

unencumbered assets was \$33.1 million.<sup>81</sup> The Committee disagreed and argued for a higher value. At the confirmation trial, the values of the unencumbered real property and easements were contested, with three parties submitting different values.

**1. The Debtors' Value For The Motor Vehicles Is Appropriate And Unchallenged.**

61. The value of Hawaiian Telcom's motor vehicle fleet was not contested. The Debtors initially valued their motor vehicles at approximately \$1.4 million, based on their book value.<sup>82</sup>
62. The Debtors later reviewed this valuation and determined that, based on Kelly Blue Book value or other similar market indicators, the motor vehicles may have a value of \$3.3 million.<sup>83</sup>
63. Using either the book value or the Kelly Blue Book value for the motor vehicles provides a reasonable basis for determining their fair market value. The difference between their book and Kelly Blue Book values is not material under the Debtors' allocation of value and waterfall analysis.<sup>84</sup>

**2. The Debtors' Range Of Value For**

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81 Ex. D-2 at 62 (Disclosure Statement); Mandava Direct ¶ 15.

82 Ex. D-2 at 61 (Disclosure Statement).

83 Nystrom Direct ¶ 68; Mandava Direct ¶ 17.

84 Mandava Direct ¶ 17.

**Unencumbered Real Property Held In Fee Is Reasonable.**

64. The Debtors determined the value of the unencumbered real property held in fee to be \$31.7 million.

**(a) The Debtors Reasonably Valued  
The Unencumbered Real Property At \$31.7 Million.**

65. The Debtors' determination used the tax-assessed values of the unencumbered real properties as a proxy for their value. The tax assessed values were determined by matching the parcels of unencumbered property held in fee with their tax-assessed values from the county tax assessors' web sites.<sup>85</sup>

66. The reasonableness from the perspective of unsecured creditors of the \$31.7 million value the Plan ascribed to the unencumbered real property was confirmed by the independent \$19.1 million valuation reached by the Secured Lenders' appraisal expert, James E. Hallstrom, Jr., who appraised the fair market value of the unencumbered properties using a sales comparison approach.<sup>86</sup> In fact, the difference between the tax assessed

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85 Ex. D-14 at 3 (Zolfo Cooper Report); Mandava Direct ¶ 17.

86 Hallstrom Direct ¶¶ 8, 14.

Docket No. 1362, Declaration of James E. Hallstrom, Jr., in Support of Secured Lenders' Memorandum of Law in Support of Confirmation of the Joint Chapter 11 Plan of Reorganization of Hawaiian Telcom Communications, Inc. and Its Debtor Affiliates ("Hallstrom Direct"). Mr. Hallstrom has 38 years of appraisal experience in Hawaii, is licensed in the State of Hawaii and holds the CRE, MAI and SPRA designations.

(Continued...)

value of the properties under the Plan and the actual fair market value of the properties under Mr. Hallstrom's valuation demonstrates that the unsecured creditors are receiving more under the Plan than they would be receiving under a traditional waterfall. The excess consideration the unsecured creditors are receiving results from an agreement by the Secured Parties to provide excess value to the unsecured creditors.

**(b) The Debtors' And Secured Lenders Experts'  
Testimony On Easements Establish That They  
Have No Market Value.**

67. The Debtors, Secured Lenders and the Committee's experts agreed that the proper method for valuing the Debtors' unencumbered easements was to determine their market value.<sup>87</sup> The three primary methods to determine market value are the sales comparison approach, the income approach, and the cost approach.<sup>88</sup>
68. The most common method for valuing easements is the sales comparison approach. The Debtors' appraisal expert, Robert C. Hastings, Jr., MAI,

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Hallstrom Direct ¶ 3. Mr. Hallstrom was qualified to testify as the Secured Lenders' real estate appraisal expert and opined on the value of the Debtors' unencumbered fee and easement real property interests.

<sup>87</sup> Hastings Direct ¶ 13; Hallstrom Direct, ¶ 23; November 12, 2009 Tr. at 149:16-18 (Tesh testimony).

<sup>88</sup> Hastings Direct ¶ 10; November 12, 2009 Tr. at 85:10-13 (Hallstrom testimony).

SRPA, and the Secured Lenders' expert, Mr. Hallstrom, agreed that the Debtors' easements have no market value.<sup>89</sup>

69. Mr. Hastings and Mr. Hallstrom applied recognized market valuation methodologies in valuing the easements. Mr. Hastings used the recognized sales comparison approach to value the easements.<sup>90</sup> Similarly, Mr. Hallstrom considered whether a market exists for the easements.<sup>91</sup>
70. In his 40 years working in real estate valuation in Hawaii, having seen "20,000 to 40,000" easements, Mr. Hastings is unaware of a market for restricted-use easements.<sup>92</sup>
71. Further, because almost all easements are granted for nominal consideration, usually \$1 or \$10, the nominal price also suggests that landowners place virtually no value on the easements.<sup>93</sup>
72. Similarly, in his "38 years of appraising in the Islands [Mr. Hallstrom] ha[s] never come[ ] across a buyer or seller of an existing easement."<sup>94</sup>

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<sup>89</sup> Hastings Direct ¶¶ 32-33; Hallstrom Direct ¶ 23.

<sup>90</sup> Hastings Direct ¶ 32.

<sup>91</sup> Hallstrom Direct ¶ 26.

<sup>92</sup> November 10, 2009 Tr. at 148:2 (Hastings testimony); Hastings Direct ¶ 35.

<sup>93</sup> Hastings Direct ¶ 41; see November 12, 2009 Tr. at 162:9-14 ("Q. If a landowner is willing to give . . . an easement for nominal value, that could suggest that the market value is low, isn't that right? A. Of the individual easement? Q. Right. A. It could suggest that.").

73. Mr. Hastings also conducted additional research specific to this case to determine if such a market existed.<sup>95</sup> He “[l]ooked in the Bureau of Conveyances . . . talked to [his] partners [and] associates” and looked at a real estate marketplace web site.<sup>96</sup>
74. “[U]nder the circumstances, after analyzing all of the data, there were no sales, there were no buyers, there was no market . . . [a]nd that is what led to a value of \$0 for each of the easements.”<sup>97</sup>
75. In addition, other utility companies, such as Oceanic Time Warner, use the Debtors’ easements without securing their own easements.<sup>98</sup> Accordingly, Oceanic Time Warner would not be interested in buying the Debtors’ easements because “they have the right to pull through the conduit or they

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94 November 12, 2009 Tr. at 86:10-12 (Hallstrom testimony).

95 November 10, 2009 Tr. at 123:4-12 (Hastings testimony).

96 November 10, 2009 Tr. at 123:6-8 (Hastings testimony).

97 November 10, 2009 Tr. at 121:23-122:2 (Hastings testimony).

98 Hastings Direct ¶ 38; November 12, 2009 Tr. at 188:18-21 (Tesh testimony) (stating his awareness that Oceanic Time Warner used Hawaiian Telcom’s easements), 189:15-18 (“Q. Now, you’re aware that there are laws that require a power company to allow a telecommunications company to use their easements, aren’t you? A. I am.”) Nov. 12, 2009 (Tesh testimony); Hrg. Tr. 151:8-13, Nov. 9, 2009 (Edl Testimony) (testifying that other utility companies run their lines on Hawaiian Telcom’s easements, for a fee)..

have the right to attach to poles throughout the entire system that Hawaiian Telcom operates, along with the power companies.”<sup>99</sup>

76. Both Mr. Hastings and Mr. Hallstrom were cross-examined on their valuation conclusions. Both Mr. Hallstrom and Mr. Hastings relied on appropriate methodologies and their opinions and testimony are credible.<sup>100</sup>

77. Hawaiian Telcom’s easements do not form a corridor. A corridor is a long, narrow strip of property rights for which the highest and best use is to provide an economic or social benefit by connecting the end points.<sup>101</sup> Hawaiian Telcom’s easements do not form a corridor by themselves because “these easements connect up end to end with public rights-of-way.”<sup>102</sup> They may form a corridor in combination with other parts of the Debtors’ network, but the easements themselves do not have connectivity because “they don’t always connect through Hawaiian Telcom property.”<sup>103</sup>

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<sup>99</sup> November 10, 2009 Tr. at 125:16-19 (Hastings testimony); see also November 10, 2009 Tr. at 125:16-19 (Hastings testimony) (“[T]here is no evidence that any payment is made in the income approach[on account] of these very limited easement rights.”).

<sup>100</sup> November 13, 2009 Tr. at 226:17-21 (statement by the Court).

<sup>101</sup> Tesh Direct ¶ 37.

<sup>102</sup> November 10, 2009 Tr. at 107:10-11 (Hastings testimony); November 12, 2009 Tr. at 194:7-14 (Tesh testimony); see also November 10, 2009 Tr. at 107:14-16 (Hastings testimony) (“Basically, most of these are going to be the extension . . . from trunk lines within the public right-of-way to individual residences.”).

<sup>103</sup> November 12, 2009 Tr. at 192-21:194:6 (Tesh testimony).

78. In addition, a review of SEC filings or other possible disclosures from telecommunications companies demonstrates that easements are not valued independently of the network.<sup>104</sup> The same is true for Wall Street analyst reports.<sup>105</sup>
79. There is no buyer for these easements apart from a potential buyer of the Debtors' entire enterprise. During Lazard's efforts to market the Debtors' business, Lazard did not receive any inquiries regarding a transaction involving just the easements.<sup>106</sup>
80. Also, Hawaiian Telcom does not separately account for its easements or carry them as an asset on its books.<sup>107</sup> While the Debtors capitalize costs associated with acquiring easements, this does not reflect that the easements have an independent value.<sup>108</sup> Those costs are necessary for placing a

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104 Melton Direct ¶ 78.

105 Melton Direct ¶ 79.

106 Melton Direct ¶ 79.

107 Melton Direct ¶ 80; Reich Direct ¶ 85.

108 Reich Direct ¶ 83 (explaining that "because it is the poles, lines, and other equipment on the easements that generate revenue, these are the items that generate value"); November 9, 2009 Tr. at 150:4-5 (Edl testimony) ("[T]he value is in the transmission facilities that ride on those poles.").

portion of the Debtors' network in use, but they are not attributable to any value for the easements.<sup>109</sup>

81. The asset that appears in the Debtors' 10-K for 2007 titled "franchise for street right of way" is not related to the value of easements or rights of way but "represents the capitalization of tax avoidance resulting from the Debtors' franchise street right of way."<sup>110</sup> "It relates to the avoidance that [Hawaiian Telcom's] franchise provides to avoid a ... 2-1/2% utility tax."<sup>111</sup>
82. Moreover, when The Carlyle Group acquired the company in 2005, it did not attribute any value to the easements.<sup>112</sup>

**(c) The Debtors Would Not Need  
To Move Off The Unencumbered Property.**

83. Even if there were any basis to assume the Debtors might need to replace the easements, the Debtors have the power of eminent domain and could reacquire any unencumbered property or easements if needed.<sup>113</sup>

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<sup>109</sup> Reich Direct ¶ 83; see November 12, 2009 Tr. at 100:24-101:1 (Hallstrom testimony) ("On a stand-alone basis, an easement, a Hawaiian Telcom easement or another easement, does not create any kind of value.").

<sup>110</sup> Ex. D-10 at 61 (Hawaiian Telcom Communications, Inc. Form 10-K for 2007); Reich Direct ¶ 85; November 9, 2009 Tr. at 75:16-17 (Reich testimony) (stating that there is no link between the tax avoidance and street rights of way).

<sup>111</sup> November 9, 2009 Tr. at 75:19-21 (Reich testimony).

<sup>112</sup> Wilson Direct ¶ 95.

84. Using eminent domain, the Debtors would not have to pay any more than the properties' "fair market value." That value is determined by what the open and competitive market would pay. As discussed above, because of the highly specialized nature of the unencumbered property, the market either does not exist (for the easements) or would only support the cost of the land without the specialized structures thereon.<sup>114</sup>
85. And because 95% of the Debtors' easements are jointly owned with local power utilities, Hawaiian Telcom could continue to use the poles and conduits without moving any equipment.<sup>115</sup> This means that if the Debtors lost their rights to the easements, the easements would exist through the power company.<sup>116</sup> They would not need to reacquire the easements but "would be able to reattach [to] the poles, and [the] lines are there."<sup>117</sup> Even if the Debtors lost their easements, they would still own or have rights to use the poles and conduits that support the lines.

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<sup>113</sup> Hawaii Rev. Stat. § 101-4; Edl Direct ¶ 14; November 9, 2009 Tr. at 153:15-23 (Edl testimony) (stating that if the Debtors were being forced to move a central office, "we would use eminent domain to stay where we're at").

<sup>114</sup> November 10, 2009 Tr. at 121:19-25 (Hastings testimony).

<sup>115</sup> Hastings Direct ¶ 31; Hallstrom Direct ¶ 24(a); November 12, 2009 Tr. at 158:17-20 (Tesh testimony).

<sup>116</sup> 47 U.S.C. § 224(f)(1); Haw. Admin. Rules § 6-80-74(a).

<sup>117</sup> November 10, 2009 Tr. at 137:9-10 (Hastings testimony) (noting that the Debtors "already had their equipment in place").

86. Hawaiian Telcom would not have to pay more than fair market value, if anything, to reacquire any land interests in easements or the unencumbered property because of its statutory rights of eminent domain and rights regarding shared telecommunication poles and conduits

**3. The Evidence Of The Value Of The Encumbered Assets Is Not Necessary To The Court's Analysis Of The Debtors' Plan.**

87. In addition to the value of the unencumbered assets, the Committee also presented evidence regarding the value of the assets encumbered by the Secured Parties' liens. The Committee's evidence, while received by the Court, is not necessary to this Court's determination. Given the extent of the Secured Parties' liens as well as the proper enterprise valuation, there is no need to determine the exact value of the encumbered assets.

**C. Warrants Are An Appropriate Recovery Under The Plan.**

88. The third primary contested area focused on whether warrants are an appropriate form of recovery for these chapter 11 cases and whether the Debtors properly valued the warrants. Hawaiian Telcom proved that warrants are an appropriate form of recovery and that the warrants have a value of \$12.3 million. Additionally, Hawaiian Telcom established it is protecting substantial tax benefits by using warrants instead of common stock under the Plan.

**1. Warrants Are An Appropriate Form  
Of Recovery For The Class 5 Claimants.**

89. Under the Plan, the holders of Class 5 Claims, the senior noteholders, will receive in the money warrants with a value of \$12.3 million.<sup>118</sup> The holders of these warrants can exercise these warrants without any out-of-pocket costs, through an optional cashless exercise feature.

**(a) The Bankruptcy Code Requires  
Value, The Plan's Warrants Have Value.**

90. A warrant is a security that gives the holder the right, but not the obligation, to acquire the underlying common stock of the company that issued the warrant at a specified price (the "exercise price") within a set period of time (the "term").<sup>119</sup>

91. The value of a warrant is comprised of (a) its intrinsic value and (b) the option premium. Intrinsic value is the amount by which a company's stock price exceeds the exercise price of the warrant. Warrants with intrinsic value are described as "in-the-money," while warrants without intrinsic value are described as "out-of-the-money." A warrant would be "at-the-money" or

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<sup>118</sup> Mandava Direct ¶ 3.

<sup>119</sup> Mandava Direct ¶ 21.

out-of-the-money when the stock price is equal to or less than the exercise price, respectively.<sup>120</sup>

92. There is no evidence that the option premium should be ignored.<sup>121</sup> Indeed, the Secured Lenders' expert testified that because the common stock of reorganized Hawaiian Telcom will be publicly traded post-emergence, there will be a liquid market for the warrants in which holders of the warrants may realize the entire value of the warrants (intrinsic and option) by selling them to willing buyers at a minimal discount.<sup>122</sup>
93. The Committee's expert recognized that if the Committee's calculation of Hawaiian Telcom's TDV were correct, (a) the value of the Warrants would be substantially greater and (b) the subscription rights that were distributed to the Senior Noteholders under the Plan, which are currently valued at par under the Plan's assumed TDV, could also have significant value.<sup>123</sup>

**(b) Warrants Are Frequently  
Used in Chapter 11 Proceedings.**

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<sup>120</sup> Mandava Direct ¶ 22.

<sup>121</sup> November 12, 2009 Tr. at 242:22-243:6 (Schaeffer testimony).

<sup>122</sup> Wilson Direct ¶ 71; November 12, 2009 Tr. at 246:3-248:19 (Schaeffer testimony).

<sup>123</sup> November 12, 2009 Tr. at 256:17-260:22 (Schaeffer testimony).

94. Warrants are commonly used as consideration in bankruptcy proceedings and have been used to provide value to various stakeholders in several recent chapter 11 cases.<sup>124</sup>
95. Hawaiian Telcom provided evidence of both in- and out-of-the money warrants used in 11 different chapter 11 cases.<sup>125</sup> The Committee did not demonstrate that warrants are an inappropriate form of recovery in a contested plan and did not present evidence to contradict the Debtors' evidence on the use of warrants.<sup>126</sup>
96. The Committee's expert recognized that warrants are used in chapter 11 cases and testified that that he had "seen them in restructuring plans."<sup>127</sup>

**2. The Debtors Preserve Substantial Tax Benefits  
From The Use Of Warrants Instead Of Common Stock.**

97. By providing warrants instead of stock to the Senior Noteholders, Hawaiian Telcom will likely save in the range of \$13 million to \$31 million in federal income taxes between 2010 and 2013.<sup>128</sup>

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124 Mandava Direct ¶ 16.

125 Mandava Direct ¶ 16-17.

126 November 13, 2009 Tr. at 227:12-17 (statements by the Court).

127 November 12, 2009 Tr. at 244:18-22 (Schaeffer testimony).

128 Tucker Direct ¶ 26.

Docket No. 1351, Written Direct Testimony of Howard Tucker, Ernst & Young LLP, Docket No. 1351 ("Tucker Direct"). Mr. Tucker is a Partner at Ernst & Young LLP  
(Continued...)

### **3. The Debtors Properly Valued The Warrants.**

#### **(a) The Black-Scholes Model Is The Proper Method To Value The Warrants.**

98. The warrants provide \$12.3 million in value to the holders of Class 5 Claims when properly valued utilizing the Black-Scholes formula.<sup>129</sup> The Black-Scholes formula is a widely adopted tool to estimate the value of options, warrants, and other similar derivative instruments. Advisors to all three parties used the Black-Scholes formula to determine the value of the warrants under the Plan.<sup>130</sup> In addition, the evidence demonstrated that, because the Plan contemplates that the New Common Stock will be publicly traded post-emergence, there will be a liquid market where holders can freely sell their warrants to willing buyers with minimal discount.

#### **(b) Lazard Utilized A Reasonable Time Period To Determine The Value Of The Warrants.**

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(“E&Y”) and has provided tax advisory services on behalf of E&Y to Hawaiian Telcom since November 2008. Mr. Tucker advised Hawaiian Telcom on various tax matters regarding Hawaiian Telcom’s filing for bankruptcy and the impact of the Plan on Hawaiian Telcom’s tax attributes, including net operating losses and net unrealized built-in losses. Tucker Direct ¶ 26. The Committee elected not to cross examine Mr. Tucker or contest any of his analysis.

129 Mandava Direct ¶ 32.

130 Mandava Direct ¶ 30; Wilson Direct ¶¶ 73-75; Schaeffer Direct ¶ 104.

99. The Black-Scholes model uses the following inputs to assess the value of warrants: (a) stock price; (b) exercise price; (c) volatility of the common stock; (d) term; and (e) risk-free rate.<sup>131</sup>
100. Lazard used appropriate measures for each of the inputs, including an appropriate volatility measure. Lazard utilized a rolling 100-day average over a six month period to determine volatility based on a group of Hawaiian Telcom's peers.<sup>132</sup>

**D. The Debtors Properly Allocated Value To The Constituents.**

101. The fourth primary contested issue is whether the Debtors properly allocated value between the Secured Parties and the unsecured creditors. The Debtors allocated value consistent with guidance from case law and the extent of the Secured Parties' liens. Based on the Debtors' allocation, the unsecured creditors will obtain a greater recovery under the Plan than under a traditional waterfall. Hawaiian Telcom also confirmed that the Plan was reasonable by checking the results of a traditional waterfall under an alternative allocation methodology. Under both approaches, the unsecured creditors will receive more under the Debtors' Plan.

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<sup>131</sup> Mandava Direct ¶ 31.

<sup>132</sup> Mandava Direct ¶ 32; November 10, 2009 Tr. at 162:24-163:11 (Mandava testimony).

102. The Plan provides for a recovery of \$12.3 million of value in warrants to holders of Class 5 Claims as well as up to \$500,000 in cash to holders of other general unsecured claims.<sup>133</sup> Under a traditional waterfall, recoveries to unsecured creditors would be less than \$10.6 million.<sup>134</sup> The Plan provides a recovery of \$12.8 million for the unsecured creditors, which is greater than the amount the unsecured creditors would receive under a traditional waterfall plan.<sup>135</sup>

**1. Under The Debtors' Allocation Of Value,  
The Senior Noteholders Receive A Greater  
Recovery Than Required By The Bankruptcy Code.**

103. Hawaiian Telcom's analysis properly accounted for the scope of the Secured Parties' liens and the extent of recovery for the unsecured creditors.<sup>136</sup> Hawaiian Telcom allocated the going concern value of the encumbered assets, including intangibles, to the Secured Parties and allocated the going concern value of the unencumbered assets to the unsecured creditors.<sup>137</sup>

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133 Mandava Direct ¶ 4.

134 Mandava Direct ¶ 3; see also, . ¶ 166 infra.

135 Mandava Direct ¶ 5.

136 Mandava Direct ¶ 13.

137 Mandava Direct ¶¶ 15-16.

104. In order to allocate the value properly between the Secured Parties and the unsecured creditors, the Debtors first determined the scope of the liens held by the Secured Parties and determined that they had liens on substantially all of the Debtors' assets, except for certain categories of unencumbered assets.<sup>138</sup>
105. Under the Debtors' allocation of value, Lazard first calculated the total distributable value before emergence and then deducted \$33.1 million for unencumbered assets based on the Debtors' and their advisors' valuation of the unencumbered assets.<sup>139</sup>
106. Mr. Mandava testified that under a traditional waterfall, after determining the distributable value and subtracting the value of the unencumbered assets, the Secured Lenders would have an unsecured deficiency claim of \$154.5 million and the unsecured creditors would only recover \$10.6 million.<sup>140</sup> Mr. Schaeffer conceded, however, that the recovery due to unsecured creditors under a waterfall analysis would be even less, because the Secured

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<sup>138</sup> Mandava Direct ¶ 13; Nystrom Direct ¶¶ 22-23; November 13, 2009 Tr. at 16:7-12 (Schaeffer testimony) (recognizing certain aspects of the Secured Lenders' collateral package through estimate of value of the encumbered tangible assets); *id.* at 19:11-17 (recognizing certain aspects of the Secured Lenders' collateral package related to encumbered intangible assets).

<sup>139</sup> Mandava Direct ¶ 15.

<sup>140</sup> Mandava Direct ¶¶ 15-16.

Lenders are entitled, on account of their deficiency claim, to recover their pro rata share of the recovery of the Subordinated Noteholders pursuant to a subordination provision in the applicable indenture.<sup>141</sup>

**(a) The Declining Value Of The Collateral.**

107. The adequate protection payments the Debtors paid to the Secured Parties were warranted because the evidence demonstrates that the collateral securing the Secured Parties' claims has suffered and will continue to suffer diminution in value since the Petition Date.<sup>142</sup> The Committee did not provide evidence to effectively dispute this fact; rather, the Committee's expert conceded that the value of certain of Hawaiian Telcom's equipment has deteriorated since the Petition Date and that Hawaiian Telcom's investments in its network have not been sufficient to outweigh this deterioration.<sup>143</sup>
108. Furthermore, the evidence shows that relevant measures of the enterprise value of Hawaiian Telcom demonstrate a decline in Hawaiian Telcom's

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141 Schaeffer Direct ¶ 88 n. 18.

142 See *infra*, n. 251, 252.

143 Turner Direct ¶¶ 38-42, 45-46; November 12, 2009 Tr. at 130:22-131:16 (Turner testimony); *id.* at 137:15-18.

enterprise value since the Petition Date.<sup>144</sup> Specifically, Mr. Wilson testified that projected declines in certain relevant measures of Hawaiian Telcom's financial and operational performance from the Petition Date through the projected emergence date include (a) a decrease in number of access lines since the Petition Date, (b) a decrease in cash balance, (c) a decrease in last twelve months revenue, (d) a decrease in last twelve months EBITDA; and (e) a decrease in free cash flow.<sup>145</sup>

**2. Under The Alternative Methodology,  
The Senior Noteholders Receive A Greater  
Recovery Than Required By The Bankruptcy Code.**

109. Alternatively, Lazard conducted a separate analysis, whereby Hawaiian Telcom allocated the total distributable value (before emergence costs) between encumbered and unencumbered assets, based on the ratio of forced going concern sale values.<sup>146</sup>
110. This analysis also used the \$33.1 million midpoint of the unencumbered asset value range and Lazard's determination of enterprise value. Lazard discounted the going concern value of all assets based on a forced sale (except for cash which would not have a discounted value) under the

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144 Wilson Direct ¶¶ 9-15.

145 Wilson Direct ¶ 15.

146 Mandava Direct ¶ 18.

scenario that all assets were sold as a going concern.<sup>147</sup> Lazard applied the same forced going concern sale discount to the unencumbered assets, which would also be sold in a force sale scenario.<sup>148</sup>

111. Based on the alternative approach, the maximum value allocable to the unencumbered assets is \$32.2 million, which provides a total recovery of only \$10 million to the unsecured creditors. The Plan provides a total recovery to the unsecured creditors of \$12.8 million.<sup>149</sup>

**3. The General Unsecured Creditors' Recovery Is Appropriate.**

112. Under the Plan, the holders of unsecured claims that are not Class 5 or Class 6 claims will receive a recovery of between 1% and 2% on their claims. They will receive those payments in the form of cash distributions.
113. The presence of the \$500,000 cap ensures that the Debtors will have sufficient liquidity to fund distributions under the Plan and continue operations on the Effective Date.<sup>150</sup>
114. The unsecured creditors should be provided with cash pursuant to the Plan rather than warrants because these creditors would not receive any

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<sup>147</sup> Mandava Direct ¶ 18.

<sup>148</sup> Mandava Direct ¶ 18.

<sup>149</sup> Mandava Direct ¶ 19.

<sup>150</sup> Reich Direct ¶ 45.

meaningful distribution through warrants based on the size of their claims (Classes 7, 8, 11, 12, 13, and 14 having no expected allowable claims; Class 9 having expected allowable claims of approximately \$35 to \$45 million; and Class 10 having expected allowable claims of approximately \$5 million); and these trade creditors, who are situated differently than investors in the Debtors, would likely prefer a cash distribution instead of a distribution through warrants because warrants would require them to become investors in Reorganized Hawaiian Telcom.<sup>151</sup>

115. Moreover, the Classes that will receive cash distributions voted in favor of the Plan.<sup>152</sup>

**E. The Compensation Programs Were Developed And Proposed In Good Faith.**

116. In its Objection to the Plan, the Committee argued that the Debtors' management equity incentive program, which is part of the Plan (the "Management Equity Incentive Plan"), was proposed in bad faith.

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<sup>151</sup> Reich Direct ¶ 46.

<sup>152</sup> McGuire Direct ¶¶ 3, 12.

Docket No. 1407 Supplemental Written Direct Testimony of Sean McGuire Kurtzman Carson Consultants LLC ("McGuire Direct"). Mr. McGuire is a Senior Managing Consultant for Kurtzman Carson Consultants LLC ("KCC"). Mr. McGuire managed KCC's efforts to serve the Solicitation Packages consistent with the Solicitation Order. Mr. McGuire further managed the tabulation of voting results for all classes other than the Class 5 Senior Noteholders. McGuire Direct ¶ 3.

However, there were no objections or challenges to the 2009 incentive compensation program (the “2009 Incentive Program”) at the confirmation trial.

**1. The Reserve of New Common Stock for the Management Equity Incentive Program Is Appropriate.**

117. The Plan provides that 10% of the New Common Stock shall be reserved for a Management Equity Incentive Program (as defined in the Plan), which will be implemented by the board of directors of Reorganized Hawaiian Telcom.<sup>153</sup>

118. Reservation of 10% of the New Common Stock for the Management Equity Incentive Plan is reasonable.

**2. The 2009 Incentive Program Is Appropriate.**

119. The 2009 Incentive Program is a reasonable and necessary program for the Debtors. The 2009 Incentive Program covers all of Hawaiian Telcom’s non-sales workers, including Hawaiian Telcom’s union members and is necessary to incentivize Hawaiian Telcom’s non-commissioned workforce.<sup>154</sup>

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<sup>153</sup> November 9, 2009 Tr. at 89:24-90:13 (Nystrom testimony).

<sup>154</sup> November 9, 2009 Tr. at 91:4-8 (Nystrom testimony).

120. Under the 2009 Incentive Program, there are no guaranteed payments and the company must meet its target metrics before there is any payment. The financial performance relating to the 2009 Incentive Program has not yet been determined and any payments thereunder will not be made until 2010.<sup>155</sup>
121. The payments to senior management under the 2009 Incentive Program are necessary and appropriate. As part of the process to develop the 2009 Incentive Program, Towers Perrin reviewed the performance compensation provisions and analyzed the senior management's total compensation. Towers Perrin benchmarked the compensation against peers and with Towers' Perrin input, Hawaiian Telcom determined that senior management's compensation is at or below average. The 2009 Incentive Program is reasonable.<sup>156</sup>
122. Hawaiian Telcom presented the 2009 Incentive Program to the Court in the Spring of 2008 as part of its incentive compensation program and the 2009 Incentive Program was part of the Plan filed in the summer. While the Secured Lenders filed a "reservation of rights" before the confirmation trial, no party objected to the 2009 Incentive Program at the confirmation trial and

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<sup>155</sup> November 9, 2009 Tr. at 91:8-14 (Nystrom testimony).

<sup>156</sup> November 9, 2009 Tr. at 91:15-92:2 (Nystrom testimony).

the Debtors' evidence on the 2009 Incentive Program stands unrebutted. The Secured Lenders submitted their case at the close of the confirmation trial without raising any argument or contradicting any evidence on this topic.

**III. THE PLAN COMPLIES WITH ALL NECESSARY STATUTORY PROVISIONS.**

123. No party has contested the Plan's compliance with most of the provisions of section 1129 and the Debtors' evidence stands unrebutted and unchallenged. In those instances where the Committee challenged the statutory requirements, its evidence and arguments were unpersuasive.
124. The Committee's primary arguments may overlap with certain of the statutory requirements under section 1129 of the Bankruptcy Code detailed above. To the extent there is overlap, the evidence set forth supra is incorporated herein.<sup>157</sup>
125. Based upon these Findings of Fact and Conclusions of Law, the Plan satisfies the requirements for confirmation set forth in section 1129 of the Bankruptcy Code.

**A. The Court Has Jurisdiction And The Debtors Are Eligible For Relief.**

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<sup>157</sup> The capitalized terms used herein have the same meaning provided in the Plan.

126. The Court has jurisdiction over these chapter 11 cases pursuant to 28 U.S.C. §§ 157 and 1334. Venue is proper pursuant to 28 U.S.C. §§1408 and 1409. Confirmation is a core proceeding pursuant to 28 U.S.C. § 157(b) and this Court has exclusive jurisdiction to determine whether the Plan complies with the applicable provisions of the Bankruptcy Code and should be confirmed.
127. The Debtors were and are entities eligible for relief under section 109 of the Bankruptcy Code.
128. The Court takes judicial notice of the docket of the chapter 11 cases maintained by the Clerk of the Court, including, without limitation, all pleadings and other documents filed and orders entered thereon. The Court also takes judicial notice of all evidence proffered or adduced and all arguments made at the hearings held before the Court during the pendency of the chapter 11 cases.

**B. The Debtors' Plan Complies With Section 1129(a)(1) of the Bankruptcy Code.**

129. The Plan complies with all applicable provisions of the Bankruptcy Code as required by section 1129(a)(1) of the Bankruptcy Code, including, without limitation, sections 1122 and 1123 of the Bankruptcy Code.

**1. Proper Classification (11 U.S.C. §§ 1122 And 1123(a)(1)).**

130. The classification of Claims and Interests under the Plan is proper under the Bankruptcy Code. Pursuant to sections 1122(a) and 1123(a)(1) of the