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IN THE UNITED STATES BANKRUPTCY COURT  
FOR THE NORTHERN DISTRICT OF CALIFORNIA  
SAN FRANCISCO DIVISION

In re Case No. 01-30127  
(Jointly Administrated with, 01-30125-C7,  
01-30126-C7, and 01-30128-C7)  
Chapter 7  
Debtors  
Date: July 18, 2003  
Time: 9:30 a.m.  
Place: 235 Pine St., 23rd Floor  
San Francisco, California  
Hon. Thomas E. Carlson

NOTICE OF JOINT MOTION AND JOINT MOTION  
BY TRUSTEES FOR APPROVAL OF COMPROMISE OF CONTROVERSIES

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B. STATEMENT OF FACTS

The following pertinent facts are supported by the concurrent declarations of Mr. Ozawa and Ms. Schoenmann

1. History of Four Debtor Cases

The Debtors consist of four related companies: Group, Communications, Virginia and International. These bankruptcy cases were commenced on January 16, 2001 (the "Petition Date"), following the collapse of a planned merger with Bell Atlantic Corporation, doing business as Verizon Communications, and related entities (collectively, "Verizon"), pursuant to an agreement between Verizon and Group. The bankruptcy cases began under chapter 11 of the United States Bankruptcy Code, during which most of the estates' assets were sold to AT&T Corporation. Following that sale, each of the cases was converted to chapter 7 of the Bankruptcy Code, on June 12, 2001, and Ms. Schoenmann was appointed as the trustee of all four Debtors' estates.

During the bankruptcy cases, Group's and Communications' estates pursued breach of contract and fraud causes of action against Verizon, and in 2002, those causes of action were settled and released, with the approval of the Bankruptcy Court, in exchange for payment by Verizon to the bankruptcy estates in the amount of \$175,000,000. After payment of remaining liens encumbering the settlement funds and certain other costs, the estates retained approximately \$110,000,000 in net proceeds, without allocation among the four estates.

Because of emerging conflicts between Group's estate and Communications' estate with respect to competing claims of entitlement to the net settlement proceeds, it became evident to Ms. Schoenmann that the four estates would be best served by Ms. Schoenmann continuing as trustee only as to some, but not all, of the estates until issues as to allocation and entitlement with respect to the net settlement proceeds, as well as other issues among the estates, had been resolved. Therefore, as of October 23, 2002, Ms. Schoenmann resigned as trustee of Group's chapter 7 estate, but remained trustee of the chapter 7 estates of Communications, Virginia and International. The United States Trustee appointed an interim trustee, Charles Sims, as trustee of the Group estate (the "Interim Group Trustee"), and on December 3, 2002, a special meeting of creditors was held to elect a permanent trustee. On December 31, 2002, the United States Trustee filed a report confirming the

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I. NOTICE

NOTICE IS HEREBY GIVEN that on July 18, 2003, at 9:30 a.m., or as soon thereafter as counsel may be heard, in the Courtroom of the Honorable Thomas R. Carlson, United States Bankruptcy Judge, United States Bankruptcy Court for the Northern District of California, 235 Pine Street, 23rd Floor, San Francisco, California, E. LYNN SCHOENMANN, as trustee (the "Communications Trustee") of the chapter 7 estates of NORTHPOINT COMMUNICATIONS, INC., ("Communications"), NORTHPOINT COMMUNICATIONS OF VIRGINIA, INC. ("Virginia"), and NORTHPOINT INTERNATIONAL, INC. ("International"), debtor herein, and MICHAEL M. OZAWA, as trustee (the "Group Trustee") of the chapter 7 estate of NORTHPOINT COMMUNICATIONS GROUP, INC., a debtor herein ("Group"), by and through their respective undersigned counsel, will, and hereby do, jointly move the above-entitled Court for the entry of an order, pursuant to Rule 9019 of the Federal Rules of Bankruptcy Procedure and Section 102(a) of the United States Bankruptcy Code, approving a global compromise of all controversies between and among the estates of all four debtors herein (collectively, the "Debtors"), including without limitation disputes as to substantive consolidation, subrogation and allocation issues referenced hereinbelow, as set forth in a written settlement agreement (the "Settlement Agreement") by and between the Communications Trustee and the Group Trustee described hereinbelow and attached to the supporting declarations of Ms. Schoenmann and Mr. Ozawa.

This joint motion (the "Compromise Motion") is based upon this notice and motion, the declarations of E. Lynn Schoenmann and Michael M. Ozawa filed concurrently herewith and any and all exhibits attached thereto, the certificates of service of all such materials, all other pleadings and papers filed in these cases, and such other evidence and argument as may be presented by either of the moving parties prior to or during a hearing of this Compromise Motion.

NOTICE IS FURTHER HEREBY GIVEN that, pursuant to Rule 9014-1(c)(2) of the above-referenced Court's local rules, any opposition to this Compromise Motion must be filed and served upon counsel for the Communications Trustee and the Group Trustee no less than five (5) days prior to the scheduled date of the aforementioned hearing, and must be accompanied by any declarations or memoranda of law the objecting party wishes to present in support of its position.

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election of Michael M. Ozawa as the permanent trustee of the Group estate.

2. Claims and Issues Between Estates

The competing claims of the estates to funds and other assets, as well as other issues between the estates, quickly materialized once the estates were separated. On November 26, 2002, for example, the Interim Group Trustee filed a proof of claim against the estate of Communications, seeking payment of an amount in excess of \$48,000,000 based upon a theory of subrogation (the "Subrogation Claim"). On December 16, 2002, the Communications Trustee filed a motion seeking substantive consolidation of the estates of all four Debtors (the "Consolidation Motion").<sup>1</sup> On February 24, 2003, the Group Trustee filed a memorandum in opposition (the "Group Opposition")<sup>2</sup> to the Consolidation Motion. In addition, other parties have filed opposing and supporting briefs with respect to the Consolidation Motion.

Issues raised in the Consolidation Motion, the Group Opposition and later briefs filed by each trustee in support of their respective positions centered primarily around the following issues:

- The Group Trustee contended that most or all net proceeds arising from the Verizon settlement belonged to the Group estate, rather than the Communications estate, because the settlement stemmed primarily from a breach of contract cause of action asserted by Group, as the only party to the merger agreement with Verizon.
- The Group Trustee further contended that he was entitled to all other assets and funds of the Communications estate as well, including any Verizon settlement proceeds allocable to the Communications estate, up to the approximate amount of \$48,000,000, under the doctrines of subrogation and equitable exoneration, based on the argument that a portion of Verizon settlement proceeds had been utilized to repay loans of which Communications was the principal obligor and Group was only a guarantor.
- The Communications Trustee contended that a significant portion of the Verizon settlement proceeds belonged to the Communications estate, rather than the Group estate, because they derived from resolution of the fraud claim asserted by

<sup>1</sup> (Docket No. 983). The trustee respectfully request that the Court take judicial notice of this document.  
<sup>2</sup> (Docket No. 1053). The trustee respectfully request that the Court take judicial notice of this document.

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II. MOTION

A. INTRODUCTION

This Compromise Motion is brought jointly by the Communications Trustee and the Group Trustee, in order to seek approval, pursuant to the provisions of Rule 9019 of the Federal Rules of Bankruptcy Procedure and Section 105(a) of the United States Bankruptcy Code, of a compromise that the two trustees have reached with respect to a range of disputes between them and their respective estates. The compromise, described in more detail below, is intended to resolve complicated and consuming issues as to substantive consolidation, disputed allocation of settlement proceeds and claims of subrogation that have been the subject of litigation between and among the estates for the last six months.<sup>1</sup>

Pursuant to the proposed global compromise, a one-time distribution will be made to claimants holding rights under bonds issued by Group, all other assets and liabilities will be consolidated into one estate, the Virginia estate (Case No. 01-30125 C7) and remaining funds and proceeds of those consolidated assets will be used to pay and fully satisfy all administrative<sup>2</sup> and priority claims (including all allowed and unpaid chapter 11 expenses) and to make a pro rata distribution to other creditors of remaining funds without further delay and cost of litigation between the two trustees. As discussed below, the compromise will result in the termination of now pending litigation that would otherwise substantially delay the administration of all four estates at considerable cost to each such estate, upon terms that the two trustees believe to be fair and reasonable under the circumstances of these cases. Both the Communications Trustee and the Group Trustee believe that the proposed settlement is in the best interests of their respective estates, and that the compromise should be approved by the Court under the legal authorities referenced hereinbelow. This Compromise Motion is therefore brought jointly by the two trustees in order to obtain that approval.

<sup>1</sup> Settlements by the trustees as to the matters underlying the proposed Settlement Agreement are not intended to, and shall not, waive, compromise or limit any rights, claims, causes of action, damages or defenses, or constitute admission, in the event the compromise is not approved by the Court.

<sup>2</sup> Certain limited and specific administrative expenses will be paid by the Group Trustee from the \$46 million one-time payment to the Group Trustee.

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Communications and not by Group

The Communications Trustee also contended that even if the Verizon settlement proceeds derived largely from the breach of contract cause of action asserted against Verizon, those funds belonged primarily to the Communications estate nonetheless, because while Group was the only nominal plaintiff asserting the breach of contract cause of action, Communications was the de facto plaintiff with respect to that cause of action, and the functional party to the underlying merger agreement, inasmuch as Communications, rather than Group, was required to provide all of the substantive obligations and performance under that contract.

The Communications Trustee argued to refute the Group Trustee's arguments for equitable exoneration and subrogation, on three primary bases: first, because the settlement funds did not belong to Group, as argued above, neither subrogation nor the exoneration applied; second, those doctrines did not apply because both Communications and Group were primary obligors and beneficiaries of the settlement proceeds, and third, any subrogation or exoneration doctrine asserted by Group, even if otherwise enforceable, were nullified by the doctrine of equitable subordination.

The Communications Trustee contended that under all of the circumstances of the Debtors, the only reasonable, practical and principled manner of allocating the Verizon settlement proceeds and other funds of the estate, absent an overly expensive and time-consuming process that would result in an arbitrary and unfair distribution of assets, would be to substantively consolidate the four estates and distribute the net proceeds pro rata basis. The Communications Trustee contended that under applicable decisional law, the case for substantive consolidation was compelled by the excessive entanglement of the four corporate Debtors and the unfairness to creditors in recognizing arbitrary divisions among them.

The Group Trustee contended that substantive consolidation was not justified under the facts of the case or applicable decisional law, in light of the clear structural

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1 distinctions between the corporate entities and the reliance of creditors upon the  
2 separateness of those entities, and that the Verizon settlement proceeds could be  
3 readily allocated between the estates without the necessity of consolidation

4 Both the Group Trustee and the Communications Trustee investigated and researched the  
5 foregoing issues and allegations, briefed legal authorities supportive of their respective positions, and  
6 initiated extensive discovery directed toward the litigation of those issues, including document  
7 production requests, initial disclosures and more than a dozen deposition subpoenas

8 On March 6, 2003, the Bankruptcy Court issued its scheduling order with respect to the  
9 Consolidation Motion and the Group Opposition. Among other things, with the parties'  
10 encouragement, the Bankruptcy Court ordered that the parties engage in settlement negotiations  
11 before commencing formal discovery. In addition, the Bankruptcy Court directed that an evidentiary  
12 hearing of the Consolidation Motion be conducted on June 17, 2003. On or about April 14 and 25,  
13 2003, the Group Trustee filed two separate motions for partial, and then for full, summary judgment  
14 (collectively, the "Summary Judgment Motions") with respect to the Consolidation Motion, both of  
15 which were scheduled for hearing on May 23, 2003

### 16 3. Mediation And Settlement

17 Pursuant to the Bankruptcy Court's order, the Communications Trustee and the Group  
18 Trustee, together with their respective professional, participated in a mediation session before the  
19 Honorable Dennis Montali on April 14, 2003 in an attempt to resolve all disputes between them,  
20 whether directly related to the Consolidation Motion or otherwise. Although that session did not  
21 result immediately in a consensual resolution of such disputes, subsequent discussions between the  
22 trustees and their counsel produced a tentative settlement, subject to approval by the Bankruptcy  
23 Court. Accordingly, on May 8, 2003, at the request of the parties hereto and in order to facilitate  
24 continued settlement efforts, the Court issued an order suspending litigation of the Consolidation  
25 Motion, and, in particular, removing from the Court's calendar the May 23, 2003 hearing of the  
26 Summary Judgment Motions and the June 17, 2003 hearing of the Consolidation Motion, and  
27 postponing all scheduled depositions and discovery deadlines, pending further order of the Court.

28 \* (Docket Nos. 1103 and 1170). The trustees respectfully request that the Court take judicial notice of these documents

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1 The two trustees and their counsel have now documented their proposed compromise, in the  
2 form of a written settlement agreement entitled "Settlement Agreement Between NorthPoint Trustee  
3 (All Disputes, Including Consolidation, Subrogation And Allocation)," as attached to the supporting  
4 declarations of Mr. Schoenmann and Mr. Ozawa as Exhibit "A." The essential terms of the  
5 settlement agreement (the "Settlement Agreement"), subject to approval by the Bankruptcy Court, are  
6 as follows:

- 7 • **Payment To Group Trustee** On the Settlement Agreement's effective date, the  
8 Communications Trustee will pay to the Group Trustee the amount of \$86,000,000  
9 from funds presently claimed by both Group's and Communications' estates. These  
10 funds, and any interest accrued thereon after receipt by the Group Trustee, will be  
11 used to make the following disbursements (or reserves in the event that payments in  
12 question are subject to dispute or approval).
  - 13 o First, for full payment of any federal, state or local income tax liabilities of the  
14 Debtors for the tax year 2002, when the settlement with Verizon was  
15 consummated,
  - 16 o Second, for payment of any corporate tax owed by Group to the State of  
17 Delaware, up to the amount of \$150,000,
  - 18 o Third, for full payment of all allowed fees and expenses of the Interim Group  
19 Trustee and the Group Trustee, and all professionals retained by those trustees,  
20 under Sections 327 *et seq.* of the Bankruptcy Code;
  - 21 o Fourth, for full payment of all allowable fees and costs owing to the Indenture  
22 trustee under the Indenture agreement pursuant to which Group issued bonds,  
23 and
  - 24 o Fifth, *pro rata* payments to holders of bonds issued by Group.
- 25 • **Substantive Consolidation** All assets of the four Debtors' estates other than the  
26 \$86,000,000 of funds to be paid to the Group Trustee as described above, will be

27 This description is intended for summary purposes only, and should not be viewed as  
28 comprehensive or exhaustive of the terms of the Settlement Agreement, for which interested parties  
should review the Settlement Agreement itself.

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1 consolidated into one estate, Virginia's estate, case no. 01-30125-C7, and all claims  
2 against any of the four Debtors' estates, other than those to be paid by the Group  
3 Trustee as described above, will be consolidated into that estate (the "Consolidated  
4 Estate") Ms. Schoenmann will act as the trustee of the Consolidated Estate,  
5 responsible for administration of the consolidated assets, and Mr. Ozawa will remain  
6 trustee of the Group estate, responsible for the administration of the \$86,000,000 in  
7 funds paid as described above

8 • **Reserve and Claims Release** The Group Trustee will be required to maintain  
9 adequate reserves for full payment of all asserted claims that are the responsibility of  
10 the Group estate, as described above

11 • **Exclusion of Consolidated Estate** None of the claims to be paid, either in full or on  
12 a *pro rata* basis, by the Group Trustee, as described above, including without  
13 limitation bond claims, income tax claims for the year 2002 and the fees and expenses  
14 of the Interim Group Trustee, the Group Trustee and the Indenture trustee and each of  
15 their respective professionals, will be paid to any extent from any of the assets of the  
16 Consolidated Estate, and none of the holders of such claims shall have any right to  
17 payment or recourse from the Consolidated Estate, its trustee or its assets to any  
18 extent

19 • **Mutual General Release** The Communications Trustee and the Group Trustee,  
20 together with related agents and estates, will release each other from any and all  
21 claims against each other, including without limitation the Group Trustee's opposition  
22 to substantive consolidation and claims of subrogation, exoneration and allocation

### 4. Estimated Outcomes With And Without Settlement

24 Both the Group Trustee and the Communications Trustee believe that the proposed Settlement  
25 Agreement is in the best interests of their respective estates. Both such trustees believe that all four  
26 Debtors' estates will benefit from the avoidance of significant expense and considerable delay that  
27 would attend continued litigation of the issues now pending between them. In addition, each trustee  
28 believes that the avoidance of risks of loss inherent in continued litigation further justifies the terms

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1 of settlement

2 From the perspective of the Group Trustee, he believes that the Group estate is likely to  
3 prevail on each of the litigation issues, which would result in a higher distribution for the bondholders  
4 of Group than the proposed settlement -- as much as an additional six cents per dollar of claim if the  
5 entire \$110 million plus the proceeds of avoidance actions were allocated to the Group Trustee.  
6 However, that distribution would be delayed not only by the completion of all underlying litigation  
7 and any appeals thereon, but also by the need to withhold distributions pending claims resolution and  
8 other administrative issues. Accordingly, the business judgment of the Group Trustee is that the  
9 benefit of a prompt, albeit discounted, fixed distribution outweighs the chance of the potentially  
10 higher but delayed recovery if the Group Trustee pursued litigation rather than settlement. Moreover,  
11 while the Group Trustee is confident that he would prevail in litigation, the outcome of litigation is  
12 never certain

13 From the perspective of the Communications estate, the settlement terms will likely result in  
14 an outcome more favorable than a loss in litigation, although not as favorable as a full success in that  
15 litigation. If, for example, the Consolidation Motion were denied and the Group Trustee's position as  
16 to subrogation, exoneration and allocation were sustained, Communications' general unsecured  
17 creditors would receive no distribution at all, nor would priority claims or unpaid chapter 11 expenses  
18 be paid to any extent. Alternatively, if the Consolidation Motion were granted, according to the  
19 Communications Trustee's present estimate, all administrative and priority claims would be paid in  
20 full and distributions upon allowed unsecured claims would be roughly equal to between 16% and  
21 19% of allowed amounts (depending upon the outcome of claims reviews and allowances)

22 Under the settlement, on the other hand, assuming available funds of approximately  
23 \$30,500,000 (after payment of \$86,000,000 to the Group Trustee and resolution of outstanding claims  
24 benefiting the estate), priority and administrative claims of roughly \$20,000,000 and general  
25 unsecured claims between \$60,000,000 and \$130,000,000, the Communications Trustee presently  
26 estimates that the outcome will be as follows: all allowed priority and administrative claims,  
27 including all unpaid chapter 11 expenses, will be paid in full, and distributions to Communications'  
28 general unsecured creditors will likely be in the range of 8.1% to 17.5% of allowed amounts.

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1 Assuming the middle of that range in settlement, or approximately 12.8%, as compared to the  
2 middle of the estimated range in the event of full success, 17.8%, the Communications Trustee views  
3 the likely result of settlement, being roughly 72% of the estimated outcome in the event of complete  
4 litigation success, to be fair and reasonable under the circumstances of these cases. Particularly given  
5 the prospect of much earlier and less expensive resolution of the estates' claims and assets, the  
6 Communications Trustee believes that the estimated settlement outcome is significantly more  
7 favorable than continued litigation with its attendant delays, expenses and risks of loss.

8 Accordingly, both trustees, in their considered exercise of business judgment, believe that the  
9 proposed Settlement Agreement is in the best interests of their respective estates and their creditors

### 10 C. LEGAL DISCUSSION

11 The Group Trustee and the Communications Trustee submit that the proposed compromise  
12 between them and their respective estates, as memorialized in the Settlement Agreement, is fair and  
13 equitable and in the best interests of all such estates, is the product of each trustee's reasonable  
14 exercise of business judgment, and should be approved by the Bankruptcy Court under the authority  
15 of applicable law, as set forth below.

16 A bankruptcy trustee has authority to compromise controversies affecting a chapter 7 estate,  
17 subject to approval by the Bankruptcy Court, pursuant to Bankruptcy Rule 9019(a) of the Federal  
18 Rules of Bankruptcy Procedure, which provides in pertinent part as follows: "On motion by the  
19 trustee and after ... notice to creditors ... the Court may approve a compromise or settlement." Fed. R.  
20 Bankr. P. 9019(a). In reviewing proposed settlements, the standard that courts applied under the  
21 former Bankruptcy Act is also applicable under the Bankruptcy Code. See *Matter of Carla Leather*,  
22 *Inc.*, 44 B.R. 457, 466 (Bankr. S.D.N.Y. 1984). As stated by the United States Supreme Court in  
23 *Protective Committee for Independent Stockholders of TMT Trailer Ferry, Inc. v. Anderson*, 390 U.S.  
24 414 (1968), under the Bankruptcy Code, in order to approve a proposed settlement, a court must have  
25 found that the settlement was "fair and equitable" based on an "educated estimate of the complexity,  
26 expense, and likely duration of... litigation, the possible difficulties of collecting on any judgment  
27 which might be obtained and all other factors relevant to a full and fair assessment of the wisdom of  
28 the proposed compromise." *Id.* at 423. The United States Supreme Court also stated that "[b]asic to

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1 this process in every instance, of course, is the need to compare the terms of the compromise with the  
2 likely rewards of litigation." *Id.* at 424

3 More recently, the Ninth Circuit Court of Appeals has held that, in considering a proposed  
4 compromise, the Court must evaluate (i) the probability of success in the litigation, (ii) the  
5 difficulties, if any, in the matter of collection; (iii) the complexity of the litigation involved, and the  
6 expense, inconvenience and delay necessarily attending to it, and (iv) the paramount interest of the  
7 creditors and a proper deference to their reasonable views in the premises. See *Martin v Kane (In re*  
8 *A&C Properties)*, 784 F.2d 1377, 1381 (9th Cir. 1986), *cert denied sub nom. Martin v Robinson*,  
9 479 U.S. 854 (1986); see also, *In accord, Woodson v. Fireman's Fund Insur. Co. (In re Woodson)*,  
10 839 F.2d 610, 620 (9th Cir. 1988), see also, *In re MGS Marketing*, 111 B.R. 264, 267 (Bankr. 9th  
11 Cir. 1990)

12 A court, however, should not substitute its own judgment for the judgment of a trustee. See  
13 *Carla Leather*, 44 B.R. at 465. In reviewing a proposed settlement, the Court is not "to decide the  
14 numerous questions of law and fact ... but rather to canvass the issues and see whether the settlement  
15 falls below the lowest point in the range of reasonableness." *In re W T Grant & Co.*, 699 F.2d 599,  
16 608 (2d Cir. 1983), *cert denied*, 464 U.S. 832. A "mini-trial" on the merits of the underlying cause  
17 of action is not required and should not be undertaken by the Bankruptcy Court. See *In re Blair*, 538  
18 F.2d 849 (9th Cir. 1976); see also, *In re Walsh Construction, Inc.*, 669 F.2d 1325 (9th Cir. 1981)

19 Pursuant to the foregoing standard, the Group Trustee and the Communications Trustee  
20 believe that the Settlement Agreement should be approved by the Bankruptcy Court

### 21 1. The Complexity of the Litigation

22 As is evident from the pleadings and discovery demands filed by the Group Trustee and the  
23 Communications Trustee, the pending litigation of the Consolidation Motion is complex and fact-  
24 intensive, justifying settlement upon reasonable terms. Full litigation of the motion and related  
25 matters would necessitate resolution of interrelated and complex legal and factual issues involving,  
26 among other disputed matters, substantive consolidation, subrogation, subordination, exoneration and  
27 the proper allocation of the Verizon settlement proceeds. The Communications Trustee's request for  
28 substantive consolidation, in particular, involves a fact-intensive, two-pronged analysis, which would

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require the Bankruptcy Court to assess both the costs of disentangling the assets of the competing estates and the manner in which the Debtors represented themselves to their creditors. See *Bonham v. Crompton (In re Reagan Bankers)*, 22 F.3d 750 (9th Cir. 2000). The Consolidation Motion alleges numerous facts concerning the manner in which the assets of the business were owned and managed, the nature and content of Group's public disclosures, the corporate governance of the entities, and the manner in which the business enterprises represented itself to its creditors. In support of substantive consolidation. The Group Trustee, in his Opposition and Summary Judgment Motions, alleges yet other facts that he argues preclude consolidation and require allocation of proceeds, and subrogation of claims, as contended by the Group Trustee. Taken together, and assuming that the Summary Judgment Motions had not been granted by the Court, the two trustees' positions require resolution of intricate factual issues in order to apply decisional law that is largely unsettled by appellate courts.

The Verizon settlement proceeds, which comprise the majority of the remaining assets of the estates herein, have not yet been allocated among the estates. Because the Court must make determinations as to the extent of entanglement of the Debtors' assets and prejudices to the various creditor-constituencies, in order to rule upon the Consolidation Motion, the Court must necessarily reach conclusions, even if preliminary, as to the feasibility and efficacy of any allocation of the settlement proceeds, a determination that will in turn require an analysis of the underlying Verizon litigation, the underlying merger agreement with Verizon, and competing claims between the estates as to ownership of causes of action. The Group Trustee's claim of ownership of all settlement proceeds by virtue of Group's status as a party to the underlying merger agreement, and the Communications Trustee's claim of ownership of those proceeds by virtue of its role as the *de facto*, or functional, party to the merger agreement, must, in the Communications Trustee's view, be examined in light of the practical and economic realities of the planned NorthPoint-Verizon merger of late 2000. The Communications Trustee believes that that examination, in turn, would entail litigation of the relative merits of the breach of contract and fraud claims in the lawsuit brought against Verizon, the economic and legal terms of merger that affected the parties and the nature of Verizon's alleged breaches and fraud. Unless the Court were to grant the Summary Judgment Motions and overrule the Communications Trustee's opposition thereto, those issues would require

very substantial testimony and documentary evidence, entailing numerous witnesses and historical evidence. Whereas both trustees argue that the evidence weighs heavily in favor of their respective estate, a full trial of all pertinent evidence, and further, extensive briefing on all related legal issues, would be required in order to resolve the trustee's polar-opposite positions on the relevant issues.

Subrogation claims asserted by the Group Trustee raise equally complex and factually intensive issues that would have to be addressed and resolved. The Group Trustee contends that the Group estate is subrogated to the rights of Communications' secured lender (Canadian Imperial Bank of Commerce, or "CIBC"), with respect to Verizon settlement proceeds of approximately \$48,000,000 paid to CIBC and allegedly owned by the Group estate. By that theory, the Group Trustee claims a superpriority claim against all future funds of Communications' estate, including any proceeds of avoidance causes of action. The Communications Trustee asserts defenses that she believes raise significant factual issues as to whether Group was a primary or secondary obligor with respect to amounts owing to CIBC, whether Group, along with Communications, benefited from advances made by CIBC, and whether any subrogation rights that Group might otherwise hold are barred by theories of subordination. Each such issue, in the Communications Trustee's view, requires a significant examination of the interrelationship of the Debtors' and their respective relationships with CIBC and its funding prior to the commencement of the bankruptcy cases, among other factual inquiries.

The need for resolution of the foregoing issues, as well as other substantial issues that would be presented and argued in the event of full litigation of the Consolidation Motion and other disputes between the trustees, demonstrate a sufficiently high level of legal and factual complexity to justify settlement upon appropriate terms.

#### 2. The Probability of Success

Both trustees, of course, believe that full litigation of the Consolidation Motion and related issues would result in success and vindication of their respective, and wholly contrary, positions. However, both trustees also recognize that there exists for each a risk of loss and that ultimate success cannot be assured. As importantly, both trustees recognize that continued litigation would lead to significant delays in distributions of the proceeds that remain in the hands of the trustee.

no distributions could be made, given the fundamental impact that any final ruling in the litigation would have upon the structure, assets and economics of each estate. In all, the trustees believe that full litigation would likely delay any distributions by any of the Debtors' estates for many months or even years. Such a significant delay clearly comprises a difficulty in the timing of collection, militating toward a reasonable settlement short of full litigation. Avoidance of such delay, through reasonable settlement terms as proposed herein, is consistent with the trustee's duties under Section 704(1) of the Bankruptcy Code, which requires the trustee of a chapter 7 estate to "collect and reduce to money the property of the estate for which such trustee serves, and close such estate as expeditiously as is compatible with the best interests of parties in interest." Such avoidance of delay therefore warrants the settlement proposed here.

#### 4. The Interests of Creditors

The two trustees believe that the proposed Settlement Agreement is in the best interests of all four Debtors' estates. The compromise will have the effect of settling complex and extensive disputes that would otherwise consume very substantial time and estate funds in full litigation, delaying and diminishing distributions to all creditors. The proposed settlement avoids many months or years of expensive litigation and uncertain outcomes upon terms that are favorable to all parties. Whereas the settlement terms will not provide any creditor (other than administrative creditors) with as much as it would receive from full success in the litigation, it will provide all creditors with more than would be received in the event of a loss. In the trustees' view, the settlement strikes a fair and equitable balance between the best and worst outcomes for all estates, and does so far earlier and less expensively than full litigation would.

Moreover, in the view of the Communications Trustee, the terms of the proposed Settlement Agreement will benefit creditors by consolidating the four Debtors' estates, with certain exceptions delineated below, and realizing significant cost efficiencies as a result. Among the four estates, there are numerous examples of duplicated, misfiled or vague claims with respect to which considerable administrative time and expense, if not litigation risks, will be entailed in determining the proper estate against which to charge them, and in determining whether one estate is liable to another estate for indemnification with respect thereto. Such costs will be largely avoided under the terms of the

proposed Settlement Agreement, by the effectuation of a consolidation of the four estates into one.

Under the proposed settlement, the only unsecured claims asserted against any of the four estates that will not be subject to substantive consolidation are the claims of holders of bonds (collectively, the "Bondholders") issued by Group. Other proofs of claim that were filed against Group's bankruptcy estate, and all claims filed against all other estates, will be subject to the substantive consolidation under the terms of the proposed settlement. The Group Trustee has concluded in the exercise of his business judgment, that it is in the best interests of the Group estate as a whole to exclude only the Bondholders (but not other creditors that filed claims in the Group case) from substantive consolidation.

The Group Trustee believes that that distinction is appropriate because in the Group Trustee's view, nearly all creditors of the four Debtors' estates other than the Bondholders dealt exclusively with Communications, the operating entity. Although some of those creditors filed claims in Group's bankruptcy case, the Group Trustee believes that his review of each of those proofs of claim, and the underlying agreements, shows not only that those creditors did business with Communications, but also that nearly all of the contracts and purchase orders were in the name of Communications, not Group.<sup>5</sup> In the view of the Group Trustee, in contrast to other creditors of the four estates, only the Bondholders appear to have relied solely on the credit of Group in purchasing the bonds, since only Group, and not Communications, was liable for payment of the bonds. In fact, the Group Trustee contends, as an illustration of that fact, that the prospectus for the sale and exchange of the bonds explicitly and repeatedly warned the Bondholders that they did not have any direct recourse against Communications or its assets, meaning that their sole source of repayment was Group. In light of the

<sup>5</sup> Other than the Bondholders, there appear to have been a few entities, such as investment bankers, that may have entered into agreements directly with Group rather than Communications. However, the Group Trustee contends that there is no reason to believe that those entities expressly relied upon the sole credit of Group or Communications in extending credit or providing services. With respect to any securities claims of shareholders that have been asserted against Group, such claims are subordinated to those of unsecured creditors under Section 510(b) of the Bankruptcy Code, and thus would not be entitled to any credit in any distribution of proceeds by the Group Trustee.

The actual outcome of a trial with respect to issues of substantive consolidation, subrogation, exoneration, subordination and allocation, cannot be predicted with any certainty, particularly given the wide disparity of views of the two trustees as to the state of applicable law. For example, while the Group Trustee argues that the case law governing substantive consolidation cautions courts that consolidation is to be used sparingly, see *Bonham v. Crompton (In re Reagan Bankers)*, 22 F.3d 750 (9th Cir. 2000) ("Of course, '[r]esort to consolidation should not be Pavlovian,' . . . but as almost every other court has noted, should be used 'sparingly,')" (*quotation omitted*), the Communications Trustee believes that there is a clear modern trend in the courts toward consolidating estates as a means of equitable distribution of funds of uncertain or entangled ownership. There are relatively few published authorities that provide guidance as to the appropriate outcome of a request for consolidation in this case. Further, the fact-intensive nature of a consolidation analysis adds to the uncertainty of outcome of any request for substantive consolidation.

Similarly, issues as to allocation of the Verizon settlement proceeds and subrogation of claims of CIBC involve significant factual determinations. The trustee's presentations of facts, through testimony and documents, are diametrically opposed, and the ultimate outcome of those issues cannot be predetermined with certainty.

#### 3. The Difficulties with Collection

Given the fact that the funds in dispute are in hand, difficulties of collection, *per se*, are not a significant factor in analysis of settlement. However, the timing of collection is very much a factor. Because of the complexity of the issues involved, the extensive discovery required and the parties' necessary reliance upon evolving and unsettled law, full litigation would certainly require very significant delays for all parties. Any trial of the Consolidation Motion, regardless of its outcome, would likely be followed by one or more appeals, which, in turn, would extend the duration of the litigation by many months, if not years. Further, if the Consolidation Motion were denied, other motions, concerning allocation and subrogation, would certainly follow, leading to further litigation and additional appeals.

During that litigation, none of the Debtors' estates could be fully administered, and virtually

ongoing, the Group Trustee has negotiated terms of the Settlement Agreement pursuant to which the claims of Bondholders will remain recourse solely against Group and will not be subject to substantive consolidation with other claims asserted by unsecured creditors that - unlike the Bondholders - appear to have relied in whole or part upon the credit of Communications.

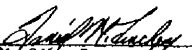
For these reasons, the trustees believe that the terms of the proposed Settlement Agreement are fair and reasonable to, and in the best interests of, their respective estates, and should be approved by the Court accordingly.

#### D. CONCLUSION

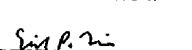
For the foregoing reasons, the Communications Trustee and the Group Trustee each respectfully requests that the Bankruptcy Court grant the relief as requested herein and enter its order approving the terms of the Settlement Agreement.

DATED: June 29, 2003

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