

KIRKLAND & ELLIS LLP
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**

In re:	:	
	:	
ALLEGIANCE TELECOM, INC., <u>et al.</u>,	:	Chapter 11 Case No.
	:	03-13057 (RDD)
	:	
Debtors.	:	Jointly Administered

**MOTION OF THE DEBTORS FOR AN
ORDER (A) PURSUANT TO RULE 9019 OF THE
FEDERAL RULES OF BANKRUPTCY PROCEDURE,
APPROVING THAT CERTAIN SETTLEMENT AGREEMENT,
DATED AS OF MARCH 16, 2004, WITH NORTEL NETWORKS, INC.
AND (B) PURSUANT TO SECTION 365 OF THE BANKRUPTCY
CODE, APPROVING AND AUTHORIZING THE ASSUMPTION OF AN
EXECUTORY CONTRACT, AS AMENDED, WITH NORTEL NETWORKS, INC.**

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

Allegiance Telecom, Inc. ("ATI") and its direct and indirect subsidiaries, including Shared Technologies Allegiance, Inc. ("Shared Technologies"), as debtors and debtors in possession (collectively, the "Debtors"), respectfully represent:

Introduction

1. On May 14, 2003 (the "Commencement Date"), each of the Debtors commenced with this Court a voluntary case under chapter 11 of title 11 of the 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(a) and 1108 of the Bankruptcy Code.

2. The Debtors' chapter 11 cases have been consolidated for procedural purposes only and are being jointly administered pursuant to rule 1015(b) of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules").

3. No trustee or examiner has been appointed in these chapter 11 cases. On May 28, 2003, pursuant to section 1102 of the Bankruptcy Code, the United States Trustee for the Southern District of New York the ("U.S. Trustee") appointed a statutory committee of unsecured creditors (the "Creditors Committee") in these chapter 11 cases. Nortel Networks, Inc. ("Nortel") is one of the members of the Creditors Committee.

Jurisdiction

4. This Court has subject matter jurisdiction to consider and determine this Motion pursuant to 28 U.S.C. § 1334. This is a core proceeding pursuant to 28 U.S.C. § 157(b). Venue is proper before this Court pursuant to 28 U.S.C. §§ 1408 and 1409.

An Overview of Debtors' Business

5. The Debtors are facilities-based national local exchange carriers that provide 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. The Debtors offer their 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 collocation services;

- integrated local long distance/Internet access offerings, which provide customers with integrated voice and Internet access over a single broadband line;
- services to other service providers, including equipment colocation, managed modem ports and Internet protocol traffic aggregation; and
- customer premise equipment sales and maintenance services.

6. As of December 31, 2003, the Debtors served more than 100,000 business customers in major markets throughout the United States. As of December 31, 2003, Allegiance employed approximately 2,893 people, of which approximately 66 employees were covered by collective bargaining agreements.

7. As of December 31, 2003, the Debtors had approximately \$284.2 million of unrestricted cash on hand. As of December 31, 2003, the Debtors' consolidated books and records reflected assets totaling approximately \$1.136 billion and liabilities totaling approximately \$1.449 billion. For the twelve months ending December 31, 2003, the Debtors, on a consolidated basis, reported revenues of approximately \$776.9 million and net losses of approximately \$360.0 million.

8. As set forth above, Shared Technologies is one of the Debtors in these chapter 11 cases. On June 17, 2002, ATI acquired (the "Shared Technologies Acquisition") certain assets from WorldCom Inc. ("WorldCom") related to the customer premises equipment ("CPE") business of Shared Technologies Fairchild Telecom, Inc., a wholly-owned subsidiary of WorldCom. As a result of the Shared Technologies Acquisition, Shared Technologies was formed as one of ATI's indirect subsidiaries.

9. Shared Technologies is one of the nation's largest providers of telecommunications CPE, including installation and maintenance services for CPE, with more than 5,000 business customers nationwide comprising of medium to large commercial

businesses, national equipment accounts, governmental agencies and hospitals. Shared Technologies sells, installs and maintains CPE, including key telephone systems and other telephone and data equipment.

10. On February 20, 2004, this Court entered an Order approving the sale to XO Communications, Inc. (“XO”) of (a) substantially all of the assets of ATI and Allegiance Telecom Company Worldwide (“ATCW”), a direct subsidiary of ATI and one of the Debtors in these chapter 11 cases, and (b) the stock of the reorganized subsidiaries of ATCW, *other than Shared Technologies*. On March 18, 2004, the Debtors filed the Debtors’ Joint Plan of Reorganization Pursuant to Chapter 11 of the Bankruptcy Code, which provides for the emergence of Shared Technologies as a reorganized stand-alone entity.

Distributorship Agreement with Nortel Networks, Inc.

11. Prior to the Commencement Date, Shared Technologies Fairchild Telecom, Inc. and Nortel (f/k/a Northern Telecom Inc.) entered into a certain Distributorship Agreement, dated January 6, 1997 (as amended, the “Nortel Agreement”), pursuant to which Shared Technologies Fairchild Telecom, Inc. resold certain Nortel products to customers located in the United States.

12. In connection with the Shared Technologies Acquisition, the Nortel Agreement was assigned to Shared Technologies pursuant to that certain Assignment and Delegation Agreement, by and between Nortel, WorldCom Purchasing, L.L.C./Shared Technologies Fairchild Telecom and Shared Technologies (f/n/a Allegiance CPE, Inc.), dated September 12, 2002.

13. Prior to the filing of this Motion, the Debtors and Nortel entered into negotiations regarding the terms of the Nortel Agreement and the resolution of certain disputes regarding pre-petition amounts due to Nortel under the Nortel Agreement. As a result of these

negotiations, a settlement was reached and the parties agreed to (a) amend the Nortel Agreement and (b) settle all claims and disputes among Nortel and the Debtors related to the Nortel Agreement. In that regard, the Debtors have agreed, subject to Court approval of the Settlement Agreement (as defined below), to assume the Nortel Agreement, as modified by the Nortel Amendment (as defined below).

Settlement Agreement and the Nortel Amendment

Settlement Agreement

14. The Debtors and Nortel, subject to Court approval, have entered into that certain Settlement Agreement, dated as of March 16, 2004 (the "Settlement Agreement").¹ The Settlement Agreement provides that, subject to Court approval, the Settlement Agreement shall become effective retroactive as of January 1, 2004.

15. Under the Settlement Agreement,² Nortel has made certain concessions relating to, among other things, the renewal term of the Nortel Agreement and certain promotion funds and customer demonstration facilities to be provided by Nortel. Specifically, in connection with the Nortel Agreement, the Debtors participate in the Nortel Networks 2003 U.S.

¹ On March 26, 2004, this Court entered that certain Order, Pursuant to Section 107(b) of the Bankruptcy Code and Rule 9018 of the Federal Rules of Bankruptcy Procedure, Authorizing (A) the Debtors to File Under Seal Certain Agreements with Nortel Networks, Inc. and (B) the Court to Conduct an In Camera Hearing on Motion of the Debtors for an Order (I) Pursuant to Rule 9019 of the Federal Rules of Bankruptcy Procedure, Approving that Certain Settlement Agreement, Dated as of March 16, 2004, with Nortel Networks, Inc. and (II) Pursuant to Section 365 of the Bankruptcy Code, Approving and Authorizing the Assumption of an Executory Contract, as Amended, with Nortel Networks, Inc. (the "Under Seal Order"). Pursuant to the Under Seal Order, the Debtors are authorized to file (and have filed) with this Court a complete copies of the Settlement Agreement, the Nortel Agreement and the Nortel Amendment (the "Sealed Agreements"). Contemporaneously with the filing of this Motion, copies of the Sealed Agreements have been provided to Nortel, the U.S. Trustee, attorneys for the Creditors Committee, attorneys for XO and attorneys for the Debtors' prepetition lenders (the "Prepetition Lenders"), subject to strict confidentiality requirements. The Seal Agreements are filed under seal as Exhibit "A" to this Motion.

² In the event of any inconsistency between the meaning of the terms used in the Settlement Agreement and the terms used in this Motion, the meaning of the terms used in the Settlement Agreement shall control.

Incentive Discount Plan, dated February 7, 2003 (the “Volume Incentive Discount Plan”). Under the Volume Discount Plan, the Debtors, subject to meeting a certain threshold for the aggregate amount of equipment purchases in the preceding calendar year, receive a 10% (ten percent) discount for purchases of equipment under the Nortel Agreement in each calendar year. As of the Commencement Date, the Debtors owed certain pre-petition amounts (the “Pre-Petition Amounts”) to Nortel under the Nortel Agreement. The aggregate amount of the Pre-Petition Amounts is \$1,433,254.84, as set forth on Exhibit “B” to the Settlement Agreement. As part of the settlement, Nortel has agreed to (a) allow the Debtors to apply the Pre-Petition Amounts to the Debtors’ achievement level under the Volume Incentive Discount Plan in 2003 and (b) acknowledge that the necessary threshold, which entitles the Debtors to receive a discount under the Nortel Agreement in 2004, has been met.³ In exchange for Nortel’s concessions related to, among other things, (c) the Debtors’ achievement level under the Nortel Agreement, (d) the renewal term of the Nortel Agreement and (e) promotion funds and customer demonstration facilities to be provided by Nortel, the Debtors have agreed to pay \$1,320,254.84 to Nortel in full satisfaction of the Pre-Petition Amounts.

16. In addition, under the Settlement Agreement, Nortel and the Debtors have agreed to waive, release and forever discharge each other, each other’s respective affiliates and each others’ and respective affiliates’ officers, directors, employees and agents from and against any claims, liabilities and damages that each party may have against such released parties, as applicable, arising out of the Nortel Agreement prior to December 31, 2003, except for any claims, liabilities and damages relating to the payment of the Pre-Petition Amounts.

³ As a result of receiving this discount, Shared Technologies anticipates to receive savings of approximately \$250,000 in 2004.

Nortel Amendment

17. The Debtors and Nortel have negotiated and, subject to Court approval, have entered into that certain Amendment No. 7 to the Distributorship Agreement 4.01 (the “Nortel Amendment”), which modifies the terms of the Nortel Agreement. In that regard, the Debtors have agreed to assume the Nortel Agreement, as amended by the Nortel Amendment, contingent upon this Court’s approval of the Settlement Agreement. The Settlement Agreement provides that, subject to Court approval, the Nortel Agreement (as amended by the Nortel Amendment) shall be effective as of the date which is ten (10) calendar days after the entry of the Court order approving this Motion. The Nortel Amendment modifies the Nortel Agreement to provide for, among other things, (a) the renewal of the Nortel Agreement, (b) the return to the payment terms that existed prior to the Commencement Date and (c) the right of Shared Technologies to assign the Nortel Agreement to a third party under certain conditions.

Relief Requested⁴

18. By this Motion, the Debtors seek entry of an order (a) pursuant to Bankruptcy Rule 9019(a), approving the terms of the Settlement Agreement and (b) pursuant to section 365 of the Bankruptcy Code, authorizing and approving the assumption of the Nortel Agreement, as amended by the Nortel Amendment.

Basis for Relief Requested

Bankruptcy Rule 9019

19. Bankruptcy Rule 9019(a) provides, in relevant part, that “[o]n motion by [a debtor in possession] and after notice and a hearing, the court may approve a compromise and

⁴ Pursuant to the Under Seal Order, the hearing on this Motion will be conducted in camera and attended solely by (a) representatives from the Debtors, Nortel, the U.S. Trustee and XO and (b) attorneys for (i) the Debtors, (ii) Nortel, (iii) XO, (iv) the Creditors Committee and (v) the Prepetition Lenders.

settlement.” Compromises and settlements are “a normal part of the process of reorganization.” Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc. v. Anderson, 390 U.S. 414, 424 (1968) (citing Case v. Los Angeles Lumber Prods. Co., 308 U.S. 106, 130 (1939)).

20. To approve a compromise and settlement under Bankruptcy Rule 9019, a bankruptcy court should find that the compromise and settlement is fair and equitable, reasonable and in the best interests of the debtor’s estate. See, e.g., In re Ionosphere Clubs, Inc., 156 B.R. 414, 426 (S.D.N.Y. 1993), aff’d, 17 F.3d 600 (2d Cir. 1994) (citations omitted); In re Enron Corp., Case No. 02 Civ. 8489, 2003 WL 230838, *2 (S.D.N.Y. Jan. 31, 2003). The decision to approve a particular settlement lies within the sound discretion of the bankruptcy court. Nellis v. Shugrue, 165 B.R. 115, 122-123 (S.D.N.Y. 1994). In exercising its discretion, the bankruptcy court must make an independent determination that the settlement is fair and reasonable. Id. at 122. The court may consider the opinions of the debtor in possession and its counsel that the settlement is fair and reasonable. Id.; see In re Purofied Down Prods. Corp., 150 B.R. 519, 522 (S.D.N.Y. 1993). This discretion should be exercised by the bankruptcy court “in light of the general public policy favoring settlements.” In re Hibbard Brown & Co., Inc., 217 B.R. 41, 46 (Bankr. S.D.N.Y. 1998); Shugrue, 165 B.R. at 123 (“the general rule [is] that settlements are favored and, in fact, encouraged by the approval process outlined above”).

21. In determining whether to approve a proposed settlement, a bankruptcy court need not decide the numerous issues of law and fact raised by the settlement, but rather should “canvass the issues and see whether the settlement ‘fall[s] below the lowest point in the range of reasonableness.’” In re W.T. Grant Co., 699 F.2d 599, 608 (2d Cir. 1983); see also Purofied Down Prods., 150 B.R. at 522 (“the court need not conduct a ‘mini-trial’ to determine the merits of the underlying [dispute]”).

22. In deciding whether a particular settlement falls within the “range of reasonableness,” courts consider the following factors:

- a. the probability of success in the litigation;
- b. the difficulties associated with collection;
- c. the complexity of the litigation, and the attendant expense, inconvenience and delay; and
- d. the paramount interests of creditors.

See Purofied Down Prods., 150 B.R. at 122 (citing Drexel v. Loomis, 35 F.2d 800, 806 (8th Cir. 1989)); Six West Retail Acquisition, Inc. v. Loews Cineplex Entm’t Corp., 286 B.R. 236, 248 n.13 (S.D.N.Y. 2002), see also In re Drexel Burnham Lambert Group, Inc., 960 F.2d 285, 292 (2d Cir. 1992).

23. “The ‘reasonableness’ of a settlement depends upon all factors, including probability of success, the length and cost of the litigation, and the extent to which the settlement is truly the product of ‘arms-length’ bargaining, and not of fraud or collusion.” Ionosphere Clubs, 156 B.R. at 428.

Assumption of Nortel Agreement

24. Section 365(a) of the Bankruptcy Code provides that a debtor in possession, “subject to the court’s approval, may . . . assume any executory contract . . . of the debtor.” 11 U.S.C. § 365(a).

25. Section 365(b)(1) of the Bankruptcy Code codifies the requirements for assuming an executory contract of a debtor. This subsection provides:

- (1) If there has been a default in an executory contract or unexpired lease of the debtor, the trustee may not assume such contract or lease unless, at the time of the assumption of such contract or lease, the trustee —

- (A) cures, or provides adequate assurance that the trustee will promptly cure, such default;
- (B) compensates, or provides adequate assurance that the trustee will promptly compensate, a party other than the debtor to such contract of lease, for any actual pecuniary loss to such party resulting from such default; and
- (C) provides adequate assurance of future performance under such contract or lease.

11 U.S.C. § 365(b)(1).

26. The standard to be applied by a court in determining whether an executory contract should be assumed is the “business judgment” test, which is premised on the debtor’s business judgment that the assumption would be beneficial to its estate. See Orion Pictures Corp. v. Showtime Networks, Inc. (In re Orion Pictures Corp.), 4 F.3d 1095, 1099 (2d Cir. 1993); In re Gucci, 193 B.R. 411, 415 (S.D.N.Y. 1996).

27. “More exacting scrutiny would slow the administration of the debtor’s estate and increase its cost, interfere with the Bankruptcy Code’s provision for private control of administration of the estate, and threaten the court’s ability to control a case impartiality.” Richmond Leasing Co. v. Capital Bank, N.A., 762 F.2d 1303, 1311 (5th Cir. 1985) (citations omitted).

28. Some courts used the following factors in determining whether the “business judgment” standard in the context of an assumption of an executory contract is satisfied: (a) whether the contract or lease is profitable or advantageous to the debtor; and (b) whether the estate will be able to perform its contractual obligations under the contract. See In re National Sugar Refining Co., 26 B.R. 765, 767 (Bankr. S.D.N.Y. 1983); In re Del Grosso, 115 B.R. 136, 138 (Bankr. N.D. Ill. 1990).

29. Upon finding that the debtor has exercised its sound business judgment in determining that the assumption or rejection of an executory contract is in the best interests of the debtors, its creditors and all parties in interest, the court should approve such assumption or rejection under section 365(a) of the Bankruptcy Code. See, e.g., In re Riodizio, Inc., 204 B.R. 417, 424 (Bankr. S.D.N.Y. 1997); In re Bradlees Stores, Inc., 194 B.R. 555, 558 n.1 (Bankr. S.D.N.Y. 1996); In re G Survivor Corp., 171 B.R. 755, 757 (Bankr. S.D.N.Y. 1994); In re Ionosphere Clubs, Inc., 100 B.R. 670, 673 (Bankr. S.D.N.Y. 1989).

**The Settlement Agreement Should be Approved
Because it Falls Within the Range of Reasonableness**

30. In the instant case, the Settlement Agreement is fair and equitable, falls well within the range of reasonableness and enables the parties to avoid the costs of additional negotiations and potential litigation. Absent authorization to enter into the Settlement Agreement, the Debtors and Nortel may require judicial intervention to resolve their disputes arising under the Nortel Agreement. Those disputes include, but are not limited to, (a) the term of renewal of the Nortel Agreement, (b) the cure amount under the Nortel Agreement, (c) the treatment of certain promotion funds under the Nortel Agreement and (d) the Debtors' achievement under the Volume Incentive Discount Plan in 2003. The undertaking of uncertain litigation would be an unnecessary drain on the resources of the Debtors' estates and would divert the attention of their management and legal personnel from their restructuring efforts, including the confirmation and consummation of the Debtors' chapter 11 plan of reorganization.

31. The value accruing from the Settlement Agreement, including (a) the elimination of potential negotiation and litigation costs and (b) the Debtors receiving, among other things, a discount under the Nortel Agreement for 2004, as well as benefits related to certain promotion funds and demonstration facilities, represents a substantial benefit to the

Debtors' estates. In addition, the Settlement Agreement resolves all outstanding claims and issues between the Debtors and Nortel with respect to the Nortel Agreement, including the resolution of Nortel's pre-petition claims and determination of the cure amounts under the Nortel Agreement, without the need for any litigation. For the foregoing reasons, the Settlement Agreement should be approved pursuant Bankruptcy Rule 9019.

Assumption of the Nortel Agreement is Supported by the Debtors' Business Judgment and Should be Approved by the Court

32. The assumption of the Nortel Agreement is in the best interests of the Debtors' estates. As set forth above, the Nortel Agreement, as amended by the Nortel Amendment, contains numerous business terms, which are favorable for the Debtors. As a result, the Nortel Agreement, as amended by the Nortel Amendment, is beneficial to the Debtors' estates. Notably, if the Nortel Agreement were not assumed, as amended, then the Debtors would reject the Nortel Agreement. The rejection of the Nortel Agreement would result in significant rejection damage claims against the Debtors' estates. Based on the foregoing, the assumption of the Nortel Agreement, as amended, is the product of the Debtors' sound business judgment and should be approved.

Cure of Defaults Under the Nortel Agreement, as Amended by the Nortel Amendment

33. Prior to the assumption of an executory contract, a debtor must cure outstanding defaults under such contract. In that regard and as set forth above, the Debtors and Nortel have agreed that the Debtors will pay Nortel an amount of \$1,320,254.84 (the "Cure Payment") in full satisfaction of the Pre-Petition Amounts. The Settlement Agreement provides that the Debtors will make the Cure Payment within ten (10) calendar days after entry of the Court order approving the assumption of the Nortel Agreement, as amended by the Nortel Amendment.

34. Upon the receipt of the Cure Payment, Nortel has agreed not to (a) file any proofs of claims in the Debtors' chapter 11 cases with respect to the Pre-Petition Amounts and withdraw with prejudice any proofs of claims filed on account of such Pre-Petition Amounts, (b) vote in connection with any plan of reorganization in these chapter 11 cases as to the Pre-Petition Amounts, (c) object to any plan of reorganization filed in the Debtors' chapter 11 cases and (d) receive any distribution in the Debtors' chapter 11 cases on account of such Pre-Petition Amounts. Nortel has also agreed to resign from membership on the Creditors Committee.

35. Further, Nortel and the Debtors have agreed that as of the date of this Motion, except for the payment of the Pre-Petition Amounts, there are no defaults that need to be cured under the Nortel Agreement.

36. For the reasons stated above and in the exercise of their sound business judgment, the Debtors believe that the assumption of the Nortel Agreement, as amended by the Nortel Amendment, is in the best interests of the Debtors, their estates, creditors and other parties in interest.

Waiver of Memorandum of Law

37. This Motion includes citations to the applicable authorities and does not raise any novel issues of law. Accordingly, the Debtors respectfully request that the Court waive the requirement contained in 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

38. Notice of this Motion has been provided to: (a) the U.S. Trustee; (b) attorneys for the Prepetition Lenders; (c) attorneys for the Creditors Committee; (d) attorneys for Nortel; (e) attorneys for XO and (f) all parties on the Master Service List established and maintained pursuant to that certain order establishing notice procedures in these chapter 11 cases,

dated May 15, 2003. In light of the nature of the relief requested herein, the Debtors submit that no other or further notice is required.

39. No previous request for the relief sought herein has been made by the Debtors to this or any other court.

WHEREFORE the Debtors respectfully request that the Court enter an order (a) pursuant to Bankruptcy Rule 9019(a), approving the terms of the Settlement Agreement, (b) pursuant to section 365 of the Bankruptcy Code, authorizing and approving the assumption of the Nortel Agreement, as amended by the Nortel Amendment and (c) granting the Debtors such other and further relief as it deems just and proper.

Dated: New York, New York
March 26, 2004

Respectfully submitted,

/s/ Jonathan S. Henes

Matthew A. Cantor (MC-7727)

Jonathan S. Henes (JH-1979)

KIRKLAND & ELLIS LLP

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

EXHIBIT A (FILED UNDER SEAL)

THE SEALED AGREEMENTS