

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

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	:	Chapter 11
In re	:	
	:	Case No. 03-13057 (RDD)
ALLEGIANCE TELECOM, INC., <u>et al.</u> ,	:	
	:	(Jointly Administered)
Debtors.	:	
	:	
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AFFIDAVIT OF CONSTANCE LOOSEMORE IN SUPPORT OF LIMITED OBJECTION OF KMC TELECOM XI LLC TO MOTION OF THE DEBTORS FOR AN ORDER, PURSUANT TO (A) RULE 9019 OF THE FEDERAL RULES OF BANKRUPTCY PROCEDURE, APPROVING THE CONFIDENTIAL SETTLEMENT AGREEMENT AND MUTUAL RELEASE, DATED FEBRUARY 27, 2004, AMONG LEVEL 3 COMMUNICATIONS, LLC AND THE DEBTORS; (B) SECTION 363 OF THE BANKRUPTCY CODE AUTHORIZING THE TRANSFER, AS A PART OF SUCH A SETTLEMENT, OF CERTAIN ASSETS FREE AND CLEAR OF LIENS, CLAIMS AND ENCUMBRANCES, AND (C) SECTION 365 OF THE BANKRUPTCY CODE, APPROVING AND AUTHORIZING, AS A PART OF SUCH SETTLEMENT, THE ASSUMPTION AND ASSIGNMENT OF AN EXECUTORY CONTRACT

STATE OF NEW JERSEY)
) ss.:
COUNTY OF SOMERSET)

Constance Loosemore, being duly sworn, deposes and states:

1. I am the Vice President, Treasurer and Assistant Secretary of KMC Telecom Holdings, Inc. (“Holdings”), a corporation organized under the laws of the State of Delaware, and the Vice President, Treasurer and Assistant Secretary of KMC Telecom Holdings XI LLC (“KMC”), an indirect, wholly-owned subsidiary of Holdings. KMC is counterparty to that certain Primary Rate Interface Services Agreement dated as of February 11, 2002, as amended from time to time (the “KMC Agreement”) between KMC and Allegiance Telecom

Company Worldwide (“Allegiance”). A true and correct copy of the KMC Agreement (with amendments) is attached hereto as Exhibit 1.

2. I am generally familiar with KMC’s day-to-day operations, business affairs and books and records, as well as the terms and conditions of the KMC Agreement and KMC’s performance thereunder, as well as the facts associated with KMC’s relationship with Allegiance. Except as otherwise noted, I make this Affidavit of my personal knowledge.

3. In my capacities with Holdings and KMC, I am authorized to submit this affidavit in support of the Limited Objection of KMC Telecom XI LLC to Motion of the Debtors for an Order, Pursuant to (A) Rule 9019 of the Federal Rules of Bankruptcy Procedure, Approving the Confidential Settlement Agreement and Mutual Release, Dated February 27, 2004, Among Level 3 Communications, LLC and the Debtors; (B) Section 363 of the Bankruptcy Code Authorizing the Transfer, as a Part of Such a Settlement, of Certain Assets Free and Clear of Liens, Claims and Encumbrances, and (C) Section 365 of the Bankruptcy Code, Approving and Authorizing, as a Part of Such Settlement, the Assumption and Assignment of an Executory Contract (the “Settlement Motion”). Capitalized terms used but not described herein shall have the meaning ascribed to such terms in the Settlement Motion. I have read the Limited Objection and concur with the statements made therein, and am submitting this Affidavit to provide specific support for the factual assertions set forth in that Objection.

4. It is my understanding that KMC provides Allegiance with approximately 43% of the telecommunications ports which Allegiance, in turn, provides to Level 3 under the INSPA.

5. In conjunction and simultaneously with the KMC Agreement, KMC and Allegiance entered in an Interconnection Agreement, whereby Allegiance made available certain

colocation space in its facilities, so that KMC could locate its equipment there for purposes of performing under the KMC Agreement. The Interconnection Agreement accordingly was intended as an integrated part of the KMC Agreement. A copy of the Interconnection Agreement is attached hereto as Exhibit 2

6. To the best of my knowledge, information and belief, the ports under both the INSPA and the KMC Agreement are used largely, if not entirely, to provide managed modem service to AOL (now a division or subsidiary of Time Warner, Inc.), under an agreement between AOL and Genuity, to which Level 3 succeeded when it acquired Genuity's assets. Although KMC does not have a copy of the AOL-Genuity contract (other than the heavily redacted copy which has been filed with the SEC), it is my understanding that the various provisions in that contract were sought to be implemented in the INSPA, and in turn, implemented in KMC Agreements, so that each of these agreements would mirror the provisions of the AOL agreement. The reason for this similarity is that the INSPA was an agreement which enabled Genuity to perform its obligations to AOL, and the KMC Agreement, in turn, was an agreement which enabled Allegiance to perform its obligations to Genuity, so that each of the agreements needed to have similar provisions related to performance, cancellation, price adjustment, and the like.

7. In particular, it is my understanding that AOL was given the right, under certain circumstances (the particulars of which I am not aware), to reduce the services it was to acquire from Genuity based on a reduction of demand for AOL's services (the "Downturn"). Genuity, in turn, was allowed under the INSPA and in response to an AOL Downturn notice to reduce the services it would acquire from Allegiance, and Allegiance, in turn, under various conditions and subject to various limitations, could reduce the services it would acquire from

KMC. To the best of my knowledge, information and belief, the INSPA and KMC Agreement, as well as the AOL agreement (see Level 3 10-K, at 79), also contain provisions for price reductions based on third party offers to provide service at lower prices.

8. On March 16, 2004, KMC received an electronic “soft copy” of a purported Allegiance Downturn notice, a true and correct copy of which is attached hereto as Exhibit 3. Were this Downturn notice effective and valid (which KMC disputes), it would significantly reduce the services provided by KMC under the KMC Agreement, which otherwise expires on December 31, 2006.

9. There is reason to be skeptical of the legitimacy of the Downturn notice from Allegiance, even apart from the various reasons that the notice does not comply with the requirements of the KMC Agreement. The notice itself admits that Allegiance has disputed the propriety of the notice which it received from Level 3. Second, the notice is unaccompanied by any documentation to support the alleged fact that Allegiance received a Downturn notice from Level 3, let alone any evidence that Level 3 in turn received the requisite Downturn notice from AOL – and neither Allegiance nor Level 3 has been willing to provide those AOL notices unless KMC agrees that they cannot be used in Court, or anywhere else. Third, there is ground for suspicion as to the facts and circumstances surrounding the alleged receipt of a Downturn notice from AOL, because KMC has reason to believe that Level 3 may not have enforced its contractual rights and resist such notice, rather it entered into a “side deal” with AOL on the issue. Level 3 also would have the incentive to enter into such a “side deal” with AOL. First, as set forth in Level 3’s most recently filed 10-K, Time Warner, AOL’s parent, represents 24% of Level 3’s telecommunications revenue and 11% of its total revenue, equal to \$446 million in 2003, and appears to be Level 3’s largest customer. Thus, Level 3 had substantial motivation to

acquiesce to any AOL demand, even if not compliant with the terms of the AOL-Genuity contract. Second, and even more significant, the notion of a Downturn in business from AOL is inconsistent with the actual experience of KMC as to the ports purported to be part of the Downturn notice, which are and have been operating at high-capacity utilization levels.

10. In particular, the Downturn notice appears to be part of an effort by Level 3 to redirect traffic from ports provided by KMC under the KMC Agreement, to other ports on the Level 3 network which are underutilized. Although we do not have direct access as to the precise ports maintained by Level 3, KMC's technical estimate of available NPA/NXX telephone numbers suggests that Level 3 provides or can provide service in 120 of the 144 local calling areas which are subject to the KMC Agreement. Moreover, in conversations prior to the filing of the Motion, Level 3's representative stated that there was a 98% overlap between its capabilities and the services provided under the KMC Agreement. Level 3 would therefore have substantial incentive to move traffic to its own lines, if it could do so, stop using the ports and circuits provided by KMC which it is required to take under the KMC Agreement, and thereby seek to avoid paying KMC for those services.

11. There has been an ongoing dispute between Allegiance and Level 3, in which Level 3 asserted that there were performance deficiencies in Allegiance's performance under the INSPA, and Allegiance steadfastly contended that its performance met all contractual requirements. Inasmuch as KMC is a subcontractor to Allegiance – providing 43% of the ports under the INSPA – a failure of performance by KMC would have necessarily triggered a performance failure by Allegiance. Accordingly, Allegiance's view that it complied with its own contract necessarily implies that it equally believed that KMC complied with all of its contractual obligations as well. This is particularly true because the performance criteria under the KMC

Agreement and the INSPA are substantially similar, as might be anticipated because the KMC Agreement was negotiated to enable Allegiance to perform under the INSPA and accordingly, as noted above, mirrored its terms.

12. During the course of performance of the KMC Agreement, since the parties reached an October 2002 settlement of outstanding performance issues and other than in respect of a September 2003 agreement on delay credits (all of which have already been credited to Allegiance), KMC has not received a notice of deficient performance under the KMC Agreement. Nor has Allegiance initiated any of the mandatory dispute resolution procedures required under the terms and conditions set forth in section 22 of the KMC Agreement.

13. KMC has significant concern regarding the financial condition of the proposed assignee of the KMC Agreement, Level 3. According to Moody's, Level 3's outstanding senior debt bears an issuer rating of Caa2, which is Moody's third lowest rating – immediately above ratings of obligations which are in or very near default (Ca and C) – and eight rungs below the minimum investment grade, which in Moody's terminology is Baa3. (A list of the definitions for Moody's ratings is attached hereto as Exhibit 4). Moody's description of the Caa category highlights the risk faced by Level 3's creditors, which is the risk that will be imposed on KMC if its Agreement is assigned to Level 3:

Obligations rated Caa are judged to be of poor standing and are subject to very high credit risk.

See Exhibit 4 hereto.¹

¹ Moody's (see Exhibit 4) also explains the numbers in its rankings as follows:

Note: Moody's appends numerical modifiers 1, 2, and 3 to each generic rating classification from Aa through Caa. The modifier 1 indicates that the obligation ranks in the higher end of its generic rating category; the modifier 2 indicates a mid-range ranking; and the modifier 3 indicates a ranking in the lower end of that rating category.

14. The combination of Level 3's poor financial condition, as reflected in its 10-K and Moody's rating, its declaration in the Settlement Agreement (in addition to other conversations) of an intent to move ports to its own network, which it is not allowed to do under the KMC Agreement, its refusal to provide documents in response to KMC's request, its rush (together with the Debtors) to force a hearing on March 25, and the assertions and attempts to preserve claims of alleged KMC performance failures which Allegiance never before asserted and indeed has steadfastly denied, are inconsistent with adequate assurance of future performance, which cannot be provided absent the Financial Assurances and Structural Assurances set forth in KMC's Limited Objection. In addition, because the Interconnection Agreement is part and parcel of the KMC Agreement and necessary to enable KMC to perform thereunder, an assumption and assignment of the Interconnection Agreement must be part of any assumption and assignment of the KMC Agreement.

Pursuant to 28 U.S.C. § 1746, I declare under penalty of perjury that the foregoing is true and correct.

Executed on this 22nd day of March, 2004

/s/ Constance Loosemore
Constance Loosemore

Vice President, Treasurer and Assistant
Secretary of KMC Telecom XI LLC

Subscribed and sworn to before me
this 22nd day of March, 2004

/s/ Barbara Perrette
Notary Public of New Jersey
My Commission Expires: September 11, 2007