

LIQUIDATION ANALYSIS

Pursuant to section 1129(a)(7) of the Bankruptcy Code¹ (often called the “Best Interest Test”), the Bankruptcy Code requires that each Holder of an Impaired Claim or Equity Interest either (i) accept the Plan, or (ii) receive or retain under the Plan property of a value, as of the Effective Date, that is not less than the value such non-accepting Holder would receive or retain if the Debtors were to be liquidated under chapter 7 of the Bankruptcy Code on the Effective Date. In determining whether the Best Interest Test has been met, the first step is to determine the dollar amount that would be generated from a hypothetical liquidation of the Debtors’ assets in chapter 7. The gross amount of Cash available would be the sum of the proceeds from the disposition of the Debtors’ assets and the Cash held by the Debtors at the commencement of their chapter 7 cases. Such amount then would be reduced by the costs and expenses of the liquidation. Prior to determining whether the Best Interest Test has been met for general unsecured creditors, further reductions would be required to eliminate Cash and the asset liquidation proceeds that would be applied to Secured Claims and amounts necessary to satisfy chapter 11 Administrative Expense Claims, Priority Tax Claims, and Priority Non-Tax Claims that are senior to ATCW Unsecured Claims and ATI Unsecured Claims, including any incremental Administrative Expense Claims that may result from the termination of the Debtors’ business and the liquidation of their assets. Any remaining Cash would be available for distribution to general unsecured creditors and Equity Interest Holders in accordance with the distribution hierarchy established by section 726 of the Bankruptcy Code.

The following liquidation analysis (the “Liquidation Analysis”) was prepared by the Debtors’ management with the assistance of the Debtors’ advisors, and presents only the Debtors’ view as to the values that would be obtained and anticipated recoveries upon a conversion to a chapter 7 case under the Bankruptcy Code. This Liquidation Analysis has been disputed by the Dissenting Creditors.

The Liquidation Analysis assumes that the Debtors would announce a conversion to chapter 7 as of April 20, 2004. The Liquidation Analysis also assumes that the liquidation of the Debtors would commence under direction of a Court-appointed chapter 7 trustee and continue for nine months, during which time all of the Company’s major assets either would be sold or conveyed to the applicable lienholders and the Cash proceeds, net of liquidation-related costs, would be distributed to creditors. Although some assets might be liquidated in less than nine months, other assets would be more difficult to collect or sell, thus requiring a liquidation period of up to nine months. The liquidation period would allow for the collection of receivables, sale of assets, and wind-down of daily operations.

For certain assets, estimates of the liquidation proceeds were made for each asset individually. For other assets, liquidation values were assessed for general classes of assets by estimating the percentage recoveries that a chapter 7 trustee might achieve through their

¹ Unless otherwise defined herein, all capitalized terms have the meanings ascribed to such terms in the Debtors’ Amended Disclosure Statement pursuant to Section 1125 of the Bankruptcy Code, dated April 21, 2004 (the “Disclosure Statement”).

disposition. The Liquidation Analysis was performed on a consolidated basis and assumes that the Debtors' liquidation proceeds would be distributed in accordance with Bankruptcy Code sections 726 and 1129(b). The following Liquidation Analysis should be read in conjunction with the accompanying notes.

IMPORTANT CONSIDERATIONS AND ASSUMPTIONS

1. *Execution risk of liquidation.* A liquidation of the Debtors would be complicated and difficult in both scale and scope. The assets of the Debtors include millions of dollars worth of integrated telecommunications equipment and thousands of miles of network infrastructure. The assets are located throughout the United States of America and would be subject to the laws of virtually half the states within the United States of America. Given the complexity of such an undertaking, the Debtors believe significant execution risk exists if liquidation were actually pursued.
2. *The Liquidation Analysis depends on estimates and assumptions.* The Liquidation Analysis is based on a number of estimates and assumptions that, although developed and considered reasonable by the management and the advisors of the Debtors, are inherently subject to significant economic, business, regulatory, and competitive uncertainties and contingencies beyond the control of the Debtors or its management. The Liquidation Analysis is also based on the Debtors' best judgment of how numerous decisions in the liquidation process would be resolved. A chapter 7 trustee may come to different conclusions at the time of such liquidation. ACCORDINGLY, THERE CAN BE NO ASSURANCES THAT THE VALUES REFLECTED IN THIS LIQUIDATION ANALYSIS WOULD BE REALIZED IF THE DEBTORS WERE, IN FACT, TO UNDERGO SUCH A LIQUIDATION AND ACTUAL RESULTS COULD VARY MATERIALLY AND ADVERSELY FROM THOSE CONTAINED HEREIN.
3. *Liquidation assumed to commence on April 20, 2004.* This analysis assumes the conversion of the current chapter 11 cases to chapter 7 cases as of April 20, 2004. A chapter 7 trustee would be either elected by creditors or appointed by the Bankruptcy Court to administer the estate. The asset values for the liquidation of the non-Cash assets shown on the Debtors' balance sheet was the unaudited original cost of those assets as of December 31, 2003 and represent a proxy for the asset figures that would likely be available as of April 20, 2004.
4. *Wind-down costs and length of liquidation process.* The Debtors have assumed that the Federal Communications Commission and/or state regulatory commissions would require a continuation of service to the Debtors' customers for at least 90 days after liquidation was announced. As shown below, such a requirement will result in significant additional costs to the liquidation. The Debtors have also assumed that the chapter 7 trustee would need an additional six months to finalize the liquidation process, although there can be no assurances that all assets will be completely liquidated during this time period.

5. *Effect of a conversion to chapter 7 cases on the sale transaction with XO Communications, Inc.* The Debtors have assumed that in the event of a conversion of the current chapter 11 cases to chapter 7 cases on April 20, 2004, XO would exercise its right under Section 8.1(c) of the Purchase Agreement to terminate the Purchase Agreement. Although this termination may not actually occur, given the occurrence of the Early Funding Date on April 13, 2004, the Debtors believe that a conversion to chapter 7 cases on April 20, 2004 would cause significant disruption to the closing of the sale to XO under the Purchase Agreement and, based on public announcements by the Debtors and XO that might be required in light of such a conversion, XO and Allegiance could experience a significant loss of its customer base. Moreover, XO could use such a conversion to renegotiate the Purchase Price under the Purchase Agreement. The Debtors cannot estimate the size of such Purchase Price adjustment.
6. *Settlement with Level 3 Communications, Inc.* The Debtors received payment under the Level 3 Settlement Agreement in the amount of \$54 million on April 19, 2004. The Debtors have assumed that this amount will remain an asset of the Debtors. However, in the event that XO terminates the Purchase Agreement due to a conversion to chapter 7 cases, XO would no longer be performing its obligations under the Level 3 Settlement Agreement. In that event, Level 3 may declare a breach under the Level 3 Settlement Agreement and bring an action against the Debtors for return of the \$54 million amount paid by Level 3 to the Debtors under the Level 3 Settlement Agreement. In the event that Level 3 succeeded in such action, Level 3 would have an Administrative Expense Claim against the Debtors in the amount of \$54 million.
7. *Reasonableness of Liquidation Analysis.* To the extent that the Debtors' Chapter 11 Cases convert to cases under chapter 7, it is impossible to predict what scenarios would result. One possible scenario is that XO would not exercise its right to terminate the Purchase Agreement, Level 3 would not seek recovery of the \$54 million paid pursuant to the Level 3 Settlement Agreement, and the Compromise and Settlement described in the Disclosure Statement would not occur (the "Potential Scenario"). Further, if the Chapter 11 Cases converted to cases under chapter 7, it is likely that threatened litigation regarding the priority of claims, liens, or guaranties that could be asserted by the ATI Note Trustees and/or the Creditors Committee may be brought. Assuming that the litigation brought by the Creditors Committee and/or the ATI Note Trustees failed on each and every claim, and assuming that contrary to the Debtors' historical booking of certain Intercompany Claims as debt obligations, notwithstanding the absence of promissory notes, such Intercompany Claims were deemed equity contributions, it is possible that Holders of ATCW Unsecured Claims would receive payment in full and Holders of ATI Unsecured Claims would receive a recovery of approximately 14.8% to 28.1% of the amount of their Claims. However, the ATI Note Trustees would undoubtedly prosecute certain causes of action against the Secured Lenders and the Debtors, and individual Holders of Claims against ATI may also pursue causes of action against such parties. In addition, the chapter 7 trustee would incur substantial legal and other professional fees in undertaking in depth analysis of all potential outcomes of the chapter 7 cases including, without limitation, litigation with the ATI Note Trustees, the treatment of Intercompany Claims and the appropriateness of

substantive consolidation of all the Debtors or any subset thereof. There can be no guaranty as to the potential recoveries to creditors in such circumstances. However, this Potential Scenario is unlikely. XO may exercise its right to terminate the Purchase Agreement, Level 3 may seek to recover the \$54 million as an Administrative Expense Claim, and the Debtors expect that substantial litigation will be pursued by the chapter 7 trustee regarding the equal and ratable lien and guaranty theories set forth by the ATI Note Trustees, the characterization of Intercompany Claims and the justifications for substantive consolidation of all or a subset of the Debtors. Accordingly, the Debtors believe that this Liquidation Analysis is appropriate and reasonable given the range of possible occurrences in the event of a conversion of these Chapter 11 Cases to cases under chapter 7.

Allegiance Telecom, Inc.

Liquidation Analysis - Unaudited

PROCEEDS AVAILABLE FOR DISTRIBUTION UNDER CHAPTER 7 LIQUIDATION (\$US Millions)

	<u>Notes</u>	<u>Estimated Liquidation Proceeds</u>	<u>Estimated Asset Realization</u>
Proceeds from Liquidation			
Cash	A	\$ 294.2	100.0%
Accounts Receivable, Net	B	50.1	47.3%
Prepaid Expenses and Other Current Assets	C	6.3	24.5%
Property and Equipment, Net	D	287.1	42.1%
Long-term Investments, Restricted	E	4.5	58.1%
Other Long-term Assets	F	4.3	20.9%
Preference Payments	G	1.9	
Gross Proceeds from Liquidation		\$ 648.4	56.6%
Chapter 7 Administrative Claims - Section 503(b)			
Trustee & Receiver Fees	H	10.6	
Counsel for Trustee	I	5.3	
Other Professional Fees	J	10.6	
Wind-down Costs	K	73.7	
Total Chapter 7 Administrative Claims		\$ 100.2	
NET PROCEEDS AVAILABLE FOR DISTRIBUTION		\$ 548.2	

Allegiance Telecom, Inc.

Liquidation Analysis - Unaudited

DISTRIBUTION OF NET PROCEEDS - RECOVERY

(\$US Millions)

	Notes	% Recovery	Recovery Value	Total Claim Amount
Secured Claims (Class 2)	P	100.0%	\$ 0.1	\$ 0.1
Professional Fee Claims	M	100.0%	5.8	5.8
Senior Lender Claims (Class 3)	Q	100.0%	477.8	477.8
Administrative Expense Claims	L	33.8%	63.2	187.1
Priority Tax Claims	N	33.8%	1.3	3.8
Priority Non-Tax Claims (Class 1)	O	0.0%	-	0.1
ATCW Unsecured Claims (Class 4)	R	0.0%	-	378.2
ATI Unsecured Claims (Class 5)	S	0.0%	-	677.1
Subordinated Claims (Class 6)	T	0.0%	-	-
Equity Interests (Class 7)	U	0.0%	-	-
			<u>\$ 548.2</u>	<u>\$ 1,730.0</u>

NOTES TO LIQUIDATION ANALYSIS

- A. Cash.** The Cash balance reflects management's projection of Cash as of April 20, 2004. Cash includes Cash and Cash equivalents and short-term investments. The Debtors' short-term investments are comprised of certificates of deposit.
- B. Accounts Receivable, Net.** Estimated proceeds realizable from accounts receivable under a liquidation are based on management's assessment of the collectibility of those receivables taking into consideration the historical collection experience, the type of obligor, the credit quality of the obligor and the aging of the accounts. The liquidation value of accounts receivable was estimated by applying collection rates to categories of receivables believed to have similar characteristics such as type of obligor and aging. Additional factors such as time, difficulty of collection, and certain offset rights were

also considered. All pre-petition carrier access billing accounts receivable were offset against Claims by the respective obligors. The result is assumed to be an estimate of the proceeds that would be available in an orderly liquidation scenario and takes into account the inevitable difficulty a liquidating company has in collecting receivables. Collections during a liquidation of the Debtors may be further impaired by the likely damage Claims for breaches of and/or the likely rejection of customer contracts as customers attempt to set off outstanding amounts owed to the Debtors against such Claims.

- C. **Prepaid Expenses and Other Current Assets.** This asset group consists primarily of short-term Cash deposits, equipment held in inventory, prepaid rents, prepaid insurance premiums, prepaid maintenance services and other prepaid services. Management has reviewed the individual components for this account and has estimated a liquidation recovery of approximately 25% of the balance, as most of these prepaid services will expire during the wind-down period. The recoveries consist primarily of liquidation of the equipment held in inventory.
- D. **Property and Equipment, Net (“P&E”).** P&E, including construction-in-progress, includes network assets such as switches and transmission equipment, fiber under capital lease, data network assets, customer premise equipment, as well as furniture and fixtures, leasehold improvements, computer hardware and software, office equipment, motor vehicles, and other various assets. Management reviewed the various asset classes included and assigned estimated recovery rates based on type of asset. Additional consideration was given for the “forced sale” nature of the liquidation, the need to disconnect or otherwise prepare the asset for sale, and the physical location, and accessibility of the asset in estimating the recovery rates. The overall average recovery rate across all fixed asset classes was determined to be approximately 19% of the original cost basis.
- E. **Long-term Investments, Restricted.** Long-term restricted investments include certificates of deposit held as collateral for letters of credit (LOCs) issued on behalf of the Debtors. The underlying collateral for LOCs related to real estate leases (in lieu of a Cash deposit) is assumed to be set off against any rejection Claims and ATCW Unsecured Claims of the landlords holding the LOCs. The remaining LOCs for insurance and for purchase agreements total approximately \$4.5 million and will be surrendered and the certificates of deposit will be returned to the estate.
- F. **Other Long-term Assets.** This asset group consists primarily of Cash deposits for workers’ compensation, general and auto liability insurance reserves, numerous real estate deposits, utility deposits, and miscellaneous vendor deposits. Management believes that the Debtors will not receive any material recovery of the individual deposits (other than the workers’ compensation deposit and general and auto liability insurance deposit) based on the chapter 7 liquidation and the fact that the other deposits would reduce Secured Claims and ATCW Unsecured Claims. Other long-term assets include expenses that were incurred and capitalized in relation to the ATI Notes and Credit Agreement, which are unrecoverable.

- G. Preference Payments.** This asset consists of recoveries on preference actions against vendors and other entities that received payments during the 90 days prior to the Petition Date. For purposes of this analysis, management estimates a recovery of approximately \$1.9 million related to this asset class.
- H. Trustee & Receiver Fees.** Compensation for the chapter 7 trustee will be limited to fee guidelines in section 326 of the Bankruptcy Code. For purposes of this analysis management has assumed trustee fees to be 3.0% of the proceeds recovered from non-Cash assets in the liquidation.
- I. Counsel for Trustee.** Compensation for trustee's counsel is estimated at 50% of estimated trustee and receiver fees.
- J. Other Professional Fees.** Management estimates that Professional fees for legal, financial, and other advice during the chapter 7 proceedings to be equal to the trustee and receiver fees (approximately \$1.15 million per month).
- K. Wind-Down Costs.** The Debtors assume the chapter 7 liquidation process will take a total of nine months to complete. The Debtors have assumed that the Federal Communications Commission and/or state regulatory commissions will require the Debtors to continue to provide service to its existing customer base for at least 90 days in order to allow customers to transition to alternative providers. Based on this assumption, management has assumed that during this first 90-day period, the Debtors will need to keep its network operating. Management has assumed a shut down for all other parts of the Debtors' network upon initiation of the liquidation.

During the wind-down period, customers are expected to disconnect service at a much faster rate than in the normal course of business. Because no new customers will be added, operating expenses (employee and real estate costs) are estimated to decrease to the lowest cost level required to support service while customers transition off the Debtors' network. After the first 90-day period, operating costs are assumed to reduce to minimal levels as the chapter 7 trustee further rejects contracts and leases and manages the wind-down of the assets. A nominal workforce would be maintained for network maintenance, billings and collections, customer service, legal and finance functions. Wind-down costs are offset by collections of new revenues, assumed to be 47% of new revenues during the wind-down period. This percentage is based on the average net recovery assumed for pre-chapter 7 receivables. Due to the difficulty in collecting new receivables during the wind-down period, management believes that the actual collection rate on new receivables during the chapter 7 process may be lower. Other wind-down costs include employee severance costs, stay bonuses for those employees who are required during the wind-down process, and network access costs.

- L. Administrative Expense Claims.** Prior to determining what proceeds would be available for general unsecured creditors under the chapter 7 proceedings, Cash and asset liquidation proceeds would be reduced in order to satisfy chapter 11

Administrative Expense Claims, Priority Tax Claims, and Priority Non-Tax Claims that are senior to ATCW Unsecured Claims and ATI Unsecured Claims, including any incremental Administrative Expense Claims that may result from the termination of the Debtors' business and the liquidation of their assets. These Claims represent accounts payable and accrued liabilities (associated with postpetition chapter 11 goods and services), utilities expenses and access charges and professional fees related to the chapter 11 proceedings, as well as rejection of previously assumed executory contracts. Also included in the Administrative Expense Claims are liquidation damages of \$40 million related to the XO Communications Asset Purchase Agreement, if the case went to Chapter 7 and the transaction with XO did not close.

- M. Professional Fee Claims.** This category of Claims represents all Administrative Expense Claims for the compensation of Professionals and reimbursement of expenses incurred by such Professionals through the liquidation date. Pursuant to the terms of the Debtors' cash collateral order, there is a carve out for the payment of the Professional Fee Claims. As such, the Senior Lender Claims are subordinate to the Professional Fee Claims for this purpose.
- N. Priority Tax Claims.** This group of Claims includes any Claim of a governmental unit of the kind specified in sections 502(i) and 507(a)(8) of the Bankruptcy Code.
- O. Priority Non-Tax Claims (Class 1).** These Claims primarily represent chapter 11 Claims, other than Administrative Expense Claims or Priority Tax Claims, entitled to priority in right of payment under section 507 (a) of the Bankruptcy Code.
- P. Secured Claims (Class 2).** This group of Claims includes Claims filed by Incumbent Local Exchange Carrier ("ILEC") customers and miscellaneous other vendors with set off rights. The underlying collateral for the Secured Claims is assumed to be set off against the Secured Claims, and that the holders of the Secured Claims would receive no additional distribution.
- Q. Senior Lender Claims (Class 3).** Senior Lender Claims include all Claims arising under or in connection with the Credit Agreement. Senior Lender Claims are paid in full.
- R. ATCW Unsecured Claims (Class 4).** ATCW Unsecured Claims include trade accounts payable, access payables, IRU Claims, litigation and rejection Claims, and various other Claims. The Debtors believe that the aggregate amount of ATCW Unsecured Claims in a chapter 7 case will be significantly higher than the total for such Claims in the chapter 11 cases as the number of customers, vendors, and counterparties to contracts and leases is significant, and each party could file Claims for damages. Such Claims would be *pari-passu* with the Debtors' current ATCW Unsecured Claims, would significantly increase the Claims against the Debtors, and ultimately reduce the overall recovery to the Holders of ATCW Unsecured Claims.

- S. **ATI Unsecured Claims (Class 5).** ATI Unsecured Claims include Claims arising under or in connection with the ATI Notes other than the fees of the ATI Note Trustees accruing under the ATI Note Indentures.
- T. **Subordinated Claims (Class 6).** Holders of Subordinated Claims receive no recovery in liquidation.
- U. **Equity Interests (Class 7).** Holders of common stock receive no recovery in the liquidation.