

KIRKLAND & ELLIS
Citigroup Center
153 East 53rd Street
New York, New York 10022-4675
Telephone: (212) 446-4800
Facsimile: (212) 446-4900
Matthew A. Cantor (MC-7727)
Jonathan S. Henes (JH-1979)

Attorneys for Debtors and Debtors in Possession

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

	X	
In re	:	
	:	Chapter 11 Case No.
Allegiance Telecom, Inc., <u>et al.</u> ,	:	03-_____ ()
	:	
Debtors.	:	Jointly Administered
	X	

**APPLICATION OF THE DEBTORS PURSUANT TO
SECTIONS 327(a) AND 328(a) OF THE BANKRUPTCY
CODE SEEKING ENTRY OF AN ORDER AUTHORIZING
THE EMPLOYMENT AND RETENTION OF
KIRKLAND & ELLIS AS ATTORNEYS FOR THE DEBTORS**

TO THE HONORABLE UNITED STATES BANKRUPTCY JUDGE:

Allegiance Telecom, Inc. and its direct and indirect subsidiaries, as debtors and debtors in possession (collectively, “Allegiance” or the “Debtors”), respectfully represent:

Introduction

1. On the date hereof (the “Commencement Date”), the Debtors each commenced with this Court a voluntary case under chapter 11 of title 11, United States Code (the “Bankruptcy Code”). The Debtors are authorized to operate their businesses and manage their properties as debtors in possession pursuant to sections 1107 and 1108 of the Bankruptcy Code. Simultaneously with the filing of their petitions and this Application, the Debtors requested an

order for the joint administration of their chapter 11 cases pursuant to Federal Rule of Bankruptcy Procedure 1015(b) (the “Bankruptcy Rules”).

Jurisdiction

2. This Court has subject matter jurisdiction to consider and determine this Application pursuant to 28 U.S.C. § 1334. This is a core proceeding within the meaning of 28 U.S.C. § 157(b). Venue is proper before this court pursuant to 28 U.S.C. §§ 1408 and 1409.

An Overview of Allegiance’s Business

3. Allegiance is a facilities-based national local exchange carrier that provides integrated telecommunications products and services to small and medium-sized business customers, large businesses (i.e., national customers with multiple locations), governmental entities, wholesale customers and other institutional users. Allegiance offers its customers a variety of services, including:

- local and long distance voice services, including basic telephone services and advanced calling features;
- broadband and other Internet and data services, including high-speed Internet access, wide area network interconnection, domain name registration, web hosting, email and colocation services;
- integrated local long distance/Internet access offerings, which provide customers with integrated voice and Internet access over a single broadband line;
- wholesale services to other regional and national service providers, including equipment colocation, managed modem ports and Internet protocol traffic aggregation; and
- customer premise equipment sales and maintenance services.

4. Allegiance serves more than 100,000 business customers in 36 markets. Allegiance employs approximately 3,560 people, of which approximately 97 employees are covered by collective bargaining agreements.

5. As of the Commencement Date, the Debtors have approximately \$245 million of cash. As of December 31, 2002, the Debtors' consolidated books and records reflected assets totaling approximately \$1.441 billion and liabilities totaling approximately \$1.397 billion. For the three months ending December 31, 2002, the Debtors, on a consolidated basis, reported revenues of approximately \$204.91 million, EBITDA (i.e., earnings before interest, depreciation, taxes, amortization, non-cash deferred compensation expense and non-cash goodwill impairment charges) of approximately negative \$34 million and net losses of approximately \$120 million.

**Allegiance is Critical to Promoting Sustainable
Competition in the Local Telecommunication Marketplace**

The Telecommunications Act of 1996

6. In February of 1996, Congress enacted the Telecommunications Act of 1996 (the "Telecom Act"), with the stated purpose of:

promot[ing] competition and reduc[ing] regulation in order to secure lower prices and higher quality services for American telecommunications consumers and encourage the rapid deployment of new telecommunications technologies.

H.R. REP No. 104-204(I), 104th Cong. 1st Sess. 1995 (July 24, 1995), reprinted in 1996 U.S.C.C.A.N. 10, **10. In that regard, the Telecom Act required Incumbent Local Exchange Carriers, including the Regional Bell Operating Companies ("ILECs") – i.e., existing telecommunications monopolies – to allow newly created Competitive Local Exchange Carriers ("CLECs") to (a) interconnect with the ILECs, (b) access portions of the ILEC network and (c) collocate their equipment in ILEC facilities all at forward-looking cost based rates. In addition, CLECs were permitted to purchase ILEC services at wholesale prices and resell them to customers at retail prices.

7. The enactment of the Telecom Act spurred entrepreneurs to start hundreds of new businesses to compete in the local telecommunications marketplace. During the late

1990s, investors recognized the growth opportunity inherent in the opening of a competitive local telecommunications marketplace and invested billions of dollars in equity and debt capital into a multitude of telecommunications companies primed to provide competing services to American consumers.

8. Funded with significant amounts of investment capital, two types of CLECs emerged. The first type of CLECs were “resellers”. Specifically, “reseller” CLECs purchased telecommunications services from ILECs at a discount and resold the services to customers at a higher price. Thus, these CLECs simply offered consumers the same services supplied by ILECs - generally at lower prices. To be successful with this low margin business model, “reseller” CLECs invested their capital in sales and marketing efforts designed to acquire a substantial customer-base and attendant market-share in a relatively short period of time and ahead of their many competitors. However, because resellers were providing the identical services as the ILECs (with no differentiation) and were attempting to build a large market share in a highly competitive market, this business model was flawed and many in the telecommunications industry believe that the “resale” business will fail.

9. The second type of CLECs were “facilities-based” CLECs. These CLECs invested significant sums of money to build their own proprietary infrastructure and network in order to effectively compete with the ILECs. Specifically, facilities-based CLECs combined elements of an ILEC’s network with their own to provide consumers with true differentiated services. As Michael Powell stated in his partial dissent to the FCC’s 2003 Triennial Review:

Facilities -based competition means a competitor can offer real differentiated service to consumers Facilities-based competitors own more of their own network and control more of their costs, thereby offering consumers real potential for lower prices. Facilities-based competitors offer greater rewards for the economy – buying more equipment from other suppliers . . . and

creating more jobs. . . . And, facilities providers create vital redundant networks that can serve own nation if other facilities are damaged by those hostile to our way of life.

F.C.C., 2003 Triennial Review - Open Meeting, Separate Statement of Chairman Michael R. Powell, dissenting in part (February 20, 2003) (transcript available at www.fcc.gov/wcb/cpd/triennial_review/). Allegiance is such a facilities-based CLEC with a nationwide network and a facility-based business strategy.

The Allegiance Nationwide Network – Servicing 36 Metropolitan Areas

10. In 1997, a management team of industry veterans launched Allegiance and focused on building a reliable nationwide network based on proven technologies, a nationwide direct sales force primarily focused on the small to medium sized business enterprise and information processing systems to support its operations. Allegiance was one of the first major local exchange carriers to open markets utilizing the “smart build” strategy. This strategy allowed a more rapid ramp-up in operations than the traditional competitive local exchange model in which extensive networks were built, including fiber networks, prior to the generation of significant revenues. In contrast, Allegiance’s initial network build-out simply required (a) deploying digital switching platforms with local and long distance capability and (b) leasing transport facilities from the incumbent local exchange carriers and other competitive local exchange carriers to connect its switches with its transmission equipment colocated in the incumbent local exchange carrier’s central offices. Once traffic volume justified further “success-based” investment, Allegiance leased dark fiber or built specific network segments. This strategy offered two major economic benefits. First, it enabled Allegiance to enter new markets with alacrity and reduce up-front capital requirements for entering individual markets prior to revenue generation. Second, in contrast to the traditional competitive local exchange carriers that generally built their networks in highly concentrated downtown areas due to the high

cost of constructing fiber networks, Allegiance's business model enabled it to provide services to customers in downtown areas as well as the more geographically dispersed, less competitive areas of its targeted markets.

11. Allegiance's initial business plan proposed entering into 24 of the largest metropolitan areas in the United States. Subsequently, management expanded its business plan to (a) increase the total number of target markets to 36, (b) increase its service area, i.e., its colocation "footprint" in its original 24 markets, and (c) acquire long-term rights to use dark fiber rings to replace network elements leased by the Debtors from the incumbent local exchange carriers.

12. In addition to internal growth, Allegiance's business plan included growth through strategic acquisitions. For example, in December 2001, Allegiance acquired certain assets of Intermedia Business Internet (the "Intermedia Acquisition"). The Intermedia Acquisition enabled Allegiance to (a) become a Tier 1 Internet access provider, (b) provide large quantities of data transmitted at high-speeds over the Internet to and from a customer's premises, (c) efficiently exchange traffic with other Internet backbone providers giving Allegiance greater control over its Internet access, and (d) leverage its local service presence to provide additional services to its target market. In June 2003, Allegiance acquired certain assets of Shared Technologies (the "Shared Technologies Acquisition"). The Shared Technologies Acquisition (a) added customer premises equipment sales, installation and maintenance to Allegiance's portfolio of integrated products and services, (b) strategically enhanced Allegiance's target market of small to medium size business enterprises, and (c) allowed Allegiance to provide a complete communications solution to business customers.

13. As of the date hereof, Allegiance provides its telecommunications services in major metropolitan areas across the United States, including the following 36 markets: Atlanta,

Austin, Baltimore, Boston, Chicago, Cleveland, Dallas, Denver, Detroit, Fort Lauderdale, Fort Worth, Houston, Long Island, Los Angeles, Miami, Minneapolis/St. Paul, New York City, Northern New Jersey, Oakland, Ontario/Riverside, CA, Orange County, Philadelphia, Phoenix, Pittsburgh, Portland, Sacramento, St. Louis, San Antonio, San Diego, San Francisco, San Jose, Seattle, Tampa, Washington, D.C., West Palm Beach/Boca Raton and White Plains. Allegiance is colocated in 849 central offices and has a Tier 1 Internet backbone.

The FCC Recognizes the Importance of Allegiance

14. Federal policy recognizes the importance of facilities-based CLECs and Allegiance is the model. In that regard, the Federal Communications Commission (the “FCC”) recently published its latest rules for local competition in the *FCC Triennial Review*. In reviewing these rules, a Kaufman Bros. Equity Research Report, dated March 4, 2003, stated that “*Allegiance is the blueprint for local competition proposed by the FCC.*” In addition, Kevin J. Martin, Commissioner of the FCC has noted:

Allegiance has focused on building a business that adheres to the letter of the Telecom Act while leveraging the entrepreneurial spirit of the law, as well. Today, Allegiance stands as a model of what Congress intended in 1996, and what we hope to achieve in the years ahead – new entrants that have the opportunity to continue to invest in infrastructure, bring innovation and offer new service offerings to consumers in local markets that are open to fair and robust competition.

Kevin J. Martin, Commissioner, F.C.C., Address to the Telecommunications Law Conference and the Texas Chapter of the Federal Communications Bar Association (March 7, 2002) (transcript available at www.fcc.gov/Speeches/Martin/2002/spkjm203.html).

15. Thus, it is clear that Allegiance, by focusing on an intelligent – well thought out business model – building its own network and offering its consumers innovative services, is an integral player in the telecommunications marketplace and a model for the

nation's policy of promoting sustainable facilities-based competition in the local telecommunications arena. With an appropriate capital structure and a reduction in unnecessary costs, Allegiance believes it will be one of the most successful telecommunications companies in the United States.

Capital Structure of the Debtors

Capital Stock

16. Allegiance Telecom, Inc. has two classes of authorized stock: (a) 750,000,000 shares of common stock, with par value of \$0.01 per share and (b) 1,000,000 shares of preferred stock, with par value of \$0.01 per share. As of December 31, 2002, Allegiance Telecom, Inc. had (i) 124,830,110 shares of common stock issued and outstanding, with 295 registered holders and at least 20,000 beneficial owners, and (ii) no shares of preferred stock outstanding. Allegiance Telecom, Inc.'s common stock is publicly traded on the Nasdaq National Market under the symbol "ALGX."

17. Allegiance Telecom, Inc. owns 100% of the capital stock of Allegiance Telecom Company Worldwide ("ATCW"), and ATCW directly or indirectly owns 100% of the capital stock of each of the other Debtors.

Prepetition Notes

18. In 1998, Allegiance Telecom, Inc. issued two series of notes: (i) 11 3/4% Senior Discount Notes with a face value of \$445 million, due on February 15, 2008 (the "Senior Discount Notes") and (ii) 12 7/8% Senior Notes with a face value of \$205 million, due on May 15, 2008 (the "Senior Notes"). The Senior Discount Notes were issued under that certain Indenture, dated as of February 3, 1998, between Allegiance Telecom, Inc. and The Bank of New York, as Indenture Trustee. The Senior Notes were issued under that certain Indenture, dated as of July 7, 1998, between Allegiance Telecom, Inc. and The Bank of New York, as

Indenture Trustee. Neither the Senior Discount Notes nor the Senior Notes are secured by any assets of the Debtors or guaranteed by any of the Debtors.

Prepetition Credit Agreement

19. Prior to the Commencement Date, ATCW entered into that certain Credit and Guaranty Agreement, dated as of February 15, 2000, as amended as of November 27, 2002 (the “Prepetition Credit Agreement”), among ATCW, as borrower; all of the other Debtors, as guarantors; Goldman Sachs Credit Partners L.P. (“Goldman Sachs”), as syndication agent and sole lead arranger; General Electric Capital Corporation (“GECC”) (as successor to Toronto Dominion (Texas), Inc.), as administrative agent, BankBoston, N.A. (“BankBoston”) and Morgan Stanley Senior Funding, Inc. (“Morgan Stanley”), as co-documentation agents; Goldman Sachs, GECC, BankBoston, Morgan Stanley, certain managing agents, and lenders party thereto from time to time (collectively, the “Prepetition Lenders”). As of the Commencement Date, the amount outstanding under the Prepetition Credit Agreement was approximately \$465.3 million. The Debtors have pledged substantially all of their assets as collateral under the Prepetition Credit Agreement, including (a) the capital stock of ATCW and (b) substantially all of the assets of ATCW and its direct and indirect subsidiaries, including the capital stock owned by ATCW in each of its Debtor subsidiaries. As of the Commencement Date, there were 27 Prepetition Lenders under the Prepetition Credit Agreement.

Events Leading to Chapter 11 Filing

20. The distressed economic environment in the United States that followed the economic boom of the late 1990s has had a global and adverse impact on the telecommunications industry. In the late 1990s, in an effort to finance operations and build their networks, telecommunications companies borrowed significant amounts of money from lenders and the public through the issuance of debt. The resulting significant indebtedness incurred by

telecommunications companies, combined with poor economic conditions required many companies, including the Debtors, to focus on reducing their debt either through out of court restructurings or the chapter 11 process.

21. Many of Debtors' existing and potential customers have experienced their own financial difficulties, thereby decreasing customer demand for existing and new services. The financial difficulties of the Debtors' customers has led to non-payment, partial payment, or slow payment of bills for services provided by the Debtors. The financial instability of other companies in the telecommunications industry has adversely affected the willingness of potential customers to move their telecommunications services to the Debtors. In addition, certain of the Debtors' suppliers have requested deposits, letters of credit, or other types of security. Moreover, telecommunications carriers that owe reciprocal and/or intercarrier compensation to the Debtors have either refused to pay or failed to pay in a timely manner for the services provided by the Debtors.

22. As a consequence of the foregoing, the Debtors' business operations were adversely impacted and, due to revenue trends and continuing negative EBITDA, the Debtors determined that their current level of indebtedness needed to be significantly reduced. Thus, in order to maximize the long-term wealth generating capacity of their business operations, the Debtors, among other things, (a) established a special restructuring committee of the Board of Directors of Allegiance Telecom, Inc., (b) retained restructuring advisors, and (c) commenced extensive negotiations with their senior lenders and bondholders, as detailed below.

Negotiations with the Prepetition Lenders and the Ad Hoc Committee of Bondholders

23. The Debtors, in the exercise of their sound business judgment - and in recognition of the distressed economic environment and the need for the Debtors' businesses to focus on profitability instead of high revenue growth - determined that a meaningful de-

leveraging of their capital structure was crucial for the preservation and maximization of the value of their businesses. In that regard, the Debtors, in conjunction with their financial advisors and the Board of Directors of Allegiance Telecom, Inc., commenced the process of determining the appropriate capital structure for their business operations. After determining the appropriate capital structure, the Debtors commenced negotiations with the Prepetition Lenders and the Ad Hoc Committee (as defined below) to effectuate a restructuring transaction.

24. In October of 2002, Allegiance began negotiations with its Prepetition Lenders regarding a potential restructuring of its long-term debt. On November 27, 2003, Allegiance and its Prepetition Lenders entered into that certain First Amendment to the Prepetition Credit Agreement (the “Amendment”). Pursuant to the Amendment, the Debtors obtained a moratorium on their financial covenants through April 30, 2003. In exchange for the Amendment, Allegiance agreed, among other things, (a) that an event of default would occur on April 30, 2003 unless it reduced its long term debt to a level not to exceed \$645 million, and (b) to repay \$15 million to the Prepetition Lenders on account of debt owed under the Prepetition Credit Agreement. During the latter part of 2002 and to meet covenants under the Amendment, the Debtors significantly lowered their capital expenditures, reduced headcount, substantially decreased growth, eliminated less profitable products and services, and continued to optimize their existing network assets.

25. After entering into the Amendment, the Debtors commenced negotiations with the Prepetition Lenders to consummate a permanent restructuring. In connection with the negotiations regarding the permanent restructuring, the Debtors commenced negotiations with an *ad hoc* committee of noteholders, which is comprised of certain holders of the Senior Notes and the Senior Discount Notes (the “Ad Hoc Committee”).

26. The Debtors, the Prepetition Lenders and the Ad Hoc Committee were not able to reach an agreement concerning the permanent restructuring prior to the April 30 deadline. On April 29, 2003, in order to avoid the occurrence of certain events of default under the Prepetition Credit Agreement, the Debtors and the Prepetition Lenders entered into a forbearance agreement (the “Forbearance Agreement”), which expires on May 15, 2003. The Forbearance Agreement provided for, among other things, a pay down of \$5 million of principal owed under the Prepetition Credit Agreement.

27. After entering into the Forbearance Agreement, the Debtors continued their negotiations with the Prepetition Lenders and the Ad Hoc Committee. However, the parties were unable to reach an agreement prior to the expiration of the term of the Forbearance Agreement. Consequently, the Debtors, in the exercise of their prudent business judgment, determined that it was in the best interests of all of their stakeholders and for the maximization of the value of their businesses to commence these chapter 11 cases and consummate a restructuring of their indebtedness under the auspices of this Court.

The Retention of Kirkland & Ellis

28. The Debtors seek court approval, pursuant to section 327(a) of the Bankruptcy Code, to employ and retain Kirkland & Ellis (“K&E”) as their attorneys in connection with the commencement and prosecution of these chapter 11 cases. Pursuant to section 328(a) of the Bankruptcy Code, the Debtors request that the Court approve the retention of K&E, under a general retainer, as their attorneys, to perform the extensive legal services that will be necessary during these chapter 11 cases in accordance with K&E’s normal hourly rates and policies in effect when K&E renders the services or incurs the expenses.

29. Contemporaneously herewith, the Debtors are seeking authorization to retain Togut, Segal & Segal (“TSS”) to represent the Debtors in all matters in which K&E may have conflicts in its representation of the Debtors in these chapter 11 cases.

30. The Debtors have been informed that Matthew A. Cantor and Jonathan S. Henes, partners at K&E, as well as other partners of, counsel to and associates of K&E, who will be employed in these chapter 11 cases, are members in good standing of, among others, the Bar of the State of New York and the United States District Court for the Southern District of New York.

31. The Debtors have selected K&E as their attorneys because of the firm’s knowledge, and in particular, its recognized experience of the Debtors’ business and financial affairs and its extensive general experience and knowledge in the field of debtors’ protections and creditors’ rights and business reorganizations under chapter 11 of the Bankruptcy Code. K&E has represented the Debtors in corporate and litigations matter since 1997 and in restructuring matters since September, 2002.

32. In addition, K&E possesses extensive expertise, experience and knowledge practicing before bankruptcy courts (including this Court). K&E has been actively involved in major chapter 11 cases, and has represented debtors in many cases, including In re Fleming Companies, Inc., Case No. 03-10945 (Bankr. D. Del. April 1, 2003); In re Conseco, Inc., Case No. 02-49672 (Bankr. N.D. Ill. Dec. 17, 2002); In re UAL Corporation, Case No. 02-48191 (Bankr. N.D. Ill. Dec. 9, 2002); In re Dade Behring Holdings, Inc., Case No. 02-290201 (Bankr. N.D. Ill. Aug. 1, 2002); In re Polymer Group, Inc., Case No. 02-05773 (Bankr. D.S.C. May 11, 2002); In re Chiquita Brands International, Inc., Case No. 01-18812 (Bankr. S.D. Ohio Nov. 28, 2001); In re Quality Stores, Inc., Case No. 01-10662 (Bankr. W.D. Mich. Oct. 20,

2001); In re Homelife Corp., Case No. 01-02412 (Bankr. D.Del. July 16, 2001); In re Teligent, Inc., Case No. 02-12974 (Bankr. S.D.N.Y. June 18, 2001); In re Humphrey's Inc., Case No. 01-13742 (Bankr. N.D. Ill. Apr. 17, 2001); In re Trans World Airlines, Inc., Case No. 01-00056 (Bankr. D. Del. filed Jan. 10, 2001); In re United Artists Theatre Co., Case No. 00-03514 (Bankr. D. Del. Sept. 5, 2000); In re AmeriServe Food Distrib., Inc., Case No. 00-00358 (Bankr. D. Del. Jan. 31, 2000); In re Zenith Elec. Corp., Case No. 99-02911 Bankr. D. Del. Aug. 23, 1999); In re Harnischfeger Indus., Inc., Case No. 99-02171 (Bankr. D. Del. June 7, 1999).

33. In connection with its representation of the Debtors prior to and with respect to the commencement of these chapter 11 cases, K&E has become intimately familiar with their businesses, affairs and capital structure. Accordingly, K&E has the necessary background to deal effectively with many of the potential legal issues that may arise in the context of the Debtors' chapter 11 cases. The Debtors believe that K&E is both well qualified and uniquely able to represent them in their chapter 11 cases in a most efficient and timely manner.

34. If the Debtors were required to retain attorneys other than K&E to assist the Debtors in the prosecution of these chapter 11 cases, the Debtors, their estates and all parties in interest would be unduly prejudiced by the time and expense necessarily attendant to such attorneys' familiarization with the intricacies of the Debtors and their business operations.

35. The employment of K&E under a general retainer is appropriate and necessary to enable the Debtors to execute faithfully their duties as debtors and debtors in possession and to implement the restructuring and reorganization of the Debtors.

Services to be Provided

36. Subject to the Court's approval, the professional services that K&E will render to the Debtors may include, but shall not be limited to, the following:

- a. advise the Debtors with respect to their powers and duties as debtors in possession in the continued management and operation of their businesses and properties;
- b. attend meetings and negotiate with representatives of creditors and other parties in interest;
- c. take all necessary action to protect and preserve the Debtors' estates, including prosecuting actions on the Debtors' behalf, defending any action commenced against the Debtors and representing the Debtors' interests in negotiations concerning litigation in which the Debtors are involved, including, but not limited to, objections to claims filed against the estates;
- d. prepare on the Debtors' behalf all motions, applications, answers, orders, reports and papers necessary to the administration of the estates;
- e. negotiate and prepare on behalf of the Debtors a plan of reorganization and all related documents;
- f. represent the Debtors in connection with obtaining postpetition loans;
- g. advise the Debtors in connection with any potential sale of assets;
- h. appear before this Court and any appellate courts and protect the interests of the Debtors' estates before these Courts;
- i. consult with the Debtors regarding tax matters; and
- j. perform all other necessary legal services and provide all other necessary legal advice to the Debtors in connection with these chapter 11 cases.

37. K&E has stated its desire and willingness to act in these chapter 11 cases and render the necessary professional services as attorneys for the Debtors. To the best of the Debtors' knowledge, the partners and associates of K&E do not have any connection with or any interest adverse to the Debtors, their creditors or any other party in interest, or their respective attorneys and accountants, except as may be set forth in the affidavit of Matthew A. Cantor, a partner of K&E, dated May 14, 2003 (the "Cantor Affidavit"), which is annexed hereto as Exhibit "A." As such, K&E is a "disinterested person," as that phrase is defined in section 101(14) of the Bankruptcy Code and as modified by section 1107(b) of the Bankruptcy Code,

and K&E's employment is necessary and in the best interests of the Debtors and the Debtor's estates.

38. As described more fully in the Cantor Affidavit, Madison Dearborn Capital Partners II, L.P. and/or certain of its affiliates ("Madison Dearborn") are equity security holders of the Debtors. In addition, Morgan Stanley Investment Management and/or certain of its affiliates ("Morgan Stanley") are equity security holders and bondholders of the Debtors. K&E currently represents both Madison Dearborn and Morgan Stanley in matters unrelated to the Debtors. For the fiscal year April 1, 2002 through March 31, 2003, Madison Dearborn represented approximately 2.26% of K&E's gross revenues and Morgan Stanley represented approximately 3.70% of K&E's gross revenues. In addition, three other creditors of the Debtors and their affiliates account for between .99% to 1.5% of K&E's gross revenue for that same period: specifically, (i) Bank of America and its subsidiaries ("Bank of America") (approximately 0.99%); (ii) Citicorp and its subsidiaries ("Citicorp") (approximately 1.30%) and (iii) Verizon and its subsidiaries ("Verizon") (approximately 1.31%).

39. K&E will not represent Madison Dearborn, Morgan Stanley, Bank of America, Citicorp, or Verizon (the "Conflicts Parties") in any matters relating to the Debtors. In addition, K&E will not represent the Debtors in any matter relating to the Conflicts Parties. As stated above, TSS will represent the Debtors in any and all matters related to the Conflicts Parties and with other conflicts that may arise in connection with K&E's representation of the Debtors in these chapter 11 cases.

40. K&E is not a creditor of the Debtors. During the twelve (12) month period prior to the Commencement Date, K&E received from the Debtors an aggregate of \$1,708,956.84 for professional services performed and to be performed and expenses incurred

and to be incurred, including advance payments in the amount of \$1,244,928.78 (the “Advance Payments”) for professional services performed and to be performed and expenses incurred and to be incurred in connection with these chapter 11 cases. Other than the Advanced Payments, all payments received by K&E from the Debtors have been in made in the ordinary course of business of K&E, in the ordinary course of business of the Debtors, and consistent with prior dealings between the Debtors and K&E. K&E has used the Advance Payments to credit the Debtors’ account for K&E’s estimated charges for professional services performed and expenses incurred up to the time of the commencement of these chapter 11 cases and has reduced the balance of the credit available to the Debtors by the amount of such charges. As of the Commencement Date, K&E has a remaining credit balance in favor of the Debtors for future professional services to be performed, and expenses to be incurred, in the approximate amount of \$600.000, subject to processing of all time and disbursements up to the commencement of these chapter 11 cases.

41. The Debtors understand that, during these chapter 11 cases, K&E intends to apply to the Court for allowances of compensation and reimbursement of actual and necessary expenses in accordance with the applicable provisions of the Bankruptcy Code, the Bankruptcy Rules, the Local Rules for the Southern District of New York (the “Local Bankruptcy Rules”), guidelines establishing the office of the United States Trustee of for the Southern District of New York (the “United States Trustee”), and orders of this Court for all services performed and expenses incurred after the Commencement Date.

42. Pursuant to section 328(a) of the Bankruptcy Code, the Debtors may retain K&E on any reasonable terms and conditions. The Debtors submit that the most reasonable terms and conditions are those charged by K&E to the Debtors and other clients on a daily basis

in a competitive market for legal services. Therefore, the Debtors and K&E have agreed that K&E shall be paid its customary hourly rates for services rendered that are in effect from time to time, as set forth in the Cantor Affidavit, and shall be reimbursed according to K&E's customary reimbursement policies.

43. The Debtors seek approval of the Application on an interim basis in order to provide parties an opportunity to object to the relief requested herein. If the Court approves the Application, and no objections are timely filed, the Debtors' request that the Application be deemed granted on a final basis without further notice or hearing.

Waiver of Memorandum of Law

44. Because there are no novel issues of law presented herein, the Debtors respectfully request that the Court waive the requirement that the Debtors file a memorandum of law in support of this Application pursuant to Local Bankruptcy Rule 9013-1(b).

Notice

45. Notice of this Application has been provided to: (a) the Office of the United States Trustee for the Southern District of New York; (b) attorneys for the Prepetition Lenders; and (c) attorneys for the Ad Hoc Committee. In light of the nature of the relief requested herein, the Debtors submit that no other or further notice is required.

No Prior Request

46. No prior application for the relief requested herein has been made to this or any other Court.

WHEREFORE, the Debtors respectfully request that the Court enter an order, substantially in the form attached hereto, authorizing the Debtors to employ and retain K&E as attorneys for the Debtors effective as of the Commencement Date and granting such further relief as is just and proper.

Dated: New York, New York
May 14, 2003

By: /s/ Mark B. Tresnowski
Name: Mark B. Tresnowski
Title: Executive Vice President,
General Counsel and Secretary