cogent valuation

Valuation Case

The Valuation of NorthPoint's Lawsuit Against Verizon used in the Test for Solvency

The trustee of the bankruptcy estate of NorthPoint alleged a 90-day preference period leading up to NorthPoint's Chapter 11 filing and demanded that the preference payments be returned to the estate. Cogent Valuation valued NorthPoint's pending litigation against Verizon for breach of their merger agreement, and determined that were the value of the IP (litigation) included as a NorthPoint asset that NorthPoint had been solvent at all times during the 90-days prior to the bankruptcy filing.

NorthPoint v. Verizon

On August 7, 2000, NorthPoint Communications, Inc. and Verizon Communications Inc. entered into an agreement whereby a new entity would be formed through the combination of NorthPoint with certain Verizon assets. The new entity would be owned 55% by Verizon, and become a national provider of DSL services.

On November 29, 2000 Verizon abruptly announced it was aborting the deal. Based on NorthPoint's recently reported lower than expected revenues, and deteriorating financial, business and operating conditions. Verizon asserted that these developments constituted a material adverse change in NorthPoint consistent with the terms of the merger agreement that provided a legitimate reason for Verizon to terminate the contemplated Transaction.

Because no alternative financing had been identified, cash strapped NorthPoint filed for protection from its creditors under Chapter 11 of the Bankruptcy Code on January 16, 2001. NorthPoint subsequently sued Verizon for economic damages totaling three billion dollars alleging that Verizon breached the merger agreement because, NorthPoint claimed, there had been no material adverse change.

The Preference Claim

At around the time of Verizon's announcement to terminate the merger, NorthPoint had made payments to certain creditors. The general creditors of the Company claimed that NorthPoint was not solvent at all times during the 90-day period and that payments made during that period must be returned to the Estate for distribution in accordance with the terms of the bankruptcy settlement.

NorthPoint was not solvent during the period based upon its balance sheet or the market value of its stated assets. Nevertheless, NorthPoint's claim against Verizon, which was filed on November 30, 2000, was a "contingent asset" for NorthPoint during the 90-day period, and was not reported on the Company's financial statements. There was a case to be made that NorthPoint would have expected to prevail in its claim of breech of agreement against Verizon, and that the present value of the damages award would be sufficient to create positive net worth on NorthPoint's balance sheet.

Solvency and the Contingent Assets

If it could be shown that the market value of all of NorthPoint's assets, including its contingent assets, exceeded its liabilities, the Company would have been solvent at all times prior to the bankruptcy filing and no preference issue would have arisen.

The financial analyses and opinion demonstrated through a decision tree analysis and the use of Monte Carlo Simulation, that the expected value of the lawsuit at the time of the Chapter 11 filing was $457.7 million. The expected value of the lawsuit added together with NorthPoint's stated assets established that the market value of its total assets exceeded the total value of its liabilities by $115 million. Therefore, the Company had been solvent for the 90-days preceding the bankruptcy filing.

The analysis considered the facts that were known at the time of the alleged preference period. Furthermore, the analysis considered certain information involving contemporaneous events that were knowable at the time of the transaction and its cancellation. The information became known through discovery and certain testimony that was provided by the deposition of witnesses who were integral to the contemplated transaction.

Decision Tree Analysis

The value of NorthPoint's contingent asset is the present value of the potential litigation proceeds from

About the Firm

Cogent Valuation is a nationally recognized firm that has provided independent valuation and financial advisory opinions in thousands of situations since 1991. Cogent Valuation utilizes proprietary research, intensive due diligence, and the experience and insights of its professionals to produce thoughtful, well-documented opinions that have consistently withstood the scrutiny of clients and their advisors, investors, regulators, and courts.

the lawsuit filed against Verizon on December 8, 2000 and that could have been anticipated as early as November 29, 2000, the date of the alleged Verizon wrongdoing.

The valuation of the potential litigation proceeds was derived from a review of the documents produced in the actual litigation, discussions with counsel familiar with the litigation process, and the relevant expenses that would have been incurred in pursing this lawsuit to its final determination.

The NorthPoint Model (the "Model") expresses the expected cost of each of the legal steps that were foreseeable and that could have been anticipated during the period November 29, 2000 through January 16, 2001 (the interval between Verizon's canceling the MergerAgreement and NorthPoint's bankruptcy filing), including the timing and length of these phases, the probabilities of each of the actions by the two parties, the related costs, and the expected outcome. The Model to value the lawsuit utilized a decision tree contemplating all of the courses and concomitant events that the action could have taken through the court system, the time it would have taken to bring the action to the final determination, the probability of each outcome, and the time value of the monetary award, if any, for each event.

Through our investigation of the documentation of information known at the time of the preference combined with discussions with litigators experienced in similar claims and the related legal process, certain general assumptions were necessary in the modeling that combined the facts of the lawsuit and informed judgments of the legal process to facilitate the probable outcomes of the claim.

Upon filing the claim in San Francisco Superior Court, the three possible paths of the lawsuit included: mediation; trial without negotiation; and request for summary judgment. Eight of the major factors used in the Model are highlighted below.

- Timing of the request for summary judgment.
- Possible outcomes of the request for summary judgment.
- The trial and the possible outcomes of the trial and negotiated settlement during trial.
- The appeal process by the losing party.
- Negotiated settlement during the appeal phase.
- Size of the settlement based on expected damages award.
- Possibility of review of the case by California and U.S. Supreme Courts.
- The probability and timing of each event in the path to possible outcomes.

Finally, damages were calculated that could be paid to NorthPoint, whether either the San Francisco Superior Court or the Court of Appeal of San Francisco opined in favor of the plaintiff, based on information that was known or knowable during the period of November 29, 2000 through January 16, 2001. This information is highlighted below:

- The total economic damage claimed by NorthPoint.
- The value of the Merger consideration to have been paid by Verizon.
- The loss in equity value as measured by the decline in NorthPoint's stock price just prior to and just after Verizon's announced withdrawal from the Merger.
- The loss in equity value based on the terms of the Merger consideration.
- The loss in equity value based on NorthPoint's stock price prior to the Merger announcement on August 7, 2000.
- The opinions of three experts regarding the economic damages incurred by NorthPoint.
- The present value of each future economic event calculated at the risk free rate for the time period for each corresponding event, respectively.

Alternative Scenarios and Expected Value

Combining the information with the process described above, two decision tree analyses were developed based on "more favorable" (Scenario A) and "less favorable" (Scenario B) assumptions from NorthPoint's shareholders' vantage. Scenario A assumed the lowest legal costs, the shortest time for each event sequence to lead to a payout determination, and the highest payout either by court decision or through a negotiated settlement. Scenario B assumed the highest legal costs, the longest time to a payout determination, and the lowest payout either by court decision or through negotiated settlement.

Finally, scenario testing was performed through the use of Monte Carlo Simulation software in order to determine the most likely (or expected value) developed through the Decision Tree Analysis. Taken together, the product of the litigation analyses is the fair market value of the lawsuit.

Contact Cogent Valuation

San Francisco Office
601 California St., Suite 800 — 415.392.0888 V
San Francisco, CA 94108 — 415.392.7070 F

Orange County Office
4 Hutton Centre Dr., Suite. 720 — 714.668.0272 V
Santa Ana, CA 92707 — 714.668.0137 F

Los Angeles Office
21700 Oxnard St., Suite. 1080 — 818.905.8330 V
Woodland Hills, CA 91367 — 818.905.8340 F

cogent valuation