the Debtors to have filed proofs of claim asserting that their claims are secured and entities who hold secured claims according to the Debtors’ schedules of assets and liabilities; and (vii) counterparties to those executory

contracts and unexpired leases that the Debtors may seek to assume, reject or modify in conjunction with a Sale.

**9. Objections**

Objections shall set forth in writing with particularity the grounds for such objections or other statements of position and be filed with the Bankruptcy Court and served not less than two business days before the Sale Hearing on (i) Debtors' undersigned counsel at their respective specified addresses; (ii) Houlihan Lokey Howard & Zukin, 685 Third Avenue, 15th Floor, New York, New York 10017, Attention: Mr. Saul E. Burian; (iii) FTI/Policano & Manzo, 622 Third Avenue, New York, New York 10017, Attention: Mr. Christopher Kearns; (iv) the Office of the United States Trustee; (v) Stroock & Stroock & Lavan LLP, 180 Maiden Lane, New York, New York 10038, Attention: Lawrence Handelsman, Esq.; (vi) Murphy Sheneman Julian & Rogers, 101 California Street, 39th Floor, San Francisco, California 94111, Attention: Cecily A. Dumas, Esq.; and (vii) Piper Marbury Rudnick & Wolfe, 1200 - 19th Street, N.W., Washington D.C. 20036, Attention: John G. McJunkin, Esq.

**10. Failure to Consummate Purchase**

If for any reason a Winning Bidder fails to consummate a Sale of Assets, or any part thereof, the offeror of the second highest and best Bid for any of the same Assets (as determined by the Debtors after consultation with the Creditors' Committee and the Secured Creditors) will automatically be deemed to have submitted the highest or best bid, and to the extent such offeror and the Debtors consent, the Debtors and such offeror are authorized to effect the sale of the Assets, or any part thereof, to such offeror as soon as is commercially reasonable without further order of the Bankruptcy Court. If such failure to

consummate the purchase is the result of a breach by the Winning Bidder, such breaching bidder's Earnest Down Payment shall be forfeited to the Debtors, and the Debtors specifically reserve the right to seek all available damages from the defaulting bidder.

**11. Return of Earnest Down Payment**

After the Sale Hearing, if Winning Bids have been selected and sales of the Assets to Winning Bidders, which have been approved by the Bankruptcy Court, have closed, the Earnest Down Payments of the Qualified Bidders who are not Winning Bidders shall be returned.

**12. Reservation of Rights**

The Debtors reserve their rights, after consultation with the Creditors' Committee and the Secured Creditors: (i) to impose, at or prior to the Auction, additional terms and conditions on a Sale of Assets; (ii) to extend the deadlines set forth in the Auction Procedures, adjourn the Auction at the Auction, and/or adjourn the Sale Hearing in open court without further notice; (iii) to withdraw from Sale any Assets at any time prior to or during the Auction and to make subsequent attempts to market the same; and (iv) to reject all bids, if in the Debtors' reasonable judgment no bid is for a fair and adequate price.

**13. Prepetition Secured Creditors' Consents**

The Sale of the Assets may require the consents of certain of the Debtors' secured creditors. Consequently, the determinations to be made by the Debtors in connection with a Sale of the Assets and the above-described Auction Procedures may be subject to such consents.

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(703) 836-7004

**Proposed Local Counsel for the Debtors and Debtors-in-Possession**

Dated: June 1, 2001

UNITED STATES BANKRUPTCY COURT  
FOR THE EASTERN DISTRICT OF VIRGINIA

Alexandria Division

In re:	)	
	)	Chapter 11
PATHNET TELECOMMUNICATIONS	)	
INC., et al.	)	Case No. 01-12264 - SSM
	)	Jointly Administered
Debtors.	)	
	)	

NOTICE OF AUCTION AND SALE HEARING

On June 22, 2001, the United States Bankruptcy Court for the Eastern District of Virginia (the “**Bankruptcy Court**”) entered an Order (the “**Sale Procedure Order**”) granting the Debtors’ motion for the entry of an order, pursuant to 11 U.S.C. §§ 105(a), 363 and 365, approving: (1) the sale of the Debtors’ rights, title and interests in assets free and clear of liens and interests pursuant to the Auction Procedures; (2) the auction procedures annexed thereto as “Exhibit A” (the “**Auction Procedures**”) in connection with the proposed disposition by sale, lease, license, or other commercially

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reasonable manner (to “**Sell**” or a “**Sale**”) of any and all of the assets of the Debtors (collectively or in part, the “**Assets**”); (3) certain bid protection as described in the Motion (the “**Bid Protection**”); and (4) the notice of auction and sale hearing, substantially in the form attached thereto as “**Exhibit B**”, (the “**Notice of Auction and Sale Hearing**”), approving the auction procedures annexed hereto as “**Exhibit A**” (the “**Auction Procedures**”) which procedures are to be applied in connection with the proposed disposition by sale, lease, license, or other manner (to “**Sell**” or a “**Sale**”) of any and all of the assets of the Debtors, in whole, in part or parts, or in combination (collectively or in part, the “**Assets**”) by one or more Sales to one or more bidders. The Assets may be sold free and clear of all liens, claims, interests and encumbrances at the sale hearing scheduled for July 24, 2001, at 1:30 p.m. or such other date and time as the Debtors may request subject to Bankruptcy Court approval (the “**Sale Hearing**”).

All interested bidders should read carefully the Auction Procedures. To the extent there are any inconsistencies between the Auction Procedures as set forth in “**Exhibit A**” hereto and the summary description of its terms and conditions contained in this Notice, the terms of the Auction Procedures control.

Pursuant to the Auction Procedures, a public auction of the Assets will be conducted at the offices of Covington & Burling, 1201 Pennsylvania Avenue, N.W., Washington, D.C. at **10:00 a.m.** Eastern Time on **July 11, 2001**, or such other date, time and place as the Debtors may determine (the “**Auction**”).

Pursuant to the Auction Procedures, any bidder desiring to submit a bid at the Auction (a “**Bid**”) must send a letter of interest to the Debtors’ investment banker, Houlihan Lokey Howard & Zukin, 685 Third Avenue, 15th Floor, New York, New York

10017, Attention: Mr. Saul E. Burian. and must first be qualified by the Debtor (a **“Qualified Bidder”**).

Pursuant to the Auction Procedures, the Debtors may (i) impose additional terms and conditions at or prior to the Auction, (ii) extend the deadlines set forth in the Auction Procedures, adjourn the Auction at the Auction, and/or adjourn the Sale Hearing in open court without further notice, (iii) withdraw from Sale any Assets at any time prior to or during the Auction and make subsequent attempts to market the same, and (iv) reject all Bids, if in the Debtors' reasonable judgment, no Bid is for a fair and adequate price.

All requests for information concerning the Assets should be directed to the Debtors' investment banker, Houlihan Lokey Howard & Zukin, 685 Third Avenue, 15th Floor, New York, New York 10017, Attention: Mr. Saul E. Burian (Tel. 212-497-4245).

The Sale Hearing will be held before the United States Bankruptcy Court for the Eastern District of Virginia (Alexandria Division), 200 South Washington Street, Alexandria, Virginia on July 24, 2001, at 1:30 p.m., or such other date and time as the Debtors may request subject to Bankruptcy Court approval. The Sale Hearing may be adjourned in open court from time to time, without further notice.

At the Sale Hearing, the Debtors will seek, among other things, the Bankruptcy Court's approval, pursuant to sections 105(a), 363, 365(a) and 1146 of the Bankruptcy Code and Rules 2002, 6004, 6006, and 9006 or the Federal Rules of Bankruptcy Procedure, of:

- (i) The Sale of the Assets to the winning bidder(s) at the Auction, free and clear of all liens, claims, encumbrances and interests, pursuant to an asset

purchase agreement(s) to be entered into between the Debtors and the winning bidder(s);

(ii) The assumption and assignment of certain executory contracts and unexpired leases and the rejection of certain unassumed executory contracts and unexpired leases;

(iii) The exemption of any Sales of Assets from stamp and similar taxes; and

(iv) Any other related relief.

Objections to any relief requested by the Debtors shall be set forth in writing with particularity the grounds for such objections or other statements of position and be filed with the Bankruptcy Court and served by not less than two business days before the Sale Hearing on (i) Debtors' undersigned counsel at their respective specified addresses; (ii) Houlihan Lokey Howard & Zukin, 685 Third Avenue, 15th Floor, New York, New York 10017, Attention: Mr. Saul E. Burian; (iii) FTI/Policano & Manzo, 622 Third Avenue, New York, New York 10017, Attention: Mr. Christopher Kearns; (iv) the Office of the United States Trustee, 115 South Union Street, Alexandria, Virginia 22314, Attention: Jack Frankel, Esq.; (v) Stroock & Stroock & Lavan LLP, 180 Maiden Lane, New York, New York 10038, Attention: Lawrence Handelsman, Esq.; (vi) Murphy Sheneman Julian & Rogers, 101 California Street, 39th Floor, San Francisco, California 94111, Attention: Cecily A. Dumas, Esq.; and (vii) Piper Marbury Rudnick & Wolfe, 1200 - 19th Street, N.W., Washington D.C. 20036, Attention: John G. McJunkin, Esq.

*Anna P. Engh by counsel*

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*H. Jason Gold*

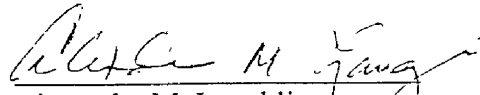
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**Proposed Local Counsel for the Debtors  
and Debtors-in-Possession**

June 1, 2001

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on this 1st day of June, 2001, the foregoing Motion Of The Debtors For Order Approving:(1) Sale Of Assets Free And Clear Of Liens And Interests, (2) Auction Procedures For Sales Of Assets, (3) Certain Bid Protection, (4) Form Of Notice Of Auction And Sale Hearing was sent via first class mail postage prepaid to all creditors and parties in interest as set forth on the attached service lists.\*

  
Alexander M. Laughlin

\* Pursuant to Local Rule 5005-1(C) (8), the attached service lists are not being served on each of the parties, but is attached to the original Certificate of Service filed with the Court.

UNITED STATES BANKRUPTCY COURT  
FOR THE EASTERN DISTRICT OF VIRGINIA

Alexandria Division

In re: )  
 )  
PATHNET TELECOMMUNICATIONS ) Chapter 11  
INC., et al. )  
 ) Case No. 01-12264 - SSM  
 ) Jointly Administered  
Debtors. )  
 )

ORDER APPROVING: (1) SALES OF ASSETS  
FREE AND CLEAR OF LIENS AND INTERESTS, (2) AUCTION PROCEDURES  
FOR SALES OF ASSETS, (3) CERTAIN BID PROTECTION, AND  
(4) FORM OF NOTICE OF AUCTION AND SALE HEARING

Upon the motion of Pathnet Telecommunications, Inc. (“PTI”), and its affiliated Debtors and Debtors-in-possession in the above-captioned cases, Pathnet, Inc. (“PNI”), Pathnet Operating, Inc. (“POI”), Pathnet Operating of Virginia, Inc. (“POV”), Pathnet Real Estate LLC (“PRE”) and Pathnet Fiber Equipment LLC (“PFE” and collectively with PTI, PNI, POI, POV and PRE, the “Debtors”), (the “Motion”)<sup>1</sup> for the entry of an order for the entry of an order, pursuant to pursuant to 11 U.S.C. §§ 105(a), 363 and 365, approving: (1) the sale of the Debtors’ rights, title and interests in assets free and clear of liens and interests pursuant to the Auction Procedures, (2) the auction procedures annexed thereto as “Exhibit A” (the “Auction Procedures”) in connection with the proposed disposition by sale, lease, license, or other commercially reasonable manner (to “Sell” or a “Sale”) of any and all of the assets of the Debtors (collectively or in part, the

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<sup>1</sup> Capitalized terms not defined in this Order shall have the meanings given to them in the Motion.

“Assets”); (3) certain bid protection as described in the Motion (the “**Bid Protection**”); and (4) the notice of auction and sale hearing, substantially in the form attached thereto as “Exhibit B”, (the “**Notice of Auction and Sale Hearing**”), all as more fully set forth in the Motion; and due and proper notice of the Motion having been given; and after due deliberation and sufficient cause appearing therefore; it is hereby

FOUND AND DETERMINED THAT<sup>2</sup>:

A. The Debtors have articulated a sound business purpose for the sale of the Assets pursuant to the Auction Procedures:

B. The Debtors have articulated good and sufficient reasons for approval of the Notice of Auction and Sale Hearing, the Auction Procedures and the Bid Protection in connection with the Sale of the Assets:

C. The Auction Procedures are reasonable and appropriate to maximize the return on the Assets:

D. The Bid Protection is necessary and in the best interest of creditors and the Debtors’ estates; and

E. The Notice of Auction and Sale Hearing is sufficient and reasonably designed to give proper notice to all parties in interest.

NOW, THEREFORE, IT IS HEREBY ORDERED, that the Motion is granted; and it is further

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<sup>2</sup> Findings of fact shall be construed as conclusion of law and conclusions of law shall be construed as findings of fact when appropriate. See Fed. R. Bankr. P. 7052. Statements made by the Court from the bench at the hearing shall constitute additional conclusions of law and findings of fact as appropriate.

ORDERED, that the Debtors are authorized to Sell their rights, title and interests in the Assets free and clear of all liens, encumbrances, claims, charges and interests; provided, however, that any liens, encumbrances, claims, charges and interests in the Assets shall attach to the respective net proceeds of the Sale in the order of their priority, with the same validity, force and effect that they now have as against the Assets and subject to any claims and defenses the Debtors may have with respect thereto: and it is further

ORDERED, that the Debtors are authorized to executed and deliver such agreements and other documents that may be necessary to effect the Sale pursuant to the Auction Procedures: and it is further

ORDERED, that the Notice of Auction and Sale Hearing is hereby approved, and it is further

ORDERED, that the Debtors may conduct an auction of the Assets (the “**Auction**”) in accordance with the Auction Procedures, which procedures are hereby approved, and it is further

ORDERED, that the Bid Protection is hereby approved: and it is further

ORDERED that the Debtors are authorized to pay (without further order of this Court) up to the maximum amount of the Break-Up Fee and the Expense Reimbursement pursuant to a Stalking Horse Agreement(s) approved by the Creditors’ Committee and the Secured Creditors in accordance with such Stalking Horse Agreement(s): and it is further



ORDERED, that the Break-Up Fee and the Expense Reimbursement Bid Protection shall be administrative expenses pursuant to Section 507(a)(1) of the Bankruptcy Code; and it is further

ORDERED, that the Debtors shall serve the Notice of Auction and Sale Hearing upon the entities and in the manner specified in the Auction Procedures. Such service shall be deemed good and sufficient notice of this Order, the Motion, and all proceedings to be held thereon; and it is further

ORDERED, that the Debtors may seek such other bid protection as they believe is appropriate in their business judgment on five business days' notice or such lesser notice as may be approved by the Bankruptcy Court; and it is further

ORDERED, that the hearing on such other bid protection as may be requested by the Debtors shall be held on June 22, 2001, at 9:30 a.m., or such other date and time as the Debtors may request, subject to approval by the Bankruptcy Court.

ORDERED, that the Debtors shall hold the Auction in accordance with the Auction Procedures at the offices of Covington & Burling, 1201 Pennsylvania Avenue, N.W., Washington, D.C. on July 11, 2001 at 10:00 a.m. Eastern Time or such other date, time and place as the Debtors may determine. Any person seeking to participate as a bidder at the Auction must comply with the Auction Procedures; and it is further

ORDERED, that the Debtors shall file and serve, at least six business days before the Sale Hearing, the Winning Bidder Notice; and it is further

ORDERED, that objections, if any, to relief sought at the Sale Hearing shall be filed and served in accordance with the Auction Procedures such that the objection is

actually received by all required entities no less than two business days before the hearing;  
and it is further

ORDERED, that the hearing to confirm the results of the Auction and to approve the terms of any Sale of Assets and assumption and assignment of any related executory contracts and unexpired leases will be held on July 24, 2001, at 1:30 p.m. Eastern Time, or at such other date and time as the Debtors may request, subject to Court approval (the “**Sale Hearing**”); and it is further

ORDERED, that the Debtors may extend the deadlines set forth in the Auction Procedures, may adjourn the Auction at the Auction, and/or may seek adjournment of the Sale Hearing in open court, all without further notice; and it is further

ORDERED, that the Court shall retain jurisdiction to hear and determine all matters arising from or relating to the implementation of this Order.

Alexandria, Virginia

Dated: June \_\_\_, 2001

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HON. STEPHEN S. MITCHELL  
United States Bankruptcy Judge

PREPARED BY:

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**Proposed Local Counsel for the Debtors and Debtors-in-Possession**

CERTIFICATION PURSUANT TO LOCAL RULE 9022-1

I HEREBY CERTIFY that on this 1st day of June, 2001, a copy of the foregoing Order Approving: (1) Sales of Assets Free and Clear of Liens and Interests, (2) Auction Procedures for Sales of Assets, (3) Certain Bid Protection, and (4) Form of Notice of Auction and Sale Hearing was sent by first-class mail, postage prepaid to all the parties on the attached service lists.\*

\_\_\_\_\_  
Alexander M. Laughlin

\* Pursuant to Local Rule 5005-1(C) (8), the attached service lists are not being served on each of the parties, but is attached to the original Certificate of Service filed with the Court.