

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	

**MOTION FOR ENTRY OF (I) INTERIM AND FINAL ORDERS
AUTHORIZING THE DEBTORS TO (A) USE CASH COLLATERAL AND (B)
PROVIDE ADEQUATE PROTECTION TO PREPETITION LENDERS AND (II) AN
ORDER SCHEDULING A FINAL HEARING PURSUANT TO BANKRUPTCY RULE 4001**

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 Motion, the Debtors requested an order

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

Jurisdiction

2. This Court has subject matter jurisdiction to consider and determine this Motion 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, taxes, depreciation, 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 (as successor to Toronto Dominion (Texas), Inc.), as administrative agent (the “Agent”), BankBoston, N.A. (“BankBoston”) and Morgan Stanley Senior Funding, Inc. (“Morgan Stanley”), as co-documentation agents; Goldman Sachs, the Agent, 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.

Relief Requested

28. By this Motion, the Debtors seek entry of an order, pursuant to sections 105, 361 and 363 of the Bankruptcy Code and Bankruptcy Rules 2002, 4001 and 9014:

- (a) authorizing the Debtors, pursuant to section 363(c) of the Bankruptcy Code, to use Cash Collateral (as defined below);
- (b) authorizing the Debtors, pursuant to sections 361 and 363 of the Bankruptcy Code, to provide adequate protection to the Prepetition Lenders with respect to any diminution in value of the Prepetition Lenders’ interests in the Collateral (as defined below) whether from the use of the Cash Collateral or the use, sale, lease, depreciation, decline in market price or otherwise of the Collateral; and
- (c) scheduling a final hearing on this Motion (the “Final Hearing”), pursuant to Bankruptcy Rule 4001, no later than twenty (20) days

after the entry of the interim order, to consider entry of a final order authorizing the use of Cash Collateral and approving the notice procedures in respect of the Final Hearing.

The Prepetition Financing

29. As set forth above, prior to the Commencement Date, the Debtors, to finance their operations, entered into the Prepetition Credit Agreement. As of the Commencement Date, the total amount outstanding under the Prepetition Credit Agreement was approximately \$465.3 million.

30. The Prepetition Credit Agreement is collaterally secured by liens upon and security interests in substantially all of the Debtors' assets (collectively, the "Collateral"). Substantially all of the cash and cash equivalents held by the Debtors constitute "cash collateral," as defined in section 363(a) of the Bankruptcy Code, of the Prepetition Lenders ("Cash Collateral").¹

Immediate Need For Use of Cash Collateral

31. An immediate need exists for the Debtors to be able to use Cash Collateral. As of the Commencement Date, the Debtors have only a limited amount of unencumbered cash and this unencumbered cash is not sufficient to fund the Debtors' business operations. Of course, cash is the lifeblood of the Debtors' business operations. In that regard, absent the ability to use Cash Collateral, the Debtors will not be able to pay insurance, wages, rent, utility charges and other operating expenses. Consequently, without access to Cash Collateral, the Debtors will not be able to maintain their business operations and continue their

¹ As set forth below, the Debtors have approximately \$26 million in cash (the "Disputed Amount") in Account #343605, which is an interest bearing account, at JPMorgan Chase Bank (the "Disputed Account"). The Debtors dispute the Agent's asserted security interest in the Disputed Account. Until further Order of this Court, the Debtors will maintain the Disputed Amount and all interest related thereto in the Disputed Account and not use such cash. The Debtors reserve their right to file an action to avoid any asserted security interest in the Disputed Amount or the Disputed Account and the Lenders reserve their right to defend, object or otherwise respond to any such action.

restructuring efforts. Accordingly, the Debtors' estates would be immediately and irreparably harmed.

32. If the Debtors are unable to obtain sufficient operating liquidity to meet their postpetition obligations on a timely basis, a permanent and irreplaceable loss of business will occur, causing a loss of value to the detriment of the Debtors and their creditors. This potential loss of sales and going concern value would be extremely harmful to the Debtors, their estates and their creditors at this critical juncture. The Debtors cannot obtain funds sufficient to administer their estates and operate their businesses other than by obtaining the relief requested herein pursuant to section 363 of the Bankruptcy Code.

Summary of Proposed Terms and Conditions for the Use of Cash Collateral

A. Budget

33. The Debtors' management has formulated a budget for the use of Cash Collateral from the Commencement Date through August 8, 2003 (collectively, the "Budget"), which Budget shall be updated by no later than the date of the Final Hearing, and thereafter the Budget shall be updated monthly to maintain a full 13 week forecast period. A true and correct copy of the Budget is annexed to the proposed form of the order, approving the relief requested in this Motion on an interim basis (the "Interim Order"), as Exhibit "B." The Debtors believe that the Budget includes all reasonable, necessary and foreseeable expenses to be incurred in the ordinary course in connection with the operation of their businesses for the period set forth in the Budget. The Debtors also believe that the use of Cash Collateral in accordance with the Budget will provide the Debtors with adequate liquidity to pay administrative expenses as they become due and payable during the period covered by the Budget.

34. The Prepetition Lenders have consented to the Debtors' use of Cash Collateral in the ordinary course of business in accordance with the Budget and subject to the express terms and conditions set forth in the Interim Order; provided, however, that any Cash Collateral received on account of or from the Collateral in excess of that needed to conduct the Debtors' businesses, as set forth in the Budget, is to be retained by the Debtors where the Debtors currently maintain accounts to which the Agent's liens and claims for the benefit of itself and the Prepetition Lenders shall attach. In addition, the Debtors agreed not to transfer any additional funds into the Disputed Account.

35. Subject to the terms and conditions of the Interim Order, the Debtors may use the Cash Collateral to pay their ordinary and necessary business expenses as set forth on the Budget; provided, however; that such use shall not be in excess of cash on hand, collections actually received in connection with accounts, disposition of inventory, and sales of approved Collateral existing on the Commencement Date and generated thereafter. The Debtors believe that the Budget includes all reasonable, necessary, and foreseeable expenses to be incurred in the ordinary course of business in connection with the operation of their businesses for the period set forth in the Budget. In no event shall the Debtors use any Cash Collateral to pay, in the aggregate, any amounts in excess of the Total Weekly Disbursements, as provided for in the Budget as the cumulative disbursements for such week (the "Total Weekly Disbursements") provided, however, budgeted amounts not used in any one week may be carried forward in the Budget, with the exception of payroll, to be used by the Debtors in subsequent weeks. The Amounts disbursed for Capital Expenditures shall not exceed the capital expenditure line item in the Budget each week, inclusive of any Capital Expenditure carry forward amounts. Further, amounts disbursed for payroll shall not exceed the payroll line item in the Budget by more than 10% in each week and any unused amount in each payroll line item may not be carried forward.

The Debtors shall not pay an expense in advance of the week in which a particular expense is scheduled to be paid, except for incidental items not greater than \$50,000.

36. The Debtors further agreed not to incur any administrative expenses other than as set forth in the Budget, exclusive of professional fees as to professionals whose engagements are approved by the Bankruptcy Court pursuant to sections 327 and 1103 of the Bankruptcy Code and fees payable pursuant to 28 U.S.C. § 1930, without the prior written consent of the Agent or approval by the Bankruptcy Court after notice to the Agent and a hearing. After five (5) days notice to the U.S. Trustee and any Committee (as defined below), the Agent and the Debtors may mutually agree to modify the Budget without further Order of this Court.

37. In addition to maintaining compliance with the Budget as provided for herein, the Debtors will maintain a minimum weekly cash balance (the “Minimum Cash Balance”) determined at the close of business on Friday of each week as: (i) the Debtors’ cash balance on the Petition Date (excluding the Disputed Amount) (the “Cash Balance”), minus (ii) the Cumulative Cash Used as defined and set forth on the Budget (the “Cumulative Cash Used”). The Debtors shall provide to the Agent and the Ad Hoc Committee an initial report reflecting the Cash Balance within five (5) business days from entry of the Interim Order and thereafter a report reflecting the Minimum Cash Balance will be provided in accordance with Paragraph 17 (e) of the Interim Order.

B. Carve-Out

38. The Debtors request that, notwithstanding any provision of the Interim Order to the contrary, the liens on the Collateral, the Replacement Liens (as defined below) and the 507(b) Claims (as defined below) granted to the Agent, on behalf of itself and the Prepetition Lenders, pursuant to the Interim Order, shall be subject and subordinate to a carve out (the

“Carve Out”) for the payment of (a) the allowed and unpaid professional fees and expenses incurred by the Debtors and by any statutory committee appointed in these chapter 11 cases (the “Committee”), pursuant to sections 327(a) and 1103 of the Bankruptcy Code, through the Expiration Date (as defined below) plus \$2 million to cover professional fees and expenses accrued after the Expiration Date (the “Professional Fee Carve Out”); (b) the approved professional fees and expenses incurred by any court approved professional employed by a Chapter 7 Trustee or Chapter 11 Trustee up to the amount of \$50,000 (the “Trustee Cap”); and (c) fees payable to the U.S. Trustee required to be paid pursuant to 28 U.S.C. §1930; provided, however, that in any event, the Carve Out shall not include, and no Cash Collateral available to the Debtors pursuant to the Interim Order shall be used to pay professional fees and disbursements incurred in connection with prosecuting and asserting any claims or causes of action against the Agent or the Prepetition Lenders, other than the Prepetition Lenders that failed to meet their obligations under the Prepetition Credit Agreement, provided, further, however, that the Carve Out shall include the Committee’s investigation rights pursuant to Paragraph 14 of the Interim Order. The Debtors further request that the Professional Fee Carve Out shall not be reduced by any allowed interim amounts paid to the professionals pursuant to separate orders of the Court or any prepetition retainers paid by the Debtors to professionals retained by them.

C. Investigation of Validity, Perfection and Enforceability of the Agent’s Liens and Security Interests

39. For a period of ninety (90) days from the appointment of the Committee, the Committee, and, if no Committee is appointed, any non-debtor party in interest, shall be entitled to investigate the validity, perfection and enforceability of the Agent’s liens and security interests held on behalf of the Prepetition Lenders and the obligations arising under the Prepetition Loan Documents, or to assert any other claims or causes of action against Agent and

Prepetition Lenders (the “Investigation Termination Date”). If the Committee, or if no Committee is appointed, any non-debtor party in interest, determines that there may be a challenge to the Agent’s prepetition liens or the Prepetition Lenders’ prepetition obligations by the Investigation Termination Date, upon five (5) business days’ written notice to the Debtors and the Prepetition Lenders, the Committee, or, if no Committee is appointed, any non-debtor party in interest, shall be permitted to file and prosecute an objection or claim related thereto, and shall have only until the Investigation Termination Date to file such objection or otherwise initiate an appropriate action (including a motion to obtain court authority to bring such an action) or adversary proceeding on behalf of the Debtors’ estates setting forth the basis of any such challenge, claim or cause of action. If such action is not filed on or before the Investigation Termination Date (or such other later date as extended by the written consent of the Debtors and the Agent), the stipulations contained in Paragraph 12 of the Interim Order shall be irrevocably binding on the Committee and all parties in interest without further action by any party or this Court. Unless the Agent and the Debtors each consents in writing to an extension, the Investigation Termination Date may not be extended, unless cause therefor is shown and only after notice to the Agent and the Debtors and the filing of a motion and scheduling of a hearing date before the expiration of the Investigation Termination Date.

**D. Extraordinary Provisions² under
This Court’s General Order No. M-274**

40. This Court’s Guidelines for Financial Requests (the “Guidelines”), which were adopted by General Order No. M-274, dated as of September 9, 2002, require the Debtors to conspicuously disclose any Extraordinary Provisions (as defined in the Guidelines) to be

² This term shall have a meaning ascribed to it in General Order No. M-274 of the United States Bankruptcy Court for the Southern District of New York, dated as of September 9, 2002.

approved by the Interim Order. The proposed Interim Order includes the following Extraordinary Provisions:

Section 506(c) Waiver. So long as the Prepetition Lenders are consenting to or otherwise providing use of Cash Collateral and except as expressly provided herein, no expenses of administration of the Debtors' estates shall be charged pursuant to section 506(c) of the Bankruptcy Code, or otherwise, against the Collateral or any collateral supporting the Replacement Liens. Nothing contained in the Interim Order shall be deemed to be consent by the Agent or the Prepetition Lenders, whether express or implied, to any claims against the Collateral or the collateral supporting the Replacement Liens under section 506(c) of the Bankruptcy Code or otherwise.

This Extraordinary Provision is typical for a consensual arrangement to use Cash Collateral between a debtor and prepetition lenders.

E. Term

41. The Debtors' right to use Cash Collateral under the Interim Order shall commence on the date of the entry of the Interim Order and expire on the earlier of (i) the date of the entry of the Final Order granting use of Cash Collateral, (ii) the close of business on July 15, 2003, unless mutually extended by the Agent and the Debtors, or (iii) the occurrence of a Termination Event as defined in Paragraph 18 of the Interim Order (collectively referred to as the "Expiration Date"). In no event shall the Debtors be authorized to use Cash Collateral for any purposes or under any terms other than those set forth herein and as set forth in the Budget or as may otherwise be approved by this Court following notice and hearing as may be required; provided, however, that nothing in this Interim Order shall be deemed a waiver of the Debtors' rights to seek additional use of Cash Collateral or the Agent's and the Lenders' rights to oppose any such request.

42. The proposed Interim Order provides that a Termination Event shall occur, unless cured by the Debtors or waived by the Agent and Requisite Lenders, (a) upon the fifth (5th) business day following the delivery of written notice to the Debtors by the Agent of

any breach or default by the Debtors of the terms and provisions of the Interim Order, including, but not limited to (i) failure to furnish to the Agent those reports and information listed in Paragraphs 3 and 17 of the Interim Order, (ii) noncompliance with the Budget as defined in Paragraph 2 of the Interim Order, unless with respect to each of the foregoing, the Debtors have cured such breach or default within such five (5) business day period; and (b) without notice of any kind upon (i) the failure to maintain the Minimum Cash Balance as required by Paragraph 3 of this Interim Order, (ii) the failure to make any payment to or for the Agent on behalf of itself or the Lenders as required by this Interim Order, (iii) the conversion of the chapter 11 case to a chapter 7 case or appointment of a trustee without the consent of the Agent and (iv) the initiation of any lawsuit or adversary proceeding by the Debtors (excluding any lawsuit or proceeding related to the Disputed Amount and Disputed Account) seeking to challenge the validity or priority of (or to subordinate) any of the Agent's and the Lenders' liens and security interests on any of the Collateral, unless waived by the Agent at the direction of the Required Lenders.

Basis for Relief Requested

A. Legal Authority to Use Cash Collateral

43. Pursuant to section 363(c)(2) of the Bankruptcy Code, a debtor in possession may only use "cash collateral" with the consent of the secured party with an interest therein or court approval. 11 U.S.C. § 363(c)(2). Section 363(e) of the Bankruptcy Code provides that, upon request of an entity that has an interest in cash collateral sought to be used by a debtor, the court shall prohibit or condition such use of cash collateral as is necessary to provide adequate protection of such entity's interest. Id. § 363(e).

44. Courts determine the means for providing adequate protection on a case-by-case basis. See In re Mosello, 195 B.R. 277, 289 (Bankr. S.D.N.Y. 1996); In re Realty Southwest Assocs., 140 B.R. 360 (Bankr. S.D.N.Y. 1992); In re Beker Indus. Corp., 58 B.R. 725

(Bankr. S.D.N.Y. 1986); see also In re O'Connor, 808 F.2d 1393, 1396 (10th Cir. 1987); In re Martin, 761 F.2d 472 (8th Cir. 1985). Adequate protection is provided to protect a secured creditor from any diminution in the value of its interest in the particular collateral during the period of use. See In re 495 Central Park Avenue Corp., 136 B.R. 626, 631 (Bankr. S.D.N.Y. 1992); In re Beker Indus. Corp., 58 B.R. at 736; In re Hubbard Power & Light, 202 B.R. 680 (Bankr. E.D.N.Y. 1996).

B. Adequate Protection

45. As adequate protection for the use and any diminution in value of the Prepetition Lenders' interest in the Collateral, if any, the Debtors have agreed, subject to Court approval, to provide the following adequate protection to or for the benefit of the Prepetition Lenders. The Debtors propose to provide such adequate protection in an amount equal to the aggregate diminution in value of the Prepetition Lenders' interest in the Collateral, if any, from and after the Commencement Date.

(a) Replacement Liens. The Debtors propose to provide adequate protection to the Prepetition Lenders, to the extent that the use of Cash Collateral actually diminishes the value of Cash Collateral, by granting the Agent for itself and on behalf of the Prepetition Lenders, as security for any diminution in value of the Prepetition Lenders' interest in Cash Collateral, a valid, perfected and enforceable security interest (the "Replacement Liens") equivalent to a lien granted under the section 364(c) of the Bankruptcy Code in and upon all of the assets of the Debtors in existence prior to the Commencement Date and hereby created after the Commencement Date, including without limitation, all of the Debtors' accounts, contract rights, inventory, machinery and equipment, licenses, general intangibles, real property, and such other collateral in which the Agent on behalf of itself, and the Prepetition Lenders had an interest prior to the commencement of these chapter 11 cases (but not including claims or causes of action arising solely under sections 544, 547, 548, 549, 550 and 553 of the Bankruptcy Code and the proceeds therefrom), whether such property was owned on the Commencement Date or thereafter created, acquired or arising, and all improvements, additions and extensions thereto, all replacement thereof, all books and records with respect thereto and all products and proceeds of the foregoing, specifically including any

proceeds of the foregoing deposited into bank accounts opened by the Debtors prepetition, any accounts opened by the Debtors after the Commencement Date and the accounts themselves; provided, however, that nothing in the Interim Order shall grant a lien or security interest in favor of the Prepetition Lenders in the Disputed Account or Disputed Amount.

The Replacement Liens shall be subject only to (i) the Carve Out; (ii) the security interests of the Agent, on behalf of itself and the Prepetition Lenders, in the same order of priority as such interests existed on the Commencement Date; (iii) any certificates of deposit, (iv) any Collateral subject to valid security interests or liens, including without limitation, any assets acquired or to be acquired or to be acquired by the Debtors which are subject to a purchase money security interest by third party (except to the extent such Collateral was encumbered by junior liens and security interests in favor of the Agent); and (v) the Disputed Account and the Disputed Amount.

The Replacement Liens granted in the Interim Order (i) are and shall be in addition to all security interests, liens and rights of set-off existing in favor of the Agent and the Prepetition Lenders on the Commencement Date; (ii) are and shall be valid, perfected, enforceable and effective as of the date of the entry of the Interim Order without any further action by the Debtors or the Agent, and the Prepetition Lenders and without the necessity of the execution, filing or recordation of any financing statements, security agreements, vehicle lien applications, filings with the United States Patent and Trademark Office, mortgages or other documents; and (iii) shall secure the payment of indebtedness to the Agent and the Prepetition Lenders, as the case may be, in an amount equal to any diminution in value of the Cash Collateral or any other Collateral.

(b) Administrative Priority Claims. In addition to the Replacement Liens granted to the Agent, on behalf of itself and the Prepetition Lenders, pursuant to the Interim Order, the Agent and the Debtors propose to grant an administrative claim under sections 503(b)(1), 507(a), and 507(b) of the Bankruptcy Code (the “507(b) Claims”) for the amount by which adequate protection afforded for any diminution of value of the Cash Collateral from and after the Commencement Date or any other Collateral proves to be inadequate. Such 507(b) Claims shall be allowed and have priority over all other costs and expenses of the kind specified in or ordered pursuant to sections 105, 326, 330, 331, 503(b), 506(c), 507(a), 507(b) or 726 of the Bankruptcy Code, subject to the Carve Out.

(c) Payment of Postpetition Interest. As further adequate protection for the use of Cash Collateral and other Collateral, the Agent shall receive from the Debtors periodic payments in an amount

equal to the interest payments due and owing under the Prepetition Credit Agreement at the applicable non-default rate of interest on the principal amount of the Obligations (as defined in the Prepetition Credit Agreement) due and owing under the Prepetition Credit Agreement as of the Commencement Date, with such payments being due on the dates mandated for payments of interest under the Prepetition Credit Agreement.

(d) Payment of Certain Fees. In addition, the Debtors will continue to pay to the Agent all other actual and reasonable fees, costs and expenses provided for under the Prepetition Credit Agreement, including, but not limited to, actual and reasonable legal fees and costs of the Agent's counsel and financial advisory fees and costs of such professionals engaged by the Agent on behalf of the Prepetition Lenders; provided, however, that such financial advisory fees and costs shall not exceed \$175,000 per month.

46. In addition to the aforementioned proposed forms of adequate protection, the Prepetition Lenders are also adequately protected as a result of the continuation of the Debtors' business operations. Without the use of Cash Collateral, the Debtors would forego business opportunities and their operations would be irreparably harmed. The Debtors believe that the going concern value of their businesses is significantly greater than their liquidation value. Accordingly, the continued operation of the Debtors' businesses protects the Prepetition Lenders' interests. See In re 499 W. Warren St. Assocs., L.P., 142 B.R. 53, 56 (Bankr. N.D.N.Y. 1992) (where the court found a secured creditor's interest in collateral adequately protected when cash collateral was applied to normal operating and maintenance expenditures on the collateral property); In re Willowood E. Apartments of Indianapolis II, Ltd., 114 B.R. 138, 143 (Bankr. S.D. Ohio 1990); In re Aqua Assocs., 124 B.R. 192, 196 (Bankr. E.D. Pa. 1991) ("The important question, in determining whether the protection to a creditor's secured interest is adequate, is whether that interest, whatever it is, is being unjustifiably jeopardized.") (citation omitted).

The Interim Approval Should Be Granted

47. Bankruptcy Rule 4001(b) provides that a final hearing on a motion to use cash collateral pursuant to section 363 of the Bankruptcy Code may not be commenced earlier than fifteen (15) days after the service of such motion. Upon request, however, the court is empowered to conduct an interim expedited hearing on the motion at which it may authorize a debtor to use cash collateral to the extent necessary to avoid immediate and irreparable harm to a debtor's estate. Section 363(c)(3) of the Bankruptcy Code authorizes the court to conduct a preliminary hearing and to authorize the use of cash collateral "if there is a reasonable likelihood that the [debtor] will prevail at the final hearing under [section 363(e) of the Bankruptcy Code]." 11 U.S.C. 363(c)(3).

48. Bankruptcy Rule 4001(b)(2) permits a court to approve a debtor's request for authorization to use cash collateral during the 15-day period following the filing of a motion requesting authorization to use cash collateral, "only to the extent necessary to avoid immediate and irreparable harm to the estate pending a final hearing." Fed. R. Bankr. P. 4001(b)(2).

49. Pursuant to Bankruptcy Rule 4001(b), the Debtors request that the Court conduct an expedited interim hearing on this Motion on the date hereof (the "Interim Hearing") and enter the Interim Order authorizing the Debtors to use Cash Collateral from and after the entry of such Interim Order.

50. Pending the Final Hearing, the Debtors require immediate access to cash in order to satisfy the day-to-day financing needs of the Debtors' business operations. It is essential that the Debtors immediately stabilize their operations and resume paying for ordinary, postpetition operating expenses, as well as certain prepetition expenses approved by this Court on the Commencement Date, to minimize any damage occasioned by the commencement of these chapter 11 cases.

51. Absent immediate access to the Cash Collateral for their continuing business operations, the Debtors will be unable to pay operating expenses and, therefore, be unable to continue to conduct their business operations pending the Final Hearing. Consequently, if interim relief is not granted, the Debtors' attempt to maintain value as a going concern will be immediately and irreparably jeopardized to the detriment of their estates, their creditors and other parties in interest. To protect the Prepetition Lenders, the Debtors' use of Cash Collateral will be limited to the amounts set forth in the Budget, thereby providing additional safeguards for all creditors of the Debtors' estates.

52. Accordingly, the Debtors request that, pending the Final Hearing, the Court authorize the Debtors' use of Cash Collateral in an amount and pursuant to the terms of the Interim Order and the Budget.

Request for Final Hearing

53. Pursuant to Bankruptcy Rule 4001(b)(2), the Debtors respectfully request that the Court set a date for the Final Hearing that is no later than twenty (20) days following the Commencement Date. The Debtors propose that by no later than two (2) business days following the Interim Hearing, they will serve, via first class mail, a copy of the Interim Order and a notice of the Final Hearing on the parties listed in paragraph 34 below and top 40 unsecured creditors.

54. Based upon the foregoing, the Debtors submit that the Motion should be granted.

Waiver of Memorandum of Law

55. 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 Motion pursuant to rule 9013-1(b) of the Local Bankruptcy Rules for the Southern District of New York that a separate memorandum of law be submitted.

Notice

56. Notice of this Motion has been provided to: (a) the Office of the United States Trustee for the Southern District of New York; (b) attorneys for the Agent; 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

57. No prior request for the relief sought in this Motion 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, granting the relief requested herein and such other and further relief as the Court may deem appropriate.

Dated: New York, New York
May 14, 2003

Respectfully submitted,

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

Attorneys for Debtors and Debtors in Possession