

CURTIS L. KENNEDY
ATTORNEY AT LAW

8405 E. PRINCETON AVE.
DENVER, CO 80237-1741
CurtisLKennedy@aol.com

TELEPHONE (303) 770-0440

ALSO ADMITTED IN:
UNITED STATES SUPREME COURT
STATE OF ARIZONA
STATE OF OKLAHOMA
STATE OF TEXAS
WASHINGTON, D.C.

September 27, 2012

What Was Idearc Truly Worth When the Spin-Off Occurred?

We all know about the pitiful consequences that have been bestowed on the retirees who had been involuntarily transferred from Verizon to Idearc/SuperMedia as part of the Spin-Off transaction. In no other business transaction has Verizon transferred retirees. Presently, there are two court cases attacking the Spin-Off transaction, and both cases are pending in the Dallas federal court. Of course, one case is for the benefit of all transferred retirees. **The other case that all retirees ought to pay attention to is the major creditors' lawsuit against Verizon.** The Spin-Off transaction not only eventually led to the creditors' significant financial losses, it caused retirees to lose the security of their retiree benefits, especially health care coverage.

The outcome of the creditors' case may have very significant repercussions for our *Murphy, et al., v. Verizon Communications Inc., et al.*, case which also awaits rulings by Dallas Senior Federal Judge A. Joe Fish. In the *Murphy* case, the Class of 2,750 persons retired before the November 17, 2006 Spin-Off of Idearc seek to be restored into Verizon's sponsored retiree benefit plans. The attorneys for the Plaintiff in the creditors' case plan to utilize at trial a lot of the evidence I gathered during my investigation and formal discovery work performed in the *Murphy* case, including my depositions of certain witnesses.

The creditors' case of *U S Bank, NA v. Verizon Communications Inc., et al.*, is set for a "Phase 1" trial to begin in Dallas federal court before Senior Judge A. Joe Fish on Monday, October 15, 2012. This is the Bankruptcy Litigation Trust's case that has been hard fought over the past few years. U S Bank, NA is the bankruptcy appointed "Litigation Trustee" and is the Plaintiff leading the creditors' fraud case that was filed in the aftermath of Idearc's infamous bankruptcy. All of the Plaintiff's claims arise out of Verizon's November 17, 2006 Spin-Off of its failing print and on-line Directories Business to Idearc Inc., now known as SuperMedia Inc.

In the months prior to the Spin-Off and throughout this case, Verizon has contended that the Directories Business (i.e., "Verizon Information Services") would be better off if it were an independent company. A straightforward sale would have subjected Verizon to billions of dollars in taxes. Therefore, Verizon leadership decided to do a spin-off that would avoid taxes.

On October 18, 2006, after conducting a very cryptic half hour meeting via telephone and reviewing a packet of Power Point presentations, the Verizon Board of Directors gave full approval for the Spin-Off transaction. A month later, on the last day to do the transaction, the retirees were thrown into the mix. Of course, no retiree had any prior knowledge, no fiduciary advocate, no legal representation, no union representation, and no say in the matter. The designated group of retirees were simply treated like obsolete telephone equipment being disposed of by Verizon.

In one of his many court rulings, Judge Fish specifically noted and quoted one of Verizon's lawyers who wrote only a few weeks before the final Spin-Off date: "[s]ince we basically decided not to give [Idearc] eyes, ears, limbs and advisors until close to closing, I am not sure why we would want to give it a brain." At the proverbial "11th Hour" before the closing, Verizon EVP John Dierksen, acting as the *sole* director of Idearc, resigned his director position and he appointed a new set of corporate directors. The new directors hurriedly executed a resolution to ratify and approve the Spin-Off transaction. In reality, the new Idearc board had no choice but to sign off on the Spin-Off. In a well-reasoned order entered by Judge Fish a few months ago, he concluded that the hastily executed resolution is invalid as a matter of law.

Anyhow, two big time creditors, JPMorgan and Bears Stearns, ("the usual suspects") swooped in and agreed to finance the Spin-Off deal. Then, they quickly sold the debt to hundreds of other financial institutions. On the Spin-Off date, Idearc was saddled with \$9.5 billion in debt and long term liabilities and several billion dollars in contingent tax obligations. Idearc's common stock, as reflected by trading on the New York Stock Exchange, was valued at between \$3.9 billion and \$5.5 billion for nearly a year after the Spin-Off. Towards the end of year 2007, analysts continued to recommend that investors hold their Idearc stock. Then, everything started to collapse. Eventually, Idearc had to file for bankruptcy protection and emerged renamed as SuperMedia.

For Phase 1 of the creditor's fraud case, there is one overarching highly contested factual issue that Senior Judge A. Joe Fish will be deciding. In short, the issue is the following: **What was the true market value of Idearc shortly before and when the Spin-Off occurred in November 2006?** Was it \$5.3 billion? Was it \$6.5 billion? Was it \$9.1 billion? Was it \$13.3 billion? Was the domestic Directories Business that Idearc obtained from Verizon worth more or less than the debt that Idearc incurred in the Spin-Off?

During the past few months, Judge Fish has addressed numerous legal issues in this very complicated case. First, he has decided two motions to dismiss, decisions which dismissed part of the Plaintiff's original Complaint. Then, he has twice ruled that there will be no jury and he will make all of the trial rulings. Next, Judge Fish has methodically addressed the 11 separate claims filed against the Defendants and he has dismissed some of the claims. On September 24, 2012, he entered an order denying Verizon's requests to have stricken from consideration at the trial several expert opinion reports that buttress the Plaintiff's claims against Verizon. Judge Fish has ruled that the Plaintiff's expert testimony, in combination with a handful of documents, give rise to a "genuine dispute of material fact" about whether "Idearc was . . . worth more or less

than \$9.1 billion” at the time of the Spin-Off. Judge Fish has not yet ruled on the Plaintiff’s request to have stricken from consideration at the trial several expert opinion reports submitted by Verizon and the other defendants. In fairness, he will likely consider the reports.

Certain aspects of Plaintiff’s Amended Complaint are no longer in the case to be tried next month as result of prior orders and decisions made by Judge Fish. At trial, the Plaintiff bears the burden of proof to prove Idearc’s true valuation when the Spin-Off occurred. If the Plaintiff fails to prove that Idearc’s value at the time of the Spin-Off was less than the \$9.1 billion in debt Idearc incurred with that transaction, then, the Plaintiff cannot prevail on any of the remaining claims.

The following is a summary of what remains in the case to be tried in Phase 1 beginning on October 15:

In Count 1, Plaintiff claims that the burdens imposed upon Idearc by certain spin agreements, particularly a “tax-sharing agreement” constitute fraudulent consideration to Verizon and they were entered into by Verizon with actual intent to hinder, delay, or defraud creditors of Idearc. The tax sharing agreement imposed draconian restrictions on Idearc. The issue to be decided by Judge Fish is whether Idearc’s assumption of certain contractual obligations constituted a fraudulent transfer. Of course, one of the contractual obligations *imposed* upon Idearc was the obligation to pay retiree pension and welfare benefits pursuant to the “Employee Matters Agreement” executed on the very last day of the Spin-Off. Another legal issue to be addressed by Judge Fish is whether the Texas-based state law claims asserted in Count 1 are precluded by a certain Bankruptcy Code provision. The Plaintiff asserts that the spin agreements should be voided, and that Plaintiff recover a money judgment against Verizon;

In Count 2, Plaintiff claims that Idearc did not receive reasonably equivalent value in exchange for the spin agreements that were made with Verizon, that Idearc was insolvent at the time of the Spin-Off or became insolvent as a result of the Spin-Off, and that the value of the assets Verizon transferred to Idearc, i.e., the Directories Business, was worth far less than what Idearc gave Verizon in exchange. The Plaintiff seeks the same relief as in Count 1;

In Count 3, Plaintiff claims that Verizon EVP John Diercksen, while acting as the sole director of Idearc, breached fiduciary duties to Idearc and also to its creditors. Among the wrongs that Mr. Diercksen is accused of doing are: not giving Idearc an independent brain until it was too late; making Idearc become liable for misrepresentations and omissions that Verizon made when filing certain SEC formal statements; allowing an illegal transfer of dividends, cash payments and debt from Idearc to Verizon when Idearc was not properly funded or was insolvent; and unfairly making Idearc bound to the harsh terms of a tax-sharing agreement with the goal of benefiting Verizon. The central issue at trial will be whether Mr. Diercksen acted with wilful misconduct or was grossly negligent. The Plaintiff is seeking a money judgment to be paid for by Verizon’s insurance or by Verizon;

In Count 4, Plaintiff claims that Verizon aided and abetted Mr. Diercksen's breach of fiduciary duty and the corporation should be held equally accountable. The Plaintiff seeks to have Verizon forfeit any benefit the corporation received as a result of the Spin-Off;

In Count 5, Plaintiff claims that Verizon demanded one of Idearc's subsidiaries to unlawfully loan about \$475 million to Verizon and the corporation did not give back in exchange fair value. Verizon gave the Idearc subsidiary a one page illiquid demand note that was for far less than the loan amount transferred to Verizon. The Plaintiff seeks to receive a money judgment enforceable against Verizon;

In Count 6, Plaintiff claims that Verizon caused another Idearc subsidiary to give to GTE certain property, common stock and credit borrowings and the Idearc subsidiary did not receive reasonably equivalent value in exchange. The Plaintiff claims the transaction made the Idearc subsidiary to become insolvent and seeks a money judgment against Verizon equal to the value of the distribution that was made to GTE;

In Count 8, Plaintiff claims that, while acting as Idearc's sole director, Mr. Diercksen authorized and approved Idearc to issue a dividend to Verizon in the form of \$9.5 billion in combined notes and cash, and Mr. Diercksen willfully, or at a minimum negligently, authorized and approved the dividend to Verizon even though Idearc lacked a surplus or net profits under which the dividends could legitimately occur. With respect to Count 8, there is a dispute of material fact as to Mr. Diercksen's state of mind at the time of the Spin-Off. And, another issue to be decided is whether Idearc had sufficient surplus at the time of the Spin-Off to declare the dividend. Judge Fish has ruled that should the Plaintiff prove this claim against Verizon, the corporation can only be found liable for \$7.1 billion; and

In Count 9, Plaintiff claims that both Verizon and Mr. Diercksen acted as promoters of Idearc and breached fiduciary duties owed to Idearc. The Plaintiff seeks monetary damages and punitive damages.

Overall, the Plaintiff claims that Verizon knew that Idearc was a dying business, worth much less than what the creditors were tricked into believing and, as a result of the behind the scenes scheming done by Verizon and Mr. Diercksen, the creditors were duped into believing Idearc was worth much more. The Plaintiff claims Verizon, Mr. Diercksen and others simply schemed to hide the truth, including two unfavorable 5 year business plan analysis, one performed internally and one performed by an external consultant, about the real value of Idearc when promoting the Spin-Off. Within a month or two after the Spin-Off, Idearc generated internal reports suggesting its liabilities far exceeded its assets.

Overall, the Defendants claim that Idearc was worth exactly what the market considered the new independent company to be worth. The Defendants claim that the Plaintiff's case boils down to the proposition that, since Idearc eventually filed for bankruptcy protection in March 2009, Idearc must have been insolvent when it was spun off back in November 2006. The Defendants claim that Idearc was solvent and had a promising future. The Defendants contend

the proof is in the fact that investors in the stock market reacted very positively to the Spin-Off deal when it occurred and during the following year.

The Plaintiff counter argues and will present evidence at trial to support its position that Verizon leaders engaged in a concerted effort to artificially inflate Idearc's market value, the market never learned about either Verizon's manipulation of Idearc's business plan or the truth regarding Idearc's future prospects.

At Phase 1 of the trial, some of which I plan to attend, both sides will call as witnesses former Verizon officers, former Idearc officers, Mr. Dierksen, inside and outside legal counsel, representatives of investment bankers and rating agencies, financial advisors, tax experts, solvency and economic experts who either knew or didn't know the very important intimate financial details about Verizon's directories business and the effort to promote the Spin-Off transaction. The Phase 1 of the trial is expected to last about two weeks, or longer, although seasoned judges like Judge Fish manage to condense the proceedings.

The case is very high stakes and it has generated tons of legal paperwork with over 570 separate court filings made to date, and the parties are not done with their submissions. There are numerous lawyers working on both sides and hundreds of thousands of pages of documents. The Defendants have done all they can to out-spend the Plaintiff, paying just one of their eight expert witnesses over \$4 million. Both sides will spend a small fortune making travel arrangements and booking hotel rooms for their witnesses attending the trial. The Verizon Defendants have arranged a special lease of office space nearby the downtown Dallas federal court.

All of the important court filings for both of the cases concerning the same erstwhile Spin-Off transaction are posted at the website maintained by your Association of BellTel Retirees Inc, your retiree organization which is footing the bill for the *Murphy* case. I will have more to report to you about the creditors' case after Phase 1 of the trial is concluded in Dallas.

Sincerely,

A handwritten signature in black ink that reads "Curtis L. Kennedy". The signature is written in a cursive, flowing style.

Curtis L. Kennedy