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COUNSEL FOR BELLSOUTH TELECOMMUNICATIONS, INC.

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

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

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

OBJECTION OF BELLSOUTH TELECOMMUNICATIONS, INC. TO DEBTORS' DISCLOSURE STATEMENT PURSUANT TO SECTION 1125 OF THE BANKRUPTCY CODE

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

COMES NOW BellSouth Telecommunications, Inc. ("BellSouth"), by and through its undersigned counsel, and hereby objects to the Debtors' Disclosure Statement Pursuant to Section 1125 of the Bankruptcy Code (the "Disclosure Statement") and respectfully shows the Court as follows:

I. BACKGROUND

1. On May 14, 2003 (the "Petition Date"), Allegiance Telecom, Inc., et al. (the "Debtors"), each filed a voluntary petition for relief under Chapter 11 of Title 11, United States Code (the "Bankruptcy Code"). Since the Petition Date, the Debtors have continued to operate their businesses as debtors-in-possession pursuant to Sections 1107 and 1108 of the Bankruptcy Code.

2. On or about May 28, 2003, an Official Committee of Unsecured Creditors was appointed in these cases.

3. BellSouth provides various telecommunications services to the Debtors pursuant to contract and tariff.

4. On or about February 18, 2004, the Debtors entered into an asset purchase agreement with XO Communications, Inc. (the "Asset Purchase Agreement"), which sale was approved by this Court's order dated February 20, 2004 (the "Sale Order").

5. Thereafter, on or about March 18, 2004, the Debtors filed the Disclosure Statement and the Debtors' Joint Plan of Reorganization Pursuant to Chapter 11 of the Bankruptcy Code (the "Plan"). The Court has scheduled a hearing on approval of the Disclosure Statement for April 16, 2004.

II. OBJECTIONS TO THE DISCLOSURE STATEMENT

A. The Proposed Treatment of Tariffs Violates the Bankruptcy Code

6. Throughout the Plan, Disclosure Statement, and Purchase Agreement, the Debtors include several references to the treatment of tariffs through which various telecom entities, including BellSouth, provide services to the Debtors

(collectively, the "Tariffs"). BellSouth also provides services to the Debtors under contracts other than Tariffs. The Debtors propose to require utilities providers to continue to provide services pursuant to Tariffs or contracts after confirmation of the proposed Plan without providing for assumption or cure under Section 365 of the Bankruptcy Code.

7. Section H.2 of the Disclosure Statement provides, in pertinent part:

> After the Initial Effective Date, all Utility Companies shall continue to provide to the Debtors, Reorganized STFI, the Reorganized Subsidiaries or Buyer without interruption all Utility Services provided to the Debtors prior to the Initial Effective Date whether such Utility Services were provided pursuant to a contract or Tariff.

Disclosure Statement at § H.2.

8. Not only does the Disclosure Statement attempt to impermissibly require that BellSouth continue to provide services after the Initial Effective Date without requiring the Debtors to comply with the assumption and cure requirements of Section 365 of the Bankruptcy Code, but it also requires BellSouth to provide services to the buyer, XO Communications, Inc. ("XO").

9. There is no authority in the Bankruptcy Code to support the Debtor's position. The Bankruptcy Code contains no provision which would allow a debtor to require that BellSouth continue to provide services to the Debtor after its agreements have been deemed rejected or have not been properly assumed and cure amounts paid. Similarly, there is no authority in the Bankruptcy Code for the position that BellSouth could be forced to provide services to a third party such as XO.

10. The Debtors are improperly seeking to reap the benefits of both assumption (continued service) and rejection (non-payment of cure amounts). Section 365(a) of the Bankruptcy Code, however, requires that the Debtors make the choice whether to assume or reject their executory contracts, and the Bankruptcy Code does not provide an option whereby the Debtors may obtain the benefits of both assumption and rejection while simultaneously avoiding their respective burdens.

11. In addition, the Debtors have yet to file their Schedules 1 through 5 to the Plan setting forth those executory contracts to be rejected under the Plan. As a result, BellSouth has insufficient information to determine whether the Debtors intend to assume or reject their contracts with BellSouth.

B. Tariffs Are Executory Contracts Subject to Assumption and Cure

12. As set forth above, BellSouth provides services to the Debtors pursuant to contracts and Tariffs, both of which are executory contracts subject to the assumption and cure requirements set forth in the Bankruptcy Code. However, the Debtors' Plan fails to treat Tariffs as executory contracts.

13. Courts routinely treat tariffs as executory contracts, subject to the assumption and cure requirements in the Bankruptcy Code. See, e.g., Metro East Center for Conditioning and Health v. Qwest Comm. Int'l, Inc., 294 F.3d 924, 926 (7th Cir. 2002) (finding that a tariff is the equivalent of a contract for purposes of the Federal Arbitration Act); Marcus v. AT&T, 138 F.3d 46, 56 (2d Cir. 1998) (finding that tariffs are parties' "agreements"); Cahnmann v. Sprint Corp., 133 F.3d 484, 487 (7th Cir. 1998) ("[T]he filed tariff is the contract between the plaintiff . . . and

Sprint."); Penn Central Co. v. General Mills, Inc., 439 F.2d 1338, 1340 (8th Cir. 1971) (stating that "a tariff is no different from any contract").

14. While the term "executory contract" is not defined in the Bankruptcy Code, courts generally define the term to include contracts on which performance remains due to some extent on both sides. See In re O.P.M. Leasing Servs., 23 B.R. 104, 117-18 (Bankr. S.D.N.Y. 1982) (holding that continuing obligations on both sides compelled the conclusion that a master lease was executory). Additionally, this Court has embraced Professor Countryman's definition of an executory contract: "[A] contract under which the obligation of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other." Countryman, Executory Contracts in Bankruptcy: Part I, 57 Minn. L. Rev. 439, 460 (1973); see also In re Texaco, Inc., 73 B.R. 960, 964 (Bankr. S.D.N.Y. 1987) (holding that an indenture was an executory contract because performance remained due on both sides).

15. Tariffs are properly considered executory contracts with performance remaining due by both parties. For example, the Tariffs require the Debtors to purchase specified amounts of services and require BellSouth to provide such services. Failure to perform by either party would constitute a material breach. The obligations of the Debtors and BellSouth under the Tariffs clearly represent performance due on the part of both parties, such that the Tariffs should be considered executory contracts requiring cure.

16. The Debtors' attempt to force providers of utilities services under the Tariffs, including BellSouth, to continue to perform their obligations without assuming or curing all existing defaults violates Section 365 of the Bankruptcy Code and would be an injustice to BellSouth.

17. The Debtors must assume and cure any pre-petition and post-petition defaults under the Tariffs if they desire to force BellSouth to continue to provide services after the Initial Effective Date.

C. The Debtors Have Failed to Make Adequate Disclosures Regarding Substantive Consolidation

18. The Plan provides as follows regarding substantive consolidation:

> In accordance with the settlement of Claims and controversies under the Plan and for the purposes of voting and Distributions under the Plan only: (a) all assets and all liabilities of the ATCW Debtors will be treated as though the ATCW Debtors were merged; (b) any pre-Initial Effective Date obligation of any ATCW Debtor and all guarantees thereof executed by one or more of the ATCW Debtors will be deemed to be one obligation of the consolidated ATCW Debtors; (c) any Claims filed or to be filed in connection with any such obligation and such guarantees will be deemed one Claim against the consolidated ATCW Debtors; and (d) each and every Claim filed in the individual Chapter 11 Case of any of the ATCW Debtors will be deemed filed against the consolidated ATCW Debtors in the consolidated case.

Plan at § I.

19. The "sole purpose of substantive consolidation is to ensure the equitable treatment of all creditors." United Sav. Bank v. Augie/Restivo Baking Co. (In re Augi/Restivo Baking Co.), 860 F.2d 515, 518 (2nd Cir. 1988). However, neither the Plan nor Disclosure Statement contain sufficient information regarding substantive consolidation to determine whether that goal may be achieved under the Plan. Since the Disclosure Statement does not explain of the effect of substantive consolidation on creditors' claims and

rights, it is uncertain how the creditors will be affected, or if they will receive any benefit from substantive consolidation. The Debtors do not examine, and indeed even fail to mention, that alternatives to substantive consolidation may exist for the purposes of voting or distribution, and provide no basis for their use of substantive consolidation in the Plan. Without supporting information in the Disclosure Statement, it is impossible to determine whether creditors are being treated equitably under the Plan.

20. Substantive consolidation is appropriate where: (i) creditors dealt with the entities as a single economic unit and did not rely on their separate identity in extending credit or (ii) the affairs of the debtors are so entangled that consolidation will benefit all creditors. See id. at 518. While the Plan clearly contemplates the use of substantive consolidation for the limited purposes of voting and distribution, the Plan and the Disclosure Statement fail to provided any facts that support the application of this doctrine on either ground.

D. The Parties' Setoff Rights Should Be Reserved

21. Section 3.5 of the Purchase Agreement clearly contemplates offset in the following manner:

> (a) The Cure Amounts, if any, as determined by the Bankruptcy Court, necessary to cure all defaults, if any, under Allegiance's interconnection agreements with incumbent local exchange carriers ("ILECS"), together with any other payments made to settle pre-Petition disputes between any of Sellers or the Operating Subsidiaries and ILECS under such agreements, under tariffs or otherwise after the date hereof (the "ILEC Cure Amounts") shall be resolved in accordance with this Section 3.5(a). Buyer and Sellers shall work cooperatively and in good faith with respect to paying, objecting to and settling the ILEC Cure Amounts, it being understood that all pre-Petition accounts receivable of Sellers or the Operating Subsidiaries owed by ILECs (the "ILEC Set Off Amounts") shall be set off against the ILEC Cure Amounts and thereby used as currency to pay the ILEC

> Cure Amounts. Sellers shall pay all ILEC Cure Amounts (whether in cash or by application of the ILEC Set Off Amounts). Buyer and Sellers agree that subject to this Section 3.5(a), Buyer should have standing in the Cases with regard to ILEC Cure Amounts and the parties shall take such position in the Cases.

Purchase Agreement at § 3.5(a).

22. The Disclosure Statement discusses the Debtors' ability to setoff for distribution purposes as follows:

> The Debtors or ATLT may, but shall not be required to, set-off against or recoup from any Allowed Claim on which payments are to be made pursuant to the Plan, any claims of any nature whatsoever (except for those claims and rights (including, without limitation, set off rights) constituting Acquired Assets), the Debtors or ATLT may have against the Holders of such Claim that is not released under Article X of the Plan and the Distributions to be made pursuant hereto on account of such Claim, but neither the failure to do so nor the allowance of any Claim hereunder shall constitute a waiver or release by the Debtors of any such Claim the Debtors may have against the Holder of such Claim.

Disclosure Statement at § F.7.

23. The Disclosure Statement is silent upon whether substantive consolidation impacts a creditor's rights to setoff given that under the proposed substantive consolidation, although the Debtors are proposing to be treated as one for all obligations they owe, as well as for all obligations owed to them. Under such circumstances, the Disclosure Statement must clearly state whether only the Debtors' right to setoff is preserved. Since the ultimate purpose of substantive consolidation is fairness to creditors, it would only be fair to allow creditors to retain their rights to offset obligations of the Debtors.

24. Furthermore, to the extent that the Disclosure Statement is approved, a specific provision should be included in the Plan to provide that notwithstanding any provision to the contrary in the Disclosure Statement, none of BellSouth's or any other creditor's rights are

being abridged in any way with respect to resolution of its claims, including its offset rights, pending a full and complete adjudication of its claims.

E. XO Should not Have Standing to Participate in the Plan Process

25. BellSouth further objects to approval of the Disclosure Statement to the extent that the Debtors seek to impart standing upon XO to participate in the plan confirmation process through the Plan, Disclosure Statement, and Sale Order.

26. BellSouth objects on the grounds that as a potential purchaser of estate assets and not a creditor of these estates, XO does not have standing to participate in the plan confirmation process. See, e.g., In re Rook Broadcasting of Idaho, Inc., 154 B.R. 970, 974 (Bankr. D. Idaho 1993) (finding that prospective purchaser of debtors' assets did not have standing to object to the debtors' disclosure statement because it had "no interest in the bankruptcy estate, other than its desire to purchase estate assets. No interest of [the prospective purchaser was] affected by the results of the debtors' bankruptcy, other than incidentally."); In re Crescent Mfg. Co., 122 B.R. 979, 981 (Bankr. N.D. Ohio 1990) (holding that prospective purchaser of the debtor's assets was without standing to object to debtor's motion to extend exclusivity); In re Karpe, 84 B.R. 926, 929 (Bankr. M.D. Pa. 1988) (holding that prospective purchaser of debtor's assets was a non-creditor with no standing to file a motion to approve the sale of its own bid).

III. CONCLUSION

The Debtors' proposed treatment of utility service providers, including BellSouth, is in direct violation of the Bankruptcy Code. The Debtors may not require that BellSouth continue to provide services to the Debtors or to XO under

contracts or Tariffs after the conclusion of the bankruptcy case without complying with the assumption and cure requirements of Section 365 of the Bankruptcy Code. The Plan is, therefore, patently unconfirmable, and approval of the Disclosure Statement should be denied.

Furthermore, the Debtors have also failed to make adequate disclosures related to their attempt to substantively consolidate these estates and have failed to provide creditors with sufficient information to assess the affect of any substantive consolidation on creditors' claims and other rights, including setoff.

Wherefore, BellSouth requests that this Court deny approval of the Debtor's Disclosure Statement and grant BellSouth other such relief that is just and proper.

Dated: April 13, 2004

Respectfully submitted,

/s/ Paul M. Rosenblatt

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	:	
Debtor.	:	**(Jointly Administered)**

CERTIFICATE OF SERVICE

The undersigned hereby certifies that on April 13, 2004, a true and correct copy of the following:

Objection of BellSouth Telecommunications, Inc. to Debtors' Disclosure Statement Pursuant to Section 1125 of the Bankruptcy Code

was transmitted via facsimile to the parties listed below:

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DATED this 13th day of April, 2004.
Atlanta, Georgia

/s/ Paul M. Rosenblatt

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