Hearing Date: April 16, 2004, at 10:00 a.m.
Objection Deadline: April 13, 2004, at 4:00 p.m.

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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re:	Chapter 11 Case No. 03-13057 (RDD)
ALLEGIANCE TELECOM, INC., et al.,	
Debtors.	

OBJECTION OF LEAD PLAINTIFFS IN SECURITIES LAW CLASS ACTION INDIVIDUALLY, AND AS LEAD PLAINTIFFS, ON BEHALF OF EQUITY HOLDERS, TO APPROVAL OF THE DEBTOR'S DISCLOSURE STATEMENT

TO THE HONORABLE ROBERT D. DRAIN,
UNITED STATES BANKRUPTCY JUDGE:

Oscar Private Equity Investments, Brett Messing and Marla Messing ("Objectors") have been appointed by the United States District Court for the Northern District of Texas (Dallas Division) as the Lead Plaintiffs in a pending class action for violation of the federal securities laws brought against various current and/or former senior officers of the debtor, Allegiance Telecom, Inc. ("Debtor"). The action, styled Oscar Private Equity Investments, Individually and on Behalf of All Others Similarly Situated. v. Royce J. Holland, Thomas M. Lord, Daniel Yost and Anthony Parella, Civil No. 3-CV-2761-H (the "Class Action") is being prosecuted on behalf of those persons and entities (hereinafter, together with Lead Plaintiffs, the "Class Claimants"), who purchased or otherwise acquired securities of the Debtor between April

24, 2001 through February 19, 2002, inclusive (the "Class Period"), and who were thereby damaged by the conduct of the named defendants ("Non-Debtor Class Action Defendants"). The Class Action does not name the Debtor as a defendant and, consequently is not stayed by operation of 11 U.S.C. §362. Objectors/Lead Plaintiffs hereby object to the proposed Disclosure Statement in conjunction with the Debtor's Plan of Reorganization[1] (the "Plan"), on the ground that it fails to inform creditors that purported non-debtor releases may be determined to be impermissibly broad and overreaching, thereby rendering the Plan non-confirmable. Based on the facts and controlling law, Objectors respectfully state the following:

SUMMARY OF THE RELIEF REQUESTED

1. The Disclosure Statement, in the section entitled "Releases by Holders of Claims and Equity Interests," (Disclosure Statement, §V, K, 2) contains overly-broad release language which could be interpreted as a release of non-debtors with respect to claims brought by non-debtors, such as the Class Claimants. As such, it constitutes an improper attempt by the Debtor to eliminate, by subterfuge, valid claims which are currently being pursued against the Non-Debtor Class Action Defendants in a pending proceeding in the United States District Court for the Northern District of Texas.

2. Applicable law does not countenance such an unjustifiable and unjust result. 11 U.S.C. §524(e) expressly provides that the "discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt." While several courts have found that, under highly unusual circumstances, 11 U.S.C. §105 empowers a court to grant releases to non-debtors, no equitable reasons exist to justify such extraordinary relief herein. The potential non-debtor releases are: (1) non-consensual; (2) wholly without consideration; and (3) not necessary for the successful implementation of the Debtor's Plan of Reorganization – which is, in essence, a Chapter 11 liquidation.

[1] The Plan is filed by the Debtor and its affiliated entities (the "Debtors").

3. To ward against "judicial overreaching unwarranted by the circumstances, unauthorized by the Code, and destructive of the rule of law," the scope of a release of a non-debtor should be explicit and unambiguous, and should be limited to property of the debtor's estate. In re Artra Group, Inc., 300 B.R. 699, 704-07 (Bankr. N.D. Ill. 2003). Here, the non-debtor releases may not be specific enough to prevent the Non-Debtor Class Action Defendants from asserting that confirmation of the Debtor's Plan of Reorganization precludes prosecution of the Class Action. In an abundance of caution, and to avoid serious unintended collateral consequences, Objectors seek modification of the Debtor's Disclosure Statement to clearly inform creditors that any non-debtor releases proposed in the Plan of Reorganization do not enjoin the prosecution of the Class Action and to include language that affirmatively and expressly exempts all securities law claims asserted against non-debtors from being released, discharged, enjoined or affected in any way by the Plan or any Order confirming the Plan.

NATURE OF OBJECTORS' CLAIMS AND RELEVANT ADDITIONAL FACTS

4. On November 13, 2003, the Class Action was filed in the United States District Court for the Northern District of Texas alleging violations under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78j(b) and 78t(a), and Rule 10b-5 promulgated by the SEC pursuant thereto, by certain current and/or former officers and directors of the Debtor. The defendants originally named in the action, Royce J. Holland and Thomas M. Lord, did not inform plaintiffs' counsel that the Debtor would seek an order from this Court extending the automatic stay to suspend prosecution of the Class Action against any Non-Debtor Class Action Defendant. Objectors are informed and believe that no such order was sought or obtained. See In re Bidermann Industries, U,S,A, Inc., 200 B.R. 779, 782-83 (Bankr. S.D.N.Y. 1996); In re Richard B. Vance & Co., 289 B.R. 692, 697 (Bankr. C. D. Ill. 2003)(and cases cited therein).

5. On February 6, 2004, by Order of the Texas District Court, pursuant to the provisions of the Private Securities Litigation Reform Act of 1995, Objectors were appointed Lead Plaintiffs and the law firm of Glancy Binkow & Goldberg, LLP was designated Lead Counsel for the Class Claimants.

6. Several days earlier, on February 4, 2004, Class Action Defendants Royce Holland and Thomas Lord filed a motion to dismiss the Class Action complaint pursuant to Rule 12 of the Federal Rules of Civil Procedure. The motion was denied on March 17, 2004.

7. On March 26, 2004, Objectors filed an amended complaint in the Class Action which, inter alia, added Daniel Yost and Anthony Parella as named defendants.

8. The Debtor herein is not, and was never, named as a defendant in the Class Action. The Class Action seeks recovery of damages from defendants Royce J. Holland, Thomas M. Lord, Daniel Yost, and Anthony Parella based upon their knowing and/or reckless conduct in violation of the federal securities laws which damaged the Class Claimants. Class Claimants are current and former common stockholders of the Debtor, Equity Holders who may be designated as either Class 6 or Class 7 Claimants or both[2] under the Plan. Class Claimants will recover nothing under the Debtor's proposed Plan of Reorganization.

9. Specifically, the Class Action alleges that during the Class Period, the Non-Debtor Class Action Defendants, to wit, Debtor's Chairman and Chief Executive Officer Royce J. Holland, Executive Vice President and Chief Financial Officer, Thomas J. Lord, Chief Operating Officer and President Daniel Yost, and Executive Vice President for Sales Anthony Parella, artificially inflated the price of Debtor's publicly traded shares by knowingly and recklessly exaggerating the results of the Debtor's operations in several respects, most important of which was a material overstatement of Debtor's key operational metric, its "installed line" count.

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[2] To the extent that Class Claimants are not current Equity Holders, it would appear that their claims would be included within the Class 6 Subordinated Claims, which are treated the same as the Class 7 Equity Interests under the Plan.

10. On February 19, 2002, its was revealed that the Non-Debtor Class Action Defendants had overstated the Debtor's installed line count by 125,000 lines – a significant overstatement (12.3%) of total lines installed. In response to this shocking admission, the Class Claimants' holdings plunged 28% in a single day's trading, thereby damaging Objectors and the Class. Fifteen months after this devastating announcement, the Debtor was unable to meet its debt obligations and, on May 14, 2003, filed the instant Chapter 11 proceeding.

11. The Class Action alleges that during the Class Period the Debtor's common stock price was artificially inflated by the actions of the Non-Debtor Class Action Defendants to a Class Period high of $20.35 per share on May 2, 2001. On or about May 2, 2001, the Company had 113,396,784 shares of common stock outstanding.

12. The Class Claimants have Equity Interest (Class 7) claims and/or Subordinated (Class 6) claims. Pursuant to the Debtor's Disclosure Statement, under the Plan, the Class Claimants are not entitled to, and do not retain, any property or interest in property on account of their current or past equity interest in the Debtor. Therefore, they are presumed to reject the Debtor's Plan of Reorganization and the potential non-debtor releases are non-consensual.

13. The Non-Debtor Class Action Defendants have not made any monetary contribution to the Debtor's Plan of Reorganization or toward payment of any creditor claims.

14. Although identified as a plan of reorganization, the Plan is, in essence, a Chapter 11 liquidation, as the majority of assets of Allegiance have been sold and/or will be distributed pursuant to the Debtor's Plan of Reorganization. This is not a case where the Debtor, Allegiance Telecom, is in the process of an ongoing reorganization; i.e., seeking to emerge from the bankruptcy as a functioning telecommunications provider.

BASIS FOR RELIEF REQUESTED

A. The Releases Provided In The Plan Could Be Inadvertently Interpreted As An Affirmative Grant Of Extraordinary Relief Under 11 U.S.C. §105

15. The Debtor's Disclosure Statement violates 11 U.S.C. §1125(a) -- which requires that the Plan proponent provide holders of impaired claims with "adequate information" to enable a hypothetical reasonable investor typical of holders of claims or equity interests of the relevant class to make an informed judgment about the plan -- because the Disclosure Statement fails to inform creditors as to the scope of the releases of non-debtors and that the releases are impermissibly broad.[3] The Disclosure Statement contains the following purported releases to non-debtors on non-debtor claims:

> **Releases by Holders of Claims and Equity Interests.** On the Initial Effective Date, each Holder of a Claim or Equity Interest shall be deemed to forever release, waive and discharge all Claims, Equity Interests, demands, debts, rights, causes of action or liabilities, whether direct or derivative, liquidated or unliquidated, fixed or contingent, matured or unmatured, disputed or undisputed, known or unknown, foreseen or unforeseen, then existing or thereafter arising, in law, equity or otherwise that are based in whole or in part on any act or omission, transaction, event or other occurrence taking place on or prior to the Initial Effective Date in any way relating to the Debtors, the Chapter 11 Cases, the Plan or the Disclosure Statement against (a) the current or former representatives, directors, officers and employees of the Debtors and the Debtors' agents, advisors and Professionals, in each case in their capacity as such; (b) the Holders of ATI Note Claims and the ATI Note Trustees in each case in their capacity as such, (c) the Holders of the Senior Lender Claims, (d) the current or former members of the Creditors Committee and the advisors and attorneys for the Creditors Committee, in each case in their capacity as such, (e) the Buyer, (f) the ATI Note Trustees, and (g) the respective affiliates and current or former representatives, officers, directors, employees, agents, members, direct and indirect shareholders, advisors, attorneys and professionals of the foregoing, in each case in their capacity as such; provided, however, nothing in this Section 10.6 of the Plan shall effect a release in favor of any person other than the Debtors with respect to Causes of Action based on willful misconduct, criminal conduct, misuse of confidential information that causes damage, fraud, ultra vires acts or gross negligence.

[3] Lead Plaintiffs recognize that this is one of several stages in the proceeding and a precursor to the Plan confirmation hearing. In the interest of judicial economy and without waiving any rights to raise this issue at a later time, Objectors raise this issues now to further the objectives of section 1125(a), namely providing proper disclosures to impaired creditors.

16. Notwithstanding the savings language at the end of the paragraph, such release language may be interpreted by the Non-Debtor Class Action Defendants, or intended, as a release of the claims asserted in the Class Action and a bar to the continued prosecution of that action. If so, the release would be impermissibly broad, overreaching, and in violation of both 11 U.S.C. §524(e) and fundamental principles of fairness. Congress enacted 11 U.S.C. §524(e) to strictly prohibit the release of non-debtors from their liability when they have not formally availed themselves of the benefits and burdens of the bankruptcy process. See Gillman v. Continental Airlines, 203 F. 3d 203, 212 (3rd Cir. 2000) ("Section 524(e) of the Bankruptcy Code makes clear that the bankruptcy discharge of a debtor, by itself does not operate to relieve non-debtors of their liabilities."); In re Artra Group, Inc., 300 B.R. at 704-05 (under 11 U.S.C. §105(a) "bankruptcy court lacks power to permanently enjoin one non-debtor from suing another non-debtor, especially when the enjoined party objects or does not consent").

17. As explained by the court in Artra Group, a bankruptcy court may use its equitable powers to enjoin a proceeding against a non-debtor where "such proceedings would defeat or impair its jurisdiction over the case before it." 300 B.R. at 703. Indeed, the Supreme Court in Celotex Corp. v. Edwards, 514 U.S. 300, 308-10 (1995) held that a bankruptcy court's power under 11 U.S.C. §105 "is limited to matters 'related to' the debtor's bankruptcy estate." 300 B.R. at 703. Here, the Class Action has no effect on the Debtor's estate. Even if the Class Action Defendants possess indemnification claims against the Debtor, any D&O insurance proceeds would be available for that purpose. More significantly, such indemnification claims would be subordinated under 11 U.S.C. §510(b) and would have no economic impact on the Debtor's estate.

B. The Circumstances Herein Do Not Warrant Use Of The Court's Equitable Powers To Grant Releases to Non-Debtors

18. Some appellate courts, including the Second Circuit, have held that the use of a bankruptcy court's equitable power under section 105(a) to permit a release of non-debtors in highly unusual circumstances does not conflict with 11 U.S.C. §524(e). In re Transit Group

Inc., 286 B.R. 811, 816 (Bankr. M.D. Fla. 2002) (survey of decisions on both sides of issue). However, as one court in this District explained: "Section 105(a) does not give a bankruptcy court unfettered discretion to discharge a non-debtor from liability. The language of §105(a) limits the bankruptcy court's discretion to acts necessary or appropriate to carry out the purposes of the Bankruptcy Code, which was intended to provide protection to debtors, not non-debtors." In re Chateaugay Corp., 167. B.R. 776, 781 (Bankr. S.D.N.Y 1994).

19. Consequently, a court's use of its equitable powers must be carefully weighed and considered; the "[r]outine inclusion of non-debtor releases is not appropriate." Transit Group, 286 B.R. at 817. Rather, the non-debtor releases "must be necessary and fair." Id. (citing In re Drexel, Burnham, Lambert Group, Inc., 960 F.2d 285 (2d Cir. 1992), where $350 million was paid into settlement in exchange for non-debtors' releases). Here, there is no indication that this Court has been made aware that it is being asked to provide the extraordinary relief of a broad release of non-debtors or that such a release is in any way justified by unusual circumstances.

20. The "unusual circumstances" recognized by courts within the Second Circuit include substantial funds being contributed to a settlement in exchange for the requested release, see, e.g., Drexel, 960 F. 2d at 293; identity of debtor and non-debtor, see In re Ms. Kipps, Inc., 34 B.R. 91, 93 (Bankr. S.D.N.Y. 1983); and that the time and energy of the non-debtor needed to be focused upon the reorganization of the Debtor and its ongoing business operations. See, e.g., In re Ionosphere Clubs, Inc., 111 B.R. 423, 434 (Bankr. S.D.N.Y. 1990)(prosecution of action to be stayed would have disrupted operations of Eastern Airlines); Ms. Kipps, supra, id.

21. None of these factors are present in the instant action. There is no large settlement for the Class Claimants being funded by the Non-Debtor Class Action Defendants. To the contrary, the potential releases lack any consideration. Indeed, under the proposed Plan, the claims of the Class Claimants will be completely wiped out. Moreover, the claims alleged against the Class Action Defendants have been litigated in the District Court (thus far) without

any assertion by said defendants that there is an identity of interest between themselves and the Debtor. (In any event, such a claim was expressly rejected in Sunbeam Sec. Litig., 261 B.R. 534, 537 & n. 2 (S.D. Fla. 2001). Finally, the release of the Non-Debtor Class Action Defendants is in no way essential to implementation of the Plan or to any ongoing business operations of the Debtor. As the Plan reveals, it is, in essence, a Chapter 11 liquidation.[4]

22. Whereas no unusual circumstances exist whereby this Court would affirmatively exercise its equitable powers to further the goals of the Bankruptcy Code, to permit the releases at issue to be worded in such a manner as to potentially deprive the Class Claimants of their right to proceed against the Non-Debtor Class Action Defendants would not only contravene applicable law but would violate basic principles of fundamental fairness – depriving Class Claimants of their day in court in exchange for no benefit to the Debtor's estate.

C. The Disclosed Plan Is Patently Uncomfirmable As A Matter Of Law

23. Section 1129(a)(1) of the Bankruptcy Code requires that, in order to be confirmed, a plan of reorganization must comply with all the applicable provisions of the Bankruptcy Code. In the previous section Objectors explain why any purported releases of the Non-Debtor Class Action Defendants would violated 11 U.S.C. §524(e). Bankruptcy courts have held that plans that violate 11 U.S.C. §524(e), and thus violate 11 U.S.C. §1129(a)(1),

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[4] While admonishing "such an injunction is a dramatic measure to be used cautiously" and limited to "unusual circumstances" (citing Drexel), the Sixth Circuit, in Class 5 Nevada Claimants v. Dow Corning Corp. (in Re Dow Corning Corp.), 280 F. 3d 648, 658 (6th Cir. 2002), devised a seven-part test, similar to that employed in the Second Circuit, to determine whether it is appropriate for a bankruptcy court to enjoin a non-consenting creditor's claims: (1) identity of interests between the debtor and the third party, usually an indemnity relationship, such that a suit against the non-debtor is, in essence, a suit against the debtor or will deplete the assets of the estate; (2) the non-debtor has contributed substantial assets to the reorganization; (3) the injunction is essential to the reorganization, namely, the reorganization hinges on the debtor being free from indirect suits against parties who would have indemnity claims against the debtor; (4) the impaired class, or classes, have overwhelmingly voted to accept the plans; (5) the plan provides a mechanism to pay for all, or substantially all, of the class or classes affected by the injunction; (6) the plan provides an opportunity for those claimants who choose not to settle to recover in full and; (7) the bankruptcy court made a record of specific findings that support its conclusions. Not a single one of the seven factors is present here.

cannot be confirmed over an objection. See, e.g., Lowenschuss, 67 F.3d 1394, 1401 (9th Cir. 1995), cert. denied. 517 U.S. 1243, 116 S.Ct. 2497, 135 L.E.2d 189 (1996); In re Zale Corporation, 62 F.3d 746, 760 (5th Cir. 1995) (bankruptcy court lacks authority to approve settlement agreement containing permanent injunction that constituted an impermissible discharge of a non-debtor).

24. If it is the Debtor's intention to release non-Debtors then the Disclosure Statement describes a plan of reorganization that is unconfirmable on its face, for the reasons stated above, and therefore should not be approved. See, *e.g.*, In re 266 Washington Associates, 141 B.R. 275, 288 (Bankr. E.D.N.Y. 1992) ("A disclosure statement will not be approved where, as here, it describes a plan which is fatally flawed and thus incapable of confirmation."), aff'd, 147 B.R. 827 (E.D.N.Y. 1992); In re Copy Crafters Quickprint, Inc., 92 B.R. 973, 980 (Bankr. N.D.N.Y. 1988) ("[A]pproval [of a disclosure statement] should not be withheld if … it is apparent that the plan will not comply with [Bankruptcy] Code §1129(a)…"); In re Pecht, 57 B.R. 137, 139 (Bankr. E.D.Va. 1986) ("If, on the face of the plan, the plan could not be confirmed, then the court will not subject the estate to the expense of soliciting votes and seeking confirmation"). This principle applies here. The Plan (and Disclosure Statement) - or at least those portions purporting to grant third party releases without providing adequate justification and consideration - do not satisfy the Bankruptcy Code's various confirmation requirements.

25. Further, because the Plan's non-Debtor releases are ambiguously drafted and could be interpreted as an involuntary release of the Objectors' claims in the Class Action against Non-Debtor Defendants, the Plan is unconfirmably vague in violation of 11 U.S.C. 1129(a). In re E.I. Parks No. 1 Ltd. Partnership, 122 B.R. 549, 558 (Bankr. W.D. Ark. 1990).

26. In order to bring the Plan into compliance with the requirements of the Bankruptcy Code, specifically 11 U.S.C. §§ 524(e) and 1129(a), the Plan must provide and affirmatively state that the claims by Objectors and the Class Claimants against Non-Debtor Class Action Defendants, or any non-debtor third party for that matter, are not enjoined, released or limited in any way by the Plan.

27. Without the clarifications requested by the Objectors, the Plan could, in effect, create a trap for the unwary, imposing an involuntary release of creditors' and interest holders' claims in favor of numerous non-debtor insiders and agents with no corresponding benefit or consideration.

28. If the Debtor does not seek to obtain a release of the claims of the Objectors and the Class Claimants against any non-Debtors, the Plan should state the same in a clear, concise and unambiguous manner and the Debtors should agree to the clarifications sought.

CONCLUSION

29. In light of the fact that the Plan does not assert that broad non-debtor releases are necessary for either its confirmation or the successful reorganization of the Debtor's business operations, such releases – which are also not supported by consideration and are non-consensual – should not be the inadvertent result of ambiguous language contained in the Plan.

30. Objectors hereby request modification of the Debtor's Disclosure Statement to: (a) clearly inform creditors that the Court is not affirmatively granting broad releases of non-debtors and (b) explicitly exclude the Class Action from the scope of any release provisions by including language that expressly states that all securities claims asserted against non-debtor defendants are not released, discharged, enjoined or affected in any way by the Plan or any Order confirming the Plan.

31. Until the Disclosure Statement specifically informs creditors that the release provisions have no impact on the rights of the Objectors and the Class Claimants or the claims asserted in the Class Action against the Non-Debtor Class Action Defendants (or any non-debtor), Objectors respectfully request that the Disclosure Statement not be approved.

32. To the extent that any objection, in whole or in part, contained herein is deemed to be an objection to confirmation rather than, or in addition to, an objection to the

adequacy of the Disclosure Statement, Objectors reserve their rights to assert such objection or objections to confirmation of the Plan.

WAIVER OF MEMORANDUM OF LAW

33. Given the nature of the relief requested, and because controlling statutory and case law has been cited herein, Objectors respectfully request that this Court dispense with and waive the requirement for submission of a memorandum of law contained in S.D.N.Y. Local Bankruptcy Rule 9013-1(b). Objectors reserve the right to file a memorandum of law in reply to any objections or responses to this Objection.

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

NOTICE

35. Notice of this Objection has been given in accordance with the Notice of Hearing on Motion for an Order Approving the Disclosure Statement dated March 16, 2004.

WHEREFORE, the Objectors respectfully request that the Court grant the relief requested herein and grant such other future relief as may be just and proper.

Dated: April 13, 2004
New York, New York

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UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

In re: **ALLEGIANCE TELECOM, INC., et al.** Debtors.	Case No. 03-13057 (RDD) Chapter 11

CERTIFICATION OF SERVICE

I, Ira M. Levee, of full age, certify that on April 13, 2004, I caused to be served by facsimile and first class mail a copy of Objection of Lead Plaintiffs in Securities Law Class Action Individually, and as Lead Plaintiffs, on Behalf of Equity Holders, to Approval of the Debtors' Disclosure Statement by facsimile and first class mail to all parties of the annexed Service List.

Dated: April 13, 2004

By: /s/ Ira M. Levee
Ira M. Levee

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